LANDSTAR SYSTEM INC
Form 10-Q
August 07, 2006

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

(Mark One)

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

For the quarterly period ended **July 1, 2006**

OR

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

For the transition period from _________________ to _____________________

Commission File Number: **0-21238**

LANDSTAR SYSTEM, INC.

(Exact name of registrant as specified in its charter)

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

13410 Sutton Park Drive South, Jacksonville, Florida

(Address of principal executive offices)

32224

(Zip Code)

(904) 398-9400

(Registrant s telephone number, including area code)

N/A

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

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

Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

Yes o No x

The number of shares of the registrant s common stock, par value $0.01 per share, outstanding as of the close of business on July 28, 2006 was 57,623,003.

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PART I Financial Information

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

The interim consolidated financial statements contained herein reflect all adjustments (all of a normal, recurring nature) which, in the opinion of management, are necessary for a fair statement of the financial condition, results of operations, cash flows and changes in shareholders equity for the periods presented. They have been prepared in accordance with Rule 10-01 of Regulation S-X and do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. Operating results for the twenty six weeks ended July 1, 2006 are not necessarily indicative of the results that may be expected for the entire fiscal year ending

December 30, 2006.

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.

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

	July 1, 2006	Dec 31, 2005
ASSETS		
Current Assets		
Cash and cash equivalents	$ 80,815	$ 29,398
Short-term investments	21,699	20,693
Trade accounts receivable, less allowance of $5,484 and $4,655	369,300	534,274
Other receivables, including advances to independent contractors, less allowance of $4,718 and $4,342	16,086	11,384
Deferred income taxes and other current assets	29,695	21,106
Total current assets	517,595	616,855
Operating property, less accumulated depreciation and amortization of $72,881 and $68,561	88,614	89,131
Goodwill	31,134	31,134
Other assets	32,391	28,694
Total assets	$ 669,734	$ 765,814
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Cash overdraft	$ 24,812	$ 29,829
Accounts payable	134,284	164,509
Current maturities of long-term debt	13,704	12,122
Insurance claims	27,459	27,887
Other current liabilities	55,268	65,149
Total current liabilities	255,527	299,496
Long-term debt, excluding current maturities	94,625	154,851
Insurance claims	36,417	37,840
Deferred income taxes	17,702	17,938
Shareholders Equity		
Common stock, $0.01 par value, authorized 160,000,000 shares, issued 64,666,698 and 64,151,902	647	642
Additional paid-in capital	97,365	84,532
Retained earnings	443,420	392,549
Cost of 6,573,231 and 5,344,883 shares of common stock in treasury	(275,864)	(221,776)
Accumulated other comprehensive loss	(58)	(211)

Note receivable arising from exercise of stock options	(47)	(47)
Total shareholders equity	265,463	255,689
Total liabilities and shareholders equity	$ 669,734	$ 765,814

See accompanying notes to consolidated financial statements.

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

	Twenty Six Weeks Ended		Thirteen Weeks Ended	
	July 1, 2006	**June 25, 2005**	**July 1, 2006**	**June 25, 2005**
Revenue	$ 1,253,280	$ 1,041,316	$ 643,238	$ 539,104
Investment income	1,252	1,235	873	696
Costs and expenses:				
Purchased transportation	944,309	783,092	486,059	405,514
Commissions to agents	97,521	82,039	50,510	42,913
Other operating costs	22,288	16,615	10,220	7,917
Insurance and claims	20,574	22,904	9,022	9,779
Selling, general and administrative	70,924	63,851	35,088	32,036
Depreciation and amortization	8,050	7,928	3,957	3,966
Total costs and expenses	1,163,666	976,429	594,856	502,125
Operating income	90,866	66,122	49,255	37,675
Interest and debt expense	3,142	1,989	1,292	1,052
Income before income taxes	87,724	64,133	47,963	36,623
Income taxes	33,909	24,891	18,498	14,199
Net income	$ 53,815	$ 39,242	$ 29,465	$ 22,424
Earnings per common share	$ 0.92	$ 0.66	$ 0.50	$ 0.38
Diluted earnings per share	$ 0.90	$ 0.64	$ 0.50	$ 0.37
Average number of shares outstanding:				
Earnings per common share	58,700,000	59,878,000	58,499,000	59,402,000
Diluted earnings per share	59,665,000	61,137,000	59,287,000	60,421,000
Dividends paid per common share	$ 0.050		$ 0.025	

See accompanying notes to consolidated financial statements.

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

	Twenty Six Weeks Ended	
	July 1, 2006	**June 25, 2005**
OPERATING ACTIVITIES		
Net income	$ 53,815	$ 39,242
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of operating property	8,050	7,928
Non-cash interest charges	87	87
Provisions for losses on trade and other accounts receivable	3,287	2,884
(Gains) losses on sales and disposals of operating property	112	(668)
Director compensation paid in common stock	265	193
Deferred income taxes, net	(653)	(2,375)
Stock-based compensation	3,297	3,028
Changes in operating assets and liabilities:		
Decrease in trade and other accounts receivable	156,985	55,705
Increase in other assets	(9,245)	(9,382)
Decrease in accounts payable	(30,225)	(15,504)
Decrease in other liabilities	(9,336)	(2,239)
Increase (decrease) in insurance claims	(1,851)	1,261
NET CASH PROVIDED BY OPERATING ACTIVITIES	174,588	80,160
INVESTING ACTIVITIES		
Net change in other short-term investments	(3,306)	(6,067)
Sales and maturities of investments	17,929	3,013
Purchases of investments	(18,094)	(1,309)
Purchases of operating property	(1,214)	(1,184)
Proceeds from sales of operating property	1,057	3,109
NET CASH USED BY INVESTING ACTIVITIES	(3,628)	(2,438)
FINANCING ACTIVITIES		
Increase (decrease) in cash overdraft	(5,017)	1,039
Proceeds from repayment of notes receivable arising from exercises of stock options		275
Dividends paid	(2,944)	
Proceeds from exercises of stock options	5,975	4,018
Excess tax benefit on stock option exercises	3,269	1,233
Borrowings on revolving credit facility		2,000
Purchases of common stock	(54,694)	(80,659)

Principal payments on long-term debt and capital lease obligations	(66,132)	(5,427)
NET CASH USED BY FINANCING ACTIVITIES	(119,543)	(77,521)
Increase in cash and cash equivalents	51,417	201
Cash and cash equivalents at beginning of period	29,398	61,684
Cash and cash equivalents at end of period	$ 80,815	$ 61,885

See accompanying notes to consolidated financial statements.

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LANDSTAR SYSTEM, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY
Twenty Six Weeks Ended July 1, 2006
(Dollars in thousands)
(Unaudited)

	Common Stock		Add'l Paid-In	Retained	Treasury Stock at Cost		Accumulated Other Comprehensive Income	Note Receivable Arising from Exercise of Stock	
	Shares	Amount	Capital	Earnings	Shares	Amount	(Loss)	Options	Total
Balance December 31, 2005	64,151,902	$ 642	$ 84,532	$ 392,549	5,344,883	$ (221,776)	$ (211)	$ (47)	$ 255,689
Net income				53,815					53,815
Dividends paid				(2,944)					(2,944)
Director compensation paid in common stock	6,000		265						265
Purchases of common stock					1,242,948	(54,694)			(54,694)
Stock based compensation expense			3,297						3,297
Exercises of stock options, including excess tax benefit	508,796	5	9,239						9,244
Incentive compensation paid in common stock			32		(14,600)	606			638
Change in other comprehensive income on available-for-sale investments, net							153		153

of income taxes

Balance July 1, 2006	64,666,698	$ 647	$ 97,365	$ 443,420	6,573,231	$ (275,864)	$ (58)	$ (47)	$ 265,463

See accompanying notes to consolidated financial statements.

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

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

(1) Share-Based Payments

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 twenty six and thirteen weeks ended June 25, 2005, net income was reduced by $2,129,000 and $1,069,000, respectively, and earnings per common share was reduced by $.04 and $.02 in the twenty six and thirteen weeks ended June 25, 2005, respectively, and diluted earnings per share was reduced by $.03 and $.02 in the twenty six and thirteen weeks ended June 25, 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 twenty six weeks ended June 25, 2005, has been adjusted to conform to the current year presentation. In the accompanying unaudited Consolidated Statements of Cash Flows for the twenty six week periods ended July 1, 2006 and June 25, 2005, the Company realized tax benefits of $3,269,000 and $1,233,000, respectively, in excess of recognized compensation cost and reported that amount as a cash outflow from operating activities and a cash inflow from financing activities.

Share-based payment arrangements

As of July 1, 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):

	Twenty Six Weeks Ended		Thirteen Weeks Ended	
	July 1, 2006	June 25, 2005	July 1, 2006	June 25, 2005
Total cost of share-based payment plans during the period	$ 3,297	$ 3,028	$ 1,886	$ 1,516
Amount of related income tax benefit recognized during the period	1,063	899	596	447
Net cost of share based payment plans during the period	$ 2,234	$ 2,129	$ 1,290	$ 1,069

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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 July 1, 2006, there were 6,793,016 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, all independent 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 twenty six 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 twenty six and thirteen week periods ended July 1, 2006 and June 25, 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	(508,796)	$ 11.74		
Forfeited/expired	(17,800)	$ 15.03		
Options outstanding at July 1, 2006	2,898,056	$ 25.71	7.5	$ 60,700
Options exercisable at July 1, 2006	1,099,584	$ 15.65	6.0	$ 34,095

The weighted average grant date fair value of stock options granted during the twenty six week periods ended July 1, 2006 and June 25, 2005 was $15.32 and $12.76, respectively.

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The total intrinsic value of stock options exercised during the twenty six and thirteen week periods ended July 1, 2006 was $16,410,000 and $8,189,000, respectively. The total intrinsic value of stock options exercised during the twenty six and thirteen week periods ended June 25, 2005 was $11,352,000 and $2,693,000, respectively.

As of July 1, 2006, there was $15,989,000 of total unrecognized compensation cost related to non-vested stock options granted under the plans. The compensation cost related to these non-vested options is expected to be recognized over a weighted average period of 2.6 years.

(2) Dividends on Common Stock

On May 31, 2006, the Company paid cash dividends of $0.025 per common share to stockholders of record on May 10, 2006. On February 28, 2006, the Company paid cash dividends of $0.025 per common share to stockholders of record on February 14, 2006.

(3) Income Taxes

The provisions for income taxes for the 2006 and 2005 twenty six week periods were based on estimated full year combined effective income tax rates of approximately 38.7% and 38.8%, 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-based compensation.

(4) 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):

	Twenty Six Weeks Ended		**Thirteen Weeks Ended**	
	July 1, 2006	**June 25, 2005**	**July 1, 2006**	**June 25, 2005**
Average number of common shares outstanding	58,700	59,878	58,499	59,402
Incremental shares from assumed exercises of stock options	965	1,259	788	1,019
Average number of common shares and common share equivalents outstanding	59,665	61,137	59,287	60,421

For the twenty six and thirteen week periods ended June 25, 2005, there were 470,000 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. For the twenty six and thirteen week periods ended July 1, 2006, there were no such options outstanding.

(5) Additional Cash Flow Information

During the 2006 twenty six week period, Landstar paid income taxes and interest of $34,789,000 and $3,925,000, respectively. During the 2005 twenty six week period, Landstar paid income taxes and interest of $29,760,000 and $2,221,000, respectively. Landstar acquired operating property by entering into capital leases in the amount of $7,488,000 and $12,955,000 in the 2006 and 2005 twenty six week periods, respectively.

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(6) Segment Information

The following tables summarize information about Landstar s reportable business segments as of and for the twenty six and thirteen week periods ended July 1, 2006 and June 25, 2005 (in thousands):

	Twenty Six Weeks Ended July 1, 2006				
	Carrier	Global Logistics	Insurance	Other	Total
External revenue	$ 895,933	$ 340,467	$ 16,880		$ 1,253,280
Investment income			1,252		1,252
Internal revenue	23,908	999	16,411		41,318
Operating income	88,064	17,022	15,089	$ (29,309)	90,866
Goodwill	20,496	10,638			31,134
Total assets	362,475	144,153	99,271	63,835	669,734

	Twenty Six Weeks Ended June 25, 2005				
	Carrier	Global Logistics	Insurance	Other	Total
External revenue	$ 783,521	$ 242,588	$ 15,207		$ 1,041,316
Investment income			1,235		1,235
Internal revenue	11,640	888	17,848		30,376
Operating income	70,279	9,142	11,628	$ (24,927)	66,122
Goodwill	20,496	10,638			31,134
Total assets	329,230	76,178	97,352	40,623	543,383

	Thirteen Weeks Ended July 1, 2006				
	Carrier	Global Logistics	Insurance	Other	Total
External revenue	$ 467,620	$ 167,042	$ 8,576		$ 643,238
Investment income			873		873
Internal revenue	12,052	639	10,472		23,163
Operating income	47,493	8,295	8,413	$ (14,946)	49,255

	Thirteen Weeks Ended June 25, 2005				
	Carrier	Global Logistics	Insurance	Other	Total
External revenue	$ 412,478	$ 118,892	$ 7,734		$ 539,104
Investment income			696		696
Internal revenue	5,756	538	11,258		17,552
Operating income	39,248	3,976	7,536	$ (13,085)	37,675

(7) Comprehensive Income

The following table includes the components of comprehensive income for the twenty six and thirteen week periods ended July 1, 2006 and June 25, 2005 (in thousands):

	Twenty Six Weeks Ended		Thirteen Weeks Ended	
	July 1, 2006	June 25, 2005	July 1, 2006	June 25, 2005
Net income	$ 53,815	$ 39,242	$ 29,465	$ 22,424
	153	(109)	16	(31)

Unrealized holding gains (losses) on available-for-sale investments, net of income taxes				
Comprehensive income	$ 53,968	$ 39,133	$ 29,481	$ 22,393

Accumulated other comprehensive loss at July 1, 2006 of $58,000 represents the unrealized holding loss on available-for-sale investments of $90,000, net of income tax benefits of $32,000.

(8) Commitments and Contingencies

As of July 1, 2006, Landstar had $27,219,000 of letters of credit outstanding under the Company s revolving credit facility and $42,585,000 of letters of credit secured by investments held by the Company s insurance segment. Short-term investments include $19,683,000 in current maturities of investment grade bonds and $2,016,000 of cash equivalents held by the Company s insurance segment at July 1, 2006. These short-term investments together with $994,000 of the non-current portion of investment grade bonds and $21,958,000 of cash equivalents included in other assets at July 1, 2006, provide collateral for the $42,585,000 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. The Complaint alleges that certain aspects of the Company s motor carrier leases with its BCO Independent Contractors violate certain federal leasing regulations and seeks injunctive relief, an unspecified amount

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of damages and attorney s fees. Claims are currently pending against the following Company entities: Landstar Inway, Inc., Landstar Ligon, Inc. and Landstar Ranger, Inc. (the Defendants). On April 7, 2005, Plaintiffs amended the Complaint (the Amended Complaint) to include additional allegations with respect to violations of certain federal leasing regulations. On August 30, 2005, the Court granted a motion by Plaintiffs to certify the case as a class action.

Discovery is ongoing but substantially complete in the case, which is currently scheduled for a jury trial in October 2006. The Plaintiffs and the Defendants each have motions for partial summary judgment pending before the Court, which is expected to rule on these motions prior to or at trial. On August 4, 2006, the Defendants filed a motion, which is pending, asking that the Court bifurcate the proceedings such that only common issues of law would be decided on a classwide basis and any remaining issues of fact, including whether any class member can prove liability or damages, would be tried on an individualized basis.

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. In the event that the Court rules for Defendants on all or a portion of the legal issues raised in the pending motions for summary judgment or, ultimately, 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 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 believes it is probable that it will 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 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 and buses. 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.

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 July 1, 2006 and June 25, 2005, the Company had a network of 1,249 and 1,106 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:

	Twenty Six Weeks Ended		Thirteen Weeks Ended	
	July 1, 2006	**June 25, 2005**	**July 1, 2006**	**June 25, 2005**
Carrier Segment:				
External revenue generated through (in thousands):				
BCO Independent Contractors	$ 640,596	$ 599,222	$ 336,803	$ 316,547

Truck Brokerage Carriers	255,337	184,299	130,817	95,931
	$ 895,933	$ 783,521	$ 467,620	$ 412,478
Revenue per revenue mile	$ 2.00	$ 1.81	$ 2.01	$ 1.82
Revenue per load	$ 1,594	$ 1,454	$ 1,607	$ 1,463
Average length of haul (miles)	797	802	800	802
Number of loads	562,000	539,000	291,000	282,000
<u>Global Logistics Segment:</u>				
External revenue generated through (in thousands):				
BCO Independent Contractors (1)	$ 47,163	$ 35,335	$ 22,331	$ 17,497
Truck Brokerage Carriers	198,301	154,665	97,674	75,584
Rail, air, ocean and bus carriers (2)	95,003	52,588	47,037	25,811
	$ 340,467	$ 242,588	$ 167,042	$ 118,892
Revenue per load (3)	$ 1,504	$ 1,484	$ 1,507	$ 1,431
Number of loads (3)	189,000	158,000	97,000	82,000

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

(2) Included in the 2006 twenty six and thirteen week periods was $19,438,000 and $8,582,000, 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).

(3) Number of loads and revenue per load in the twenty six and thirteen week periods ended July 1, 2006, exclude the effect of $56,297,000 and $20,848,000, respectively, of revenue derived from transportation services provided under the FAA contract. Number of loads and revenue per load in the twenty six and thirteen week periods ended June 25, 2005, exclude the effect of $8,075,000 and $775,000, respectively, of revenue derived under the FAA contract. See

Use of Non-GAAP Financial Measures.

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

	July 1, 2006	June 25, 2005
BCO Independent Contractors	8,347	7,840
Truck Brokerage Carriers:		
Approved and active [1]	14,034	12,458
Other approved	7,977	7,605
	22,011	20,063
Total available truck capacity providers	30,358	27,903
Number of trucks provided by BCO Independent Contractors	9,047	8,609

[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 36.2% during the twenty six week period ended July 1, 2006 and 32.6% during the twenty six week period ended June 25, 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.

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 depends on when such claims are 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:

	Twenty Six Weeks Ended		**Thirteen Weeks Ended**	
	July 1, 2006	**June 25, 2005**	**July 1, 2006**	**June 25, 2005**
Revenue	100.0%	100.0%	100.0%	100.0%
Investment income	0.1	0.1	0.1	0.1
Costs and expenses:				
Purchased transportation	75.3	75.2	75.6	75.2
Commissions to agents	7.8	7.9	7.8	8.0
Other operating costs	1.8	1.6	1.6	1.5
Insurance and claims	1.6	2.2	1.4	1.8
Selling, general and administrative	5.7	6.1	5.4	5.9
Depreciation and amortization	0.6	0.7	0.6	0.7
Total costs and expenses	92.8	93.7	92.4	93.1

Operating income	7.3	6.4	7.7	7.0
Interest and debt expense	0.3	0.2	0.2	0.2
Income before income taxes	7.0	6.2	7.5	6.8
Income taxes	2.7	2.4	2.9	2.6
Net income	4.3%	3.8%	4.6%	4.2%

TWENTY SIX WEEKS ENDED JULY 1, 2006 COMPARED TO TWENTY SIX WEEKS ENDED JUNE 25, 2005

Revenue for the 2006 twenty six week period was $1,253,280,000, an increase of $211,964,000, or 20.4%, over the 2005 twenty six week period. The increase was attributable to increased revenue of $112,412,000, $97,879,000 and $1,673,000 at the carrier, global logistics and insurance segments, respectively. With respect to the carrier segment, revenue per load increased approximately 10% in the 2006 twenty six week period while the number of loads delivered in the 2006 twenty six week period increased approximately 4%. The average length of haul per load at the carrier segment decreased approximately 1%, however, revenue per revenue mile increased approximately 10%. Included in revenue at the global logistics segment for the 2006 and 2005 twenty six week periods was $56,297,000 and $8,075,000, respectively, of revenue related to disaster relief efforts for the storms that impacted the United States. 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 twenty six week period increased approximately 20% and revenue per load increased approximately 1% over the 2005 period.

Investment income at the insurance segment was $1,252,000 and $1,235,000 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 75.3% and 75.2% 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 increased revenue provided under the FAA contract in 2006, which tends to have a lower cost of purchased transportation. Commissions to agents were 7.8% and 7.9% of revenue in 2006 and 2005, respectively. The decrease in commissions to agents as a percentage of revenue was primarily attributable to increased revenue provided under the FAA contract which tends to have a lower cost of commissions to agents. Other operating costs were 1.8% 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 trailer rent and maintenance costs, as a result of the Company s on going effort to reduce the cost of Company provided trailing equipment. Insurance and claims were 1.6% of revenue in 2006 compared with 2.2% 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, 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 5.7% of revenue in 2006 compared with 6.1% 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, partially offset by an increased provision for bonuses under the Company s incentive compensation plans and an increased provision for customer bad debt. 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 finance a portion of the 2005 fiscal year end receivable from the FAA.

The provisions for income taxes for the 2006 and 2005 twenty six week periods were based on estimated full year combined effective income tax rates of approximately 38.7% and 38.8%, 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 $53,815,000, or $0.92 per common share ($0.90 per diluted share), for the twenty six week period ended July 1, 2006, which included approximately $7,615,000 of operating income related to the $56,297,000 of revenue attributable to disaster relief services provided primarily under the FAA contract. The $7,615,000 of operating income, net of related income taxes, increased net income by $4,690,000, or $0.08 per common share ($0.08 per diluted share). Net income was $39,242,000, or $0.66 per common share ($0.64 per diluted share), for the twenty six week period ended June 25, 2005, which included approximately $1,505,000 of operating income related to the $8,075,000 of revenue attributable to disaster relief services provided primarily under the FAA contract. The $1,505,000 of operating income, net of related income taxes, increased net income by $927,000, or $0.02 per common share ($0.02 per diluted share). The 2006 and 2005 twenty six week periods included stock compensation expense of $3,297,000 and $3,028,000, respectively, or $2,234,000 and $2,129,000, respectively, net of related income tax benefits. Stock compensation expense reduced earnings per common share $0.04 ($0.04 per diluted share) and $0.04

($0.03 per diluted share), respectively, in the 2006 and 2005 twenty six week periods.

THIRTEEN WEEKS ENDED JULY 1, 2006 COMPARED TO THIRTEEN WEEKS ENDED JUNE 25, 2005

Revenue for the 2006 thirteen week period was $643,238,000, an increase of $104,134,000, or 19.3%, compared to the 2005 thirteen week period. The increase was attributable to increased revenue of $55,142,000, $48,150,000 and $842,000 at the carrier, global logistics and insurance segments, respectively. With respect to the carrier segment, revenue per load increased approximately 10% in the 2006 thirteen week period while the number of loads delivered in the 2006 thirteen week period increased approximately 3%. 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 10%. Included in revenue at the global logistics segment in the 2006 thirteen week period was $20,848,000 of revenue related to disaster relief efforts for the storms that impacted the United States. Excluding the number of loads and revenue related to disaster relief efforts provided by the global logistics segment in the 2006 thirteen week period, the number of loads delivered by the global logistics segment in the 2006 thirteen week period increased approximately 18% and revenue per load increased approximately 5% over the 2005 period.

Investment income at the insurance segment was $873,000 and $696,000 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 75.6% and 75.2% 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 increased revenue provided under the FAA contract in 2006, which tends to have a lower cost of purchased transportation, and lower rates paid to Truck Broker Carriers for non-FAA related revenue. Commissions to agents were 7.8% of revenue in 2006 and 8.0% in 2005. The decrease in commissions to agents as a percentage of revenue compared to prior year was primarily attributable to increased revenue provided for disaster relief services under the FAA contract, which tends to have a lower cost of commissions to agents. Other operating costs were 1.6% and 1.5% 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 trailer rent and maintenance costs. Insurance and claims were 1.4% 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, 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 5.9% 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. 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 0.2% of revenue in both 2006 and 2005.

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 38.6% and 38.8%, 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 $29,465,000, or $0.50 per common share ($0.50 per diluted share), in the 2006 thirteen week period, which included approximately $2,606,000 of operating income related to the $20,848,000 of revenue attributable to disaster relief services provided primarily under the FAA contract. The $2,606,000 of operating income, net of related income taxes, increased net income by $1,605,000, or $0.03 per common share ($0.03 per diluted share). Net income was $22,424,000, or $0.38 per common share ($0.37 per diluted share), in the 2005 thirteen week period. The 2006 and 2005 thirteen week periods included stock compensation expense of $1,886,000 and $1,516,000, respectively, or $1,290,000 and $1,069,000, 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.

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 $265,463,000 at July 1, 2006, compared to $255,689,000 at December 31, 2005. The increase in shareholders equity was primarily a result of net income for the period and exercises of stock options, partially offset by the purchase of 1,242,948 shares of the Company s common stock at a total cost of $54,694,000. At July 1, 2006, the Company may purchase up to an additional 1,282,279 shares of its common stock under its authorized stock purchase programs. Shareholders equity was 71% of total capitalization (defined as total debt plus equity) at July 1, 2006 compared to 60% at December 31, 2005.

Long-term debt including current maturities was $108,329,000 at July 1, 2006, $58,644,000 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 a vast majority of the $215,250,000 December 31, 2005 receivable from the FAA during the twenty six week period ended July 1, 2006.

Working capital and the ratio of current assets to current liabilities were $262,068,000 and 2.0 to 1, respectively, at July 1, 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 $174,588,000 in the 2006 twenty six week period compared with $80,160,000 in the 2005 twenty six week period. The increase in cash flow provided by operating activities was primarily attributable to the timing of collections of trade accounts receivable, including the vast majority of the 2005 fiscal year end receivable from the FAA for disaster relief transportation services provided during the later half of fiscal 2005, and increased earnings.

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 July 1, 2006, the Company had $60,000,000 in borrowings outstanding and $27,219,000 of letters of credit outstanding under the Fourth Amended and Restated Credit Agreement. At July 1, 2006, there was $137,781,000 available for future borrowings under the Company s Fourth Amended and Restated Credit Agreement. In addition, the Company has $42,585,000 in letters of credit outstanding, as collateral for insurance claims, that are secured by investments and cash equivalents totaling $44,651,000.

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, 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 twenty six week period, the Company purchased $1,214,000 of operating property and acquired $7,488,000 worth of trailing equipment by entering into capital leases. Landstar anticipates acquiring approximately $35,000,000 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.

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. The Complaint alleges that certain aspects of the Company s motor carrier leases with its BCO Independent Contractors violate certain federal leasing regulations and seeks injunctive relief, an unspecified amount of damages and attorney s fees. Claims are currently pending against the following Company entities: Landstar Inway, Inc., Landstar Ligon, Inc. and Landstar Ranger, Inc. (the Defendants). On April 7, 2005, Plaintiffs amended the Complaint (the Amended Complaint) to include additional allegations with respect to violations of certain federal leasing regulations. On August 30, 2005, the Court granted a motion by Plaintiffs to certify the case as a class action.

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Discovery is ongoing but substantially complete in the case, which is currently scheduled for a jury trial in October 2006. The Plaintiffs and the Defendants each have motions for partial summary judgment pending before the Court, which is expected to rule on these motions prior to or at trial. On August 4, 2006, the Defendants filed a motion, which is pending, asking that the Court bifurcate the proceedings such that only common issues of law would be decided on a classwide basis and any remaining issues of fact, including whether any class member can prove liability or damages, would be tried on an individualized basis.

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. In the event that the Court rules for Defendants on all or a portion of the legal issues raised in the pending motions for summary judgment or, ultimately, 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 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 believes it is probable that it will 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.

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 July 1, 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 twenty six week period, insurance and claims costs included $3,332,000 of favorable adjustments to prior years claims estimates. During the 2005 twenty six week period, insurance and claims costs included $2,301,000 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 July 1, 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

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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.

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

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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 July 1, 2006, the weighted average interest rate on borrowings outstanding was 5.45%. During the second quarter of fiscal 2006, the average outstanding balance under the Fourth Amended and Restated Credit Agreement was approximately $60,414,000. 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 July 1, 2006 was estimated to approximate carrying value. Assuming that debt levels on the Fourth Amended and Restated Credit Agreement remain at $60,000,000, the balance at July 1, 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 $600,000 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 $994,000, the balance at July 1, 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.

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 July 1, 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 July 1, 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. The Complaint alleges that certain aspects of the Company s motor carrier leases with its BCO Independent Contractors violate certain federal leasing regulations and seeks injunctive relief, an unspecified amount of damages and attorney s fees. Claims are currently pending against the following Company entities: Landstar Inway, Inc., Landstar Ligon, Inc. and Landstar Ranger, Inc. (the Defendants). On April 7, 2005, Plaintiffs amended the Complaint (the Amended Complaint) to include additional allegations with respect to violations of certain federal leasing regulations. On August 30, 2005, the Court granted a motion by Plaintiffs to certify the case as a class action.

Discovery is ongoing but substantially complete in the case, which is currently scheduled for a jury trial in October 2006. The Plaintiffs and the Defendants each have motions for partial summary judgment pending before the Court, which is expected to rule on these motions prior to or at trial. On August 4, 2006, the Defendants filed a motion, which is pending, asking that the Court bifurcate the proceedings such that only common issues of law would be decided on a classwide basis and any remaining issues of fact, including whether any class member can prove liability or damages, would be tried on an individualized basis.

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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. In the event that the Court rules for Defendants on all or a portion of the legal issues raised in the pending motions for summary judgment or, ultimately, 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 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 believes it is probable that it will 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. 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.

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 April 1, 2006 to July 1, 2006, the Company s second 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
April 1, 2006				2,275,927
Apr. 2, 2006 Apr. 29, 2006				2,275,927

Apr. 30, 2006	May 27, 2006	719,800	$	44.00	719,800	1,556,127
May 28, 2006	July 1, 2006	273,848	$	43.43	273,848	1,282,279
Total		993,648	$	43.84	993,648	

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, 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 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.

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On April 28, 2005, 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. During the thirteen week period ended July 1, 2006, the Company completed the purchase of shares authorized for purchase under this program. On July 28, 2005, 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 July 28, 2005 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

On May 4, 2006, Landstar System, Inc. (LSI) held its Annual Meeting of Stockholders (the Meeting) at its principal offices in Jacksonville, Florida. The matters voted upon at the Meeting included (i) the election of the two Class I directors for terms to expire at the 2009 Annual Meeting of Stockholders, (ii) the ratification of appointment of KPMG LLP as LSI s independent registered public accounting firm for fiscal year 2006 and (iii) an amendment to the Company s Executive Incentive Compensation Plan (the EICP Plan) to increase the maximum amount that the Compensation Committee of the Board of Directors of LSI may award as an annual bonus to an eligible participant under the EICP to $3,000,000.

Pursuant to LSI s Restated Certificate of Incorporation, the Board of Directors has fixed the number of directors at seven: two Class I directors whose members terms will expire at the 2009 Annual Meeting of Stockholders; three Class II directors whose members terms will expire at the 2007 Annual Meeting of Stockholders; and two Class III directors whose members terms will expire at the 2008 Annual Meeting of Stockholders. With respect to the election of two Class I directors at the Meeting, nominee Ronald W. Drucker and nominee Henry H. Gerkens were elected to the Board of Directors of LSI. Mr. Drucker received 53,964,504 votes for election to the Board and 1,346,481 votes were withheld. Mr. Gerkens received 53,967,711 votes for election to the Board and 1,343,274 votes were withheld. The names of the other directors whose terms of office as directors continued after the Meeting are as follows: Merritt J. Mott (a Class II director), William S. Elston (a Class II director), Diana M. Murphy (a Class II director), David G. Bannister (a Class III director) and Jeffrey C. Crowe (a Class III director).

The proposal to ratify the appointment of KPMG LLP as LSI s independent registered public accounting firm for fiscal year 2006 was approved by LSI s stockholders. Votes for the proposal were 54,873,017, votes against were 433,559 and votes abstaining were 4,409.

The proposal to approve the amendment to the Company s EICP Plan was approved by LSI s stockholders. Votes for the proposal were 53,585,259, votes against were 1,680,641 and votes abstaining were 45,085.

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.

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

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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: August 4, 2006

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

Date: August 4, 2006

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