LANDSTAR SYSTEM INC
Form 10-Q
May 02, 2008

Table of Contents

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 29, 2008**

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, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange 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 21, 2008 was 52,737,878.

Index

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 29, 2008 are not necessarily indicative of the results that may be expected for the entire fiscal year ending December 27, 2008.

These interim financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company s 2007 Annual Report on Form 10-K.

2

Table of Contents

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

	March 29, 2008	Dec 29, 2007
ASSETS		
Current Assets		
Cash and cash equivalents	$ 80,980	$ 60,750
Short-term investments	24,046	22,921
Trade accounts receivable, less allowance of $4,264 and $4,469	303,588	310,258
Other receivables, including advances to independent contractors, less allowance of $4,987 and $4,792	19,896	11,170
Deferred income taxes and other current assets	17,252	28,554
Total current assets	445,762	433,653
Operating property, less accumulated depreciation and amortization of $93,254 and $88,284	128,291	132,369
Goodwill	31,134	31,134
Other assets	33,010	31,845
Total assets	$ 638,197	$ 629,001
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Cash overdraft	$ 27,211	$ 25,769
Accounts payable	110,980	117,122
Current maturities of long-term debt	23,525	23,155
Insurance claims	27,705	28,163
Accrued income taxes	15,278	14,865
Other current liabilities	41,239	40,501
Total current liabilities	245,938	249,575
Long-term debt, excluding current maturities	124,172	141,598
Insurance claims	36,458	37,631
Deferred income taxes	21,063	19,411
Shareholders Equity		
Common stock, $0.01 par value, authorized 160,000,000 shares, issued 65,856,787 and 65,630,383 shares	659	656
Additional paid-in capital	140,590	132,788
Retained earnings	623,308	601,537

Cost of 13,121,109 shares of common stock in treasury	(554,252)	(554,252)
Accumulated other comprehensive income	261	57
Total shareholders equity	210,566	180,786
Total liabilities and shareholders equity	$ 638,197	$ 629,001

See accompanying notes to consolidated financial statements.

Table of Contents

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

	Thirteen Weeks Ended March 29, 2008	Thirteen Weeks Ended March 31, 2007
Revenue	$ 608,828	$ 576,649
Investment income	1,096	1,740
Costs and expenses:		
Purchased transportation	465,029	434,058
Commissions to agents	46,814	46,632
Other operating costs	6,584	5,506
Insurance and claims	9,521	17,540
Selling, general and administrative	35,857	33,165
Depreciation and amortization	5,130	4,617
Total costs and expenses	568,935	541,518
Operating income	40,989	36,871
Interest and debt expense	2,142	1,592
Income before income taxes	38,847	35,279
Income taxes	15,104	13,675
Net income	$ 23,743	$ 21,604
Earnings per common share	$ 0.45	$ 0.39
Diluted earnings per share	$ 0.45	$ 0.38
Average number of shares outstanding:		
Earnings per common share	52,601,000	55,926,000
Diluted earnings per share	53,003,000	56,470,000
Dividends paid per common share	$ 0.0375	$ 0.0300

See accompanying notes to consolidated financial statements.

Table of Contents

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

	Thirteen Weeks Ended	
	March 29, 2008	**March 31, 2007**
OPERATING ACTIVITIES		
Net income	$ 23,743	$ 21,604
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of operating property	5,130	4,617
Non-cash interest charges	43	43
Provisions for losses on trade and other accounts receivable	1,045	392
Losses (gains) on sales/disposals of operating property	12	(979)
Deferred income taxes, net	1,684	654
Stock-based compensation	1,693	1,792
Changes in operating assets and liabilities:		
Decrease (increase) in trade and other accounts receivable	(3,101)	10,481
Decrease in other assets	10,750	9,689
Decrease in accounts payable	(6,142)	(1,909)
Increase (decrease) in other liabilities	1,040	(3,348)
Increase (decrease) in insurance claims	(1,631)	9,043
NET CASH PROVIDED BY OPERATING ACTIVITIES	34,266	52,079
INVESTING ACTIVITIES		
Net change in other short-term investments	(4,217)	1
Sales and maturities of investments	4,037	12,232
Purchases of investments	(1,318)	(15,505)
Purchases of operating property	(361)	(2,327)
Proceeds from sales of operating property		2,165
NET CASH USED BY INVESTING ACTIVITIES	(1,859)	(3,434)
FINANCING ACTIVITIES		
Increase (decrease) in cash overdraft	1,442	(275)
Dividends paid	(1,972)	(1,682)
Proceeds from exercises of stock options	4,964	2,026
Excess tax benefit on stock option exercises	1,148	508
Purchases of common stock		(23,585)
Principal payments on long-term debt and capital lease obligations	(17,759)	(39,348)

NET CASH USED BY FINANCING ACTIVITIES	(12,177)	(62,356)
Increase (decrease) in cash and cash equivalents	20,230	(13,711)
Cash and cash equivalents at beginning of period	60,750	91,491
Cash and cash equivalents at end of period	$ 80,980	$ 77,780

See accompanying notes to consolidated financial statements.

Table of Contents

LANDSTAR SYSTEM, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY
Thirteen Weeks Ended March 29, 2008
(Dollars in thousands)
(Unaudited)

	Common Stock		Additional Paid-In	Retained	Treasury Stock at Cost		Accumulated Other Comprehensive	
	Shares	**Amount**	**Capital**	**Earnings**	**Shares**	**Amount**	**Income**	**Total**
Balance December 29, 2007	65,630,383	$ 656	$ 132,788	$ 601,537	13,121,109	$ (554,252)	$ 57	$ 180,786
Net income				23,743				23,743
Dividends paid ($0.0375 per share)				(1,972)				(1,972)
Stock-based compensation expense			1,693					1,693
Exercises of stock options, including excess tax benefit	226,404	3	6,109					6,112
Unrealized gain on available-for-sale investments, net of income taxes							204	204
Balance March 29, 2008	65,856,787	$ 659	$ 140,590	$ 623,308	13,121,109	$ (554,252)	$ 261	$ 210,566

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

As of March 29, 2008, 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 29, 2008	March 31, 2007
Total cost of the Plans during the period	$ 1,693	$ 1,792
Amount of related income tax benefit recognized during the period	530	523
Net cost of the Plans during the period	$ 1,163	$ 1,269

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 2008 and 2007 thirteen-week periods:

	2008	2007
Expected volatility	33.0%	33.0%
Expected dividend yield	0.0375%	0.0300%
Risk-free interest rate	3.00%	4.75%
Expected lives (in years)	4.1	4.2

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 29, 2008 and March 31, 2007 was $12.60 and $14.22, respectively.

The following table summarizes information regarding the Company s stock options under the Plans:

	Number of Options	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (000s)
Options outstanding at December 29, 2007	2,198,308	$ 31.10		
Granted	777,500	$ 42.30		
Exercised	(226,404)	$ 21.92		
Forfeited	(2,000)	$ 43.99		

Options outstanding at March 29, 2008	2,747,404	$	35.02	7.6	$ 48,474
Options exercisable at March 29, 2008	1,049,438	$	30.54	6.2	$ 23,210

As of March 29, 2008, there were 5,613,304 shares of the Company s common stock reserved for issuance upon exercise of options granted and to be granted under the Plans.

The total intrinsic value of stock options exercised during the thirteen-week periods ended March 29, 2008 and March 31, 2007 was $6,085,000 and $4,050,000, respectively.

Table of Contents

As of March 29, 2008, there was $16,411,000 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 3.6 years.

(2) Income Taxes

The provisions for income taxes for the 2008 and 2007 thirteen-week periods were based on estimated full year combined effective income tax rates of approximately 38.9% and 38.8%, respectively, which were higher than the statutory federal income tax rate primarily as a result of state taxes, the meals and entertainment exclusion and non-deductible stock-based compensation.

(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 to calculate diluted earnings per share (in thousands):

	Thirteen Weeks Ended	
	March 29, 2008	**March 31, 2007**
Average number of common shares outstanding	52,601	55,926
Incremental shares from assumed exercises of stock options	402	544
Average number of common shares and common share equivalents outstanding	53,003	56,470

For the thirteen-week periods ended March 29, 2008 and March 31, 2007, there were 90,500 and 803,000, 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 2008 thirteen-week period, Landstar paid income taxes and interest of $1,281,000 and $2,427,000, respectively. During the 2007 thirteen-week period, Landstar paid income taxes and interest of $1,219,000 and $2,112,000, respectively. Landstar acquired operating property by entering into capital leases in the amount of $703,000 and $8,020,000 in the 2008 and 2007 thirteen-week periods, respectively.

(5) Segment Information

Historically, the Company reported the results of three operating segments: the carrier segment, the global logistics segment and the insurance segment. Beginning in the thirteen-week period ended March 29, 2008, the Company revised the presentation format of its segment disclosure to consolidate the previously reported three segments to two segments: the transportation logistics segment and the insurance segment. This change in segment reporting reflected increased centralization and consolidation of certain administrative and sales functions across all of the Company s operating subsidiaries and the increased similarity of the services provided by the operations of the Company s various operating subsidiaries, primarily with respect to truck brokerage services. As a result of this change in presentation, the revenue and operating results formerly separated into the carrier and global logistics segments, together with corporate overhead, which was previously included as other in the segment information, were consolidated into the transportation logistics segment. This change in segment reporting had no impact on the Company s consolidated balance sheets, income statements, cash flows or changes in shareholders equity for any periods. This change in segment reporting also had no impact on financial reporting with respect to the Company s insurance segment. Prior period segment information has been adjusted to reflect the change in segment reporting.

Table of Contents

The following table summarizes information about Landstar s reportable business segments as of and for the thirteen-week periods ended March 29, 2008 and March 31, 2007 (in thousands):

	Thirteen Weeks Ended					
	March 29, 2008			March 31, 2007		
	Transportation Logistics	Insurance	Total	Transportation Logistics	Insurance	Total
External revenue	$ 599,600	$ 9,228	$ 608,828	$ 567,439	$ 9,210	$ 576,649
Investment income		1,096	1,096		1,740	1,740
Internal revenue		5,852	5,852		6,196	6,196
Operating income	32,386	8,603	40,989	33,512	3,359	36,871
Goodwill	31,134		31,134	31,134		31,134

(6) Comprehensive Income

The following table includes the components of comprehensive income for the thirteen-week periods ended March 29, 2008 and March 31, 2007 (in thousands):

	Thirteen Weeks Ended	
	March 29, 2008	March 31, 2007
Net income	$ 23,743	$ 21,604
Unrealized holding gains on available-for-sale investments, net of income taxes	204	15
Comprehensive income	$ 23,947	$ 21,619

Accumulated other comprehensive income at March 29, 2008 of $261,000 represents the unrealized holding gains on available-for-sale investments of $404,000, net of related income taxes of $143,000.

(7) Commitments and Contingencies

As of March 29, 2008, Landstar had $26,868,000 of letters of credit outstanding under the Company s revolving credit facility and $45,303,000 of letters of credit secured by investments held by the Company s insurance segment. Short-term investments include $4,788,000 in current maturities of investment grade bonds and $19,258,000 of cash equivalents held by the Company s insurance segment at March 29, 2008. These short-term investments together with $16,565,000 of the non-current portion of investment grade bonds and $6,827,000 of cash equivalents included in other assets at March 29, 2008, provide collateral for the $45,303,000 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 District Court) in Jacksonville, Florida, against the Company and certain of its subsidiaries. The complaint was amended on April 7, 2005 (as amended, the Amended Complaint). The Amended Complaint alleged that certain aspects of the Company s motor carrier leases and related practices with its BCO Independent Contractors violate certain federal leasing regulations and sought injunctive relief, an unspecified amount of damages and attorney s fees. On August 30, 2005, the District Court granted a motion by the Plaintiffs to certify the case as a class action.

On January 16, 2007, the District 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 March 29, 2007, the District Court denied 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 and the Defendants each filed motions with the District Court concerning an award of attorney fees from the other party.

The Plaintiffs have filed an appeal with the United States Court of Appeals for the Eleventh Circuit (the Appellate Court) with respect to certain of the District Court s rulings, including the judgments entered by the District Court in favor of the Defendants on the issues of damages and injunctive relief. The Defendants have asked the Appellate Court to affirm the rulings of the District Court that have been appealed by the Plaintiffs. The Defendants have also filed a cross-appeal with the Appellate Court with respect to certain other rulings of the District Court. Although no assurances can be given with respect to the outcome of the appeal or any proceedings that may be conducted thereafter, the Company believes it has meritorious defenses and it intends to continue asserting these defenses vigorously.

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 29, 2007 and Management s Discussion and Analysis of Financial Condition and Results of Operations included in the 2007 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 and logistics 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 and logistics 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 handle customers freight. The nature of the Company s business is such that a significant portion of its operating costs varies directly with revenue.

Historically, the Company reported the results of three operating segments: the carrier segment, the global logistics segment and the insurance segment. Beginning in the thirteen-week period ended March 29, 2008, the Company revised the presentation format of its segment disclosure to consolidate the previously reported three segments to two segments: the transportation logistics segment and the insurance segment. This change in segment reporting reflected increased centralization and consolidation of certain administrative and sales functions across all of the Company s operating subsidiaries and the increased similarity of the services provided by the operations of the Company s various operating subsidiaries, primarily with respect to truck brokerage services. As a result of this change in presentation, the revenue and operating results formerly separated into the carrier and global logistics segments, together with corporate overhead, which was previously included as other in the segment information, were consolidated into the transportation logistics segment. This change in reporting had no impact on reporting with respect to the insurance segment.

The transportation logistics segment markets its services primarily through independent commission sales agents. Each of the independent commission sales agents have the opportunity to market all of the services provided by the transportation logistics segment. The transportation logistics segment provides a wide range of transportation and logistics services, including truckload transportation, rail intermodal, the arrangement of multimodal (ground, air, ocean and rail) moves, contract logistics, emergency transportation services, air and ocean cargo services and warehousing. Truckload services primarily are provided 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, includi