

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

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2006

OR

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

For the transition period from            to

Commission File Number: 0-13468

**EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.**

(Exact name of registrant as specified in its charter)

**Washington**

(State or other jurisdiction of  
incorporation or organization)

**91-1069248**

(IRS Employer Identification Number)

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

(Address of principal executive offices)

**98104**

(Zip Code)

**(206) 674-3400**

(Registrant's telephone number, including area code)

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

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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 November 6, 2006, the number of shares outstanding of the issuer's Common Stock was 213,170,373.

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

	September 30, 2006	December 31, 2005
<b>Assets</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 499,529	\$ 463,894
Short-term investments	386	123
Accounts receivable, less allowance for doubtful accounts of \$13,280 at September 30, 2006 and \$12,777 at December 31, 2005	812,224	709,331
Deferred Federal and state income taxes	8,717	7,208
Other current assets	14,161	21,405
Total current assets	1,335,017	1,201,961
Property and equipment, less accumulated depreciation and amortization of \$170,228 at September 30, 2006 and \$152,304 at December 31, 2005	445,964	333,787
Goodwill, less accumulated amortization of \$765 at September 30, 2006 and December 31, 2005	7,774	7,774
Other intangibles, net	7,957	8,997
Other assets, net	14,952	13,525
	\$ 1,811,664	\$ 1,566,044
<b>Liabilities and Shareholders Equity</b>		
<b>Current liabilities:</b>		
Accounts payable	562,592	479,546
Accrued expenses, primarily salaries and related costs	135,467	103,674
Federal, state and foreign income taxes	36,225	29,281
Total current liabilities	734,284	612,501
Deferred Federal and state income taxes	34,430	13,278
Minority interest	21,338	13,883
<b>Shareholders equity:</b>		
Preferred stock, par value \$.01 per share		
Authorized 2,000,000 shares; none issued		
Common stock, par value \$.01 per share		
Authorized 320,000,000 shares; issued and outstanding 213,121,366 shares at September 30, 2006, and 213,227,042 shares at December 31, 2005	2,131	2,132
Additional paid-in capital	120,343	180,905
Retained earnings	894,893	745,984
Accumulated other comprehensive income	4,245	(2,639)
Total shareholders equity	1,021,612	926,382

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Commitments and contingencies

	\$	1,811,664	\$	1,566,044
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See accompanying notes to condensed consolidated financial statements.

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

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

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EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.  
AND SUBSIDIARIES

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

(Unaudited)

	Three months ended September 30, 2006		Nine months ended September 30, 2005	
		2005		2005
<b>Revenues:</b>				
Airfreight	\$ 575,285	\$ 478,294	\$ 1,611,556	\$ 1,272,392
Ocean freight and ocean services	433,212	383,975	1,158,151	1,018,053
Customs brokerage and other services	221,226	184,173	613,932	509,160
Total revenues	1,229,723	1,046,442	3,383,639	2,799,605
<b>Operating expenses:</b>				
Airfreight consolidation	453,246	377,758	1,263,803	992,465
Ocean freight consolidation	343,909	308,385	915,568	829,614
Customs brokerage and other services	93,230	78,374	255,163	214,258
Salaries and related costs	183,995	155,450	517,422	433,965
Rent and occupancy costs	13,877	13,993	40,972	41,197
Depreciation and amortization	9,341	7,840	26,020	22,782
Selling and promotion	8,484	7,059	25,398	21,725
Other	22,384	20,147	63,832	56,985
Total operating expenses	1,128,466	969,006	3,108,178	2,612,991
Operating income	101,257	77,436	275,461	186,614
Interest expense	(4 )	(14 )	(41 )	(262 )
Interest income	4,236	3,031	12,900	7,903
Other, net	743	1,355	2,875	3,425
Other income, net	4,975	4,372	15,734	11,066
Earnings before income taxes and minority interest	106,232	81,808	291,195	197,680
Income tax expense	47,133	31,344	119,688	77,090
Net earnings before minority interest	\$ 59,099	\$ 50,464	\$ 171,507	\$ 120,590
Minority interest	4,704	(2,060 )	977	(4,442 )
Net earnings	\$ 63,803	\$ 48,404	\$ 172,484	\$ 116,148
Diluted earnings per share	\$ .29	\$ .22	\$ .78	\$ .53
Basic earnings per share	\$ .30	\$ .23	\$ .81	\$ .54
Dividends declared per common share	\$	\$	\$ .11	\$ .075
Weighted average diluted shares outstanding	221,417,053	221,334,628	220,539,975	220,901,210
Weighted average basic shares outstanding	213,524,680	213,737,374	213,557,892	213,583,128

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See accompanying notes to condensed consolidated financial statements.

Certain 2005 amounts have been restated as required by the modified retrospective method in connection with the implementation of FAS 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.

EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.  
AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows  
(In thousands)

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
<b>Operating activities:</b>				
Net earnings	\$ 63,803	\$ 48,404	\$ 172,484	\$ 116,148
Adjustments to reconcile net earnings to net cash provided by operating activities:				
Provision for losses on accounts receivable	259	782	752	424
Deferred income tax expense	4,572	6,111	38,169	21,013
Excess tax benefits from employee stock plans	(1,194)	(1,919)	(22,202)	(8,241)
Stock compensation expense	11,813	8,364	29,629	25,048
Depreciation and amortization	9,341	7,840	26,020	22,782
Gain on sale of property and equipment		(811)	(214)	(856)
Minority interest in earnings of consolidated entities	(4,768)	2,087	(757)	3,890
Other	1,704	775	3,280	1,068
Changes in operating assets and liabilities:				
Increase in accounts receivable	(66,758)	(97,236)	(95,757)	(98,884)
Increase in other current assets	14,011	9,015	7,711	7,269
Increase in accounts payable and other current liabilities	51,895	67,580	119,274	97,805
Net cash provided by operating activities	84,678	50,992	278,389	187,466
<b>Investing activities:</b>				
(Increase) decrease in short-term investments	30	25	(253)	13
Purchase of property and equipment	(9,668)	(22,967)	(131,501)	(66,159)
Proceeds from sale of property and equipment	52	1,082	317	1,331
Other	(1,999)	77	(1,513)	(1,262)
Net cash used in investing activities	(11,585)	(21,783)	(132,950)	(66,077)
<b>Financing activities:</b>				
Proceeds (repayments) of short-term debt, net		37		(2,093)
Proceeds from issuance of common stock	19,353	21,153	45,373	32,228
Repurchases of common stock	(44,139)	(30,153)	(157,767)	(80,166)
Excess tax benefits from employee stock plans	1,194	1,919	22,202	8,241
Net distributions to minority interests	(4,053)		(4,053)	(133)
Dividends paid			(23,576)	(16,055)
Net cash used in financing activities	(27,645)	(7,044)	(117,821)	(57,978)
Effect of exchange rate changes on cash	(613)	405	8,017	(10,951)
Increase in cash and cash equivalents	44,835	22,570	35,635	52,460
Cash and cash equivalents at beginning of period	454,694	438,873	463,894	408,983
Cash and cash equivalents at end of period	\$ 499,529	\$ 461,443	\$ 499,529	\$ 461,443
<b>Interest and taxes paid:</b>				
Interest	\$ 22	\$ 6	\$ 54	\$ 240
Income taxes	17,713	10,297	60,764	38,857

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See accompanying notes to condensed consolidated financial statements.

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



EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.  
AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

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

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

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

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

**Note 2. Comprehensive Income**

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

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

(in thousands)	Three months ended September 30, 2006		2005		Nine months ended September 30, 2006		2005	
Net earnings	\$	63,803	\$	48,404	\$	172,484	\$	116,148
Foreign currency translation adjustments net of tax of: \$18 and \$(18) for the three months ended September 30, 2006 and 2005, and \$(3,714) and \$6,235 for the nine months ended September 30, 2006 and 2005.		(33	)	32		6,897	(11,578	)
Unrealized loss on securities net of tax of \$(14) and \$4 for the three months ended September 30, 2006 and 2005, and \$38 and \$41 for the nine months ended September 30, 2006 and 2005.		20		(6		)	(13	)
Total comprehensive income	\$	63,790	\$	48,430	\$	179,368	\$	104,513

### Note 3. Business Segment Information

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

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

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

(in thousands)	UNITED STATES	OTHER NORTH AMERICA	ASIA	EUROPE	AUSTRALASIA	LATIN AMERICA	MIDDLE EAST	ELIMINATIONS	CONSOLIDATED
<b>Three months ended September 30, 2006:</b>									
Revenues from unaffiliated customers	\$ 240,300	30,085	709,222	160,565	14,595	17,305	57,651		1,229,723
Transfers between geographic areas	29,516	2,136	4,266	8,335	1,573	2,092	3,082	(51,000)	)
Total revenues	\$ 269,816	32,221	713,488	168,900	16,168	19,397	60,733	(51,000)	) 1,229,723
Net revenues	\$ 136,810	15,251	101,202	54,412	8,403	8,388	14,872		339,338
Operating income	\$ 27,313	3,718	50,380	11,998	2,311	1,546	3,991		101,257
Identifiable assets at quarter end	\$ 854,409	67,458	415,273	349,654	27,506	33,518	63,802	44	1,811,664
Capital expenditures	\$ 6,378	226	799	1,430	29	269	537		9,668
Depreciation and amortization	\$ 4,976	318	1,369	1,738	197	406	337		9,341
Equity	\$ 1,165,850	27,797	307,047	102,363	16,065	13,533	27,779	(638,822)	) 1,021,612
<b>Three months ended September 30, 2005:</b>									
Revenues from unaffiliated customers	\$ 199,139	25,354	616,305	133,297	12,372	14,500	45,475		1,046,442
Transfers between geographic areas	25,313	1,547	3,511	6,368	1,492	1,999	2,173	(42,403)	)
Total revenues	\$ 224,452	26,901	619,816	139,665	13,864	16,499	47,648	(42,403)	) 1,046,442
Net revenues	\$ 115,242	12,036	84,226	44,837	7,559	7,095	10,930		281,925
Operating income	\$ 21,127	1,475	43,083	7,344	2,030	1,419	958		77,436
Identifiable assets at quarter end	\$ 705,474	55,849	372,276	304,809	25,636	26,573	43,848	7,408	1,541,873
Capital expenditures	\$ 20,333	204	767	913	135	330	285		22,967
Depreciation and amortization	\$ 3,875	377	1,192	1,529	191	312	364		7,840
Equity	\$ 950,642	21,120	279,106	89,116	16,713	9,593	20,202	(504,752)	) 881,740
<b>Nine months ended September 30, 2006:</b>									
Revenues from unaffiliated customers	\$ 689,680	88,720	1,894,933	457,198	40,383	50,215	162,510		3,383,639
Transfers between geographic areas	82,443	5,828	12,120	23,560	4,603	6,096	8,144	(142,794)	)
Total revenues	\$ 772,123	94,548	1,907,053	480,758	44,986	56,311	170,654	(142,794)	) 3,383,639
Net revenues	\$ 388,670	45,804	270,896	156,345	23,827	23,862	39,701		949,105
Operating income	\$ 80,059	10,921	132,519	32,622	6,419	4,485	8,436		275,461
Identifiable assets at period end	\$ 854,409	67,458	415,273	349,654	27,506	33,518	63,802	44	1,811,664
Capital expenditures	\$ 115,142	521	8,020	5,240	375	1,060	1,143		131,501
Depreciation and amortization	\$ 13,461	1,014	3,769	5,003	584	1,153	1,036		26,020
Equity	\$ 1,165,850	27,797	307,047	102,363	16,065	13,533	27,779	(638,822)	) 1,021,612
<b>Nine months ended September 30, 2005:</b>									

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Revenues from unaffiliated customers	\$ 549,915	68,968	1,578,092	394,040	35,857	43,165	129,568		2,799,605
Transfers between geographic areas	60,939	3,894	9,359	17,366	4,139	5,437	5,956	(107,090)	)
Total revenues	\$ 610,854	72,862	1,587,451	411,406	39,996	48,602	135,524	(107,090)	) 2,799,605
Net revenues	\$ 311,261	36,231	211,777	131,731	21,328	19,638	31,302		763,268
Operating income	\$ 48,391	6,276	100,227	19,107	5,250	3,650	3,713		186,614
Identifiable assets at period end	\$ 705,474	55,849	372,276	304,809	25,636	26,573	43,848	7,408	1,541,873
Capital expenditures	\$ 56,770	716	2,917	3,432	672	882	770		66,159
Depreciation and amortization	\$ 11,097	1,106	3,578	4,541	517	859	1,084		22,782
Equity	\$ 950,642	21,120	279,106	89,116	16,713	9,593	20,202	(504,752)	) 881,740

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

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

(Amounts in thousands, except share and per share amounts)	Three months ended September 30,		
	Net Earnings	Weighted Average Shares	Earnings Per Share
<u>2006</u>			
Basic earnings per share	\$ 63,803	213,524,680	\$ .30
Effect of dilutive potential common shares		7,892,373	
Diluted earnings per share	\$ 63,803	221,417,053	\$ .29
<u>2005</u>			
Basic earnings per share	\$ 48,404	213,737,374	\$ .23
Effect of dilutive potential common shares		7,597,254	
Diluted earnings per share	\$ 48,404	221,334,628	\$ .22

(Amounts in thousands, except share and per share amounts)	Nine months ended September 30,		
	Net Earnings	Weighted Average Shares	Earnings Per Share
<u>2006</u>			
Basic earnings per share	\$ 172,484	213,557,892	\$ .81
Effect of dilutive potential common shares		6,982,083	
Diluted earnings per share	\$ 172,484	220,539,975	\$ .78
<u>2005</u>			
Basic earnings per share	\$ 116,148	213,583,128	\$ .54
Effect of dilutive potential common shares		7,318,082	
Diluted earnings per share	\$ 116,148	220,901,210	\$ .53

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

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
Shares	128,000	500	128,000	500

**Note 5. Stock and Cash Dividends**

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

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

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

**Note 6. Shareholders Equity**



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### A. Stock Option Plans

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

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

Upon the exercise of non-qualified stock options and disqualifying dispositions of incentive stock options, the Company derives a tax deduction measured by the excess of the market value over the option price at the date of 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 which exceeds the estimated fair value of the options is credited to additional paid-in capital.

### B. Stock Purchase Plan

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

### C. Adoption of SFAS 123R

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

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

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

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

	December 31, 2005 As previously reported	SFAS No. 123R Adjustments	Reclassifications	As restated
Deferred Federal and state income taxes	\$ 25,939	\$ (12,661 )		\$ 13,278
Shareholders' equity:				
Additional paid-in capital	18,663	162,242		180,905
Retained earnings	895,565	(149,581 )		745,984

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

	Three months ended September 30, 2005 As previously reported	SFAS 123R Adjustments	Reclassifications	As restated
Salaries and related costs	\$ 145,629	\$ 8,364	\$ 1,457	\$ 155,450
Other operating expenses	21,604		(1,457 )	20,147
Total operating expenses	960,642	8,364		969,006
Operating income	85,800	(8,364 )		77,436
Earnings before income taxes and minority interest	90,172	(8,364 )		81,808
Income tax expense	32,343	(999 )		31,344
Net earnings before minority interest	57,829	(7,365 )		50,464
Net earnings	55,769	(7,365 )		48,404
Diluted earnings per share	\$ .25	\$	\$	\$ .22
Basic earnings per share	\$ .26	\$	\$	\$ .23

	Nine months ended September 30, 2005 As previously reported	SFAS 123R Adjustments	Reclassifications	As restated
Salaries and related costs	\$ 405,024	\$ 25,048	\$ 3,893	\$ 433,965
Other operating expenses	60,877		(3,892 )	56,985
Total operating expenses	2,587,943	25,048		2,612,991
Operating income	211,662	(25,048 )		186,614

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Earnings before income taxes and minority interest	222,728	(25,048	)	197,680
Income tax expense	80,129	(3,039	)	77,090
Net earnings before minority interest	142,599	(22,009	)	120,590
Net earnings	138,157	(22,009	)	116,148
Diluted earnings per share	\$ .62	\$	\$	\$ .53
Basic earnings per share	\$ .65	\$	\$	\$ .54

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

	<b>Three months ended September 30, 2005</b>			
	<b>As previously reported</b>	<b>SFAS 123R Adjustments</b>	<b>Reclassifications</b>	<b>As restated</b>
Net earnings	\$ 55,769	\$ (7,365 )		\$ 48,404
Deferred income tax expense	4,258	1,853		6,111
Excess tax benefits from employee stock plans		(1,919 )		(1,919 )
Tax benefits from employee stock plans	2,852	(2,852 )		
Stock compensation expense		8,364		8,364
Net cash provided by operating activities	52,911	(1,919 )		50,992
Excess tax benefits from employee stock plans		1,919		1,919
Net cash used in financing activities	\$ (8,963 )	\$ 1,919	\$	\$ (7,044 )

	<b>Nine months ended September 30, 2005</b>			
	<b>As previously reported</b>	<b>SFAS 123R Adjustments</b>	<b>Reclassifications</b>	<b>As restated</b>
Net earnings	\$ 138,157	\$ (22,009 )		\$ 116,148
Deferred income tax expense	12,245	8,768		21,013
Excess tax benefits from employee stock plans		(8,241 )		(8,241 )
Tax benefits from employee stock plans	11,807	(11,807 )		
Stock compensation expense		25,048		25,048
Minority interest in earnings of consolidated entities	3,757		133	3,890
Net cash provided by operating activities	195,574	(8,241 )	133	187,466
Excess tax benefits from employee stock plans		8,241		8,241
Net distributions to minority interests			(133 )	(133 )
Net cash used in financing activities	\$ (66,086 )	\$ 8,241	(133 )	\$ (57,978 )

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

	<b>Number of shares</b>	<b>Weighted average exercise price per share</b>	<b>Weighted average remaining contractual life</b>	<b>Aggregate intrinsic value (in thousands)</b>
Outstanding at December 31, 2005	22,266,646	\$ 14.64		
Options granted	3,108,100	44.20		
Options exercised	(2,678,533 )	10.65		

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Options forfeited	(275,450	)	22.07		
Options expired	(15,200	)	11.53		
Outstanding at September 30, 2006	22,405,563		\$ 19.12	6.04 years	\$ 571,243
Exercisable at September 30, 2006	11,897,088		\$ 11.66	4.22 years	\$ 391,625

	Unvested Options	
	Number of shares	Weighted average fair value per share
Balance at December 31, 2005	11,368,450	\$ 9.57
Options granted	3,108,100	22.69
Options vested	(3,692,625 )	7.75
Options forfeited	(275,450 )	11.15
Balance at September 30, 2006	10,508,475	\$ 14.05

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

	For the nine months ended September 30,			
	2006		2005	
Dividend yield	.51		% .56	%
Volatility	41	43	% 44 - 49	%
Risk-free interest rates	5.03	5.11	% 3.64	4.14 %
Expected life (years) stock option plans	7.21	8.89	6.67	9.36
Expected life (years) stock purchase rights plans	1		1	
Weighted average fair value of stock options granted during the period	\$ 22.69		\$ 25.38	
Weighted average fair value of stock purchase rights granted during the period	\$ 12.41		\$ 14.33	

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 three months ended September 30, 2006 and 2005 was \$8 million and \$12 million, respectively. The total intrinsic value of options exercised during the nine months ended September 30, 2006 and 2005 was \$98 million and \$46 million, respectively.

As of September 30, 2006, the total unrecognized compensation cost related to unvested stock options is \$114,696 and the weighted average period over which that cost is expected to be recognized is 1.97 years.

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

	For the three months ended		For the nine months ended	
	September 30, 2006	2005	September 30, 2006	2005
Stock compensation expense	\$ 11,813	\$ 8,364	\$ 29,629	\$ 25,048
Recognized tax benefit, net	\$ 710	\$ 999	\$ 2,178	\$ 3,039

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.

#### Note 7. Recent Accounting Pronouncements

In June 2006, the FASB ratified the Emerging Issues Task Force (EITF) Issue 06-3, How Sales 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 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 EITF 06-3.

In July 2006, the Financial Accounting Standards Board (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 is currently assessing the impact of the adoption of FIN 48.

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. SAB 108 is effective for companies with fiscal years ending after November 15, 2006 and is required to be adopted by the Company in its fiscal year ending December 31, 2006. However, early application is encouraged in any report for an interim period of the first fiscal year ending after November 15, 2006, filed after the publication of this guidance. The Company is currently assessing the impact of the adoption of SAB 108.

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.

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

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

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

### **EXECUTIVE SUMMARY**

Expeditors International of Washington, Inc. is engaged in the business of global logistics management, including international freight forwarding and consolidation, for both air and ocean freight. The Company acts as a customs broker in all

domestic offices, and in many of its international offices. The Company also provides additional services for its customers including value-added distribution, purchase order management, vendor consolidation and other logistics solutions. The Company does not compete for overnight courier or small parcel business. The Company does not own or operate aircraft or steamships.

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

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

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

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

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

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

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

As further discussed under liquidity and capital resources, total capital expenditures in 2006 are expected to exceed \$140 million.

In terms of the opportunities, challenges and risks that management is focused on in 2006, the Company operates in 58 countries throughout the world in the competitive global logistics industry and Company activities are tied directly to the global economy. From the inception of the Company, management has believed that the elements required for a successful global service organization can





only be assured through recruiting, training, and ultimately retaining superior personnel. The Company's greatest challenge is now and always has been perpetuating a consistent global culture which demands:

Total dedication, first and foremost, to providing superior customer service;

Aggressive marketing of all of the Company's service offerings;

Ongoing development of key employees and management personnel via formal and informal means;

Creation of unlimited advancement opportunities for employees dedicated to hard work, personal growth and continuous improvement;

Individual commitment to the identification and mentoring of successors for every key position so that when inevitable change is required, a qualified and well-trained internal candidate is ready to step forward; and

Continuous identification, design and implementation of system solutions, both technological and otherwise, to meet and exceed the needs of our customers while simultaneously delivering tools to make our employees more efficient and more effective.

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

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

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

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

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

accounts receivable valuation;

the useful lives of long-term assets;

the accrual of costs related to ancillary services the Company provides;

establishment of adequate insurance liabilities for the portion of the freight related exposure which the Company has self-insured; and

accrual of tax expense on an interim basis.

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

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

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

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

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

stock price volatility, employee exercise patterns, pre-vesting option forfeitures, post-vesting option terminations, and the future interest rates and dividend yields.

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

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

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

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

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

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

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

## Results of Operations

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

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

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	Three months ended September 30, 2006			2005			Nine months ended September 30, 2006			2005		
	Amount	Percent of net revenues		Amount	Percent of net revenues		Amount	Percent of net revenues	Amount	Percent of net revenues		
(Amounts in thousands)												
<b>Net revenues:</b>												
Airfreight	\$ 122,039	36	%	\$ 100,536	36	%	\$ 347,753	37	%	\$ 279,927	37	%
Ocean freight and ocean services	89,303	26		75,590	27		242,583	25		188,439	25	
Customs brokerage and other services	127,996	38		105,799	37		358,769	38		294,902	38	
Net revenues	339,338	100		281,925	100		949,105	100		763,268	100	
<b>Operating expenses:</b>												
Salaries and related costs	183,995	54		155,450	55		517,422	55		433,965	57	
Other	54,086	16		49,039	18		156,222	16		142,689	19	
Total operating expenses	238,081	70		204,489	73		673,644	71		576,654	76	
Operating income	101,257	30		77,436	27		275,461	29		186,614	24	
Other income, net	4,975	1		4,372	2		15,734	2		11,066	2	
Earnings before income taxes and minority interest	106,232	31		81,808	29		291,195	31		197,680	26	
Income tax expense	47,133	14		31,344	11		119,688	13		77,090	10	
Net earnings before minority interest	59,099	17		50,464	18		171,507	18		120,590	16	
Minority interest	4,704	1		(2,060)	(1)		977	(1)		(4,442)	(1)	
Net earnings	\$ 63,803	18	%	\$ 48,404	17	%	\$ 172,484	18	%	\$ 116,148	15	%

Airfreight net revenues increased 21% and 24% for the three and nine-month periods ended September 30, 2006, respectively, as compared with the same periods for 2005. These increases are primarily the result of increases in airfreight tonnage of 17% and 21% for the three and nine-month periods ended September 30, 2006 as compared with the same periods for 2005.

The Company's North American airfreight net revenues increased 23% for the three months ended September 30, 2006, as compared with the same period for 2005. Airfreight net revenues for Asia, for Europe and for the Middle East/Indian subcontinent increased 21%, 18% and 58%, respectively, for the three month comparative periods. Yields between the two periods were relatively stable, with export tonnage increases of 17% from North America, 15% from Asia, 19% from Europe and 39% from the Middle East/Indian subcontinent being primarily responsible for net revenue growth. These tonnage increases were primarily the result of market share gains driven by focused sales activity.

For the nine months ended September 30, 2006, as compared with the same period for 2005, the Company's North American airfreight net revenues increased 23% while airfreight net revenues for Asia, for Europe and for the Middle East/Indian subcontinent increased 29%, 18% and 41%, respectively. Yields for the comparative nine month periods diminished slightly, but remained essentially stable. Export tonnage increases of 19% from North America, 22% from Asia, 21% from Europe and 34% from the Middle East/Indian subcontinent being primarily responsible for net revenue growth. These tonnage increases, as with the quarter ended September 30, 2006, were also primarily the result of market share gains driven by focused sales activity.

Ocean freight volumes, measured in terms of forty-foot container equivalent units (FEUs), increased 23% for the three month period ended September 30, 2006, as compared with the same period for 2005, while ocean freight and ocean services net revenues increased 18% during the same period. The difference between these two growth rates is primarily a result of year over year increases in the Company's fee-based order management and ocean forwarding business. For the nine month period ended September 30, 2006 as compared with the same period for 2005, FEU count increased 19% while ocean freight and ocean services net revenues increased 29% during the same period. The difference in these two growth rates is also attributable to the same dynamics as described for the three month period.

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

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The Company continued its focus of offering competitive rates to customers at the retail level, while leveraging freight volumes to obtain favorable rates from carriers at the wholesale level. The Company's North American ocean freight net revenues increased approximately 18% and 35% for the three and nine-month periods ended September 30, 2006, respectively, as compared with the same periods for 2005. This was due to an increase in container traffic, primarily from Asia and increases in order

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management and ocean forwarding business, which was a result of continued marketing efforts. Ocean freight net revenues for Asia and for Europe increased 18% and 16%, respectively, for the three months ended September 30, 2006, and 31% and 9%, respectively, for the nine months ended September 30, 2006, as compared with the same periods for 2005. This increase was also a result of continued marketing efforts.

Customs brokerage and other services net revenues increased 21% and 22% for the three and nine-month periods ended September 30, 2006, respectively, as compared with the same periods for 2005 as a result of the Company's continuing reputation for providing high quality service. Consolidation within the customs brokerage market has also contributed to this increase as customers seek out customs brokers with more sophisticated computerized capabilities critical to an overall logistics management program. In addition, increased emphasis on regulatory compliance continues to benefit the Company's customs brokerage offerings.

Salaries and related costs increased 18% and 19% during the three and nine-month periods ended September 30, 2006, as compared with the same periods in 2005 as a result of (1) the Company's increased hiring of sales, operations, and administrative personnel in existing and new offices to accommodate increases in business activity, and (2) increased compensation levels. As previously noted, the Company adopted SFAS 123R using the modified retrospective application method and has restated all periods presented to include compensation expense for all unvested stock options and share awards beginning with the first period restated. Accordingly, salaries and related costs for the three and nine months ended September 30, 2006 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 the three and nine-month periods ended September 30, 2006, respectively, as compared to the same periods 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 the three and nine-months ended September 30, 2006 and 2005 are as follows:

	For the three months ended September 30, 2006		2005		For the nine months ended September 30, 2006		2005	
Salaries and related costs	\$	183,995	\$	155,450	\$	517,422	\$	433,965
As a % of net revenue		54.2	%	55.1	%	54.5	%	56.9
Stock compensation expense	\$	11,813	\$	8,364	\$	29,629	\$	25,048
As a % of salaries and related costs		6.4	%	5.4	%	5.7	%	5.8
As a % of net revenue		3.5	%	3.0	%	3.1	%	3.3

The increase in stock compensation expense as a percentage of salaries and related costs for the three months ended September 30, 2006, as compared to the same period in 2005, is primarily the result of a change in the vesting of stock options granted under the Directors' Plan. Directors' Plan options granted in June 2005, vested immediately. Accordingly, the Black-Scholes determined fair-value compensation expense for those options of \$1,815, was expensed entirely in June 2005. The terms of the Directors' Plan options issued in June 2006, was amended to require vesting over a 12 month period. Accordingly, \$899 of the total Black-Scholes determined fair value compensation expense of \$3,575, was included in stock option compensation expense during the third quarter of 2006.

Historically, the relatively consistent relationship between salaries and net revenues is the result of a compensation philosophy that has been maintained since the inception of the Company: offer a modest base salary and the opportunity to share in a fixed and determinable percentage of the operating profit of the business unit controlled by each key employee. Using this compensation model, changes in individual compensation will occur in proportion to changes in Company profits. Management believes that the growth in revenues, net revenues and net earnings for the three and nine-month periods ended September 30, 2006 are a result of the incentives inherent in the Company's compensation program.

Other operating expenses increased 10% and 9% for the three and nine-month periods ended September 30, 2006, as compared with the same periods in 2005 as communications expense, quality and training expenses, and other costs expanded to accommodate the Company's growing operations. Other operating expenses as a percentage of net revenues decreased 146 basis points and 224 basis points for the three and nine-month periods ended September 30, 2006, respectively, as compared with the same periods in 2005. This was primarily due to the continued achievement of cost containment objectives.

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



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Other income, net, increased 14% and 42% for the three and nine-month periods ended September 30, 2006, as compared with the same periods in 2005. Due to higher interest rates on higher average cash balances and short-term investments during the three and nine-

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months ended September 30, 2006, as compared with the same periods for 2005, interest income increased \$1 million and \$5 million, respectively.

During the third quarter of 2006, the Company increased its ownership percentages in various joint ventures. As a result of finalizing these additional investments, the third quarter includes a one-time credit of \$5.0 million to minority interest.

The Company pays income taxes in the United States and other jurisdictions, as well as other taxes which are typically included in costs of operations. The Company's consolidated effective income tax rate during the three month period ended September 30, 2006, was 44.4% as compared to 38.3% for the same period in 2005. The Company's consolidated effective income tax rate during the nine month period ended September 30, 2006 was 41.1% as compared to 39.0% for the same period in 2005. Income tax expense for the three and nine-month periods ended September 30, 2006, includes a \$2.3 million true-up of estimated foreign tax credits relating to the American Jobs Creation Act. These amounts had previously been recorded as deferred tax assets. In refining the Company's tax credit computation, it was determined that these tax credits are no longer available. The periods in 2005 have been restated to include the tax benefit related to stock-based compensation expense recorded as a result of applying the requirements of SFAS 123R under the modified retrospective method. Although a tax benefit related to stock-based compensation expense is recorded for non-qualified stock options at the time the related compensation expense is recognized, the tax benefit received for disqualifying dispositions of incentive stock options cannot be anticipated. The higher consolidated effective income tax rate during the three month period ended September 30, 2006, as compared to the same period in 2005, is partially the result of a smaller tax benefit received for disqualifying dispositions of incentive stock options occurring during the third quarter of 2006 compared to 2005.

### Currency and Other Risk Factors

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

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

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

The nature of the Company's worldwide operations necessitates the Company dealing with a multitude of currencies other than the U.S. dollar. This results in the Company being exposed to the inherent risks of the international currency markets and governmental interference. Some of the countries where the Company maintains offices and/or agency relationships have strict currency control regulations which influence the Company's ability to hedge foreign currency exposure. The Company tries to compensate for these exposures by accelerating international currency settlements among its offices or agents. The Company enters into foreign currency hedging transactions only in limited locations where there are regulatory or commercial limitations on the Company's ability to move money freely or the short-term financial outlook is such that hedging is the way to avoid short-term exchange losses. Any such hedging activity during the three and nine-months ended September 30, 2006 and 2005 was insignificant. For the three and nine-months ended September 30, 2006, the Company had foreign exchange gains of approximately \$15 and \$819, respectively, on a net basis. For the same periods of 2005, respectively, the Company had foreign exchange losses of approximately \$91 and foreign exchange gains of approximately \$580, respectively, on a net basis. The Company had no foreign currency derivatives outstanding at September 30, 2006 and 2005.

### Sources of Growth

During the third quarter of 2006, the Company opened 2 satellite offices (+), as follows:

#### United States

Omaha, NE+

#### Other North America

Querétaro, Mexico+

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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

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that have been included in the Company's operating results for at least one full year. The table below presents same store comparisons for the three and nine-months ended September 30, 2006 (which is the measure of any increase from the same period of 2005) and for the three and nine-months ended September 30, 2005 (which measures growth over 2004).

	For the three months ended			For the nine months ended			
	September 30, 2006	%	2005	September 30, 2006	%	2005	%
Net revenue	20	%	17	24	%	14	%
Operating income	30	%	27	47	%	21	%

### Liquidity and Capital Resources

The Company's principal source of liquidity is cash generated from operating activities. Net cash provided by operating activities for the three and nine-months ended September 30, 2006, was \$85 million and \$278 million, as compared with \$51 million and \$187 million for the same periods of 2005. The \$34 million increase for the three months ended September 30, 2006 is primarily due to increased net earnings. The \$91 million increase for the nine months ended September 30, 2006, is principally due to increased net earnings and a favorable swing in the timing of receipts and disbursements represented by the accounts receivable and accounts payable balances.

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

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

Cash used in investing activities for the three and nine-months ended September 30, 2006, was \$12 million and \$133 million, as compared with \$22 million and \$66 million during the same periods of 2005. The largest use of cash in investing activities is cash paid for capital expenditures. As a non-asset based provider of integrated logistics services, the Company does not own any physical means of transportation (i.e., airplanes, ships, trucks, etc.). However, the Company does have need, on occasion, to purchase buildings to house staff and to facilitate the staging of customers' freight. The Company routinely invests in technology, office furniture and equipment and leasehold improvements. In the third quarter of 2006, the Company made capital expenditures of \$10 million as compared with \$23 million for the same period in 2005. The Company currently expects to spend approximately \$27 million for ongoing capital expenditures in 2006. In addition to property and equipment, ongoing capital expenditures include leasehold improvements, warehouse equipment, computer hardware and furniture and fixtures. Total capital expenditures in 2006 are estimated to be \$140 million. This includes ongoing capital expenditures as noted above, plus additional real estate acquisitions and development required to carry out the Company's plan adopted under IRC 965. During the second quarter of 2006, the Company spent \$67 million for the acquisition of real estate and office/warehouse facilities in Miami, Florida. The Company expects to finance capital expenditures in 2006 with cash.

Cash used in financing activities during the three and nine-months ended September 30, 2006 were \$28 million and \$118 million as compared with \$7 million and \$58 million for each of the same periods in 2005. The Company uses the proceeds from stock option exercises to repurchase the Company's stock on the open market. In 2005, the Company established a policy of repurchasing stock to prevent growth in issued and outstanding shares as a result of stock option exercises. The increase in cash used in financing activities during the three and nine-months ended September 30, 2006 compared with the same periods in 2005 is primarily the result of this new policy. During the nine months ended September 30, 2006 and 2005 the net use of cash in financing activities included the payment of dividends of \$.11 per share and \$.075 per share, respectively.

At September 30, 2006, working capital was \$601 million, including cash and short-term investments of \$500 million. The Company had no long-term debt at September 30, 2006.

The Company maintains international and domestic unsecured bank lines of credit. At September 30, 2006, the U.S. facility totaled \$50 million and international bank lines of credit, excluding the U.K. bank facility, totaled \$15 million. In addition, the Company maintains a bank facility

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

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with its U.K. bank for \$13 million which is available for short-term borrowings and issuances of standby letters of credit. At September 30, 2006 the Company had no amounts outstanding on these lines of credit but was contingently liable for \$59 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

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properly recorded as obligations in the books of the respective foreign subsidiaries, and there would be no need to record additional expense in the unlikely event the parent company were to be required to perform.

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

In some cases, the Company's ability to repatriate funds from foreign operations may be subject to foreign exchange controls. At September 30, 2006, cash and cash equivalent balances of \$391 million were held by the Company's non-U.S. subsidiaries, of which \$66 million was held in banks in the United States.

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

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

#### **Foreign Exchange Risk**

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

Foreign exchange rate sensitivity analysis can be quantified by estimating the impact on the Company's earnings as a result of hypothetical changes in the value of the U.S. dollar, the Company's functional currency, relative to the other currencies in which the Company transacts business. All other things being equal, an average 10% weakening of the U.S. dollar, throughout the nine months ended September 30, 2006, would have had the effect of raising operating income approximately \$21 million. An average 10% strengthening of the U.S. dollar, for the same period, would have had the effect of reducing operating income approximately \$17 million. This analysis does not take in to account changes in shipping patterns based upon this hypothetical currency fluctuation. For example, a weakening in the U.S. dollar would be expected to increase exports from the United States and decrease imports into the United States over some relevant period of time, but the exact affect of this change cannot be quantified without making speculative assumptions.

At September 30, 2006, the Company had approximately \$7 million of net unsettled intercompany transactions. The Company currently does not use derivative financial instruments to manage foreign currency risk and only enters into foreign currency hedging transactions in limited locations where regulatory or commercial limitations restrict the Company's ability to move money freely. Any such hedging activity during the three and nine-months ended September 30, 2006, was insignificant. The Company had no foreign currency derivatives outstanding at September 30, 2006 and 2005. The Company instead follows a policy of accelerating international currency settlements to manage foreign exchange risk relative to intercompany billings. The majority of intercompany billings are resolved within 30 days and intercompany billings arising in the normal course of business are fully settled within 90 days.

#### **Interest Rate Risk**

At September 30, 2006, the Company had cash and cash equivalents and short-term investments of \$500 million, the vast majority of which is subject to variable short-term interest rates. The Company had no short-term borrowings at September 30, 2006. A hypothetical change in the interest rate of 10% would not have a significant impact on the Company's earnings.

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

### **Item 4. 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.

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

**Changes in Internal Controls**

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

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EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.  
AND SUBSIDIARIES

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

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

**Item 1A. Risk Factors**

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

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

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs
July 1-31, 2006	1,014	\$ 54.50	1,014	13,964,789
August 1-31, 2006	183,703	41.12	183,703	13,839,144
September 1-30, 2006	906,334	40.50	906,334	13,332,772
Total	1,091,051	\$ 40.61	1,091,051	13,332,772

In November 1993, the Company's Board of Directors authorized a Non-Discretionary Stock Repurchase Plan. This plan was amended in February 2001 to increase the authorization to repurchase up to 20 million shares of the Company's common stock. This authorization has no expiration date. This plan was disclosed in the Company's report on Form 10-K filed March 31, 1995. In the third quarter of 2006, 471,032 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 third quarter of 2006, 620,019 shares were repurchased under the Discretionary Stock Repurchase Plan. These discretionary repurchases were made to keep the number of issued and outstanding shares from growing as a result of stock option exercises.

**Item 5. Other Information**

- (a) None.
- (b) None.



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**Item 6. Exhibits**

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

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

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SIGNATURES

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

EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.

November 9, 2006

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

November 9, 2006

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

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EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.  
AND SUBSIDIARIES

Form 10-Q Index and Exhibits

September 30, 2006

<b>Exhibit Number</b>	<b>Description</b>
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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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