

## Management's Discussion and Analysis of Financial Condition and Results Of Operations

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 and 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 services, 2) ocean freight and ocean services, 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: 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 carriers 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 the financial stability and operating capabilities of asset-based carriers, space allotments available from carriers, governmental regulation or 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.

Primarily as a result of the global economic downturn, the Company's air and ocean freight volumes were lower in the second half of 2008 as compared to the same period in 2007. Also, airfreight volumes in the second half of 2008 were lower than volumes in the first half of 2008. These results are unprecedented in the Company's history. At this point in time, the Company cannot predict the ongoing impact of the current global economic downturn or whether various governmental stimulus plans will be effective.

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.

In terms of the opportunities, challenges and risks that management focused on in 2008, 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 other wise, 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 improving 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 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 various tax liabilities; 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 11 to the consolidated financial statements in this report, the Company accounts for share-based compensation in accordance with Statement of Financial Accounting Standard No. 123R (revised 2004), "Share-based Payment" (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 4F in the consolidated financial statements for the assumptions used for grants issued during the years ended December 31, 2008, 2007 and 2006. 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 forfeiture 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 December 2007, the Financial Accounting Standards Board (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. The Company had minority interest of \$17,498 as of December 31, 2008 and \$17,208 as of December 31, 2007, 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 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 2008, 2007, and 2006, 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                                              | 2008              |                         | 2007              |                         | 2006              |                         |
|-----------------------------------------------------------|-------------------|-------------------------|-------------------|-------------------------|-------------------|-------------------------|
|                                                           | Amount            | Percent of net revenues | Amount            | Percent of net revenues | Amount            | Percent of net revenues |
| <b>Net revenues:</b>                                      |                   |                         |                   |                         |                   |                         |
| Airfreight services                                       | \$ 578,756        | 36%                     | \$ 528,148        | 36%                     | \$ 470,638        | 36%                     |
| Ocean freight and ocean services                          | 394,637           | 25                      | 346,616           | 24                      | 322,580           | 25                      |
| Customs brokerage and other services                      | 629,868           | 39                      | 578,197           | 40                      | 497,742           | 39                      |
| <b>Net revenues</b>                                       | <b>1,603,261</b>  | <b>100</b>              | <b>1,452,961</b>  | <b>100</b>              | <b>1,290,960</b>  | <b>100</b>              |
| <b>Overhead expenses:</b>                                 |                   |                         |                   |                         |                   |                         |
| Salaries and related costs                                | 863,846           | 54                      | 791,879           | 55                      | 701,824           | 54                      |
| Other                                                     | 266,279           | 17                      | 237,682           | 16                      | 214,020           | 17                      |
| <b>Total overhead expenses</b>                            | <b>1,130,125</b>  | <b>71</b>               | <b>1,029,561</b>  | <b>71</b>               | <b>915,844</b>    | <b>71</b>               |
| Operating income                                          | 473,136           | 29                      | 423,400           | 29                      | 375,116           | 29                      |
| Other income, net                                         | 26,436            | 2                       | 26,273            | 2                       | 20,548            | 2                       |
| <b>Earnings before income taxes and minority interest</b> | <b>499,572</b>    | <b>31</b>               | <b>449,673</b>    | <b>31</b>               | <b>395,664</b>    | <b>31</b>               |
| Income tax expense                                        | 196,593           | 12                      | 179,815           | 12                      | 160,661           | 13                      |
| <b>Net earnings before minority interest</b>              | <b>302,979</b>    | <b>19</b>               | <b>269,858</b>    | <b>19</b>               | <b>235,003</b>    | <b>18</b>               |
| Minority interest                                         | (1,965)           | —                       | (704)             | —                       | 91                | —                       |
| <b>Net earnings</b>                                       | <b>\$ 301,014</b> | <b>19%</b>              | <b>\$ 269,154</b> | <b>19%</b>              | <b>\$ 235,094</b> | <b>18%</b>              |

## 2008 compared with 2007

Airfreight services net revenues in 2008 increased 10% compared with 2007 primarily due to an increase in net revenue per kilo of 12% which was offset by a 4% decline in global airfreight tonnage. Airfreight services net revenues from North America and Europe increased 14% and 13%, respectively, in 2008 as compared to 2007, primarily a result of tonnage increases of 6% and 3%, respectively, combined with net revenue per kilo increases of 11% and 6%, respectively. Airfreight services net revenues from Asia increased 1% for 2008 compared with 2007, primarily a result of a 14% increase in net revenue per kilo offset by an 11% decrease in tonnage. These changes are primarily the result of a more favorable business mix, reduction in less profitable business, development of more profitable long haul routes and enhanced opportunities to create more efficient and cost effective consolidations.

Ocean freight and ocean services net revenues increased 14% during 2008, as compared to 2007. Ocean freight net revenues are comprised of three basic services: ocean freight consolidation, direct ocean forwarding and order management. The majority of the Company's ocean freight net revenue is derived from ocean freight consolidation which represented 59% of ocean freight net revenue in 2008 and 60% in 2007. Ocean freight consolidation net revenue grew at a rate of 11% in 2008, as compared to 2007, while the other services, ocean forwarding and order management, which are primarily fee based, grew at rates of 16% and 21%, respectively. Ocean freight consolidation volumes, measured in terms of forty-foot container equivalent units (FEUs), in 2008 were approximately equal to 2007 while net revenue per container, on an aggregate basis, increased 11% for the same period. The increase in ocean freight net revenues is a combination of the Company's response to changing market dynamics with aggressive sales efforts in and the underlying impact of carrier capacity cutbacks on the market in general.

The Company's North American ocean freight net revenues increased approximately 9% in 2008 compared to 2007. Over 50% of the increase in ocean freight net revenues was a result of growth in the order management and ocean forwarding business. Ocean freight net revenues for Asia and Europe increased 17% and 24%, respectively, in 2008 as compared to 2007. These increases were a result of continued marketing efforts and opportunities provided by customer service initiatives.

Customs brokerage and other services net revenues increased 9% in 2008 as compared with 2007. 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 9% in 2008 compared to 2007 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 2008 and 2007 are as follows:

| In thousands                         | Years ended December 31, |            |
|--------------------------------------|--------------------------|------------|
|                                      | 2008                     | 2007       |
| Salaries and related costs           | \$ 863,846               | \$ 791,879 |
| As a % of net revenue                | 53.9%                    | 54.5%      |
| Stock compensation expense           | \$ 44,879                | \$ 44,917  |
| As a % of salaries and related costs | 5.2%                     | 5.7%       |
| As a % of net revenue                | 2.8%                     | 3.1%       |

Of the 62 basis point decrease in salaries and related costs as a percentage of net revenue for 2008, as compared with 2007, 30 basis points are the result of the decrease in stock compensation expense as a percentage of net revenue.

The remaining 32 basis point decrease in salaries and related costs as a percentage of net revenue for 2008, as compared with 2007, can be attributed to productivity increases which resulted from more efficient staffing utilization. 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 are a result of the incentives inherent in the Company's compensation program.

Other overhead expenses increased 12% in 2008 as compared with 2007 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 increased 1% in 2008 as compared with 2007. The Company incurred legal and related expenses of \$10 million in 2008 as compared to \$4 million in 2007, primarily attributable to the Department of Justice's ("DOJ") ongoing investigations of air cargo freight forwarders and related legal proceedings as described further in Note 7 to the consolidated financial statements in this Annual Report. The Company will continue to incur substantial legal costs, which could include fines and/or penalties, until these proceedings are concluded. If the DOJ and/or EC concludes that the Company has engaged in anti-competitive behavior, such fines and/or penalties could have a material impact on the Company's financial condition, results of operations and operating cash flows. Despite the legal and related expenditures mentioned above, other overhead expenses as a percentage of net revenues remained relatively constant for 2008 as compared to 2007. This was primarily due to the continued achievement of cost containment objectives.

Other income, net, remained relatively constant in 2008 when compared with 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 2008 was 39.4% as compared to 40.0% for 2007.

#### 2007 compared with 2006

Airfreight services 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 services 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 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. The Company incurred legal and related expenses of \$4 million in 2007, primarily attributable to the DOJ ongoing investigation of air cargo freight forwarders and related legal proceedings as described further in Note 7 to the consolidated financial statements in this Annual Report. 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.

#### Currency and Other Risk Factors

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

Historically, the primary competitive factors in the international logistics industry have been price and quality of service, including reliability, responsiveness, expertise, convenience, and scope of operations. The Company emphasizes quality service and believes that its prices are competitive with those of others in the industry. 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 more 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 2008, 2007 and 2006 was insignificant. Net unrealized foreign currency losses incurred in 2008 were \$191. Net unrealized foreign currency gains incurred in 2007 were \$1,300. Net unrealized foreign currency losses incurred in 2006 were \$321. The Company had no foreign currency derivatives outstanding at December 31, 2008 and 2007.

### Sources of Growth

During 2008, the Company opened 7 full-service offices (+) and 4 satellite offices (\*) as follows:

| Asia                                       | Europe                  | Latin America                | North America                       | Near/Middle East                        |
|--------------------------------------------|-------------------------|------------------------------|-------------------------------------|-----------------------------------------|
| + Fuzhou,<br>People's Republic<br>of China | + Bucharest,<br>Romania | * Lázaro Cárdenas,<br>Mexico | + Raleigh Durham,<br>North Carolina | * Coimbatore,<br>India                  |
| + Suzhou,<br>People's Republic<br>of China |                         |                              | + Milwaukee,<br>Wisconsin           | + Dammam,<br>Kingdom of<br>Saudi Arabia |
|                                            |                         |                              |                                     | * Kolkata,<br>India                     |
|                                            |                         |                              |                                     | + Manama,<br>Kingdom of Bahrain         |
|                                            |                         |                              |                                     | * Mundra,<br>India                      |

Suzhou, People's Republic of China and Milwaukee, Wisconsin converted from satellite offices to full-service offices during 2008.

**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, 2008, 2007 and 2006.

Same store comparisons for the years ended December 31,

|                  | 2008 | 2007 | 2006 |
|------------------|------|------|------|
| Net revenues     | 10%  | 12%  | 21%  |
| Operating income | 12%  | 13%  | 38%  |

### 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, 2008 was \$409 million, as compared with \$313 million for 2007. This \$96 million increase is primarily due to increased net earnings and a decrease in accounts receivable which outpaced the decrease in accounts payable and other accrued current liabilities

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, 2008 was \$59 million, as compared with \$88 million during the same period of 2007. 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, 2008, the Company made capital expenditures of \$60 million as compared with \$83 million for the same period in 2007. Capital expenditures in 2007 included \$35 million for the purchase of 48,300 square feet of office space in Kowloon, Hong Kong. Other capital expenditures in 2008 and 2007 related primarily to investments in technology, office furniture and equipment and leasehold improvements. Total capital expenditures in 2009 are currently estimated to be \$70 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 2009 with cash.

Cash used in financing activities for the year ended December 31, 2008 was \$161 million as compared with \$175 million in 2007. The Company uses the proceeds from stock option exercises to repurchase the Company's stock on the open market. In 2008, the Company continued its policy of repurchasing stock to limit growth in issued and outstanding shares as a result of stock option exercises. The decrease in cash used in financing activities for the year ended December 31, 2008 as compared with the same period in 2007 is primarily due to fewer shares repurchased. The proceeds from issuance of stock during 2008 were also significantly lower due to fewer aggregate shares exercised, as compared to 2007. During 2008 and 2007 the net use of cash in financing activities included the payment of dividends of \$.32 per share and \$.28 per share, respectively.

At December 31, 2008, working capital was \$903 million, including cash and short-term investments of \$742 million. The Company had no long-term debt at December 31, 2008. The Company follows established guidelines relating to credit quality, diversification and maturities of its investments to preserve principal and maintain liquidity. The Company's investment portfolio has not been adversely impacted by the recent disruption in the credit markets. However, if there is continued and expanded disruption in the credit markets, there can be no assurance that the Company's investment portfolio will not be adversely affected in the future.

The Company cannot forecast the potential impact that the recent disruptions in the world financial markets and associated credit tightening may have on the underlying global economy. Management believes that the Company has effective credit control procedures, and historically has experienced relatively insignificant collection problems. The Company cannot predict what fallout any of these disruptions might have on freight volumes due to changes in consumer demand or on customers' abilities to pay.

The Company maintains international and domestic unsecured bank lines of credit. At December 31, 2008, the United States facility totaled \$50 million and the international bank lines of credit totaled \$22 million. In addition, the Company maintains a bank facility with its U.K. bank for \$10 million which is available for issuances of standby letters of credit. At December 31, 2008, the Company had no amounts outstanding on these lines of credit, but was contingently liable for \$79 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, 2008, the Company's contractual obligations and other commitments are as follows:

| In thousands                              | Total amounts committed | Payments Due by Period |                  |                  |                 |
|-------------------------------------------|-------------------------|------------------------|------------------|------------------|-----------------|
|                                           |                         | Less than 1 year       | 1-3 years        | 3-5 years        | After 5 years   |
| <b>Contractual Obligations:</b>           |                         |                        |                  |                  |                 |
| Operating leases                          | \$ 84,949               | \$ 33,721              | \$ 34,479        | \$ 14,645        | \$ 2,104        |
| Unconditional purchase obligations        | 362,354                 | 362,354                | —                | —                | —               |
| Construction obligations                  | 8,980                   | 8,980                  | —                | —                | —               |
| <b>Total contractual cash obligations</b> | <b>\$ 456,283</b>       | <b>\$ 405,055</b>      | <b>\$ 34,479</b> | <b>\$ 14,645</b> | <b>\$ 2,104</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, 2008, will be fulfilled during 2009 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 |
| Standby letters of credit | \$ 79,449               | \$ 71,947                                  | \$ 6,644  | \$ 95     | \$ 763        |

The Company has a Non-Discretionary Stock Repurchase Plan to repurchase shares from the proceeds of stock option exercises. As of December 31, 2008, the Company had repurchased and retired 18,161,750 shares of common stock at an average price of \$17.56 per share over the period from 1994 through 2008. During 2008, 1,255,514 shares were repurchased at an average price of \$39.31 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, 2008, the Company had repurchased and retired 15,590,002 shares of common stock at an average price of \$32.36 per share over the period from 2001 through 2008. During 2008, 2,641,423 shares were repurchased at an average price of \$39.69. 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, 2008, cash and cash equivalent balances of \$482 million were held by the Company's non-United States subsidiaries, of which \$65 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, 2008, 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, 2008, would have had the effect of raising operating income approximately \$40 million. An average 10% strengthening of the U.S. dollar, for the same period, would have the effect of reducing operating income approximately \$33 million. This analysis does not take into account changes in shipping patterns based upon this hypothetical currency fluctuation. For example, a weakening in the U.S. dollar would be expected to increase exports from the United States and depress imports into the United States over some relevant period of time, but the exact effect of this change cannot be quantified without making speculative assumptions.

As of December 31, 2008, the Company had approximately \$5 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, 2008, was insignificant. Net unrealized foreign currency losses incurred in 2008 were \$191. Net unrealized foreign currency gains incurred in 2007 were \$1,300. Net unrealized foreign currency losses incurred in 2006 were \$321. The Company had no foreign currency derivatives outstanding at December 31, 2008 and 2007. 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, 2008, the Company had cash and cash equivalents and short-term investments of \$742 million, of which \$397 million was invested at various short-term market interest rates. There were no short-term borrowings at December 31, 2008. 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 2007 and 2008.