

LANDSTAR SYSTEM INC  
Form 10-Q  
October 28, 2011  
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**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 September 24, 2011

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.**

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(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 has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files): Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange 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 October 17, 2011 was 46,905,754.



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**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 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 thirty nine weeks ended September 24, 2011, are not necessarily indicative of the results that may be expected for the entire fiscal year ending December 31, 2011.

These interim financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's 2010 Annual Report on Form 10-K.

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## LANDSTAR SYSTEM, INC. AND SUBSIDIARY

## CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share amounts)

(Unaudited)

	September 24, 2011	December 25, 2010
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 69,409	\$ 44,706
Short-term investments	28,177	23,266
Trade accounts receivable, less allowance of \$4,652 and \$5,324	388,235	307,350
Other receivables, including advances to independent contractors, less allowance of \$5,018 and \$5,511	53,515	23,943
Deferred income taxes and other current assets	19,073	21,652
<b>Total current assets</b>	<b>558,409</b>	<b>420,917</b>
Operating property, less accumulated depreciation and amortization of \$147,237 and \$137,830	128,388	132,649
Goodwill	57,470	57,470
Other assets	59,090	72,846
<b>Total assets</b>	<b>\$ 803,357</b>	<b>\$ 683,882</b>
<b>LIABILITIES AND EQUITY</b>		
Current Liabilities		
Cash overdraft	\$ 23,061	\$ 24,877
Accounts payable	180,488	137,297
Current maturities of long-term debt	16,548	22,172
Insurance claims	75,511	40,215
Other current liabilities	68,268	53,785
<b>Total current liabilities</b>	<b>363,876</b>	<b>278,346</b>
Long-term debt, excluding current maturities	110,526	99,439
Insurance claims	30,336	31,468
Deferred income taxes	20,078	23,662
Equity		
Landstar System, Inc. and subsidiary shareholders' equity		
Common stock, \$0.01 par value, authorized 160,000,000 shares, issued 66,595,036 and 66,535,169 shares	666	665
Additional paid-in capital	164,766	169,268
Retained earnings	917,100	844,132
Cost of 19,689,466 and 18,674,902 shares of common stock in treasury	(805,189)	(763,182)
Accumulated other comprehensive income	1,198	881
<b>Total Landstar System, Inc. and subsidiary shareholders' equity</b>	<b>278,541</b>	<b>251,764</b>

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Noncontrolling interest		(797)
Total equity	278,541	250,967
Total liabilities and equity	\$ 803,357	\$ 683,882

See accompanying notes to consolidated financial statements.

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## LANDSTAR SYSTEM, INC. AND SUBSIDIARY

## CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands, except per share amounts)

(Unaudited)

	Thirty Nine Weeks Ended		Thirteen Weeks Ended	
	September 24, 2011	September 25, 2010	September 24, 2011	September 25, 2010
Revenue	\$ 1,931,560	\$ 1,812,635	\$ 684,013	\$ 622,826
Investment income	1,294	1,069	373	495
Costs and expenses:				
Purchased transportation	1,459,660	1,381,955	518,300	474,665
Commissions to agents	153,165	134,695	54,990	47,316
Other operating costs	22,050	21,952	6,427	6,448
Insurance and claims	34,096	37,609	9,381	11,480
Selling, general and administrative	112,252	114,886	39,206	41,070
Depreciation and amortization	19,336	18,444	6,549	6,456
Total costs and expenses	1,800,559	1,709,541	634,853	587,435
Operating income	132,295	104,163	49,533	35,886
Interest and debt expense	2,340	2,699	735	1,035
Income before income taxes	129,955	101,464	48,798	34,851
Income taxes	49,642	38,761	18,640	13,315
Net income	80,313	62,703	30,158	21,536
Less: Net loss attributable to noncontrolling interest	(62)	(712)		(266)
Net income attributable to Landstar System, Inc. and subsidiary	\$ 80,375	\$ 63,415	\$ 30,158	\$ 21,802
Earnings per common share attributable to Landstar System, Inc. and subsidiary	\$ 1.69	\$ 1.27	\$ 0.64	\$ 0.44
Diluted earnings per share attributable to Landstar System, Inc. and subsidiary	\$ 1.68	\$ 1.27	\$ 0.64	\$ 0.44
Average number of shares outstanding:				
Earnings per common share	47,670,000	49,921,000	47,358,000	49,434,000
Diluted earnings per share	47,735,000	49,990,000	47,387,000	49,447,000
Dividends paid per common share	\$ 0.155	\$ 0.140	\$ 0.055	\$ 0.050

See accompanying notes to consolidated financial statements.





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LANDSTAR SYSTEM, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Thirty Nine Weeks Ended	
	September 24, 2011	September 25, 2010
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 80,313	\$ 62,703
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of operating property and intangible assets	19,336	18,444
Non-cash interest charges	164	164
Provisions for losses on trade and other accounts receivable	4,308	3,539
Losses (gains) on sales/disposals of operating property	(253)	570
Deferred income taxes, net	(4,205)	(1,592)
Stock-based compensation	3,783	3,567
Changes in operating assets and liabilities:		
Increase in trade and other accounts receivable	(114,765)	(49,502)
Decrease in other assets	3,957	323
Increase in accounts payable	43,191	25,677
Increase in other liabilities	14,401	10,582
Increase (decrease) in insurance claims	34,164	(6,192)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>84,394</b>	<b>68,283</b>
<b>INVESTING ACTIVITIES</b>		
Net change in other short-term investments		149
Sales and maturities of investments	65,646	31,145
Purchases of investments	(58,279)	(60,865)
Purchases of operating property	(3,460)	(25,474)
Proceeds from sales of operating property	2,463	948
<b>NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES</b>	<b>6,370</b>	<b>(54,097)</b>
<b>FINANCING ACTIVITIES</b>		
Decrease in cash overdraft	(1,816)	(6,422)
Dividends paid	(7,407)	(7,003)
Proceeds from exercises of stock options	656	1,527
Excess (shortfall) tax effect on stock option exercises	(122)	1,556
Borrowings on revolving credit facility	10,000	40,000
Purchases of common stock	(41,966)	(54,647)
Principal payments on capital lease obligations	(17,575)	(19,912)
Purchase of noncontrolling interest	(8,000)	
<b>NET CASH USED BY FINANCING ACTIVITIES</b>	<b>(66,230)</b>	<b>(44,901)</b>

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Effect of exchange rate changes on cash and cash equivalents	169	71
Increase (decrease) in cash and cash equivalents	24,703	(30,644)
Cash and cash equivalents at beginning of period	44,706	85,719
Cash and cash equivalents at end of period	\$ 69,409	\$ 55,075

See accompanying notes to consolidated financial statements.

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## LANDSTAR SYSTEM, INC. AND SUBSIDIARY

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Thirty Nine Weeks Ended September 24, 2011

(Dollars in thousands)

(Unaudited)

	Landstar System, Inc. and Subsidiary Shareholders								
	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Treasury Stock at Cost Shares	Treasury Stock at Cost Amount	Accumulated Other Comprehensive Income	Non- controlling Interest	Total
Balance December 25, 2010	66,535,169	\$ 665	\$ 169,268	\$ 844,132	18,674,902	\$ (763,182)	\$ 881	\$ (797)	\$ 250,967
Net income (loss)				80,375				(62)	80,313
Dividends paid (\$0.155 per share)				(7,407)					(7,407)
Purchases of common stock					1,013,507	(41,966)			(41,966)
Purchase of noncontrolling interest			(8,859)					859	(8,000)
Stock-based compensation			3,783						3,783
Exercises of stock options and issuance and vesting of non-vested stock, including shortfall tax effect	59,867	1	574		1,057	(41)			534
Foreign currency translation							169		169
Unrealized gain on available-for-sale investments, net of income taxes							148		148
Balance September 24, 2011	66,595,036	\$ 666	\$ 164,766	\$ 917,100	19,689,466	\$ (805,189)	\$ 1,198	\$	\$ 278,541

See accompanying notes to consolidated financial statements.

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## 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". Significant intercompany accounts have been eliminated in consolidation.

**(1) Noncontrolling Interest**

In the Company's 2009 fiscal third quarter, the Company acquired A3 Integration, LLC and its subsidiaries through A3i Acquisition, LLC, an entity in which the Company owned 100% of the non-voting, preferred interests and, from the date of acquisition to January 2011, 75% of the voting, common equity interests. A subsidiary of the Company purchased the remaining 25% of the voting, common equity interests in A3i Acquisition, LLC in January 2011.

**(2) Significant Accounting Policies***Financial Instruments*

The Company's financial instruments include cash equivalents, short and long term investments, trade and other accounts receivable, accounts payable, other accrued liabilities, current and non-current insurance claims and long term debt plus current maturities ("Debt"). The carrying value of cash equivalents, trade and other accounts receivable, accounts payable, current insurance claims and other accrued liabilities approximate fair value as the assets and liabilities are short term in nature. Short and long term investments are carried at fair value as further described in the Investments footnote below. The carrying value of non-current insurance claims approximate fair value as the Company generally has the ability to, but is not required to, settle claims in a short term. The Company's Debt includes borrowings under the Company's revolving credit facility plus borrowings relating to capital lease obligations used to finance trailing equipment. The interest rates on borrowings under the revolving credit facility are typically tied to short-term LIBOR rates that adjust monthly and, as such, carrying value approximates fair value. Interest rates on borrowings under capital leases approximate the interest rates that would currently be available to the Company under similar terms and, as such, carrying value approximates fair value.

**(3) Share-based Payment Arrangements**

As of September 24, 2011, the Company had two employee equity incentive plans, the 2002 employee stock option and stock incentive plan (the ESOSIP) and the 2011 equity incentive plan (the 2011 EIP). The Company also has a stock compensation plan for members of its Board of Directors (the Directors Stock Compensation Plan). The ESOSIP, 2011 EIP and Directors Stock Compensation Plan are each referred to herein as a Plan, and, collectively, as the Plans. In May 2011, the Company's shareholders approved the 2011 EIP. The provisions of the 2011 EIP, which replaces the ESOSIP, are substantially similar to the provisions of the ESOSIP. 6,000,000 shares of the Company's common stock were authorized for issuance under the 2011 EIP. No further grants can be made under the ESOSIP, including 2,239,117 shares of the Company's common stock previously reserved for issuance under the ESOSIP. Amounts recognized in the financial statements with respect to these Plans are as follows (in thousands):

	Thirty Nine Weeks Ended		Thirteen Weeks Ended	
	September 24, 2011	September 25, 2010	September 24, 2011	September 25, 2010
Total cost of the Plans during the period	\$ 3,783	\$ 3,567	\$ 1,310	\$ 1,199

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Amount of related income tax benefit recognized during the period	992	906	354	285
Net cost of the Plans during the period	\$ 2,791	\$ 2,661	\$ 956	\$ 914

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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 2011 and 2010 thirty-nine-week periods:

	2011	2010
Expected volatility	35.0%	37.0%
Expected dividend yield	0.450%	0.400%
Risk-free interest rate	1.75%	2.50%
Expected lives (in years)	4.0	4.2

The Company utilizes historical data, including exercise patterns and employee departure behavior, in estimating the term that 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 thirty-nine-week periods ended September 24, 2011 and September 25, 2010 was \$12.06 and \$12.00, respectively.

The following table summarizes information regarding the Company's stock options granted 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 25, 2010	2,295,831	\$ 39.73		
Granted	273,000	\$ 41.79		
Exercised	(99,555)	\$ 34.24		
Forfeited	(118,700)	\$ 41.59		
Options outstanding at September 24, 2011	2,350,576	\$ 40.11	6.2	\$
Options exercisable at September 24, 2011	1,110,143	\$ 39.70	4.9	\$

As of September 24, 2011, there were 1,788,462 stock options outstanding that were out-of-the-money based on that day's per share closing market price of \$38.51 as reported on the NASDAQ Global Select Market. The remaining stock options outstanding as of September 24, 2011 that were in-the-money had an aggregate intrinsic value of \$2,805,000. As of September 24, 2011, there were 800,429 exercisable stock options outstanding that were out-of-the-money. The remaining exercisable stock options outstanding as of September 24, 2011 that were in-the-money had an aggregate intrinsic value of \$2,412,000. The total intrinsic value of stock options exercised during the thirty-nine-week periods ended September 24, 2011 and September 25, 2010 was \$983,000 and \$9,115,000, respectively.

As of September 24, 2011, there was \$9,349,000 of total unrecognized compensation cost related to non-vested stock options granted under the Plans. The unrecognized compensation cost related to these non-vested options is expected to be recognized over a weighted average period of 2.8 years.

The fair value of each share of non-vested restricted stock issued under the Plans is based on the fair value of a share of the Company's common stock on the date of grant. The following table summarizes information regarding the Company's non-vested restricted stock under the Plans:

	Number of Shares	Weighted Average Grant Date Fair Value
Non-vested restricted stock outstanding at December 25, 2010	29,854	\$ 39.49

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Granted	22,410	\$	44.82
Vested	(6,056)	\$	42.41
Forfeited	(2,938)	\$	37.13
Non-vested restricted stock outstanding at September 24, 2011	43,270	\$	42.00

As of September 24, 2011, there was \$1,400,000 of total unrecognized compensation cost related to non-vested shares of restricted stock granted under the Plans. The unrecognized compensation cost related to these non-vested shares of restricted stock is expected to be recognized over a weighted average period of 2.3 years.



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As of September 24, 2011, there were 118,959 shares of the Company's common stock reserved for issuance under the Directors' Stock Compensation Plan and 8,336,576 shares of the Company's common stock reserved for issuance in the aggregate under the Company's other Plans.

**(4) Income Taxes**

The provisions for income taxes for the 2011 and 2010 thirty-nine-week periods were each based on an effective income tax rate of approximately 38.2%, which was 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.

**(5) Earnings Per Share**

Earnings per common share attributable to Landstar System, Inc. and subsidiary are based on the weighted average number of common shares outstanding, including outstanding restricted stock, and diluted earnings per share attributable to Landstar System, Inc. and subsidiary are based on the weighted average number of common shares outstanding, including outstanding restricted stock, 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 attributable to Landstar System, Inc. and subsidiary to the average number of common shares and common share equivalents outstanding used to calculate diluted earnings per share attributable to Landstar System, Inc. and subsidiary (in thousands):

	Thirty Nine Weeks Ended		Thirteen Weeks Ended	
	September 24, 2011	September 25, 2010	September 24, 2011	September 25, 2010
Average number of common shares outstanding	47,670	49,921	47,358	49,434
Incremental shares from assumed exercises of stock options	65	69	29	13
Average number of common shares and common share equivalents outstanding	47,735	49,990	47,387	49,447

For the thirty-nine-week and thirteen-week periods ended September 24, 2011, there were 224,844 and 578,867, respectively, options outstanding to purchase shares of common stock excluded from the calculation of diluted earnings per share attributable to Landstar System, Inc. and subsidiary because they were antidilutive. For the thirty-nine-week and thirteen-week periods ended September 25, 2010 there were 1,353,313 and 1,650,313, respectively, options outstanding to purchase shares of common stock excluded from the calculation of diluted earnings per share attributable to Landstar System, Inc. and subsidiary because they were antidilutive.

**(6) Additional Cash Flow Information**

During the 2011 thirty-nine-week period, Landstar paid income taxes and interest of \$42,120,000 and \$2,368,000, respectively. During the 2010 thirty-nine-week period, Landstar paid income taxes and interest of \$36,568,000 and \$2,847,000, respectively. Landstar acquired operating property by entering into capital leases in the amount of \$13,038,000 and \$14,145,000 in the 2011 and 2010 thirty-nine-week periods, respectively.

**(7) Segment Information**

The following tables summarize information about Landstar's reportable business segments as of and for the thirty-nine-week and thirteen-week periods ended September 24, 2011 and September 25, 2010 (in thousands):

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	Thirty Nine Weeks Ended					
	September 24, 2011			September 25, 2010		
	Transportation Logistics	Insurance	Total	Transportation Logistics	Insurance	Total
External revenue	\$ 1,906,037	\$ 25,523	\$ 1,931,560	\$ 1,787,107	\$ 25,528	\$ 1,812,635
Investment income		1,294	1,294		1,069	1,069
Internal revenue		21,681	21,681		21,463	21,463
Operating income	113,749	18,546	132,295	88,460	15,703	104,163
Expenditures on long-lived assets	3,460		3,460	25,474		25,474
Goodwill	57,470					