

EGL INC  
Form 10-Q  
August 09, 2006

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

[x]  
Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended June 30, 2006  
or  
[  
]  
Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from \_\_\_ to \_\_\_

**Commission File Number 0-27288**  
**EGL, INC.**  
(Exact name of registrant as specified in its charter)

**Texas** **76-0094895**  
(State or Other Jurisdiction of Incorporation or Organization) (IRS Employer Identification No.)

**15350 Vickery Drive, Houston, Texas 77032**  
**(281) 618-3100**

---

(Address of Principal Executive Offices, Including Registrant's Zip Code, and Telephone Number, Including Area Code)

N/A

---

Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report

Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days.

Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer.

Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Outstanding common stock of the registrant was 40,657,261 (net of 5,741,681 treasury shares).

---

**EGL, INC.**  
**INDEX TO FORM 10-Q**

**PART I. FINANCIAL INFORMATION**

**Item 1.**

**Financial Statements**

Condensed Consolidated Balance Sheets as of June 30, 2006 and December 31, 2005	1
Condensed Consolidated Statements of Income for the Six Months ended June 30, 2006 and 2005	2
Condensed Consolidated Statements of Income for the Three Months ended June 30, 2006 and 2005	3
Condensed Consolidated Statements of Cash Flows for the Six Months ended June 30, 2006 and 2005	4
Condensed Consolidated Statement of Stockholders' Equity for the Six Months ended June 30, 2006	5
Notes to Condensed Consolidated Financial Statements	6

**Item 2.**

<b>Management's Discussion and Analysis of Financial Condition and Results of Operations</b>	24
--	----

**Item 3.**

<b>Quantitative and Qualitative Disclosures About Market Risk</b>	36
---	----

**Item 4.**

<b>Controls and Procedures</b>	36
--------------------------------	----

<b>PART II. OTHER INFORMATION</b>	36
-----------------------------------	----

**Item 1.**

<b>Legal Proceedings</b>	36
--------------------------	----

<b>Item 1A. Risk Factors</b>	37
------------------------------	----

**Item 2.**

<b>Unregistered Sales of Equity Securities and Use of Proceeds</b>	38
--	----

**Item 3.**

<b>Defaults Upon Senior Securities</b>	38
--	----

**Item 4.**

**Submission of Matters to a Vote of Security Holders** 38

**Item 5.**

**Other Information** 38

**Item 6.**

**Exhibits** 40

**SIGNATURES** 41

**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS**

**EGL, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(unaudited)**

*(in thousands, except par values)*

	<b>June 30,</b>	<b>December 31,</b>
	<b>2006</b>	<b>2005</b>
<b>ASSETS</b>		
Current assets:	\$	\$
Cash and cash equivalents	134,776	111,507
Restricted cash	11,149	11,702
Trade receivables, net of allowance of \$11,311 and \$12,566	545,726	560,954
Other receivables	27,266	30,237
Income tax receivable	4,924	4,367
Deferred income taxes	9,528	10,626
Other current assets	34,379	25,045
Total current assets	767,748	754,438
Property and equipment, net	176,057	185,906
Goodwill	115,493	113,048
Other assets, net	53,846	35,849
	\$	\$
Total assets	1,113,144	1,089,241
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:	\$	\$
Trade payables and accrued transportation costs	333,401	342,351
Accrued salaries and related costs	54,593	51,541
Current portion of long-term debt	9,492	15,967

Edgar Filing: EGL INC - Form 10-Q

Income taxes payable	4,423	5,215
Accrued selling, general and administrative expenses and other liabilities	95,151	93,410
Total current liabilities	497,060	508,484
Deferred income taxes	22,854	22,736
Long-term debt	183,979	214,555
Other noncurrent liabilities	19,656	20,122
Total liabilities	723,549	765,897
Minority interests	2,005	1,616
Commitments and contingencies (Notes 6, 10 and 11)		
Stockholders' equity:		
Common stock, \$0.001 par value, 200,000 shares authorized; 46,394 and 45,771 shares issued; 40,652 and 39,966 shares outstanding	46	46
Additional paid-in capital	80,102	56,405
Retained earnings	423,946	398,036
Accumulated other comprehensive loss	(9,208)	(23,902)
Unearned compensation	-	(376)
Treasury stock, 5,742 and 5,805 shares held	(107,296)	(108,481)
Total stockholders' equity	387,590	321,728
	\$	\$
Total liabilities and stockholders' equity	1,113,144	1,089,241

See notes to unaudited condensed consolidated financial statements.

**EGL, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
**(unaudited)**

*(in thousands, except per share amounts)*

	<b>Six Months Ended</b>	
	<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>
	\$	\$
Revenues	1,523,656	1,481,920
Cost of transportation	1,036,782	1,031,992
Net revenues	486,874	449,928
Operating expenses:		
Personnel costs	274,959	261,124
Facility costs	46,759	45,849
Depreciation and amortization	16,569	17,783
Selling and promotion	9,956	10,442
EEOC legal settlement	-	(5,975)
General and administrative	90,232	85,979
Total operating expenses	438,475	415,202
Operating income	48,399	34,726
Interest expense	5,269	810
Interest income	(1,329)	(1,000)
Other	2,160	(1,672)
Total non-operating (income) expense	6,100	(1,862)
Income before provision for income taxes	42,299	36,588
Provision for income taxes	16,389	16,721
	\$	\$
Net income	25,910	19,867
	\$	\$
Basic earnings per share	0.64	0.39
Basic weighted-average common shares outstanding	40,297	51,328
Diluted earnings per share	\$	\$

Edgar Filing: EGL INC - Form 10-Q

	0.64	0.38
Diluted weighted-average common shares outstanding	40,802	51,692

See notes to unaudited condensed consolidated financial statements.



**EGL, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
**(unaudited)**

*(in thousands, except per share amounts)*

	<b>Three Months Ended</b>	
	<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>
	\$	\$
Revenues	771,293	781,254
Cost of transportation	521,620	544,758
Net revenues	249,673	236,496
Operating expenses:		
Personnel costs	140,363	135,922
Facility costs	23,668	22,807
Depreciation and amortization	7,658	9,149
Selling and promotion	6,102	5,348
General and administrative	45,364	42,267
Total operating expenses	223,155	215,493
Operating income	26,518	21,003
Interest expense	2,475	432
Interest income	(811)	(661)
Other	954	(2,036)
Total non-operating (income) expense	2,618	(2,265)
Income before provision for income taxes	23,900	23,268
Provision for income taxes	9,094	10,566
	\$	\$
Net income	14,806	12,702
	\$	\$
Basic earnings per share	0.37	0.25
Basic weighted-average common shares outstanding	40,496	50,614
Diluted earnings per share	\$	\$

Edgar Filing: EGL INC - Form 10-Q

	0.36	0.25
Diluted weighted-average common shares outstanding	40,936	50,863

See notes to unaudited condensed consolidated financial statements.

**EGL, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(unaudited)**  
*(in thousands)*

	<b>Six Months Ended</b>	
	<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>
Cash flows from operating activities:		
	\$	\$
Net income	25,910	19,867
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	16,569	17,783
Bad debt expense	1,627	3,306
Stock-based compensation expense	5,310	-
Amortization of unearned compensation	-	168
Impairment of assets	369	146
Deferred income tax expense (benefit)	2,767	(2,021)
Tax benefit of employee stock plans	-	1,196
Equity in losses of affiliates	142	43
Minority interests	571	(20)
Other	(377)	73
Changes in assets and liabilities, excluding business combinations:		
Decrease in trade receivables	24,288	36,565
Decrease in other receivables	4,337	3,355
Increase in other assets and liabilities	(11,707)	(10,824)
Increase (decrease) in payable and other accrued liabilities	(18,627)	15,574
Net cash provided by operating activities	51,179	85,211
Cash flows from investing activities:		
Capital expenditures	(17,830)	(25,569)
Decrease in restricted cash	593	7,585
Proceeds from sales of property and equipment	3,303	1,025
Proceeds from property insurance	517	-
Acquisition of business, net of cash acquired	(1,444)	-
Cash received from sale of unconsolidated affiliates	1,254	-

## Edgar Filing: EGL INC - Form 10-Q

Earnout payments	-	(4,186)
Other	296	1,423
Net cash used in investing activities	(13,311)	(19,722)
Cash flows from financing activities:		
Proceeds from issuance of debt	197,098	83,402
Repayment of debt	(232,541)	(52,641)
Issuance (repayment) of short-term debt with maturities of less than three months, net	(2,513)	1,773
Payment of financing fees	(90)	(15)
Repayment of financed insurance premiums and software maintenance	(2,603)	(1,516)
Payments on capital lease obligations	(1,123)	(863)
Repurchases of common stock	-	(93,588)
Proceeds from exercise of stock options	14,251	5,497
Excess tax benefit of employee stock plans	5,023	-
Issuance of common stock for employee stock purchase plan	613	535
Cash received from (dividends paid to) minority interest partners	(186)	453
Net cash used in financing activities	(22,071)	(56,963)
Effect of exchange rate changes on cash	7,472	2,839
Increase in cash and cash equivalents	23,269	11,365
Cash and cash equivalents, beginning of the period	111,507	92,918
	\$	\$
Cash and cash equivalents, end of the period	134,776	104,283

See notes to unaudited condensed consolidated financial statements.

**EGL, INC.**  
**CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY**  
**(unaudited)**

*(in thousands)*

	Common stock			Retained earnings	Accumulated other comprehensive income (loss)	Unearned compensation	Treasury stock		Total
	Shares	Amount	Additional paid-in capital				Shares	Amount	
Balance at December 31, 2005	45,771	\$ 46	\$ 56,405	\$ 398,036	\$ (23,902)	\$ (376)	(5,805)	(108,481)	\$ 321,728
Net income	-	-	-	25,910	-	-	-	-	25,910
Change in value of marketable securities, net	-	-	-	-	(2)	-	-	-	(2)
Minimum pension liability adjustment, net of tax	-	-	-	-	596	-	-	-	596
Change in fair value of cash flow hedge, net of tax	-	-	-	-	589	-	-	-	589
Foreign currency translation adjustments	-	-	-	-	13,511	-	-	-	13,511
Treasury shares issued under employee stock purchase plan	-	-	231	-	-	-	20	382	613
Exercise of stock options, including tax benefit	623	-	19,335	-	-	-	-	-	19,335
	-	-	(803)	-	-	-	43	803	-

Treasury shares issued for restricted stock awards									
Stock-based compensation expense	-	-	5,310	-	-	-	-	-	5,310
Reclass of unearned compensation upon adoption of SFAS 123R	-	-	(376)	-	-	376	-	-	-
		\$	\$	\$	\$	\$		\$	\$
Balance at June 30, 2006	46,394	46	80,102	423,946	(9,208)	-	(5,742)	(107,296)	387,590

See notes to unaudited condensed consolidated financial statements.

**EGL, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

The accompanying unaudited condensed consolidated financial statements have been prepared by EGL, Inc. (EGL or the Company) in accordance with the rules and regulations of the Securities and Exchange Commission (the SEC) for interim financial statements and, accordingly, do not include all information and footnotes required under generally accepted accounting principles for complete financial statements. The year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. The financial statements have been prepared in conformity with the accounting principles and practices disclosed in, and should be read in conjunction with, the annual audited financial statements of the Company included in the Company's Annual Report on Form 10-K (File No. 0-27288). In the opinion of management, these interim financial statements contain all adjustments (consisting only of normal recurring adjustments) necessary for a fair statement of the Company's financial position at June 30, 2006 and the results of its operations and cash flows for the three and six months ended June 30, 2006. Results of operations and cash flows for the three and six months ended June 30, 2006 are not necessarily indicative of the results that may be expected for EGL's full fiscal year.

**Note 1 - Organization, operations and summary of significant accounting policies**

EGL is a global transportation, supply chain management and information services company operating in one business segment and dedicated to providing flexible logistics solutions on a price competitive basis. The Company's services include air and ocean freight forwarding, customs brokerage, local pick up and delivery service, materials management, warehousing, trade facilitation and procurement, integrated logistics and supply chain management services. The Company provides services in over 100 countries on six continents through offices around the world as well as through its worldwide network of exclusive and nonexclusive agents. The principal markets for all lines of business are North America, Europe and Asia with significant operations in the Middle East, India, South America and South Pacific (see Note 14).

**Basis of presentation and principles of consolidation**

The accompanying condensed consolidated financial statements include EGL and all of its wholly-owned subsidiaries and investments which the Company controls, through majority ownership or other variable interests. All significant intercompany balances and transactions have been eliminated in consolidation. Investments in 50% or less owned affiliates, over which the Company has significant influence, are accounted for by the equity method. The Company has reclassified certain prior year amounts to conform to the current year presentation.

**Use of estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates that affect the amounts reported in the financial statements and accompanying notes. Management considers many factors in selecting appropriate operational and financial accounting policies and controls, and in developing the assumptions that are used in the preparation of these financial statements. Management must apply significant judgment in this process. Among the factors, but not fully inclusive of all factors

that may be considered by management in these processes are: the range of accounting policies permitted by accounting principles generally accepted in the United States of America; management's understanding of the Company's business both historical results and expected future results; expectations of the future performance of the economy, both domestically and globally, within various areas that serve the Company's principal customers and suppliers of goods and services; expected rates of change, sensitivity and volatility associated with the assumptions used in developing estimates; and whether historical trends are expected to be representative of future trends. The estimation process often times may yield a range of potentially reasonable estimates of the ultimate future outcomes and management must select an amount that lies within that range of reasonable estimates based upon the quantity, quality and risks associated with the variability that might be expected from the future outcome and the factors considered in developing the estimate. This estimation process may result in the selection of estimates that could be viewed as conservative or aggressive by others. Management attempts to use its business and financial accounting judgment in selecting the most appropriate estimate, however, actual amounts could and will differ from those estimates.



**EGL, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**Revenue recognition**

Domestic revenues and most domestic operating costs are recognized when shipments are picked up from the customer. International revenues and freight consolidation costs are recognized in the period when shipments are tendered to a carrier for transport to a foreign destination. This is one of the permissible methods under Emerging Issues Task Force (EITF) Issue No. 91-9, Revenue and Expense Recognition for Freight Services in Process. This method generally results in recognition of revenues and gross profit earlier than methods that do not recognize revenues until a proof of delivery is received. This method of revenue and cost recognition does not result in a material difference than if revenue and costs were recognized upon delivery. Customs brokerage and other revenues are recognized upon completing the documents necessary for customs clearance or completing other fee-based services. Revenues recognized as an indirect air carrier or an ocean freight consolidator include the direct carrier's charges to EGL for carrying the shipment. Revenues recognized in other capacities include only the commissions and fees received. The Company reports the costs of certain reimbursed incidental activities on a gross basis in revenues and cost of transportation.

**Stock-based compensation**

Stock-based compensation is accounted for in accordance with SFAS No. 123 (Revised) Share-Based Payment (SFAS 123R). The Company adopted SFAS 123R as of January 1, 2006. The Company establishes fair values for its equity awards to determine its cost and recognizes the related expense over the appropriate vesting period. The Company recognizes expense for stock options, restricted stock and shares issued under the Company's employee stock purchase plan. Before the adoption of SFAS 123R, the Company applied Accounting Principles Board No. 25, Accounting for Stock Issued to Employees, (APB 25) and related interpretations. See Note 4 for additional information related to stock-based compensation expense.

**New accounting pronouncements**

On January 1, 2006, the Company adopted SFAS No. 154, Accounting Changes and Error Corrections (SFAS No. 154). SFAS No. 154 replaces APB Opinion No. 20, Accounting Changes, and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements, and changes the requirements for the accounting for and reporting of a change in accounting principle. The adoption of SFAS No. 154 did not have a material impact on the Company's results of operations or its financial condition.

FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, was published July 18, 2006 clarifying FAS 109, Accounting for Income Taxes. FIN 48 sets the threshold for recognizing tax positions as more likely than not that the position will be sustained upon examination by the relevant taxing authorities. A position that meets the threshold shall be measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement. Subsequent de-recognition occurs during any period when the threshold is no longer met.

Interest and penalties otherwise applicable to the difference between the tax position recognized and the tax position taken on the return will be accrued and consistently reported in the financial statements. Additional disclosure will be required in tabular format showing changes to the tax benefits recognized during the period and the reason for such changes. The effective date is for fiscal years beginning after December 15, 2006. The Company is evaluating the interpretation but has not yet determined the impact, if any, this adoption will have on its financial statements.

## **Note 2 Business combination**

In January 2006, the Company acquired from our former agent, certain freight forwarding and customs brokerage operations in Colombia for approximately \$1.4 million, net of cash acquired. The Company recognized \$926,000 in goodwill, \$513,000 for customer relationships and \$150,000 for non-compete agreements in connection with these acquisitions. The purchase agreements for the acquisitions provided for additional contingent three-year earnout payments of up to \$1.1 million in the aggregate if certain post-acquisition performance criteria are achieved. The Company recorded the acquisitions above using the purchase method of accounting; with the related results of operations being included in the Company's consolidated financial statements from the date of acquisition forward. The pro forma

## EGL, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

effect on revenues and net income of the Company assuming these acquisitions were consummated at January 1, 2005 was immaterial.

**Note 3 - Earnings per share**

Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the three and six months ended June 30, 2006 and 2005. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. Stock options, shares issued under the employee stock purchase plan and restricted stock awards are the only potentially dilutive share equivalents the Company had outstanding for both periods presented.

The table below indicates the potential common shares issuable which were included for purposes of computing diluted earnings per common share (in thousands):

	Six Months Ended		Three Months Ended	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
	\$	\$	\$	\$
Net income used in diluted earnings per common share	25,910	19,867	14,806	12,702
Weighted-average common shares outstanding used in basic earnings per common share	40,297	51,328	40,496	50,614
Net dilutive potential common shares issuable on exercise of options, restricted stock awards and shares issued under the employee stock purchase plan	505	364	440	249
Weighted-average common shares and dilutive potential common shares used in diluted earnings per common share	40,802	51,692	40,936	50,863

Potential common shares issuable which were excluded from diluted potential common shares as their effect would be anti-dilutive were 1.5 and 1.2 million for six months ended June 30, 2006 and 2005, respectively; and 1.5 million and 1.4 million for three months ended June 30, 2006 and 2005, respectively. The shares are anti-dilutive because the assumed proceeds under the treasury stock method are greater than the average market price of the underlying shares.

**Note 4 - Stock-based compensation**

Stock-based awards are granted under the provisions of the following plans:

*Long-Term Incentive Plan*

The Long-Term Incentive Plan permits the award of stock options at an exercise price equal to the fair market value of the common stock on the date of grant, as defined in the plan. A maximum of 12.2 million shares is authorized for issuance under the plan. Options awarded under the plan generally vest ratably over a three-year or five-year period from date of grant (or 100% upon death). Vested options granted to date generally terminate seven years from date of grant. Additional awards may be granted under the Long-Term Incentive Plan in the form of cash, stock, or stock appreciation rights. The stock appreciation rights awards may consist of the right to receive payment in cash or common stock. Any such award may be subject to certain conditions, including continuous service with the Company or achievement of certain business objectives.

**EGL, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

*EGL Director Plan*

The Director Plan provides for an award to each non-employee director at the time they join the Board of either an option to purchase 10,000 shares of common stock or a number of shares of restricted stock, as determined at the discretion of the Board or a committee of the Board. In addition, each non-employee director serving on the day after the annual shareholders meeting will receive an award of an option to purchase 2,500 shares of common stock or a number of shares of restricted stock, as determined at the discretion of the Board or a committee of the Board. These awards vest on the earlier of the first anniversary of the date of award or the day preceding the annual meeting of shareholders following the award. The Board or a committee of the Board may also make additional awards under the Director Plan, including awards of restricted stock to nonemployee directors in lieu of cash payments of annual retainers or annual committee chair or lead director fees. A maximum of 400,000 shares are authorized to be issued under the plan.

*Stock purchase plan*

In 1999, the Company initiated an employee stock purchase plan (ESPP) to provide eligible employees of the Company and its participating subsidiaries, including subsidiaries based outside of the United States, with the opportunity to purchase the Company's common stock through payroll deductions. Employees may purchase common stock under this plan during a six-month offering period based on a formula provided in the plan document, which generally allows the Company's employees to purchase common stock at 85% of quoted fair market value. Under this plan, 550,000 shares are authorized for purchase. During the six months ended June 30, 2006 and 2005, 20,000 and 31,000 shares, respectively, of common stock were purchased under this plan.

In December 2004, the FASB issued SFAS 123R. SFAS 123R is a revision of SFAS No. 123, Accounting for Stock-Based Compensation, (SFAS 123) and supersedes APB 25. SFAS 123R eliminates the alternative of using the intrinsic value method of accounting that was provided in SFAS 123, which generally resulted in no compensation expense recorded in the financial statements related to the issuance of stock options or shares issued under the Company's ESPP. SFAS 123R requires that the cost resulting from all stock-based awards be recognized in the financial statements. SFAS 123R establishes fair value as the measurement objective in accounting for stock-based awards and requires all companies to apply a fair-value-based measurement method in accounting for generally all stock-based awards with employees.

The Company adopted SFAS 123R as of January 1, 2006 using the modified-prospective transition method. Under this transition method, compensation expense includes: a) compensation expense for all stock-based awards granted through January 1, 2006, but for which the requisite service period had not been completed as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and b) compensation expense for all stock-based awards granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. Results from prior periods have not been restated.

Prior to January 1, 2006, the Company accounted for stock-based awards to employees and non-employee directors using the intrinsic value method prescribed in APB 25. Under APB 25, the Company generally only recorded stock-based compensation expense for restricted stock and was not required to recognize compensation expense for the cost of stock options or shares issued under the Company's ESPP.

As a result of adopting SFAS 123R, the Company recognized stock-based compensation expense for stock options, restricted stock and shares issued under the ESPP of \$2.7 million or \$1.7 million after tax and \$5.3 million or \$3.2 million after tax in the three and six month periods ended June 30, 2006, respectively. The impact of stock-based compensation expense on basic and diluted earnings per share was \$0.04 and \$0.08 for the three and six month periods ended June 30, 2006, respectively. The following table illustrates the pro forma effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123 to stock-based awards for the three and six month periods ended June 30, 2005 (in thousands, except per share amounts):

## EGL, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

	<b>Six Months Ended June 30, 2005</b>	<b>Three Months Ended June 30, 2005</b>
	\$	\$
Net income as reported	19,867	12,702
Add: Total stock-based compensation expense included in net income, net of tax	91	49
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of tax	1,065	504
	\$	\$
Pro forma net income	18,893	12,247
Earnings per share:	\$	\$
Basic-as reported	0.39	0.25
Basic-pro forma	0.37	0.24
Diluted-as reported	0.38	0.25
Diluted-pro forma	0.37	0.24

*Stock Options*

Option awards issued under the Long-Term Incentive Plan are subject to a graded vesting over a service period of 3 or 5 years. Option awards issued under the EGL Director Plan generally are subject to vesting over a twelve-month period. In December 2005, the Company granted options to purchase 1.4 million shares to certain of its employees and executive officers with the number of options to be exercisable contingent upon satisfying performance vesting and time vesting criteria. The performance vesting of the option shares is determined based upon the Company's earnings per share (EPS) for the year ending December 31, 2006. Any portion of the option shares that do not satisfy the performance vesting criteria will terminate upon determining the EPS for 2006. The portion of the options that

satisfy the performance criteria will vest over a three year period with one third vesting in March 2007 upon determination of the EPS for 2006 with the remaining shares vesting in two equal installments in December 2007 and 2008. The Company believes it is probable that such performance criteria will be met and began recognizing expense on such options effective January 1, 2006. There was no compensation expense in 2005 for these stock-based awards.

Compensation costs for awards with service conditions only are recognized on a straight-line basis over the requisite service period for the entire award. Compensation costs for awards with performance and service conditions granted prior to the adoption of SFAS 123R are recognized on a straight-line basis over the requisite service period. For awards granted after January 1, 2006 with performance and service conditions, compensation cost will be recognized using the graded-vesting attribution method.

A summary of stock option transactions for the six months ended June 30, 2006 is as follows:

	<b>Options</b> (in thousands)	<b>Weighted average exercise price</b>	<b>Average remaining life in years</b>	<b>Aggregate intrinsic value</b> (in thousands)
		\$		\$
Outstanding at December 31, 2005	3,145	28.08		
Granted	144	43.79		
Exercised	(623)	22.88		
Cancelled or forfeited	(102)	26.86		
		\$		\$
Outstanding at June 30, 2006	2,564	30.28	5.74	50,986
		\$		\$
Exercisable at June 30, 2006	512	20.73	3.14	15,073



## EGL, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Options to purchase 144,000 shares of stock were issued during the six months ended June 30, 2006. The weighted-average fair values of options granted during the six months ended June 30, 2006 was \$19.42. The total intrinsic value of options exercised during the six months ended June 30, 2006 and 2005 was \$12.9 million and \$9.7 million, respectively. Option exercises are settled with newly issued shares of the Company's common stock.

A summary of the unvested shares as of December 31, 2005 and changes during the six months ended June 30, 2006 is as follows:

	Shares (in thousands)	Weighted average grant date price
		\$
Unvested at December 31, 2005	2,014	31.60
Granted	144	43.79
Vested	(24)	27.69
Cancelled or forfeited	(82)	27.55
		\$
Unvested at June 30, 2006	2,052	32.66

As of June 30, 2006, there was \$24.8 million of total unrecognized compensation cost related to unvested stock options granted under the Company's plans. That cost is expected to be recognized over a weighted-average period of 2.38 years. The total fair value of shares vested during the six months ended June 30, 2006 and 2005 was \$1.0 million and \$5.9 million, respectively.

The fair value of each option granted is estimated on the date of grant using the Black-Scholes model. Expected volatility is based on historical volatility of the Company's stock over a preceding period commensurate with the expected term of the option adjusted for future projected volatility. The expected term was determined using the simplified method described in SEC Staff Accounting Bulletin No. 107. The risk-free rate for the expected term of

the option is based on the U.S. Treasury rate with a maturity commensurate with the expected term of the option in effect at the time of the grant. Expected dividend yield was not considered in the option pricing formula as the Company does not pay dividends and has no plans to do so in the future. The weighted average assumptions used for grants in the six months ended June 30, 2006 are as follows:

Expected volatility	45.00%
Risk-free interest rate	4.74
Expected life of option (years)	4.50

*Restricted Stock*

The Company issues restricted stock to certain executive officers and other key employees under the Long-Term Incentive Plan. The Company issued 37,500 shares of restricted common stock to its executive officers and other key employees on March 16, 2006. One-fifth of the restricted shares vested in March 2006. The remaining restricted shares will then vest in four equal installments in December of the years 2006 through 2009. Upon vesting, the shares of common stock of the Company awarded as set forth above shall have no further restrictions. In addition, restricted stock is issued to the Company's Board of Directors under the EGL Director Plan generally with a twelve-month vesting period. The Company issued 6,700 shares of restricted common stock under the Director Plan on May 16, 2006.

## EGL, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The fair value of restricted stock is the excess of the average market price or closing price of the Company's common stock at the date of grant over the exercise price, which is zero. Under the provisions of SFAS 123R, the recognition of unearned compensation at the date restricted stock is granted is no longer required. Therefore, the amount that had been in unearned compensation expense as of January 1, 2006 was reclassified into additional paid-in capital.

A summary of restricted stock transactions for the six months ended June 30, 2006 is as follows:

	Restricted stock (in thousands)	Weighted average grant price \$	Average remaining life in years	Aggregate intrinsic value (in thousands)
Outstanding at December 31, 2005	25	22.59		
Granted	44	43.83		
Vested	(22)	45.92		
Cancelled or forfeited	-	-		
		\$		\$
Outstanding at June 30, 2006	47	40.46	2.86	2,214

The weighted-average fair values of restricted stock granted during the six months ended June 30, 2006 was \$43.83. The total intrinsic value of restricted stock released during the six months ended June 30, 2006 was \$999,000. As of June 30, 2006, there was \$2.0 million of total unrecognized compensation cost related to restricted stock. That cost is expected to be recognized over a weighted-average period of 2.86 years. The Company generally issues shares for restricted stock and shares under the ESPP from treasury shares.

**Note 5 - Comprehensive income**

Components of comprehensive income are as follows (in thousands):

**Six Months Ended****Three Months Ended**

	<b>June 30,</b>		<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	\$	\$	\$	\$
Net income	25,910	19,867	14,806	12,702
Foreign currency translation adjustments	13,511	(7,899)	9,948	(4,303)
Marketable securities, net	(2)	(2)	(9)	(2)
Minimum pension liability adjustment, net of tax	596	-	-	-
Fair value of cash flow hedge, net of tax	589	-	213	-
	\$	\$	\$	\$
Comprehensive income	40,604	11,966	24,958	8,397

**Note 6 Future lease obligations**

The Company maintains facility accruals for its remaining lease obligations under noncancelable operating leases at domestic and international locations that the Company has vacated and consolidated due to excess capacity resulting from the Company having multiple facilities in certain locations and changing business needs. All lease costs for facilities being consolidated were charged to operations until the date that the Company vacated each facility.

Non-merger restructuring facility accruals are included in other liabilities and other non-current liabilities on the condensed consolidated balance sheet. The changes in these accruals during the six months ended June 30, 2006 are as follows:

**EGL, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

	<b>Future lease obligations, net of subleasing income</b>
	(in thousands)
Accrued liability at December 31, 2005	\$
	5,066
Additions	136
Revisions to estimates	56
Payments	(470)
Accrued liability at June 30, 2006	\$
	4,788

Amounts recorded for future lease obligations are net of approximately \$15.9 million in anticipated future recoveries from actual sublease agreements and \$8.8 million from expected sublease agreements as of June 30, 2006. Sublease income has been anticipated only in locations where sublease agreements have been executed as of June 30, 2006 or are deemed probable of execution. The Company's lease agreements for these facilities expire from 2006 to 2025 and sublease agreements expire from 2006 to 2012. There is a risk that subleasing transactions will not occur within the same timing or pricing assumptions made by the Company, or at all, which could result in future revisions to these estimates.

**Note 7 Accrued selling, general and administrative expenses and other liabilities**

Accrued selling, general and administrative expenses and other liabilities consist of the following amounts (in thousands):

**June 30,                      December 31,**

Edgar Filing: EGL INC - Form 10-Q

	<b>2006</b>	<b>2005</b>
General and administrative expense accruals	\$ 28,424	\$ 30,321
Insurance payable	24,083	18,609
Other current liabilities	19,567	16,134
Accrued professional fees and legal matters	13,332	16,623
Other accrued taxes	6,396	7,205
Accrued interest	2,067	2,251
Vacant facilities accruals	1,282	2,267
Total	\$ 95,151	\$ 93,410

**Note 8 Debt**

Debt consists of the following amounts (in thousands):

	<b>June 30,</b>	<b>December 31,</b>
	<b>2006</b>	<b>2005</b>
	\$	\$
Senior floating rate secured notes	100,000	100,000
Borrowings on revolving line of credit	62,200	93,800
Financed vehicles	21,236	18,012
Borrowings on international credit facilities	2,661	7,347
Mortgage payable	2,383	2,040
Financed software licenses and maintenance	672	1,859
Financed insurance premiums	588	1,740
Notes payable to sellers	400	400
Other debt	3,331	5,324
Total debt	193,471	230,522
Current portion of debt	9,492	15,967
Long-term debt	\$	\$

183,979

214,555

**EGL, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**Amended and Restated Credit Agreement**

The Company entered into an agreement dated as of September 30, 2005 establishing a \$300 million, senior secured revolving credit facility (the Amended and Restated Credit Agreement). The Amended and Restated Credit Agreement amends and restates the Company's prior revolving credit agreement dated as of September 15, 2004, as previously amended (the Prior Credit Agreement). The Amended and Restated Credit Agreement is with a syndicate of 13 financial institutions with Bank of America, N.A., as lender and administrative agent and matures on September 30, 2010.

The Company may use borrowings under the Amended and Restated Credit Agreement for working capital, capital expenditures and other lawful corporate purposes, to make permitted acquisitions and investments, to pay dividends subject to certain limitations and to repurchase its common stock.

Amounts borrowed under the Amended and Restated Credit Agreement are guaranteed by all of the Company's existing and future direct and indirect domestic subsidiaries and secured equally and ratably by:

-

all of the Company's present and future shares of capital stock of (or other ownership or profit interests in) each of its present and future subsidiaries (limited, in the case of certain material first-tier foreign subsidiaries, to a pledge of 65% of the capital stock of such subsidiaries);

-

all of the Company's and each of its domestic subsidiaries' present and future property and assets; and

-

all proceeds and products of the property and assets described above.

Loans under the Amended and Restated Credit Agreement will initially bear interest at a rate per annum equal to either, at the Company's option, (1) LIBOR plus 1.25% or (2) the Base Rate (defined as the higher of Bank of



America, N.A. s prime rate or 0.50% over the Federal Funds rate). In addition, the Company is initially required to pay a commitment fee of 0.30% on the undrawn amounts under the Amended and Restated Credit Agreement.

Interest rates and commitment fees under the Amended and Restated Credit Agreement are subject to increase or decrease as a function of the ratio of the Company s Consolidated Net Funded Indebtedness to Consolidated EBITDA (each as defined in the Amended and Restated Credit Agreement). The Company may select interest periods of one, two, three or six months for LIBOR loans, subject to availability. Interest will be payable at the end of the selected interest period, but no less frequently than quarterly.

Under the Amended and Restated Credit Agreement, the Company is subject to various covenants, including, among others, the following:

-

a requirement that the Company maintain, on a rolling four-quarter basis, a ratio of Consolidated Net Funded Indebtedness to Consolidated EBITDA (each as defined in the Amended and Restated Credit Agreement) of not greater than 3.5 to 1.0 through December 31, 2006, and decreasing to 3.0 to 1.0 thereafter;

-

a requirement that, on a rolling four-quarter basis, the Company have a ratio of Consolidated EBIT to Consolidated Interest Charges (each as defined in the Amended and Restated Credit Agreement) of at least 2.5 to 1.0 through December 31, 2006 and increasing to 3.0 to 1.0 thereafter;

-

a requirement that, at the end of each fiscal quarter, the Company have a ratio of book accounts receivable by the Company and its subsidiaries to Consolidated Net Funded Indebtedness (as defined in the Amended and Restated Credit Agreement) of at least 1.1 to 1.0; and

-

limitations on, among other things, liens indebtedness, asset sales, dividends and stock redemptions, investments and acquisitions, transactions with affiliates and consolidations, mergers and sales of all or a substantial part of the Company s consolidated assets.

**EGL, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

The Amended and Restated Credit Agreement contains events of default customary for an agreement of this type. The occurrence of certain specified internal control events that could reasonably be expected to have a material adverse effect on the Company also constitutes an event of default under the Amended and Restated Credit Agreement. If a default occurs and is continuing, the administrative agent may, among other things, declare all outstanding principal amounts immediately due and payable.

The Amended and Restated Credit Agreement contains a \$75 million sub-facility for letters of credit. At June 30, 2006, the Company had borrowings of \$62.2 million, \$16.6 million in letters of credit outstanding and unused borrowing capacity of \$221.2 million under the Amended and Restated Credit Agreement.

**Note Purchase Agreement**

On October 12, 2005, the Company entered into a note purchase agreement (the Note Purchase Agreement) providing for the issuance and sale of \$100 million aggregate principal amount of floating rate, senior secured notes due October 12, 2012 (the Notes) to the purchasers named therein. Banc of America Securities LLC acted as placement agent for this offering. The issuance and sale of the Notes by the Company, and the resale of the Notes by Banc of America Securities LLC was made pursuant to one or more exemptions from the registration requirements of the Securities Act of 1933.

The Notes are guaranteed by all of the Company's existing and future direct and indirect domestic subsidiaries and are secured by:

-

all of the Company's present and future shares of capital stock of (or other ownership or profit interests in) each of its present and future subsidiaries (limited, in the case of certain material first-tier foreign subsidiaries, to a pledge of 65% of the capital stock of such subsidiaries);

-

all of the Company's and each of its domestic subsidiaries' present and future property and assets; and

-

all proceeds and products of the property and assets described above.

The Notes rank pari passu in right of payment with the Company's obligations under its Amended and Restated Credit Agreement and the obligations of the Company's guarantor subsidiaries to guarantee the Company's obligations under the Note Purchase Agreement rank pari passu in right of payment with their guarantees in respect of the Amended and Restated Credit Agreement.

Interest on the Notes will accrue at a floating rate per annum equal to LIBOR plus 1.65% for the applicable interest period. Interest periods are defined as the three month period commencing on the closing date and each successive three month period thereafter. Interest on the Notes is payable quarterly in arrears on the last day of each interest period.

Under the Note Purchase Agreement, the Company is subject to various covenants, including, among others, the following:

-

a requirement that the Company maintain, on a rolling four-quarter basis, a ratio of Consolidated Net Debt to Consolidated EBITDA (each as defined in the Note Purchase Agreement) of not greater than 3.5 to 1.0;

-

a requirement that the Company maintain, on a rolling four-quarter basis, a ratio of Consolidated EBIT to Consolidated Interest Expense (each as defined in the Note Purchase Agreement) of at least 2.5 to 1.0;

-

a requirement that the Company have, at all times, a ratio of (x) book accounts receivable of the Company and certain subsidiaries to (y) Consolidated Net Debt (as defined in the Note Purchase Agreement) of at least 1.1 to 1.0;

**EGL, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

-

a requirement that the Company not, at any time, permit the aggregate amount of all Priority Debt (as defined in the Note Purchase Agreement) to exceed 10% of its Consolidated Net Worth (as defined in the Note Purchase Agreement) as of the most recently ended fiscal quarter; and

-

limitations on, among other things, liens asset sales, dividends and stock redemptions, investments and acquisitions, transactions with affiliates and consolidations and mergers.

The Note Purchase Agreement contains customary events of default. If a default occurs and is continuing, the Notes then outstanding shall (either automatically or by declaration of the holders of more than 50% of the principal amount of Notes then outstanding, depending upon the circumstances resulting in the default) become immediately due and payable. If an event of default occurs and is continuing because the Company failed to pay principal, interest or other amounts due and payable on the Notes, then any Note holder may declare all of the Notes held by it to be immediately due and payable.

**International credit facilities and other debt**

As of June 30, 2006, the Company had \$25.3 million of borrowing capacity on international credit facilities and \$2.7 million outstanding against those facilities. Borrowings under international bank lines of credit are generally renewed upon expiration. The notes payable to seller is composed of a note payable to the former owners of the Company's operations in Thailand, which is payable in annual installments of \$200,000 through 2008. As of June 30, 2006, the Company has \$588,000 outstanding under financed insurance premiums payable in monthly installments of approximately \$196,000 through September 2006. Financed software licenses and maintenance are payable in quarterly installments of approximately \$234,000 and \$265,000 in September and December 2006, respectively and \$175,000 in March 2007. Loans for financed vehicles are payable in monthly payments totaling approximately \$355,000 through July 2011 and have implied interest rates averaging 7.2%.

**Note 9 Interest rate swap**

In November 2005, the Company entered into an interest rate swap transaction with a third-party financial institution to hedge its exposure to changes in the fair value of the Company's \$100 million floating rate, senior secured notes, which has been designated as a fair value hedge under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended by SFAS 149. In accordance with the swap agreement, the notional amount stepped

down to \$75 million in April 2006.

The fair value of the Company's interest rate swap agreement recorded as a derivative asset and included in other assets, net on the Company's condensed consolidated balance sheet totaled approximately \$727,000 as of June 30, 2006, and recorded as a derivative liability and included in other noncurrent liabilities in the Company's condensed consolidated balance sheet totaled approximately \$301,000 as of December 31, 2005. The change in the mark-to-market valuation is a component of other comprehensive income (see Note 5). The interest rate swap expires in January 2009.

**Note 10 Guarantees**

The Company guarantees certain financial liabilities, the majority of which relate to the Company's freight forwarding operations. The Company, in the normal course of business, is required to guarantee certain amounts related to customs bonds and services received from airlines. These types of guarantees are usual and customary in the freight forwarding industry. The Company operates as a customs broker and prepares and files all formal documentation required for clearance through customs agencies, obtains customs bonds, facilitates the payment of import duties on behalf of the importer and arranges for payment of collect freight charges. The Company also assists the importer in obtaining the most advantageous commodity classifications, qualifying for duty drawback refunds and arranging for surety bonds for importers.

**EGL, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

The Company secures guarantees primarily by three methods: a \$75 million standby letter of credit subfacility (Note 8), surety bonds and security time deposits, which are restricted as to withdrawal for a specified timeframe and are classified on the Company's balance sheet as restricted cash.

The Company issues IATA (International Air Transportation Association) related guarantees, customs bonds and letters of credit in the normal course of business. IATA-related guarantees and customs bonds are issued to facilitate the movement and clearance of freight. Letters of credit include, but are not limited to, facilities associated with insurance requirements and certain potential tax obligations. Generally, letters of credit have one-year or two-year terms and are renewed upon expiration. As of June 30, 2006, total IATA-related guarantees, customs bonds and letters of credit were approximately \$92.9 million. Approximately \$66.3 million of guarantees, customs bonds and letters of credit were outstanding, including guarantees of the Company's trade payables and accrued transportation costs and borrowings against its international credit facilities of \$14.2 million which were recorded as liabilities on the Company's consolidated balance sheet.

**Note 11 Contingencies**

**Litigation**

One former and two current independent contractor pickup and delivery ( P&D ) drivers filed a complaint in California state court on September 12, 2005, on behalf of themselves and similarly situated drivers in California alleging various causes of action based on their theory that the drivers are employees and not independent contractors. The complaint requests (i) that the matter be designated as a class action on behalf of all independent contractor P&D drivers working for the Company in California; (ii) a declaratory judgment that the Company has violated the law; (iii) an equitable accounting; and (iv) an unspecified amount of damages and restitution in the form of business expenses, unpaid overtime, meal period compensation, unlawful deductions from wages, statutory penalties, interest, attorneys' fees and costs. The Company removed the case to federal district court for the Northern District of California, and the parties have agreed to focus only on the individual claims of the three named defendants in the first phase of the proceedings. In the event one or more of the plaintiffs' claims survive the summary judgment phase, the next phase would focus on whether the action is maintainable as a class action. The Company intends to vigorously defend this lawsuit and believes that plaintiffs are properly classified as independent contractors.

**Other legal matters**

In addition, the Company is party to routine litigation incidental to its business, which primarily involves employment matters or claims for goods lost or damaged in transit or improperly shipped. Many of the other lawsuits to which the Company is a party are covered by insurance and are being defended by Company's insurance carriers. The Company has established accruals for these other matters and it is management's opinion that the resolution of such litigation will not have a material adverse effect on the Company's consolidated financial position, results of operations or cash

flows. However, a substantial settlement payment or judgment in excess of the Company's accruals could have a material adverse effect on its consolidated results of operations or cash flows.

**U.K. fire damage**

On January 9, 2005, the Company's London (Thurrock) warehouse and all contents were destroyed by fire. At the time of the fire, the Company maintained insurance coverage for damaged property, business interruption and cargo losses with insurance limits of \$35 million for damaged property and business interruption and \$10 million for cargo losses.

In March 2006, the Company received a payment of \$517,000 on its property insurance claim which resulted in a gain of \$324,000 in the accompanying condensed consolidated statement of income. On March 31, 2006, the Company resolved its outstanding business interruption claim with its insurance carrier. The total agreed amount was \$3.1 million which includes the \$928,000 interim payment received in May 2005. The outstanding payment of \$2.2 million, of which

**EGL, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

\$223,000, \$1.5 million and \$483,000 were recorded in revenues, personnel costs and other selling, general and administrative expenses, respectively, was received on May 4, 2006.

As of June 30, 2006, \$4.7 million of cargo claims have been settled under the Company's insurance policy. An additional estimated \$6.4 million of claims remain open of which \$5.3 million is deemed probable of recovery under the Company's insurance policy. As of June 30, 2006, the Company has recorded a liability of \$1.1 million for the estimated claims in excess of its insurance policy limits, of which \$46,000 and \$213,000 was expensed in the first and second quarters of 2006, respectively. At June 30, 2006, a \$5.3 million insurance receivable and a \$6.4 million insurance liability for these estimated cargo losses were included in the Company's condensed consolidated balance sheet. However, existing claims could be settled in excess of the Company's insurance limits, which could have a material adverse impact on its financial position, cash flows and results of operations.

**U.S. Government billing**

During 2003 and 2004, the Company acted as a logistics subcontractor in the Middle East to Kellogg Brown & Root, Inc. (KBR), which as general contractor provided various services to the U.S. Department of Defense (DOD) and other U.S. government agencies. In 2004, the Company received an administrative subpoena from the Office of Inspector General of the DOD requesting documents relating to the billing of war risk surcharges by the Company on certain shipments of KBR freight in the period from late 2003 to mid-2004. The Company has cooperated fully with the government's request and its investigation. In the course of its internal investigation of the matter, the Company reviewed documents related to the imposition of war risk surcharges on it by transportation providers. The Company uncovered evidence suggesting that certain documents related to the imposition of war risk surcharges on the Company, that were then charged to KBR, were false and the charges were not warranted. Following this discovery, and with approval from the government, the Company engaged auditors to conduct a forensic analysis of war risk surcharges charged by the Company. This analysis concluded that approximately \$1.1 million of war risk surcharges charged by the Company were not actually imposed on the Company by transportation providers. The Company provided the results of this investigation to the government and promptly terminated two employees for violation of the Company's Code of Conduct.

As a result of discussions with the government, we received a letter from the United States Attorneys Office for the Eastern District of Texas on December 12, 2005, offering to settle the war risk surcharge issue for the sum of \$4.0 million. Of the \$4.0 million, \$1.1 million reimburses the government for war risk surcharges (the full amount of which had been previously reserved in EGL's financial statements), and the remaining \$2.9 million represents penalties for improper billings. EGL entered into a settlement agreement with the government in accordance with the letter on June 5, 2006 and paid the \$4.0 million on June 21, 2006. Recognizing EGL's cooperation in and assistance with the government's review, as part of the settlement the United States Attorneys Office and the Defense Criminal Investigative Service agreed to waive all investigatory expenses. In addition, the United States Attorneys Office for the Eastern District of Texas is not expected to recommend to the DOD or the Department of Justice any criminal indictment of the Company related to the war risk surcharges.



**Federal income tax audit**

The Company's U.S. federal income tax returns from fiscal years 2000 to 2001 are currently subject to examination by the Internal Revenue Service (IRS). The case has been with the Appeals Division of the IRS since June 2005 with settlement discussions continuing.

The income tax returns that are under audit are the income tax returns filed by EGL for fiscal years ended September 30, 2000, September 30, 2001, December 31, 2001, and the final income tax return filed by Circle International Group, Inc., a subsidiary of EGL, Inc., for the fiscal year ended October 2, 2000, when it was a separate company prior to the merger with EGL, Inc.

Specifically, the IRS is proposing to disallow various merger transaction costs taken as tax deductions related to the merger of EGL and Circle, and to allocate certain merger and selling, general and administrative expenses to all of its

## EGL, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

foreign affiliates which were taken as tax deductions on the 2000 and 2001 fiscal return years for both EGL and Circle. The IRS is also proposing to disallow the deduction of various software research and development expenditures that were taken as tax deductions on the 2000 and 2001 fiscal tax returns for EGL.

If the proposed adjustments were upheld, the Company would be required to pay a total amount of approximately \$14 million in cash taxes, of which approximately \$6.5 million would impact the consolidated statement of income, plus accrued interest of approximately \$5.7 million through June 30, 2006. The remaining cash tax impact of \$7.5 million is related to temporary items that will be recovered in future periods. No penalties have been proposed by the IRS as part of this examination. Interest will continue to accrue until the matters are resolved. The Company believes that the matters raised by the IRS were properly reported on its U.S. federal income tax returns in accordance with applicable laws and regulations in effect during the tax periods involved and is challenging these adjustments vigorously. While the outcome of proceedings for these matters cannot be predicted with certainty, the Company believes that its U.S. federal income tax returns were completed in accordance with applicable laws and regulations and does not believe material adjustments to its tax returns are probable at this time. However there is no assurance that the final outcome of the future proceedings with the IRS will not result in material adjustments which would have a material adverse impact on the Company's results of operations, financial position and cash flows.

**Note 12 Employee benefit plans**

The Company maintains the EGL, Inc. 401(k) Plan pursuant to which the Company provides up to dollar for dollar discretionary matching of employee tax-deferred savings up to a maximum of 5% of eligible compensation for employees in the United States. Each participant vests in the Company's contribution over the course of five years at a vesting rate of 20% per year. During the three months and six months ended June 30, 2006, the Company funded the 2005 discretionary contribution to the plan of \$2.0 million.

Certain of our international subsidiaries sponsor defined benefit pension plans covering certain full-time employees. Benefits are based on the employee's years of service and compensation. The Company's plans are funded in conformity with the funding requirements of applicable government regulations of the country in which the plans are located. These foreign plans are not subject to the United States Employee Retirement Income Security Act of 1974. Components of compensation expense consisted of the following (in thousands):

	<b>Six Months Ended</b>		<b>Three Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Net benefit cost for defined benefit plans:				

Edgar Filing: EGL INC - Form 10-Q

	\$	\$	\$	\$
Service cost	1,119	1,191	715	689
Interest cost	1,009	1,132	648	672
Expected return on plan assets	(991)	(1,106)	(625)	(658)
Recognized gains and losses	25	7	11	6
Amortization of prior service cost	177	180	134	105
Net pension enhancement and curtailment/ settlement expense	-	(2)	4	6
	\$	\$	\$	\$
Net benefit cost for defined benefit plans	1,339	1,402	887	820
	\$	\$	\$	\$
Contributions to benefit plans	1,123	1,294	254	354

Estimated contributions to the defined benefit plans for the period of July 1 to December 31, 2006 are approximately \$331,000.

**EGL, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**Note 13 Related party transactions**

**Aircraft usage payments**

In conjunction with the Company's business activities, the Company periodically utilized aircraft owned or leased by entities that are controlled by James R. Crane, the Company's Chief Executive Officer. In January 2005, the Company purchased from an unrelated party an aircraft that was previously leased by an entity controlled by Mr. Crane for \$12.5 million to be utilized for business travel, eliminating the use of Mr. Crane's aircraft and reimbursement thereof.

For 2006, the Compensation Committee of the Board of Directors of the Company approved, in lieu of incremental cash compensation, an arrangement to provide Mr. Crane, or his designees, with up to an aggregate of 141.3 hours of personal use of the Company's aircraft without reimbursement by Mr. Crane. In the three months and six months ended June 30, 2006, Mr. Crane used 25.6 and 53.6 hours, respectively. Members of the Company's Board of Directors are also allowed personal usage of the Company's aircraft subject to availability, with priority given to the Company's usage, and the cumulative number of hours allowed for all directors may not exceed 100 hours per year. In the six months ended June 30, 2006, the directors did not utilize the company plane. The Company intends to include usage of its aircraft as taxable income as required by current U.S. federal income tax regulations for Mr. Crane and each director. The U.S. federal income tax regulations also restrict the amount of corporate tax deductions for operating costs and tax depreciation attributable to personal use of the company plane. The amount of non-deductible personal use expense is reduced by the imputed income recognized by the employee.

In the second quarter of 2006, the Company made a decision to sell the aircraft as it was not utilized to the extent anticipated when purchased. The sale is expected to be completed by the end of 2006. As of June 30, 2006, the Company had designated the aircraft as an asset held for sale. The Company reclassified \$11.4 million, which represents the net realizable value of the aircraft as of June 30, 2006, from property, plant and equipment to assets held for sale. The Company recognized an impairment loss on the asset of \$369,000, which is the difference of the carrying value of the asset and the net realizable value of the asset at June 30, 2006. The asset held for sale is included in other assets, net on the Company's condensed consolidated balance sheet.

**Shared employees**

Certain of the Company's employees also perform services for unaffiliated companies owned by Mr. Crane. The Company is reimbursed for these services based upon an allocation percentage of total salaries agreed to by the Company and Mr. Crane. During the six months ended June 30, 2006 and 2005, the Company was reimbursed \$31,000 and \$101,000, respectively. The Company received reimbursements of \$23,000 and \$26,000 for the quarter ended June 30, 2006 and 2005, respectively. The amount billed but not received as of June 30, 2006 was \$31,000 and is included in other receivables on the consolidated balance sheets.

**Note 14 Business segment information**

The Company is organized functionally in geographic operating segments. Accordingly, management focuses its attention on revenues, net revenues, income before taxes, identifiable assets, capital expenditures and depreciation and amortization in each of these geographical divisions when evaluating the effectiveness of geographic management.

## EGL, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Financial information regarding the Company's operations by geographic division for the six and three months ended June 30, 2006 and 2005 is as follows (in thousands):

	North America	South America	Europe, Middle East & Africa	Asia & South Pacific	Eliminations	Total Reportable Segments
Six months ended June 30, 2006:	\$	\$	\$	\$	\$	\$
Total revenues	678,765	48,184	304,071	528,204	(35,568)	1,523,656
Interdivision revenues	(13,234)	(2,921)	(7,923)	(11,490)	35,568	-
	\$	\$	\$	\$	\$	\$
Revenues from external customers	665,531	45,263	296,148	516,714	-	1,523,656
	\$	\$	\$	\$	\$	\$
Total net revenues	288,892	16,925	102,982	78,075	-	486,874
Intercompany (income) expense	(1,371)	(1,589)	(1,894)	4,854	-	-
	\$	\$	\$	\$	\$	\$
Net revenues	287,521	15,336	101,088	82,929	-	486,874
	\$	\$	\$	\$		\$
Income before taxes	40,251	412	13,834	13,769		68,266
	\$	\$	\$	\$		\$
Capital expenditures	13,678	772	2,672	1,107		18,229
Depreciation and amortization expense	\$	\$	\$	\$		\$
	7,696	453	2,329	2,070		12,548

Six months ended June 30,  
2005:

Edgar Filing: EGL INC - Form 10-Q

	\$	\$	\$	\$	\$	\$
Total revenues	674,658	54,496	328,249	457,686	(33,169)	1,481,920
Interdivision revenues	(10,779)	(2,837)	(9,243)	(10,310)	33,169	-
	\$	\$	\$	\$	\$	\$
Revenues from external customers	663,879	51,659	319,006	447,376	-	1,481,920
	\$	\$	\$	\$	\$	\$
Total net revenues	272,003	12,680	95,563	69,682	-	449,928
Intercompany (income) expense	1,848	(1,478)	(2,773)	2,403	-	-
	\$	\$	\$	\$	\$	\$
Net revenues	273,851	11,202	92,790	72,085	-	449,928
	\$	\$	\$	\$		\$
Income (loss) before taxes	26,845	827	(1,945)	12,995		38,722
	\$	\$	\$	\$		\$
Capital expenditures	9,295	222	1,068	2,167		12,752
Depreciation and amortization expense	\$	\$	\$	\$		\$
	10,166	291	2,138	2,088		14,683

## EGL, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

	North America	South America	Europe, Middle East & Africa	Asia & South Pacific	Eliminations	Total Reportable Segments
Three months ended June 30, 2006:	\$	\$	\$	\$	\$	\$
Total revenues	346,448	24,705	152,306	265,548	(17,714)	771,293
Interdivision revenues	(6,595)	(1,502)	(3,875)	(5,742)	17,714	-
	\$	\$	\$	\$	\$	\$
Revenues from external customers	339,853	23,203	148,431	259,806	-	771,293
	\$	\$	\$	\$	\$	\$
Total net revenues	146,238	8,872	54,901	39,662	-	249,673
Intercompany (income) expense	(649)	(813)	(838)	2,300	-	-
	\$	\$	\$	\$	\$	\$
Net revenues	145,589	8,059	54,063	41,962	-	249,673
	\$	\$	\$	\$		\$
Income before taxes	20,437	283	8,331	8,207		37,258
	\$	\$	\$	\$		\$
Capital expenditures	7,313	442	2,401	630		10,786
Depreciation and amortization expense	\$	\$	\$	\$		\$
	3,348	171	1,128	994		5,641
Three months ended June 30, 2005:						
Total revenues	\$	\$	\$	\$	\$	\$



Edgar Filing: EGL INC - Form 10-Q

	351,164	29,603	171,340	246,822	(17,675)	781,254
Interdivision revenues	(5,790)	(1,552)	(4,973)	(5,360)	17,675	-
	\$	\$	\$	\$	\$	\$
Revenues from external customers	345,374	28,051	166,367	241,462	-	781,254
	\$	\$	\$	\$	\$	\$
Total net revenues	142,482	7,005	50,060	36,949	-	236,496
Intercompany (income) expense	368	(670)	(1,573)	1,875	-	-
	\$	\$	\$	\$	\$	\$
Net revenues	142,850	6,335	48,487	38,824	-	236,496
	\$	\$	\$	\$		\$
Income (loss) before taxes	17,721	305	1,395	6,573		25,994
	\$	\$	\$	\$		\$
Capital expenditures	4,088	148	684	1,637		6,557
Depreciation and amortization expense	\$	\$	\$	\$		\$
	5,222	152	1,109	1,118		7,601

Revenues from transfers between divisions represent approximate amounts that would be charged if an unaffiliated company provided the services. Revenues and expenses for geographic divisions include 100 percent of amounts for unconsolidated affiliates directly involved in freight forwarding activities. Total divisional revenues are reconciled with total consolidated revenues by eliminating inter-divisional revenues and revenues and expenses for unconsolidated affiliates. Income (loss) before taxes by geographic division includes profits (losses) on intercompany transactions.

Performance measurement and resource allocation for the reportable segments are based on many factors. The primary financial measures used by management to evaluate the operating performance of the Company's segments include the revenues, costs and expenses directly controlled by each reportable segment and exclude the following:

-

certain costs related to general corporate functions and

-

interest and certain other miscellaneous nonoperating income and expenses not directly used in assessing the performance of the operating segments.

The Company does not maintain a corporate balance sheet, therefore segment asset information monitored by management includes general corporate assets, as applicable, in the respective operating segments.

## EGL, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The reconciliation between income before taxes, capital expenditures and depreciation and amortization for reportable segments to consolidated amounts is as follows (in thousands):

	Six Months Ended		Three Months Ended	
	2006	2005	2006	2005
	\$	\$	\$	\$
Income before taxes for reportable segments	68,266	38,722	37,258	25,994
Interest, corporate administrative expenses and other miscellaneous nonoperating income (expense)	(25,967)	(2,134)	(13,358)	(2,726)
	\$	\$	\$	\$
Income before taxes	42,299	36,588	23,900	23,268
	\$	\$	\$	\$
Capital expenditures for reportable segments	18,229	12,752	10,786	6,557
Capital expenditures not allocated to segments	(399)	12,817	(425)	318
	\$	\$	\$	\$
Capital expenditures	17,830	25,569	10,361	6,875
	\$	\$	\$	\$
Depreciation and amortization for reportable segments	12,548	14,683	5,641	7,601
Depreciation and amortization not allocated to segments	4,021	3,100	2,017	1,548
	\$	\$	\$	\$
Depreciation and amortization	16,569	17,783	7,658	9,149

The Company's identifiable assets by geographic division are summarized below (in thousands):

	<b>North America</b>	<b>South America</b>	<b>Europe, Middle East &amp; Africa</b>	<b>Asia &amp; South Pacific</b>	<b>Consolidated</b>
	\$	\$	\$	\$	\$
Balance at June 30, 2006	588,747	45,391	247,988	231,018	1,113,144
	\$	\$	\$	\$	\$
Balance at December 31, 2005	582,525	42,861	240,107	223,748	1,089,241

**EGL, INC.**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following is management's discussion and analysis of certain significant factors that have affected selected aspects of the Company's financial position and operating results during the periods included in the accompanying unaudited condensed consolidated financial statements. This discussion should be read in conjunction with the condensed consolidated financial statements as of and for the three and six months ended June 30, 2006 and the discussion under Management's Discussion and Analysis of Financial Condition and Results of Operations in the annual audited financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005 (File No. 0-27288).

**Overview**

The primary macroeconomic growth indicators of our business include general growth in the economy, international trade, particularly out of Asia, the level of high-tech spending and the increase in outsourcing of logistics projects. Business drivers that we control and focus on internally are our ability to: (i) link transportation services with our logistics services, (ii) cross-sell our services to existing and prospective customers and (iii) collaborate with our customers to provide flexible, cost-effective and profitable supply chain solutions.

We achieved gross revenues of \$771 million for the quarter ended June 30, 2006, a 1.3% decrease over gross revenues of \$781 million in the second quarter of 2005. Our financial position was strengthened by lower costs and increased net revenues in the second quarter of 2006. We remain committed to leveraging our infrastructure by containing our operating expenses and improving our yield management in 2006.

Our results of operations, cash flows and financial position for the second quarter of 2006 reflect, among other things, the following:

*Leveraging our global network.* In the second quarter of 2006, we continued to leverage our global network and our ability to cross-sell services to increase volumes for all of our service offerings in all geographic divisions. In addition, our balanced product offering enabled us to provide flexible solutions to our customers both domestically and internationally.

*Continued focus on net revenue margins.* Gross revenues declined by 1% in the second quarter of 2006 as compared to the second quarter of 2005 in part due to our decision last year to re-evaluate and aggressively address specific business that did not generate acceptable levels of operating income. Additionally, ocean gross revenues were impacted by price declines as additional container ship capacity was introduced into certain ocean trade lanes. Our continued focus on addressing low margin business resulted in a 6% growth in net revenues. Net revenue margins improved to 32.4% in the second quarter of 2006 from 30.3% in the second quarter of 2005.

*Income tax.* The tax rate for the second quarter of 2006 was 38.1% which includes the impact of foreign operating losses for which no tax benefit will be realized.

*Cash flows from operations.* Cash flows from operations for the first six months of 2006 were \$51.2 million as compared to operating income of \$48.4 million.

## EGL, INC.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

*Global deployment of information technology systems.* In 2006, we continued the global deployment of our EGL Vision Suite of Technologies—Logistics Vision, Financial Vision and People Vision. Logistics Vision is the freight forwarding system that allows a seamless flow of data across the globe, eliminating duplicate data entry on multiple systems. Financial Vision is the Oracle-based financial system that allows global visibility of financial results, streamlined financial reporting and the ability to automate intercompany accounting and settlements. People Vision is the Oracle-based human resources application that allows global visibility to employee tracking, training and development. Management continues to believe that successful deployment of systems remains a critical component of improving operational efficiencies and effectively growing the business. The global deployment of EGL Vision has continued in 2006.

Our organization continues to focus on increasing net revenue growth across all product lines and increasing operating income in all geographic locations.

**Results of Operations**

	<b>2006</b>		<b>Six Months Ended June 30,</b>		<b>2005</b>	
	<b>Amount</b>	<b>% of Total Revenues</b>	<b>Amount</b>	<b>% of Total Revenues</b>	<b>Amount</b>	<b>% of Total Revenues</b>
Revenues:						
	\$		\$			
Air freight forwarding	999,652	65.6	953,711	64.3		
Ocean freight forwarding	222,200	14.6	220,208	14.9		
Customs brokerage and other	301,804	19.8	308,001	20.8		
	\$		\$			
Revenues	1,523,656	100.0	1,481,920	100.0		
		<b>% of Revenues</b>		<b>% of Revenues</b>		
Net revenues:						
	\$		\$			
Air freight forwarding	276,518	27.7	262,065	27.5		

Edgar Filing: EGL INC - Form 10-Q

Ocean freight forwarding	53,323	24.0	44,292	20.1
Customs brokerage and other	157,033	52.0	143,571	46.6
Net revenues	486,874	32.0	449,928	30.4
		<b>% of Net Revenues</b>		<b>% of Net Revenues</b>
Operating expenses:				
Personnel costs	274,959	56.5	261,124	58.0
Other selling, general and administrative expenses	163,516	33.6	160,053	35.6
EEOC legal settlement	-	-	(5,975)	(1.3)
Operating income	48,399	9.9	34,726	7.7
Nonoperating (income) expense, net	6,100	1.2	(1,862)	(0.4)
Income before provision for income taxes	42,299	8.7	36,588	8.1
Provision for income taxes	16,389	3.4	16,721	3.7
	\$		\$	
Net income	25,910	5.3	19,867	4.4



**EGL, INC.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

**Six Months Ended June 30, 2006 Compared to Six Months Ended June 30, 2005**

Revenues increased \$41.8 million, or 2.8%, to \$1,523.7 million in the six months ended June 30, 2006 compared to \$1,481.9 million in the six months ended June 30, 2005, due to a \$46.0 million increase in air freight forwarding revenues and a \$2.0 million increase in ocean freight forwarding revenues offset by a \$6.2 million decrease in customs brokerage and other revenues. Net revenues, which represent revenues less freight transportation costs, increased \$37.0 million, or 8.2%, to \$486.9 million in the six months ended June 30, 2006, compared to \$449.9 million in the six months ended June 30, 2005 due to increases across all product lines. Net revenue margins of 32.0% increased by 160 basis points from the second quarter of 2005 due to improvements in ocean freight forwarding and customs brokerage and other margins.

*Air freight forwarding revenues.* Air freight forwarding revenues increased \$46.0 million, or 4.8%, to \$999.7 million in the six months ended June 30, 2006 compared to \$953.7 million in the six months ended June 30, 2005 primarily due to continuing volume increases in Asia/South Pacific and North America.

Air freight forwarding net revenues increased \$14.4 million, or 5.5%, to \$276.5 million in the six months ended June 30, 2006 compared to \$262.1 million in the six months ended June 30, 2005 due to increases in all geographic regions, especially North America. Air freight forwarding margins increased to 27.7% in the six months ended June 30, 2006 compared to 27.5% for the six months ended June 30, 2005 due to our decision to re-evaluate and aggressively address specific business that did not generate acceptable levels of operating income.

*Ocean freight forwarding revenues.* Ocean freight forwarding revenues increased \$2.0 million, or 0.9%, to \$222.2 million in the six months ended June 30, 2006 compared to \$220.2 million in the six months ended June 30, 2005 primarily due to volume increases in Asia/South Pacific and Europe/Middle East due to our increased focus on the ocean market and our customers' continued shift toward a lower cost deferred product.

Ocean freight forwarding net revenues increased \$9.0 million, or 20.3%, to \$53.3 million in the six months ended June 30, 2006 compared to \$44.3 million in the six months ended June 30, 2005 primarily due to increases in Asia/South Pacific and Europe/Middle East. Ocean forwarding margins increased to 24.0% in the six months ended June 30, 2006 compared to 20.1% in the six months ended June 30, 2005 from increases across all geographic divisions due to the introduction of more capacity by ocean carriers which has resulted in lower prices.

*Customs brokerage and other revenues.* Customs brokerage and other revenues, which include warehousing, distribution and other logistics services, decreased \$6.2 million, or 2.0% to \$301.8 million in the six months ended June 30, 2006 compared to \$308.0 million in the six months ended June 30, 2005. Customs brokerage revenues decreased primarily due to a decline in Europe/Middle East and North America trade activity. Warehousing and logistics revenues increased due to continued growth in Asia/South Pacific and South America, offset by a decline in

Europe/Middle East.

Customs brokerage and other net revenues increased by \$13.4 million, or 9.3%, to \$157.0 million in the six months ended June 30, 2006 compared to \$143.6 million in the six months ended June 30, 2005. Customs brokerage and other margins increased to 52.0% for the six months ended June 30, 2006, compared to 46.6% for the six months ended June 30, 2005, primarily due to new projects with higher margins in North America and Europe/Middle East and disposition of several lower margin projects.

*Personnel costs.* Personnel costs include all compensation expenses, including those relating to sales commissions and salaries and to headquarters employees and executive officers. Personnel costs increased \$13.9 million, or 5.3%, to \$275.0 million in the six months ended June 30, 2006 compared to \$261.1 million in the six months ended June 30, 2005. As a percentage of net revenues, personnel costs were 56.5% in the six months ended June 30, 2006 compared to 58.0% in the six months ended June 30, 2005 due to growth in net revenues offset somewhat by a 6% increase in headcount. The increase in personnel costs was due primarily to stock-based compensation expense resulting from the implementation of FAS 123R and increased incentive compensation expense due to our strong financial performance in the six months ended June 30, 2006. We implemented FAS 123R on January 1, 2006 and incurred \$5.3

**EGL, INC.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

million of stock-based compensation expense during the six months ended June 30, 2006, as compared to \$91,000 of stock-based compensation expense in the six months ended June 30, 2005.

*Other selling, general and administrative expenses.* Other selling, general and administrative expenses increased \$3.4 million, or 2.1%, to \$163.5 million in the six months ended June 30, 2006 compared to \$160.1 million in the six months ended June 30, 2005. The increase is primarily due to higher professional fees and insurance premiums and claims activity offset by decreased bad debt expense and depreciation. As a percentage of net revenues, other selling, general and administrative expenses were 33.6% in the six months ended June 30, 2006, compared to 35.6% in the six months ended June 30, 2005.

*EEOC legal settlement.* In February 2005, we recaptured \$6.0 million of \$8.5 million previously held in a fund to resolve potential claims in connection with a 2001 consent decree with the EEOC, resulting primarily from a significantly lower number of qualified claimants than originally projected.

*Nonoperating (income) expense, net.* For the six months ended June 30, 2006, nonoperating expense, net, was \$6.1 million compared to nonoperating income of \$1.9 million for the six months ended June 30, 2005. The \$8.0 million change was due primarily to a \$3.2 million increase in foreign exchange losses due to a weakening of the U.S. dollar particularly against Asian currencies and a \$4.1 million increase in net interest expense.

*Effective tax rate.* The effective tax rate for the six months ended June 30, 2006 was 38.7% compared to 45.7% for the six months ended June 30, 2005. The effective tax rate decreased from the six months ended June 30, 2005 due to a reduction of foreign operating losses for which no tax benefit will be realized.

## EGL, INC.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

**Results of Operations**

	<b>Three Months Ended June 30,</b>			
	<b>2006</b>	<b>% of Total</b>	<b>2005</b>	<b>% of Total</b>
	<b>Amount</b>	<b>Revenues</b>	<b>Amount</b>	<b>Revenues</b>
	(in thousands, except percentages)			
Revenues:				
	\$		\$	
Air freight forwarding	504,780	65.5	509,108	65.1
Ocean freight forwarding	112,710	14.6	115,335	14.8
Customs brokerage and other	153,803	19.9	156,811	20.1
	\$		\$	
Revenues	771,293	100.0	781,254	100.0
		<b>% of</b>		<b>% of</b>
		<b>Revenues</b>		<b>Revenues</b>
Net revenues:				
	\$		\$	
Air freight forwarding	139,399	27.6	138,829	27.3
Ocean freight forwarding	27,970	24.8	23,428	20.3
Customs brokerage and other	82,304	53.5	74,239	47.3
Net revenues	249,673	32.4	236,496	30.3
		<b>% of Net</b>		<b>% of Net</b>
		<b>Revenues</b>		<b>Revenues</b>
Operating expenses:				
Personnel costs	140,363	56.2	135,922	57.5
Other selling, general and administrative expenses	82,792	33.2	79,571	33.6
Operating income	26,518	10.6	21,003	8.9

Edgar Filing: EGL INC - Form 10-Q

Nonoperating (income) expense, net	2,618	1.0	(2,265)	(1.0)
Income before provision for income taxes	23,900	9.6	23,268	9.9
Provision for income taxes	9,094	3.7	10,566	4.5
	\$		\$	
Net income	14,806	5.9	12,702	5.4

**Three Months Ended June 30, 2006 Compared To Three Months Ended June 30, 2005**

Revenues decreased \$10.0 million, or 1.3%, to \$771.3 million in the three months ended June 30, 2006 compared to \$781.3 million in the three months ended June 30, 2005 due to decreases of \$4.3 million in air freight forwarding revenues, \$2.6 million in ocean freight forwarding revenues and \$3.0 million in customs brokerage and other revenues. Net revenues, which represent revenues less freight transportation costs, increased \$13.2 million, or 5.6%, to \$249.7 million in the three months ended June 30, 2006 compared to \$236.5 million in the three months ended June 30, 2005 due to increases across all product lines. Net revenue margins of 32.4% increased by 210 basis points from the second quarter of 2005 due to improvements in all product lines.

*Air freight forwarding revenues.* Air freight forwarding revenues decreased \$4.3 million, or 0.8%, to \$504.8 million in the three months ended June 30, 2006 compared to \$509.1 million in the three months ended June 30, 2005 primarily due to declines in volume and shipments in North America and South America and a decrease in Europe/Middle East due to an increase in shipments and volumes at lower selling rates. These decreases were offset by increases in volume and shipments in Asia/South Pacific.

Air freight forwarding net revenues increased \$570,000, or 0.4%, to \$139.4 million in the three months ended June 30, 2006 compared to \$138.8 million in the three months ended June 30, 2005 due to increases in Europe/Middle

**EGL, INC.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

East and North America, offset by a decrease in Asia/South Pacific. Air freight forwarding margins increased to 27.6% in the three months ended June 30, 2006 compared to 27.3% for the three months ended June 30, 2005 due to our decision to re-evaluate and aggressively address specific business that did not generate acceptable levels of operating income.

*Ocean freight forwarding revenues.* Ocean freight forwarding revenues decreased \$2.6 million, or 2.3%, to \$112.7 million in the three months ended June 30, 2006 compared to \$115.3 million in the three months ended June 30, 2005 due primarily to declines in South America, North America and Europe/Middle East, offset by an increase in Asia/South Pacific. While volume and shipments increased across all geographic divisions, ocean gross revenues were impacted by price declines as additional container ship capacity was introduced into certain ocean trade lanes.

Ocean freight forwarding net revenues increased \$4.6 million, or 19.7%, to \$28.0 million in the three months ended June 30, 2006 compared to \$23.4 million in the three months ended June 30, 2005 primarily due to increases in Asia/South Pacific and Europe/Middle East. Ocean forwarding margins, increased to 24.8% in the three months ended June 30, 2006 compared to 20.3% in the three months ended June 30, 2005 from increases across all geographic divisions due to the introduction of more capacity by ocean carriers which has resulted in lower prices.

*Customs brokerage and other revenues.* Customs brokerage and other revenues, which include warehousing, distribution and other logistics services, decreased \$3.0 million, or 1.9%, to \$153.8 million in the three months ended June 30, 2006 compared to \$156.8 million in the three months ended June 30, 2005. Customs brokerage revenues decreased primarily due to a decline in Europe/Middle East and North America trade activity. Warehousing and logistics revenues increased due to growth in North America and Asia/South Pacific, offset by a decline in Europe/Middle East.

Customs brokerage and other net revenues increased by \$8.1 million, or 10.9%, to \$82.3 million in the three months ended June 30, 2006 compared to \$74.2 million in the three months ended June 30, 2005. Customs brokerage and other margins increased to 53.5% for the three months ended June 30, 2006 compared to 47.3% for the three months ended June 30, 2005 primarily due to higher margins in Europe/Middle East and North America resulting from new projects with higher margins and disposition of several lower margin projects.

*Personnel costs.* Personnel costs include all compensation expenses, including those relating to sales commissions and salaries and to headquarters employees and executive officers. Personnel costs increased \$4.5 million, or 3.3%, to \$140.4 million in the three months ended June 30, 2006, compared to \$135.9 million in the three months ended June 30, 2005. As a percentage of net revenues, personnel costs were 56.2% in the three months ended June 30, 2006, compared to 57.5% in the three months ended June 30, 2005, due to growth in net revenues offset by an increase in headcount. The increase in personnel costs was due primarily to stock-based compensation expense resulting from the implementation of FAS 123R and increased temporary labor. We implemented FAS 123R on January 1, 2006 and incurred \$2.7 million of stock-based compensation expense during the three months ended June 30, 2006, as compared to \$49,000 of stock-based compensation expense in the three months ended June 30, 2005. Temporary

labor increased primarily due to new logistics projects in North America.

*Other selling, general and administrative expenses.* Other selling, general and administrative expenses increased \$3.2 million or 4.0%, to \$82.8 million in the three months ended June 30, 2006 compared to \$79.6 million in the three months ended June 30, 2005. The increase is primarily due to increased communications costs, professional fees, facilities and maintenance costs and travel and entertainment expenses, offset by a decrease in depreciation. As a percentage of net revenues, other selling, general and administrative expenses were 33.2% in the three months ended June 30, 2006, compared to 33.6% in the three months ended June 30, 2005.

*Nonoperating income (expense), net.* For the three months ended June 30, 2006, nonoperating expense, net, was \$2.6 million compared to nonoperating income of \$2.3 million for the three months ended June 30, 2005. The \$4.9 million change was primarily due to a \$2.5 million increase in foreign exchange losses due to a weakening of the U.S. dollar particularly against certain Asian currencies and a \$1.9 million increase in net interest expense.

**EGL, INC.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

*Effective tax rate.* The effective tax rate for the three months ended June 30, 2006 was 38.1% compared to 45.4% for the three months ended June 30, 2005. The effective tax rate decreased from the three months ended June 30, 2005 due to a reduction of foreign operating losses for which no tax benefit will be realized.

**Liquidity and Capital Resources**

*General*

Our ability to satisfy our debt obligations, fund working capital and make capital expenditures depends upon our future performance, which is subject to general economic conditions and other factors, some of which are beyond our control. If we achieve significant near-term revenue growth, we may experience a need for increased working capital financing as a result of the difference between our collection cycles and the timing of our payments to vendors.

Historically, we have generated higher cash flow from operations in the first half of the year than the second half of the year, reflecting the seasonality of our business.

We make significant disbursements on behalf of our customers for transportation costs (primarily ocean) and customs duties for which the customer is the primary obligor. The billings to customers for these disbursements, which are several times the amount of revenues and fees derived from these transactions, are not recorded as revenues and expense on our statement of income; rather, they are reflected in our trade receivables and trade payables. Growth in the level of this activity or lengthening of the period of time between incurring these costs and being reimbursed by our customers for these costs may negatively affect our liquidity.

As primarily a non-asset based freight forwarder, we do not have significant capital expenditures that would be required of an asset based forwarder. We believe our anticipated capital expenditures for 2006 will be in the range of \$45 to \$50 million, with a range of \$32 to \$37 million expected on information systems expenditures. Our capital expenditures for the six months ended June 30, 2006, were \$17.8 million.

Based on current plans, we believe that our existing capital resources, including \$134.8 million of cash and cash equivalents and \$221.2 million of available borrowing capacity on our credit facility, will be sufficient to meet working capital requirements through June 30, 2007. However, future changes in our business could cause us to consume available resources before that time. Additionally, funds may not be available when needed and even if available, additional funds may be raised through financing arrangements and/or the issuance of preferred or common stock or convertible securities on terms and prices significantly more favorable than those of the currently outstanding common stock, which could have the effect of diluting or adversely affecting the holdings or rights of our existing stockholders. If adequate funds are unavailable, we may be required to delay, scale back or eliminate some of our operating activities, including, without limitation, the timing and extent of our marketing programs, and the extent and timing of hiring additional personnel. We cannot provide assurance that additional financing will be available to us on acceptable terms, or at all.



*Cash flows from operating activities.* Net cash provided by operating activities was \$51.2 million in the six months ended June 30, 2006 compared to \$85.2 million in the six months ended June 30, 2005. The decrease in cash flows from operating activities is primarily due to a net decrease in changes from working capital, offset somewhat by an increase in net income. In the six months ended June 30, 2006, there was a \$1.7 million net decrease in cash from changes in working capital, primarily due to a \$18.6 million decrease in payables and other accrued liabilities and a \$11.7 million increase in other assets and liabilities, offset by a \$24.3 million decrease in trade receivables, due to improved collection efforts, and a \$4.3 million decrease in other receivables. In the six months ended June 30, 2005, there was a \$44.7 million net increase in working capital, primarily due to a \$36.6 million decrease in trade receivables, due to improved collection efforts, a \$15.6 million increase in payables and other accrued liabilities and a \$3.4 million decrease in other receivables, offset by a \$10.8 million increase in other assets and liabilities.

*Cash flows from investing activities.* Net cash used in investing activities in the six months ended June 30, 2006 was \$13.3 million compared to \$19.6 million in the six months ended June 30, 2005. We incurred capital expenditures

**EGL, INC.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

of \$17.8 million during the six months ended June 30, 2006 as compared to \$25.6 million during the six months ended June 30, 2005. Capital expenditures in 2005 related primarily to the purchase of a corporate plane for \$12.5 million. In the six months ended June 30, 2006, we received \$3.3 million from sales of property and equipment as compared to \$1.0 million in the six months ended June 30, 2005. In the six months ended June 30, 2006, \$594,000 was transferred from restricted cash, as compared to the six months ended June 30, 2005, during which \$7.6 million was transferred from restricted cash primarily as a result of the U.S. District Court order granting the recapture of \$6.0 million of the Settlement Fund. In connection with our acquisition of Miami International Forwarders in 2003 and the buyout of a minority interest partner in Thailand in 2001, we made earnout payments totaling \$4.2 million in the six months ended June 30, 2005. Additionally, in the six months ended June 30, 2006, we purchased a freight forwarding and customs brokerage operation in Colombia for \$1.4 million, net of cash acquired and received \$1.3 million from the sale of TDS Logistic, Inc.

*Cash flows from financing activities.* Net cash used in financing activities in the six months ended June 30, 2006 was \$22.1 million compared to net cash used of \$57.0 million in the six months ended June 30, 2005. The cash used in financing activities for the six months ended June 30, 2006 consists of \$232.5 million in repayments of debt, \$2.6 million of repayment of financed insurance premiums, \$2.5 million from the repayment of short-term debt, net of issuances and \$1.1 million in payments of capital lease obligations, offset by \$197.1 million in proceeds from the issuance of debt, \$14.3 million in proceeds from the exercise of 623,000 stock options and \$5.0 million in excess tax benefits from employee stock plans. The cash used in financing activities in the six months ended June 30, 2005 consists of the repurchase of approximately 4.9 million shares of our outstanding common stock for \$93.6 million, \$52.6 million in repayments of debt, \$1.5 million of repayment of financed insurance premiums and \$863,000 in payments of capital lease obligations, offset by \$83.4 million in proceeds of the issuance of debt, \$5.5 million from the exercise of 295,000 stock options and \$1.8 million from the issuance of short-term debt, net of repayments.

*Amended and Restated Credit Agreement*

We entered into an agreement dated as of September 30, 2005 establishing a \$300 million, senior secured revolving credit facility (the Amended and Restated Credit Agreement). The Amended and Restated Credit Agreement amends and restates our prior revolving credit agreement dated as of September 15, 2004, as previously amended (the Prior Credit Agreement). The Amended and Restated Credit Agreement is with a syndicate of 13 financial institutions with Bank of America, N.A., as lender and administrative agent and matures on September 30, 2010.

We may use borrowings under the Amended and Restated Credit Agreement for working capital, capital expenditures and other lawful corporate purposes, to make permitted acquisitions and investments, to pay dividends subject to certain limitations and to repurchase our common stock.

Amounts borrowed under the Amended and Restated Credit Agreement are guaranteed by all of our existing and future direct and indirect domestic subsidiaries and secured equally and ratably by:

-

all of our present and future shares of capital stock of (or other ownership or profit interests in) each of our present and future subsidiaries (limited, in the case of certain material first-tier foreign subsidiaries, to a pledge of 65% of the capital stock of such subsidiaries);

-

all of our and each of our domestic subsidiaries present and future property and assets; and

-

all proceeds and products of the property and assets described above.

Loans under the Amended and Restated Credit Agreement will bear interest initially at a rate per annum equal to either, at our option, (1) LIBOR plus 1.25% or (2) the Base Rate (defined as the higher of Bank of America, N.A.'s prime rate or 0.50% over the Federal Funds rate). In addition, we are required to pay a commitment fee of 0.30% on the undrawn amounts under the Amended and Restated Credit Agreement. Interest rates and commitment fees under the Amended and Restated Credit Agreement are subject to increase or decrease as a function of the ratio of our

**EGL, INC.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

Consolidated Net Funded Indebtedness to Consolidated EBITDA (each as defined in the Amended and Restated Credit Agreement). We may select interest periods of one, two, three or six months for LIBOR loans, subject to availability. Interest will be payable at the end of the selected interest period, but no less frequently than quarterly.

Under the Amended and Restated Credit Agreement, we are subject to various covenants, including, among others, the following:

-

a requirement that we maintain, on a rolling four-quarter basis, a ratio of Consolidated Net Funded Indebtedness to Consolidated EBITDA (each as defined in the Amended and Restated Credit Agreement) of not greater than 3.5 to 1.0 through December 31, 2006, and decreasing to 3.0 to 1.0 thereafter;

-

a requirement that, on a rolling four-quarter basis, we have a ratio of Consolidated EBIT to Consolidated Interest Charges (each as defined in the Amended and Restated Credit Agreement) of at least 2.5 to 1.0 through December 31, 2006, and increasing to 3.0 to 1.0 thereafter;

-

a requirement that, at the end of each fiscal quarter, we have a ratio of book accounts receivable by us and our subsidiaries to Consolidated Net Funded Indebtedness (as defined in the Amended and Restated Credit Agreement) of at least 1.1 to 1.0; and

-

limitations on, among other things, liens indebtedness, asset sales, dividends and stock redemptions, investments and acquisitions, transactions with affiliates and consolidations, mergers and sales of all or a substantial part of our consolidated assets.

The Amended and Restated Credit Agreement contains events of default customary for an agreement of this type. The occurrence of certain specified internal control events that could reasonably be expected to have a material adverse effect on us also constitutes an event of default under the Amended and Restated Credit Agreement. If a default occurs and is continuing, the administrative agent may, among other things, declare all outstanding principle amounts immediately due and payable.

The Amended and Restated Credit Agreement contains a \$75 million sub-facility for letters of credit. At June 30, 2006, we had borrowings of \$62.2 million, \$16.6 million in letters of credit outstanding and unused borrowing capacity of \$221.2 million under the Amended and Restated Credit Agreement.

*Note Purchase Agreement*

On October 12, 2005, we entered into a note purchase agreement (the Note Purchase Agreement) providing for the issuance and sale of \$100 million aggregate principal amount of floating rate, senior secured notes due October 12, 2012 (the Notes) to the purchasers named therein. Banc of America Securities LLC acted as placement agent for this offering. The issuance and sale of the Notes by us, and the resale of the Notes by Banc of America Securities LLC was made pursuant to one or more exemptions from the registration requirements of the Securities Act of 1933.

The Notes are guaranteed by all of our existing and future direct and indirect domestic subsidiaries and are secured by:

-

all of our present and future shares of capital stock of (or other ownership or profit interests in) each of our present and future subsidiaries (limited, in the case of certain material first-tier foreign subsidiaries, to a pledge of 65% of the capital stock of such subsidiaries);

-

all of our and each of our domestic subsidiaries present and future property and assets; and

-

all proceeds and products of the property and assets described above.

**EGL, INC.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

The Notes rank pari passu in right of payment with our obligations under our Amended and Restated Credit Agreement and the obligations of our guarantor subsidiaries to guarantee our obligations under the Note Purchase Agreement rank pari passu in right of payment with their guarantees in respect of the Amended and Restated Credit Agreement.

Interest on the Notes will accrue at a floating rate per annum equal to LIBOR plus 1.65% for the applicable interest period. Interest periods are defined as the three month period commencing on the closing date and each successive three month period thereafter. Interest on the Notes is payable quarterly in arrears on the last day of each interest period.

Under the Note Purchase Agreement, we are subject to various covenants, including, among others, the following:

-

a requirement that we maintain, on a rolling four-quarter basis, a ratio of Consolidated Net Debt to Consolidated EBITDA (each as defined in the Note Purchase Agreement) of not greater than 3.5 to 1.0;

-

a requirement that we maintain, on a rolling four-quarter basis, a ratio of Consolidated EBIT to Consolidated Interest Expense (each as defined in the Note Purchase Agreement) of at least 2.5 to 1.0;

-

a requirement that we have, at all times, a ratio of (x) book accounts receivable of the Company and certain subsidiaries to (y) Consolidated Net Debt (as defined in the Note Purchase Agreement) of at least 1.1 to 1.0;

-

a requirement that we not, at any time, permit the aggregate amount of all Priority Debt (as defined in the Note Purchase Agreement) to exceed 10% of its Consolidated Net Worth (as defined in the Note Purchase Agreement) as of the most recently ended fiscal quarter; and

-

limitations on, among other things, liens asset sales, dividends and stock redemptions, investments and acquisitions, transactions with affiliates and consolidations and mergers.

The Note Purchase Agreement contains customary events of default. If a default occurs and is continuing, the Notes then outstanding shall (either automatically or by declaration of the holders of more than 50% of the principal amount of Notes then outstanding, depending upon the circumstances resulting in the default) become immediately due and payable. If an event of default occurs and is continuing because we failed to pay principal, interest or other amounts due and payable on the Notes, then any Note holder may declare all of the Notes held by it to be immediately due and payable.

*Capital expenditures.* We are in the process of developing and implementing computer system solutions for operational, human resources and financial systems. Once placed into service, depreciation related to the systems is charged on a straight-line basis over the expected useful life of the software. As of June 30, 2006, \$44.6 million of this software was under development and was not being depreciated. Our expected capital expenditures for the year ending December 31, 2006 are approximately \$45 to \$50 million, including approximately \$32 to \$37 million for information technology development and upgrades.

*Litigation.* We are party to routine litigation incidental to our business, which primarily involves other employment matters or claims for goods lost or damaged in transit or improperly shipped. Many of the other lawsuits to which we are a party are covered by insurance and are being defended by our insurance carriers. We have established accruals for these other matters and it is management's opinion that resolution of such litigation will not have a material adverse effect on our consolidated financial position. However, a substantial settlement payment or judgment in excess of our accruals could have a material adverse effect on our consolidated results of operations or cash flows.

*Federal income tax audit.* As discussed in note 11 of the notes to our consolidated financial statements, EGL's U.S. federal income tax returns from fiscal years 2000 to 2001 have been audited by the IRS with the case currently at

**EGL, INC.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

the Appeals division for resolution. The IRS has proposed, among other items, to disallow various merger transaction costs and various software research and development expenditures taken as tax deductions. If the proposed adjustments are upheld, we would be required to pay a total of approximately \$14 million in cash taxes, of which approximately \$6.5 million would impact the consolidated statement of income, plus accrued interest of approximately \$5.7 million through June 30, 2006. We believe our U.S. federal income tax returns were completed in accordance with applicable laws and regulations and do not believe material adjustments to our tax returns are probable. However, there is no assurance that the final outcome will not result in material adjustments which would have a material adverse impact on our results of operations and cash flows.

**Off-Balance Sheet Arrangements**

As is common in our industry, we have entered into certain off-balance sheet arrangements in the ordinary course of business that result in risks not directly reflected in our balance sheets. Our significant off-balance sheet arrangements include liabilities associated with guarantees secured by letters of credit, surety bonds and security time deposits and non-cancelable operating leases. We have not engaged in any off-balance sheet financing arrangements through special purpose entities.

*Guarantees.* We guarantee certain financial liabilities, the majority of which relate to our freight forwarding operations. In the normal course of our business, we are required to guarantee certain amounts related to customs bonds and services received from airlines. These types of guarantees are usual and customary in the freight forwarding industry. We operate as a customs broker and prepare and file all formal documentation required for clearance through customs agencies, obtain customs bonds, facilitate the payment of import duties on behalf of the importer and arrange for payment of collect freight charges. We also assist the importer in obtaining the most advantageous commodity classifications, qualifying for duty drawback refunds and arranging for surety bonds.

We secure these guarantees primarily by three methods: a \$75 million standby letter of credit sub-facility included within our Amended and Restated Credit Agreement, surety bonds and security time deposits. Security time deposits are restricted as to withdrawal for a specified timeframe and are classified on our balance sheet as restricted cash. As of June 30, 2006, we had \$16.6 million in letters of credit outstanding. We also issue IATA (International Air Transportation Association) related guarantees, customs bonds and letters of credit in the normal course of business. IATA related guarantees and customs bonds are issued to facilitate the movement and clearance of freight. Letters of credit include, but are not limited to, guarantees associated with insurance requirements and certain potential tax obligations. Generally, guarantees have one-year or two-year terms and are renewed upon expiration. As of June 30, 2006, total IATA related guarantees, customs bonds and letters of credit were approximately \$92.9 million. Approximately \$66.3 million of guarantees, customs bonds and letters of credit were outstanding, including guarantees of our trade payables and accrued transportation costs and borrowings against our international credit facilities of \$14.2 million, which were recorded as liabilities on our consolidated balance sheet.



*Leases.* We enter into operating lease agreements, principally for freight operation facilities and office space. These leases are non-cancelable and expire on various dates through 2025. Certain of our lease agreements contain renewal options and rent escalation clauses. These leases allow us to conserve cash by paying a monthly lease payment for use of facilities, rather than purchasing the facilities. We may decide to cancel or terminate a lease before the end of its term due to excess capacity resulting from having multiple facilities in certain locations or changing business needs, in which case we typically are liable to the lessor for the remaining lease payments under the term of the lease. We maintain facility accruals for remaining lease obligations under non-cancelable operating leases at domestic and international locations that we have vacated.

**EGL, INC.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

**Contractual Obligations**

As of June 30, 2006, there have not been any material changes in EGL's contractual obligations as presented in its Annual Report on Form 10-K for the year ended December 31, 2005.

**New Accounting Pronouncements and Critical Accounting Policies**

See note 1 of the notes to the consolidated financial statements for the year ended December 31, 2005 in our Annual Report on Form 10-K and see note 1 of the notes to the condensed consolidated financial statements included in Item I.

**EGL, INC.**

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There have been no material changes in exposure to market risk from that discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

**ITEM 4. CONTROLS AND PROCEDURES**

The Company maintains systems of disclosure controls and procedures designed to (1) ensure that information required to be disclosed in the Company's reports required by the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, (2) and that such information is accumulated and communicated to the Company's management, including its chief executive officer and chief financial officer as appropriate, to allow timely decisions regarding required disclosure, as defined in Rules 13a - 15 (e) and 15d - 15(e) under the Exchange Act. During the quarter the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the chief executive officer and the chief financial officer, of the effectiveness of the design and operation of the disclosure controls and procedures as of June 30, 2006. Based upon that evaluation, the Company's chief executive officer and chief financial officer concluded that the Company's disclosure controls and procedures were effective.

During the quarter ended June 30, 2006, there was no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

During 2003 and 2004, EGL acted as a logistics subcontractor in the Middle East to Kellogg Brown & Root, Inc. ( KBR ), which as general contractor provided various services to the U.S. Department of Defense ( DOD ) and other U.S. government agencies. In 2004, we received an administrative subpoena from the Office of Inspector General of the DOD requesting documents relating to the billing of war risk surcharges by EGL on certain shipments of KBR freight in the period from late 2003 to mid-2004. EGL cooperated fully with the government's request and its investigation. In the course of our internal investigation of the matter, we reviewed documents related to the imposition of war risk surcharges on EGL by transportation providers. EGL uncovered evidence suggesting that certain documents related to the imposition of war risk surcharges on EGL, that were then charged to KBR, were false and the charges were not warranted. Following this discovery, and with approval from the government, we engaged auditors to conduct a forensic analysis of war risk surcharges charged by EGL. This analysis concluded that

approximately \$1.1 million of war risk surcharges charged by EGL were not actually imposed on EGL by transportation providers. We provided the results of this investigation to the government and promptly terminated two employees for violation of EGL's Code of Conduct.

As a result of discussions with the government, we received a letter from the United States Attorneys Office for the Eastern District of Texas on December 12, 2005 offering to settle the war risk surcharge issue for the sum of \$4.0 million. Of the \$4.0 million, \$1.1 million reimburses the government for war risk surcharges (the full amount of which had been previously reserved in EGL's financial statements), and the remaining \$2.9 million represents penalties for improper billings. EGL entered into a settlement agreement with the government in accordance with the letter on June 5, 2006 and paid the \$4.0 million on June 21, 2006. Recognizing EGL's cooperation in and assistance with the government's review, as part of the settlement the United States Attorneys Office and the Defense Criminal Investigative Service agreed to waive all investigatory expenses. In addition, the United States Attorneys Office for the Eastern District of Texas is not expected to recommend to the DOD or the Department of Justice any criminal indictment of EGL related to the war risk surcharges. In December 2005, EGL recorded a charge of \$2.9 million for this penalty.

One former and two current independent contractor pickup and delivery ( P&D ) drivers filed a complaint in California state court on September 12, 2005, on behalf of themselves and similarly situated drivers in California alleging various causes of action based on their theory that the drivers are employees and not independent contractors. The complaint requests (i) the matter be designated as a class action on behalf of all independent contractor P&D drivers working for EGL in California; (ii) a declaratory judgment that EGL has violated the law; (iii) an equitable accounting and an unspecified amount of damages; and (iv) restitution in the form of business expenses, unpaid overtime, meal

**EGL, INC.**

period compensation, unlawful deductions from wages, statutory penalties, interest, attorneys' fees and costs. We removed the case to federal district court for the Northern District of California, and the parties have agreed to focus only on the individual claims of the three named defendants in the first phase of the proceedings. In the event one or more of the plaintiffs' claims survive the summary judgment phase, the next phase would focus on whether the action is maintainable as a class action. We intend to vigorously defend this lawsuit and believe that plaintiffs are properly classified as independent contractors.

In addition, we are party to routine litigation incidental to our business, which primarily involves employment matters or claims for goods lost or damaged in transit or improperly shipped. Many of the other lawsuits to which we are a party are covered by insurance and are being defended by our insurance carriers. We have established accruals for these other matters and it is management's opinion that resolution of such litigation will not have a material adverse effect on our consolidated financial position. However, a substantial settlement payment or judgment in excess of our accruals could have a material adverse effect on our consolidated results of operations or cash flows.

**ITEM 1A. RISK FACTORS**

*Our results of operations could be adversely affected as a result of goodwill impairments.*

When we acquire a business, we record an asset called goodwill equal to the excess amount we pay for the business, including liabilities assumed, over the fair value of the tangible and intangible assets of the business we acquire. Through December 31, 2001, pursuant to generally accepted accounting principles, we amortized this goodwill over its estimated useful life of 40 years following the acquisition, which directly impacted our earnings. In June, 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 142 which provides that effective at the beginning of the 2002 Fiscal Year, goodwill and other intangible assets that have indefinite useful lives not be amortized, but instead must be tested at least annually for impairment, and intangible assets that have finite useful lives should continue to be amortized over their useful lives. SFAS No. 142 also provides specific guidance for testing goodwill and other non-amortized intangible assets for impairment. SFAS No. 142 requires management to make certain estimates and assumptions to allocate goodwill to our company's geographical divisions and to determine the fair value of the geographical division's net assets and liabilities, including, among other things, an assessment of market conditions, projected cash flows, investment rates, cost of capital and growth rates, which could significantly impact the reported value of goodwill and other intangible assets. Fair value is determined using a combination of the discounted cash flow, market multiple and market capitalization valuation approaches. Absent any impairment indicators, we perform our impairment tests annually during the fourth quarter. Future impairments, if any, will be recognized as operating expenses.

*We may not be successful in continuing to meet the requirements of the Sarbanes-Oxley Act of 2002.*

The Sarbanes-Oxley Act of 2002 has introduced many requirements applicable to us regarding corporate governance and financial reporting, including the requirements, beginning with the Annual Report for the Fiscal Year Ended December 31, 2004, for management to report on our internal controls over financial reporting and for our independent registered public accounting firm to attest to this report. We continue actions to ensure our ability to comply with these requirements, including but not limited to, the engaging of outside experts to assist in the evaluation of our controls, adding staff to our internal audit department and documenting our existing controls. As of December 31, 2005, we were in compliance. However, there can be no assurance that we will be successful in complying in future years. Failure to maintain compliance could result in a decrease in the market value of our common stock and other publicly-traded securities, the reduced ability to obtain financing, the loss of customers, penalties and additional expenditures to meet the requirements.

*We may not be successful in deploying our global IT infrastructure.*

Global deployment of our logistics and sales information technology infrastructure is a critical component of our continued world-wide growth. As we continue our deployment of these systems to our offices throughout the world during 2006, there is no certainty that the deployment will meet our internal timelines or be successful. Our failure to

**EGL, INC.**

successfully and timely deploy these information technology systems can adversely impact our operational efficiencies and could slow or prevent future growth.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

NONE

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

NONE

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

Our annual meeting of stockholders was held in Houston, Texas on May 16, 2006 for the purpose of voting on the proposals described below. Proxies for the meeting were solicited pursuant to Section 14(a) of the Securities Exchange Act of 1934 and there was no solicitation in opposition to management's solicitation.

Stockholders approved the election of seven directors, each to serve for a one-year term, by the following votes:

<b><u>Director</u></b>	<b><u>For</u></b>	<b><u>Withheld</u></b>
James R. Crane	32,986,133	820,322
Frank J. Hevrdejs	30,325,063	3,481,392
Paul William Hobby	32,721,021	1,085,434
Michael K. Jhin	32,735,936	1,070,519
Milton Carroll	32,736,036	1,070,419
Neil E. Kelley	22,301,448	11,505,007
James C. Flagg	31,034,472	2,771,983

**ITEM 5. OTHER INFORMATION****FORWARD-LOOKING STATEMENTS**

The statements contained in all parts of this document (including the portion, if any, appended to this Form 10-Q or incorporated by reference) that are not historical facts are, or may be deemed to be, forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Such forward-looking statements include, but are not limited to, those relating to (i) projections of revenues, income or loss, earnings or loss per share, capital expenditures, dividends, capital structure or other financial items; (ii) plans and objectives of management for future operations, including plans or objectives relating to EGL's service offerings;

(iii) future economic performance; (iv) assumptions underlying or relating to any of the matters in clauses (i) through (iii); and (v) other statements that include expectations, intentions, projections, developments, future events, expected performance, underlying assumptions, and other statements which are other than statements of historical facts.



**EGL, INC.**

Forward-looking statements in this Form 10-Q (including the portion, if any, appended to the Form 10-Q or incorporated by reference) are also identifiable by use of the following words and other similar expressions, among others:

-	-
anticipate,	intend,
-	-
believe,	may,
-	-
budget,	might,
-	-
could,	plan,
-	-
estimate,	predict,
-	-
expect,	project and
-	-
forecast,	should.

These statements involve risks and uncertainties including, but not limited to, our ability to manage and continue growth, risks associated with operating in international markets, events impacting the volume of international trade, our ability to comply with rules relating to the performance of U.S. government contracts, fuel shortages and price volatility of fuel, seasonal trends in our business, currency devaluations and fluctuations in foreign markets, our effective income tax rate, our ability to upgrade our information technology systems, protecting our intellectual property rights, heightened global security measures, availability of cargo space, increases in the prices charged by our suppliers, competition in the freight industry and our ability to maintain market share, material weaknesses within our internal controls, dependence on our founder, liability for loss or damage to goods, the results of litigation, exposure to fines and penalties if our owner/operators are deemed to be employees, failure to comply with environmental, health and safety, and criminal laws and regulations and governmental permit and licensing requirements and other factors detailed in the Company's Annual Report on Form 10-K for the year ended December 31, 2005 and other

filings with the Securities and Exchange Commission. Should one or more of these risks or uncertainties materialize (or the consequences of such a development worsen), or should underlying assumptions prove incorrect, actual outcomes may vary materially from those forecasted or expected. The Company disclaims any intention or obligation to update publicly or revise such statements, whether as a result of new information, future events or otherwise.

**EGL, INC.**

**ITEM 6. EXHIBITS:**

<b><u>Exhibit Number</u></b>	<b><u>Description</u></b>
*3.1	Second Amended and Restated Articles of Incorporation of EGL, as amended (filed as Exhibit 3(i) to EGL's Form 8-A/A filed with the Securities and Exchange Commission on September 29, 2000 and incorporated herein by reference).
*3.2	Statement of Resolutions Establishing the Series A Junior Participating Preferred Stock of EGL (filed as Exhibit 3(ii) to EGL's Form 10-Q for the fiscal quarter ended June 30, 2001 and incorporated herein by reference).
*3.3	Amended and Restated Bylaws of EGL, as amended (filed as Exhibit 3(ii) to EGL's Form 10-Q for the fiscal quarter ended June 30, 2000 and incorporated herein by reference).
*10.1	Form of 2006 Incentive Bonus Plan for Executive Management employees (filed as Exhibit 99.1 to EGL's Form 8-K filed with the Securities and Exchange Commission on April 12, 2006 and incorporated herein by reference).
*10.2	Amended and Restated Non Employee Director Stock Plan (filed as Exhibit 99.1 to EGL's Form 8-K filed with the Securities and Exchange Commission on May 22, 2006 and incorporated herein by reference).
*10.3	Form of EGL, Inc. Indemnification Agreement (filed as Exhibit 99.2 to EGL's Form 8-K filed with the Securities and Exchange Commission on May 22, 2006 and incorporated herein by reference).
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) (filed herewith).
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) (filed herewith).
32	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).

\* Incorporated by reference as indicated.



**EGL, INC.**

**SIGNATURES**

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

EGL, INC.

Date: August 9, 2006

By:

/s/ James R. Crane

---

James R. Crane

Chairman and

Chief Executive Officer

Date: August 9, 2006

By:

/s/ Charles H. Leonard

---

Charles H. Leonard

Chief Financial Officer



**EGL, INC.**

**INDEX TO EXHIBITS**

<b><u>Exhibit Number</u></b>	<b><u>Description</u></b>
*3.1	Second Amended and Restated Articles of Incorporation of EGL, as amended (filed as Exhibit 3(i) to EGL's Form 8-A/A filed with the Securities and Exchange Commission on September 29, 2000 and incorporated herein by reference).
*3.2	Statement of Resolutions Establishing the Series A Junior Participating Preferred Stock of EGL (filed as Exhibit 3(ii) to EGL's Form 10-Q for the fiscal quarter ended June 30, 2001 and incorporated herein by reference).
*3.3	Amended and Restated Bylaws of EGL, as amended (filed as Exhibit 3(ii) to EGL's Form 10-Q for the fiscal quarter ended June 30, 2000 and incorporated herein by reference).
*10.1	Form of 2006 Incentive Bonus Plan for Executive Management employees (filed as Exhibit 99.1 to EGL's Form 8-K filed with the Securities and Exchange Commission on April 12, 2006 and incorporated herein by reference).
*10.2	Amended and Restated Non Employee Director Stock Plan (filed as Exhibit 99.1 to EGL's Form 8-K filed with the Securities and Exchange Commission on May 22, 2006 and incorporated herein by reference).
*10.3	Form of EGL, Inc. Indemnification Agreement (filed as Exhibit 99.2 to EGL's Form 8-K filed with the Securities and Exchange Commission on May 22, 2006 and incorporated herein by reference).
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) (filed herewith).
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) (filed herewith).
32	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).

\* Incorporated by reference as indicated.

