

expd 07 **Executive Summary**

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

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

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

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

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

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

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

The Company's ability to provide services to its customers is highly dependent on good working relationships with a variety of entities including airlines, ocean steamship lines, and governmental agencies. The significance of maintaining acceptable working relationships with governmental agencies and asset-based providers involved in global trade has gained increased importance as a result of ongoing concern over terrorism. As each carrier labors

to comply with governmental regulations implementing security policies and procedures, inherent conflicts emerge which can and do affect global trade to some degree. A good reputation helps to develop practical working understandings that will effectively meet security requirements while minimizing potential international trade obstacles. The Company considers its current working relationships with these entities to be satisfactory. However, changes in space allotments available from carriers, governmental deregulation efforts, "modernization" of the regulations governing customs brokerage, and/or changes in governmental quota restrictions could affect the Company's business in unpredictable ways.

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

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

As further discussed under liquidity and capital resources, total capital expenditures in 2008 are expected to exceed \$85 million.

In terms of the opportunities, challenges and risks that management focused on in 2007, the Company operates in 61 countries throughout the world in the competitive global logistics industry and Company activities are tied directly to the global economy. From the inception of the Company, management has believed that the elements required for a successful global service organization can only be assured through recruiting, training, and ultimately retaining superior personnel. The Company's greatest challenge is now and always has been perpetuating a consistent global culture which demands:

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

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

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

Critical Accounting Estimates

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

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

While judgments and estimates are a necessary component of any system of accounting, the Company's use of estimates is limited primarily to the following areas:

- 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;
- accrual of tax expense on an interim basis; and
- calculation of share-based compensation expense.

These estimates, other than the calculation of share-based compensation expense, are not highly uncertain and have not historically been subject to significant change. 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, other than the calculation of share-based compensation expense, would not produce materially different results than those reported.

As described in Note 1 to the consolidated financial statements in this report, the Company accounts for share-based compensation in accordance with 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 on a straight-line basis over the option vesting periods.

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

The Company uses the Black-Scholes model for estimating the fair value of stock options. Refer to Note 4e in the consolidated financial statements for the assumptions used for grants issued during the years ended December 31, 2007, 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 123R, the guidance included in Securities and Exchange Commission Staff Accounting Bulletin No. 107 (SAB 107) and the company's historical and currently expected future experience. Looking to future events, management has been strongly influenced by historical patterns which may not be valid predictors of future developments and any future deviation may be material.

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

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

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

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

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, "Fair Value Measurements" (SFAS 157), supplemented by FASB Financial Staff Position 157-1 and 2. 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, except for certain nonfinancial assets and liabilities for which it will adopt the provisions of SFAS 157 in the first quarter of 2009. The Company does not expect the adoption of SFAS 157 to have a material impact on the Company's consolidated financial condition or results of operations.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS 159). Under the provisions of SFAS 159, companies may choose to account for eligible financial instruments, warranties and insurance contracts at fair value on a contract-by-contract basis. Changes in fair value will be recognized in earnings each reporting period. SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is required to and plans to adopt the provisions of SFAS 159 beginning in the first quarter of 2008. The Company does not expect the adoption of SFAS 159 to have a material impact on the Company's consolidated financial condition or results of operations.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51" (SFAS 160). SFAS 160 changes the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. SFAS 160 modifies the accounting for changes in a parent's ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The Company is required to and plans to adopt the provisions of SFAS 160 beginning in the first quarter of 2009. While the Company is still assessing the impact of the adoption of SFAS 160, it had minority interest of \$17,208 and \$16,275 as of December 31, 2007 and December 31, 2006, respectively, that it expects will be reclassified to equity under the provisions of SFAS 160.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" (SFAS 141R). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The Company is required to and plans to adopt the provisions of SFAS 141R beginning in the first quarter of 2009. The Company is currently assessing the impact of the adoption of SFAS 141R. The impact will depend upon the acquisitions, if any, the Company consummates after the effective date.

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 2007, 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.

In thousands	2007		2006		2005	
	Amount	Percent of net revenues	Amount	Percent of net revenues	Amount	Percent of net revenues
NET REVENUES:						
Airfreight	\$ 528,148	36%	\$ 470,638	36%	\$ 391,773	37%
Ocean freight and ocean services	346,616	24	322,580	25	260,261	25
Customs brokerage and other services	578,197	40	497,742	39	409,588	38
Net revenues	1,452,961	100	1,290,960	100	1,061,622	100
OVERHEAD EXPENSES:						
Salaries and related costs	791,879	55	701,824	54	596,804	56
Other	237,682	16	214,020	17	193,765	18
Total overhead expenses	1,029,561	71	915,844	71	790,569	74
Operating income	423,400	29	375,116	29	271,053	26
Other income, net	26,273	2	20,548	2	15,644	1
Earnings before income taxes and minority interest	449,673	31	395,664	31	286,697	27
Income tax expense	179,815	12	160,661	13	389,365	8
Net earnings before minority interest	269,858	19	235,003	18	197,332	19
Minority interest	(704)	—	91	—	(6,896)	(1)
Net earnings	\$ 269,154	19%	\$ 235,094	18%	\$ 190,436	18%

2007 compared with 2006

Airfreight net revenues in 2007 increased 12% compared with 2006 primarily because of an increase in airfreight volumes. Global airfreight tonnages in 2007 increased 8% compared with 2006. Airfreight yields expended 83 basis points (a 4% increase) as compared with 2006. The Company's North American export airfreight net revenues increased 7% in 2007 compared to 2006, primarily the result of increased market share attributable to focused sales activity. Airfreight net revenues from Asia and from Europe increased 17% and 9%, respectively, for 2007 compared with 2006. These changes are the result of market pricing and tonnage increases of 9% from Asia and 3% from Europe. Management attributes these tonnage increases to effective sales efforts.

Ocean freight volumes, measured in terms of forty-foot container equivalent units (FEUs), increased 15% over 2006 while ocean freight and ocean services net revenues increased 7% during the same period. The difference between these two rates is a result of a year-over-year decrease in ocean freight yields of 173 basis points (an 8% decrease) which were partially offset by year-over-year increases in the Company's fee-based order management and ocean forwarding business. The primary reason for the decline in ocean freight yields was due to direct carrier cost increases that market conditions would not allow to be passed on in a timely manner.

The Company's North American ocean freight net revenues increased approximately 5% in 2007 compared to 2006. This was due to an increase in container traffic, primarily from Asia. Increases in ocean freight net revenues were primarily a result of increases in the order management and ocean forwarding business, which were an outcome of continued marketing efforts and customer service initiatives. Ocean freight net revenues for Asia and Europe increased 6% and 10%, respectively, in 2007 as compared to 2006. These increases were also a result of continued marketing efforts and customer service initiatives.

Customs brokerage and other services net revenues increased 16% in 2007 as compared with 2006. 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 13% in 2007 compared to 2006 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.

The effect of including stock-based compensation expense in salaries and related costs for 2007 and 2006 are as follows:

In thousands	Years ended December 31,	
	2007	2006
Salaries and related costs	\$ 791,879	\$ 701,824
As a % of net revenue	54.5%	54.4%
Stock compensation expense	\$ 44,917	\$ 41,739
As a % of salaries and related costs	5.7%	5.9%
As a % of net revenue	3.1%	3.2%

Historically, the relatively consistent relationship between salaries and net revenues is the result of a compensation philosophy that has been maintained since the inception of the Company: offer a modest base salary and the opportunity to share in a fixed and determinable percentage of the operating profit of the business unit controlled by each key employee. Using this compensation model, changes in individual compensation will occur in proportion to changes in Company profits. Management believes that the growth in revenues, net revenues and net earnings for 2007 are a result of the incentives inherent in the Company's compensation program.

Other overhead expenses increased 11% in 2007 as compared with 2006 as rent expense, communications expense, process improvement and training expenses, and other costs expanded to accommodate the Company's growing operations. Other overhead expenses as a percentage of net revenues decreased 1% in 2007 as compared with 2006.

Other income, net, increased 28% in 2007 as compared with 2006. Due to higher interest rates on higher average cash balances and short-term investments during 2007, interest income increased by \$4 million for the year ended December 31, 2007.

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 2007 was 40.0% as compared to 40.6% for 2006.

2006 compared with 2005

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

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

The Company continued its focus of offering competitive rates to customers at the retail level, while leveraging freight volumes to obtain favorable rates from carriers at the wholesale level. The Company's North American ocean freight net revenues increased 28% in 2006 compared to 2005. Ocean freight net revenues from Asia increased 24% and from Europe increased 12% for 2006 compared with 2005. The global increases in ocean freight net revenue are primarily a result of market share expansion.

Customs brokerage and other services net revenues increased 22% in 2006 as compared with 2005. Management believes this increase is attributable to increased market share as a result of the Company's reputation for providing high quality service and increased opportunities within the customs brokerage market. These opportunities arise as customers seek out customs brokers with sophisticated computerized capabilities. In addition, the Company's customs brokerage offerings have benefited from increased emphasis on regulatory compliance.

Salaries and related costs increased 18% in 2006 compared to 2005 as a result of (1) the Company's increased hiring of sales, operations, and administrative personnel in existing and new offices to accommodate increases in business activity and (2) increased compensation levels. As previously noted, the Company adopted SFAS 123R using the modified retrospective application method and has restated all periods presented to include compensation expense for all unvested stock options and share awards beginning with the first period restated. Accordingly, salaries and related costs for the year ended December 31, 2005 have been increased to include compensation expense for the fair value of unvested stock options.

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The decline in salaries and related costs as a percentage of net revenue for 2006 as compared with the same period for 2005, can be attributed to leveraging increased business volumes with improved productivity and increasing overall efficiency through technological advances. The effect of including stock-based compensation expense in salaries and related costs for 2006 and 2005 are as follows:

In thousands	Years ended December 31,	
	2006	2005
Salaries and related costs	\$ 701,824	\$ 596,804
As a % of net revenue	54.4%	56.2%
Stock compensation expense	\$ 41,739	\$ 33,457
As a % of salaries and related costs	5.9%	5.6%
As a % of net revenue	3.2%	3.2%

Historically, the relatively consistent relationship between salaries and net revenues is the result of a compensation philosophy that has been maintained since the inception of the Company: offer a modest base salary and the opportunity to share in a fixed and determinable percentage of the operating profit of the business unit controlled by each key employee.

Other overhead expenses increased 10% in 2006 as compared with 2005 as rent expense, communications expense, quality and training expenses, and other costs expanded to accommodate the Company's growing operations. Other overhead expenses as a percentage of net revenues decreased 1% in 2006 as compared with 2005. Management believes that this was significant as it reflects the successful achievement of ongoing cost containment objectives at the branch level.

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

The Company pays income taxes in the United States and other jurisdictions, as well as other taxes which are typically included in costs of operations. The Company's consolidated effective income tax rate in 2006 of 40.6% increased when compared with the 31.2% rate in 2005. The lower tax rate in 2005 is primarily the result of the Company adopting a plan under Internal Revenue Code (IRC) 965, which was added by the American Jobs Creation Act. In accordance with IRC 965, the Company recorded a one-time tax benefit of \$22 million in the fourth quarter of 2005. In order to qualify for this credit, the Company adopted a plan which required qualified capital expenditures of approximately \$105 million. The Company completed the required capital expenditures during 2006. Additionally, income tax expense in 2005 has been restated to include the tax benefit related to stock-based compensation expense recorded as a result of applying the requirements of SFAS 123R under the modified retrospective method. Although a tax benefit related to stock-based compensation expense is recorded for non-qualified stock options at the time the related compensation expense is recognized, the tax benefit received for disqualifying dispositions of incentive stock options cannot be anticipated. The higher consolidated effective income tax rate for 2006 as compared to 2005 is partially the result of a smaller tax benefit received for disqualifying dispositions of incentive stock options during 2006 than was realized 2005.

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 still a trend 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 2007, 2006 and 2005 was insignificant. Net foreign currency gains realized in 2007 were \$1,300. Net foreign currency losses realized in 2006 were \$321. Net foreign currency gains realized in 2005 were \$862. The Company had no foreign currency derivatives outstanding at December 31, 2007 and 2006.

Sources of Growth

During 2007, the Company opened 7 full-service offices (*) and 5 satellite offices (+), as follows:

<u>Asia</u>	<u>Europe</u>	<u>Latin America</u>	<u>North America</u>	<u>Near/Middle East</u>	<u>South Pacific</u>
Batam, Indonesia+	Krakow, Poland+	Guatemala City, Guatemala*	Knoxville, Tennessee+	Abu Dhabi, United Arab Emirates*	Christchurch, New Zealand+
Chongqing, PRC*	Maastricht, The Netherlands+			Amman, Jordan*	
Hangzhou, PRC*				Doha, Qatar*	
Yantai, PRC*					

Chongqing, People's Republic of China (PRC) and Yantai, PRC converted from satellite offices to full-service offices during 2007.

expd 07 *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, 2007, 2006 and 2005.

Same store comparisons for the years ended December 31:

	2007	2006	2005
Net revenues	12%	21%	16%
Operating income	13%	38%	28%

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, 2007 was \$313 million, as compared with \$333 million for 2006. This \$20 million decrease is principally due to an increase in accounts receivable which outpaced the increase in accounts payable and increased net earnings. Additionally, this decrease in net cash provided by operating activities was impacted by a smaller increase in taxes payable, net of prepaid taxes.

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 and continuing well into the fourth quarter) causes an excess of customer billings over customer collections. This cyclical growth in customer receivables consumes available cash.

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

Cash used in investing activities for the year ended December 31, 2007 was \$88 million, as compared with \$143 million during the same period of 2006. 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, 2007, the Company made capital expenditures of \$83 million as compared with \$139 million for the same period in 2006. Capital expenditures in 2007 included \$35 million for the purchase of 48,300 square feet of office space in Kowloon, Hong Kong. Capital expenditures in 2006 included \$67 million for the acquisition of real estate and office/warehouse facilities in Miami, Florida and real estate development expenditures of \$22 million related to projects in Seattle, Washington and Houston, Texas. Other capital expenditures in 2007 and 2006 related primarily to investments in technology, office furniture and equipment and leasehold improvements. Total capital expenditures in 2008 are currently estimated to be \$85 million. This includes normal capital expenditures as noted above, plus additional real estate acquisitions and development, although to a lesser extent than in the past few years. The Company expects to finance capital expenditures in 2008 with cash.

Cash used in financing activities for the year ended December 31, 2007 was \$175 million as compared with \$160 million for the same period in 2006. The Company uses the proceeds from stock option exercises to repurchase the Company's stock on the open market. In 2007, the Company continued its policy of repurchasing stock to prevent growth in issued and outstanding shares as a result of stock option exercises. The increase in cash used in financing activities for the year ended December 31, 2007 compared with the same period in 2006 is primarily the result of this policy. During 2007 and 2006 the net use of cash in financing activities included the payment of dividends of \$.28 per share and \$.22 per share, respectively.

At December 31, 2007, working capital was \$765 million, including cash and short-term investments of \$575 million. The Company had no long-term debt at December 31, 2007.

The Company maintains international and domestic unsecured bank lines of credit. At December 31, 2007, the United States facility totaled \$50 million and the international bank lines of credit totaled \$19 million. In addition, the Company maintains a bank facility with its U.K. bank for \$14 million which is available for issuances of standby letters of credit. At December 31, 2007, the Company had no amounts outstanding on these lines of credit, but was contingently liable for \$74 million from standby letters of credit and guarantees. The standby letters of credit and 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, 2007, 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
CONTRACTUAL OBLIGATIONS:					
Operating leases	\$ 78,389	\$ 37,382	\$ 30,829	\$ 7,493	\$ 2,685
Unconditional purchase obligations	263,273	263,273	—	—	—
Construction obligations	17,578	15,366	2,212	—	—
Total contractual cash obligations	<u>\$ 359,240</u>	<u>\$ 316,021</u>	<u>\$ 33,041</u>	<u>\$ 7,493</u>	<u>\$ 2,685</u>

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, 2007, will be fulfilled during 2008 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
OTHER COMMITMENTS:					
International lines of credit	\$ 19,067	\$ 19,067	\$ —	\$ —	\$ —
Standby letters of credit	74,498	69,409	4,814	182	93
Total commitments	\$ 93,565	\$ 88,476	\$ 4,814	\$ 182	\$ 93

The Company has a Non-Discretionary Stock Repurchase Plan to repurchase shares from the proceeds of stock option exercises. As of December 31, 2007, the Company had repurchased and retired 16,906,236 shares of common stock at an average price of \$15.94 per share over the period from 1994 through 2007. During 2007, 1,498,763 shares were repurchased at an average price of \$43.78 per share.

The Company has a Discretionary Stock Repurchase Plan under which Management is allowed to repurchase such shares as may be necessary to reduce the issued and outstanding stock to 200,000,000 shares of common stock. As of December 31, 2007, the Company had repurchased and retired 12,948,579 shares of common stock at an average price of \$30.87 per share over the period from 2001 through 2007. During 2007, 3,196,383 shares were repurchased at an average price of \$44.42. These discretionary repurchases were made to limit the growth in the number of issued and outstanding shares 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, 2007, cash and cash equivalent balances of \$395 million were held by the Company's non-United States subsidiaries, of which \$50 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, 2007, the Company did not have any material off-balance-sheet arrangements, as defined in Item 303(a)(4)(ii) of 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 reporting currency, relative to the other currencies in which the Company transacts business. All other things being equal, an average 10% weakening of the U.S. dollar, throughout the year ended December 31, 2007, would have had the effect of raising operating income approximately \$36 million. An average 10% strengthening of the U.S. dollar, for the same period, would have the effect of reducing operating income approximately \$29 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

expd 07 States over some relevant period of time, but the exact effect of this change cannot be quantified without making speculative assumptions.

As of December 31, 2007, the Company had approximately \$6 million of net unsettled intercompany transactions. The Company currently does not use derivative financial instruments to manage foreign currency risk and only enters into foreign currency hedging transactions in limited locations where regulatory or commercial limitations restrict the Company's ability to move money freely. Any such hedging activity throughout the year ended December 31, 2007, was insignificant. Net foreign currency gains realized in 2007 were \$1,300. Net foreign currency losses realized in 2006 were \$321. Net foreign currency gains realized in 2005 were \$862. The Company had no foreign currency derivatives outstanding at December 31, 2007 and 2006. 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, 2007, the Company had cash and cash equivalents and short-term investments of \$575 million, of which \$1 million was invested at various short-term market interest rates. There were no short-term borrowings at December 31, 2007. 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 2006 and 2007.