LANDSTAR SYSTEM INC
Form 10-Q
May 04, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended **March 31, 2007**

OR

o **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: **0-21238**

LANDSTAR SYSTEM, INC.

(Exact name of registrant as specified in its charter)

Delaware	**06-1313069**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

13410 Sutton Park Drive South, Jacksonville, Florida

(Address of principal executive offices)

32224

(Zip Code)

(904) 398-9400

(Registrant s telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the 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 (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (check one)

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes o No þ

The number of shares of the registrant s common stock, par value $0.01 per share, outstanding as of the close of business on April 20, 2007 was 55,560,135.

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PART I Financial Information

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

The interim consolidated financial statements contained herein reflect all adjustments (all of a normal, recurring nature) which, in the opinion of management, are necessary for a fair statement of the financial condition, results of operations, cash flows and changes in shareholders equity for the periods presented. They have been prepared in accordance with Rule 10-01 of Regulation S-X and do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. Operating results for the thirteen weeks ended March 31, 2007 are not necessarily indicative of the results that may be expected for the entire fiscal year ending December 29, 2007.

These interim financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company s 2006 Annual Report on Form 10-K.

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LANDSTAR SYSTEM, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share amounts)
(Unaudited)

	March 31, 2007	Dec. 30, 2006
ASSETS		
Current Assets		
Cash and cash equivalents	$ 77,780	$ 91,491
Short-term investments	20,701	21,548
Trade accounts receivable, less allowance of $4,589 and $4,834	300,255	318,983
Other receivables, including advances to independent contractors, less allowance of $3,987 and $4,512	22,053	14,198
Deferred income taxes and other current assets	17,154	25,142
Total current assets	437,943	471,362
Operating property, less accumulated depreciation and amortization of $78,307 and $77,938	115,501	110,957
Goodwill	31,134	31,134
Other assets	36,006	33,198
Total assets	$ 620,584	$ 646,651
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Cash overdraft	$ 25,160	$ 25,435
Accounts payable	120,404	122,313
Current maturities of long-term debt	19,578	18,730
Insurance claims	27,386	25,238
Other current liabilities	55,138	58,478
Total current liabilities	247,666	250,194
Long-term debt, excluding current maturities	78,415	110,591
Insurance claims	43,127	36,232
Deferred income taxes	20,424	19,360
Shareholders Equity		
Common stock, $0.01 par value, authorized 160,000,000 shares, issued 65,127,496 and 64,993,143	651	650
Additional paid-in capital	112,345	108,020
Retained earnings	519,195	499,273

Cost of 9,583,961 and 9,028,009 shares of common stock in treasury	(401,247)	(377,662)
Accumulated other comprehensive income (loss)	8	(7)
Total shareholders equity	230,952	230,274
Total liabilities and shareholders equity	$ 620,584	$ 646,651

See accompanying notes to consolidated financial statements.

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LANDSTAR SYSTEM, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
(Dollars in thousands, except per share amounts)
(Unaudited)

	Thirteen Weeks Ended March 31, 2007	Thirteen Weeks Ended April 1, 2006
Revenue	$ 576,649	$ 610,042
Investment income	1,740	379
Costs and expenses:		
Purchased transportation	434,058	458,250
Commissions to agents	46,632	47,011
Other operating costs	5,506	12,068
Insurance and claims	17,540	11,552
Selling, general and administrative	33,165	35,836
Depreciation and amortization	4,617	4,093
Total costs and expenses	541,518	568,810
Operating income	36,871	41,611
Interest and debt expense	1,592	1,850
Income before income taxes	35,279	39,761
Income taxes	13,675	15,411
Net income	$ 21,604	$ 24,350
Earnings per common share	$ 0.39	$ 0.41
Diluted earnings per share	$ 0.38	$ 0.41
Average number of shares outstanding:		
Earnings per common share	55,926,000	58,901,000
Diluted earnings per share	56,470,000	59,919,000
Dividends paid per common share	$ 0.030	$ 0.025

See accompanying notes to consolidated financial statements.

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LANDSTAR SYSTEM, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	Thirteen Weeks Ended	
	March 31, 2007	**April 1, 2006**
OPERATING ACTIVITIES		
Net income	$ 21,604	$ 24,350
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of operating property	4,617	4,093
Non-cash interest charges	43	44
Provisions for losses on trade and other accounts receivable	392	1,892
Gains on sales of operating property	(979)	(158)
Deferred income taxes, net	654	276
Stock-based compensation	1,792	1,411
Changes in operating assets and liabilities:		
Decrease in trade and other accounts receivable	10,481	84,836
Decrease in other assets	9,689	2,738
Decrease in accounts payable	(1,909)	(18,368)
Decrease in other liabilities	(3,348)	(2,016)
Increase (decrease) in insurance claims	9,043	(1,560)
NET CASH PROVIDED BY OPERATING ACTIVITIES	52,079	97,538
INVESTING ACTIVITIES		
Net change in other short-term investments	1	1,448
Sales and maturities of investments	12,232	10,328
Purchases of investments	(15,505)	(11,701)
Purchases of operating property	(2,327)	(668)
Proceeds from sales of operating property	2,165	415
NET CASH USED BY INVESTING ACTIVITIES	(3,434)	(178)
FINANCING ACTIVITIES		
Decrease in cash overdraft	(275)	(5,834)
Dividends paid	(1,682)	(1,474)
Proceeds from exercises of stock options	2,026	2,376
Excess tax benefit on stock option exercises	508	1,694
Purchases of common stock	(23,585)	(11,131)
Principal payments on long-term debt and capital lease obligations	(39,348)	(62,988)

NET CASH USED BY FINANCING ACTIVITIES	(62,356)	(77,357)
Increase (decrease) in cash and cash equivalents	(13,711)	20,003
Cash and cash equivalents at beginning of period	91,491	29,398
Cash and cash equivalents at end of period	$ 77,780	$ 49,401

See accompanying notes to consolidated financial statements.

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LANDSTAR SYSTEM, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY
Thirteen Weeks Ended March 31, 2007
(Dollars in thousands)
(Unaudited)

	Common Stock		Add'l Paid-In	Retained	Treasury Stock at Cost		Accumulated Other Comprehensive Income	
	Shares	Amount	Capital	Earnings	Shares	Amount	(Loss)	Total
Balance December 30, 2006	64,993,143	$ 650	$ 108,020	$ 499,273	9,028,009	$ (377,662)	$ (7)	$ 230,274
Net income				21,604				21,604
Dividends paid				(1,682)				(1,682)
Purchases of common stock					555,952	(23,585)		(23,585)
Stock-based compensation			1,792					1,792
Exercises of stock options, including excess tax benefit	134,353	1	2,533					2,534
Unrealized holding gains on available-for-sale investments, net of income taxes							15	15
Balance March 31, 2007	65,127,496	$ 651	$ 112,345	$ 519,195	9,583,961	$ (401,247)	$ 8	$ 230,952

See accompanying notes to consolidated financial statements.

LANDSTAR SYSTEM, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

The consolidated financial statements include the accounts of Landstar System, Inc. and its subsidiary, Landstar System Holdings, Inc., and reflect all adjustments (all of a normal, recurring nature) which are, in the opinion of management, necessary for a fair statement of the results for the periods presented. The preparation of the consolidated financial statements requires the use of management s estimates. Actual results could differ from those estimates. Landstar System, Inc. and its subsidiary are herein referred to as Landstar or the Company.

(1) Share-Based Payments

Share-based payment arrangements

As of March 31, 2007, the Company had two employee stock option plans and one stock option plan for members of its Board of Directors (the Plans). Amounts recognized in the financial statements with respect to these Plans are as follows (in thousands):

	Thirteen Weeks Ended	
	March 31, 2007	**April 1, 2006**
Total cost of share-based payment plans during the period	$ 1,792	$ 1,411
Amount of related income tax benefit recognized during the period	523	467
Net cost of share based payment plans during the period	$ 1,269	$ 944

The fair value of each option grant on its grant date was calculated using the Black-Scholes option pricing model with the following weighted average assumptions for grants made in the 2007 and 2006 thirteen week periods:

	2007	2006
Expected volatility	33.0%	34.0%
Expected dividend yield	0.3%	0.3%
Risk-free interest rate	4.75%	4.75%
Expected lives (in years)	4.2	4.5

The Company utilizes historical data, including exercise patterns and employee departure behavior, in estimating the term options will be outstanding. Expected volatility was based on historical volatility and other factors, such as expected changes in volatility arising from planned changes to the Company s business, if any. The risk-free interest rate was based on the yield of zero coupon U.S. Treasury bonds for terms that approximated the terms of the options granted. The weighted average grant date fair value of stock options granted during the thirteen week periods ended March 31, 2007 and April 1, 2006 was $14.22 and $15.32, respectively.

Summary details for plan stock options

Information regarding the Company s stock options is as follows:

	Number of Options	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (000s)

Options outstanding at December 30, 2006	2,566,571	$	27.35			
Granted	266,500	$	42.97			
Exercised	(134,353)	$	15.09			
Options outstanding at March 31, 2007	2,698,718	$	29.50	7.3	$	44,101
Options exercisable at March 31, 2007	1,220,903	$	23.59	6.2	$	27,162

As of March 31, 2007, there were 6,329,018 shares of the Company s common stock reserved for issuance upon exercise of options granted and to be granted under the Plans.

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The total intrinsic value of stock options exercised during the thirteen week periods ended March 31, 2007 and April 1, 2006 was $4,050,000 and $8,221,000, respectively.

As of March 31, 2007, there was $14,252,000 of total unrecognized compensation cost related to non-vested stock options granted under the Plans. The compensation cost related to these non-vested options is expected to be recognized over a weighted average period of 2.7 years.

(2) Income Taxes

The provisions for income taxes for both the 2007 and 2006 thirteen week periods were based on an estimated full year combined effective income tax rate of approximately 38.8%, which was higher than the statutory federal income tax rate primarily as a result of state income taxes, the meals and entertainment exclusion and non-deductible stock-based compensation.

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

As of December 31, 2006, the date of adoption of FIN 48, the Company had $11.5 million of unrecognized tax benefits representing the provision for the uncertainty of certain tax positions plus a component of interest and penalties. The implementation of FIN 48 did not have a significant impact on the provision for unrecognized tax benefits as of December 31, 2006. Estimated interest and penalties on the provision for the uncertainty of certain tax positions is included in income tax expense. Upon adoption there was $5,116,000 accrued for the estimated interest and penalties related to the uncertainty of certain tax positions. The Company does not currently anticipate any significant increase or decrease to the unrecognized tax benefit during the remainder of 2007.

The Company is subject to U.S. federal income tax as well as income tax in the majority of state jurisdictions. The Company has concluded all U.S. federal income tax matters through 2002. Substantially all material income tax matters in major state and local income tax jurisdictions have been concluded for all years prior to 2002.

(3) Earnings Per Share

Earnings per common share amounts are based on the weighted average number of common shares outstanding and diluted earnings per share amounts are based on the weighted average number of common shares outstanding plus the incremental shares that would have been outstanding upon the assumed exercise of all dilutive stock options.

The following table provides a reconciliation of the average number of common shares outstanding used to calculate earnings per share to the average number of common shares and common share equivalents outstanding used in calculating diluted earnings per share (in thousands):

	Thirteen Weeks Ended	
	March 31, 2007	**April 1, 2006**
Average number of common shares outstanding	55,926	58,901
Incremental shares under stock option plans	544	1,018
Average number of common shares and common share equivalents outstanding	56,470	59,919

For the thirteen week periods ended March 31, 2007 and April 1, 2006, there were 803,000 and 599,000, respectively, options outstanding to purchase shares of common stock excluded from the calculation of diluted earnings per share because they were antidilutive.

(4) Additional Cash Flow Information

During the 2007 thirteen week period, Landstar paid income taxes and interest of $1,219,000 and $2,112,000, respectively. During the 2006 thirteen week period, Landstar paid income taxes and interest of $2,985,000 and $2,375,000, respectively. Landstar acquired operating property by entering into capital leases in the amount of $8,020,000 in the 2007 thirteen week period. Landstar did not acquire operating property by entering into capital leases in the 2006 thirteen week period.

(5) Segment Information

The following tables summarize information about Landstar s reportable business segments as of and for the thirteen week periods ended March 31, 2007 and April 1, 2006 (in thousands):

	Thirteen Weeks Ended March 31, 2007				
	Carrier	Global Logistics	Insurance	Other	Total
External revenue	$ 423,574	$ 143,865	$ 9,210		$ 576,649
Investment income			1,740		1,740
Internal revenue	12,696	822	6,196		19,714
Operating income	41,409	4,688	3,359	$ (12,585)	36,871
Goodwill	20,496	10,638			31,134

	Thirteen Weeks Ended April 1, 2006				
	Carrier	Global Logistics	Insurance	Other	Total
External revenue	$ 428,313	$ 173,425	$ 8,304		$ 610,042
Investment income			379		379
Internal revenue	11,856	360	5,939		18,155
Operating income	40,571	8,727	6,676	$ (14,363)	41,611
Goodwill	20,496	10,638			31,134

(6) Comprehensive Income

The following table includes the components of comprehensive income for the thirteen week periods ended March 31, 2007 and April 1, 2006 (in thousands):

	Thirteen Weeks Ended	
	March 31, 2007	April 1, 2006
Net income	$ 21,604	$ 24,350
Unrealized holding gains on available -for-sale investments, net of income taxes	15	137
Comprehensive income	$ 21,619	$ 24,487

Accumulated other comprehensive income at March 31, 2007 of $8,000 represents the unrealized holding gains on available-for-sale investments of $12,000, net of related income taxes of $4,000.

(7) Commitments and Contingencies

As of March 31, 2007, Landstar had $27,219,000 of letters of credit outstanding under the Company s revolving credit facility and $46,003,000 of letters of credit secured by investments held by the Company s insurance segment. Short-term investments include $18,289,000 in current maturities of investment grade bonds and $2,412,000 of cash equivalents held by the Company s insurance segment at March 31, 2007. These short-term investments together with $4,514,000 of the non-current portion of investment grade bonds and $23,068,000 of cash equivalents included in other assets at March 31, 2007, provide collateral for the $46,003,000 of letters of credit issued to guarantee payment of insurance claims.

On November 1, 2002, the Owner-Operator Independent Drivers Association, Inc. (OOIDA) and certain BCO Independent Contractors (as defined below) (collectively with OOIDA, the Plaintiffs) filed a putative class action complaint on behalf of independent contractors who provide truck capacity to the Company and its subsidiaries under exclusive lease arrangements (BCO Independent Contractors) in the United States District Court for the Middle District of Florida (the Court) in Jacksonville, Florida, against the Company and certain of its subsidiaries, which was amended on April 7, 2005 (the Amended Complaint). The Amended Complaint alleges that certain aspects of the Company s motor carrier leases and related practices with its BCO Independent Contractors violate certain federal leasing regulations and seeks injunctive relief, an unspecified amount of damages and attorney s fees. On August 30, 2005, the Court granted a motion by the Plaintiffs to certify the case as a class action.

On October 6, 2006, the Court issued a summary judgment ruling which found, among other things, that (1) the lease agreements of the Defendants (as defined below) literally complied with the requirements of Section 376.12(d) of the applicable federal leasing regulations relating to reductions to revenue derived from freight upon which BCO Independent Contractors compensation is calculated, (2) charge-back amounts which include fees and profits to the motor carrier are not unlawful under Section 376.12(h) and (3) the Defendants had violated 376.12(h) of the regulations by failing to provide access to documents to determine the validity of

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certain charges. On January 12, 2007, the Court ruled that the monetary remedy available to the Plaintiffs would be limited to damages sustained as a result of the violation and rejected Plaintiffs request for equitable relief in the form of restitution or disgorgement.

On January 16, 2007, the Court ordered the decertification of the class of BCO Independent Contractors for purposes of determining remedies. Immediately thereafter, the trial commenced for purposes of determining what remedies, if any, would be awarded to the remaining named BCO Independent Contractor Plaintiffs against the following subsidiaries of the Company: Landstar Inway, Inc., Landstar Ligon, Inc. and Landstar Ranger, Inc. (the Defendants). On January 18, 2007, in response to a motion filed by the Defendants following the presentation by the Plaintiffs of their case in chief, the Court granted judgment as a matter of law in favor of the Defendants on the issue of damages and stated that the Plaintiffs had failed to present evidence that any of the Plaintiffs had sustained damages as a result of any violation of the applicable federal leasing regulations. On that date, the Court also ruled that access to documents describing a third party vendor s charges to determine the validity of charge-back amounts under 376.12(h) was not required under Defendants current lease with respect to programs where the lease contains a price to a BCO Independent Contractor that is not calculated on the basis of a third party vendor s charge to the Defendants. On March 29, 2007, the Court granted judgment as a matter of law in favor of the Defendants on the issue of Plaintiffs request for injunctive relief, entered a Judgment in favor of the Defendants and issued written orders setting forth its rulings related to the decertification of the class and the denial of Plaintiffs requests for damages and injunctive relief. The Plaintiffs have notified the Court of their intent to appeal certain of the Court s rulings. The Plaintiffs and the Defendants have each also filed motions with the Court concerning an award of attorney fees from the other party.

The Company is involved in certain other claims and pending litigation arising from the normal conduct of busines