

EXPEDITORS INTERNATIONAL OF WASHINGTON INC  
Form 10-K  
March 01, 2007

**UNITED STATES**  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM 10-K**

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2006

OR

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**  
(I.R.S. 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)

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

Title of each class  
Common Stock, par value \$.01 per share

Name of each exchange on which registered  
NASDAQ Global Market

**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

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

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 June 30, 2006, the aggregate market value of the registrant's Common Stock held by non-affiliates of the registrant was approximately \$11,670,749,657.

At February 26, 2007 the number of shares outstanding of registrant's Common Stock was 214,077,158.

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement for the Registrant's 2007 Annual Meeting of Shareholders to be held on May 2, 2007 are incorporated by reference into Part III of this Form 10-K.

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Forward-Looking Statements

In accordance with the provisions of the Litigation Reform Act, the Company is making readers aware that forward-looking statements, because they relate to future events, are by their very nature subject to many important risk factors which could cause actual results to differ materially from those contained in the forward-looking statements. For additional information about forward-looking statements and for an identification of risk factors and their potential significance, see Safe Harbor for Forward-Looking Statements Under Securities Litigation Reform Act of 1995; Certain Cautionary Statements immediately preceding Part II, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations in this report.

PART I

ITEM 1 BUSINESS

Expeditors International of Washington, Inc. is engaged in the business of providing global logistics services. The Company offers its customers a seamless international network supporting the movement and strategic positioning of goods. The Company's services include the consolidation or forwarding of air and ocean freight. In each United States office, and in many overseas offices, the Company acts as a customs broker. The Company also provides additional services including distribution management, vendor consolidation, cargo insurance, purchase order management and customized logistics information. The Company does not compete for domestic freight, overnight courier or small parcel business and does not own aircraft or steamships.

The Company, including its majority-owned subsidiaries, operates full service offices ( ) in the cities identified below. Full service offices have also been established in locations where the Company maintains unilateral control over assets and operations and where the existence of the parent-subsidiary relationship is maintained by means other than record ownership of voting stock (#). In other cities, the Company contracts with independent agents to provide required services and has established approximately 110 such relationships world-wide. Locations where Company employees perform sales and customer service functions are identified below as international service centers (\*). Wholly-owned locations operating under the supervision and control of another full service office are identified as satellite offices (+). In each case, the opening date for the full service office, international service center or satellite office is set forth in parenthesis.

NORTH AMERICA

UNITED STATES

Seattle (5/79)  
Chicago (7/81)  
San Francisco (7/81)  
New York (11/81)  
Los Angeles (5/82)  
Atlanta (8/83)  
Boston (11/85)  
Miami (3/86)  
Minneapolis (7/86)  
Denver (2/88)  
Detroit (7/88)  
Portland (7/88)  
Cincinnati (8/89)  
Cleveland (7/90)  
Phoenix (7/91)  
Louisville (10/91)  
St. Louis (4/92)  
Houston (4/92)  
Baltimore (4/92)  
Dallas (5/92)  
Columbus (6/92)  
Charlotte (7/92)  
Newark (9/94)  
Philadelphia (3/95)  
Charleston (6/95)  
Memphis (8/95)  
Salt Lake City (11/95)  
+ Syracuse (4/96)  
Norfolk (9/96)

Buffalo-Peace Bridge (1/97)  
El Paso (1/97)  
Laredo (2/97)  
Nogales (2/97)  
San Diego (7/97)  
+ Rochester (10/97)  
McAllen (4/98)  
Pittsburgh (6/99)  
Savannah (3/00)  
+ Milwaukee (7/00)  
Kansas City (8/00)  
Washington, D.C. (9/00)  
Nashville (10/01)  
+ Huntsville (12/02)  
Austin (2/03)  
Orlando (8/03)  
Tampa (9/03)  
+ New Orleans (9/04)  
+ Omaha (7/06)  
+ Calexico (6/06)

PUERTO RICO  
San Juan (5/95)

CANADA  
Toronto (5/84)  
Vancouver (9/95)  
+ Windsor (6/98)  
Montreal (4/99)  
Calgary (9/04)

Guadalajara (9/97)  
Nogales (1/99)  
Ciudad Juarez (5/00)  
Monterrey (1/05)  
Reynosa (6/06)  
+ Querétaro (9/06)

SOUTH AND CENTRAL AMERICA

ARGENTINA  
Buenos Aires (1/98)

BRAZIL  
Sao Paulo (9/95)  
Rio de Janeiro (9/95)  
Campinas (9/95)  
+ Santos (10/97)  
Manaus (7/00)  
Porto Alegre (1/05)

CHILE  
Santiago (2/95)  
+ Concepcion (4/03)

COLOMBIA  
Bogota (12/98)  
+ Cali (12/98)  
+ Medellin (7/00)

COSTA RICA

PERU  
Lima (12/05)

VENEZUELA  
Caracas (1/01)

ASIA

BANGLADESH  
Dhaka (6/89)  
+ Chittagong (8/93)

CAMBODIA  
Phnom Penh (4/00)

PEOPLE'S REPUBLIC OF CHINA  
Guangzhou (4/94)  
Beijing (7/94)  
Dalian (7/94)  
Shanghai (7/94)  
Shenzhen (7/94)  
Qingdao (7/94)  
Tianjin (7/94)  
Xi'an (7/94)  
Xiamen (7/94)  
+ Chengdu (9/00)  
Ningbo (7/01)  
+ Suzhou (9/01)  
+ Zhongshan (9/01)  
Hangzhou (10/01)

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|  |                     |                       |                    |
|--|---------------------|-----------------------|--------------------|
| Indianapolis (11/96)                   |                     | San Jose (10/03)      | + Kunshan (12/01)  |
| + Port Huron-Blue Water Bridge (12/96) | MEXICO              |                       | + Fuzhou (6/02)    |
| + Detroit Ambassador Bridge (12/96)    | Mexico City (6/95)  | GUATEMALA             | + Yantai (11/02)   |
| + Lewiston-Queenston (12/96)           | Nuevo Laredo (4/97) | Guatemala City (1/07) | + Shenyang (12/02) |

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|                        |                         |                         |                         |
|------------------------|-------------------------|-------------------------|-------------------------|
| + Wuhan (1/03)         | VIETNAM                 | PORTUGAL                | Mumbai (Bombay) (1/97)  |
| + Huizhou (12/03)      | Ho Chi Minh City (5/00) | Lisbon (10/91)          | Bangalore (6/97)        |
| + Zhuhai (12/03)       | Hanoi (3/04)            | Oporto (10/91)          | Chennai (Madras) (6/97) |
| + Foshan (1/04)        | + Da Nang (9/05)        |                         | + Hyderabad (9/01)      |
| Chongqing (7/04)       |                         | SPAIN                   | + Tiruppur (3/05)       |
| Dongguan (2/05)        | <u>EUROPE</u>           | Barcelona (1/94)        |                         |
| Nanjing (3/05)         | AUSTRIA                 | Madrid (1/94)           | KUWAIT                  |
| Macau (5/05)           | Vienna (11/95)          | Alicante (4/96)         | # Kuwait City (7/97)    |
| + Shantou (12/06)      | + Graz (3/06)           |                         |                         |
| HONG KONG              | BELGIUM                 | SWEDEN                  | LEBANON                 |
| Kowloon (9/81)         | Brussels (7/90)         | Stockholm (1/94)        | Beirut (8/99)           |
| INDONESIA              | + Antwerp (4/91)        | Goteborg (1/94)         |                         |
| Jakarta (12/90)        | THE CZECH REPUBLIC      | + Malmoe (3/05)         | PAKISTAN                |
| Surabaya (2/92)        | Prague (6/98)           |                         | Karachi (9/96)          |
| JAPAN                  | FINLAND                 | SWITZERLAND             | Lahore (9/96)           |
| Tokyo (1/01)           | Helsinki (4/94)         | Chiasso (2/01)          | + Sialkot (6/03)        |
| Osaka (1/01)           |                         | Zurich (10/05)          | + Islamabad (10/06)     |
| KOREA                  | FRANCE                  | UNITED KINGDOM          | QATAR                   |
| + Pusan (10/94)        | Paris (1/97)            | London (4/86)           | Doha (1/07)             |
| Seoul (10/94)          | Mulhouse (1/97)         | Manchester (11/88)      | SAUDI ARABIA            |
| + Bupyeong (6/96)      | Lyon (1/97)             | Birmingham (3/90)       | # Riyadh (7/92)         |
| + Chonan (6/96)        | Lille (3/97)            | Glasgow (4/92)          | # Jeddah (7/92)         |
| + Kwangju (6/96)       | Bodeaux (7/00)          | Bristol (3/97)          |                         |
| + Kumi (6/96)          |                         | East Midlands (1/99)    | SRI LANKA               |
| + Masan (6/96)         | GERMANY                 | + Hull (1/00)           | Colombo (3/95)          |
| + Taegu (6/96)         | Frankfurt (4/92)        | Belfast (9/01)          |                         |
|                        | Munich (4/92)           | Aberdeen (9/05)         | TURKEY                  |
| MALAYSIA               | Dusseldorf (4/92)       | <u>AUSTRALASIA</u>      | Ankara (1/99)           |
| Penang (11/87)         | Stuttgart (4/92)        | AUSTRALIA               | Istanbul (1/99)         |
| Kuala Lumpur (6/90)    | Hamburg (1/93)          | Sydney (8/88)           | Izmir (1/99)            |
| Johor Bahru (11/94)    | Nuremberg (1/01)        | Melbourne (8/88)        | Mersin (1/99)           |
| MARIANA ISLANDS        | + Hannover (1/05)       | Brisbane (10/93)        | + Adana (1/99)          |
| Saipan (7/00)          | HUNGARY                 | Perth (12/94)           | U.A.E.                  |
| PHILIPPINES            | Budapest (4/00)         | Adelaide (10/97)        | * Abu Dhabi (1/94)      |
| Manila (8/98)          | IRELAND                 | FIJI                    | Dubai (10/98)           |
| + Olongapo City (8/98) | Dublin (3/97)           | * Nadi (7/96)           | CYPRUS                  |
| + Mandaue City (9/99)  | Cork (3/97)             | * Suva (5/97)           | * Nicosia (6/96)        |
| SINGAPORE              | Shannon (3/97)          | NEW ZEALAND             | * Larnaca (1/98)        |
| Singapore (9/81)       | ITALY                   | Auckland (8/88)         | <u>AFRICA</u>           |
| TAIWAN                 | Milan (4/93)            | <u>NEAR/MIDDLE EAST</u> | SOUTH AFRICA            |
| Taipei (9/81)          | Verona (4/93)           | EGYPT                   | Johannesburg (3/94)     |
| + Kaohsiung (9/81)     | Florence (3/98)         | Cairo (2/95)            | Durban (3/94)           |
| + Taichung (9/81)      | + Turin (4/05)          | + Alexandria (2/95)     | Capetown (1/97)         |
| + Hsin-Chu (9/89)      | THE NETHERLANDS         | GREECE                  | + Maseru (6/03)         |
| THAILAND               | Amsterdam (6/94)        | Athens (2/99)           | + Port Elizabeth (7/03) |
| Bangkok (9/94)         | Rotterdam (3/95)        | + Thessaloniki (2/99)   | MADAGASCAR              |
| + Laem Chabang (8/05)  | POLAND                  | INDIA                   | Antananarivo (11/01)    |
|                        | Warsaw (2/05)           | New Delhi (7/96)        | MAURITIUS               |
|                        |                         |                         | Port Louis (7/99)       |

The Company was incorporated in the State of Washington in May 1979. Its executive offices are located at 1015 Third Avenue, 12th Floor, Seattle, Washington, and its telephone number is (206) 674-3400.

The Company's internet address is <http://www.expeditors.com>. The Company makes available free of charge through its internet website its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission (SEC).

For information concerning the amount of revenues, net revenues, operating income, identifiable assets, capital expenditures and depreciation and amortization attributable to the geographic areas in which the Company conducts its business, see Note 9 to the consolidated financial statements.

Beginning in 1981, the Company's primary business focus was on airfreight shipments from Asia to the United States and related customs brokerage and other services. In the mid-1980's, the Company began to expand its service capabilities in export airfreight, ocean freight and distribution services. Today the Company offers a complete range of global logistics services to a diversified group of customers, both in terms of industry specialization and geographic location. As opportunities for profitable growth arise, the Company plans to create new offices. While the Company has historically expanded through organic growth, the Company has also been open to growth through acquisition of, or establishing joint ventures with, existing agents or others within the industry.

#### Airfreight Services

Airfreight services accounted for approximately 37, 37, and 39 percent of the Company's 2006, 2005, and 2004 consolidated revenues net of freight consolidation expenses ( net revenues ), respectively. When performing airfreight services, the Company typically acts either as a freight consolidator or as an agent for the airline which carries the shipment. When acting as a freight consolidator, the Company purchases cargo space from airlines on a volume basis and resells that space to its customers at lower rates than the customers could obtain directly from airlines. When moving shipments between points where the volume of business does not facilitate consolidation, the Company receives and forwards individual shipments as the agent of the airline which carries the shipment. Whether acting as an agent or consolidator, the Company offers its customers knowledge of optimum routing, familiarity with local business practices, knowledge of export and import documentation and procedures, the ability to arrange for ancillary services, and assistance with space availability in periods of peak demand.

In its airfreight forwarding operations, the Company procures shipments from its customers, determines the routing, consolidates shipments bound for a particular airport distribution point, and selects the airline for transportation to the distribution point. At the distribution point, the Company or its agent arranges for the consolidated lot to be broken down into its component shipments and for the transportation of the individual shipments to their final destinations.

The Company estimates its average airfreight consolidation weighs approximately 3,500 to 4,500 pounds and a typical consolidation includes merchandise from several shippers. Because shipment by air is relatively expensive compared with ocean transportation, air shipments are generally characterized by a high value-to-weight ratio, the need for rapid delivery, or both.

The Company typically delivers shipments from a Company warehouse at the origin to the airline after consolidating the freight into containers or onto pallets. Shipments normally arrive at the destination distribution point within forty-eight hours after such delivery. During peak shipment periods, cargo space available from the scheduled air carriers can be limited and backlogs of freight shipments may occur. When these conditions exist, the Company may charter aircraft to meet customer demand.

The Company consolidates individual shipments based on weight and volume characteristics in cost-effective combinations. Typically, as the weight or volume of a shipment increases, the cost per pound/kilo or cubic inch/centimeter charged by the Company decreases. The rates charged by airlines to forwarders and others also generally decrease as the weight or volume of the shipment increases. As a result, by aggregating shipments and presenting them to an airline as a single shipment, the Company is able to obtain

a lower rate per pound/kilo or cubic inch/centimeter than that which it charges to its customers for the individual shipment, while generally offering the customer a lower rate than could be obtained from the airline for an unconsolidated shipment.

The Company's net airfreight forwarding revenues from a consolidated shipment include the differential between the rate charged to the Company by an airline and the rate which the Company charges to its customers, commissions paid to the Company by the airline carrying the freight and fees for ancillary services. Such ancillary services provided by the Company include preparation of shipping and customs documentation, packing, crating and insurance services, negotiation of letters of credit, and preparation of documentation to comply with local export laws. When the Company acts as an agent for an airline handling an unconsolidated shipment, its net revenues are primarily derived from commissions paid by the airline and fees for ancillary services paid by the customer.

The Company does not own aircraft and does not plan to do so. Management believes that the ownership of aircraft would subject the Company to undue business risks, including large capital outlays, increased fixed operating expenses, problems of fully utilizing aircraft and competition with airlines. Because the Company relies on commercial airlines to transport its shipments, changes in carrier policies and practices such as pricing, payment terms, scheduling, and frequency of service may affect its business.

The Company also performs breakbulk services which involve receiving and breaking down consolidated airfreight lots and arranging for distribution of the individual shipments. Breakbulk service revenues also include commissions from agents for airfreight shipments.

#### Ocean Freight and Ocean Services

Ocean freight services accounted for approximately 25, 25, and 23 percent of the Company's 2006, 2005, and 2004 consolidated net revenues, respectively. The Company's revenues as an ocean freight forwarder are derived from commissions paid by the carrier and revenues from fees charged to customers for ancillary services which the Company may provide, such as preparing documentation, procuring insurance, arranging for packing and crating services, and providing consultation. The Company operates Expeditors International Ocean (EIO) an Ocean Transportation Intermediary, sometimes referred to as, a Non-Vessel Operating Common Carrier (NVOCC) specializing in ocean freight consolidation from Asia to the United States. EIO also provides service, on a smaller scale, to and from any location where the Company has an office or agent. As an NVOCC, EIO contracts with ocean shipping lines to obtain transportation for a fixed number of containers between various points during a specified time period at an agreed rate. EIO solicits Less-than Container Load (LCL) freight to fill the containers and charges lower rates than those available directly from shipping lines. EIO also handles full container loads for customers that do not have annual shipping volumes sufficient to negotiate comparable contracts directly with the ocean carriers. The Company does not own vessels and generally does not physically handle the cargo.

Expeditors Cargo Management Systems (ECMS) supplies a sophisticated ocean consolidation service. The Company owns and maintains software that allows it to sell ECMS to large volume customers that have signed their own service contracts with the ocean carriers. As an ocean consolidator, ECMS may obtain LCL freight from several vendors and consolidate this cargo into full containers. The Company's revenues as an ocean consolidator are derived from handling LCL cargo at origin and from the fees paid by customers for access to data captured during the consolidation process.

#### Customs Brokerage and Other Services

Customs brokerage and other services accounted for approximately 38 percent of each of the Company's 2006, 2005, and 2004 consolidated net revenues, respectively. As a customs broker, the Company assists importers to clear shipments through customs by preparing required documentation, calculating and providing for payment of duties on behalf of the importer, arranging for any required inspections by governmental agencies, and arranging for delivery. The Company also provides other value added services at destination such as warehousing and product distribution, time definite transportation and inventory management. None of these other services are currently individually significant to the Company's net revenues.

The Company provides customs clearance services in connection with many of the shipments it handles as a freight forwarder. However, substantial customs brokerage revenues are derived from customers that elect to use a competing forwarder. Conversely, shipments handled by the Company as a forwarder may be processed by another customs broker selected by the customer.

The Company also provides custom clearances for goods moving by rail and truck between the United States, Canada and/or Mexico. The commodities being cleared and the time sensitive nature of the border brokerage business require the Company to continue to make enhancements to its systems in order to provide competitive service.

The Company's wholly-owned subsidiary, Expeditors Tradewin, L.L.C., responds to customer driven requests for high-end customs consulting services. The demand for these services was stimulated by the changes made by Customs and Border Protection of the Department of Homeland

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Security in response to the 1993 Customs Modernization Act. Fees for these non-transactional services are based upon hourly billing rates and bids for mutually agreed procedures.

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### Marketing and Customers

The Company provides flexible service and seeks to understand the needs of the customers from points of origin to ultimate destinations. Although the domestic importer usually designates the logistics company and the services that will be required, the foreign shipper may also participate in this selection process. Therefore, the Company coordinates its marketing program to reach both domestic importers and their overseas suppliers.

The Company's marketing efforts are focused primarily on the traffic, shipping and purchasing departments of existing and potential customers. The district manager of each office is responsible for marketing, sales coordination, and implementation in the area in which he or she is located. All employees are responsible for customer service and relations.

The Company staffs its offices largely with managers and other key personnel who are citizens of the nations in which they operate and who have extensive experience in global logistics. Marketing and customer service staffs are responsible for marketing the Company's services directly to local shippers and traffic managers who may select or influence the selection of the logistics vendor and for ensuring that customers receive timely and efficient service. The Company believes that its expertise in supplying solutions customized to the needs of its customers, its emphasis on coordinating its origin and destination customer service and marketing activities, and the incentives it gives to its managers have been important elements of its success.

The goods handled by the Company are generally a function of the products which dominate international trade between any particular origin and destination. Shipments of computer components, other electronic equipment, housewares, sporting goods, machine parts, and toys, comprise a significant percentage of the Company's business. Typical import customers include computer retailers and distributors of consumer electronics, department store chains, clothing and shoe wholesalers, manufacturers and catalogue stores. Historically, no single customer has accounted for five percent or more of the Company's revenues.

### Competition

The global logistics services industry is intensely competitive and is expected to remain so for the foreseeable future. There are a large number of companies competing in one or more segments of the industry, but the number of firms with a global network that offer a full complement of logistics services is more limited. Depending on the location of the shipper and the importer, the Company must compete against both the niche players and larger entities. While there is currently a marked trend within the industry toward consolidation into larger firms striving for immediate multinational and multi-service networks, the regional and local competitors maintain a strong market presence.

Historically, the primary competitive factors in the global logistics services 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 the prices of others in the industry. Recently, larger customers have exhibited a trend toward more sophisticated and efficient procedures for the management of the logistics supply chain by embracing strategies such as just-in-time inventory management. This trend has made computerized customer service capabilities a significant factor in attracting and retaining customers. These computerized customer service capabilities include customized Electronic Data Interchange, ( EDI ), and on-line freight tracing and tracking applications. The customized EDI applications allow the transfer of key information between the customers' systems and the Company's systems. Freight tracing and tracking applications provide customers with real time visibility to the location, transit time and estimated delivery time of inventory in transit.

Management believes that the ability to develop and deliver innovative solutions to meet customers' increasingly sophisticated information requirements is a critical factor in the ongoing success of the Company. Accordingly, the Company has devoted a significant amount of resources towards the maintenance and enhancement of systems that will meet these customer demands. Management believes that the Company's existing systems are competitive with the systems currently in use by other logistics services companies with which it competes.

Unlike many of its competitors, who have tended to grow by merger and acquisition, the Company operates the same accounting and transportation computer software, running on a common hardware platform, in all of its full-service locations. Small and middle-tier competitors, in general, do not have the resources available to develop these customized systems. 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. 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. As a result, the Company has pursued a strategy emphasizing organic growth supplemented by certain strategic acquisitions.



The Company's ability to attract, retain, and motivate highly qualified personnel with experience in global logistics services is an essential, if not the most important, element of its ability to compete in the industry. To this end, the Company has adopted incentive compensation programs which make percentages of branch revenues or profits available to managers for distribution among key personnel. The Company believes that these incentive compensation programs, combined with its experienced personnel and its ability to coordinate global marketing efforts, provide it with a distinct competitive advantage and account for historical growth that competitors have generally matched only through acquisition.

#### Currency and Other Risk Factors

The nature of the Company's worldwide operations necessitate 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. Many 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 these offices or agents.

In addition, the Company's ability to provide service to its customers is highly dependent on good working relationships with a variety of entities including airlines, steamship lines and governmental agencies. The Company considers its current working relationships with these entities to be good. However, changes in space allotments available from carriers, governmental deregulation efforts, modernization of the regulations governing customs clearance, and/or changes in governmental quota restrictions could affect the Company's business in unpredictable ways.

#### Seasonality

Historically, the Company's operating results have been subject to seasonal trends 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 has been the result of, or 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 will continue in future periods.

A significant portion of the Company's revenues are derived from customers in 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 shifting consumer demand for retail goods and 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.

#### Environmental

In the United States, the Company is subject to Federal, state and local provisions regulating the discharge of materials into the environment or otherwise for the protection of the environment. Similar laws apply in many other jurisdictions in which the Company operates. Although current operations have not been significantly affected by compliance with these environmental laws, governments are becoming increasingly sensitive to environmental issues, and the Company cannot predict what impact future environmental regulations may have on its business. The Company does not anticipate making any material capital expenditures for environmental control purposes during the remainder of the current or succeeding fiscal years.

#### Employees

At January 31, 2007, the Company employed approximately 11,600 people, 4,390 in the United States and 660 in the balance of North America, 590 in South America, 1,570 in Europe, 3,250 in Asia & Australasia, 850 in the Near/Middle East and 290 in Africa. Approximately 1,650 of the Company's employees are engaged principally in sales and marketing and customer service, 7,100 in operations and 2,850 in finance and administration. The Company is not a party to any collective bargaining agreement and considers its relations with its employees to be satisfactory.

In order to retain the services of highly qualified, experienced, and motivated employees, the Company places considerable emphasis on its non-equity incentive compensation programs and stock option plans.



## Executive Officers of the Registrant

The following table sets forth the names, ages, and positions of current executive officers of the Company.

| Name                   | Age | Position   |
|------------------------|-----|--|
| Peter J. Rose          | 63  | Chairman and Chief Executive Officer and director                  |
| James L.K. Wang        | 59  | President-Asia and director  |
| Glenn M. Alger         | 50  | President and Chief Operating Officer                              |
| Rommel C. Saber        | 49  | President-Europe, Africa, Near/Middle East and Indian Subcontinent |
| Robert L. Villanueva   | 54  | President-The Americas   |
| Sandy K.Y. Liu         | 59  | Chief Operating Officer-Asia                                       |
| R. Jordan Gates        | 51  | Executive Vice President-Chief Financial Officer and director      |
| Timothy C. Barber      | 47  | Executive Vice President-Global Sales                              |
| Rosanne Esposito       | 55  | Executive Vice President-Global Customs                            |
| Eugene K. Alger        | 46  | Senior Vice President-North America                                |
| Jean Claude Carcaillet | 61  | Senior Vice President-Australasia                                  |
| Philip M. Coughlin     | 46  | Senior Vice President-North America                                |
| Roger A. Idiart        | 53  | Senior Vice President-Air Cargo                                    |
| Charles J. Lynch       | 46  | Senior Vice President-Corporate Controller                         |
| Jeffrey S. Musser      | 41  | Senior Vice President and Chief Information Officer                |
| Daniel R. Wall         | 38  | Senior Vice President-Ocean Services                               |
| Amy J. Tangeman        | 38  | Vice President-General Counsel and Secretary                       |

Peter J. Rose has served as a director and Vice President of the Company since July 1981. Mr. Rose was elected a Senior Vice President of the Company in May 1986, Executive Vice President in May 1987, President and Chief Executive Officer in October 1988, and Chairman and Chief Executive Officer in May 1991.

James L.K. Wang has served as a director and the Managing Director of Expeditors International Taiwan Ltd., the Company's former exclusive Taiwan agent, since September 1981. In 1991, Mr. Wang's employment agreement was assigned to E.I. Freight (Taiwan), Ltd., the Company's exclusive Taiwan agent through 2004. Mr. Wang's contract is now assigned to ECI Taiwan Co. Ltd., a wholly-owned subsidiary of the Company. In October 1988, Mr. Wang became a director of the Company and its Director-Far East, and Executive Vice President in January 1996. In May 2000, Mr. Wang was elected President-Asia.

Glenn M. Alger joined the Company in July 1981 as a District Manager. Mr. Alger was elected Vice President and Regional Manager in October 1988, Senior Vice President-U.S. Operations in January 1992, Senior Vice President and Director-North America in January 1993, and Executive Vice President and Director-North America in March 1997. In September 1999, Mr. Alger was elected President and Chief Operating Officer. Mr. Alger has announced his intention to retire in 2007.

Rommel C. Saber joined the Company as Director-Near/Middle East in February 1990 and was elected Senior Vice President-Sales and Marketing in January 1993. Mr. Saber was elected Senior Vice President-Air Export in September 1993. In July 1997, Mr. Saber was elected Senior Vice President Near/Middle East and Indian Subcontinent and Executive Vice President-Europe, Africa and Near/Middle East in August 2000. In February 2006, Mr. Saber was elected President-Europe, Africa, Near/Middle East and Indian Subcontinent.

Robert L. Villanueva joined the Company as Regional Vice President Northwest U.S. Region in April 1994. In September 1999, he was elected Executive Vice President-The Americas and President-The Americas in May 2004.

Sandy K.Y. Liu became Chief Operating Officer-Asia of the Company in January 2001. From 1969 through 2000, Mr. Liu was employed in various positions by China Airlines. In November 1998, Mr. Liu was appointed President of China Airlines.

R. Jordan Gates joined the Company as its Controller-Europe in February 1991. Mr. Gates was elected Chief Financial Officer and Treasurer of the Company in August 1994 and Senior Vice President-Chief Financial Officer and Treasurer in January 1998. In May 2000, Mr. Gates was elected Executive Vice President-Chief Financial Officer and Treasurer. Mr. Gates was also elected as a director in May 2000.

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Timothy C. Barber joined the Company in May 1986. Mr. Barber was promoted to District Manager of the Seattle office in January 1987 and Regional Vice President in January 1993. Mr. Barber was elected Vice President-Sales and Marketing in September 1993 and Senior Vice President-Sales and Marketing in January 1998. In September 1999, Mr. Barber was elected Executive Vice President-Global Sales.

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Rosanne Esposito joined the Company as its Director-U.S. Import Services in January 1996. Ms. Esposito was promoted to Vice President in May 1997 and Senior Vice President-Global Customs in May 2001. In May 2004, Ms. Esposito was promoted to Executive Vice President-Global Customs.

Eugene K. Alger joined the Company in October 1982. Mr. Alger was promoted to District Manager and Regional Vice President of the Los Angeles office in May 1983. He was elected Regional Vice President-Southwestern U.S. and Mexico Region in January 1992, and Senior Vice President of North America in September 1999.

Jean Claude Carcaillet joined the Company as Managing Director-Australasia in August 1988. Mr. Carcaillet was elected Senior Vice President-Australasia in September 1997.

Philip M. Coughlin joined the Company in October 1985. In August 1986, Mr. Coughlin was promoted to District Manager. Mr. Coughlin was elected Regional Manager for New England and Canada in January 1991, Regional Vice President-Northeastern U.S. and Northern Border in January 1992, and Senior Vice President of North America in September 1999.

Roger A. Idiart joined the Company as its Manager of Gateway Operations in December 1995. Mr. Idiart was elected Vice President-Global Air Cargo in January 1998, and Senior Vice President-Air Cargo in May 2001.

Charles J. Lynch joined the Company in September 1984. Mr. Lynch was promoted to Assistant Controller in July 1985 and Controller-Domestic Operations in January 1989. Mr. Lynch was elected Corporate Controller in January 1991 and Vice President-Corporate Controller in January 1998. In May 2002, Mr. Lynch was elected Senior Vice President-Corporate Controller.

Jeffrey S. Musser joined the Company in February 1983. Mr. Musser was promoted to District Manager in October 1989 and Regional Vice President in September 1999. Mr. Musser was elected Senior Vice President-Chief Information Officer in January 2005.

Daniel R. Wall joined the Company in March 1987. Mr. Wall was promoted to District Manager in May 1992 and Global Director-Account Management in March 2002. Mr. Wall was elected Vice President-ECMS in January 2004 and Senior Vice President-Ocean Services in September 2004.

Amy J. Tangeman joined the Company in January 1997. Ms. Tangeman was promoted to Assistant General Counsel in November 2001. In October 2006, Ms. Tangeman was elected Vice-President-General Counsel and Secretary.

#### Regulation and Security

With respect to the Company's activities in the air transportation industry in the United States, it is subject to regulation by the Transportation Security Administration of the Department of Homeland Security as an indirect air carrier. The Company's overseas offices and agents are licensed as airfreight forwarders in their respective countries of operation. The Company is licensed in each of its offices or, in the case of its newer offices, has made application for a license as an airfreight forwarder by the International Air Transport Association ( IATA ). IATA is a voluntary association of airlines and air transport related entities which prescribes certain operating procedures for airfreight forwarders acting as agents for its members. The majority of the Company's airfreight forwarding business is conducted with airlines which are IATA members.

The Company is licensed as a customs broker by Customs and Border Protection ( CBP ) of the Department of Homeland Security in each U.S. customs district in which it does business. All United States customs brokers are required to maintain prescribed records and are subject to periodic audits by CBP. Additionally, the Company participates in government supply chain security programs such as Customs-Trade Partnership Against Terrorism ( C-TPAT ) in the United States. In other jurisdictions in which the Company performs clearance services, the Company is licensed by the appropriate governmental authority.

The Company is registered as an Ocean Transportation Intermediary ( OTI ) (sometimes referred to as NVOCC-Non-Vessel Owned Common Carrier) by the Federal Maritime Commission ( FMC ). The FMC has established certain qualifications for shipping agents, including certain surety bonding requirements. The FMC also is responsible for the economic regulation of OTI/NVOCC activity originating or terminating in the United States. To comply with these economic regulations, vessel operators and NVOCCs, such as EIO, are required to file tariffs electronically which establish the rates to be charged for the movement of specified commodities into and out of the United States. The FMC has the power to enforce these regulations by assessing penalties.

The Company does not believe that current United States and foreign governmental regulations impose significant economic restraint upon its business operations. In general, the Company conducts its business activities in each country through a majority-owned subsidiary corporation that is organized and existing under the laws of that country. However, the regulations of foreign governments can impose barriers to the

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Company's ability to provide the full range of its business activities in a wholly or majority United States-owned subsidiary. For example, foreign ownership of a customs brokerage business is prohibited in some jurisdictions

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and less frequently the ownership of the licenses required for freight forwarding and/or freight consolidation is restricted to local entities. When the Company encounters this sort of governmental restriction, it works to establish a legal structure that meets the requirements of the local regulations while also giving the Company the substantive operating and economic advantages that would be available in the absence of such regulation. This can be accomplished by creating a joint venture or exclusive agency relationship with a qualified local entity that holds the required license. In cases where the Company has unilateral control over the assets and operations of the local entity, notwithstanding the lack of technical majority ownership of common stock, the Company consolidates the accounts of the local entity. In such cases, consolidation is necessary to fairly present the financial position and results of operations of the Company because of the existence of the parent-subsidiary relationship by means other than record ownership of voting common stock.

The war on terror and governments' overriding concern for the safety of passengers and citizens who import and/or export goods into and out of their respective countries has resulted in a proliferation of cargo security regulations over the past several years. While these cargo regulations have already created a marked difference in the security arrangements required to move shipments around the globe, regulations are expected to become more stringent in the future. As governments look for ways to minimize the exposure of their citizens to potential terror related incidents, the Company and its competitors in the transportation business may be required to incorporate security procedures within their scope of services to a far greater degree than has been required in the past. The Company feels that increased security requirements may involve further investments in technology and more sophisticated screening procedures being applied to potential customers, vendors and employees. While many of these regulations have not been finalized at this time, it is the Company's position that much of the increased costs of compliance with security regulations will need to be passed through to those who are beneficiaries of the Company's services.

#### Cargo Liability

When acting as an airfreight consolidator, the Company assumes a carrier's liability for lost or damaged shipments. This legal liability is typically limited by contract to the lower of the transaction value or the released value (\$9.07 per pound unless the customer declares a higher value and pays a surcharge), except if the loss or damage is caused by willful misconduct or in the absence of an appropriate airway bill. The airline which the Company utilizes to make the actual shipment is generally liable to the Company in the same manner and to the same extent. When acting solely as the agent of the airline or shipper, the Company does not assume any contractual liability for loss or damage to shipments tendered to the airline.

When acting as an ocean freight consolidator, the Company assumes a carrier's liability for lost or damaged shipments. This liability is typically limited by contract to the lower of the transaction value or the released value (\$500 per package or customary freight unit unless the customer declares a higher value and pays a surcharge). The steamship line which the Company utilizes to make the actual shipment is generally liable to the Company in the same manner and to the same extent. In its ocean freight forwarding and customs clearance operations, the Company does not assume cargo liability.

When providing warehouse and distribution services, the Company limits its legal liability by contract and tariff to an amount generally equal to the lower of fair value or fifty cents per pound with a maximum of fifty dollars per lot which is defined as the smallest unit that the warehouse is required to track. Upon payment of a surcharge for warehouse and distribution services, the Company will assume additional liability.

The Company maintains marine cargo insurance covering claims for losses attributable to missing or damaged shipments for which it is legally liable. The Company also maintains insurance coverage for the property of others which is stored in Company warehouse facilities. This insurance coverage is provided by a Vermont based insurance entity wholly owned by the Company. The coverage is fronted and reinsured by a global insurance company. The total risk retained by the Company in 2006 was approximately \$4 million, although actual and estimated losses are expected to be less. In addition, the Company is licensed as an insurance broker through its subsidiary, Expeditors Cargo Insurance Brokers, Inc. and places stand alone insurance coverage for other customers.

ITEM 1A RISK FACTORS

**RISK FACTORS**

International Trade

**DISCUSSION AND POTENTIAL SIGNIFICANCE**

The Company primarily provides services to customers engaged in international commerce. Everything that affects international trade has the potential to expand or contract the Company's primary market. For example, international trade is influenced by:

- currency exchange rate and interest rate fluctuations;
- changes in governmental policies;
- changes in international and domestic customs regulations;
- wars, acts of terrorism, and other conflicts;
- natural disasters;
- changes in consumer attitudes regarding goods made in countries other than their own; and
- changes in the price and readily available quantities of oil and other petroleum-related products.

Third Party Vendors

The Company is a non-asset based supplier of global logistics services. As a result, the Company depends on a variety of asset-based third party vendors. The quality and profitability of the Company's services depend upon effective selection, management and discipline of third party vendors.

Predictability of Results

The Company is not aware of any accurate means of forecasting short-term customer requirements. However, long-term customer satisfaction depends upon the Company's ability to meet these unpredictable short-term customer requirements. Personnel costs, the Company's single largest variable expense, are always less flexible in the very near term as the Company must staff to meet uncertain demand. As a result, short-term operating results could be disproportionately affected.

Foreign Operations

The majority of the Company's revenues and operating income come from operations conducted outside the United States. To maintain a global service network, the Company may be required to operate in hostile locations and in dangerous situations.

Key Personnel

The Company is a service business. The quality of this service is directly related to the quality of the Company's employees. Identifying, training and retaining key employees is essential to continued growth and future profitability. Continued loyalty to the Company will not be assured by contract.

Technology

Increasingly, the Company must compete based upon the flexibility and sophistication of the technologies utilized in performing its core businesses. Future results depend upon the Company's success in the cost effective development and integration of communication and information systems technologies.

Growth

To date, the Company has relied primarily upon organic growth and has tended to avoid growth through acquisition. Future results will depend upon the Company's ability to continue to grow internally or to demonstrate the ability to successfully identify and integrate non-dilutive acquisitions.

Regulatory Environment

As a publicly traded corporation, the Company is affected by regulations from a number of sources. The current business environment tends to stress the avoidance of risk through regulation and oversight, the effect of which is likely to be unforeseen costs and potentially unforeseen consequences.

In reaction to the global war on terror, governments around the world are continuously enacting or updating security regulations. The implementation of these regulations, including deadlines and substantive requirements, is driven by political urgencies rather than the industries' realistic ability to comply. Failure to timely comply may result in increased operating costs, restrictions on operations and/or fines and penalties.

ITEM 1B UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2 PROPERTIES

The Company owns the following properties:

| Location  | Nature of Property                     |
|---|--|
| <b>United States:</b>                                     |  |
| Seattle, Washington                                       | Office buildings                       |
| Near Seattle-Tacoma International Airport (in Washington) | Office building                        |
| Houston, Texas  | Office and warehouse                   |
| Nassau County, New York                                   | Office and warehouse                   |
| Middlesex County, New Jersey                              | Office and warehouse                   |
| Near San Francisco International Airport (in California)  | Office and warehouse                   |
| Near Los Angeles International Airport (in California)    | Office and warehouse                   |
| Near O'Hare International Airport (in Illinois)           | Office and warehouse                   |
| Miami, Florida  | Office, warehouse and free trade zone* |
| <b>Asia:</b>  |  |
| Kowloon, Hong Kong  | Office                                 |
| Taipei, Taiwan  | Office                                 |
| Seoul, Korea  | Office                                 |
| Shanghai, China   | Office building and Acreage            |
| Near Beijing Airport (in Beijing)                         | Acreage                                |
| <b>Europe:</b>  |  |
| Brussels, Belgium   | Office and warehouse                   |
| Dublin, Ireland   | Office and warehouse                   |
| Cork, Ireland   | Office and warehouse                   |
| Near Heathrow Airport (in London, England)                | Acreage                                |
| <b>Latin America:</b>                                     |  |
| Alajuela, Costa Rica                                      | Office building                        |
| <b>Middle East:</b>                                       |  |
| Cairo, Egypt  | Office and warehouse                   |

\*Company directly owns 50% with Cargo Ventures, LLC, a private, non-affiliated real estate development company.

The Company leases and maintains 71 additional offices and satellite locations in the United States and 196 offices throughout the world, each located close to an airport, ocean port, or on an important border crossing. The majority of these facilities contain warehouse facilities. Lease terms are either on a month-to-month basis or terminate at various times through 2015. See Note 7 to the Company's consolidated financial statements for lease commitments. As an office matures, the Company will investigate the possibility of building or buying suitable facilities. The Company believes that current leases can be extended and that suitable alternative facilities are available in the vicinity of each present facility should extensions be unavailable at the conclusion of current leases.

ITEM 3 LEGAL PROCEEDINGS

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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 material effect on the Company's operations or financial position.

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ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

PART II

ITEM 5 MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The following table sets forth the high and low sale prices in the over-the-counter market for the Company's Common Stock as reported by The NASDAQ Global Market under the symbol EXPD.

| Quarter<br>2006 | Common Stock<br>High | Low       | Quarter<br>2005 | Common Stock<br>High | Low       |
|-----------------|----------------------|-----------|-----------------|----------------------|-----------|
| First           | \$ 43.640            | \$ 32.825 | First           | \$ 28.875            | \$ 26.255 |
| Second          | \$ 56.810            | \$ 42.310 | Second          | \$ 27.155            | \$ 23.585 |
| Third           | \$ 58.320            | \$ 37.360 | Third           | \$ 28.500            | \$ 24.735 |
| Fourth          | \$ 48.990            | \$ 39.790 | Fourth          | \$ 36.370            | \$ 26.875 |

There were 5,703 shareholders of record as of February 26, 2007. Management estimates that there were approximately 28,454 beneficial shareholders at that date.

The Board of Directors declared semi-annual dividends during the two most recent fiscal years as follows:

|                   |         |
|-------------------|---------|
| June 15, 2006     | \$ .11  |
| December 15, 2006 | \$ .11  |
| June 15, 2005     | \$ .075 |
| December 15, 2005 | \$ .075 |

ISSUER PURCHASES OF EQUITY SECURITIES

| Period              | Total Number of<br>Shares Purchased | Average Price Paid per<br>Share | Total Number of<br>Shares Purchased<br>as Part of a<br>Publicly<br>Announced Plans<br>or Programs | Maximum Number<br>of Shares that<br>May Yet Be<br>Purchased Under<br>the Plans or<br>Programs |
|---------------------|-------------------------------------|---------------------------------|---|---|
| October 1-31, 2006  | 1,078                               | \$ 46.54                        | 1,078   | 13,371,901  |
| November 1-30, 2006 | 165,973                             | \$ 46.81                        | 165,973   | 13,298,223  |
| December 1-31, 2006 | 248,741                             | \$ 40.31                        | 248,741   | 13,184,829  |
| Total               | 415,792                             | \$ 42.92                        | 415,792   | 13,184,829  |

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

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expiration date. This plan was disclosed in the Company's report on Form 10-K filed March 31, 1995. In the fourth quarter of 2006, 107,043 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 fourth quarter of 2006, 308,749 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.

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## ITEM 6 SELECTED FINANCIAL DATA

## Financial Highlights

In thousands except per share data

|   | 2006         | 2005      | 2004      | 2003      | 2002      |
|---|--------------|-----------|-----------|-----------|-----------|
| Revenues                                    | \$ 4,625,966 | 3,901,781 | 3,317,499 | 2,624,941 | 2,296,903 |
| Net earnings                                | 235,094      | 190,436   | 129,949   | 98,970    | 93,276    |
| Diluted earnings per share                  | 1.06         | .86       | .59       | .46       | .44       |
| Basic earnings per share                    | 1.10         | .89       | .61       | .47       | .45       |
| Dividends declared and paid per share       | .22          | .15       | .11       | .08       | .06       |
| Working capital                             | 632,691      | 589,460   | 521,544   | 383,614   | 250,920   |
| Total assets                                | 1,822,338    | 1,566,044 | 1,364,053 | 1,044,078 | 879,948   |
| Shareholders' equity                        | 1,069,935    | 926,382   | 821,144   | 662,259   | 529,577   |
| Diluted weighted average shares outstanding | 222,223      | 220,230   | 220,117   | 216,228   | 213,417   |
| Basic weighted average shares outstanding   | 213,455      | 213,555   | 212,768   | 209,467   | 207,786   |

All share and per share information have been adjusted to reflect a 2-for-1 stock split effected in June, 2006.

Certain amounts for the years 2002 through 2005 have been restated as required by the modified retrospective method in connection with the implementation of Statement of Financial Accounting Standard 123R (SFAS 123R). See Note 5D to the consolidated financial statements for further discussion of the impact of the adoption of SFAS 123R.

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

From time to time, the Company or its representatives have made or may make forward-looking statements, orally or in writing. Such forward-looking statements may be included in, but not limited to, press releases, oral statements made with the approval of an authorized executive officer or in various filings made by the Company with the Securities and Exchange Commission. The words or phrases "will likely result", "are expected to", "will continue", "is anticipated", "estimate", "project" or similar expressions are intended to identify forward-looking statements within the meaning of the Securities Litigation Reform Act. Such statements are qualified in their entirety by reference to and are accompanied by the discussion in Item 1A of certain important factors that could cause actual results to differ materially from such forward-looking statements.

The risks included in Item 1A are not exhaustive. Furthermore, reference is also made to other sections of this report which include additional factors which could adversely impact the Company's business and financial performance. Moreover, the Company operates in a very competitive and rapidly changing environment. New risk factors emerge from time to time and it is not possible for management to predict all of such risk factors, nor can it assess the impact of all of such risk factors on the Company's business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Accordingly, forward-looking statements cannot be relied upon as a guarantee of actual results.

Shareholders should be aware that while the Company does, from time to time, communicate with securities analysts, it is against the Company's policy to disclose to such analysts any material non-public information or other confidential commercial information. Accordingly, shareholders should not assume that the Company agrees with any statement or report issued by any analyst irrespective of the content of such statement or report. Furthermore, the Company has a policy against issuing financial forecasts or projections or confirming the accuracy of forecasts or projections issued by others. Accordingly, to the extent that reports issued by securities analysts contain any projections, forecasts or opinions, such reports are not the responsibility of the Company.

ITEM 7 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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, taxation, regional and global conflicts. 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 effects the 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. These are the revenue categories presented in the financial statements.

The Company is managed along four geographic areas of responsibility: The Americas; Asia; Europe, Africa, Near/Middle East and Indian Subcontinent (EMAIR); and Australasia. Each area is divided into sub-regions which are composed of operating units with individual profit and loss responsibility. The Company's business involves shipments between operating units and typically touches more than one geographic area. The nature of the international logistics business necessitates a high degree of communication and cooperation among operating units. Because of this inter-relationship between operating units, it is very difficult to look at one geographic area and draw meaningful conclusions as to its contribution to the Company's overall success on a stand-alone basis.

The Company's operating units share revenue using the same arms-length pricing methodologies the Company uses when its offices transact business with independent agents. The Company's strategy closely links compensation with operating unit profitability. Individual success likely involves cooperation with other operating units.

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 2007 are expected to exceed \$106 million.

In terms of the opportunities, challenges and risks that management focused on in 2006, the Company operates in 60 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 Estimates**

A summary of the Company's significant accounting policies can be found in Note 1 to the consolidated financial statements in this Annual Report.

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 to the consolidated financial statements in this 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.

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 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 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 5D in the consolidated financial statements for the assumptions used for grants issued during the years ended December 31, 2006, 2005 and 2004. 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.

#### Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) ratified the Emerging Issues Task Force (EITF) Issue 06-3, *How Taxes Collected From Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement*, (EITF 06-3). The scope of EITF 06-3 includes any tax assessed by a governmental authority that is both imposed on and concurrent with a specific revenue-producing transaction between a seller and a customer, including but not limited to sales and value-added taxes. In EITF 06-3 a consensus was reached that entities may adopt a policy of presenting these taxes in the income statement on either a gross or net basis. If these taxes are significant, an entity should disclose its policy of presenting taxes and the amount of taxes if reflected on a gross basis in the income statement. EITF 06-3 is effective for interim and annual reporting periods beginning after December 15, 2006. The Company is required to and plans to adopt EITF 06-3 in the first quarter of 2007. The Company presents revenues net of sales and value-added taxes in its consolidated statement of earnings and does not anticipate changing its policy as a result of the adoption of EITF 06-3.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of FASB Statement No. 109, (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the Company's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes* (SFAS 109). The interpretation establishes guidelines for recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is required to and plans to adopt the provisions of FIN 48 beginning in the first quarter of 2007. The Company does not expect the adoption of FIN 48 to have a material impact on the Company's consolidated financial condition or results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is required to and plans to adopt the provisions of SFAS 157 beginning in the first quarter of 2008. The Company is currently assessing the impact of the adoption of SFAS 157.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). Under the provisions of SFAS 159, Companies may choose to account for eligible financial instruments, warranties and insurance contracts at fair value on a contract-by-contract basis. Changes in fair value will be recognized in earnings each reporting period. SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is required to and plans to adopt the provisions of SFAS 159 beginning in the first quarter of 2008. The Company is currently assessing the impact of the adoption of SFAS 159.

## 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 2006, 2005, and 2004, 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.

| In thousands  | 2006       | Percent of net |   | 2005       | Percent of net |   | 2004       | Percent of net |   |
|---|------------|----------------|---|------------|----------------|---|------------|----------------|---|
|   | Amount     | revenues       |   | Amount     | revenues       |   | Amount     | revenues       |   |
| <b>Net revenues:</b>                                      |            |                |   |            |                |   |            |                |   |
| Airfreight  | \$ 470,638 | 37             | % | \$ 391,773 | 37             | % | \$ 348,949 | 39             | % |
| Ocean freight and ocean services                          | 322,580    | 25             |   | 260,261    | 25             |   | 210,967    | 23             |   |
| Customs brokerage and other services                      | 489,721    | 38             |   | 407,575    | 38             |   | 346,321    | 38             |   |
| Net revenues  | 1,282,939  | 100            |   | 1,059,609  | 100            |   | 906,237    | 100            |   |
| <b>Overhead expenses:</b>                                 |            |                |   |            |                |   |            |                |   |
| Salaries and related costs                                | 701,824    | 55             |   | 596,804    | 56             |   | 513,814    | 57             |   |
| Other   | 205,999    | 16             |   | 191,752    | 18             |   | 180,999    | 20             |   |
| Total overhead expenses                                   | 907,823    | 71             |   | 788,556    | 74             |   | 694,813    | 77             |   |
| Operating income  | 375,116    | 29             |   | 271,053    | 26             |   | 211,424    | 23             |   |
| Other income, net   | 20,548     | 2              |   | 15,644     | 1              |   | 8,535      | 1              |   |
| <b>Earnings before income taxes and minority interest</b> |            |                |   |            |                |   |            |                |   |
| Earnings before income taxes and minority interest        | 395,664    | 31             |   | 286,697    | 27             |   | 219,959    | 24             |   |
| Income tax expense  | 160,661    | 13             |   | 89,365     | 8              |   | 84,971     | 9              |   |
| <b>Net earnings before minority interest</b>              |            |                |   |            |                |   |            |                |   |
| Net earnings before minority interest                     | 235,003    | 18             |   | 197,332    | 19             |   | 134,988    | 15             |   |
| Minority interest   | 91         |                |   | (6,896)    | (1)            |   | (5,039)    | (1)            |   |
| Net earnings  | \$ 235,094 | 18             | % | \$ 190,436 | 18             | % | \$ 129,949 | 14             | % |

2006 compared with 2005

Airfreight net revenues in 2006 increased 20% compared with 2005 primarily because of an increase in airfreight volumes. Global airfreight tonnages in 2006 increased 18% compared with 2005. Airfreight yields remained relatively constant at 21% for 2006 as compared to 2005. The Company's North American export airfreight net revenues increased 19% in 2006 compared to 2005, primarily the result of increased market share attributable to focused sales activity. Airfreight net revenues from Asia and from Europe increased 22% and 18%, respectively, for 2006 compared with 2005. These changes are the result of market pricing and tonnage increases of 19% from Asia and 16% from Europe. Management attributes these tonnage increases to effective sales efforts.

Ocean freight volumes, measured in terms of forty-foot container equivalents (FEUs), increased 20% over 2005 while ocean freight and ocean services net revenues increased 24% during the same period. Ocean freight yields increased 2% to 21% in 2006 as compared to 2005.

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 28% in 2006 compared to 2005. Ocean freight net revenues from Asia increased 24% and from Europe increased 12% for 2006 compared with 2005. The global increases in ocean freight net revenue are primarily a result of market share expansion.



Customs brokerage and other services net revenues increased 20% in 2006 as compared with 2005. Management believes this increase is attributable to increased market share as a result of the Company's reputation for providing high quality service and increased opportunities within the customs brokerage market. These opportunities arise as customers seek out customs brokers with sophisticated computerized capabilities. In addition, the Company's customs brokerage offerings have benefited from increased emphasis on regulatory compliance.

Salaries and related costs increased 18% in 2006 compared to 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 years ended December 31, 2006 and 2005 have been increased to include compensation expense for the fair value of unvested stock options.

The decline in salaries and related costs as a percentage of net revenue for 2006 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. The effect of including stock-based compensation expense in salaries and related costs for 2006 and 2005 are as follows:

| In thousands                         | Years ended December 31, |            |
|--------------------------------------|--------------------------|------------|
|                                      | 2006                     | 2005       |
| Salaries and related costs           | \$ 701,824               | \$ 596,804 |
| As a % of net revenue                | 54.7                     | % 56.3     |
| Stock compensation expense           | \$ 41,739                | \$ 33,457  |
| As a % of salaries and related costs | 5.9                      | % 5.6      |
| As a % of net revenue                | 3.3                      | % 3.2      |

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 2006 are a result of the incentives inherent in the Company's compensation program.

Other overhead expenses increased 7% in 2006 as compared with 2005 as rent expense, communications expense, quality and training expenses, and other costs expanded to accommodate the Company's growing operations. Other overhead expenses as a percentage of net revenues decreased 2% in 2006 as compared with 2005. Management believes that this was significant as it reflects the successful achievement of ongoing cost containment objectives at the branch level.

Other income, net, increased 31% in 2006 as compared with 2005. Due to higher interest rates on higher average cash balances and short-term investments during 2006, interest income increased by \$7 million for the year ended December 31, 2006.

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 in 2006 of 40.6% increased when compared with the 31.2% rate in 2005. The lower tax rate in 2005 is primarily the result of the Company adopting a plan under Internal Revenue Code (IRC) 965, which was added by the American Jobs Creation Act. In accordance with IRC 965, the Company recorded a one-time tax benefit of \$22 million in the fourth quarter of 2005. In order to qualify for this credit, the Company adopted a plan which required qualified capital expenditures of approximately \$105 million. The Company completed the required capital expenditures during 2006. Additionally, income tax expense in 2005 has 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 higher consolidated effective income tax rate for 2006 as compared to 2005 is partially the result of a smaller tax benefit received for disqualifying dispositions of incentive stock options during 2006 than was realized 2005.



2005 compared with 2004

Airfreight net revenues in 2005 increased 12% compared with 2004 primarily because of an increase in airfreight volumes. Global airfreight tonnages in 2005 increased 9% compared with 2004. The 1% decrease in airfreight yields in 2005 was primarily a result of air carrier fuel surcharges which the Company typically passes on without a profit element. The Company's North American export airfreight net revenues increased 13% in 2005 compared to 2004, primarily the result of increased market share attributable to focused sales activity. Airfreight net revenues from Asia and from Europe increased 15% and 8%, respectively, for 2005 compared with 2004. These increases are the result of market price increases, partially offset by yield declines of less than 1%, and increased tonnage of 13% from Asia and 2% from Europe, primarily as a result of increased sales success.

Ocean freight volumes, measured in terms of forty-foot container equivalents (FEUs), increased 18% over 2004 while ocean freight and ocean services net revenues increased 23% during the same period. The increase in net revenue can be attributed to cyclical market conditions and trade lane imbalances.

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 22% in 2005 compared to 2004. Ocean freight net revenues from Asia increased 31% and from Europe decreased 1% for 2005 compared with 2004. The increase in North American and Asian ocean freight net revenue are primarily a result of greater market share. The decrease experienced in Europe is primarily due to decreased export volumes which can be attributable to the relative value of European currencies throughout the year.

Customs brokerage and other services net revenues increased 18% in 2005 as compared with 2004. This is a result of the Company's reputation for providing high quality service and increased opportunities within the customs brokerage market. These opportunities arise as customers seek out customs brokers with sophisticated computerized capabilities. In addition, the Company's customs brokerage offerings have benefited from increased emphasis on regulatory compliance.

Salaries and related costs increased 16% in 2005 compared to 2004 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 years ended December 31, 2005 and 2004 have been increased to include compensation expense for the fair value of unvested stock options.

The decline in salaries and related costs as a percentage of net revenue for 2005 as compared with the same period for 2004, can be attributed to leveraging increased business volumes with improved productivity and increasing overall efficiency through technological advances. The effect of including stock-based compensation expense in salaries and related costs for 2005 and 2004 are as follows:

| In thousands                         | Years ended December 31, |         |      |         |
|--------------------------------------|--------------------------|---------|------|---------|
|                                      | 2005                     |         | 2004 |         |
| Salaries and related costs           | \$                       | 596,804 | \$   | 513,814 |
| As a % of net revenue                |                          | 56.3    | %    | 56.7 %  |
| Stock compensation expense           | \$                       | 33,457  | \$   | 29,621  |
| As a % of salaries and related costs |                          | 5.6     | %    | 5.8 %   |
| As a % of net revenue                |                          | 3.2     | %    | 3.3 %   |

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 2005 are a result of the incentives inherent in the Company's compensation program.

Other overhead expenses increased 6% in 2005 as compared with 2004 as rent expense, communications expense, quality and training expenses, and other costs expanded to accommodate the Company's growing operations. Other overhead expenses as a percentage of net revenues decreased 2% in 2005 as compared with 2004. Management believes that this was significant as it reflects the successful achievement of ongoing cost containment objectives at the branch level.



Other income, net, increased 83% in 2005 as compared with 2004. Due to higher interest rates on higher average cash balances and short-term investments during 2005, interest income increased by \$6 million for the year ended December 31, 2005.

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 in 2005 of 31.2% decreased when compared with the 38.6% rate in 2004. The lower tax rate in 2005 is primarily the result of the Company adopting a plan under Internal Revenue Code (IRC) 965, which was added by the American Jobs Creation Act. In accordance with IRC 965, the Company recorded a one-time tax benefit of \$22 million in the fourth quarter of 2005. In order to qualify for this credit, the Company adopted a plan which requires qualified capital expenditures of approximately \$105 million over the next two to three years.

#### 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 customer service and believes that its prices are competitive with those of others in the industry. 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. The Company believes that this trend has resulted in customers using fewer service providers with greater technological capacity and consistent global coverage. 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 around the world or the short-term financial outlook in any country is such that hedging is the most time-sensitive way to avoid short-term exchange losses. Any such hedging activity during 2006, 2005 and 2004 was insignificant. Net foreign currency losses realized in 2006 were \$321. Net foreign currency gains realized in 2005 and 2004 were \$862 and \$86, respectively. The Company had no foreign currency derivatives outstanding at December 31, 2006 and 2005.

#### Sources of Growth

During 2006, the Company opened 2 full-service offices ( ) and 6 satellite offices (+), as follows:

| ASIA          | EUROPE         | NORTH AMERICA         | MIDDLE EAST          |
|---------------|----------------|-----------------------|----------------------|
| Shantou, PRC+ | Graz, Austria+ | Reynosa, Mexico       | Islamabad, Pakistan+ |
| Xi'an, PRC    |                | Querétaro, Mexico+    |                      |
|               |                | Omaha, Nebraska+      |                      |
|               |                | Calexico, California+ |                      |

Xi'an, People's Republic of China (PRC) converted from a satellite office to a full-service office during 2006.

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 on a year-over-year basis for the years ended December 31, 2006, 2005 and 2004.

Same store comparisons for the years ended December 31,

|                                 | 2006 | 2005 | 2004 |   |
|---------------------------------|------|------|------|---|
| Net revenues                    | 21   | % 16 | % 20 | % |
| Operating income                | 38   | % 28 | % 31 | % |
| 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 year ended December 31, 2006 was \$333 million, as compared with \$267 million for 2005. This \$66 million increase is principally due to increased net earnings. The increase in taxes payable, net of prepaid taxes, is the result of higher tax liabilities on higher earnings and lower relative amounts of estimated tax payments.

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 certain of 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 year ended December 31, 2006 was \$143 million, as compared with \$91 million during the same period 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. For the year ended December 31, 2006, the Company made capital expenditures of \$141 million as compared with \$91 million for the same period in 2005. Capital expenditures in 2006 included \$67 million for the acquisition of real estate and office/warehouse facilities in Miami, Florida. In addition, the Company had real estate development expenditures of \$22 million related to projects in Seattle, Washington and Houston, Texas. Other capital expenditures in 2006 and 2005 related primarily to investments in technology, office furniture and equipment and leasehold improvements. The Company currently expects to spend approximately \$43 million for normal capital expenditures in 2007. In addition to property and equipment, normal capital expenditures include leasehold improvements, warehouse equipment, computer hardware and furniture and fixtures. Total capital expenditures in 2007 are currently estimated to be \$106 million. This includes normal capital expenditures as noted above, plus additional real estate acquisitions and development. The Company expects to finance capital expenditures in 2007 with cash.

Cash used in financing activities for the year ended December 31, 2006 was \$160 million as compared with \$107 million for the same period in 2005. The Company uses the proceeds from stock option exercises to repurchase the Company's stock on the open market. In 2006, the Company continued its 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 for the year ended December 31, 2006 compared with the same period in 2005 is primarily the result of this policy. During 2006 and 2005 the net use of cash in financing activities included the payment of dividends of \$.22 per share and \$.15 per share, respectively.

At December 31, 2006, working capital was \$633 million, including cash and short-term investments of \$512 million. The Company had no long-term debt at December 31, 2006.

The Company maintains international and domestic unsecured bank lines of credit. At December 31, 2006, the United States facility totaled \$50 million and the international bank lines of credit, excluding the U.K. bank facility, totaled \$18 million. In addition, the Company maintains a bank facility with its U.K. bank for \$14 million which is available for short-term borrowings and issuances of standby letters of credit. At December 31, 2006, the Company had no amounts outstanding on these lines of credit, but was contingently liable for \$63 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.

At December 31, 2006, the Company's contractual obligations and other commitments are as follows:

| In thousands                              | Total             | Payments Due by Period |                  |                 |                 |
|---|-------------------|------------------------|------------------|-----------------|-----------------|
|   |                   | Less than 1 year       | 1 - 3 years      | 3 - 5 years     | After 5 years   |
| <b>Contractual Obligations:</b>           |                   |                        |                  |                 |                 |
| Operating leases                          | \$ 86,075         | \$ 37,133              | \$ 38,585        | \$ 7,939        | \$ 2,418        |
| Unconditional purchase obligations        | 293,019           | 293,019                |                  |                 |                 |
| Construction obligations                  | 7,781             | 6,890                  | 697              | 194             |                 |
| <b>Total contractual cash obligations</b> | <b>\$ 386,875</b> | <b>\$ 337,042</b>      | <b>\$ 39,282</b> | <b>\$ 8,133</b> | <b>\$ 2,418</b> |

The Company enters into short-term agreements with asset-based providers reserving space on a guaranteed basis. The pricing of these obligations varies to some degree with market conditions. The Company only enters into agreements that management believes the Company can fulfill with relative ease. Historically, the Company has not paid for guaranteed space that it has not used. Management believes, in line with historical experience, committed purchase obligations outstanding as of December 31, 2006, will be fulfilled during 2007 in the Company's ordinary course of business.

| In thousands                  | Total amounts committed | Amount of Commitment Expiration Per Period |                 |               |               |
|-------------------------------|-------------------------|--|-----------------|---------------|---------------|
|                               |                         | Less than 1 year                           | 1 - 3 years     | 3 - 5 years   | After 5 years |
| <b>Other commitments:</b>     |                         |  |                 |               |               |
| International lines of credit | \$ 19,516               | \$ 19,516                                  | \$              | \$            | \$            |
| Standby letters of credit     | 62,608                  | 58,712                                     | 3,397           | 415           | 84            |
| <b>Total commitments</b>      | <b>\$ 82,124</b>        | <b>\$ 78,228</b>                           | <b>\$ 3,397</b> | <b>\$ 415</b> | <b>\$ 84</b>  |

The Company has a Non-Discretionary Stock Repurchase Plan to repurchase shares from the proceeds of stock option exercises. As of December 31, 2006, the Company had repurchased and retired 15,407,473 shares of common stock at an average price of \$13.24 per share over the period from 1994 through 2006. During 2006, 1,105,773 shares were repurchased at an average price of \$44.20 per share.

The Company has a Discretionary Stock Repurchase Plan under which Management is allowed to repurchase such shares as may be necessary to reduce the issued and outstanding stock to 200,000,000 shares of common stock. As of December 31, 2006, the Company had repurchased and retired 9,752,196 shares of common stock at an average price of \$26.43 per share over the period from 2001 through 2006. During 2006, 2,825,042 shares were repurchased at an average price of \$44.92. These discretionary repurchases were made to keep the number of issued and outstanding shares from growing as a result of stock option exercises.

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.

In some cases, the Company's ability to repatriate funds from foreign operations may be subject to foreign exchange controls. At December 31, 2006, cash and cash equivalent balances of \$345 million were held by the Company's non-United States subsidiaries, of which \$46 million was held in banks in the United States.

#### Impact of Inflation

To date, the Company's business has not been adversely affected by inflation. Direct carrier rate increases could occur over the short- to medium-term period. Due to the high degree of competition in the market place, these rate increases can lead to an erosion in the Company's margins. As the Company is not required to purchase or maintain extensive property and equipment and has not otherwise incurred substantial interest rate-sensitive indebtedness, the Company currently has limited direct exposure to increased costs resulting from increases in interest rates.



#### Off-Balance Sheet Arrangements

As of December 31, 2006, the Company did not have any material off-balance-sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

#### ITEM 7A 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 reporting 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 year ended December 31, 2006, would have had the effect of raising operating income approximately \$22 million. An average 10% strengthening of the U.S. dollar, for the same period, would have the effect of reducing operating income approximately \$18 million. This analysis does not take into 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 depress imports into the United States over some relevant period of time, but the exact effect of this change cannot be quantified without making speculative assumptions.

As of December 31, 2006, the Company had approximately \$2 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 throughout the year ended December 31, 2006, was insignificant. The Company had no foreign currency derivatives outstanding at December 31, 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 December 31, 2006, the Company had cash and cash equivalents and short-term investments of \$512 million, of which \$1 million was invested at various short-term market interest rates. There were no short-term borrowings at December 31, 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 between 2005 and 2006.

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## ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following documents are filed on the pages listed below, as part of Part II, Item 8 of this report.

| <u>Document</u>   | <u>Page</u>      |
|---|------------------|
| 1. <u>Financial Statements and Reports of Independent Registered Public Accounting Firm:</u>                            |                  |
| <u>Reports of Independent Registered Public Accounting Firm</u>   | F-1 and F-2      |
| Consolidated Financial Statements:  |                  |
| <u>Balance Sheets as of December 31, 2006 and 2005</u>  | F-3              |
| <u>Statements of Earnings for the Years Ended December 31, 2006, 2005 and 2004</u>                                      | F-4              |
| <u>Statements of Shareholders' Equity and Comprehensive Income for the Years Ended December 31, 2006, 2005 and 2004</u> | F-5              |
| <u>Statements of Cash Flows for the Years Ended December 31, 2006, 2005 and 2004</u>                                    | F-6              |
| <u>Notes to Consolidated Financial Statements</u>   | F-7 through F-21 |
| 2. Financial Statement Schedules:   |                  |
| <u>Schedule II Valuation and Qualifying Accounts for the Years Ended December 31, 2006, 2005 and 2004</u>               | S-1              |

## ITEM 9 CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

## ITEM 9A CONTROLS AND PROCEDURES

### Evaluation of Controls and Procedures

The Company carried out an evaluation, under the supervision and with the participation of its management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in the Exchange Act Rule 13a-15(e)) as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective.

### 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.

### Management Report on Internal Control Over Financial Reporting

The management of Expeditors International of Washington, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting as required by the Sarbanes-Oxley Act of 2002 and as defined in Exchange Act Rule 13a-15(f). The Company's system of internal control over financial reporting is designed to provide reasonable assurance to the Company's management and Board of Directors regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S.

generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the

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Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

A system of internal control can provide only reasonable, not absolute assurance, that the objectives of the control system are met. Our management, including our chief executive officer and chief financial officer, conducted an assessment of the design and operating effectiveness of our internal control over financial reporting based on the framework in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Based on this assessment, our management has concluded that, as of December 31, 2006, our internal control over financial reporting was effective.

KPMG LLP, an independent registered public accounting firm, has issued an attestation report on management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2006, which is included herein at F-2.

#### ITEM 9B OTHER INFORMATION

Not applicable.

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PART III

ITEM 10 DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item is incorporated by reference to information under the caption "Proposal 1 - Election of Directors" and to the information under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" in the Company's definitive Proxy Statement for its annual meeting of shareholders to be held on May 2, 2007. See also Part I - Item 1 - Executive Officers of the Registrant.

Audit Committee and Audit Committee Financial Expert

Our Board has a separately-designated standing Audit Committee established in accordance with Section 3(a)(58)(A) of the Exchange Act. The members of the Audit Committee are James J. Casey, Dan P. Kourkouvelis, Michael J. Malone, and John W. Meisenbach. Our Board has determined that James J. Casey, Chairman of the Audit Committee, is an audit committee financial expert as defined by Item 401(h) of Regulation S-K of the Exchange Act and that each member of the Audit Committee is independent within the meaning of Rule 4200(a)(15) of the National Association of Securities Dealers' listing standards.

Code of Ethics and Governance Guidelines

We have adopted a *Code of Business Conduct* that applies to all Company employees including, of course, our principal executive officer, principal financial officer and principal accounting officer. The *Code of Business Conduct* is posted on our website at <http://www.investor.expeditors.com>. We will post any amendments to the *Code of Business Conduct* at that location. No amendments were made in 2006. In the unlikely event that the Board of Directors approves any sort of waiver to the *Code of Business Conduct* for our executive officers or directors, information concerning such waiver will also be posted at that location. No waivers were granted in 2006. In addition to posting information regarding amendments and waivers on our website, the same information will be included in a Current Report on Form 8-K within four business days following the date of the amendment or waiver, unless website posting of such amendments or waivers is permitted by the rules of The Nasdaq Stock Market, LLC.

ITEM 11 EXECUTIVE COMPENSATION

The information required by this item is incorporated by reference to information under the captions "Proposal 1 - Election of Directors" and "Executive Compensation" in the Company's definitive Proxy Statement for its annual meeting of shareholders to be held on May 2, 2007.

ITEM 12 SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this item is incorporated by reference to information under the captions "Principal Holders of Voting Securities" and "Proposal 1 - Election of Directors" in the Company's definitive Proxy Statement for its annual meeting of shareholders to be held on May 2, 2007.

Securities Authorized for Issuance under Equity Compensation Plans

The following table provides information as of December 31, 2006, regarding compensation plans under which equity securities of the Company are authorized for issuance.

Equity Compensation Plan Information  
as of December 31, 2006

| Plan Category  | Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights | Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights | Number of Securities Available for Future Issuance, Other Than Securities to be Issued Upon Exercise of All Outstanding Options, Warrants and Rights |
|--|---|---|--|
| Equity Compensation Plans Approved by Security Holders     | 21,892,181  | 19.23   | 214,602  |
| Equity Compensation Plans Not Approved by Security Holders |   |   |  |
| <b>Total</b>   | <b>21,892,181</b>   | <b>19.23</b>  | <b>214,602</b>   |

ITEM 13 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this item is incorporated by reference to information under the captions Proposal 1 Election of Directors , Executive Compensation and Certain Transactions in the Company s definitive Proxy Statement for its annual meeting of shareholders to be held on May 2, 2007.

ITEM 14 PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this item is incorporated by reference to information under the caption Relationship with Independent Public Accountants in the Company s definitive Proxy Statement for its annual meeting of shareholders to be held on May 2, 2007.

PART IV

ITEM 15 EXHIBITS, FINANCIAL STATEMENT SCHEDULES

| (a) 1. FINANCIAL STATEMENTS   | <u>Page</u>      |
|---|------------------|
| Reports of Independent Registered Public Accounting Firm  | F-1 and F-2      |
| Consolidated Balance Sheets as of December 31, 2006 and 2005  | F-3              |
| Consolidated Statements of Earnings for the Years Ended December 31, 2006, 2005 and 2004                                      | F-4              |
| Consolidated Statements of Shareholders' Equity and Comprehensive Income for the Years Ended December 31, 2006, 2005 and 2004 | F-5              |
| Consolidated Statements of Cash Flows for the Years Ended December 31, 2006, 2005 and 2004                                    | F-6              |
| Notes to Consolidated Financial Statements  | F-7 through F-21 |
| 2. FINANCIAL STATEMENT SCHEDULES  |                  |
| Schedule II Valuation and Qualifying Accounts for the Years Ended December 31, 2006, 2005 and 2004                            | S-1              |

Other schedules are omitted because of the absence of conditions under which they are required or because the required information is given in the consolidated financial statements or notes thereto.

3. EXECUTIVE COMPENSATION PLANS AND ARRANGEMENTS

The following list is a subset of the list of exhibits described below and contains all compensatory plans, contracts or arrangements in which any director or executive officer of the Company is a participant, unless the method of allocation of benefits thereunder is the same for management and non-management participants:

- (1) Form of Employment Agreement executed by the Company's Chairman and Chief Executive Officer. See Exhibit 10.23.
- (2) Form of Employment Agreement executed by the Company's President and Chief Operating Officer and certain of the Company's executive officers. See Exhibit 10.24.
- (3) The Company's Amended 1985 Stock Option Plan. See Exhibit 10.4.
- (4) Form of Stock Option Agreement used in connection with options granted under the Company's Amended 1985 Stock Option Plan. See Exhibit 10.5.
- (5) The Company's Amended 1993 Directors' Non-Qualified Stock Option Plan. See Exhibit 10.39.
- (6) Form of Stock Option Agreement used in connection with options granted under the Company's 1993 Directors' Non-Qualified Stock Option Plan. See Exhibit 10.9.
- (7) The Company's Amended 1997 Non-Qualified and Incentive Stock Option Plan. See Exhibit 10.40.
- (8) Form of Stock Option Agreement used in connection with Non-Qualified options granted under the Company's 1997 Non-Qualified and Incentive Stock Option Plan. See Exhibit 10.30.
- (9) Form of Stock Option Agreement used in connection with Incentive options granted under the Company's 1997 Non-Qualified and Incentive Stock Option Plan. See Exhibit 10.31.
- (10) The Company's 1997 Executive Incentive Compensation Plan. See Exhibit 10.32.
- (11) Form of Executive Incentive Compensation Plan Award Certification used in connection with the awards granted under the Company's 1997 Executive Incentive Compensation Plan. See Exhibit 10.33.
- (12) Form of Executive Incentive Compensation Plan Award Agreement used in connection with establishing the terms and conditions of an award under the Company's 1997 Executive Incentive Compensation Plan. See Exhibit 10.34.
- (13) The Company's 2002 Employee Stock Purchase Plan. See Exhibit 10.42.
- (14) The Company's 2005 Stock Option Plan. See Exhibit 10.45.
- (15) Form of Stock Option Agreement used in connection with Incentive options granted under the Company's 2005 Incentive Stock Option Plan. See Exhibit 10.46.
- (16) The Company's 2006 Stock Option Plan. See Exhibit 10.47.
- (17) Form of Stock Option Agreement used in connection with Incentive options granted under the Company's 2006 Incentive Stock Option Plan. See Exhibit 10.48.

(b) EXHIBITS

| Number | Exhibit  |
|--------|--|
| 3.1    | The Company's Restated Articles of Incorporation and the Articles of Amendment thereto dated December 9, 1993. (Incorporated by reference to Exhibit 3.1 to Form 10-K, filed on or about March 31, 1995.)  |
| 3.1.1  | Articles of Amendment to the Restated Articles of Incorporation dated November 12, 1996. (Incorporated by reference to Exhibit 3.1.1 to Form 10-K, filed on or about March 31, 1997.)  |
| 3.1.2  | Articles of Amendment to the Restated Articles of Incorporation dated May 20, 1999. (Incorporated by reference to Exhibit 3.1.2 to Form 10-K, filed on or about March 28, 2003.)   |
| 3.1.3  | Articles of Amendment to the Restated Articles of Incorporation dated June 12, 2002. (Incorporated by reference to Exhibit 3.1.3 to Form 10-K, filed on or about March 28, 2003.)  |
| 3.2    | The Company's Amended and Restated Bylaws. (Incorporated by reference to Exhibit 3.2 to Form 10-K, filed on or about March 28, 1994.)  |
| 10.4   | The Company's Amended 1985 Stock Option Plan. (Incorporated by reference to Exhibit 10.14 to Form 10-K, filed on or about March 28, 1991.)   |
| 10.5   | Form of Stock Option Agreement used in connection with options granted under the Company's Amended 1985 Stock Option Plan. (Incorporated by reference to Exhibit 10.15 to Form 10-K, filed on or about March 28, 1991.)  |
| 10.9   | Form of Stock Option Agreement used in connection with options granted under the Company's 1993 Directors' Non-Qualified Stock Option Plan. (Incorporated by reference to Exhibit 10.9 to Form 10-K, filed on or about March 28, 1994.)                                    |
| 10.18  | Plan and Agreement of Reorganization, dated as of January 1, 1984, between the Company and the individual shareholders of Fons Pte. Ltd. (Incorporated by reference to Exhibit 2.5 to Registration Statement No. 2-91224, filed on May 21, 1984.)                          |
| 10.19  | Plan and Agreement of Reorganization, dated as of January 1, 1984, among the Company, EIO Investment Ltd., Wong Hoy Leung, Chiu Chi Shing, and James Li Kou Wang. (Incorporated by reference to Exhibit 2.6 to Registration Statement No. 2-91224, filed on May 21, 1984.) |
| 10.23  | Form of Employment Agreement executed by the Company's Chairman and Chief Executive Officer dated November 2, 1994. (Incorporated by reference to Exhibit 10.23 to Form 10-K, filed on or about March 31, 1995.)   |
| 10.24  | Form of Employment Agreement executed by the Company's President and Chief Operating Officer and certain of the Company's executive officers dated November 2, 1994. (Incorporated by reference to Exhibit 10.24 to Form 10-K, filed on or about March 31, 1995.)          |
| 10.30  | Form of Stock Option Agreement used in connection with Non-Qualified options granted under the Company's 1997 Non-Qualified and Incentive Stock Option Plan. (Incorporated by reference to Exhibit 10.30 to Form 10-K, filed on or about March 31, 1998.)                  |
| 10.31  | Form of Stock Option Agreement used in connection with Incentive options granted under the Company's 1997 Non-Qualified and Incentive Stock Option Plan. (Incorporated by reference to Exhibit 10.31 to Form 10-K, filed on or about March 31, 1998.)                      |
| 10.32  | The Company's 1997 Executive Incentive Compensation Plan. (Incorporated by reference to Appendix B of the Company's Notice of Annual Meeting of Shareholders and Proxy Statement pursuant to Regulation 14A filed on or about March 24, 1997.)                             |



- 10.33 Form of Executive Incentive Compensation Plan Award Certification used in connection with the awards granted under the Company's 1997 Executive Incentive Compensation Plan. (Incorporated by reference to Exhibit 10.33 to Form 10-K, filed on or about March 31, 1998.)
- 10.34 Form of Executive Incentive Compensation Plan Award Agreement used in connection with establishing the terms and conditions of an award under the Company's 1997 Executive Incentive Compensation Plan. (Incorporated by reference to Exhibit 10.34 to Form 10-K, filed on or about March 31, 1998.)
- 10.39 The Company's Amended 1993 Directors' Non-Qualified Stock Option Plan. (Incorporated by reference to Appendix B of the Company's Notice of Annual Meeting of Shareholders and Proxy Statement pursuant to Regulation 14A filed on or about March 28, 2001.)
- 10.40 The Company's Amended 1997 Non-Qualified and Incentive Stock Option Plan. (Incorporated by reference to Appendix C of the Company's Notice of Annual Meeting of Shareholders and Proxy Statement pursuant to Regulation 14A filed on or about March 28, 2001.)
- 10.42 The Company's 2002 Employee Stock Purchase Plan. (Incorporated by reference to Appendix A of the Company's Notice of Annual Meeting of Shareholders and Proxy Statement pursuant to Regulation 14A filed on or about April 1, 2002.)
- 10.45 The Company's 2005 Stock Option Plan. (Incorporated by reference to Appendix A of the Company's Notice of Annual Meeting of Shareholders and Proxy Statement pursuant to Regulation 14A filed on or about March 31, 2005.)
- 10.46 Form of Stock Option Agreement used in connection with Incentive options granted under the Company's 2005 Incentive Stock Option Plan.
- 10.47 The Company's 2006 Stock Option Plan. (Incorporated by reference to Appendix A of the Company's Notice of Annual Meeting of Shareholders and Proxy Statement pursuant to Regulation 14A filed on or about March 31, 2006.)
- 10.48 Form of Stock Option Agreement used in connection with Incentive options granted under the Company's 2006 Incentive Stock Option Plan.
- 21.1 Subsidiaries of the Registrant.
- 23.1 Consent of Independent Registered Public Accounting Firm.
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 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 Section 13 or 15(d) 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.

Date: March 1, 2007

EXPEDITORS INTERNATIONAL OF  
WASHINGTON, INC.

By: /s/ R. JORDAN GATES  
R. Jordan Gates  
Executive Vice President-Chief Financial Officer

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Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on March 1, 2007.

| <b>Signature</b>                                 | <b>Title</b>  |
|--|---|
| /s/ Peter J. Rose<br>(Peter J. Rose)             | Chairman of the Board and Chief Executive Officer<br>(Principal Executive Officer) and Director               |
| /s/ R. Jordan Gates<br>(R. Jordan Gates)         | Executive Vice President-Chief Financial Officer<br>(Principal Financial and Accounting Officer) and Director |
| /s/ James Li Kou Wang<br>(James Li Kou Wang)     | President-Asia and Director   |
| /s/ James J. Casey<br>(James J. Casey)           | Director  |
| /s/ Dan P. Kourkouvelis<br>(Dan P. Kourkouvelis) | Director  |
| /s/ John W. Meisenbach<br>(John W. Meisenbach)   | Director  |
| /s/ Michael J. Malone<br>(Michael J. Malone)     | Director  |

EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.  
AND SUBSIDIARIES  
CONSOLIDATED FINANCIAL STATEMENTS  
COMPRISING ITEM 8  
ANNUAL REPORT ON FORM 10-K  
TO SECURITIES AND EXCHANGE COMMISSION FOR THE  
YEARS ENDED DECEMBER 31, 2006, 2005, AND 2004

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders

Expeditors International of Washington, Inc.:

We have audited the accompanying consolidated balance sheets of Expeditors International of Washington, Inc. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of earnings, shareholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2006. In connection with our audits of the consolidated financial statements, we also have audited the financial statement schedule II. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Expeditors International of Washington, Inc. and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 1, the Company changed its accounting policy for share-based payments to employees as required by Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment", effective as of January 1, 2006. The Company elected to use the modified retrospective transition method, which provides that the financial statements of prior periods are adjusted to reflect the fair value method of expensing share-based compensation for all awards granted on or after January 1, 1995.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Expeditors International of Washington, Inc.'s internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 1, 2007 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP

Seattle, Washington  
March 1, 2007

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders

Expeditors International of Washington, Inc.:

We have audited management's assessment, included in the accompanying *Management Report on Internal Control Over Financial Reporting* appearing under Item 9A, that Expeditors International of Washington, Inc. maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Expeditors International of Washington, Inc. maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control - Integrated Framework issued by COSO. Also, in our opinion, Expeditors International of Washington, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Expeditors International of Washington, Inc. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of earnings, shareholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2006 and our report dated March 1, 2007 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Seattle, Washington  
March 1, 2007  
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Consolidated Balance Sheets  
In thousands except share data  
December 31,

|  | 2006             | 2005             |
|--|------------------|------------------|
| <b>Current Assets:</b>   |                  |                  |
| Cash and cash equivalents  | \$ 511,358       | 463,894          |
| Short-term investments   | 578              | 123              |
| Accounts receivable, less allowance for doubtful accounts of \$13,454 in 2006 and \$12,777 in 2005   | 811,486          | 709,331          |
| Deferred Federal and state income taxes  | 7,490            | 7,208            |
| Other  | 10,925           | 21,405           |
| <b>Total current assets</b>  | <b>1,341,837</b> | <b>1,201,961</b> |
| <b>Property and Equipment:</b>   |                  |                  |
| Land   | 178,299          | 129,719          |
| Buildings and leasehold improvements   | 283,846          | 186,949          |
| Furniture, fixtures, equipment and purchased software  | 158,673          | 144,718          |
| Construction in progress   | 5,054            | 20,922           |
| Vehicles   | 3,679            | 3,783            |
|  | 629,551          | 486,091          |
| Less accumulated depreciation and amortization   | 178,695          | 152,304          |
| Property and equipment, net  | 450,856          | 333,787          |
| Goodwill, net  | 7,927            | 7,774            |
| Other intangibles, net   | 7,584            | 8,997            |
| Other assets, net  | 14,134           | 13,525           |
|  | \$ 1,822,338     | 1,566,044        |
| <b>Current Liabilities:</b>  |                  |                  |
| Accounts payable   | \$ 544,028       | \$ 479,546       |
| Accrued expenses, primarily salaries and related costs   | 122,081          | 103,674          |
| Federal, state, and foreign income taxes   | 43,036           | 29,281           |
| <b>Total current liabilities</b>   | <b>709,145</b>   | <b>612,501</b>   |
| Deferred Federal and state income taxes  | 26,743           | 13,278           |
| Minority interest  | 16,515           | 13,883           |
| <b>Shareholders' Equity:</b>   |                  |                  |
| Preferred stock,<br>par value \$.01 per share<br>Authorized 2,000,000 shares; none issued  |                  |                  |
| Common stock,<br>par value \$.01 per share<br>Authorized 320,000,000 shares; issued and outstanding 213,080,466 shares at December 31, 2006<br>and 213,227,042 shares at December 31, 2005 | 2,131            | 2,132            |
| Additional paid-in capital   | 119,582          | 180,905          |
| Retained earnings  | 934,058          | 745,984          |
| Accumulated other comprehensive income   | 14,164           | (2,639)          |
| <b>Total shareholders' equity</b>  | <b>1,069,935</b> | <b>926,382</b>   |
| Commitments and contingencies  | \$ 1,822,338     | 1,566,044        |

See accompanying notes to consolidated financial statements.

Certain 2005 amounts have been restated as required by the modified retrospective method in connection with the implementation of Statement of Financial Accounting Standard 123R (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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Consolidated Statements of Earnings

In thousands except share data

Years ended December 31,

|  | 2006         | 2005        | 2004        |
|--|--------------|-------------|-------------|
| <b>Revenues:</b>                                   |              |             |             |
| Airfreight   | \$ 2,229,545 | 1,827,009   | 1,553,881   |
| Ocean freight and ocean services                   | 1,553,048    | 1,374,197   | 1,178,975   |
| Customs brokerage and other services               | 843,373      | 700,575     | 584,643     |
| Total revenues                                     | 4,625,966    | 3,901,781   | 3,317,499   |
| <b>Operating Expenses:</b>                         |              |             |             |
| Airfreight consolidation                           | 1,758,907    | 1,435,236   | 1,204,932   |
| Ocean freight consolidation                        | 1,230,468    | 1,113,936   | 968,008     |
| Customs brokerage and other services               | 353,652      | 293,000     | 238,322     |
| Salaries and related costs                         | 701,824      | 596,804     | 513,814     |
| Rent and occupancy costs                           | 53,606       | 54,425      | 51,620      |
| Depreciation and amortization                      | 35,448       | 30,888      | 26,703      |
| Selling and promotion                              | 35,050       | 29,892      | 28,248      |
| Other  | 81,895       | 76,547      | 74,428      |
| Total operating expenses                           | 4,250,850    | 3,630,728   | 3,106,075   |
| Operating income                                   | 375,116      | 271,053     | 211,424     |
| <b>Other Income (Expense):</b>                     |              |             |             |
| Interest income                                    | 18,020       | 11,415      | 5,667       |
| Interest expense                                   | (198)        | (313)       | (42)        |
| Other, net   | 2,726        | 4,542       | 2,910       |
| Other income, net                                  | 20,548       | 15,644      | 8,535       |
| Earnings before income taxes and minority interest | 395,664      | 286,697     | 219,959     |
| Income tax expense                                 | 160,661      | 89,365      | 84,971      |
| Net earnings before minority interest              | 235,003      | 197,332     | 134,988     |
| Minority interest                                  | 91           | (6,896)     | (5,039)     |
| Net earnings                                       | \$ 235,094   | 190,436     | 129,949     |
| Diluted earnings per share                         | \$ 1.06      | .86         | .59         |
| Basic earnings per share                           | \$ 1.10      | .89         | .61         |
| Dividends declared and paid per common share       | \$ 0.22      | \$ 0.15     | \$ 0.11     |
| Weighted average diluted shares outstanding        | 222,223,312  | 220,230,176 | 220,116,684 |
| Weighted average basic shares outstanding          | 213,454,579  | 213,555,102 | 212,768,302 |

See accompanying notes to consolidated financial statements.

Certain 2005 and 2004 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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Consolidated Statements of Shareholders' Equity

and Comprehensive Income

In thousands except share data

Years ended December 31, 2006, 2005 and 2004

|   | Common stock<br>Shares | Par value | Additional<br>paid-in<br>capital | Retained<br>earnings | Accumulated<br>other<br>comprehensive<br>income (loss) | Total      |
|---|------------------------|-----------|----------------------------------|----------------------|--|------------|
| Balance at December 31, 2003                                    | 210,112,908            | \$ 2,101  | 136,405                          | 522,010              | 1,743  | 662,259    |
| Exercise of stock options                                       | 3,573,772              | 36        | 17,109                           |                      |  | 17,145     |
| Issuance of shares under stock purchase plan                    | 826,292                | 8         | 11,830                           |                      |  | 11,838     |
| Shares repurchased under provisions of stock repurchase plans   | (1,225,066 )           | (12 )     | (29,228 )                        |                      |  | (29,240 )  |
| Stock compensation expense                                      |                        |           | 29,621                           |                      |  | 29,621     |
| Tax benefits from employee stock plans                          |                        |           | 12,997                           |                      |  | 12,997     |
| Comprehensive income  |                        |           |                                  |                      |  |            |
| Net earnings  |                        |           |                                  | 129,949              |  | 129,949    |
| Unrealized gains on securities, net of tax of \$104             |                        |           |                                  |                      | 37   | 37         |
| Foreign currency translation adjustments, net of tax of \$5,568 |                        |           |                                  |                      | 9,906  | 9,906      |
| Total comprehensive income                                      |                        |           |                                  |                      |  | 139,892    |
| Dividends paid (\$.11 per share)                                |                        |           |                                  | (23,368 )            |  | (23,368 )  |
| Balance at December 31, 2004                                    | 213,287,906            | \$ 2,133  | 178,734                          | 628,591              | 11,686   | 821,144    |
| Exercise of stock options                                       | 3,612,592              | 36        | 27,118                           |                      |  | 27,154     |
| Issuance of shares under stock purchase plan                    | 699,968                | 7         | 14,049                           |                      |  | 14,056     |
| Shares repurchased under provisions of stock repurchase plans   | (4,373,424 )           | (44 )     | (85,820 )                        | (40,988 )            |  | (126,852 ) |
| Stock compensation expense                                      |                        |           | 33,457                           |                      |  | 33,457     |
| Tax benefits from employee stock plans                          |                        |           | 13,367                           |                      |  | 13,367     |
| Comprehensive income  |                        |           |                                  |                      |  |            |
| Net earnings  |                        |           |                                  | 190,436              |  | 190,436    |
| Unrealized losses on securities, net of tax of \$117            |                        |           |                                  |                      | (117 )   | (117 )     |
| Foreign currency translation adjustments, net of tax of \$7,650 |                        |           |                                  |                      | (14,208 )  | (14,208 )  |
| Total comprehensive income                                      |                        |           |                                  |                      |  | 176,111    |
| Dividends paid (\$.15 per share)                                |                        |           |                                  | (32,055 )            |  | (32,055 )  |
| Balance at December 31, 2005                                    | 213,227,042            | \$ 2,132  | 180,905                          | 745,984              | (2,639 )   | 926,382    |
| Exercise of stock options                                       | 3,053,425              | 31        | 32,268                           |                      |  | 32,299     |
| Issuance of shares under stock purchase plan                    | 730,814                | 7         | 17,008                           |                      |  | 17,015     |
| Shares repurchased under provisions of stock repurchase plans   | (3,930,815 )           | (39 )     | (175,744 )                       |                      |  | (175,783 ) |
| Stock compensation expense                                      |                        |           | 41,739                           |                      |  | 41,739     |
| Tax benefits from employee stock plans                          |                        |           | 23,406                           |                      |  | 23,406     |
| Comprehensive income  |                        |           |                                  |                      |  |            |
| Net earnings  |                        |           |                                  | 235,094              |  | 235,094    |
| Unrealized gains on securities, net of tax of \$0               |                        |           |                                  |                      | 61   | 61         |
| Foreign currency translation adjustments, net of tax of \$9,015 |                        |           |                                  |                      | 16,742   | 16,742     |
| Total comprehensive income                                      |                        |           |                                  |                      |  | 251,897    |
| Dividends paid (\$.22 per share)                                |                        |           |                                  | (47,020 )            |  | (47,020 )  |
| Balance at December 31, 2006                                    | 213,080,466            | \$ 2,131  | 119,582                          | 934,058              | 14,164   | 1,069,935  |

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See accompanying notes to consolidated financial statements.

Certain 2005 and 2004 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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Consolidated Statements of Cash Flows

In thousands

Years ended December 31,

|   | 2006       | 2005       | 2004       |
|---|------------|------------|------------|
| <b>Operating Activities:</b>  |            |            |            |
| Net earnings  | \$ 235,094 | 190,436    | 129,949    |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |            |            |            |
| Provision for losses on accounts receivable   | 1,197      | 1,313      | 2,355      |
| Deferred income tax expense (benefit)   | 4,172      | (3,700 )   | 22,529     |
| Excess tax benefits from employee stock plans                                       | (23,406 )  | (13,367 )  | (12,997 )  |
| Stock compensation expense  | 41,739     | 33,457     | 29,621     |
| Depreciation and amortization   | 35,448     | 30,888     | 26,703     |
| Gain on sale of property and equipment  | (182 )     | (897 )     | (19 )      |
| Amortization of other intangible assets   | 1,369      | 1,422      | 1,275      |
| Impairment write down of other assets   |            |            | 2,000      |
| Minority interest in earnings of consolidated entities                              | (91 )      | 6,896      | 5,039      |
| Changes in operating assets and liabilities:  |            |            |            |
| Increase in accounts receivable   | (96,414 )  | (95,015 )  | (150,213 ) |
| Increase in accounts payable and accrued expenses                                   | 85,012     | 94,826     | 104,022    |
| Increase in taxes payable, net  | 48,392     | 20,580     | 19,882     |
| Other   | 957        | 237        | 452        |
| Net cash provided by operating activities   | 333,287    | 267,076    | 180,598    |
| <b>Investing Activities:</b>  |            |            |            |
| Increase in short-term investments  | (419 )     | (12 )      | (23 )      |
| Purchase of property and equipment  | (141,225 ) | (90,781 )  | (66,244 )  |
| Proceeds from sale of property and equipment  | 397        | 1,428      | 565        |
| Other   | (1,260 )   | (1,402 )   | 722        |
| Net cash used in investing activities   | (142,507 ) | (90,767 )  | (64,980 )  |
| <b>Financing Activities:</b>  |            |            |            |
| Proceeds (repayments) of short-term debt, net                                       |            | (2,057 )   | 1,863      |
| Proceeds from issuance of common stock  | 49,314     | 41,210     | 28,983     |
| Repurchases of common stock   | (175,783 ) | (126,852 ) | (29,240 )  |
| Excess tax benefits from employee stock plans                                       | 23,406     | 13,367     | 12,997     |
| Net distributions to minority interests   | (10,024 )  | (436 )     | (284 )     |
| Dividends paid  | (47,020 )  | (32,055 )  | (23,368 )  |
| Net cash used in financing activities   | (160,107 ) | (106,823 ) | (9,049 )   |
| Effect of exchange rate changes on cash   | 16,791     | (14,575 )  | 6,582      |
| Increase in cash and cash equivalents   | 47,464     | 54,911     | 113,151    |
| Cash and cash equivalents at beginning of year                                      | 463,894    | 408,983    | 295,832    |
| Cash and cash equivalents at end of year  | \$ 511,358 | 463,894    | 408,983    |
| <b>Interest and Taxes Paid:</b>   |            |            |            |
| Interest  | \$ 194     | 253        | 41         |
| Income taxes  | 103,715    | 62,176     | 43,946     |

See accompanying notes to consolidated financial statements.

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Certain 2005 and 2004 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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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation

Expeditors International of Washington, Inc. ( the Company ) is a global logistics company operating through a worldwide network of offices, international service centers and exclusive or non-exclusive agents. The Company's customers include retailing and wholesaling, electronics, and manufacturing companies around the world. The Company grants credit upon approval to customers.

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 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 effects 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 affected 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 consolidated financial statements include the accounts of the Company and its subsidiaries stated in U.S. dollars, the Company's reporting currency. In addition, the consolidated financial statements also include the accounts of operating entities where the Company maintains a parent-subsidiary relationship through unilateral control over assets and operations together with responsibility for payment of all liabilities, notwithstanding a lack of technical majority ownership of the subsidiary common stock.

All significant intercompany accounts and transactions have been eliminated in consolidation.

All dollar amounts in the notes are presented in thousands except for share data.

B. Cash Equivalents

All highly liquid investments with a maturity of three months or less at date of purchase are considered to be cash equivalents.

C. Short-term Investments

Short-term investments are designated as available-for-sale and cost approximates market at December 31, 2006 and 2005.

D. Accounts Receivable

The Company maintains an allowance for doubtful accounts, which is reviewed at least monthly for estimated losses resulting from the inability of its customers to make required payments for services. Additional allowances may be necessary in the future if the ability of its customers to pay deteriorates.

E. Long-Lived Assets, Depreciation and Amortization

Property and equipment are recorded at cost and are depreciated or amortized on the straight-line method over the shorter of the assets' estimated useful lives or lease terms. Useful lives for major categories of property and equipment are as follows:

|   |                |
|---|----------------|
| Buildings   | 28 to 40 years |
| Furniture, fixtures, equipment and purchased software | 3 to 5 years   |
| Vehicles  | 3 to 5 years   |

Expenditures for maintenance, repairs, and renewals of minor items are charged to earnings as incurred. Major renewals and improvements are capitalized. Upon disposition, the cost and related accumulated depreciation are removed from the accounts and the resulting gain or loss is included in income for the period.

Effective January 1, 2002, the Company ceased to amortize goodwill. Goodwill is recorded net of accumulated amortization of \$765 at December 31, 2006 and 2005. For the years ended December 31, 2006 and 2005, the Company performed the required annual impairment test

during the fourth quarter and determined that no impairment had occurred.

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Other intangibles consist principally of payments made to purchase customer lists of agents in countries where the Company established its own presence by opening offices. Other intangible assets are amortized over their estimated useful lives for periods up to 15 years and are reviewed for impairment if an event or circumstance indicates that an impairment loss may have been incurred.

Balances as of December 31 are as follows:

|   | 2006      | 2005      |
|---|-----------|-----------|
| Other intangibles   | \$ 19,689 | 19,724    |
| Less accumulated amortization                                 | (12,105 ) | (10,727 ) |
|   | \$ 7,584  | 8,997     |
| Aggregate amortization expense for the year ended December 31 | \$ 1,369  | 1,422     |

Estimated annual amortization expense will approximate \$1,300 during each of the next five years.

#### F. Revenues and Revenue Recognition

The Company derives its revenues from three principal sources: 1) airfreight, 2) ocean freight, and 3) customs brokerage and other services. 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.

Airfreight revenues include the charges to the Company for carrying the shipments when the Company acts as a freight consolidator. Ocean freight revenues include the charges to the Company for carrying the shipments when the Company acts as a Non-Vessel Operating Common Carrier (NVOCC). In each case the Company is acting as an indirect carrier. When acting as an indirect carrier, the Company will issue a House Airway Bill (HAWB) or a House Ocean Bill of Lading (HOBL) to customers as the contract of carriage. In turn, when the freight is physically tendered to a direct carrier, the Company receives a contract of carriage known as a Master Airway Bill for airfreight shipments and a Master Ocean Bill of Lading for ocean shipments. At this point, the risk of loss passes to the carrier, however, in order to claim for any such loss, the customer is first obligated to pay the freight charges.

Based upon the terms in the contract of carriage, revenues related to shipments where the Company issues an HAWB or an HOBL are recognized at the time the freight is tendered to the direct carrier at origin. Costs related to the shipments are also recognized at this same time.

Revenues realized in other capacities, for instance, when the Company acts as an agent for the shipper, and does not issue an HAWB or an HOBL, include only the commissions and fees earned for the services performed. These revenues are recognized upon completion of the services.

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. Revenues related to customs brokerage and other services are recognized upon completion of the services.

Arranging international shipments is a complex task. Each actual movement can require multiple services. In some instances, the Company is asked to perform only one of these services. However, in most instances, the Company may perform multiple services. These services include destination breakbulk services and value added ancillary services such as local transportation, export customs formalities, distribution services and logistics management. Each of these services has an associated fee which is recognized as revenue upon completion of the service.

Typically, the fees for each of these services are quoted as separate components, however, customers on occasion will request an all-inclusive rate for a set of services known in the industry as door-to-door service. This means that the customer is billed a single rate for all services from pickup at origin to delivery at destination. In these instances, the revenue for origin and destination services, as well as revenue that will be characterized as freight charges, is allocated to branches as set by preexisting Company policy perhaps





supplemented by customer specific negotiations between the offices involved. Each of the Company's branches are separate profit centers and the primary compensation for the branch management group comes in the form of incentive-based compensation calculated directly from the operating income of that branch. This compensation structure ensures that the allocation of revenue and expense among components of services, when provided under an all-inclusive rate, are done in an objective manner on a fair value basis in accordance with Emerging Issues Task Force (EITF) 00-21, Revenue Arrangements with Multiple Deliverables.

G. Income Taxes

Income taxes are accounted for under the asset and liability method of accounting. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributed to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, the tax effect of loss carryforwards and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

H. Net Earnings per Common Share

Diluted earnings per share is computed using the weighted average number of common shares and dilutive potential common shares outstanding. Dilutive potential common shares represent outstanding stock options and stock purchase rights. Basic earnings per share is calculated using the weighted average number of common shares outstanding without taking into consideration dilutive potential common shares outstanding.

I. Stock Option Plans

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 years ended December 31, 2006, 2005 and 2004 have been increased to include compensation expense for the fair value of stock options and stock purchase rights on a straight line basis over the period they become vested. See Note 5D for further discussion of the impact of the adoption of SFAS 123R on the consolidated balance sheets, the consolidated results of operations, diluted earnings per share and consolidated statements of cash flows.

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## J Foreign Currency

Foreign currency amounts attributable to foreign operations have been translated into U.S. dollars using year-end exchange rates for assets and liabilities, historical rates for equity, and weighted average rates for revenues and expenses. Unrealized gains or losses arising from fluctuations in the year-end exchange rates are generally recorded as components of other comprehensive income as adjustments from foreign currency translation. Currency fluctuations are a normal operating factor in the conduct of the Company's business and exchange transaction gains and losses are generally included in freight consolidation expenses.

The Company follows a policy of accelerating international currency settlements to manage its foreign exchange exposure. Accordingly, 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 around the world. Such hedging activity during 2006, 2005, and 2004 was insignificant. Net foreign currency losses realized in 2006 were \$321. Net foreign currency gains realized in 2005 and 2004 were \$862 and \$86, respectively. The Company had no foreign currency derivatives outstanding at December 31, 2006 and 2005.

## K Comprehensive Income

Comprehensive income consists of net earnings and other gains and losses affecting shareholders' equity that, under generally accepted accounting principles in the United States, are excluded from net earnings. 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.

Accumulated other comprehensive income consists of the following:

| Years ended December 31,<br>(in thousands) | 2006      | 2005     |
|--|-----------|----------|
| Foreign currency translation adjustments   | \$ 13,765 | (2,977 ) |
| Unrealized gain on securities              | 399       | 338      |
|  | \$ 14,164 | (2,639 ) |

## L Segment Reporting

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 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.

## M. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of the assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

## N. Reclassifications

Certain prior year amounts have been reclassified to conform with the 2006 presentation.

## O. Recent Accounting Pronouncements

In June 2006, the FASB ratified the EITF Issue 06-3, "How Taxes Collected From Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement," (EITF 06-3). The scope of EITF 06-3 includes any tax assessed by a governmental authority that is both imposed on and concurrent with a specific revenue-producing transaction between a seller and a customer, including but not limited to sales and value-added taxes. In EITF 06-3 a consensus was reached that entities may adopt a policy of presenting these taxes in the income statement on either a gross or net basis. If these taxes are significant, an entity should disclose its policy of presenting taxes and the amount of taxes if reflected on a gross basis in the income statement. EITF 06-3 is effective for interim and annual reporting periods beginning after December 15, 2006. The Company is required to and plans to adopt EITF 06-3 in the first quarter of 2007. The Company presents revenues net of sales and

value-added taxes in its consolidated statement of earnings and does not anticipate changing its policy as a result of the adoption of EITF 06-3.

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In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the Company's financial statements in accordance with SFAS No. 109, Accounting for Income Taxes (SFAS 109). The interpretation establishes guidelines for recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is required to and plans to adopt the provisions of FIN 48 beginning in the first quarter of 2007. The Company does not expect the adoption of FIN 48 to have a material impact on the Company's consolidated financial condition or results of operations.

On September 13, 2006, the Securities and Exchange Commission (the SEC) issued Staff Accounting Bulletin No. 108 (SAB 108), Considering the Effects of Prior Year Misstatements when Qualifying Misstatements in Current Year Financial Statements, which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. The Company is required to and has adopted SAB 108 for its fiscal year ending December 31, 2006. The adoption of SAB 108 had no impact on the Company's financial condition or results of operations.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is required to and plans to adopt the provisions of SFAS 157 beginning in the first quarter of 2008. The Company is currently assessing the impact of the adoption of SFAS 157.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). Under the provisions of SFAS 159, Companies may choose to account for eligible financial instruments, warranties and insurance contracts at fair value on a contract-by-contract basis. Changes in fair value will be recognized in earnings each reporting period. SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is required to and plans to adopt the provisions of SFAS 159 beginning in the first quarter of 2008. The Company is currently assessing the impact of the adoption of SFAS 159.

#### NOTE 2. OTHER ASSETS

The Company regularly evaluates the recoverability of certain other assets. During 2004, the Company determined that an impairment had occurred and accordingly, a \$2,000 loss was recorded as an operating expense. No impairment occurred in 2006 or 2005.

#### NOTE 3. CREDIT ARRANGEMENTS

The Company has a \$50,000 United States bank line of credit extending through July 1, 2007. Borrowings under the line bear interest at LIBOR + .75% (6.07% at December 31, 2006) and are unsecured. As of December 31, 2006, the entire \$50,000 was available and the Company had no borrowings under this line.

The majority of the Company's foreign subsidiaries maintain bank lines of credit for short-term working capital purposes. These credit lines are supported by standby letters of credit issued by a United States bank, or guarantees issued by the Company to the foreign banks issuing the credit line. Lines of credit totaling \$19,516 and \$12,850 at December 31, 2006 and 2005, respectively, bear interest at rates up to 4% over the foreign banks' equivalent prime rates. At December 31, 2006, the Company had no amounts outstanding under these lines and was contingently liable for approximately \$62,608 under outstanding 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.

At December 31, 2006, the Company was in compliance with all restrictive covenants of these credit lines and the associated credit facilities, including maintenance of certain minimum asset, working capital and equity balances and ratios.



## NOTE 4. INCOME TAXES

Income tax expense (benefit) for 2006, 2005, and 2004 includes the following components:

|             | Federal   | State  | Foreign | Total   |
|-------------|-----------|--------|---------|---------|
| <b>2006</b> |           |        |         |         |
| Current     | \$ 68,176 | 9,760  | 78,553  | 156,489 |
| Deferred    | 2,096     | 2,076  |         | 4,172   |
|             | \$ 70,272 | 11,836 | 78,553  | 160,661 |
| <b>2005</b> |           |        |         |         |
| Current     | \$ 25,776 | 6,851  | 60,438  | 93,065  |
| Deferred    | (2,830)   | (870)  |         | (3,700) |
|             | \$ 22,946 | 5,981  | 60,438  | 89,365  |
| <b>2004</b> |           |        |         |         |
| Current     | \$ 13,741 | 2,168  | 46,533  | 62,442  |
| Deferred    | 21,253    | 1,276  |         | 22,529  |
|             | \$ 34,994 | 3,444  | 46,533  | 84,971  |

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Income tax expense differs from amounts computed by applying the United States Federal income tax rate of 35% to earnings before income taxes and minority interest as a result of the following:

|   | 2006       | 2005     | 2004      |
|---|------------|----------|-----------|
| Computed expected tax expense                         | \$ 138,482 | 100,344  | 76,986    |
| Increase (reduction) in income taxes resulting from:  |            |          |           |
| State income taxes, net of Federal income tax benefit | 7,694      | 3,888    | 2,238     |
| Nondeductible stock compensation expense, net         | 10,426     | 7,346    | 6,995     |
| IRC 965 tax benefit for repatriated foreign earnings  | 2,328      | (21,680) | )         |
| Other, net  | 1,731      | (533)    | ) (1,248) |
|   | \$ 160,661 | 89,365   | 84,971    |

In accordance with IRC 965, the Company recorded a one-time tax benefit of \$22 million in the fourth quarter of 2005. In order to qualify for this credit, the Company adopted a plan which required qualified capital expenditures of approximately \$105 million. The Company completed the required capital expenditures during 2006.

The components of earnings before income taxes and minority interest are as follows:

|               | 2006       | 2005    | 2004    |
|---------------|------------|---------|---------|
| United States | \$ 117,725 | 72,339  | 37,527  |
| Foreign       | 277,939    | 214,358 | 182,432 |
|               | \$ 395,664 | 286,697 | 219,959 |

The tax effects of temporary differences, tax credits and operating loss carryforwards that give rise to significant portions of deferred tax assets and deferred tax liabilities at December 31, 2006 and 2005 are as follows:

| Years ended December 31,  | 2006        | 2005       |
|---|-------------|------------|
| <b>Deferred Tax Assets:</b>   |             |            |
| Accrued third party charges, deductible for taxes upon economic performance (i.e. actual payment) | \$ 3,661    | 2,714      |
| Provision for doubtful accounts receivable  | 2,348       | 2,724      |
| Excess of financial statement over tax depreciation   | 4,474       | 4,828      |
| Foreign currency translation adjustment   |             | 1,603      |
| Retained liability for cargo claims   | 806         | 1,472      |
| Capital loss  | 1,140       | 1,257      |
| Deductible stock compensation expense, net  | 12,720      | 12,661     |
| Total gross deferred tax assets   | 25,149      | 27,259     |
| <b>Deferred Tax Liabilities:</b>  |             |            |
| Unremitted foreign earnings, net of related foreign tax credits                                   | (36,322)    | ) (32,174) |
| Foreign currency translation adjustment   | (7,413)     | )          |
| Other   | (667)       | ) (1,155)  |
| Total gross deferred tax liabilities  | \$ (44,402) | ) (33,329) |
| Net deferred tax liabilities  | \$ (19,253) | ) (6,070)  |
| Current deferred tax assets   | \$ (7,490)  | ) (7,208)  |
| Noncurrent deferred tax liabilities   | \$ (26,743) | ) (13,278) |



NOTE 5. SHAREHOLDERS' EQUITY

A. Stock Repurchase Plans

The Company has a Non-Discretionary Stock Repurchase Plan under which management is authorized to repurchase up to 20,000,000 shares of the Company's common stock in the open market with the proceeds received from the exercise of Employee and Director Stock Options. As of December 31, 2006, the Company had repurchased and retired 15,407,473 shares of common stock at an average price of \$13.24 per share over the period from 1994 through 2006.

In November 2001, the Board of Directors expanded the Company's Discretionary Stock Repurchase Plan to allow for the repurchase of such shares as may be necessary to reduce the issued and outstanding stock to 200,000,000 shares of common stock. As of December 31, 2006, the Company had repurchased and retired 9,752,196 shares of common stock at an average price of \$26.43 per share over the period from 2001 through 2006.

B. Stock Option Plans

At December 31, 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 1997 Option Plan was cancelled upon the approval of the 2005 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.

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 disqualifying disposition. 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 disqualified dispositions of incentive stock options. All of the tax benefit received upon option exercise for the tax deduction in excess of the estimated fair value of the options is credited to additional paid-in capital.

Details regarding the plans are as follows:

|                              | Unoptioned Shares |              | 2005 Plan    | 2006 Plan    | Directors Plan | Outstanding Options |                              |
|------------------------------|-------------------|--------------|--------------|--------------|----------------|---------------------|------------------------------|
|                              | 1985 Plan         | 1997 Plan    |              |              |                | Number of shares    | Weighted avg price per share |
| Balance at December 31, 2003 | 6,912             | 2,603,900    |              |              | 512,000        | 25,190,960          | \$ 10.53                     |
| Options granted              |                   | (2,140,950 ) |              |              | (128,000 )     | 2,268,950           | 21.02                        |
| Options exercised            |                   |              |              |              |                | (3,573,772 )        | 4.80                         |
| Options forfeited            |                   | 489,350      |              |              |                | (489,350 )          | \$ 15.32                     |
| Balance at December 31, 2004 | 6,912             | 952,300      |              |              | 384,000        | 23,396,788          | \$ 12.32                     |
| Options authorized           |                   |              | 1,809,100    |              |                |                     | \$                           |
| Options transferred          |                   | (1,190,900 ) | 1,190,900    |              |                |                     |                              |
| Options granted              |                   |              | (2,903,250 ) |              | (128,000 )     | 3,031,250           | 24.51                        |
| Options exercised            |                   |              |              |              |                | (3,612,592 )        | 7.52                         |
| Options forfeited            |                   | 234,800      | 53,500       |              |                | (545,000 )          | 17.26                        |
| Options cancelled            |                   | 3,800        |              |              |                | (3,800 )            | \$ 12.78                     |
| Balance at December 31, 2005 | 6,912             |              | 150,250      |              | 256,000        | 22,266,646          | \$ 14.64                     |
| Options authorized           |                   |              |              | 3,000,000    |                |                     | \$                           |
| Options granted              |                   |              |              | (2,984,610 ) | (128,000 )     | 3,112,610           | 44.21                        |

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|                              |       |        |            |              |                     |
|------------------------------|-------|--------|------------|--------------|---------------------|
| Options exercised            |       |        |            | (3,053,425 ) | 10.60               |
| Options forfeited            |       | 64,300 |            | (415,300 )   | 23.55               |
| Options cancelled            |       |        |            | (18,350 )    | 12.15               |
| Options not granted          |       |        | (150,250 ) |              | \$                  |
| Balance at December 31, 2006 | 6,912 |        | 79,690     | 128,000      | 21,892,181 \$ 19.23 |

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C. 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. At December 31, 2006, an aggregate of 3,127,578 shares had been issued under the 2002 Plan and \$11,399 had been withheld in connection with the plan year ending July 31, 2007.

D. 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 recording deferred tax assets based on the disclosed proforma amounts would have been incorrect under the 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 benefit that would have been 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. Certain prior year amounts have been reclassified to conform with the 2006 presentation. Third party outsourced labor costs were reclassified in the consolidated statement of earnings as a result of the growth in the Company's distribution services business. Net distributions to minority interests of immaterial amounts were reclassified to net cash used in financing activities.

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

|   | December 31, 2005<br>As<br>previously<br>reported | SFAS No.<br>123R<br>Adjustments | Reclassifications | As restated |
|---|---|---------------------------------|-------------------|-------------|
| 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 consolidated statement of earnings:**

|  | <b>Year ended December 31, 2005</b>   |                                  |                          |                    |
|--|---------------------------------------|----------------------------------|--------------------------|--------------------|
|  | <b>As<br/>previously<br/>reported</b> | <b>SFAS 123R<br/>Adjustments</b> | <b>Reclassifications</b> | <b>As restated</b> |
| Salaries and related costs                         | \$ 557,730                            | \$ 33,457                        | \$ 5,617                 | \$ 596,804         |
| Other operating expenses                           | 197,369                               |                                  | (5,617 )                 | 191,752            |
| <b>Total operating expenses</b>                    | <b>3,597,271</b>                      | <b>33,457</b>                    |                          | <b>3,630,728</b>   |
| <b>Operating income</b>                            | <b>304,510</b>                        | <b>(33,457 )</b>                 |                          | <b>271,053</b>     |
| Earnings before income taxes and minority interest | 320,154                               | (33,457 )                        |                          | 286,697            |
| Income tax expense                                 | 94,624                                | (5,259 )                         |                          | 89,365             |
| Net earnings before minority interest              | 225,530                               | (28,198 )                        |                          | 197,332            |
| <b>Net earnings</b>                                | <b>218,634</b>                        | <b>(28,198 )</b>                 |                          | <b>190,436</b>     |
| Diluted earnings per share                         | \$ .98                                | \$ (.12 )                        | \$                       | \$ .86             |
| Basic earnings per share                           | \$ 1.03                               | \$ (.14 )                        | \$                       | \$ .89             |

|  | <b>Year ended December 31, 2004</b>   |                                  |                          |                    |
|--|---------------------------------------|----------------------------------|--------------------------|--------------------|
|  | <b>As<br/>previously<br/>reported</b> | <b>SFAS 123R<br/>Adjustments</b> | <b>Reclassifications</b> | <b>As restated</b> |
| Salaries and related costs                         | \$ 479,364                            | \$ 29,621                        | \$ 4,829                 | \$ 513,814         |
| Other operating expenses                           | 185,828                               |                                  | (4,829 )                 | 180,999            |
| <b>Total operating expenses</b>                    | <b>3,076,454</b>                      | <b>29,621</b>                    |                          | <b>3,106,075</b>   |
| <b>Operating income</b>                            | <b>241,045</b>                        | <b>(29,621 )</b>                 |                          | <b>211,424</b>     |
| Earnings before income taxes and minority interest | 249,580                               | (29,621 )                        |                          | 219,959            |
| Income tax expense                                 | 88,415                                | (3,444 )                         |                          | 84,971             |
| Net earnings before minority interest              | 161,165                               | (26,177 )                        |                          | 134,988            |
| <b>Net earnings</b>                                | <b>156,126</b>                        | <b>(26,177 )</b>                 |                          | <b>129,949</b>     |
| Diluted earnings per share                         | \$ .71                                | \$ (.12 )                        | \$                       | \$ .59             |
| Basic earnings per share                           | \$ .74                                | \$ (.13 )                        | \$                       | \$ .61             |

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

|   | <b>Year ended December 31, 2005</b>   |                                  |                          |                    |
|---|---------------------------------------|----------------------------------|--------------------------|--------------------|
|   | <b>As<br/>previously<br/>reported</b> | <b>SFAS 123R<br/>Adjustments</b> | <b>Reclassifications</b> | <b>As restated</b> |
| Net earnings                                  | \$ 218,634                            | \$ (28,198 )                     | \$                       | \$ 190,436         |
| Deferred income tax (benefit) expense         | (4,779 )                              | 1,079                            |                          | (3,700 )           |
| Excess tax benefits from employee stock plans |                                       | (13,367 )                        |                          | (13,367 )          |
| Tax benefits from employee stock plans        | 19,705                                | (19,705 )                        |                          |                    |
| Stock compensation expense                    |                                       | 33,457                           |                          | 33,457             |
|   | 6,001                                 |                                  | 895                      | 6,896              |

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Minority interest in earnings of consolidated entities

|   |            |         |        |      |         |            |
|---|------------|---------|--------|------|---------|------------|
| Increase in accounts payable and accrued expenses | 103,639    |         | (8,813 | )    | 94,826  |            |
| Increase in taxes payable, net                    |            | 13,367  | 7,213  |      | 20,580  |            |
| Other   | (1,363     | )       | 1,600  |      | 237     |            |
| Net cash provided by operating activities         | 279,548    | (13,367 | )      | 895  | 267,076 |            |
| Excess tax benefits from employee stock plans     |            | 13,367  |        |      | 13,367  |            |
| Net distributions to minority interests           |            |         | (436   | )    | (436    |            |
| Net cash used in financing activities             | (119,754   | )       | 13,367 | (436 | )       | (106,823   |
| Effect of exchange rate changes on cash           | \$ (14,116 | )       | \$     | (459 | )       | \$ (14,575 |

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|  | Year ended December 31, 2004 |                          |                   |             |
|--|------------------------------|--------------------------|-------------------|-------------|
|  | As<br>previously<br>reported | SFAS 123R<br>Adjustments | Reclassifications | As restated |
| Net earnings   | \$ 156,126                   | \$ (26,177 )             | \$                | \$ 129,949  |
| Deferred income tax expense                            | 19,511                       | 3,018                    |                   | 22,529      |
| Excess tax benefits from employee stock plans          |                              | (12,997 )                |                   | (12,997 )   |
| Tax benefits from employee stock plans                 | 19,459                       | (19,459 )                |                   |             |
| Stock compensation expense                             |                              | 29,621                   |                   | 29,621      |
| Minority interest in earnings of consolidated entities | 4,103                        |                          | 936               | 5,039       |
| Increase in accounts payable and accrued expenses      | 113,904                      |                          | (9,882 )          | 104,022     |
| Increase in taxes payable, net                         |                              | 12,997                   | 6,885             | 19,882      |
| Other  | (2,545 )                     |                          | 2,997             | 452         |
| Net cash provided by operating activities              | 192,659                      | (12,997 )                | 936               | 180,598     |
| Excess tax benefits from employee stock plans          |                              | 12,997                   |                   | 12,997      |
| Net distributions to minority interests                |                              |                          | (284 )            | (284 )      |
| Net cash used in financing activities                  | (21,762 )                    | 12,997                   | (284 )            | (9,049 )    |
| Effect of exchange rate changes on cash                | \$ 7,234                     | \$                       | \$ (652 )         | \$ 6,582    |

The following tables summarize information about fixed-price stock options for the year ended December 31, 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                  | 3,112,610        | 44.21                                     |   |  |
| Options exercised                | (3,053,425 )     | 10.60                                     |   |  |
| Options forfeited                | (415,300 )       | 23.55                                     |   |  |
| Options cancelled                | (18,350 )        | 12.15                                     |   |  |
| Outstanding at December 31, 2006 | 21,892,181       | \$ 19.23                                  | 5.81 years                                  | \$ 476,987                               |
| Exercisable at December 31, 2006 | 11,518,446       | \$ 11.71                                  | 3.99 years                                  | \$ 331,821                               |

|                              | Unvested Options<br>Number of shares | Weighted average fair value per share |
|------------------------------|--------------------------------------|---------------------------------------|
| Balance at December 31, 2005 | 11,368,450                           | \$ 9.57                               |
| Options granted              | 3,112,610                            | 22.69                                 |
| Options vested               | (3,692,025 )                         | 7.75                                  |
| Options forfeited            | (415,300 )                           | 11.91                                 |
| Balance at December 31, 2006 | 10,373,735                           | \$ 14.06                              |





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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 years ended December 31, 2006, 2005 and 2004:

|  | For the years ended December 31, |       |      |      |       |   |     |       |   |
|--|----------------------------------|-------|------|------|-------|---|-----|-------|---|
|  | 2006                             |       | 2005 |      | 2004  |   |     |       |   |
| Dividend yield   | .51                              |       | %    | .56  |       | % | .54 |       | % |
| Volatility   | 44                               | 43    | %    | 44   | 49    | % | 46  |       | % |
| Risk-free interest rates   | 4.69                             | 5.11  | %    | 3.64 | 4.14  | % | 2.1 | 4.7   | % |
| Expected life (years) stock option plans                                       | 7.14                             | 8.89  |      | 6.67 | 9.36  |   | 6.6 | 9.2   |   |
| Expected life (years) stock purchase rights plans                              | 1                                |       |      | 1    |       |   | 1   |       |   |
| Weighted average fair value of stock options granted during the period         | \$                               | 22.69 |      | \$   | 12.69 |   | \$  | 10.65 |   |
| Weighted average fair value of stock purchase rights granted during the period | \$                               | 13.27 |      | \$   | 7.17  |   | \$  | 6.17  |   |

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 total intrinsic value of options exercised during the years ended December 31, 2006, 2005 and 2004 was approximately \$111 million, \$76 million and \$65 million, respectively. The estimated fair value of shares vested during the years ended December 31, 2006, 2005 and 2004 was approximately \$29 million, \$28 million and \$23 million, respectively.

As of December 31, 2006, the total unrecognized compensation cost related to unvested stock options is \$103 million and the weighted average period over which that cost is expected to be recognized is 1.91 years.

Total stock compensation expense and the total related tax benefit recognized for the years ended December 31, 2006, 2005 and 2004 are as follows:

|                             | For the years ended December 31, |           |           |
|-----------------------------|----------------------------------|-----------|-----------|
|                             | 2006                             | 2005      | 2004      |
| Stock compensation expense  | \$ 41,739                        | \$ 33,457 | \$ 29,621 |
| Recognized tax benefit, net | \$ 2,725                         | \$ 5,259  | \$ 3,444  |

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.

E. 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 in 2006, 2005 and 2004.

|  | Net earnings | Weighted average shares | Earnings per share |
|--|--------------|-------------------------|--------------------|
| 2006                                       |              |                         |                    |
| Basic earnings per share                   | \$ 235,094   | 213,454,579             | \$ 1.10            |
| Effect of dilutive potential common shares |              | 8,768,733               |                    |
| Diluted earnings per share                 | \$ 235,094   | 222,223,312             | \$ 1.06            |
| 2005                                       |              |                         |                    |
| Basic earnings per share                   | \$ 190,436   | 213,555,102             | \$ .89             |
| Effect of dilutive potential common shares |              | 6,675,074               |                    |

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|  |    |         |             |    |     |
|--|----|---------|-------------|----|-----|
| Diluted earnings per share                 | \$ | 190,436 | 220,230,176 | \$ | .86 |
| 2004                                       |    |         |             |    |     |
| Basic earnings per share                   | \$ | 129,949 | 212,768,302 | \$ | .61 |
| Effect of dilutive potential common shares |    |         | 7,348,382   |    |     |
| Diluted earnings per share                 | \$ | 129,949 | 220,116,684 | \$ | .59 |

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

| Years ended December 31, | 2006    | 2005 | 2004    |
|--------------------------|---------|------|---------|
| Shares                   | 132,510 | 500  | 128,000 |

**NOTE 6. FAIR VALUE OF FINANCIAL INSTRUMENTS**

The Company's financial instruments, other than cash, consist primarily of cash equivalents, short-term investments, accounts receivable, short-term debt, accounts payable and accrued expenses. The fair values of these financial instruments approximate their carrying amounts based upon market interest rates or their short-term nature.

**NOTE 7. COMMITMENTS**

**A. Leases**

The Company occupies office and warehouse facilities under terms of operating leases expiring up to 2015. Total rent expense for 2006, 2005 and 2004 was \$28,324, \$34,488 and \$33,197, respectively. At December 31, 2006, future minimum annual lease payments under all leases are as follows:

|            |           |
|------------|-----------|
| 2007       | \$ 37,133 |
| 2008       | 26,550    |
| 2009       | 12,035    |
| 2010       | 5,517     |
| 2011       | 2,422     |
| Thereafter | 2,418     |
|            | \$ 86,075 |

**B. Unconditional Purchase Obligations**

The Company enters into short-term agreements with asset-based providers reserving space on a guaranteed basis. The pricing of these obligations varies to some degree with market conditions. The Company only enters into agreements that management believes the Company can fulfill with relative ease. Historically, the Company has not paid for guaranteed space that it has not used. Management believes, in line with historical experience, committed purchase obligations outstanding as of December 31, 2006 of \$293,019, will be fulfilled during 2007 in the Company's ordinary course of business.

**C. Employee Benefits**

The Company has employee savings plans under which the Company provides a discretionary matching contribution. In 2006, 2005, and 2004, the Company's contributions under the plans were \$5,814, \$5,183, and \$4,383, respectively.

**NOTE 8. CONTINGENCIES**

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 operations or financial position.

## NOTE 9. BUSINESS SEGMENT INFORMATION

Financial information regarding the Company's 2006, 2005, and 2004 operations by geographic area are as follows:

|                                      | United States | Other North America | Asia      | Europe  | Australasia | Latin America | Middle East | Eliminations | Consolidated |
|--------------------------------------|---------------|---------------------|-----------|---------|-------------|---------------|-------------|--------------|--------------|
| <b>2006</b>                          |               |                     |           |         |             |               |             |              |              |
| Revenues from unaffiliated customers | \$ 932,165    | 120,381             | 2,616,098 | 618,999 | 54,948      | 67,463        | 215,912     |              | 4,625,966    |
| Transfers between geographic areas   | 109,552       | 7,956               | 16,228    | 32,595  | 6,383       | 8,368         | 11,293      | (192,375 )   |              |
| Total revenues                       | \$ 1,041,717  | 128,337             | 2,632,326 | 651,594 | 61,331      | 75,831        | 227,205     | (192,375 )   | 4,625,966    |
| Net revenues                         | \$ 525,039    | 61,531              | 359,613   | 216,110 | 32,894      | 32,931        | 54,821      |              | 1,282,939    |
| Operating income                     | \$ 102,041    | 15,433              | 178,265   | 48,366  | 8,887       | 7,519         | 14,605      |              | 375,116      |
| Identifiable assets at year end      | \$ 906,256    | 62,584              | 360,904   | 363,332 | 26,055      | 33,273        | 67,794      | 2,140        | 1,822,338    |
| Capital expenditures                 | \$ 121,005    | 820                 | 10,030    | 6,086   | 446         | 1,205         | 1,633       |              | 141,225      |
| Depreciation and amortization        | \$ 18,533     | 1,339               | 5,108     | 6,739   | 785         | 1,548         | 1,396       |              | 35,448       |
| Equity                               | \$ 1,215,298  | 26,160              | 249,017   | 117,738 | 14,844      | 16,133        | 31,570      | (600,825 )   | 1,069,935    |
| <b>2005</b>                          |               |                     |           |         |             |               |             |              |              |
| Revenues from unaffiliated customers | \$ 762,835    | 98,369              | 2,224,313 | 534,897 | 48,234      | 58,976        | 174,157     |              | 3,901,781    |
| Transfers between geographic areas   | 87,778        | 5,588               | 13,280    | 24,923  | 5,920       | 7,416         | 8,406       | (153,311 )   |              |
| Total revenues                       | \$ 850,613    | 103,957             | 2,237,593 | 559,820 | 54,154      | 66,392        | 182,563     | (153,311 )   | 3,901,781    |
| Net revenues                         | \$ 432,530    | 50,823              | 296,925   | 179,238 | 30,135      | 26,772        | 43,186      |              | 1,059,609    |
| Operating income                     | \$ 61,245     | 11,273              | 147,130   | 30,179  | 7,956       | 5,698         | 7,572       |              | 271,053      |
| Identifiable assets at year end      | \$ 805,273    | 51,312              | 322,391   | 294,555 | 21,681      | 26,639        | 47,009      | (2,816 )     | 1,566,044    |
| Capital expenditures                 | \$ 78,668     | 882                 | 3,374     | 4,534   | 1,084       | 1,290         | 949         |              | 90,781       |
| Depreciation and amortization        | \$ 15,077     | 1,484               | 4,759     | 6,107   | 830         | 1,198         | 1,433       |              | 30,888       |
| Equity                               | \$ 1,021,761  | 17,329              | 205,027   | 75,146  | 11,108      | 10,679        | 22,030      | (436,698 )   | 926,382      |
| <b>2004</b>                          |               |                     |           |         |             |               |             |              |              |
| Revenues from unaffiliated customers | \$ 628,093    | 77,696              | 1,880,135 | 492,651 | 44,042      | 52,347        | 142,535     |              | 3,317,499    |
| Transfers between geographic areas   | 69,695        | 4,288               | 11,096    | 18,921  | 5,262       | 6,188         | 6,373       | (121,823 )   |              |
| Total revenues                       | \$ 697,788    | 81,984              | 1,891,231 | 511,572 | 49,304      | 58,535        | 148,908     | (121,823 )   | 3,317,499    |
| Net revenues                         | \$ 362,961    | 42,954              | 252,189   | 164,132 | 25,583      | 21,274        | 37,144      |              | 906,237      |
| Operating income                     | \$ 43,093     | 9,872               | 115,716   | 26,330  | 5,742       | 3,742         | 6,929       |              | 211,424      |
| Identifiable assets at year end      | \$ 642,930    | 47,594              | 279,840   | 304,701 | 22,361      | 21,711        | 40,667      | 4,249        | 1,364,053    |
| Capital expenditures                 | \$ 34,856     | 2,150               | 11,153    | 13,445  | 845         | 1,744         | 2,051       |              | 66,244       |
| Depreciation and amortization        | \$ 13,539     | 1,211               | 4,044     | 5,099   | 665         | 770           | 1,375       |              | 26,703       |
| Equity                               | \$ 893,108    | 19,448              | 203,743   | 88,398  | 12,824      | 6,306         | 17,982      | (420,665 )   | 821,144      |

The Company charges its subsidiaries and affiliates for services rendered in the United States on a cost recovery basis.

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No single country outside the United States represented more than 10% of the Company's total revenue, net revenue or total identifiable assets in any period presented except as noted in the table below.

|                            | 2006   | 2005   | 2004 |
|----------------------------|--------|--------|------|
| <b>Total revenues:</b>     |        |        |      |
| Hong Kong                  | 15 %   | 15 %   | 16 % |
| People's Republic of China | 21 %   | 21 %   | 18 % |
| <b>Net revenues:</b>       |        |        |      |
| Hong Kong                  | *      | * 10 % |      |
| People's Republic of China | * 12 % | 10 %   |      |

\*Represents less than 10% in the period presented.

NOTE 10. QUARTERLY RESULTS (UNAUDITED)

|                            | 1st          | 2nd       | 3rd       | 4th       |
|----------------------------|--------------|-----------|-----------|-----------|
| <b>2006</b>                |              |           |           |           |
| Revenues                   | \$ 1,024,592 | 1,129,324 | 1,229,723 | 1,242,327 |
| Net revenues               | 296,197      | 313,570   | 339,338   | 333,834   |
| Net earnings               | 52,352       | 56,329    | 63,803    | 62,610    |
| Diluted earnings per share | .24          | .25       | .29       | .28       |
| Basic earnings per share   | .25          | .26       | .30       | .29       |
| <b>2005</b>                |              |           |           |           |
| Revenues                   | \$ 825,164   | 927,999   | 1,046,442 | 1,102,176 |
| Net revenues               | 230,683      | 250,660   | 281,925   | 296,341   |
| Net earnings               | 31,047       | 36,698    | 48,404    | 74,287    |
| Diluted earnings per share | .14          | .17       | .22       | .34       |
| Basic earnings per share   | .15          | .17       | .23       | .35       |

Net revenues are determined by deducting freight consolidation costs from total revenues. The sum of quarterly per share data may not equal the per share total reported for the year.

All share and per share information have been adjusted to reflect a 2-for-1 stock split effected in June 2006.

Certain amounts for 2005 have been restated as required by the modified retrospective method in connection with the implementation of SFAS 123R. In preparing the second quarter 2005 SFAS 123R restatements during the second quarter of 2006, an insignificant difference of \$177 was noted which should have been included for the first quarter of 2005. This insignificant amount was included in the year-to-date 2005 restated amounts reported in the second quarter of 2006. The first quarter of 2005 results presented in the above schedule are the corrected restated amounts and are not the amounts originally reported in the Form 10-Q filed for the first quarter 2006.

The fourth quarter 2005 results include a \$21,680 tax benefit (\$.10 per share increase in net earnings) as a result of a one time election under IRC 965.

SCHEDULE II

EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.

VALUATION AND QUALIFYING ACCOUNTS

FOR THE YEARS ENDED DECEMBER 31, 2006, 2005, AND 2004

| Description                                | Balance at beginning of year | Additions Charged to costs and expenses (in thousands) | Other | Deductions write-offs | Balance at end of year |
|--|------------------------------|--|-------|-----------------------|------------------------|
| Allowance for doubtful accounts receivable |                              |  |       |                       |                        |
| 2006                                       | \$ 12,777                    | \$ 1,197   | \$    | \$ 520                | \$ 13,454              |
| 2005                                       | \$ 12,842                    | \$ 1,313   | \$    | \$ 1,378              | \$ 12,777              |
| 2004                                       | \$ 11,978                    | \$ 2,355   | \$    | \$ 1,491              | \$ 12,842              |

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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C.

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ANNUAL REPORT

ON

FORM 10-K

FOR FISCAL YEAR ENDED

DECEMBER 31, 2006

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EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.

EXHIBITS

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INDEX TO EXHIBITS

| <b>Exhibit<br/>Number</b> | <b>Description</b>   |
|---------------------------|--|
| 10.46                     | Form of Stock Option Agreement used in connection with Incentive options granted under the Company's 2005 Incentive Stock Option Plan. |
| 10.48                     | Form of Stock Option Agreement used in connection with Incentive options granted under the Company's 2006 Incentive Stock Option Plan. |
| 21.1                      | Subsidiaries of the Registrant.  |
| 23.1                      | Consent of Independent Registered Public Accounting Firm.  |
| 31.1                      | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                    |
| 31.2                      | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                    |
| 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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