

LANDSTAR SYSTEM INC

Form 10-Q

November 03, 2006

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 **September 30, 2006**

OR

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

For the transition period from _____ to _____

Commission File Number: **0-21238**

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 October 20, 2006 was 56,880,698.

Index

PART I Financial Information

Item 1. Financial Statements

Consolidated Balance Sheets as of September 30, 2006 and December 31, 2005 Page 3

Consolidated Statements of Income for the Thirty Nine and Thirteen Weeks Ended September 30, 2006 and September 24, 2005 Page 4

Consolidated Statements of Cash Flows for the Thirty Nine Weeks Ended September 30, 2006 and September 24, 2005 Page 5

Consolidated Statement of Changes in Shareholders' Equity for the Thirty Nine Weeks Ended September 30, 2006 Page 6

Notes to Consolidated Financial Statements Page 7

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations Page 11

Item 3. Quantitative and Qualitative Disclosures About Market Risk Page 20

Item 4. Controls and Procedures Page 21

PART II Other Information

Item 1. Legal Proceedings Page 21

Item 1A. Risk Factors Page 22

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds Page 23

Item 6. Exhibits Page 23

Signatures Page 25

EX-31.1 Section 302 Certification of CEO

EX-31.2 Section 302 Certification of CFO

EX-32.1 Section 906 Certification of CEO

EX-32.2 Section 906 Certification of 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 thirty nine weeks ended September 30, 2006 are not necessarily indicative of the results that may be expected for the entire fiscal year ending December 30, 2006.

Edgar Filing: LANDSTAR SYSTEM INC - Form 10-Q

These interim financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's 2005 Annual Report on Form 10-K.

2

Table of ContentsLANDSTAR SYSTEM, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share amounts)

(Unaudited)

	Sept 30, 2006	Dec 31, 2005
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 82,819	\$ 29,398
Short-term investments	21,162	20,693
Trade accounts receivable, less allowance of \$5,550 and \$4,655	357,482	534,274
Other receivables, including advances to independent contractors, less allowance of \$5,024 and \$4,342	18,827	11,384
Deferred income taxes and other current assets	30,289	21,106
Total current assets	510,579	616,855
Operating property, less accumulated depreciation and amortization of \$76,885 and \$68,561	103,346	89,131
Goodwill	31,134	31,134
Other assets	33,556	28,694
Total assets	\$ 678,615	\$ 765,814
 LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Cash overdraft	\$ 29,495	\$ 29,829
Accounts payable	141,419	164,509
Current maturities of long-term debt	16,860	12,122
Insurance claims	26,526	27,887
Other current liabilities	57,249	65,149
Total current liabilities	271,549	299,496
Long-term debt, excluding current maturities	110,250	154,851
Insurance claims	38,295	37,840
Deferred income taxes	18,139	17,938
Shareholders Equity		
Common stock, \$0.01 par value, authorized 160,000,000 shares, issued 64,858,208 and 64,151,902	649	642
Additional paid-in capital	103,225	84,532
Retained earnings	472,292	392,549

Edgar Filing: LANDSTAR SYSTEM INC - Form 10-Q

Cost of 7,988,710 and 5,344,883 shares of common stock in treasury	(335,767)	(221,776)
Accumulated other comprehensive loss	(17)	(211)
Note receivable arising from exercise of stock options	0	(47)
Total shareholders' equity	240,382	255,689
Total liabilities and shareholders' equity	\$ 678,615	\$ 765,814

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)

	Thirty Nine Weeks Ended		Thirteen Weeks Ended	
	Sept 30,	Sept 24,	Sept 30,	Sept 24,
	2006	2005	2006	2005
Revenue	\$ 1,902,477	\$ 1,717,386	\$ 649,197	\$ 676,070
Investment income	2,589	2,087	1,337	852
Costs and expenses:				
Purchased transportation	1,430,411	1,286,016	486,102	502,924
Commissions to agents	149,694	135,689	52,173	53,650
Other operating costs	37,125	27,400	14,837	10,785
Insurance and claims	30,230	34,850	9,656	11,946
Selling, general and administrative	102,809	99,923	31,885	36,072
Depreciation and amortization	12,230	11,926	4,180	3,998
Total costs and expenses	1,762,499	1,595,804	598,833	619,375
Operating income	142,567	123,669	51,701	57,547
Interest and debt expense	4,950	3,194	1,808	1,205
Income before income taxes	137,617	120,475	49,893	56,342
Income taxes	53,222	46,664	19,313	21,773
Net income	\$ 84,395	\$ 73,811	\$ 30,580	\$ 34,569
Earnings per common share	\$ 1.45	\$ 1.24	\$ 0.53	\$ 0.59
Diluted earnings per share	\$ 1.43	\$ 1.22	\$ 0.53	\$ 0.58
Average number of shares outstanding:				
Earnings per common share	58,229,000	59,416,000	57,287,000	58,494,000
Diluted earnings per share	59,155,000	60,660,000	57,948,000	59,526,000
Dividends paid per common share	\$ 0.080	\$ 0.025	\$ 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)

	Thirty Nine Weeks Ended	
	Sept 30, 2006	Sept 24, 2005
OPERATING ACTIVITIES		
Net income	\$ 84,395	\$ 73,811
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of operating property	12,230	11,926
Non-cash interest charges	130	131
Provisions for losses on trade and other accounts receivable	4,218	4,649
(Gains) losses on sales and disposals of operating property	120	(206)
Director compensation paid in common stock	265	193
Deferred income taxes, net	(440)	(4,278)
Stock-based compensation	5,125	4,518
Changes in operating assets and liabilities:		
Decrease (increase) in trade and other accounts receivable	165,131	(4,226)
Increase in other assets	(9,915)	(852)
Increase (decrease) in accounts payable	(23,090)	54,246
Increase (decrease) in other liabilities	(7,368)	6,240
Decrease in insurance claims	(906)	(404)
NET CASH PROVIDED BY OPERATING ACTIVITIES	229,895	145,748
INVESTING ACTIVITIES		
Net change in other short-term investments	(2,829)	(2,728)
Sales and maturities of investments	25,015	4,018
Purchases of investments	(25,974)	(4,446)
Purchases of operating property	(2,756)	(1,851)
Proceeds from sales of operating property	1,106	3,992
NET CASH USED BY INVESTING ACTIVITIES	(5,438)	(1,015)
FINANCING ACTIVITIES		
Increase (decrease) in cash overdraft	(334)	916
Proceeds from repayment of notes receivable arising from exercises of stock options	47	275
Dividends paid	(4,652)	(1,458)
Proceeds from exercises of stock options	8,271	5,393
Excess tax benefit on stock option exercises	5,007	2,003
Borrowings on revolving credit facility	5,000	2,000

Edgar Filing: LANDSTAR SYSTEM INC - Form 10-Q

Purchases of common stock	(114,597)	(95,600)
Principal payments on long-term debt and capital lease obligations	(69,778)	(7,946)
NET CASH USED BY FINANCING ACTIVITIES	(171,036)	(94,417)
Increase in cash and cash equivalents	53,421	50,316
Cash and cash equivalents at beginning of period	29,398	61,684
Cash and cash equivalents at end of period	\$ 82,819	\$112,000

See accompanying notes to consolidated financial statements.

Table of Contents

LANDSTAR SYSTEM, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
Thirty Nine Weeks Ended September 30, 2006
(Dollars in thousands)
(Unaudited)

	Common Stock		Add 1	Retained Earnings	Treasury Stock at Cost		Accumulated	Note Receivable Arising from	Total
	Shares	Amount	Paid-In Capital		Other Comprehensive Income (Loss)	Shares	Amount	Stock Options	
Balance December 31, 2005	64,151,902	\$642	\$ 84,532	\$392,549	5,344,883	\$(221,776)	\$(211)	\$(47)	\$ 255,689
Net income				84,395					84,395
Dividends paid				(4,652)					(4,652)
Director compensation paid in common stock	6,000		265						265
Purchases of common stock					2,658,427	(114,597)			(114,597)
Stock based compensation expense			5,125						5,125
Exercises of stock options, including excess tax benefit	700,306	7	13,271						13,278
Repayment of note receivable arising from exercise of stock options								47	47
Incentive compensation paid in common stock			32		(14,600)	606			638

Change in other comprehensive income (loss) on available-for-sale investments, net of income taxes								194	194
--	--	--	--	--	--	--	--	-----	-----

Balance September 30, 2006	64,858,208	\$649	\$103,225	\$472,292	7,988,710	\$(335,767)	\$ (17)	\$ 0	\$ 240,382
----------------------------	------------	-------	-----------	-----------	-----------	-------------	---------	------	------------

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

Prior to 2006, the Company accounted for share-based payment plans in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ("APB 25"), and related interpretations. Under APB 25, no stock-based compensation was reflected in net income from stock options granted as all options granted had an exercise price equal to the fair market value of the underlying common stock on the date of grant. On January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123R ("FAS 123R"), Share-Based Payment. The Company adopted FAS 123R using the modified retrospective method. Amounts for prior year periods have been adjusted to reflect the adoption of FAS 123R.

Retrospective Application

Under the modified retrospective method, compensation cost is recognized in the financial statements beginning January 1, 2006, based on the requirements of FAS 123R for all share-based payments granted after that date, and based on the requirements of FAS 123 for all unvested awards granted prior to the effective date of FAS 123R. In addition, results for prior periods have been retrospectively adjusted utilizing the pro forma disclosures in those prior financial statements. The unaudited Balance Sheet as of December 31, 2005, reflects the adoption of FAS 123R as follows: (1) retained earnings has been reduced by \$20,421,000, representing cumulative share-based compensation expense, net of related income tax benefits, for stock options granted from 1995 through 2005, (2) additional paid-in-capital has been increased by \$23,475,000, representing cumulative share-based compensation expense and reduced by income tax benefits realized excluding tax benefits in excess of recognized compensation costs ("excess tax benefits"), for stock options granted from 1995 through 2005, and (3) deferred tax assets have been increased by \$3,054,000 representing the estimated future tax benefits attributable to share-based compensation expense expected to be realized.

As a result of the FAS 123R retroactive application, for the thirty nine and thirteen weeks ended September 24, 2005, net income was reduced by \$3,185,000 and \$1,056,000, respectively, and earnings per common share was reduced by \$.05 and \$.02 in the thirty nine and thirteen weeks ended September 24, 2005, respectively, and diluted earnings per share was reduced by \$.05 and \$.02 in the thirty nine and thirteen weeks ended September 24, 2005, respectively.

Prior to the adoption of FAS 123R, under APB 25, the Company was required to record tax benefits realized from share-based payment arrangements as an operating cash flow. However, FAS 123R requires that excess tax benefits be recorded as a financing cash inflow and corresponding operating cash outflow. The change in presentation of tax benefits from share-based payment arrangements results in a decrease in cash from operating activities and an increase in cash from financing activities of the same amount and does not impact the Company's overall cash position. The cash flow presentation for the thirty nine weeks ended September 24, 2005, has been adjusted to conform to the current year presentation. In the accompanying unaudited Consolidated Statements of Cash Flows for the thirty nine week periods ended September 30, 2006 and September 24, 2005, the Company realized tax benefits of \$5,007,000 and \$2,003,000, respectively, in excess of recognized compensation cost and reported those amounts as a cash outflow from operating activities and a cash inflow from financing activities.

Share-based payment arrangements

As of September 30, 2006, the Company had two employee stock option plans and one stock option plan for members of its Board of Directors (the "Plans"). The Plans have been approved by the Company's shareholders and are further described below. Amounts recognized in the financial statements with respect to these Plans are as follows (in thousands):

	Thirty Nine Weeks Ended		Thirteen Weeks Ended	
	Sept 30, 2006	Sept 24, 2005	Sept 30, 2006	Sept 24, 2005
Total cost of share-based payment plans during the period	\$ 5,125	\$ 4,518	\$ 1,828	\$ 1,490
Amount of related income tax benefit recognized during the period	1,611	1,333	548	434
Net cost of share based payment plans during the period	\$ 3,514	\$ 3,185	\$ 1,280	\$ 1,056

Table of Contents

Employee and director stock option plans

Under the 1993 Stock Option Plan, as amended, the Compensation Committee of the Board of Directors was authorized to grant options to Company employees to purchase up to 4,460,000 shares of common stock. Under the 2002 Employee Stock Option Plan, the Compensation Committee of the Board of Directors is authorized to grant options to Company employees to purchase up to 6,400,000 shares of common stock. Under the 1994 Directors' Stock Option Plan, as amended (the "DSOP"), options to purchase up to 420,000 shares of common stock were authorized to be granted to outside members of the Board of Directors upon election or re-election to the Board of Directors. Effective May 15, 2003, no further grants will be made under the DSOP. Also, no further grants will be made under the 1993 Stock Option Plan as it has expired.

Options granted under the Plans become exercisable in either three or five equal annual installments commencing on the first anniversary of the date of grant or vest 100% four and one-half years from the date of grant or 100% on the fifth anniversary from the date of grant, subject to acceleration in certain circumstances. All options granted under the Plans expire on the tenth anniversary of the date of grant. Under the Plans, the exercise price of each option equals the fair market value of the Company's common stock on the date of grant. As of September 30, 2006, there were 6,598,306 shares of the Company's common stock reserved for issuance upon exercise of options granted and to be granted under the Plans.

The fair value of each option grant on its grant date was calculated using the Black-Scholes option pricing model with the following assumptions for grants made in 2006 and 2005: risk-free interest rate of 4.75% and 4.5% in 2006 and 2005, respectively, expected lives of 4.5 years and 5 years in 2006 and 2005, respectively, a dividend yield of 0.3% in 2006 and no dividend yield in 2005. The expected volatility used in calculating the fair market value of stock options granted was 34% and 31% in 2006 and 2005, respectively. 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 term of the options granted.

Under the Directors' Stock Compensation Plan, outside members of the Board of Directors who are elected or re-elected to the Board will receive 6,000 shares of common stock of the Company, subject to certain restrictions including restrictions on transfer. During each of the 2006 and 2005 thirty nine week periods, 6,000 shares of the Company's common stock were issued to a member of the Board of Directors upon such member's re-election at the 2006 and 2005 annual shareholders' meetings. During the thirty nine week periods ended September 30, 2006 and September 24, 2005, the Company reported \$265,000 and \$193,000, respectively, in compensation expense representing the fair market value of these share awards.

Summary details for plan stock options

Information regarding the Company's stock options is as follows:

	Number of Options	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (000s)
Options outstanding at December 31, 2005	2,794,652	\$ 19.07		
Granted	630,000	\$ 43.60		
Exercised	(700,306)	\$ 11.81		
Forfeited/expired	(17,800)	\$ 15.03		
Options outstanding at September 30, 2006	2,706,546	\$ 26.68	7.4	\$ 42,951

Edgar Filing: LANDSTAR SYSTEM INC - Form 10-Q

Options exercisable at September 30, 2006	914,674	\$ 16.36	5.7	\$ 23,951
--	---------	----------	-----	-----------

The weighted average grant date fair value of stock options granted during the thirty nine week periods ended September 30, 2006 and September 24, 2005 was \$15.32 and \$12.76, respectively.

The total intrinsic value of stock options exercised during the thirty nine and thirteen week periods ended September 30, 2006 was \$22,548,000 and \$6,138,000, respectively. The total intrinsic value of stock options exercised during the thirty nine and thirteen week periods ended September 24, 2005 was \$14,963,000 and \$3,611,000, respectively.

Table of Contents

As of September 30, 2006, there was \$13,789,000 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 1.9 years.

(2) Income Taxes

The provisions for income taxes for both the 2006 and 2005 thirty nine week periods were based on an estimated full year combined effective income tax rate of approximately 38.7%, 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.

(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):

	Thirty Nine Weeks Ended		Thirteen Weeks Ended	
	Sept 30, 2006	Sept 24, 2005	Sept 30, 2006	Sept 24, 2005
Average number of common shares outstanding	58,229	59,416	57,287	58,494
Incremental shares under stock option plans	926	1,244	661	1,032
Average number of common shares and common share equivalents outstanding	59,155	60,660	57,948	59,526

For the thirty nine week period ended September 24, 2005, there were 495,000 options outstanding to purchase shares of common stock excluded from the calculation of diluted earnings per share because they were antidilutive. For the thirty nine week period ended September 30, 2006, there were no such options outstanding.

For the thirteen week periods ended September 30, 2006 and September 24, 2005, there were 598,000 and 495,000, 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 2006 thirty nine week period, Landstar paid income taxes and interest of \$54,381,000 and \$5,919,000, respectively. During the 2005 thirty nine week period, Landstar paid income taxes and interest of \$41,214,000 and \$3,570,000, respectively. During the thirty nine week periods ended September 30, 2006 and September 24, 2005, Landstar acquired operating property by entering into capital leases in the amount of \$24,915,000 and \$19,308,000, respectively.

(5) Segment Information

The following tables summarize information about Landstar's reportable business segments as of and for the thirty nine and thirteen week periods ended September 30, 2006 and September 24, 2005 (in thousands):

Thirty Nine Weeks Ended September 30, 2006				
Global				
Carrier	Logistics	Insurance	Other	Total
\$ 1,356,780	\$ 520,080	\$ 25,617		\$ 1,902,477

Edgar Filing: LANDSTAR SYSTEM INC - Form 10-Q

External revenue					
Investment income			2,589		2,589
Internal revenue	39,343	1,604	22,351		63,298
Operating income	137,398	25,353	24,056	\$(44,240)	142,567
Goodwill	20,496	10,638			31,134
Total assets	376,026	135,167	97,609	69,813	678,615

9

Table of Contents**Thirty Nine Weeks Ended September 24, 2005**

	Global				
	Carrier	Logistics	Insurance	Other	Total
External revenue	\$1,197,614	\$ 496,769	\$23,003		\$1,717,386
Investment income			2,087		2,087
Internal revenue	43,587	1,304	24,440		69,331
Operating income	112,979	33,403	17,697	\$ (40,410)	123,669
Goodwill	20,496	10,638			31,134
Total assets	331,110	131,796	73,567	110,524	646,997

Thirteen Weeks Ended September 30, 2006

	Global				
	Carrier	Logistics	Insurance	Other	Total
External revenue	\$460,847	\$ 179,613	\$8,737		\$649,197
Investment income			1,337		1,337
Internal revenue	15,435	605	5,940		21,980
Operating income	49,334	8,331	8,967	\$(14,931)	51,701

Thirteen Weeks Ended September 24, 2005

	Global				
	Carrier	Logistics	Insurance	Other	Total
External revenue	\$414,093	\$ 254,181	\$7,796		\$676,070
Investment income			852		852
Internal revenue	31,947	416	6,592		38,955
Operating income	42,700	24,261	6,069	\$(15,483)	57,547

(6) Comprehensive Income

The following table includes the components of comprehensive income for the thirty nine and thirteen week periods ended September 30, 2006 and September 24, 2005 (in thousands):

	Thirty Nine Weeks Ended		Thirteen Weeks Ended	
	Sept 30, 2006	Sept 24, 2005	Sept 30, 2006	Sept 24, 2005
Net income	\$84,395	\$73,811	\$30,580	\$34,569
Unrealized holding gains (losses) on available -for-sale investments, net of income taxes	194	(229)	41	(120)
Comprehensive income	\$84,589	\$73,582	\$30,621	\$34,449

Accumulated other comprehensive loss at September 30, 2006 of \$17,000 represents the unrealized holding loss on available-for-sale investments of \$27,000, net of income tax benefits of \$10,000.

(7) Commitments and Contingencies

As of September 30, 2006, Landstar had \$27,219,000 of letters of credit outstanding under the Company's revolving credit facility and \$42,879,000 of letters of credit secured by investments held by the Company's insurance segment. Short-term investments include \$20,536,000 in current maturities of investment grade bonds and \$626,000 of cash equivalents held by the Company's insurance segment at September 30, 2006. These short-term investments together with \$998,000 of the non-current portion of investment grade bonds and \$22,871,000 of cash equivalents included in other assets at September 30, 2006, provide collateral for the \$42,879,000 of letters of credit issued to guarantee payment of insurance claims.

On November 1, 2002, the Owner-Operator Independent Drivers Association, Inc. (OOIDA) and six individual independent contractors who provide truck capacity to the Company under exclusive lease arrangements (BCO Independent Contractors and collectively with OOIDA, the Plaintiffs) filed a putative class action complaint (the Complaint) in the United States District Court for the Middle District of Florida (the Court) in Jacksonville, Florida, against the Company. On April 7, 2005, Plaintiffs amended the Complaint (the Amended Complaint). Claims are currently pending against the following Company entities: Landstar Inway, Inc., Landstar Ligon, Inc. and Landstar Ranger, Inc. (the Defendants). On August 30, 2005, the Court granted a motion by Plaintiffs to certify the case as a class action.

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. Specifically, the Plaintiffs have alleged that the Company has violated the federal regulations by (i) making undisclosed and/or undocumented reductions from revenue derived from freight before calculating compensation, thereby unlawfully reducing Plaintiffs' compensation (the Revenue Claim), (ii) making charge-backs to the Plaintiffs for certain products or services that were in excess of sums actually paid by the Company for such products and services (the Charge-Back Margin Claim) and (iii) failing to provide the Plaintiffs with proper disclosure with respect to the methodology for calculating such charge-back amounts (the Charge-Back Disclosure Claim).

Table of Contents

In May 2006, the Plaintiffs served Defendants with a report, prepared by their consultant, asserting that as a result of the alleged violations by the Defendants of the federal leasing regulations, class members suffered damages, excluding interest, during the period ending April 30, 2006 of approximately \$39.1 million in the aggregate (the Plaintiffs Report). The Plaintiffs allege that the damages of the class members will continue to accrue through the pendency of this litigation and the Amended Complaint also asserts alternative damage theories, including claims for equitable relief. The Defendants had no role in preparing the Plaintiffs Report.

On October 6, 2006, the Court issued rulings on all summary judgment motions then pending that were previously filed by either the Plaintiffs or the Defendants. In these rulings, the Court (i) denied the Plaintiffs motion for summary judgment on the Revenue Claim, (ii) granted the Defendants motion, and denied the Plaintiffs motion, for summary judgment on the Charge-Back Margin Claim, (iii) granted the Plaintiffs motion, and denied the Defendants motion, for summary judgment on the Charge-Back Disclosure Claim and (iv) concluded that it need not determine at this time whether any Plaintiffs sustained damages as a result of any of the alleged violation of the federal leasing regulations and that the issue of any such damages will be unique to each class member and subject to individualized proof. The Plaintiffs have filed a motion, which is pending, requesting the Court to reconsider the denial of Plaintiffs motion for summary judgment on the Revenue Claim. The case is currently scheduled for a jury trial in January 2007.

In the event that the Court rules for Defendants on all or a portion of the legal issues raised at trial, claims for damages that are the subject of the Plaintiffs Report could be eliminated or significantly reduced. In addition, the Defendants believe that they continue to have meritorious defenses, intend to continue asserting these defenses vigorously and have retained experts in support of their positions. In this regard, the Defendants have denied that any BCO Independent Contractor has sustained any damages as a result of the alleged violations of the federal leasing regulations.

Management believes that if this litigation resulted in a liability up to the amount asserted in the Plaintiffs Report, such result would not reasonably be expected to have a material adverse effect on the financial condition of the Company, but could have a material adverse effect on the Company's results of operations in a given quarter or year. In addition, as a result of decisions in a separate insurance coverage lawsuit relating to the litigation described immediately above, the Company has recovered and believes it is probable that it will continue to recover a significant portion of the costs, including legal fees, incurred by Defendants in the defense of the litigation. No assurances can be given with respect to the outcome of any of these matters.

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 31, 2005 and Management's Discussion and Analysis of Financial Condition and Results of Operations included in the 2005 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 and third party capacity providers. 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

Table of Contents

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 subsidiaries, Landstar Logistics, Inc. and 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, buses 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 and bus providers. Beginning in August 2006, the global logistics segment began the rollout of warehouse 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 September 30, 2006, Landstar Global Logistics, Inc. has executed contracts with 34 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 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 2005 fiscal year, 466 independent commission sales agents generated \$1 million or more of Landstar s revenue and thus qualified as Million Dollar Agents. During the 2005 fiscal year, the average revenue generated by a Million Dollar Agent was \$5,063,000 and revenue generated by Million Dollar Agents in the aggregate represented 94% of consolidated Landstar revenue. As of September 30, 2006 and September 24, 2005, the Company had a network of 1,291 and 1,131 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:

Thirty Nine Weeks Ended		Thirteen Weeks Ended	
Sept 30,	Sept 24,	Sept 30,	Sept 24,
2006	2005	2006	2005

Carrier Segment:

Edgar Filing: LANDSTAR SYSTEM INC - Form 10-Q

External revenue generated through (in thousands):				
BCO Independent Contractors	\$ 964,260	\$ 906,581	\$ 323,664	\$ 307,359
Truck Brokerage Carriers	392,520	291,033	137,183	106,734
	\$ 1,356,780	\$ 1,197,614	\$ 460,847	\$ 414,093
Revenue per revenue mile	\$ 2.02	\$ 1.85	\$ 2.05	\$ 1.92
Revenue per load	\$ 1,613	\$ 1,484	\$ 1,652	\$ 1,545
Average length of haul (miles)	800	803	807	806
Number of loads	841,000	807,000	279,000	268,000
<u>Global Logistics Segment:</u>				
External revenue generated through (in thousands):				
BCO Independent Contractors (1)	\$ 78,308	\$ 91,508	\$ 31,145	\$ 56,173
Truck Brokerage Carriers	302,746	285,369	104,445	130,704
Rail, air, ocean and bus carriers (2)	139,026	119,892	44,023	67,304
	\$ 520,080	\$ 496,769	\$ 179,613	\$ 254,181
Revenue per load (3)	\$ 1,482	\$ 1,489	\$ 1,428	\$ 1,498
Number of loads (3)	294,000	241,000	105,000	83,000

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

(2) Included in the 2006 thirty nine and thirteen week periods was \$23,032,000 and \$3,594,000, respectively, of revenue attributable to buses provided under contract between Landstar Express

America, Inc. and the United States Department of Transportation/Federal Aviation Administration (the FAA). Included in the 2005 thirty nine and thirteen week periods ended September 24, 2005 was \$24,471,000 of revenue attributable to buses provided under the FAA contract.

- (3) The number of loads and revenue per load in the thirty nine and thirteen week periods ended September 30, 2006, exclude the effect of \$85,998,000 and \$29,701,000, respectively, of revenue derived from transportation services provided under the FAA contract. The number of loads and revenue per load in the thirty nine and thirteen week periods ended September 24, 2005, exclude the effect of \$137,887,000 and \$129,812,000, respectively, of revenue derived under the FAA contract. See Use of Non-GAAP Financial Measures.

Table of Contents

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:

	Sept 30, 2006	Sept 24, 2005
BCO Independent Contractors	8,463	7,846
Truck Brokerage Carriers:		
Approved and active (1)	14,604	13,328
Other approved	8,009	8,178
	22,613	21,506
Total available truck capacity providers	31,076	29,352
Number of trucks provided by BCO Independent Contractors	9,164	8,581

- (1) Active refers to Truck Brokerage Carriers who moved at least one load in the 180 days immediately preceding the fiscal quarter end.

Historically, the Company's carrier segment has primarily relied on capacity provided by BCO Independent Contractors. Pursuant to a continuing plan to augment its available capacity and increase its revenue, the Company has been increasing the carrier segment's use of capacity provided by Truck Brokerage Carriers. The percent of consolidated revenue generated through all Truck Brokerage Carriers was 36.5% during the thirty nine week period ended September 30, 2006 and 33.6% during the thirty nine week period ended September 24, 2005.

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.

Table of Contents

Trailing equipment rent, maintenance costs for 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.

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.

Prior to 2006, the Company accounted for stock-based payment plans in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25), and related interpretations. Under APB 25, no stock-based compensation was reflected in net income from stock options granted as all options granted had an exercise price equal to the fair market value of the underlying common stock on the date of grant. On January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123R (FAS 123R), Share-Based Payment. The Company adopted FAS 123R using the modified retrospective method. Amounts for prior periods have been adjusted to reflect the adoption of FAS 123R.

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

	Thirty Nine Weeks Ended		Thirteen Weeks Ended	
	Sept 30, 2006	Sept 24, 2005	Sept 30, 2006	Sept 24, 2005
Revenue	100.0%	100.0%	100.0%	100.0%
Investment income	0.1	0.1	0.2	0.1
Costs and expenses:				
Purchased transportation	75.2	74.9	74.9	74.4
Commissions to agents	7.9	7.9	8.0	7.9
Other operating costs	1.9	1.6	2.3	1.6
Insurance and claims	1.6	2.0	1.5	1.8
Selling, general and administrative	5.4	5.8	4.9	5.3
Depreciation and amortization	0.6	0.7	0.6	0.6
Total costs and expenses	92.6	92.9	92.2	91.6
Operating income	7.5	7.2	8.0	8.5
Interest and debt expense	0.3	0.2	0.3	0.2
Income before income taxes	7.2	7.0	7.7	8.3

Edgar Filing: LANDSTAR SYSTEM INC - Form 10-Q

Income taxes	2.8	2.7	3.0	3.2
Net income	4.4%	4.3%	4.7%	5.1%

THIRTY NINE WEEKS ENDED SEPTEMBER 30, 2006 COMPARED TO THIRTY NINE WEEKS ENDED SEPTEMBER 24, 2005

Revenue for the 2006 thirty nine week period was \$1,902,477,000, an increase of \$185,091,000, or 10.8%, over the 2005 thirty nine week period. The increase was attributable to increased revenue of \$159,166,000, \$23,311,000 and \$2,614,000 at the carrier, global logistics and insurance segments, respectively. With respect to the carrier segment, revenue per load increased approximately 9% in the 2006 thirty nine week period while the number of loads delivered in the 2006 thirty nine week period increased approximately 4%. The average length of haul per load at the carrier segment remained approximately the same as prior year, however, revenue per revenue mile increased approximately 9%. Included in revenue at the global logistics segment for the 2006 and 2005 thirty nine week periods was \$85,998,000 and \$137,887,000, respectively, of revenue related to disaster relief efforts for the storms that impacted the United States, including trailer rental revenue of \$15,933,000 and \$3,216,000, respectively. These disaster relief transportation services were provided primarily under a contract between Landstar Express America, Inc. and the United States Federal Aviation Administration (the FAA). Excluding the number of loads and revenue related to disaster relief efforts provided by the global logistics segment, the number of loads delivered by the global logistics segment in the 2006 thirty nine week period increased approximately 22% and revenue per load remained approximately the same as prior year.

Table of Contents

Investment income at the insurance segment was \$2,589,000 and \$2,087,000 in the 2006 and 2005 periods, respectively. The increase in investment income was primarily due to an increased rate of return, attributable to a general increase in interest rates, on investments held by the insurance segment, partially offset by a lower average investment balance.

Purchased transportation was 75.2% and 74.9% of revenue in 2006 and 2005, respectively. The increase in purchased transportation as a percentage of revenue was primarily attributable to increased truck brokerage and rail intermodal revenue, which tend to have a higher cost of purchased transportation, partially offset by the effect of increased trailer rental revenue provided under the FAA contract in 2006, the cost of which is included in other operating costs. Commissions to agents were 7.9% of revenue in both 2006 and 2005. Other operating costs were 1.9% and 1.6% of revenue in 2006 and 2005, respectively. The increase in other operating costs as a percentage of revenue was primarily attributable to trailer rental costs incurred in support of disaster relief services provided under the FAA contract, partially offset by reduced other trailer rent expense and maintenance costs, as a result of the Company's ongoing effort to reduce the cost of Company provided trailing equipment. Insurance and claims were 1.6% of revenue in 2006 compared with 2.0% of revenue in 2005. The decrease in insurance and claims as a percentage of revenue was primarily attributable to a lower frequency of trucking accidents in 2006, favorable development of prior year claims and an increase in truck brokerage and rail intermodal revenue, which tend to have a lower claims risk profile compared to revenue generated through BCO Independent Contractors. Selling, general and administrative costs were 5.4% of revenue in 2006 compared with 5.8% of revenue in 2005. The decrease in selling, general and administrative costs as a percentage of revenue was primarily attributable to the effect of increased revenue, an insurance recovery of legal fees of \$2,069,000 incurred in prior years and a decreased provision for bonuses under the Company's incentive compensation plans. Depreciation and amortization was 0.6% and 0.7% of revenue in 2006 and 2005, respectively. The decrease in depreciation and amortization as a percentage of revenue was primarily attributable to the effect of increased revenue.

Interest and debt expense was 0.3% and 0.2% of revenue in 2006 and 2005. The increase in interest and debt expense as a percentage of revenue was primarily attributable to increased interest rates and increased borrowings under the Company's revolving credit facility, which were used to fund purchases of the Company's common stock and to finance a portion of the 2005 fiscal year end receivable from the FAA, and increased capital lease obligations used to finance the acquisition of trailing equipment.

The provisions for income taxes for the 2006 and 2005 thirty nine week periods was based on estimated full year combined effective income tax rates of approximately 38.7% which in both cases 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 \$84,395,000, or \$1.45 per common share (\$1.43 per diluted share), for the thirty nine week period ended September 30, 2006, which included approximately \$12,162,000 of operating income related to the \$85,998,000 of revenue attributable to disaster relief services provided primarily under the FAA contract. The \$12,162,000 of operating income, net of related income taxes, increased net income by \$7,492,000, or \$0.13 per common share (\$0.13 per diluted share). Net income was \$73,811,000, or \$1.24 per common share (\$1.22 per diluted share), for the thirty nine week period ended September 24, 2005, which included approximately \$24,177,000 of operating income related to the \$137,887,000 of revenue attributable to disaster relief services provided primarily under the FAA contract. The \$24,177,000 of operating income, net of related income taxes, increased net income by \$14,893,000, or \$0.25 per common share (\$0.25 per diluted share). The 2006 and 2005 thirty nine week periods included stock compensation expense of \$5,125,000 and \$4,518,000, respectively, or \$3,514,000 and \$3,185,000, respectively, net of related income tax benefits. Stock compensation expense reduced earnings per common share \$0.06 (\$0.06 per diluted share) and \$0.05 (\$0.05 per diluted share), respectively, in the 2006 and 2005 thirty nine week periods.

Table of Contents**THIRTEEN WEEKS ENDED SEPTEMBER 30, 2006 COMPARED TO THIRTEEN WEEKS ENDED SEPTEMBER 24, 2005**

Revenue for the 2006 thirteen week period was \$649,197,000, a decrease of \$26,873,000, or 4.0%, compared to the 2005 thirteen week period. The decrease in revenue was attributable to a decrease in revenue related to disaster relief efforts provided primarily under the FAA contract in the thirteen week period ended September 30, 2006. Revenue for disaster relief services provided under the FAA contract in the thirteen week periods ended September 30, 2006 and September 24, 2005 was \$29,701,000 and \$129,812,000, respectively, including trailer rental revenue of \$7,585,000 and \$3,216,000, respectively. Revenue increased \$46,754,000 and \$941,000 at the carrier and insurance segments, respectively, while revenue decreased \$74,568,000 at the global logistics segment, reflecting the decrease in revenue generated under the FAA contract. With respect to the carrier segment, revenue per load increased approximately 7% in the 2006 thirteen week period while the number of loads delivered in the 2006 thirteen week period increased approximately 4%. The average length of haul per load at the carrier segment remained approximately the same compared to prior year, however, revenue per revenue mile increased approximately 7%. Excluding the number of loads and revenue related to disaster relief efforts provided by the global logistics segment in the 2006 and 2005 thirteen week periods, the number of loads delivered by the global logistics segment in the 2006 thirteen week period increased approximately 27%, however, revenue per load decreased approximately 5% compared to the 2005 thirteen week period.

Investment income at the insurance segment was \$1,337,000 and \$852,000 in the 2006 and 2005 periods, respectively. The increase in investment income was primarily due to an increased rate of return, attributable to a general increase in interest rates, on investments held by the insurance segment, and an increased average investment balance.

Purchased transportation was 74.9% and 74.4% of revenue in 2006 and 2005, respectively. The increase in purchased transportation as a percentage of revenue was primarily attributable to increased truck brokerage and rail intermodal revenue, which tend to have a higher cost of purchased transportation, partially offset by the effect of increased trailer rental revenue provided under the FAA contract in 2006, the cost of which is included in other operating costs. Commissions to agents were 8.0% of revenue in 2006 and 7.9% in 2005. 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. Other operating costs were 2.3% and 1.6% of revenue in 2006 and 2005, respectively. The increase 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, partially offset by reduced other trailer rent expense and maintenance costs. Insurance and claims were 1.5% of revenue in 2006 compared with 1.8% of revenue in 2005. The decrease in insurance and claims as a percentage of revenue was primarily attributable to a lower frequency of trucking accidents in 2006, favorable development of prior year claims and an increase in truck brokerage and rail intermodal revenue, which tend to have a lower claims risk profile compared to revenue generated through BCO Independent Contractors. Selling, general and administrative costs were 4.9% of revenue in 2006 compared with 5.3% of revenue in 2005. The decrease in selling, general and administrative costs as a percentage of revenue was primarily attributable to a decrease in the provision for bonuses under the Company's incentive compensation programs and an insurance recovery of legal fees of \$2,415,000 incurred in prior years and the first half of 2006, partially offset by the effect of decreased revenue. Depreciation and amortization was 0.6% of revenue in both 2006 and 2005.

Interest and debt expense was 0.3% and 0.2% of revenue in 2006 and 2005. The increase in interest and debt expense as a percentage of revenue was primarily attributable to increased interest rates and increased borrowings under the Company's revolving credit facility, which were used to fund purchases of the Company's common stock, and increased capital lease obligations.

The provisions for income taxes for the 2006 and 2005 thirteen week periods were based on estimated full year combined effective income tax rates of approximately 38.7% and 38.6%, respectively, which are 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 \$30,580,000, or \$0.53 per common share (\$0.53 per diluted share), in the 2006 thirteen week period, which included approximately \$4,547,000 of operating income related to the \$29,701,000 of revenue attributable to disaster relief services provided primarily under the FAA contract. The \$4,547,000 of operating income, net of related income taxes, increased net income by \$2,802,000, or \$0.05 per common share (\$0.05 per diluted share). Net income was \$34,569,000, or \$0.59 per common share (\$0.58 per diluted share), in the 2005 thirteen week period, which included \$22,672,000 of operating income related to the \$129,812,000 of revenue attributable to disaster relief services provided primarily under the FAA contract. The \$22,672,000 of operating income, net of related income taxes, increased net income by \$13,966,000, or \$0.24 per common share (\$0.23 per diluted share). The 2006 and 2005 thirteen week periods included stock compensation expense of \$1,828,000 and \$1,490,000, respectively, or \$1,280,000 and \$1,056,000, respectively, net of related income tax benefits. Stock compensation expense reduced earnings per common share \$0.02 (\$0.02 per diluted share) and \$0.02 (\$0.02 per diluted share), respectively, in the 2006 and 2005 thirteen week periods.

Table of Contents**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 \$240,382,000 at September 30, 2006, compared to \$255,689,000 at December 31, 2005. The decrease in shareholders' equity was primarily a result of the purchase of 2,658,427 shares of the Company's common stock at a total cost of \$114,597,000 and dividends paid on the Company's common stock, partially offset by net income for the period. As of September 30, 2006, the Company may purchase up to an additional 1,866,800 shares of its common stock under its authorized stock purchase programs. Shareholders' equity was 65% of total capitalization (defined as total debt plus equity) at September 30, 2006 compared to 60% at December 31, 2005.

Long-term debt including current maturities was \$127,110,000 at September 30, 2006, \$39,863,000 lower than at December 31, 2005, primarily as a result of repayment of a portion of the borrowings under the Company's senior credit facility using proceeds from the collection of the \$215,250,000 December 31, 2005 receivable from the FAA.

Working capital and the ratio of current assets to current liabilities were \$239,030,000 and 1.9 to 1, respectively, at September 30, 2006, compared with \$317,359,000 and 2.1 to 1, respectively, at December 31, 2005. 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 \$229,895,000 in the 2006 thirty nine week period compared with \$145,748,000 in the 2005 thirty nine week period. The increase in cash flow provided by operating activities was primarily attributable to the collections of the 2005 fiscal year end receivable from the FAA for disaster relief transportation services provided during the later half of fiscal 2005.

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 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 September 30, 2006, the Company had \$65,000,000 in borrowings outstanding and \$27,219,000 of letters of credit outstanding under the Fourth Amended and Restated Credit Agreement. At September 30, 2006, there was \$132,781,000 available for future borrowings under the Company's Fourth Amended and Restated Credit Agreement. In addition, the Company has \$42,879,000 in letters of credit outstanding, as collateral for insurance claims, that are secured by investments and cash equivalents totaling \$45,031,000.

On July 20, 2006, 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 August 31, 2006, to stockholders of record on August 10, 2006. On April 20, 2006, Landstar System, Inc. announced that its Board of Directors declared a cash dividend of \$0.025 per share with respect to its outstanding shares of common stock. The distribution date for this cash dividend was on May 31, 2006, to stockholders of record on May 10, 2006. On February 2, 2006, the Company announced that its Board of Directors declared a cash dividend of

\$0.025 per share with respect to its outstanding shares of common stock. The distribution date for this cash dividend was on February 28, 2006, to stockholders of record on February 14, 2006. 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 trailers 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 2006 thirty nine week period, the Company purchased \$2,756,000 of operating property and acquired \$24,915,000 of trailing equipment by entering into capital leases. Landstar anticipates acquiring approximately \$15,000,000 of operating property during the remainder of the 2006 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 2006.

Table of Contents

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 six individual independent contractors who provide truck capacity to the Company under exclusive lease arrangements (BCO Independent Contractors) and collectively with OOIDA, the Plaintiffs) filed a putative class action complaint (the Complaint) in the United States District Court for the Middle District of Florida (the Court) in Jacksonville, Florida, against the Company. On April 7, 2005, Plaintiffs amended the Complaint (the Amended Complaint). Claims are currently pending against the following Company entities: Landstar Inway, Inc., Landstar Ligon, Inc. and Landstar Ranger, Inc. (the Defendants). On August 30, 2005, the Court granted a motion by Plaintiffs to certify the case as a class action.

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. Specifically, the Plaintiffs have alleged that the Company has violated the federal regulations by (i) making undisclosed and/or undocumented reductions from revenue derived from freight before calculating compensation, thereby unlawfully reducing Plaintiffs' compensation (the Revenue Claim), (ii) making charge-backs to the Plaintiffs for certain products or services that were in excess of sums actually paid by the Company for such products and services (the Charge-Back Margin Claim) and (iii) failing to provide the Plaintiffs with proper disclosure with respect to the methodology for calculating such charge-back amounts (the Charge-Back Disclosure Claim).

In May 2006, the Plaintiffs served Defendants with a report, prepared by their consultant, asserting that as a result of the alleged violations by the Defendants of the federal leasing regulations, class members suffered damages, excluding interest, during the period ending April 30, 2006 of approximately \$39.1 million in the aggregate (the Plaintiffs Report). The Plaintiffs allege that the damages of the class members will continue to accrue through the pendency of this litigation and the Amended Complaint also asserts alternative damage theories, including claims for equitable relief. The Defendants had no role in preparing the Plaintiffs Report.

On October 6, 2006, the Court issued rulings on all summary judgment motions then pending that were previously filed by either the Plaintiffs or the Defendants. In these rulings, the Court (i) denied the Plaintiffs motion for summary judgment on the Revenue Claim, (ii) granted the Defendants' motion, and denied the Plaintiffs' motion, for summary judgment on the Charge-Back Margin Claim, (iii) granted the Plaintiffs' motion, and denied the Defendants motion, for summary judgment on the Charge-Back Disclosure Claim and (iv) concluded that it need not determine at this time whether any Plaintiffs sustained damages as a result of any of the alleged violation of the federal leasing regulations and that the issue of any such damages will be unique to each class member and subject to individualized proof. The Plaintiffs have filed a motion, which is pending, requesting the Court to reconsider the denial of Plaintiffs' motion for summary judgment on the Revenue Claim. The case is currently scheduled for a jury trial in January 2007.

In the event that the Court rules for Defendants on all or a portion of the legal issues raised at trial, claims for damages that are the subject of the Plaintiffs Report could be eliminated or significantly reduced. In addition, the Defendants believe that they continue to have meritorious defenses, intend to continue asserting these defenses vigorously and have retained experts in support of their positions. In this regard, the Defendants have denied that any BCO Independent Contractor has sustained any damages as a result of the alleged violations of the federal leasing regulations.

Management believes that if this litigation resulted in a liability up to the amount asserted in the Plaintiffs Report, such result would not reasonably be expected to have a material adverse effect on the financial condition of the Company, but could have a material adverse effect on the Company's results of operations in a given quarter or year. In addition, as a result of decisions in a separate insurance coverage lawsuit relating to the litigation described immediately above, the Company has recovered and believes it is probable that it will continue to recover a significant portion of the costs, including legal fees, incurred by Defendants in the defense of the litigation. No assurances can be

given with respect to the outcome of any of these matters.

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

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 September 30, 2006 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 2006 thirty nine week period, insurance and claims costs included \$6,923,000 of favorable adjustments to prior years claims estimates. During the 2005 thirty nine week period, insurance and claims costs included \$1,600,000 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 September 30, 2006.

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. The Company has provided for its estimated exposure attributable to income tax planning strategies. Management believes that the provision for liabilities resulting from the implementation of income tax planning strategies 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 income tax planning strategies are not appropriate.

Significant variances from management's estimates for the amount of uncollectible receivables, the ultimate resolution of claims or the provision for liabilities for income tax planning strategies 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.

RECENTLY ISSUED ACCOUNTING STANDARDS NOT CURRENTLY EFFECTIVE

In June 2006, the Financial Accounting Standards Board issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN No. 48). FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in the Company's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN No. 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 based on whether it is more likely than not that certain return positions will be sustained upon examination by taxing authorities. Implementation of FIN No. 48 is required for fiscal years beginning after December 15, 2006. Although the effect of implementing FIN No. 48 has not been quantified, management believes that the implementation of FIN No. 48 will not have a material effect on the financial position of the Company.

Table of Contents**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 statement contain forward-looking statements, such as statements which relate to Landstar's business objectives, plans, strategies and expectations. Terms such as anticipates, believes, estimates, expects, plans, predicts, may, could, will, the negative thereof and similar expressions are 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 workers' compensation claims; unfavorable development of existing accident claims; dependence on independent commission sales agents; dependence on third party capacity providers; disruptions or failures in our computer systems; a downturn in economic growth or growth in the transportation sector; substantial industry competition; and other operational, financial or legal risks or uncertainties detailed in Landstar's Form 10-K for the 2005 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 September 30, 2006, the weighted average interest rate on borrowings outstanding was 5.64%. During the third quarter of fiscal 2006, the average outstanding balance under the Fourth Amended and Restated Credit Agreement was approximately \$83,102,000. 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 September 30, 2006 was estimated to approximate carrying value. Assuming that debt levels on the Fourth Amended and Restated Credit Agreement remain at \$65,000,000, the balance at September 30, 2006, 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 \$650,000 on an annualized basis.

All amounts outstanding on the Fourth Amended and Restated Credit Agreement are payable on July 8, 2009, the expiration date 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 five years. Assuming that the long-term portion of investments in bonds remains at \$998,000, the balance at

September 30, 2006, 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.

Table of Contents

Item 4. Controls and Procedures

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 September 30, 2006, to provide reasonable assurance that information required to be disclosed by the Company in 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 September 30, 2006 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II
OTHER INFORMATION

Item 1. Legal Proceedings

On November 1, 2002, the Owner-Operator Independent Drivers Association, Inc. (OOIDA) and six individual independent contractors who provide truck capacity to the Company under exclusive lease arrangements (BCO Independent Contractors and collectively with OOIDA, the Plaintiffs) filed a putative class action complaint (the Complaint) in the United States District Court for the Middle District of Florida (the Court) in Jacksonville, Florida, against the Company. On April 7, 2005, Plaintiffs amended the Complaint (the Amended Complaint). Claims are currently pending against the following Company entities: Landstar Inway, Inc., Landstar Ligon, Inc. and Landstar Ranger, Inc. (the Defendants). On August 30, 2005, the Court granted a motion by Plaintiffs to certify the case as a class action.

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. Specifically, the Plaintiffs have alleged that the Company has violated the federal regulations by (i) making undisclosed and/or undocumented reductions from revenue derived from freight before calculating compensation, thereby unlawfully reducing Plaintiffs' compensation (the Revenue Claim), (ii) making charge-backs to the Plaintiffs for certain products or services that were in excess of sums actually paid by the Company for such products and services (the Charge-Back Margin Claim) and (iii) failing to provide the Plaintiffs with proper disclosure with respect to the methodology for calculating such charge-back amounts (the Charge-Back Disclosure Claim).

In May 2006, the Plaintiffs served Defendants with a report, prepared by their consultant, asserting that as a result of the alleged violations by the Defendants of the federal leasing regulations, class members suffered damages, excluding interest, during the period ending April 30, 2006 of approximately \$39.1 million in the aggregate (the Plaintiffs Report).

The Plaintiffs allege that the damages of the class members will continue to accrue through the pendency of this litigation and the Amended Complaint also asserts alternative damage theories, including claims for equitable relief. The Defendants had no role in preparing the Plaintiffs Report.

On October 6, 2006, the Court issued rulings on all summary judgment motions then pending that were previously filed by either the Plaintiffs or the Defendants. In these rulings, the Court (i) denied the Plaintiffs motion for summary judgment on the Revenue Claim, (ii) granted the Defendants' motion, and denied the Plaintiffs' motion, for summary judgment on the Charge-Back Margin Claim, (iii) granted the Plaintiffs' motion, and denied the Defendants' motion, for summary judgment on the Charge-Back Disclosure Claim and (iv) concluded that it need not determine at this time whether any Plaintiffs sustained damages as a result of any of the alleged violation of the federal leasing regulations and that the issue of any such damages will be unique to each class member and subject to individualized proof. The Plaintiffs have filed a motion, which is pending, requesting the Court to reconsider the denial of Plaintiffs' motion for summary judgment on the Revenue Claim. The case is currently scheduled for a jury trial in January 2007.

In the event that the Court rules for Defendants on all or a portion of the legal issues raised at trial, claims for damages that are the subject of the Plaintiffs Report could be eliminated or significantly reduced. In addition, the

Defendants believe that they continue to have meritorious defenses, intend to continue asserting these defenses vigorously and have retained experts in support of their positions. In this regard, the Defendants have denied that any BCO Independent Contractor has sustained any damages as a result of the alleged violations of the federal leasing regulations.

Table of Contents

Management believes that if this litigation resulted in a liability up to the amount asserted in the Plaintiffs Report, such result would not reasonably be expected to have a material adverse effect on the financial condition of the Company, but could have a material adverse effect on the Company's results of operations in a given quarter or year. In addition, as a result of decisions in a separate insurance coverage lawsuit relating to the litigation described immediately above, the Company has recovered and believes it is probable that it will continue to recover a significant portion of the costs, including legal fees, incurred by Defendants in the defense of the litigation. No assurances can be given with respect to the outcome of any of these matters.

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 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 31, 2005 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. Other than with respect to the risk factor set forth immediately below, 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 31, 2005 in response to Part I, Item 1A of that form.

Expiration of contract with the United States Department of Transportation/Federal Aviation Administration

Historically, the United States Government has been the Company's largest customer. During fiscal years 2001 through 2003, revenue derived from various departments of the United States Government, primarily the United States Department of Defense, contributed between 5.0% and 7.5% of the Company's annual revenue. During 2005 and 2004, revenue derived from the United States Government, represented approximately 17% and 9% of consolidated revenue, respectively. Included in revenue derived from United States Government during fiscal years 2005 and 2004 was \$275.9 million and \$63.8 million of revenue, respectively, related to disaster relief services provided by the Company for storms that impacted the United States. These emergency transportation services were provided primarily under a contract (the "FAA Contract") with the Federal Aviation Administration (the "FAA"). The \$275.9 million recognized under the FAA Contract during the 2005 fiscal year generated \$51.9 million of operating income which, net of related income taxes, increased net income by \$31.6 million. The \$63.8 million of revenue recognized under the FAA Contract during the 2004 fiscal year generated \$11.8 million of operating income which, net of related income taxes, increased net income \$7.3 million.

The FAA Contract is due to expire December 31, 2006. On October 17, 2006, the FAA notified the public of its intent to extend the FAA Contract for a period of six months beginning January 1, 2007 through June 30, 2007, with an option to extend contract performance an additional six months through December 31, 2007, if necessary. The FAA also notified the public that the United States Government intends to award a new contract by June 30, 2007, but requires the six month option referred to above in the event the award of a new contract is not made by the intended date or a post-award transition period is required.

A formal contract extension to the FAA Contract has not been executed between the FAA and Landstar Express America and there can be no assurances regarding the terms any such extension may provide or even whether such an extension will be executed at all. It is expected that the FAA will request proposals from various companies for a new contract regarding disaster relief services to be provided subsequent to 2006. The Company cannot predict whether a request for proposal, if any, will: a) be made to Landstar Express America, b) include pricing and other provisions that are the same or similar to the current contract provisions, or c) if a request for proposal is received by Landstar Express America, there can be no assurances that Landstar Express America would submit a proposal, or if it did, the FAA would select Landstar Express America as the transportation provider for disaster relief services in years subsequent to 2006.

The amount of revenue derived under the FAA Contract, if any, is dependent on the occurrence of specific events, primarily disasters, natural or otherwise, for which the Company provides emergency transportation services in support of disaster relief efforts undertaken by the United States Government and administered by the FAA. Because of the unpredictable nature of the occurrence and severity of such events, even if Landstar Express America were to enter into a new contract with the FAA, there can be no assurance that such events will occur, and if such events occur, the extent to which the FAA will require the services of Landstar Express America, if at all.

Table of Contents

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 July 1, 2006 to September 30, 2006, the Company's third 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
July 1, 2006				1,282,279
July 2, 2006 - July 29, 2006	607,800	\$ 41.90	607,800	674,479
July 30, 2006 - Aug. 26, 2006	674,479	\$ 42.89	674,479	2,000,000
Aug. 27, 2006 - Sept. 30, 2006	133,200	\$ 41.36	133,200	1,866,800
Total	1,415,479	\$ 42.32	1,415,479	

On July 20, 2006, 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 August 31, 2006, to stockholders of record on August 10, 2006. On April 20, 2006, Landstar System, Inc. announced that its Board of Directors declared a cash dividend of \$0.025 per share with respect to its outstanding shares of common stock. The distribution date for this cash dividend was on May 31, 2006, to stockholders of record on May 10, 2006. On February 2, 2006, the Company announced that its Board of Directors declared a cash dividend of \$0.025 per share with respect to its outstanding shares of common stock. The distribution date for this cash dividend was on February 28, 2006, to stockholders of record on February 14, 2006. It is the intention of the Board of Directors to pay a quarterly dividend going forward.

On July 28, 2005, 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. During the thirteen week period ended September 30, 2006, the Company completed the purchase of shares authorized for purchase under this program. On August 3, 2006, Landstar System, Inc. announced that it had been authorized by its Board of Directors to purchase up to an additional 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.

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: November 3, 2006

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

Date: November 3, 2006

/s/ Robert C. LaRose
Robert C. LaRose
Executive Vice President and Chief
Financial Officer

25