

LANDSTAR SYSTEM INC

Form 10-Q

May 04, 2007

**Table of Contents**

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

(Mark One)

**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**

**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**  
(State or other jurisdiction  
of incorporation or organization)

**06-1313069**  
(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  No

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  Accelerated filer  Non-accelerated filer

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

Yes  No

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.

**Index**

**PART I** Financial Information

**Item 1.** Financial Statements

Consolidated Balance Sheets as of March 31, 2007 and December 30, 2006 Page 3

Consolidated Statements of Income for the Thirteen Weeks Ended March 31, 2007 and April 1, 2006 Page 4

Consolidated Statements of Cash Flows for the Thirteen Weeks Ended March 31, 2007 and April 1, 2006 Page 5

Consolidated Statement of Changes in Shareholders' Equity for the Thirteen Weeks Ended March 31, 2007 Page 6

Notes to Consolidated Financial Statements Page 7

**Item 2.** Management's Discussion and Analysis of Financial Condition and Results of Operations Page 10

**Item 3.** Quantitative and Qualitative Disclosures About Market Risk Page 17

**Item 4.** Controls and Procedures Page 17

**PART II** Other Information

**Item 1.** Legal Proceedings Page 18

**Item 1A.** Risk Factors Page 19

**Item 2.** Unregistered Sales of Equity Securities and Use of Proceeds Page 19

**Item 6.** Exhibits Page 19

**Signatures** Page 21

EX-31.1 Section 302 Certification of President & CEO

EX-31.2 Section 302 Certification of V.P. & CFO

EX-32.1 Section 906 Certification of President & CEO

EX-32.2 Section 906 Certification of V.P. & CFO

**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.



**Table of Contents**

LANDSTAR SYSTEM, INC. AND SUBSIDIARY  
CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share amounts)

(Unaudited)

	<b>March 31, 2007</b>	<b>Dec. 30, 2006</b>
<b>ASSETS</b>		
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
<b>Total current assets</b>	<b>437,943</b>	<b>471,362</b>
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
<b>Total assets</b>	<b>\$ 620,584</b>	<b>\$ 646,651</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
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
<b>Total current liabilities</b>	<b>247,666</b>	<b>250,194</b>
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

Edgar Filing: LANDSTAR SYSTEM INC - Form 10-Q

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.

3

---

**Table of Contents**LANDSTAR SYSTEM, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands, except per share amounts)

(Unaudited)

	<b>Thirteen Weeks Ended</b>	
	<b>March 31, 2007</b>	<b>April 1, 2006</b>
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.

**Table of Contents**

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

	<b>Thirteen Weeks Ended</b>	
	<b>March</b>	<b>April 1,</b>
	<b>31,</b>	<b>2006</b>
	<b>2007</b>	<b>2006</b>
<b>OPERATING ACTIVITIES</b>		
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)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>52,079</b>	<b>97,538</b>
<b>INVESTING ACTIVITIES</b>		
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
<b>NET CASH USED BY INVESTING ACTIVITIES</b>	<b>(3,434)</b>	<b>(178)</b>
<b>FINANCING ACTIVITIES</b>		
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.

5

---

**Table of Contents**

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	Retained	Treasury Stock at Cost		Accumulated Other Comprehensive Income	Total
	Shares	Amount	Paid-In Capital	Earnings	Shares	Amount	(Loss)	
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.

**Table of Contents**

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):

	<b>Thirteen Weeks Ended</b>	
	<b>March 31, 2007</b>	<b>April 1, 2006</b>
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)
----------------------	---	---	--

Edgar Filing: LANDSTAR SYSTEM INC - Form 10-Q

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.

**Table of Contents**

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):

	<b>Thirteen Weeks Ended</b>	
	<b>March 31, 2007</b>	<b>April 1, 2006</b>
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**

Edgar Filing: LANDSTAR SYSTEM INC - Form 10-Q

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.

**Table of Contents****(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**

	<b>Global</b>				
	<b>Carrier</b>	<b>Logistics</b>	<b>Insurance</b>	<b>Other</b>	<b>Total</b>
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**

	<b>Global</b>				
	<b>Carrier</b>	<b>Logistics</b>	<b>Insurance</b>	<b>Other</b>	<b>Total</b>
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):

	<b>Thirteen Weeks Ended</b>	
	<b>March 31, 2007</b>	<b>April 1, 2006</b>
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



**Table of Contents**

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 business. Based on knowledge of the facts and, in certain cases, opinions of outside counsel, management believes that adequate provisions have been made for probable losses with respect to the resolution of all such other claims and pending litigation and that the ultimate outcome, after provisions thereof, will not have a material adverse effect on the financial condition of the Company, but could have a material effect on the results of operations in a given quarter or year.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion should be read in conjunction with the attached interim consolidated financial statements and notes thereto, and with the Company's audited financial statements and notes thereto for the fiscal year ended December 30, 2006 and Management's Discussion and Analysis of Financial Condition and Results of Operations included in the 2006 Annual Report on Form 10-K.

**Introduction**

Landstar System, Inc. and its subsidiary, Landstar System Holdings, Inc. (together, referred to herein as "Landstar" or the "Company"), provide transportation services to a variety of market niches throughout the United States and to a lesser extent in Canada, and between the United States and Canada, Mexico and other countries through its operating subsidiaries. Landstar's business strategy is to be a non-asset based provider of transportation capacity and logistics services delivering safe, specialized transportation services globally, utilizing a network of independent commission sales agents, third party capacity providers and employees. Landstar focuses on providing transportation services which emphasize safety, customer service and information coordination among its independent commission sales agents, customers and capacity providers. The Company markets its services primarily through independent commission sales agents and exclusively utilizes third party capacity providers to transport customers' freight. The nature of the Company's business is such that a significant portion of its operating costs varies directly with revenue. The Company has three reportable business segments. These are the carrier, global logistics and insurance segments.

The carrier segment consists of Landstar Ranger, Inc., Landstar Inway, Inc., Landstar Ligon, Inc., Landstar Gemini, Inc. and Landstar Carrier Services, Inc. The carrier segment primarily provides transportation services to the truckload market for a wide range of general commodities over irregular or non-repetitive routes utilizing dry and specialty vans and unsided trailers, including flatbed, drop deck and specialty. It also provides short-to-long haul movement of containers by truck, dedicated power-only truck capacity and truck brokerage. The carrier segment markets its services primarily through independent commission sales agents and utilizes independent contractors who provide truck capacity to the Company under exclusive lease arrangements (the "Business Capacity Owner

Independent Contractors or BCO Independent Contractors ) and other third party truck capacity providers under non-exclusive contractual arrangements ( Truck Brokerage Carriers ).

The global logistics segment is comprised of Landstar Global Logistics, Inc. and its subsidiary Landstar Express America, Inc. Transportation and logistics services provided by the global logistics segment include the arrangement of multimodal (ground, air, ocean and rail) moves, contract logistics, truck brokerage, emergency and expedited ground, air and ocean freight, bus brokerage and warehousing. The global logistics segment markets its services primarily through independent commission sales agents and utilizes capacity provided by BCO Independent Contractors and other third party capacity providers, including Truck Brokerage Carriers, railroads, air and ocean cargo carriers, bus providers and warehouse owners. Beginning in August 2006, the global logistics segment

**Table of Contents**

began the rollout of warehousing services with independent contractors who provide warehouse capacity to the Company under non-exclusive contractual arrangements ( Warehouse Capacity Owners or WCO Independent Contractors ). As of March 31, 2007, Landstar Global Logistics, Inc. has executed contracts with 112 Warehouse Capacity Owners.

The insurance segment is comprised of Signature Insurance Company ( Signature ), a wholly-owned offshore insurance subsidiary, and Risk Management Claim Services, Inc. The insurance segment provides risk and claims management services to Landstar's operating subsidiaries. In addition, it reinsures certain risks of the Company's BCO Independent Contractors and provides certain property and casualty insurance directly to Landstar's operating subsidiaries.

**Changes in Financial Condition and Results of Operations**

Management believes the Company's success principally depends on its ability to generate freight through its network of independent commission sales agents and to efficiently deliver that freight utilizing third party capacity providers. Management believes the most significant factors to the Company's success include increasing revenue, sourcing capacity and controlling costs.

While customer demand, which is subject to overall economic conditions, ultimately drives increases or decreases in revenue, the Company primarily relies on its independent commission sales agents to establish customer relationships and generate revenue opportunities. Management's primary focus with respect to revenue growth is on revenue generated by independent commission sales agents who on an annual basis generate \$1 million or more of Landstar revenue ( Million Dollar Agents ). Management believes future revenue growth is primarily dependent on its ability to increase both the revenue generated by Million Dollar Agents and the number of Million Dollar Agents through a combination of recruiting new agents and increasing the revenue opportunities generated by existing independent commission sales agents. During the 2006 fiscal year, 490 independent commission sales agents generated \$1 million or more of Landstar's revenue and thus qualified as Million Dollar Agents. During the 2006 fiscal year, the average revenue generated by a Million Dollar Agent was \$4,700,000 and revenue generated by Million Dollar Agents in the aggregate represented 92% of consolidated Landstar revenue. As of March 31, 2007 and April 1, 2006, the Company had a network of 1,338 and 1,196 independent commission sales agent locations, respectively.

Management monitors business activity by tracking the number of loads (volume) and revenue per load generated by the carrier and global logistics segments. In addition, management tracks revenue per revenue mile, average length of haul and total revenue miles at the carrier segment. Revenue per revenue mile and revenue per load (collectively, price) as well as the number of loads, can be influenced by many factors which do not necessarily indicate a change in price or volume. Those factors include the average length of haul, freight type, special handling and equipment requirements and delivery time requirements. The following table summarizes this data by reportable segment:

	<b>Thirteen Weeks Ended</b>	
	<b>March 31, 2007</b>	<b>April 1, 2006</b>
<u>Carrier Segment:</u>		
External revenue generated through (in thousands):		
BCO Independent Contractors	\$ 299,398	\$ 303,793
Truck Brokerage Carriers	124,176	124,520
	\$ 423,574	\$ 428,313
Revenue per revenue mile	\$ 1.98	\$ 1.99
Revenue per load	\$ 1,569	\$ 1,580
Average length of haul (miles)	792	793
Number of loads	270,000	271,000

Global Logistics Segment:

External revenue generated through (in thousands):

BCO Independent Contractors (1)	\$ 26,841	\$ 24,832
Truck Brokerage Carriers	79,953	100,627
Rail, air, ocean and bus carriers (2)	37,071	47,966
	\$ 143,865	\$ 173,425
Revenue per load (3)	\$ 1,560	\$ 1,500
Number of loads (3)	90,000	92,000

(1) Includes revenue from freight hauled by carrier segment BCO Independent Contractors for global logistics customers.

(2) Included in the 2007 and 2006 thirteen week period was \$481,000 and \$10,856,000, respectively, of revenue attributable to buses provided under a contract between Landstar Express America, Inc. and the United States Department of Transportation/Federal Aviation Administration (the FAA ).

**Table of Contents**

- (3) Number of loads and revenue per load excludes the effect of \$3,445,000 in 2007 and \$35,449,000 in 2006 of revenue derived from transportation services provided under the FAA contract as discussed further in the paragraphs that follow. (See the section Use of Non-GAAP Financial Measures. )

Also critical to the Company's success is its ability to secure capacity, particularly truck capacity, at rates that allow the Company to profitably transport customers' freight. The following table summarizes available truck capacity providers:

	March 31, 2007	April 1, 2006
BCO Independent Contractors	8,510	8,219
Truck Brokerage Carriers:		
Approved and active <sup>(1)</sup>	14,784	13,698
Other approved	8,758	8,381
	23,542	22,079
Total available truck capacity providers	32,052	30,298
Number of trucks provided by BCO Independent Contractors	9,158	8,932

- <sup>(1)</sup> Active refers to Truck Brokerage Carriers who moved at least one load in the 180 days

immediately  
preceding the  
fiscal quarter  
end.

The Company incurs costs that are directly related to the transportation of freight that include purchased transportation and commissions to agents. The Company incurs indirect costs associated with the transportation of freight that include other operating costs and insurance and claims. In addition, the Company incurs selling, general and administrative costs essential to administering its business operations. Management continually monitors all components of the costs incurred by the Company and establishes annual cost budgets which, in general, are used to benchmark costs incurred on a monthly basis.

Purchased transportation represents the amount a BCO Independent Contractor or other third party capacity provider is paid to haul freight. The amount of purchased transportation paid to a BCO Independent Contractor is primarily based on a contractually agreed-upon percentage of revenue generated by the haul. Purchased transportation for the brokerage services operations of the carrier segment is based on a negotiated rate for each load hauled. Purchased transportation for the brokerage services operations of the global logistics segment is based on either a negotiated rate for each load hauled or a contractually agreed-upon rate. Purchased transportation for the rail intermodal, air and ocean freight operations of the global logistics segment is based on a contractually agreed-upon fixed rate. Purchased transportation for bus services is based upon a negotiated rate per mile or per day. Purchased transportation as a percentage of revenue for truck brokerage services, rail intermodal and bus operations is normally higher than that of Landstar's other transportation operations. Purchased transportation is the largest component of costs and expenses and, on a consolidated basis, increases or decreases in proportion to the revenue generated through BCO Independent Contractors, other third party capacity providers and revenue from the insurance segment.

Commissions to agents are based on contractually agreed-upon percentages of revenue or gross profit, defined as revenue less the cost of purchased transportation, at the carrier segment and of gross profit at the global logistics segment. Commissions to agents as a percentage of consolidated revenue will vary directly with fluctuations in the percentage of consolidated revenue generated by the carrier segment, the global logistics segment and the insurance segment and with changes in gross profit at the global logistics segment and the truck brokerage operations of the carrier segment.

Rent and maintenance costs for Company provided trailing equipment, BCO Independent Contractor recruiting costs and bad debts from BCO Independent Contractors and independent commission sales agents are the largest components of other operating costs.

Potential liability associated with accidents in the trucking industry is severe and occurrences are unpredictable. Landstar's retained liability for individual commercial trucking claims varies depending on when such claims were incurred. For commercial trucking claims incurred prior to June 19, 2003 and subsequent to March 30, 2004, Landstar retains liability up to \$5,000,000 per occurrence. For commercial trucking claims incurred from June 19, 2003 through March 30, 2004, Landstar retains liability up to \$10,000,000 per occurrence. The Company also retains liability for each general liability claim up to \$1,000,000, \$250,000 for each workers' compensation claim and \$250,000 for each cargo claim. The Company's exposure to liability associated with accidents incurred by other third party capacity providers who haul freight on behalf of the Company is reduced by various factors including the extent to which they maintain their own insurance coverage. A material increase in the frequency or severity of accidents, cargo or workers' compensation claims or the unfavorable development of existing claims could be expected to materially adversely affect Landstar's results of operations.

**Table of Contents**

Employee compensation and benefits account for over half of the Company's selling, general and administrative costs.

Depreciation and amortization primarily relate to depreciation of trailing equipment and management information services equipment.

The following table sets forth the percentage relationships of income and expense items to revenue for the periods indicated:

	<b>Thirteen Weeks Ended</b>	
	<b>March 31, 2007</b>	<b>April 1, 2006</b>
Revenue	100.0%	100.0%
Investment income	0.3	0.0
Costs and expenses:		
Purchased transportation	75.3	75.1
Commissions to agents	8.1	7.7
Other operating costs	1.0	2.0
Insurance and claims	3.0	1.9
Selling, general and administrative	5.7	5.9
Depreciation and amortization	0.8	0.6
 Total costs and expenses	 93.9	 93.2
 Operating income	 6.4	 6.8
Interest and debt expense	0.3	0.3
 Income before income taxes	 6.1	 6.5
Income taxes	2.4	2.5
 Net income	 3.7%	 4.0%

**THIRTEEN WEEKS ENDED MARCH 31, 2007 COMPARED TO THIRTEEN WEEKS ENDED APRIL 1, 2006**

Revenue for the 2007 thirteen week period was \$576,649,000, a decrease of \$33,393,000, or 5.5%, compared to the 2006 thirteen week period. The decrease in revenue was primarily attributable to lower disaster relief revenue provided under the FAA contract in the thirteen week period ended March 31, 2007 compared to the thirteen week period ended April 1, 2006. Revenue for disaster relief services provided under the FAA contract in the thirteen week periods ended March 31, 2007 and April 1, 2006 was \$3,445,000 and \$35,449,000, respectively, including trailer rental revenue of \$28,000 and \$6,088,000, respectively. Revenue decreased \$4,739,000 and \$29,560,000 at the carrier and global logistics segments, respectively, while revenue increased \$906,000 at the insurance segment. With respect to the carrier segment, revenue per load, the number of loads delivered, the average length of haul and revenue per revenue mile in the 2007 thirteen week period all were approximately the same as compared to the 2006 thirteen week period. The decrease in revenue at the global logistics segment was entirely due to the decreased revenue for disaster relief services provided under the FAA contract. Excluding the number of loads and revenue related to disaster relief efforts provided by the global logistics segment in the 2007 and 2006 thirteen week periods, the number of loads delivered by the global logistics segment in the 2007 thirteen week period decreased approximately 2%, however,

revenue per load increased approximately 4% compared to the 2006 thirteen week period.

Investment income at the insurance segment was \$1,740,000 and \$379,000 in the 2007 and 2006 thirteen week periods, respectively. The increase in investment income was primarily due to an increased average investment balance and an increased rate of return, attributable to a general increase in interest rates, on investments held by the insurance segment in the 2007 period.

Purchased transportation was 75.3% and 75.1% of revenue in 2007 and 2006, respectively. The increase in purchased transportation as a percentage of revenue was primarily attributable to the effect of decreased FAA revenue, which tends to have a lower cost of purchased transportation, partially offset by a lower rate of purchased transportation paid to truck brokerage carriers and an increase in the use of Company provided trailing equipment versus trailing equipment provided by BCO Independent Contractors. Commissions to agents were 8.1% of revenue in 2007 and 7.7% in 2006. The increase in commissions to agents as a percentage of revenue compared to prior year was primarily attributable to decreased revenue provided for disaster relief services under the FAA contract, which tends to have a lower agent commission rate and increased gross profit on truck brokerage revenue. Other operating costs were 1.0% and 2.0% of revenue in 2007 and 2006, respectively. The decrease in other operating costs as a percentage of revenue was primarily attributable to trailer rental costs incurred in support of disaster relief services under the FAA contract in 2006, and a favorable settlement in 2007 of a disputed property tax position with one of the states in which the Company operates, partially offset by increased trailing equipment maintenance costs. Insurance and claims were 3.0% of revenue in 2007 compared with 1.9% of revenue in 2006. The increase in insurance and claims as a percentage of revenue was primarily attributable to a \$5,000,000 charge for



**Table of Contents**

the estimated cost of one severe accident that occurred during the first quarter of 2007 and increased frequency and severity of commercial trucking accidents in the 2007 period. Selling, general and administrative costs were 5.7% of revenue in 2007 compared with 5.9% of revenue in 2006. The decrease in selling, general and administrative costs as a percentage of revenue was primarily attributable to a decreased provision for bonuses under the Company's incentive compensation programs and a decreased provision for customer bad debt, partially offset by the effect of decreased revenue. Depreciation and amortization was 0.8% of revenue in 2007 and 0.6% in 2006. The increase in depreciation and amortization as a percentage of revenue was primarily due to an increase in Company-owned trailing equipment and the effect of decreased revenue.

Interest and debt expense was 0.3% of revenue in both 2007 and 2006.

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 compensation expense.

Net income was \$21,604,000, or \$0.39 per common share (\$0.38 per diluted share), in the 2007 thirteen week period, which included approximately \$996,000 of operating income related to the \$3,445,000 of revenue attributable to disaster relief services provided primarily under the FAA contract. The \$996,000 of operating income, net of related income taxes, increased net income by \$614,000, or \$0.01 per common share (\$0.01 per diluted share). Also included in the 2007 first quarter net income was a \$5,000,000 charge for the estimated cost of one severe accident that occurred during the first quarter of 2007. This charge, net of related income tax benefits, reduced 2007 first quarter net income by \$3,065,000, or \$0.06 per common share (\$0.05 per diluted share). Net income was \$24,350,000, or \$0.41 per common share (\$0.41 per diluted share), in the 2006 thirteen week period, which included \$5,009,000 of operating income related to the \$35,449,000 of revenue attributable to disaster relief services provided primarily under the FAA contract. The \$5,009,000 of operating income, net of related income taxes, increased net income by \$3,086,000, or \$0.05 per common share (\$0.05 per diluted share).

**USE OF NON-GAAP FINANCIAL MEASURES**

In this quarterly report on Form 10-Q, Landstar provided the following information that may be deemed non-GAAP financial measures: (1) revenue per load for the global logistics segment excluding revenue and loads related to disaster relief transportation services provided primarily under a contract with the FAA and (2) the percentage change in revenue per load for the global logistics segment excluding revenue and loads related to disaster relief transportation services provided primarily under a contract with the FAA as compared to revenue per load for the global logistics segment for the corresponding prior year period. This financial information should be considered in addition to, and not as a substitute for, the corresponding GAAP financial information also presented in this Form 10-Q.

Management believes that it is appropriate to present this financial information for the following reasons: (1) a significant portion of the disaster relief transportation services were provided under the FAA contract on the basis of a daily rate for the use of transportation equipment in question, and therefore load and per load information is not necessarily available or appropriate for a significant portion of the related revenue, (2) disclosure of the effect of the transportation services provided by Landstar relating to disaster relief efforts for the storms that impacted the United States will allow investors to better understand the underlying trends in Landstar's financial condition and results of operations, (3) this information will facilitate comparisons by investors of Landstar's results as compared to the results of peer companies and (4) management considers this financial information in its decision making.

**CAPITAL RESOURCES AND LIQUIDITY**

Shareholders' equity was \$230,952,000 at March 31, 2007, compared to \$230,274,000 at December 30, 2006. The increase in shareholders' equity was primarily a result of net income for the period, partially offset by the purchase of 555,952 shares of the Company's common stock at a total cost of \$23,585,000. As of March 31, 2007, the Company may purchase up to an additional 271,549 shares of its common stock under its authorized stock purchase programs. Shareholders' equity was 70% of total capitalization (defined as total debt plus equity) at March 31, 2007 compared to 64% at December 30, 2006.

## Edgar Filing: LANDSTAR SYSTEM INC - Form 10-Q

Long-term debt including current maturities was \$97,993,000 at March 31, 2007, \$31,328,000 lower than at December 30, 2006.

Working capital and the ratio of current assets to current liabilities were \$190,277,000 and 1.8 to 1, respectively, at March 31, 2007, compared with \$221,168,000 and 1.9 to 1, respectively, at December 30, 2006. Landstar has historically operated with current ratios within the range of 1.5 to 1 to 2.0 to 1. Cash provided by operating activities was \$52,079,000 in the 2007 thirteen week period compared with \$97,538,000 in the 2006 thirteen week period. The decrease in cash flow provided by operating activities was primarily attributable to the first quarter 2006 collection of a portion of the 2005 fiscal year end receivable from the FAA for disaster relief transportation services.

**Table of Contents**

On July 8, 2004, Landstar renegotiated its existing credit agreement with a syndicate of banks and JPMorgan Chase Bank, as administrative agent (the Fourth Amended and Restated Credit Agreement ). The Fourth Amended and Restated Credit Agreement, which expires on July 8, 2009, provides \$225,000,000 of borrowing capacity in the form of a revolving credit facility, \$75,000,000 of which may be utilized in the form of letter of credit guarantees.

At March 31, 2007, the Company had \$25,000,000 in borrowings outstanding and \$27,219,000 of letters of credit outstanding under the Fourth Amended and Restated Credit Agreement. At March 31, 2007, there was \$172,781,000 available for future borrowings under the Company's Fourth Amended and Restated Credit Agreement. In addition, the Company has \$46,003,000 in letters of credit outstanding, as collateral for insurance claims, that are secured by investments and cash equivalents totaling \$48,283,000.

On February 1, 2007, Landstar System, Inc. announced that its Board of Directors declared a cash dividend of \$0.03 per share with respect to its outstanding shares of common stock. The distribution date for this cash dividend was on February 28, 2007, to stockholders of record on February 13, 2007. It is the intention of the Board of Directors to pay a quarterly dividend going forward.

Historically, the Company has generated sufficient operating cash flow to meet its debt service requirements, fund continued growth, both internal and through acquisitions, complete or execute share purchases of its common stock under authorized share purchase programs, pay dividends and to meet working capital needs. As a non-asset based provider of transportation capacity and logistics services, the Company's annual capital requirements for operating property are generally for trailing equipment and management information services equipment. In addition, a significant portion of the trailing equipment used by the Company is provided by third party capacity providers and through leases at rental rates that vary with the revenue generated through the use of the leased equipment, thereby reducing the Company's capital requirements. During the 2007 thirteen week period, the Company purchased \$2,327,000 of operating property and acquired \$8,020,000 of trailing equipment by entering into capital leases. Landstar anticipates acquiring approximately \$34,000,000 of operating property during the remainder of the 2007 fiscal year either by purchase or by lease financing. It is expected that capital leases will fund any significant acquisitions of Company provided trailing equipment made during the remainder of 2007.

Management believes that cash flow from operations combined with the Company's borrowing capacity under the Fourth Amended and Restated Credit Agreement will be adequate to meet Landstar's debt service requirements, fund continued growth, both internal and through acquisitions, pay dividends, complete the authorized share purchase programs and meet working capital needs.

**LEGAL MATTERS**

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 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

## **Table of Contents**

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 business. Based on knowledge of the facts and, in certain cases, opinions of outside counsel, management believes that adequate provisions have been made for probable losses with respect to the resolution of all such other claims and pending litigation and that the ultimate outcome, after provisions thereof, will not have a material adverse effect on the financial condition of the Company, but could have a material effect on the results of operations in a given quarter or year.

### **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The allowance for doubtful accounts for both trade and other receivables represents management's estimate of the amount of outstanding receivables that will not be collected. Historically, management's estimates for uncollectible receivables have been materially correct. Although management believes the amount of the allowance for both trade and other receivables at March 31, 2007 is appropriate, a prolonged period of low or no economic growth may adversely affect the collection of these receivables. Conversely, a more robust economic environment may result in the realization of some portion of the estimated uncollectible receivables.

Landstar provides for the estimated costs of self-insured claims primarily on an actuarial basis. The amount recorded for the estimated liability for claims incurred is based upon the facts and circumstances known on the balance sheet date. The ultimate resolution of these claims may be for an amount greater or less than the amount estimated by management. Historically, the Company has experienced both favorable and unfavorable development of prior year claims estimates. The Company continually revises its existing claim estimates as new or revised information becomes available on the status of each claim. During the 2007 and 2006 thirteen week periods, insurance and claims costs included \$1,123,000 and \$859,000, respectively, of favorable adjustments to prior years claims estimates. It is reasonably likely that the ultimate outcome of settling all outstanding claims will be more or less than the estimated claims reserve at March 31, 2007.

The Company utilizes certain income tax planning strategies to reduce its overall cost of income taxes. Upon audit, it is possible that certain strategies might be disallowed resulting in an increased liability for income taxes. Certain of the tax planning strategies result in a level of uncertainty as to whether the positions would result in a recognizable benefit. The Company has provided for its estimated exposure attributable to certain positions that create uncertainty in the level of income tax benefit that would ultimately be realized. Management believes that the provision for liabilities resulting from the uncertainty in certain income tax positions is appropriate. To date, the Company has not experienced an examination by governmental revenue authorities that would lead management to believe that the Company's past provisions for exposures related to the uncertainty of certain income tax positions are not appropriate.

Significant variances from management's estimates for the amount of uncollectible receivables, the ultimate resolution of claims or the provision for uncertainty in income tax positions can be expected to positively or negatively affect Landstar's earnings in a given quarter or year. However, management believes that the ultimate resolution of these items, given a range of reasonably likely outcomes, will not significantly affect the long-term financial condition of Landstar or its ability to fund its continuing operations.

### **EFFECTS OF INFLATION**

Management does not believe inflation has had a material impact on the results of operations or financial condition of Landstar in the past five years. However, inflation higher than that experienced in the past five years might have an adverse effect on the Company's results of operations.

### **SEASONALITY**

Landstar's operations are subject to seasonal trends common to the trucking industry. Results of operations for the quarter ending in March are typically lower than the quarters ending June, September and December.

### **FORWARD-LOOKING STATEMENTS**

The following is a safe harbor statement under the Private Securities Litigation Reform Act of 1995. Statements contained in this document that are not based on historical facts are forward-looking statements. This Management's Discussion and Analysis of Financial Condition and Results of Operations and other sections of this Form 10-Q contain forward-looking statements, such as statements which relate to Landstar's business objectives, plans, strategies and expectations. Terms such as anticipates, believes,

**Table of Contents**

estimates, expects, plans, predicts, may, should, could, will, the negative thereof and similar expressions intended to identify forward-looking statements. Such statements are by nature subject to uncertainties and risks, including but not limited to: an increase in the frequency or severity of accidents or other claims; unfavorable development of existing accident claims; dependence on third party insurance companies; dependence on independent commission sales agents; dependence on third party capacity providers; substantial industry competition; dependence on key personnel; disruptions or failures in our computer systems; changes in fuel taxes; status of independent contractors; a downturn in economic growth or growth in the transportation sector; and other operational, financial or legal risks or uncertainties detailed in Landstar's Form 10-K for the 2006 fiscal year, described in Item 1A "Risk Factors", this report or in Landstar's other Securities and Exchange Commission filings from time to time. These risks and uncertainties could cause actual results or events to differ materially from historical results or those anticipated. Investors should not place undue reliance on such forward-looking statements and the Company undertakes no obligation to publicly update or revise any forward-looking statements.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

The Company is exposed to changes in interest rates as a result of its financing activities, primarily its borrowings on the revolving credit facility, and investing activities with respect to investments held by the insurance segment.

On July 8, 2004, Landstar entered into a new senior credit facility with a syndicate of banks and JPMorgan Chase Bank, as administrative agent (the "Fourth Amended and Restated Credit Agreement"). The Fourth Amended and Restated Credit Agreement, which expires on July 8, 2009, provides \$225,000,000 of borrowing capacity in the form of a revolving credit facility, \$75,000,000 of which may be utilized in the form of letter of credit guarantees.

The Fourth Amended and Restated Credit Agreement contains a number of covenants that limit, among other things, the incurrence of additional indebtedness, the incurrence of operating or capital lease obligations and the purchase of operating property. Landstar is required to, among other things, maintain minimum levels of Consolidated Net Worth and Fixed Charge Coverage, as each is defined in the Fourth Amended and Restated Credit Agreement.

Borrowings under the Fourth Amended and Restated Credit Agreement bear interest at rates equal to, at the option of Landstar, either (i) the greatest of (a) the prime rate as publicly announced from time to time by JPMorgan Chase Bank, (b) the three month CD rate adjusted for statutory reserves and FDIC assessment costs plus 1% and (c) the federal funds effective rate plus 1/2%, or, (ii) the rate at the time offered to JPMorgan Chase Bank in the Eurodollar market for amounts and periods comparable to the relevant loan plus a margin that is determined based on the level of the Company's Leverage Ratio, as defined in the Fourth Amended and Restated Credit Agreement. The margin is subject to an increase of 0.125% if the aggregate amount outstanding under the Fourth Amended and Restated Credit Agreement exceeds 50% of the borrowing capacity. As of March 31, 2007, the weighted average interest rate on borrowings outstanding was 5.96%. During the first quarter of fiscal 2007, the average outstanding balance under the Fourth Amended and Restated Credit Agreement was approximately \$66,297,000. Based on the borrowing rates in the Fourth Amended and Restated Credit Agreement and the repayment terms, the fair value of the outstanding borrowings as of March 31, 2007 was estimated to approximate carrying value. Assuming that debt levels on the Fourth Amended and Restated Credit Agreement remain at \$25,000,000, the balance at March 31, 2007, a hypothetical increase of 100 basis points in current rates provided for under the Fourth Amended and Restated Credit Agreement is estimated to result in an increase in interest expense of \$250,000 on an annualized basis.

All amounts outstanding on the Fourth Amended and Restated Credit Agreement are payable on July 8, 2009, the expiration of the Fourth Amended and Restated Credit Agreement.

The Company's obligations under the Fourth Amended and Restated Credit Agreement are guaranteed by all but one of Landstar System Holdings, Inc.'s subsidiaries.

Long-term investments, all of which are available-for-sale, consist of investment grade bonds having maturities of up to two years. Assuming that the long-term portion of investments in bonds remains at \$4,514,000, the balance at March 31, 2007, a hypothetical increase or decrease in interest rates of 100 basis points would not have a material impact on future earnings on an annualized basis. Short-term investments consist of short-term investment grade instruments and the current maturities of investment grade bonds. Accordingly, any future interest rate risk on these short-term investments would not be material.

**Item 4. Controls and Procedures**

## Edgar Filing: LANDSTAR SYSTEM INC - Form 10-Q

As of the end of the period covered by this report, an evaluation was carried out, under the supervision and with the participation of the Company's management, including the Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ), of the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended). Based on that evaluation, the CEO and CFO concluded that the Company's disclosure controls and procedures were effective as of March 31, 2007, to provide reasonable assurance that information required to be disclosed by the Company in



**Table of Contents**

reports that it filed or submitted under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

There were no significant changes in the Company's internal controls over financial reporting during the Company's fiscal quarter ended March 31, 2007 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

In designing and evaluating controls and procedures, Company management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Because of the inherent limitation in any control system, no evaluation or implementation of a control system can provide complete assurance that all control issues and all possible instances of fraud have been or will be detected.

**PART II OTHER INFORMATION****Item 1. Legal Proceedings**

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 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 business. Based on knowledge of the facts and, in certain cases, opinions of outside counsel, management believes that adequate provisions have been made for probable losses with respect to the resolution of all such other claims and

pending litigation and that the ultimate outcome, after provisions thereof, will not have a material adverse effect on the financial condition of the Company, but could have a material effect on the results of operations in a given quarter or year.

**Table of Contents**

## Item 1A. Risk Factors

For a discussion identifying risk factors and other important factors that could cause actual results to differ materially from those anticipated, see the discussions under Part I, Item 1A, Risk Factors in the Company's Annual Report on Form 10-K for the fiscal year ended December 30, 2006 and in Management's Discussion and Analysis of Financial Condition and Results of Operations and Notes to Consolidated Financial Statements in this Quarterly Report on Form 10-Q. There have been no material changes from the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended December 30, 2006 in response to Part I, Item 1A of that form.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Purchases of Equity Securities by the Company

The following table provides information regarding the Company's purchases of its common stock during the period from December 31, 2006 to March 31, 2007, the Company's first fiscal quarter:

Fiscal period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced programs	Maximum number of shares that may yet be purchased under the programs
December 30, 2006				827,501
Dec. 31, 2006 - Jan. 27, 2007				
Jan. 28, 2007 - Feb. 24, 2007				
Feb. 25, 2007 - Mar. 31, 2007	555,952	\$ 42.42	555,952	271,549
Total	555,952	\$ 42.42	555,952	

On August 3, 2006, Landstar System, Inc. announced that it had been authorized by its Board of Directors to purchase up to 2,000,000 shares of its common stock from time to time in the open market and in privately negotiated transactions. No specific expiration date has been assigned to the August 3, 2006 authorization.

On February 1, 2007, Landstar System, Inc. announced that its Board of Directors declared a cash dividend of \$0.03 per share with respect to its outstanding shares of common stock. The distribution date for this cash dividend was on February 28, 2007, to stockholders of record on February 13, 2007. It is the intention of the Board of Directors to pay a quarterly dividend going forward.

The Fourth Amended and Restated Credit Agreement provides for a restriction in cash dividends on the Company's capital stock only to the extent there is an event of default under the Fourth Amended and Restated Credit Agreement.

## Item 3. Defaults Upon Senior Securities

None.

## Item 4. Submission of Matters to a Vote of Security Holders

None.

## Item 5. Other Information

None.

## Item 6. Exhibits

The exhibits listed on the Exhibit Index are furnished as part of this quarterly report on Form 10-Q.

**Table of Contents**

EXHIBIT INDEX

Registrant's Commission File No.: 0-21238

Exhibit No.	Description
(31)	Certifications Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002:
31.1*	Chief Executive Officer certification, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Chief Financial Officer certification, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
(32)	Certifications Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002:
32.1**	Chief Executive Officer certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2**	Chief Financial Officer certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* Filed herewith

\*\* Furnished  
herewith

**Table of Contents**

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.

LANDSTAR SYSTEM, INC.

Date: May 4, 2007

/s/ Henry H. Gerken  
Henry H. Gerken  
President and Chief Executive Officer

Date: May 4, 2007

/s/ James B. Gattoni  
James B. Gattoni  
Vice President and Chief Financial Officer  
21