EXPEDITORS INTERNATIONAL OF WASHINGTON INC
Form 8-K
August 22, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of Report: **August 22, 2006**
(Date of earliest event reported)

EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.
(Exact name of registrant as specified in its charter)

Washington	**000-13468**	**91-1069248**
(State or other jurisdiction of incorporation or organization)	(Commission File No.)	(IRS Employer Identification Number)

1015 Third Avenue, 12th Floor, Seattle, Washington	**98104**
(Address of principal executive offices)	(Zip Code)

(206) 674-3400
(Registrant s telephone number, including area code)

N/A
(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

o Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

o Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

o Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

o Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

N/A (Former name or former address, if changed since last report)

Item 7.01. Regulation FD Disclosure.

The following information is included in this document as a result of Expeditors policy regarding public disclosure of corporate information. Answers to additional inquiries, if any, that comply with this policy are scheduled to become available on or about September 26, 2006.

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

Certain portions of this document including the answers to questions 1, 5, 6, 7, 12, 13, 16, 17, 18 and 20 contain forward-looking statements which are based on certain assumptions and expectations of future events that are subject to risks and uncertainties. Actual future results and trends may differ materially from historical results or those projected in any forward-looking statements depending on a variety of factors including, but not limited to, changes in customer demand for Expeditors services caused by a general economic slow-down, inventory build-up, decreased consumer confidence, volatility in equity markets, energy prices, political changes, or the unpredictable acts of competitors.

SELECTED INQUIRIES RECEIVED THROUGH AUGUST 2, 2006

1. How has the current Israel-Lebanon conflict impacted air and ocean freight flows into and out of both countries and the region generally? Has Expeditors been directly impacted and if so how? Roughly what percentage of Expeditors Middle East gross revenue and earnings before income tax is derived from business activities in Israel/Lebanon (in Expeditors most recent 10-K the company indicated it owned and operated an office in Lebanon but nothing in Israel). Further how do forwarders move freight in times of war into and out of hostile territories? Are there premiums that are assessed to the shipper to move this freight?

Your reading of our 10-K is correct. We do have a full service office in Beirut, Lebanon and we do not own anything in the country of Israel. Our traffic into and out of Israel is handled by an agent who has represented us in this market for a long time.

As for the impact on freight, currently Beirut has no operating airport as a result of severe runway damage. No airport, no air freight. The port of Beirut, along with the other lesser ports in Lebanon, are under naval blockade so there is currently no ocean freight moving into or out of Lebanon. The highway infrastructure has also suffered severely so no freight is moving via truck either. Certain humanitarian supplies are allowed under appropriate circumstances, but for the most part commercial cargo in and out of Lebanon is at a stand still as of mid-August 2006.

Our agent in Israel seems to be managing so far. The rocket damage is limited to northern Israel at present and thus flights continue to move in and out of Israel. Ocean freight is still moving on a regular basis through Ashdod, Israel s second largest port. As of mid-August 2006 some commercial shipping activity has resumed in Haifa, but there are some backlogs. The Israelis seem to have adapted so far and freight seems to be moving. It is not totally business as usual, but things are still moving.

From a business standpoint, whether you look at profitability or freight volumes, neither Lebanon nor Israel represent a great deal of our global business. The real ongoing concern for us here, is not financial, it is more basic than that. It is the deep concern we have for our friends and colleagues.

Most recently, the logistics expertise of our Beirut office has been applied to moving our employees to other venues. This was no small feat as many of our people did not have the paperwork required to be admitted for temporary work assignments in other countries. We went to work on this and many of our people, and their families, have now relocated temporarily to other Expeditors offices in the Middle East. A small group of our Beirut employees declined all relocation offers and have chosen to remain in Beirut. Amid the turmoil, chaos, and confusion of war, they are managing to keep the

office open. This means they are able to safeguard our computer systems and other assets and continue to look after those customer service and security needs that require attention. Our hats are off to this intrepid band. We think of them every day as we get the latest reports on the conflict. May they remain safe and so far, so good.

2. I have reviewed Income Statements downloaded from news.moneycentral.msn.com and had some particular questions about figures on your income statement. How do you come up with the figures for:

- *Revenues and Net Revenues - Do revenues include the total fees and charges billed including pass through items such as customs duty and other items advanced on behalf of customers? With respect to net revenues can I assume these are gross billings less certain items such as customs cuties, ocean or airfreight charges advanced that are not part of your services? If not, explain how you arrive at the net revenue figure?*

To start with, we would suggest that the best source for our financial information is the public filings on Forms 10-K and 10-Q available on the SEC website. The Investor Relations page of our website, found at www.investor.expeditors.com, has a link to this source material at the very bottom of the page. Click on this link and when you arrive at the SEC website put 10-K or 10-Q into the box asking for the form type. When we do this, every 10-Q or 10-K Expeditors has filed since the first quarter of 1995 shows up. For those who don t speak the plain English used by the SEC, the 10-K is an annual filing containing the year end financial statements. The Form 10-Q is filed with quarterly results for the first, second and third quarters.

Not surprisingly, the annual filings are longer and generally more comprehensive. The quarterly filings are more abbreviated and are written assuming that the reader has looked at the most recent annual filing. Accordingly, we would recommend you look at the most recent Form 10-Q, currently the one dated August 9, 2006 and the 10-K filed March 16, 2006. Each filing contains financial statements and a section called Management s Discussion and Analysis (MD&A for short). The MD&A contains, not surprisingly, a discussion and analysis of the major trends behind the numbers in the associated financial statements.

While the financial information contained many of the free financial websites is certainly useful, these websites typically do not include the footnotes and interesting tidbits often found in a well written MD&A.

Looking at MD&A you will see the following text (underlining supplied for this 8-K answer):

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. <u>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.</u> As a result of these pass through billings, the conventional Days Sales Outstanding or DSO calculation does not directly measure collection efficiency.

From this we hope that a reader will understand that we do not include duties in our revenues nor as a component of transportation costs. Our gross billings, your term and a number which does not appear in our results of operations, would include duties and other pass-through items. These

items to show up in accounts receivable on the statement of financial position, but they are properly excluded from Gross Revenue .

To explain net revenues, we again turn to a portion of the MD&A which reads:

The following table shows the consolidated net revenues (revenues less transportation expenses) attributable to the Company s principal services and the Company s expenses for 2005, 2004, and 2003, expressed as percentages of net revenues. Management believes that net revenues are a better measure than total revenues of the relative importance of the Company s principal services since total revenues earned by the Company as a freight consolidator include the carriers charges to the Company for carrying the shipment whereas revenues earned by the Company in its other capacities include only the commissions and fees actually earned by the Company.

Gross revenues include all of the revenues earned from billings to customers, both fee-based revenue, such as brokerage fees and agency fees for handling direct ocean and airfreight shipments, and transportation revenues earned as an indirect carrier. In order for us to earn transportation revenues as an indirect carrier, we will incur transportation costs from the direct carriers. Net revenues are gross revenues (which do not include advances as we learned above) less any direct transportation expenses. Net revenues give what we believe is the best picture of the relative contribution of both transportation and fee-based services.

- *Operating Expenses: Does the figure for Selling and Promotion consist of salaries and commissions paid to sales and marketing personnel or is it advertising and other such expenses?*

Selling and promotion does not contain salaries and commissions. This financial statement caption contains travel and entertainment expenses and to a lesser extent amounts for advertising and etc.

3. I m trying to find a replay of your second quarter 2006 conference call. I m assuming that Expeditors does not have earnings conference calls, but if you do, could you please tell me where to find the replay.

You are correct in your assumption. It is very difficult to find a replay because we do not do conference calls. No call, no replay. Instead we respond in writing to questions submitted by investors, potential investors and other interested people like yourself.

4. What was the air freight tonnage and ocean container count growth for the overall second quarter of 2006?

Airfreight tonnage was up 22% in the second quarter of 2006 and the ocean container count increased 17% over the same quarter of 2005.

5. Would you please explain why capital expenditures were so large in the second quarter of 2006? Did some projects get moved from the second half of the year into the quarter? From previous 8-Ks we were forecasting the total to be about $160 million for the year, is that still a reasonable number?

At this point in mid-August, we would say that $160 million is still a reasonable estimate for capital expenditures during 2006. If it is wrong, our guess would be that it is going to be on the high side of incorrect. But even the $160 million comes with an explanation.

In April 2006, we acquired real estate near the Miami airport for a purchase price of $70 million. We made this purchase in a joint venture with a third party. Each joint venture partner put up

$12.5 million in equity and Expeditors loaned the venture the balance of the purchase price. This debt obligation is secured by a first mortgage and carries a floating interest rate equal to that available from a bank. We have consolidated the entire venture (and recorded a minority interest for our partner s share) so the entire $70 million is included in our reported capital expenditure for 2006. We consolidated this investment, as opposed to accounting for it on the equity method, because we feel that our action in financing the project and our position as a future major tenant gives us more than 50% control. This was a close call, but considering all the terms of our agreement with our partner, consolidation was deemed to be the appropriate accounting treatment. When looking satisfy our ongoing capital expenditure obligation for the special tax benefit available to us in 2005, we will only be counting our 50% share.

6. We understand that your tax rate may move from time to time based on options and mix of business in various countries. Is a 39% to 40% tax rate still a reasonable estimate going forward?

We frankly did not believe that these two sentences were joined together as a single question. Your first sentence is a simple and accurate reflection of the two reasons why it is impossible to accurately predict our tax rate. Then the second ignores this explanation and asks us to opine on the unknowable. In sum, your 39 to 40 percent range is a good a guess as any we might make.

Our overall tax rate will vary from period to period based upon the mix of business between the United States and everywhere else and it will vary as a result of stock option exercises. We can explain the why of this, but we cannot predict the how much.

First, let us look at the business mix issue. While the source of our business messes with the tax rate, we are not like everybody else. The rest of our industry recognizes U.S. tax only on U.S. earnings while we record full U.S. taxation on our worldwide earnings. This is why our tax rate is higher than theirs. So the mix of business has no effect on our federal tax rate, it does change the overall effective state tax rate. This is a result of the fact that many states tax dividend income, which is how foreign earnings get back to the U.S., at a lower effective rate than they tax income from a trade or business like freight forwarding. More foreign earnings in a period and we have a slightly lower state tax rate for the period. Since it is impossible to predict the mix of earnings for any given period, it is impossible to predict our effective state tax expense.

The second wild card is the new accounting rule for stock options. These rules prohibit companies from anticipating any tax benefits resulting from disqualifying dispositions of stock acquired under employee stock purchase plans and shares acquired by exercising incentive stock options. We know that disqualifying dispositions will cause our tax rate to fall, but we have no way of knowing in advance the amount, if any, that we will have in a quarter. We could go crazy and explain what constitutes a disqualifying disposition, but we will skip that and assume you know. If we are wrong about this, just ask and we will make the effort to explain.

7. Would you please provide a little more color on the pricing environment and initial demand as the industry moves towards peak season for both air and ocean freight?

Pricing seems to be firming with respect to ocean and airfreight. The general consensus seems to be that capacity is tightening, partially due to seasonal demand and with respect to air, partially as the carriers keep excess capacity off the market as best they can.

8. Would you please provide the headcount figures for second quarter 2006 versus a year ago?

As of the end of June, our headcount looked like this:

	30-Jun-2006	30-Jun-2005	Diff.	% Diff
North America	3,888	3,376	512	15.2 %
Asia	2,918	2,506	412	16.4 %
Europe and Africa	1,777	1,722	55	3.2 %
Middle East	902	839	63	7.5 %
South America	536	504	32	6.3 %
Australasia	220	206	14	6.8 %
Information Systems	537	460	77	16.7 %
Corporate	288	291	(3)	-1.0 %
	11,066	9,904	1,162	11.7 %

9. In the first quarter 2006 press release the last paragraph cited 56 satellite locations and 5 international service centers , the second quarter 2006 press release cited only 56 international service centers . Would you please explain what has changed between these two statements?

Nothing really changed, we just made a dog s dinner of this portion of the second quarter 2006 press release. We somehow left out the words satellite locations and 5 from the second quarter release. Put them back in and all is right with the count.

Rather than continuing to dwell on this error, we thought it might be constructive to clarify the difference between an international service center and a satellite location. An international service center is a location where we have one or more Expeditors employees in a location to look after sales and customer service issues, but the operations in the location are done by a third party (our agent). The agent may be exclusive or non-exclusive with Expeditors, but these are places where we have enough business that it makes sense to have some direct Expeditors interaction with the customers and the rest of our network. Expeditors employees are always exclusively concerned with our interests.

A satellite office occurs in a country where we have an established Expeditors presence, but the office is under the supervision and control of another Expeditors office. Only Expeditors personnel will work in a satellite office and no agent will be involved. A satellite office is a distinctive part of an area already serviced by a full-service Expeditors office, it just is not quite ready to be a stand alone operation for one reason or another.

By way of example, Nicosia and Larnaca on the island of Cyprus are international service centers. The actual movement of the freight is handled by our agent, Access Global Logistics, Ltd., but we have Expeditors employees in these locations to handle sales and customer service issues. Our Milwaukee location is a satellite of our long established Chicago office. The employees in Milwaukee serve the needs of our Wisconsin customers, including all operations functions, but they do so under the direction of Chicago office. Their financial results roll up into those of the Chicago office. Because Milwaukee is a satellite there are some customers in the Milwaukee market, that will still deal directly with the Chicago office. Make Milwaukee a stand alone office and that would likely come to a halt.

After all that, our second quarter 2006 press release should have read 167 full-service offices, 56 satellite locations and 5 international service centers , but as you have pointed out, it did not.

10. You ve said in recent 8-Ks that your mix of business from end-markets is gradually expanding and diversifying beyond the core technology and retail markets to include other categories like furniture. Would you please provide an approximate update on what your current end-market mix is and what current demand trends are by end-market?

We don t track something like this over our entire customer base. What we do know is that our top 50 customers for July 2006 made up about 40% of our total net revenue. If these customers are indicative of the overall mix of the vast number that make the other 60% of our net revenue, and we don t really know if they are or are not, it would break out more or less as follows:

Hi-tech manufacturing	**38**	**%**
Retail	**28**	**%**
Manufacturing	**22**	**%**
Automotive	**5**	**%**
Oil and Gas	**3**	**%**
Furniture	**2**	**%**
Other	**2**	**%**
	100	**%**

11. What was the impact of option expense in the second quarter of 2006?

The best source for information with respect to stock option expense can be found in the 10-Q which was filed with the SEC on August 9, 2006. The raw numbers show that stock compensation for the second quarter of 2006 was $9,418,000, as compared with $9,576,000 for the same quarter of 2005. That said, we encourage you to take a look at the footnotes to the financials (Note 6) and the disclosures in the sections of MD&A entitled Critical Accounting Policies and Estimates and Results of Operations . There is more than enough detail there.

12. Selling and promotion expense was slightly higher relative to recent periods, were there any special initiatives in the second quarter of 2006?

Nothing new, we just did more of what we normally do. We had more meetings and we had more travel. As we add more business, participate in more proposals and chase more opportunities with an expanded sales force, there will be more money spent for sales related expenses. While the total amount of money increased, we watch the amount of money spent as a percentage of net revenue. Viewed in this light, the total was certainly within ranges we consider manageable and appropriate.

13. Are you having any problems finding capacity this summer in either aircraft or container ships?

No more than is usual for this time of year. Things are tightening, as things tend to do about now.

14. Why did rent and occupancy costs decline marginally for the second quarter of 2006 on a year over year basis? I would have thought with growth in the business, that these costs might have increased.

As we move into company-owned facilities in key gateway cities, we pay out less rent to third party landlords. We occupied company owned facilities in San Francisco in late 2005 and we moved into company owned facilities in Houston and Los Angeles in the second quarter of 2006. These were large locations where we were paying out a lot of rent in the second quarter of 2005. Of course, there is no such thing as free rent so we now have depreciation expense for the company owned facilities.

15. Could you/would you comment on business in July2006 relative to the second quarter and to last year s July?

We can and we will. Airfreight tonnage grew 17% in July 2006 when compared with 2005 and the ocean container count was up 21%.

16. I m a stockholder of Expeditors shares and I have noticed a substantial decline in the stock s value recently. However, I can t determine why the stock price has taken such a financial hit recently. All the information I read, or have access to, only presents positive information and in no way, in my opinion, *provides me with any clue as to why Expeditors share prices have declined so sharply. Can you give me any clues as to what has caused this substantial decline in your share price and do you expect the problem to continue?*

We also own shares in Expeditors and we noticed the same thing you did. We can t comment on why the price moves up or goes down, because we don t know.

As shareholders, we have to believe that over time, the market will value shares of stock, any stock, correctly. By correctly we mean that the price will reflect the true value of the underlying business. Having just said this, we want to point out an important, but often overlooked, fact: in the short term there can be a difference between the value of a business and the value of an investment.

We are not responsible for managing your investment, but we do worry a great deal about the business that you partially own. That business reported year over year profit increases of 69% in the first quarter of 2006. True enough this growth did decline to only a 53% increase in the second quarter of this year. The business is doing just fine, but as you note our stock currently trades at a price lower than what it was going for before we reported the first quarter results. You ask why and we have to say we have no idea.

What we do wonder is whether the new rules for accounting for stock options are at work on the stock value. We make this comment because some have noted that our P/E ratio was above the high side of the historical range. We think the reason for this was change in the stock option accounting rules. Given that Expeditors is the same company no matter whether the rules require stock option expensing or not, it is a mathematical fact that all else being equal, changing the accounting rules to drive down earnings (the E in a P/E ratio) raises the value of a constant price divided by earnings. Those who argue for a return to the historical P/E range are perhaps overlooking this fact.

Finally, we come to the fact that the market supposedly looks forward not backward and we ask is a 53% growth rate sustainable over any time period you might select? The answer is clearly no and we doubt that anyone could seriously ask such a question. So then is management saying that growth is slowing? No, what we are saying is that under our system we will do the best we can do. No more, and no less. If our collective best is ever disappointing, we ask does the problem really lie with the company or the folks setting the expectations?

17. Can Expeditors provide approximated restated third and fourth quarter 2005 levels reflecting stock option expense impact?

Sure, we were expecting to receive this question last quarter.

	Quarter ended September 30, 2005	**Quarter ended December 31, 2005**
Net Revenues:		
Airfreight	$ 100,536	$ 111,846
Ocean freight and ocean services	75,590	71,822
Customs brokerage and other services	105,799	112,673
Total net revenues	281,925	296,341
Operating expenses:		
Salaries and related costs:		
Salaries and related costs	145,629	152,706
Stock compensation expense	8,364	8,408
Others	50,496	50,787
Total operating expenses	204,489	211,901
Operating income	77,436	84,440
Other income, net	4,372	4,578
Earnings before income taxes and minority interest	81,808	89,018
Income tax expense	31,344	12,277
Net earnings before minority interest	50,464	76,741
Minority interest	(2,060)	(2,454)
Net earnings	$ 48,404	$ 74,287
Diluted earnings per share	$ 0.22	$ 0.34

Basic earnings per share