

## 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 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. 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 several 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 between 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 according to arms-length industry conventions. 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 2006 are expected to exceed \$165 million.

In terms of the opportunities, challenges and risks that management focused on in 2005, 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 Estimates*

A summary of the Company's significant accounting policies can be found in Note 1 in 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 measurement issues or 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.

#### *Recent Accounting Pronouncements*

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment" (SFAS No. 123R), which replaces SFAS No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123) and supercedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options and employee stock purchase plans, to be recognized in the financial statements based on their fair values, beginning with the first interim or annual period of the registrant's first fiscal year beginning on or after June 15, 2005, with early adoption encouraged. In addition, SFAS No. 123R will cause unrecognized expense (based on the amount in the Company's pro forma footnote disclosure) related to options vesting after the date of initial adoption to be recognized as a charge to results of operations over the remaining vesting period. The Company has adopted SFAS No. 123R as of January 1, 2006. Under SFAS No. 123R, the Company must determine the appropriate fair value model to be used for valuing share-based payments, the amortization method for compensation cost and the transition method to be used at the date of adoption. The Company will continue to use the Black-Scholes model for valuing option expense and will amortize the compensation expense using the straight-line prorated method. The Company has elected to use the modified retrospective method of transitioning to SFAS No. 123R. Under the modified retrospective method, beginning with the report on form 10-Q for the first quarter of 2006, the Company will restate all periods presented. The adoption of SFAS No. 123R will have a material impact on the consolidated balance sheet, the consolidated results of operations, earnings per share and consolidated statement of cash flows.

#### *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 2005, 2004, and 2003, 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	2005		2004		2003	
	Amount	Percent of net revenues	Amount	Percent of net revenues	Amount	Percent of net revenues
<i>Net revenues:</i>						
Airfreight	\$ 391,773	37%	\$ 348,949	39%	\$ 278,968	37%
Ocean freight and ocean services	260,261	25	210,967	23	191,116	26
Customs brokerage and other services	407,575	38	346,321	38	280,426	37
Net revenues	1,059,609	100	906,237	100	750,510	100
<i>Operating expenses:</i>						
Salaries and related costs	557,730	53	479,364	53	398,475	53
Other	197,369	18	185,828	20	165,273	22
Total operating expenses	755,099	71	665,192	73	563,748	75
Operating income	304,510	29	241,045	27	186,762	25
Other income, net	15,644	1	8,535	1	8,880	1
Earnings before income taxes and minority interest	320,154	30	249,580	28	195,642	26
Income tax expense	94,624	9	88,415	10	71,142	10
Net earnings before minority interest	225,530	21	161,165	18	124,500	16
Minority interest	(6,896)	—	(5,039)	(1)	(2,548)	—
Net earnings	\$ 218,634	21%	\$ 156,126	17%	\$ 121,952	16%

## *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. Salaries and related costs remained constant as a percentage of net revenues. 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.

This trend may not continue in 2006 and future years as a result of the adoption of SFAS 123R, which requires the expensing of the fair value of employee stock options. Management expects salaries and related costs as a percentage of net revenues will be more volatile.

Other operating 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 operating 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 29.6% decreased when compared with the 35.4% 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.

#### *2004 compared with 2003*

Airfreight net revenues in 2004 increased 25% compared with 2003 primarily because of an increase in airfreight volumes. Global airfreight tonnages in 2004 increased 23% compared with 2003. The 1% decrease in airfreight yields in 2004 was primarily a result of air carriers increasing their rates such that the Company was unable to increase its corresponding rates to customers in a timely and effective manner. As with the second half of 2003, the Company elected to absorb these short-term decreases in the interest of maintaining long-term customer relationships. The Company's North American export airfreight net revenues increased 25% in 2004 compared to 2003. The increase is partly a recovery of the prior year decrease and partly the result of increased exports from the United States due to the weakening of the U.S. dollar. Airfreight net revenues from Asia and from Europe increased 37% and 23%, respectively, for 2004 compared with 2003. These increases are the result of market price increases, partially offset by yield declines of less than 1%, and increased tonnage of 26% from Asia and 18% from Europe, primarily as a result of increased sales success.

Ocean freight volumes, measured in terms of forty-foot container equivalents (FEUs), increased 29% over 2003 while ocean freight and ocean services net revenues increased only 10% during the same period. The difference in these two growth rates is a result of a 200 basis point reduction in ocean freight yields.

The reduction in a yield is a function of two major factors:

- Revenue from ECMS in 2004 increased only 2% over 2003 because of rate pressures on vendor consolidation fees.
- A series of rate increases put forward by direct ocean freight carriers throughout 2004. Due to market conditions primarily related to capacity, these rate increases, because of magnitude and frequency, could not be passed on to customers in a timely manner.

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 in 2004 compared to 2003. Ocean freight net revenues from Asia and from Europe increased 22% and 8%, respectively, for 2004 compared with 2003.

Customs brokerage and other services net revenues increased 23% in 2004 as compared with 2003. This is a result of the Company's growing reputation for providing high quality service and consolidation within the customs brokerage market 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 has benefited the Company's customs brokerage offerings.

Salaries and related costs increased 20% in 2004 compared to 2003 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. Salaries and related costs remained constant as a percentage of net revenues. 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 2004 are a result of the incentives inherent in the Company's compensation program.

Other operating expenses increased 12% in 2004 as compared with 2003 as rent expense, 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 in 2004 as compared with 2003. Management believes that this was significant as it reflects the successful achievement of ongoing cost containment objectives at the branch level. The ability to sustain these savings into future periods is contingent upon branch level management's ability to adhere to these objectives.

Other income, net, decreased 4% in 2004 as compared with 2003. Due to higher interest rates on higher average cash balances and short-term investments during 2004, interest income increased by \$1.1 million for the year ended December 31, 2004. Rental income, net of applicable depreciation, of \$2.6 million and \$3.4 million for the years ended December 31, 2004 and 2003, respectively, is included in other income. The rental income is derived from two of the Company's properties, one located near Heathrow airport in London, England and an office and warehouse facility near the San Francisco, California International Airport. As a result of the scheduled remodeling of the San Francisco, California office and warehouse facility, rental income from that property ceased at the end of the first quarter of 2004.

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 2004 of 35.4% decreased when compared with the 36.4% rate in 2003. The lower tax rate in 2004 is the result of the decreased state tax expense caused by an increase in the taxable income sourced outside the United States and certain accounting adjustments made in 2003.

#### *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 2005, 2004 and 2003 was insignificant. Net foreign currency gains realized in 2005, 2004 and 2003 were \$862, \$86 and \$588, respectively. The Company had no foreign currency derivatives outstanding at December 31, 2005 and 2004.

The Company has traditionally generated revenues from airfreight, ocean freight and customs brokerage and other services. Historically, this annual filing has gone on to state that in light of the customer-driven trend to provide customer rates on a door-to-door basis, management foresees the potential, in the medium- to long-term, for fees normally associated with customs house brokerage to be de-emphasized and included as a component of other services offered by the Company. We now believe we were wrong about this.

### *Sources of Growth*

During 2005, the Company opened 12 full-service offices (\*) and 5 satellite offices (+), as follows:

<i>Asia</i>	<i>Europe</i>	<i>Latin America</i>	<i>North America</i>	<i>Middle East</i>
Dongguan, PRC*	Warsaw, Poland*	Porto Alegre, Brazil*	Monterrey, Mexico*	Tiruppur, India+
Nanjing, PRC*	Malmoe, Sweden+	Lima, Peru*		
Macau, PRC*	Turin, Italy+			
Laem Chabang, Thailand+	Aberdeen, Scotland*			
Ningbo, China*	Zurich, Switzerland*			
Surabaya, Indonesia*				
Johor Bahru, Malaysia*				
Da Nang, Vietnam+				

Ningbo, Surabaya and Johor Bahru converted from satellites to full-service offices in 2005.

### *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, 2005, 2004 and 2003.

Same store comparisons for the years ended December 31,

	2005	2004	2003
Net revenues	16%	20%	10%
Operating income	26%	29%	9%

## *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, 2005 was \$280 million, as compared with \$193 million for 2004. This \$87 million increase is principally due to increased net earnings and deferred tax expense on unremitted foreign earnings. The increased accounts receivable is offset by increased accounts payable, accrued expenses and taxes payable. Increased accounts receivable is primarily due to higher billings in November and December 2005, compared to the same periods in 2004. Increases in accounts payable and accrued expenses are a result of the Company's attempts to manage cash flows by matching the timing of cash outflows for payments to vendors with cash inflows from collections of customer billings.

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. Due to the Company's management of accounts payable and accrued expenses as described in the preceding paragraph, cash flow from operating activities remained positive.

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, 2005 was \$91 million, as compared with \$65 million during the same period of 2004. 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, 2005, the Company made capital expenditures of \$91 million as compared with \$66 million for the same period in 2004. Capital expenditures in 2005 included \$23 million for acquisitions of real estate and office/warehouse facilities in Houston, Texas and Seattle, Washington. In addition, the Company had real estate development expenditures of \$42 million related to projects in San Francisco and Los Angeles, California, Seattle, Washington and Houston, Texas. Other capital expenditures in 2005 and 2004 related primarily to investments in technology, office furniture and equipment and leasehold improvements. The Company currently expects to spend approximately \$27 million for normal capital expenditures in 2006. In addition to property and equipment, normal capital expenditures include leasehold improvements, warehouse equipment, computer hardware and furniture and fixtures. Total capital expenditures in 2006 are currently estimated to be \$165 million.

This includes normal capital expenditures as noted above, plus additional real estate acquisitions and development required to carry out the Company's plan adopted under IRC 965. The Company expects to finance capital expenditures in 2006 with cash.

Cash used in financing activities for the year ended December 31, 2005 was \$120 million as compared with \$22 million for the same period in 2004. 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 for the year ended December 31, 2005 compared with the same period in 2004 is primarily the result of this new policy. During 2005 and 2004 the net use of cash in financing activities included the payment of dividends of \$.30 per share and \$.22 per share, respectively.

At December 31, 2005, working capital was \$589 million, including cash and short-term investments of \$464 million. The Company had no long-term debt at December 31, 2005.

The Company maintains international and domestic unsecured bank lines of credit. At December 31, 2005, the United States facility totaled \$50 million and the international bank lines of credit, excluding the U.K. bank facility, totaled \$11 million. In addition, the Company maintains a bank facility with its U.K. bank for \$12 million which is available for short-term borrowings and issuances of standby letters of credit. At December 31, 2005, the Company had no amounts outstanding on these lines of credit, but was contingently liable for \$56 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, 2005, 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
<i>Contractual Obligations:</i>					
Operating leases	\$ 87,057	31,316	41,836	10,944	2,961
Unconditional purchase obligations	314,072	314,072	—	—	—
Construction obligations	13,261	13,261	—	—	—
<b>Total contractual cash obligations</b>	<b>\$ 414,390</b>	<b>358,649</b>	<b>41,836</b>	<b>10,944</b>	<b>2,961</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, 2005, will be fulfilled during 2006 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
<i>Other Commitments:</i>					
International lines of credit	\$ 12,850	12,850	—	—	—
Standby letters of credit	55,639	52,875	1,860	777	127
<b>Total commitments</b>	<b>\$ 68,489</b>	<b>65,725</b>	<b>1,860</b>	<b>777</b>	<b>127</b>

The Company has a Non-Discretionary Stock Repurchase Plan to repurchase shares from the proceeds of stock option exercises. As of December 31, 2005, the Company had repurchased and retired 7,150,850 shares of common stock at an average price of \$21.68 per share over the period from 1994 through 2005. During 2005, 723,135 shares were repurchased at an average price of \$56.90 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 100,000,000 shares of common stock. As of December 31, 2005, the Company had repurchased and retired 3,463,577 shares of common stock at an average price of \$37.77 per share over the period from 2001 through 2005. During 2005, 1,463,577 shares were repurchased at an average price of \$58.56. 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, 2005, cash and cash equivalent balances of \$263 million were held by the Company's non-United States subsidiaries, of which \$17 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, 2005, the Company did not have any material off-balance-sheet arrangements, as defined in Item 303(a)(4)(ii) of Securities and Exchange Commission (SEC) Regulation S-K.

### *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 year ended December 31, 2005, would have had the effect of raising operating income approximately \$24 million. An average 10% strengthening of the U.S. dollar, for the same period, would have the effect of reducing operating income approximately \$19 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 affect of this change cannot be quantified without making speculative assumptions.

As of December 31, 2005, 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, 2005, was insignificant. The Company had no foreign currency derivatives outstanding at December 31, 2005 and 2004. 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, 2005, the Company had cash and cash equivalents and short-term investments of \$464 million, of which \$342 million was invested at various short-term market interest rates. There were no short-term borrowings at December 31, 2005. 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 2004 and 2005.