LANDSTAR SYSTEM INC
Form 10-Q
August 04, 2017
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 July 1, 2017

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	**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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files):

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company and emerging growth company in Rule 12b-2 of the Exchange Act. (Check one):

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares of the registrant s common stock, par value $0.01 per share, outstanding as of the close of business on July 24, 2017 was 41,946,994.

Table of Contents

Index

PART I Financial Information

Item 1. Financial Statements (unaudited)

Consolidated Balance Sheets as of July 1, 2017 and December 31, 2016	Page 4
Consolidated Statements of Income for the Twenty Six and Thirteen Weeks Ended July 1, 2017 and June 25, 2016	Page 5
Consolidated Statements of Comprehensive Income for the Twenty Six and Thirteen Weeks Ended July 1, 2017 and June 25, 2016	Page 6
Consolidated Statements of Cash Flows for the Twenty Six Weeks Ended July 1, 2017 and June 25, 2016	Page 7
Consolidated Statement of Changes in Shareholders Equity for the Twenty Six Weeks Ended July 1, 2017	Page 8
Notes to Consolidated Financial Statements	Page 9
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	Page 16
Item 3. Quantitative and Qualitative Disclosures About Market Risk	Page 26
Item 4. Controls and Procedures	Page 26

PART II Other Information

Item 1. Legal Proceedings	Page 27
Item 1A. Risk Factors	Page 27
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	Page 27
Item 6. Exhibits	Page 28
Signatures	Page 30

EX 31.1 Section 302 CEO Certification
EX 31.2 Section 302 CFO Certification
EX 32.1 Section 906 CEO Certification
EX 32.2 Section 906 CFO Certification

Table of Contents

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, 2017 are not necessarily indicative of the results that may be expected for the entire fiscal year ending December 30, 2017.

These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company s 2016 Annual Report on Form 10-K.

Table of Contents

LANDSTAR SYSTEM, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share amounts)

(Unaudited)

	July 1, 2017	December 31, 2016
ASSETS		
Current Assets		
Cash and cash equivalents	$ 222,102	$ 178,897
Short-term investments	51,167	66,560
Trade accounts receivable, less allowance of $5,311 and $5,161	480,467	463,102
Other receivables, including advances to independent contractors, less allowance of $6,049 and $5,523	20,518	18,567
Other current assets	19,291	10,281
Total current assets	793,545	737,407
Operating property, less accumulated depreciation and amortization of $202,050 and $190,374	259,346	272,843
Goodwill	31,134	31,134
Other assets	75,249	55,207
Total assets	$ 1,159,274	$ 1,096,591
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Cash overdraft	$ 34,145	$ 36,251
Accounts payable	224,928	219,409
Current maturities of long-term debt	41,356	45,047
Insurance claims	29,077	26,121
Other current liabilities	56,998	53,483
Total current liabilities	386,504	380,311
Long-term debt, excluding current maturities	77,639	93,257
Insurance claims	30,402	26,883
Deferred income taxes and other noncurrent liabilities	55,239	53,583
Shareholders Equity		
Common stock, $0.01 par value, authorized 160,000,000 shares, issued 67,696,487 and 67,585,675 shares	677	676
Additional paid-in capital	203,410	199,414
Retained earnings	1,575,342	1,512,993

Cost of 25,749,493 and 25,747,541 shares of common stock in treasury	(1,167,600)	(1,167,437)
Accumulated other comprehensive loss	(2,339)	(3,089)
Total shareholders equity	609,490	542,557
Total liabilities and shareholders equity	$ 1,159,274	$ 1,096,591

See accompanying notes to consolidated financial statements.

Table of Contents

LANDSTAR SYSTEM, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands, except per share amounts)

(Unaudited)

	Twenty Six Weeks Ended		Thirteen Weeks Ended	
	July 1, 2017	June 25, 2016	July 1, 2017	June 25, 2016
Revenue	$ 1,651,342	$ 1,486,867	$ 870,434	$ 775,223
Investment income	1,022	743	608	363
Costs and expenses:				
Purchased transportation	1,263,111	1,129,743	667,588	589,415
Commissions to agents	134,080	123,931	70,282	64,839
Other operating costs, net of gains on asset sales/dispositions	14,400	13,992	7,503	6,585
Insurance and claims	28,406	30,307	13,893	16,094
Selling, general and administrative	79,184	71,519	40,861	36,905
Depreciation and amortization	19,831	17,093	9,897	8,655
Total costs and expenses	1,539,012	1,386,585	810,024	722,493
Operating income	113,352	101,025	61,018	53,093
Interest and debt expense	1,902	1,777	819	888
Income before income taxes	111,450	99,248	60,199	52,205
Income taxes	41,557	37,750	22,689	19,891
Net income	$ 69,893	$ 61,498	$ 37,510	$ 32,314
Earnings per common share	$ 1.67	$ 1.45	$ 0.89	$ 0.77
Diluted earnings per share	$ 1.66	$ 1.45	$ 0.89	$ 0.76
Average number of shares outstanding:				
Earnings per common share	41,907,000	42,315,000	41,935,000	42,235,000
Diluted earnings per share	42,004,000	42,424,000	42,010,000	42,357,000
Dividends per common share	$ 0.18	$ 0.16	$ 0.09	$ 0.08

See accompanying notes to consolidated financial statements.

5

Table of Contents

LANDSTAR SYSTEM, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in thousands)

(Unaudited)

	Twenty Six Weeks Ended		Thirteen Weeks Ended	
	July 1, 2017	June 25, 2016	July 1, 2017	June 25, 2016
Net income	$ 69,893	$ 61,498	$ 37,510	$ 32,314
Other comprehensive income:				
Unrealized holding gains on available-for-sale investments, net of tax expenses of $89, $217, $54 and $117	165	397	101	215
Foreign currency translation gains	585	837	448	254
Other comprehensive income	750	1,234	549	469
Comprehensive income	$ 70,643	$ 62,732	$ 38,059	$ 32,783

See accompanying notes to consolidated financial statements.

Table of Contents

LANDSTAR SYSTEM, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Twenty Six Weeks Ended	
	July 1, 2017	June 25, 2016
OPERATING ACTIVITIES		
Net income	$ 69,893	$ 61,498
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of operating property	19,831	17,093
Non-cash interest charges	127	112
Provisions for losses on trade and other accounts receivable	3,601	2,951
Gains on sales/disposals of operating property	(701)	(1,761)
Deferred income taxes, net	1,766	6,043
Stock-based compensation	2,237	2,066
Changes in operating assets and liabilities:		
(Increase) decrease in trade and other accounts receivable	(22,917)	57,274
Increase in other assets	(12,658)	(2,939)
Increase (decrease) in accounts payable	8,829	(36,238)
Increase (decrease) in other liabilities	3,316	(8,907)
Increase in insurance claims	6,475	7,943
NET CASH PROVIDED BY OPERATING ACTIVITIES	79,799	105,135
INVESTING ACTIVITIES		
Sales and maturities of investments	33,486	23,454
Purchases of investments	(34,360)	(24,377)
Purchases of operating property	(6,628)	(8,955)
Proceeds from sales of operating property	2,793	4,791
NET CASH USED BY INVESTING ACTIVITIES	(4,709)	(5,087)
FINANCING ACTIVITIES		
Decrease in cash overdraft	(2,106)	(5,254)
Dividends paid	(7,544)	(6,782)
Proceeds from exercises of stock options	1,962	900
Taxes paid in lieu of shares issued related to stock-based compensation plans	(365)	(1,690)
Excess tax benefits from stock-based awards		277
Purchases of common stock		(26,485)
Principal payments on capital lease obligations	(24,417)	(23,001)

NET CASH USED BY FINANCING ACTIVITIES	(32,470)	(62,035)
Effect of exchange rate changes on cash and cash equivalents	585	837
Increase in cash and cash equivalents	43,205	38,850
Cash and cash equivalents at beginning of period	178,897	114,520
Cash and cash equivalents at end of period	$ 222,102	$ 153,370

See accompanying notes to consolidated financial statements.

Table of Contents

LANDSTAR SYSTEM, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY

Twenty Six Weeks Ended July 1, 2017

(Dollars in thousands)

(Unaudited)

	Common Stock		Additional Paid-In	Retained	Treasury Stock at Cost		Accumulated Other Comprehensive (Loss)	
	Shares	Amount	Capital	Earnings	Shares	Amount	Income	Total
Balance December 31, 2016	67,585,675	$ 676	$ 199,414	$ 1,512,993	25,747,541	$ (1,167,437)	$ (3,089)	$ 542,557
Net income				69,893				69,893
Dividends ($0.18 per share)				(7,544)				(7,544)
Issuance of stock related to stock-based compensation plans	110,812	1	1,759		1,952	(163)		1,597
Stock-based compensation			2,237					2,237
Other comprehensive income							750	750
Balance July 1, 2017	67,696,487	$ 677	$ 203,410	$ 1,575,342	25,749,493	$ (1,167,600)	$ (2,339)	$ 609,490

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. Significant intercompany accounts have been eliminated in consolidation.

(1) Share-based Payment Arrangements

As of July 1, 2017, the Company had two employee equity incentive plans, the 2002 employee stock option and stock incentive plan (the ESOSIP) and the 2011 equity incentive plan (the 2011 EIP). No further grants can be made under the ESOSIP. The Company also has a stock compensation plan for members of its Board of Directors, the Amended and Restated 2013 Directors Stock Compensation Plan (as amended and restated as of May 17, 2016, the 2013 DSCP). 6,000,000 shares of the Company s common stock were authorized for issuance under the 2011 EIP and 115,000 shares of the Company s common stock were authorized for issuance under the 2013 DSCP. The ESOSIP, 2011 EIP and 2013 DSCP are each referred to herein as a Plan, and, collectively, as the Plans. 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, 2017	June 25, 2016	July 1, 2017	June 25, 2016
Total cost of the Plans during the period	$ 2,237	$ 2,066	$ 1,243	$ 966
Amount of related income tax benefit recognized during the period	(1,814)	(836)	(687)	(365)
Net cost of the Plans during the period	$ 423	$ 1,230	$ 556	$ 601

Included in income tax benefits recognized in the twenty-six-week periods ended July 1, 2017 and June 25, 2016 were income tax benefits of $270,000 and $172,000, respectively, recognized on disqualifying dispositions of the Company s common stock by employees who obtained shares of common stock through exercises of incentive stock options. Also included in income tax benefits recognized in the twenty-six-week period ended July 1, 2017 were excess tax benefits from stock-based awards of $751,000, as required by the Company s adoption of Accounting Standards Update 2016-09 during the first fiscal quarter of 2017. See Note 10, Recent Accounting Pronouncements, for further information.

As of July 1, 2017, there were 78,682 shares of the Company s common stock reserved for issuance under the 2013 DSCP and 4,747,396 shares of the Company s common stock reserved for issuance in the aggregate under the ESOSIP and 2011 EIP.

Restricted Stock Units

The following table summarizes information regarding the Company s outstanding restricted stock unit (RSU) awards with either a performance condition or a market condition under the Plans:

	Number of RSUs	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2016	378,238	$ 50.46
Granted	67,577	$ 76.90
Forfeited	(56,771)	$ 45.35
Outstanding at July 1, 2017	389,044	$ 55.80

During the twenty-six-week period ended July 1, 2017, the Company granted RSUs with a performance condition. RSUs with a performance condition granted on February 2, 2017 may vest on January 31 of 2020, 2021 and 2022 based on growth in operating income and diluted earnings per share from continuing operations as compared to the results from the 2016 fiscal year. Outstanding RSUs at both December 31, 2016 and July 1, 2017 include RSUs with a performance condition and RSUs with a market condition, as further described below.

Table of Contents

RSUs with a performance condition vest over a 5 year period from the date of grant based on growth in operating income and diluted earnings per share as compared to a base year, being the year immediately preceding the year of grant. At the time of grant, the target number of common shares available for issuance under the February 2, 2017, January 29, 2016 and January 27, 2015 grants equals 100% of the number of RSUs granted, and the maximum number of common shares available for issuance under the February 2, 2017, January 29, 2016 and January 27, 2015 grants equals 200% of the number of RSUs granted. In the event actual results exceed the target, the number of shares that will be granted will exceed the number of RSUs granted. The maximum number of common shares available for issuance under grants made prior to 2015 equals 100% of the number of RSUs granted. The fair value of an RSU with a performance condition was determined based on the market value of the Company s common stock on the date of grant, discounted for lack of marketability for a minimum post-vesting holding requirement. The discount rate due to lack of marketability used for RSU award grants with a performance condition for all periods was 7%. With respect to RSU awards with a performance condition, the Company reports compensation expense over the life of the award based on an estimated number of units that will vest over the life of the award, multiplied by the fair value of an RSU.

On May 1, 2015, the Company granted 20,000 RSUs that vest based on a market condition. These RSUs may vest on April 30 of 2019, 2020 and 2021 based on the Company s total shareholder return (TSR) compound annual growth rate over the vesting periods, adjusted to reflect dividends (if any) paid during such periods and capital adjustments as may be necessary. The target number of common shares available for issuance under the May 1, 2015 grant equals 100% of the number of RSUs granted, and the maximum number of common shares available for issuance under the May 1, 2015 grant equals 150% of the number of RSUs granted. In the event actual results exceed the target TSR compound annual growth rate, the number of shares that will be granted will exceed the number of RSUs granted. The fair value of this RSU award was determined at the time of grant based on the expected achievement of the market condition at the end of each vesting period. With respect to these RSU awards with a market condition, compensation expense is recognized ratably over the requisite service period under an award based on the fair market value of the award at the time of grant, regardless of whether the market condition is satisfied. Previously recognized compensation cost would be reversed, however, if the employee terminated employment prior to completing such requisite service period.

The Company recognized approximately $1,309,000 and $1,130,000 of share-based compensation expense related to RSU awards in the twenty-six-week periods ended July 1, 2017 and June 25, 2016, respectively. As of July 1, 2017, there was a maximum of $33.3 million of total unrecognized compensation cost related to RSU awards granted under the Plans with an expected average remaining life of approximately 3 years. With respect to RSU awards with a performance condition, the amount of future compensation expense to be recognized will be determined based on future operating results.

Stock Options

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

	Number of Options	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (000s)
Options outstanding at December 31, 2016	372,561	$ 48.24		
Exercised	(114,009)	$ 46.10		
Forfeited	(600)	$ 54.93		

Options outstanding at July 1, 2017	257,952	$	49.16	4.3	$	9,399
Options exercisable at July 1, 2017	237,452	$	48.53	4.1	$	8,802

The total intrinsic value of stock options exercised during the twenty-six-week periods ended July 1, 2017 and June 25, 2016 was $4,480,000 and $1,236,000, respectively.

As of July 1, 2017, there was $157,000 of total unrecognized compensation cost related to non-vested stock options granted under the Plans. The unrecognized compensation cost related to these non-vested options is expected to be recognized during 2017.

Table of Contents

Non-vested Restricted Stock and Deferred Stock Units

The following table summarizes information regarding the Company s outstanding shares of non-vested restricted stock and Deferred Stock Units (defined below) under the Plans:

	Number of Shares and Deferred Stock Units	Weighted Average Grant Date Fair Value
Non-vested at December 31, 2016	28,409	$ 58.91
Granted	39,267	$ 83.45
Vested	(16,227)	$ 61.50
Non-vested at July 1, 2017	51,449	$ 76.83

The fair value of each share of non-vested restricted stock issued and Deferred Stock Unit granted under the Plans are based on the fair value of a share of the Company s common stock on the date of grant. Shares of non-vested restricted stock are subject to vesting in three equal annual installments either on the first, second and third anniversary of the date of the grant or the third, fourth and fifth anniversary of the date of the grant, or 100% on the first anniversary of the date of the grant. For restricted stock awards granted under the 2013 DSCP plan, each recipient may elect to defer receipt of shares and instead receive restricted stock units (Deferred Stock Units), which represent contingent rights to receive shares of the Company s common stock on the date of recipient separation from service from the Board of Directors, or, if earlier, upon a change in control event of the Company. Deferred Stock Units become vested 100% on the first anniversary of the date of the grant. Deferred Stock Units do not represent actual ownership in shares of the Company s common stock and the recipient will not have voting rights or other incidents of ownership until the shares are issued. However, Deferred Stock Units do contain the right to receive dividend equivalent payments prior to settlement into shares.

As of July 1, 2017, there was $3,500,000 of total unrecognized compensation cost related to non-vested shares of restricted stock and Deferred Stock Units granted under the Plans. The unrecognized compensation cost related to these non-vested shares of restricted stock and Deferred Stock Units is expected to be recognized over a weighted average period of 3 years.

(2) Income Taxes

The provisions for income taxes for both the 2017 and 2016 twenty-six-week periods were based on estimated annual effective income tax rates of 38.2% adjusted for discrete events, such as benefits resulting from disqualifying dispositions of the Company s common stock by employees who obtained the stock through exercises of incentive stock options. The effective income tax rates for the 2017 and 2016 twenty-six-week periods were 37.3% and 38.0%, respectively, which were higher than the statutory federal income tax rate primarily as a result of state taxes, the meals and entertainment exclusion and non-deductible stock-based compensation.

During the first fiscal quarter of 2017, the Company adopted ASU 2016-09, as further described in footnote 10. As required by ASU 2016-09, the Company recognized $751,000 of excess tax benefits on stock-based awards in its provision for income taxes in the twenty-six-week period ended July 1, 2017.

(3) Earnings Per Share

Earnings per common share are based on the weighted average number of shares outstanding, including outstanding non-vested restricted stock and outstanding Deferred Stock Units. Diluted earnings per share are based on the weighted average number of common shares and Deferred Stock Units outstanding plus the incremental shares that would have been outstanding upon the assumed exercise of all dilutive stock options.

Table of Contents

The following table provides a reconciliation of the average number of common shares outstanding used to calculate earnings per common share to the average number of common shares and common share equivalents outstanding used to calculate diluted earnings per share (in thousands):

	Twenty Six Weeks Ended		Thirteen Weeks Ended	
	July 1, 2017	June 25, 2016	July 1, 2017	June 25, 2016
Average number of common shares outstanding	41,907	42,315	41,935	42,235
Incremental shares from assumed exercises of stock options	97	109	75	122
Average number of common shares and common share equivalents outstanding	42,004	42,424	42,010	42,357

For each of the twenty-six-week periods ended July 1, 2017 and June 25, 2016, no options outstanding to purchase shares of common stock were antidilutive. Outstanding RSUs were excluded from the calculation of diluted earnings per share for all periods because the performance metric requirements or market condition for vesting had not been satisfied.

(4) Additional Cash Flow Information

During the 2017 twenty-six-week period, Landstar paid income taxes and interest of $45,559,000 and $2,062,000, respectively. During the 2016 twenty-six-week period, Landstar paid income taxes and interest of $33,771,000 and $1,922,000, respectively. Landstar acquired operating property by entering into capital leases in the amounts of $5,108,000 and $17,642,000 in the 2017 and 2016 twenty-six-week periods, respectively. In addition, during the 2017 twenty-six-week period Landstar acquired $945,000 of operating property for which the Company accrued a corresponding liability in accounts payable as of July 1, 2017 related to the completion of a new freight staging and transload facility in Laredo, TX. The Company had unpaid capital expenditure purchases included in accounts payable of $1,988,000 and $5,298,000 at July 1, 2017 and December 31, 2016, respectively. Capital expenditure purchases are recorded as cash outflows from investing activities in the consolidated statement of cash flows in the period in which they are paid.

(5) Segment Information

The following table summarizes information about the Company s reportable business segments as of and for the twenty-six-week and thirteen-week periods ended July 1, 2017 and June 25, 2016 (in thousands):

	Twenty Six Weeks Ended					
	July 1, 2017			June 25, 2016		
	Transportation Logistics	Insurance	Total	Transportation Logistics	Insurance	Total
External revenue	$ 1,628,155	$ 23,187	$ 1,651,342	$ 1,463,772	$ 23,095	$ 1,486,867
Internal revenue		22,438	22,438		21,661	21,661
Investment income		1,022	1,022		743	743

Operating income	94,512	18,840	113,352	85,801	15,224	101,025
Expenditures on long-lived assets	6,628		6,628	8,955		8,955
Goodwill	31,134		31,134	31,134		31,134

	Thirteen Weeks Ended					
	July 1, 2017			June 25, 2016		
	Transportation Logistics	Insurance	Total	Transportation Logistics	Insurance	Total
External revenue	$ 858,807	$ 11,627	$ 870,434	$ 763,672	$ 11,551	$ 775,223
Internal revenue		15,104	15,104		14,430	14,430
Investment income		608	608		363	363
Operating income	50,398	10,620	61,018	46,176	6,917	53,093
Expenditures on long-lived assets	1,650		1,650	8,127		8,127

In the twenty-six and thirteen-week periods ended July 1, 2017 and June 25, 2016, no single customer accounted for more than 10% of the Company s consolidated revenue.

Table of Contents

(6) Other Comprehensive Income

The following table presents the components of and changes in accumulated other comprehensive income, net of related income taxes, as of and for the twenty-six-week period ended July 1, 2017 (in thousands):

	Unrealized Holding (Losses) Gains on Available-for-Sale Securities	Foreign Currency Translation	Total
Balance as of December 31, 2016	$ (71)	$ (3,018)	$ (3,089)
Other comprehensive income	165	585	750
Balance as of July 1, 2017	$ 94	$ (2,433)	$ (2,339)

Amounts reclassified from accumulated other comprehensive income to investment income due to the realization of previously unrealized gains and losses in the accompanying consolidated statements of income were not significant for the twenty-six-week period ended July 1, 2017.

(7) Investments

Investments include primarily investment-grade corporate bonds and U.S. Treasury obligations having maturities of up to five years (the bond portfolio). Investments in the bond portfolio are reported as available-for-sale and are carried at fair value. Investments maturing less than one year from the balance sheet date are included in short-term investments and investments maturing more than one year from the balance sheet date are included in other assets in the consolidated balance sheets. Management performs an analysis of the nature of the unrealized losses on available-for-sale investments to determine whether such losses are other-than-temporary. Unrealized losses, representing the excess of the purchase price of an investment over its fair value as of the end of a period, considered to be other-than-temporary, are to be included as a charge in the statement of income, while unrealized losses considered to be temporary are to be included as a component of shareholders equity. Investments whose values are based on quoted market prices in active markets are classified within Level 1. Investments that trade in markets that are not considered to be active, but are valued based on quoted market prices, are classified within Level 2. As Level 2 investments include positions that are not traded in active markets, valuations may be adjusted to reflect illiquidity and/or non-transferability, which are generally based on available market information. Any transfers between levels are recognized as of the beginning of any reporting period. Fair value of the bond portfolio was determined using Level 1 inputs related to U.S. Treasury obligations and money market investments and Level 2 inputs related to investment-grade corporate bonds, asset-backed securities and direct obligations of government agencies. Unrealized gains, net of unrealized losses, on the investments in the bond portfolio were $145,000 at July 1, 2017, while unrealized losses, net of unrealized gains, on the investments in the bond portfolio were $109,000 at December 31, 2016, respectively.

The amortized cost and fair values of available-for-sale investments are as follows at July 1, 2017 and December 31, 2016 (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
July 1, 2017				
Money market investments	$ 14,422	$	$	$ 14,422
Asset-backed securities	3,659	5	5	3,659
Corporate bonds and direct obligations of government agencies	80,122	311	158	80,275
U.S. Treasury obligations	11,988		8	11,980
Total	$ 110,191	$ 316	$ 171	$ 110,336
December 31, 2016				
Money market investments	$ 12,395	$	$	$ 12,395
Asset-backed securities	4,027	3	19	4,011
Corporate bonds and direct obligations of government agencies	70,069	150	239	69,980
U.S. Treasury obligations	23,037	2	6	23,033
Total	$ 109,528	$ 155	$ 264	$ 109,419

Table of Contents

For those available-for-sale investments with unrealized losses at July 1, 2017 and December 31, 2016, the following table summarizes the duration of the unrealized loss (in thousands):

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
July 1, 2017						
Asset-backed securities	$ 1,097	$ 1	$ 1,353	$ 4	$ 2,450	$ 5
Corporate bonds and direct obligations of government agencies	29,252	125	2,276	33	31,528	158
U.S. Treasury obligations	11,980	8			11,980	8
Total	$ 42,329	$ 134	$ 3,629	$ 37	$ 45,958	$ 171
December 31, 2016						
Asset-backed securities	$ 1,363	$ 6	$ 2,314	$ 13	$ 3,677	$ 19
Corporate bonds and direct obligations of government agencies	28,809	195	1,367	44	30,176	239
U.S. Treasury obligations	12,734	6			12,734	6
Total	$ 42,906	$ 207	$ 3,681	$ 57	$ 46,587	$ 264

The Company believes that unrealized losses on investments were primarily caused by rising interest rates rather than changes in credit quality. The Company expects to recover the amortized cost basis of these securities as it does not intend to sell, and does not anticipate being required to sell, these securities before recovery of the cost basis. For these reasons, the Company does not consider the unrealized losses on these securities to be other-than-temporary at July 1, 2017.

(8) Commitments and Contingencies

Short-term investments include $51,167,000 in current maturities of investments held by the Company s insurance segment at July 1, 2017. The non-current portion of the bond portfolio of $59,169,000 is included in other assets. The short-term investments, together with $15,499,000 of non-current investments, provide collateral for the $59,999,000 of letters of credit issued to guarantee payment of insurance claims. As of July 1, 2017, Landstar also had $35,962,000 of additional letters of credit outstanding under the Company s Credit Agreement.

The Company is involved in certain claims and pending litigation arising from the normal conduct of business. Many of these claims are covered in whole or in part by insurance. 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 claims and pending litigation and that the ultimate outcome, after provisions therefor, 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.

(9) Change in Accounting Estimate for Self-Insured Claims

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 applicable balance sheet date. The ultimate resolution of these claims may be for an amount greater or less than the amount estimated by management. The Company continually revises its existing claim estimates as new or revised information becomes available on the status of each claim. Historically, the Company has experienced both favorable and unfavorable development of prior years claims estimates.

Table of Contents

The following table summarizes the effect of the increase in the cost of insurance claims resulting from unfavorable development of prior year self-insured claims estimates on operating income, net income and earnings per share amounts in the consolidated statements of income for the twenty-six-week and thirteen-week periods ended July 1, 2017 and June 25, 2016 (in thousands, except per share amounts):

	Twenty Six Weeks Ended		Thirteen Weeks Ended	
	July 1, 2017	June 25, 2016	July 1, 2017	June 25, 2016
Operating income	$ 203	$ 2,816	$ 307	$ 738
Net income	125	1,740	189	456
Earnings per share		$ 0.04		$ 0.01
Diluted earnings per share		$ 0.04		$ 0.01

(10) Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2014-09 - *Revenue from Contracts with Customers* (ASU 2014-09). ASU 2014-09 is a comprehensive revenue recognition model requiring a company to recognize revenue to depict the transfer of goods or services to a customer at an amount reflecting the consideration it expects to receive in exchange for those goods or services. The standard requires more detailed disclosures to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. ASU 2014-09 becomes effective for us January 1, 2018 and permits either a full retrospective or a modified retrospective transition approach. ASU 2014-09 is not expected to have a material impact, if any, on the Company s results of operations, financial position and cash flows. The Company is still evaluating the disclosure requirements under this standard.

In February 2016, the FASB issued Accounting Standards Update 2016-02 - *Leases* (ASU 2016-02). ASU 2016-02 requires a company to recognize a right-of-use asset and lease liability for the obligation to make lease payments measured at the present value of the lease payments for all leases with terms greater than twelve months. Companies are required to use a modified retrospective transition approach to recognize leases at the beginning of the earliest period presented. ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018, and interim periods therein, and early adoption is permitted. ASU 2016-02 is not expected to have a material impact on the Company s financial statements.

In March 2016, the FASB issued Accounting Standards Update 2016-09 - *Compensation Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting* (ASU 2016-09), which is intended to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for annual periods beginning after December 15, 2016, and interim periods therein. As such, the Company adopted ASU 2016-09 during the first quarter of 2017 with an effective date of January 1, 2017. As a result of the adoption, the Company recognized excess tax benefits in the consolidated statement of income of $751,000 for the twenty-six-week period ended July 1, 2017. Prior period amounts have not been reclassified.

In June 2016, the FASB issued Accounting Standards Update 2016-13 - *Financial Instruments Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (ASU 2016-13), which requires measurement and recognition of expected versus incurred credit losses for financial assets held. ASU 2016-13 is effective for annual periods beginning after December 15, 2019, and interim periods therein. The Company is currently evaluating the impact of ASU 2016-13 on its financial statements.

15

Table of Contents

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

The following discussion should be read in conjunction with the interim consolidated financial statements and notes thereto included herein, and with the Company s audited financial statements and notes thereto for the fiscal year ended December 31, 2016 and Management s Discussion and Analysis of Financial Condition and Results of Operations included in the 2016 Annual Report on Form 10-K.

FORWARD-LOOKING STATEMENTS

The following is a safe harbor statement under the Private Securities Litigation Reform Act of 1995. Statements contained in this document that are not based on historical facts are forward-looking statements. This Management s Discussion and Analysis of Financial Condition and Results of Operations and other sections of this Form 10-Q contain forward-looking statements, such as statements which relate to Landstar s business objectives, plans, strategies and expectations. Terms such as anticipates, believes, estimates, intention, 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 other claims; unfavorable development of existing accident claims; dependence on third party insurance companies; dependence on independent commission sales agents; dependence on third party capacity providers; decreased demand for transportation services; U.S. foreign trade relationships; substantial industry competition; disruptions or failures in the Company s computer systems; cyber and other information security incidents; dependence on key vendors; changes in fuel taxes; status of independent contractors; regulatory and legislative changes; regulations focused on diesel emissions and other air quality matters; catastrophic loss of a Company facility; intellectual property; unclaimed property; and other operational, financial or legal risks or uncertainties detailed in Landstar s Form 10-K for the 2016 fiscal year, described in Item 1A Risk Factors , in 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.

Introduction

Landstar System, Inc. and its subsidiary, Landstar System Holdings, Inc. (together, referred to herein as Landstar or the Company), is a worldwide asset-light provider of integrated transportation management solutions. The Company offers services to its customers across multiple transportation modes, with the ability to arrange for individual shipments of freight to enterprise-wide solutions to manage all of a customer s transportation needs. Landstar provides services principally throughout the United States and to a lesser extent in Canada, and between the United States and Canada, Mexico and other countries around the world. The Company s services emphasize safety, information coordination and customer service and are delivered through a network of independent commission sales agents and third party capacity providers linked together by a series of technological applications which are provided and coordinated by the Company. The nature of the Company s business is such that a significant portion of its operating costs varies directly with revenue.

Landstar markets its integrated transportation management solutions primarily through independent commission sales agents and exclusively utilizes third party capacity providers to transport customers freight. Landstar s independent commission sales agents enter into contractual arrangements with the Company and are responsible for locating freight, making that freight available to Landstar s capacity providers and coordinating the transportation of the freight with customers and capacity providers. The Company s third party capacity providers consist of independent contractors who provide truck capacity to the Company under exclusive lease arrangements (the BCO Independent

Contractors), unrelated trucking companies who provide truck capacity to the Company under non-exclusive contractual arrangements (the Truck Brokerage Carriers), air cargo carriers, ocean cargo carriers and railroads. Through this network of agents and capacity providers linked together by Landstar s information technology systems, Landstar operates an integrated transportation management solutions business primarily throughout North America with revenue of $3.2 billion during the most recently completed fiscal year. The Company reports the results of two operating segments: the transportation logistics segment and the insurance segment.

The transportation logistics segment provides a wide range of integrated transportation management solutions. Transportation services offered by the Company include truckload and less-than-truckload transportation, rail intermodal, air cargo, ocean cargo, expedited ground and air delivery of time-critical freight, heavy-haul/specialized, U.S.-Canada and U.S.-Mexico cross-border, project cargo and customs brokerage. Examples of the industries serviced by the transportation logistics segment include automotive products, building products, metals, chemicals, foodstuffs, heavy machinery, retail, electronics, ammunition and explosives and military equipment. In addition, the transportation logistics segment provides transportation services to other transportation companies, including third party logistics and less-than-truckload service providers. Each of the independent commission sales agents has the opportunity to market all of the services provided by the transportation logistics segment. Billings for freight transportation services are typically charged to customers on a per shipment basis for the physical transportation of freight and are referred to as transportation revenue. During the twenty six weeks ended July 1, 2017, revenue generated by BCO Independent Contractors, Truck Brokerage Carriers and railroads represented approximately 47%, 46% and 3%, respectively, of the Company s consolidated revenue. Collectively, revenue generated by air and ocean cargo carriers represented approximately 2% of the Company s consolidated revenue in the twenty-six-week period ended July 1, 2017.

Table of Contents

The insurance segment is comprised of Signature Insurance Company, a wholly owned offshore insurance subsidiary (Signature), and Risk Management Claim Services, Inc. This segment provides risk and claims management services to certain of 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 certain of Landstar s operating subsidiaries. Revenue at the insurance segment represents reinsurance premiums from third party insurance companies that provide insurance programs to BCO Independent Contractors where all or a portion of the risk is ultimately borne by Signature. Revenue at the insurance segment represented approximately 1% of the Company s consolidated revenue for the twenty-six-week period ended July 1, 2017.

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 safely and 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, including insurance and claims.

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 emphasis with respect to revenue growth is on revenue generated by independent commission sales agents who on an annual basis generate $1 million or more of Landstar revenue (Million Dollar Agents). Management believes future revenue growth is primarily dependent on its ability to increase both the revenue generated by Million Dollar Agents and the number of Million Dollar Agents through a combination of recruiting new agents and increasing the revenue opportunities generated by existing independent commission sales agents. During the 2016 fiscal year, 502 independent commission sales agents generated $1 million or more of Landstar revenue and thus qualified as Million Dollar Agents. During the 2016 fiscal year, the average revenue generated by a Million Dollar Agent was $5,831,000 and revenue generated by Million Dollar Agents in the aggregate represented 92% of consolidated revenue.

Management monitors business activity by tracking the number of loads (volume) and revenue per load by mode of transportation. Revenue per load can be influenced by many factors other than a change in price. Those factors include the average length of haul, freight type, special handling and equipment requirements, fuel costs and delivery time requirements. For shipments involving two or more modes of transportation, revenue is generally classified by the mode of transportation having the highest cost for the load. The following table summarizes this information by trailer type for truck transportation and by mode for all others:

	Twenty Six Weeks Ended		Thirteen Weeks Ended	
	July 1, 2017	June 25, 2016	July 1, 2017	June 25, 2016
Revenue generated through (in thousands):				
Truck transportation				
Truckload:				
Van equipment	$ 978,918	$ 886,195	$ 509,135	$ 458,002
Unsided/platform equipment	520,658	451,430	283,481	242,008
Less-than-truckload	42,799	35,927	22,942	18,450

Total truck transportation	1,542,375	1,373,552	815,558	718,460
Rail intermodal	44,357	52,337	21,515	26,229
Ocean and air cargo carriers	41,185	37,710	21,595	18,902
Other (1)	23,425	23,268	11,766	11,632
	$ 1,651,342	$ 1,486,867	$ 870,434	$ 775,223
Revenue on loads hauled via BCO Independent Contractors included in total truck transportation	$ 776,085	$ 707,652	$ 411,177	$ 373,374

Table of Contents

Number of loads:				
Truck transportation				
Truckload:				
Van equipment	613,565	556,119	315,499	287,079
Unsided/platform equipment	236,427	219,034	125,242	116,292
Less-than-truckload	64,508	55,727	34,589	28,829
Total truck transportation	914,500	830,880	475,330	432,200
Rail intermodal	20,960	24,180	10,310	12,150
Ocean and air cargo carriers	11,940	9,780	6,210	5,220
	947,400	864,840	491,850	449,570
Loads hauled via BCO Independent Contractors included in total truck transportation	453,860	414,660	235,630	216,990
Revenue per load:				
Truck transportation				
Truckload:				
Van equipment	$ 1,595	$ 1,594	$ 1,614	$ 1,595
Unsided/platform equipment	2,202	2,061	2,263	2,081
Less-than-truckload	663	645	663	640
Total truck transportation	1,687	1,653	1,716	1,662
Rail intermodal	2,116	2,164	2,087	2,159
Ocean and air cargo carriers	3,449	3,856	3,477	3,621
Revenue per load on loads hauled via BCO Independent Contractors	$ 1,710	$ 1,707	$ 1,745	$ 1,721
Revenue by capacity type (as a % of total revenue):				
Truck capacity providers:				
BCO Independent Contractors	47%	48%	47%	48%
Truck Brokerage Carriers	46%	45%	46%	45%
Rail intermodal	3%	4%	2%	3%
Ocean and air cargo carriers	2%	3%	2%	2%
Other	1%	2%	1%	2%

(1) Includes primarily reinsurance premium revenue generated by the insurance segment.

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 the number of available truck capacity providers on the dates indicated:

	July 1, 2017	June 25, 2016
BCO Independent Contractors	8,818	8,856
Truck Brokerage Carriers:		
Approved and active (1)	31,636	30,137
Other approved	15,381	15,594

	47,017	45,731
Total available truck capacity providers	55,835	54,587
Trucks provided by BCO Independent Contractors	9,404	9,462

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

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

Purchased transportation represents the amount a BCO Independent Contractor or other third party capacity provider is paid to haul freight. The amount of purchased transportation paid to a BCO Independent Contractor is primarily based on a contractually agreed-upon percentage of revenue generated by loads hauled by the BCO Independent Contractor. Purchased transportation paid to a Truck Brokerage Carrier is based on either a negotiated rate for each load hauled or, to a lesser extent, a contractually agreed-upon fixed rate per load. Purchased transportation paid to railroads is based on either a negotiated rate for each load hauled or a contractually agreed-upon fixed rate per load. Purchased transportation paid to air cargo carriers is generally based on a negotiated rate for each load hauled and purchased

transportation paid to ocean cargo carriers is generally based on contractually agreed-upon fixed rates. Purchased transportation as a percentage of revenue for truck brokerage, rail intermodal and ocean cargo services is normally higher than that of BCO Independent Contractor and air cargo services. Purchased transportation is the largest component of costs and expenses and, on a consolidated basis, increases or decreases as a percentage of consolidated revenue in proportion to changes in the percentage of consolidated revenue generated through BCO Independent Contractors and other third party capacity providers and external revenue from the insurance segment, consisting of reinsurance premiums. Purchased transportation as a percent of revenue also increases or decreases in relation to the availability of truck brokerage capacity and with changes in the price of fuel on revenue generated by Truck Brokerage Carriers. The Company passes 100% of fuel surcharges billed to customers for freight hauled by BCO Independent Contractors to its BCO Independent Contractors. These fuel surcharges are excluded from revenue and the cost of purchased transportation. Purchased transportation costs are recognized upon the completion of freight delivery.

Commissions to agents are based on contractually agreed-upon percentages of revenue or net revenue, defined as revenue less the cost of purchased transportation, or net revenue less a contractually agreed upon percentage of revenue retained by Landstar. Commissions to agents as a percentage of consolidated revenue will vary directly with fluctuations in the percentage of consolidated revenue generated by the various modes of transportation and reinsurance premiums and with changes in net revenue margin, defined as net revenue divided by revenue, on services provided by Truck Brokerage Carriers, railroads, air cargo carriers and ocean cargo carriers. Commissions to agents are recognized upon the completion of freight delivery.

The Company defines gross profit as revenue less the cost of purchased transportation and commissions to agents. Gross profit divided by revenue is referred to as gross profit margin. The Company s operating margin is defined as operating income divided by gross profit.

In general, gross profit margin on revenue generated by BCO Independent Contractors represents a fixed percentage of revenue due to the nature of the contracts that pay a fixed percentage of revenue to both the BCO Independent Contractors and independent commission sales agents. For revenue generated by Truck Brokerage Carriers, gross profit margin is either fixed or variable as a percent of revenue, depending on the contract with each individual independent commission sales agent. Under certain contracts with independent commission sales agents, the Company retains a fixed percentage of revenue and the agent retains the amount remaining less the cost of purchased transportation (the retention contracts). Gross profit margin on revenue generated by railroads, air cargo carriers, ocean cargo carriers and Truck Brokerage Carriers, other than those under retention contracts, is variable in nature as the Company s contracts with independent commission sales agents provide commissions to agents at a contractually agreed upon percentage of net revenue for these type of loads. Approximately 54% of the Company s consolidated revenue in the twenty-six-week period ended July 1, 2017 was generated under contracts that have a fixed gross profit margin while 46% was under contracts that have a variable gross profit margin.

Maintenance costs for Company-provided trailing equipment and BCO Independent Contractor recruiting and qualification costs are the largest components of other operating costs. Also included in other operating costs are trailer rental costs, the provision for uncollectible advances and other receivables due from BCO Independent Contractors and independent commission sales agents and gains/losses, if any, on sales of Company-owned trailing equipment.

With respect to insurance and claims cost, potential liability associated with accidents in the trucking industry is severe and occurrences are unpredictable. For commercial trucking claims, Landstar retains liability up to $5,000,000 per occurrence. In addition, for commercial trucking claims exceeding its $5,000,000 per occurrence self-insured retention, the Company retains liability up to an additional $700,000 in the aggregate on any claims incurred on or

after May 1, 2016 through April 30, 2017, and up to an additional $500,000 in the aggregate on any claims incurred on or after May 1, 2017 through April 30, 2018. The Company also retains liability of up to $1,000,000 for each general liability claim, up to $250,000 for each workers compensation claim and up to $250,000 for each cargo claim. The Company s exposure to liability associated with accidents incurred by Truck Brokerage Carriers, railroads and air and ocean cargo carriers who transport freight on behalf of the Company is reduced by various factors including the extent to which such carriers maintain their own insurance coverage. A material increase in the frequency or severity of accidents, cargo claims or workers compensation claims or the material unfavorable development of existing claims could have a material adverse effect on Landstar s cost of insurance and claims and its results of operations.

During the twenty-six-week period ended July 1, 2017, employee compensation and benefits accounted for approximately sixty-five percent of the Company s selling, general and administrative costs.

Table of Contents

Depreciation and amortization primarily relate to depreciation of trailing equipment and information technology hardware and software.

The following table sets forth the percentage relationship of purchased transportation and commissions to agents, both being direct costs, to revenue and indirect costs as a percentage of gross profit for the periods indicated:

	Twenty Six Weeks Ended		Thirteen Weeks Ended	
	July 1, 2017	June 25, 2016	July 1, 2017	June 25, 2016
Revenue	100.0%	100.0%	100.0%	100.0%
Purchased transportation	76.5	76.0	76.7	76.0
Commissions to agents	8.1	8.3	8.1	8.4
Gross profit margin	15.4%	15.7%	15.2%	15.6%
Gross profit	100.0%	100.0%	100.0%	100.0%
Investment income	0.4	0.3	0.5	0.3
Indirect costs and expenses:				
Other operating costs, net of gains on asset sales/dispositions	5.7	6.0	5.7	5.4
Insurance and claims	11.2	13.0	10.5	13.3
Selling, general and administrative	31.2	30.7	30.8	30.5
Depreciation and amortization	7.8	7.3	7.5	7.2
Total costs and expenses	55.8	57.0	54.4	56.4
Operating margin	44.6%	43.3%	46.0%	43.9%

Management believes that a discussion of indirect costs as a percentage of gross profit is useful and meaningful to potential investors for the following principal reasons: (1) disclosure of these relative measures (i.e., each indirect operating cost line item as a percentage of gross profit) allows investors to better understand the underlying trends in the Company s results of operations; (2) due to the generally fixed nature of these indirect costs (other than insurance and claims costs), these relative measures are meaningful to investors evaluations of the Company s management of its indirect costs attributable to operations; (3) management considers this financial information in its decision-making, such as budgeting for infrastructure, trailing equipment and selling, general and administrative costs; and (4) this information facilitates comparisons by investors of the Company s results to the results of other non-asset or asset-light companies in the transportation and logistics services industry who report net revenue in Management Discussion and Analysis, which represents revenue less the cost of purchased transportation. The difference between the Company s use of the term gross profit and use of the term net revenue by other companies in the transportation and logistics services industry is due to the direct cost of commissions to agents under the Landstar business model, whereas other companies in this industry generally have no commissions to agents.

Also, as previously mentioned, the Company reports two operating segments: the transportation logistics segment and the insurance segment. External revenue at the insurance segment, representing reinsurance premiums, has historically been relatively consistent on a year-over-year basis at 2% or less of consolidated revenue and generally corresponds directly with the number of trucks provided by BCO Independent Contractors. The discussion of indirect cost line

items in Management s Discussion and Analysis of Financial Condition and Results of Operations considers the Company s costs on a consolidated basis rather than on a segment basis. Management believes this presentation format is the most appropriate to assist users of the financial statements in understanding the Company s business for the following reasons: (1) the insurance segment has no other operating costs; (2) discussion of insurance and claims at either segment without reference to the other may create confusion amongst investors and potential investors due to intercompany arrangements and specific deductible programs that affect comparability of financial results by segment between various fiscal periods but that have no effect on the Company from a consolidated reporting perspective; (3) selling, general and administrative costs of the insurance segment comprise less than 10% of consolidated selling, general and administrative costs and have historically been relatively consistent on a year-over-year basis; and (4) the insurance segment has no depreciation and amortization.

Table of Contents

TWENTY SIX WEEKS ENDED JULY 1, 2017 COMPARED TO TWENTY SIX WEEKS ENDED JUNE 25, 2016

Revenue for the 2017 twenty-six-week period was $1,651,342,000, an increase of $164,475,000, or 11%, compared to the 2016 twenty-six-week period. Transportation revenue increased $164,383,000, or 11%. The increase in transportation revenue was attributable to an increased number of loads hauled of approximately 10% and increased revenue per load of approximately 2%. Reinsurance premiums were $23,187,000 and $23,095,000 for the 2017 and 2016 twenty-six-week periods, respectively.

Truck transportation revenue generated by BCO Independent Contractors and Truck Brokerage Carriers (together, the third party truck capacity providers) for the 2017 twenty-six-week period was $1,542,375,000, or 93% of total revenue, an increase of $168,823,000, or 12%, compared to the 2016 twenty-six-week period. The number of loads hauled by third party truck capacity providers increased approximately 10% in the 2017 twenty-six-week period compared to the 2016 twenty-six-week period, and revenue per load increased approximately 2% compared to the 2016 twenty-six-week period. The increases in the number of loads hauled via truck on van and unsided/platform equipment and less-than-truckload loadings compared to the 2016 twenty-six-week period were due to a broad-based increase in demand across many customers and industries for Landstar s various truck service offerings. The increase in revenue per load on loads hauled via truck of 2% was due to an increase in the percentage of revenue contributed by heavy/specialized equipment, which typically has a higher revenue per load, a 7% increase in revenue per load on loads hauled via unsided/platform equipment, inclusive of an 11% increase in heavy/specialized revenue per load, and the impact of higher diesel fuel costs on loads hauled via Truck Brokerage Carriers. Fuel surcharges billed to customers on revenue generated by BCO Independent Contractors are excluded from revenue. Fuel surcharges on Truck Brokerage Carrier revenue identified separately in billings to customers and included as a component of Truck Brokerage Carrier revenue were $30,308,000 and $23,707,000 in the 2017 and 2016 twenty-six-week periods, respectively. It should be noted that many customers of truck brokerage services require a single all-in rate that does not separately identify fuel surcharge. Accordingly, the overall impact of changes in fuel prices on revenue and revenue per load on loads hauled via truck is likely to be greater than that indicated.

Transportation revenue generated by rail intermodal, air cargo and ocean cargo carriers (collectively, the multimode capacity providers) for the twenty-six-week period ended July 1, 2017, was $85,542,000, or 5% of total revenue, a decrease of $4,505,000, or 5%, compared to the 2016 twenty-six-week period. The number of loads hauled by multimode capacity providers in the 2017 twenty-six-week period decreased approximately 3% compared to the 2016 twenty-six-week period and revenue per load on revenue generated by multimode capacity providers decreased approximately 2% over the same period. The decrease in loads hauled by multimode capacity providers was due to a 13% decrease in rail intermodal loads, primarily attributable to decreased loadings at two specific agencies, partially offset by a 22% increase in loads hauled by air and ocean cargo carriers. The 22% increase in loads hauled by air and ocean cargo carriers was broad-based across many customers. While revenue per load on loads hauled by multimode capacity providers decreased for all modes, the decrease of 2% was primarily driven by a decrease in revenue per load generated by ocean cargo carriers. Also, revenue per load on revenue generated by multimode capacity providers is influenced by many factors, including revenue mix among the various modes of transportation used, length of haul, complexity of freight, density of freight lanes, fuel costs and availability of capacity.

Purchased transportation was 76.5% and 76.0% of revenue in the 2017 and 2016 twenty-six-week periods, respectively. The increase in purchased transportation as a percentage of revenue was primarily due to an increased rate of purchased transportation paid to Truck Brokerage Carriers. Commissions to agents were 8.1% and 8.3% of revenue in the 2017 and 2016 twenty-six-week periods, respectively. The decrease in commissions to agents as a percentage of revenue was primarily attributable to a decreased net revenue margin on revenue generated by Truck Brokerage Carriers.

Investment income was $1,022,000 and $743,000 in the 2017 and 2016 twenty-six-week periods, respectively. The increase in investment income was primarily due a higher average investment balance held by the insurance segment in the 2017 period.

Other operating costs increased $408,000 in the 2017 twenty-six-week period compared to the 2016 twenty-six-week period and represented 5.7% of gross profit in the 2017 period compared to 6.0% of gross profit in the 2016 period. The increase in other operating costs compared to the prior year was primarily due to decreased gains on sales of used trailing equipment and an increased provision for contractor bad debt, partially offset by decreased trailing equipment maintenance costs due to a lower average age of the Company-owned trailer fleet. The decrease in other operating costs as a percentage of gross profit was caused by the effect of increased gross profit, partially offset by the increase in other operating costs.

Insurance and claims decreased $1,901,000 in the 2017 twenty-six-week period compared to the 2016 twenty-six-week period and represented 11.2% of gross profit in the 2017 period compared to 13.0% of gross profit in the 2016 period. The decrease in insurance and claims expense compared to prior year was due to decreased net unfavorable development of prior years claims in the 2017 period, partially offset by increased insurance premiums on the Company s commercial trucking liability coverage. Unfavorable development of prior years claims was $203,000 and $2,816,000 in the 2017 and 2016 twenty-six-week periods, respectively. The decrease in insurance and claims as a percent of gross profit was caused by the effect of increased gross profit and the decrease in insurance and claims costs.

Table of Contents

Selling, general and administrative costs increased $7,665,000 in the 2017 twenty-six-week period compared to the 2016 twenty-six-week period and represented 31.2% of gross profit in the 2017 period compared to 30.7% of gross profit in the 2016 period. The increase in selling, general and administrative costs compared to prior year was attributable to a $6,786,000 provision for incentive compensation in the 2017 twenty-six-week period compared to a $448,000 provision in the 2016 twenty-six-week period and increased professional fees. The increase in selling, general and administrative costs as a percent of gross profit was due primarily to the increase in selling, general and administrative costs, partially offset by the effect of increased gross profit.

Depreciation and amortization increased $2,738,000 in the 2017 twenty-six-week period compared to the 2016 twenty-six-week period and represented 7.8% of gross profit in the 2017 period compared to 7.3% of gross profit in the 2016 period. The increase in depreciation and amortization expenses was due to an increased number of owned trailers in response to increased customer demand for the Company s drop and hook services and a lower average age of the trailer fleet during the 2017 twenty-six-week period as compared to the 2016 twenty-six-week period. The increase in depreciation and amortization as a percentage of gross profit was primarily due to the increased depreciation costs, partially offset by the effect of increased gross profit.

Interest and debt expense in the 2017 twenty-six-week period increased $125,000 compared to the 2016 twenty-six-week period. The increase in interest and debt expense was primarily attributable to increased interest related to capital lease obligations as the Company increased its number of owned trailers in response to customer demand.

The provisions for income taxes for both the 2017 and 2016 twenty-six-week periods were based on estimated annual effective income tax rates of 38.2%, adjusted for discrete events, such as benefits resulting from disqualifying dispositions of the Company s common stock by employees who obtained the stock through exercises of incentive stock options. The effective income tax rates for the 2017 and 2016 twenty-six-week periods were 37.3% and 38.0%, respectively, which were higher than the statutory federal income tax rate primarily as a result of state taxes, the meals and entertainment exclusion and non-deductible stock compensation expense. The effective income tax rate in the 2017 twenty-six-week period of 37.3% was less than the 38.2% estimated annual effective income tax rate primarily due to excess tax benefits recognized on stock-based compensation arrangements resulting from the Company s adoption of ASU 2016-09 during the first fiscal quarter of 2017 and disqualifying dispositions of the Company s common stock by employees who obtained the stock through the exercises of incentive stock options in the 2017 period. The effective income tax rate in the 2016 twenty-six-week period of 38.0% was less than the 38.2% estimated annual effective income tax rate primarily due to disqualifying dispositions of the Company s common stock by employees who obtained the stock through exercises of incentive stock options in the 2016 period.

Net income was $69,893,000, or $1.67 per common share ($1.66 per diluted share), in the 2017 twenty-six-week period. Net income was $61,498,000, or $1.45 per common share ($1.45 per diluted share), in the 2016 twenty-six-week period.

THIRTEEN WEEKS ENDED JULY 1, 2017 COMPARED TO THIRTEEN WEEKS ENDED JUNE 25, 2016

Revenue for the 2017 thirteen-week period was $870,434,000, an increase of $95,211,000, or 12%, compared to the 2016 thirteen-week period. Transportation revenue increased $95,135,000, or 12%. The increase in transportation revenue was attributable to an increased number of loads hauled of approximately 9% and increased revenue per load of approximately 3%. Reinsurance premiums were $11,627,000 and $11,551,000 for the 2017 and 2016 thirteen-week periods, respectively.

Truck transportation revenue generated by third party capacity providers for the 2017 thirteen-week period was $815,558,000, or 94% of total revenue, an increase of $97,098,000, or 14%, compared to the 2016 thirteen-week period. The number of loads hauled by third party truck capacity providers increased approximately 10% in the 2017 thirteen-week period compared to the 2016 thirteen-week period, and revenue per load increased approximately 3% compared to the 2016 thirteen-week period. The increases in the number of loads hauled via truck on van and unsided/platform equipment and less-than-truckload loadings compared to the 2016 thirteen-week period were all due to a broad-based increase in demand across many customers and industries for Landstar s various truck service offerings. The increase in revenue per load on loads hauled via truck of 3% was due to an increase in the percentage of revenue contributed by heavy/specialized equipment, which typically has a higher revenue per load, a 9% increase in revenue per load on loads hauled via unsided/platform equipment, inclusive of a 13% increase in heavy/specialized revenue per load, and the impact of higher diesel fuel costs on loads hauled via Truck Brokerage Carriers. The increase in revenue per load on loads hauled via truck was also partially due to an increase in revenue per load on flatbed loads not considered heavy/specialized. Fuel surcharges on Truck Brokerage Carrier revenue identified separately in billings to customers and included as a component of Truck Brokerage Carrier revenue were $15,246,000 and $11,719,000 in the 2017 and 2016 thirteen-week periods, respectively.

Table of Contents

Transportation revenue generated by multimode capacity providers for the thirteen-week period ended July 1, 2017, was $43,110,000, or 5% of total revenue, a decrease of $2,021,000, or 4%, compared to the 2016 thirteen-week period. The number of loads hauled by multimode capacity providers in the 2017 thirteen-week period decreased approximately 5% compared to the 2016 thirteen-week period and revenue per load on revenue generated by multimode capacity providers was approximately equal to the prior year period. The decrease in loads hauled by multimode capacity providers was primarily due to a 15% decrease in rail intermodal loads, attributable to decreased loadings at three specific agencies, partially offset by a 19% increase in loads hauled by air and ocean cargo carriers. The 19% increase in loads hauled by air and ocean cargo carriers was broad-based across many customers.

Purchased transportation was 76.7% and 76.0% of revenue in the 2017 and 2016 thirteen-week periods, respectively. The increase in purchased transportation as a percentage of revenue was primarily due to an increased rate of purchased transportation paid to Truck Brokerage Carriers and a decrease in the percentage of revenue contributed by BCO Independent Contractors, which typically has a lower rate of purchased transportation than revenue generated by Truck Brokerage Carriers. Commissions to agents were 8.1% and 8.4% of revenue in the 2017 and 2016 thirteen-week periods, respectively. The decrease in commissions to agents as a percentage of revenue was primarily attributable to a decreased net revenue margin on revenue generated by Truck Brokerage Carriers.

Investment income was $608,000 and $363,000 in the 2017 and 2016 thirteen-week periods, respectively. The increase in investment income was due to a higher average investments balance held by the insurance segment in the 2017 period and higher average rates of return on investments during the 2017 period.

Other operating costs increased $918,000 in the 2017 thirteen-week period compared to the 2016 thirteen-week period and represented 5.7% of gross profit in the 2017 period compared to 5.4% of gross profit in the 2016 period. The increase in other operating costs compared to the prior year was primarily due to an increased provision for contractor bad debt and decreased gains on sales of used trailing equipment. The increase in other operating costs as a percentage of gross profit was caused by the increase in other operating costs, partially offset by the effect of increased gross profit.

Insurance and claims decreased $2,201,000 in the 2017 thirteen-week period compared to the 2016 thirteen-week period and represented 10.5% of gross profit in the 2017 period compared to 13.3% of gross profit in the 2016 period. The decrease in insurance and claims expense compared to prior year was due to decreased severity of current year claims in the 2017 period, primarily as a result of the impact of a severe accident that occurred at the end of the 2016 second quarter. The decrease in insurance and claims as a percent of gross profit was caused by the decrease in insurance and claims costs and the effect of increased gross profit.

Selling, general and administrative costs increased $3,956,000 in the 2017 thirteen-week period compared to the 2016 thirteen-week period and represented 30.8% of gross profit in the 2017 period compared to 30.5% of gross profit in the 2016 period. The increase in selling, general and administrative costs compared to prior year was primarily attributable to a $3,914,000 provision for incentive compensation in the 2017 thirteen-week period compared to a $259,000 provision in the 2016 thirteen-week period. The increase in selling, general and administrative costs as a percent of gross profit was due primarily to the increase in selling, general and administrative costs, partially offset by the effect of increased gross profit.

Depreciation and amortization increased $1,242,000 in the 2017 thirteen-week period compared to the 2016 thirteen-week period and represented 7.5% of gross profit in the 2017 period compared to 7.2% of gross profit in the 2016 period. The increase in depreciation and amortization expenses was due to an increased number of owned trailers in response to increased customer demand for the Company s drop and hook services and a lower average age of the trailer fleet during the 2017 period as compared to the 2016 thirteen-week period. The increase in depreciation and

amortization as a percentage of gross profit was primarily due to the increased depreciation costs, partially offset by the effect of increased gross profit.

Interest and debt expense in the 2017 thirteen-week period decreased $69,000 compared to the 2016 thirteen-week period.

The provisions for income taxes for both the 2017 and 2016 thirteen-week periods were based on estimated annual effective income tax rates of 38.2%, adjusted for discrete events, such as benefits resulting from disqualifying dispositions of the Company s common stock by employees who obtained the stock through exercises of incentive stock options. The effective income tax rates for the 2017 and 2016 thirteen-week periods were 37.7% and 38.1%, respectively, which were higher than the statutory federal income tax rate primarily as a result of state taxes, the meals and entertainment exclusion and non-deductible stock compensation expense. The effective income tax rate

in the 2017 thirteen-week period of 37.7% was less than the 38.2% estimated annual effective income tax rate primarily due to excess tax benefits recognized on stock-based compensation arrangements resulting from the Company s adoption of ASU 2016-09 during the first fiscal quarter of 2017 and disqualifying dispositions of the Company s common stock by employees who obtained the stock through the exercises of incentive stock options in the 2017 period. The effective income tax rate in the 2016 thirteen-week period of 38.1% was less than the 38.2% estimated annual effective income tax rate primarily due to disqualifying dispositions of the Company s common stock by employees who obtained the stock through exercises of incentive stock options in the 2016 period.

Net income was $37,510,000, or $0.89 per common share ($0.89 per diluted share), in the 2017 thirteen-week period. Net income was $32,314,000, or $0.77 per common share ($0.76 per diluted share), in the 2016 thirteen-week period.

CAPITAL RESOURCES AND LIQUIDITY

Working capital and the ratio of current assets to current liabilities were $407,041,000 and 2.1 to 1, respectively, at July 1, 2017, compared with $357,096,000 and 1.9 to 1, respectively, at December 31, 2016. 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 $79,799,000 in the 2017 twenty-six-week period compared with $105,135,000 in the 2016 twenty-six-week period. The decrease in cash flow provided by operating activities was primarily attributable to the timing of collections of trade receivables.

The Company declared and paid $0.18 per share, or $7,544,000 in the aggregate, in cash dividends during the twenty-six-week period ended July 1, 2017. The Company declared and paid $0.16 per share, or $6,782,000 in the aggregate, in cash dividends during the twenty-six-week period ended June 25, 2016. During the twenty-six-week period ended July 1, 2017, the Company did not purchase any shares of its common stock. As of July 1, 2017, the Company may purchase up to 1,036,125 shares of its common stock under its authorized stock purchase program. Long-term debt, including current maturities, was $118,995,000 at July 1, 2017, $19,309,000 lower than at December 31, 2016.

Shareholders equity was $609,490,000, or 84% of total capitalization (defined as long-term debt including current maturities plus equity), at July 1, 2017, compared to $542,557,000, or 80% of total capitalization, at December 31, 2016. The increase in equity was primarily a result of net income, partially offset by dividends declared by the Company in the 2017 twenty-six-week period.

On June 2, 2016, Landstar entered into a credit agreement with a syndicate of banks and JPMorgan Chase Bank, N.A., as administrative agent (the Credit Agreement). The Credit Agreement, which matures on June 2, 2021, provides $250,000,000 of borrowing capacity in the form of a revolving credit facility, $50,000,000 of which may be utilized in the form of letter of credit guarantees. The Credit Agreement includes an accordion feature providing for a possible increase up to an aggregate borrowing amount of $400,000,000. The Company s prior credit agreement was terminated on June 2, 2016.

The Credit Agreement contains a number of covenants that limit, among other things, the incurrence of additional indebtedness. The Company is required to, among other things, maintain a minimum Fixed Charge Coverage Ratio, as defined in the Credit Agreement, and maintain a Leverage Ratio, as defined in the Credit Agreement, below a specified maximum. The Credit Agreement provides for a restriction on cash dividends and other distributions to stockholders on the Company s capital stock to the extent there is a default under the Credit Agreement. In addition, the Credit Agreement under certain circumstances limits the amount of such cash dividends and other distributions to stockholders to the extent that, after giving effect to any payment made to effect such cash dividend or other distribution, the Leverage Ratio would exceed 2.5 to 1 on a pro forma basis as of the end of the Company s most

recently completed fiscal quarter. The Credit Agreement provides for an event of default in the event that, among other things, a person or group acquires 35% or more of the outstanding capital stock of the Company or obtains power to elect a majority of the Company s directors or the directors cease to consist of a majority of Continuing Directors, as defined in the Credit Agreement. None of these covenants are presently considered by management to be materially restrictive to the Company s operations, capital resources or liquidity. The Company is currently in compliance with all of the debt covenants under the Credit Agreement.

At July 1, 2017, the Company had no borrowings outstanding and $35,962,000 of letters of credit outstanding under the Credit Agreement. At July 1, 2017, there was $214,038,000 available for future borrowings under the Credit Agreement. In addition, the Company has $59,999,000 in letters of credit outstanding as collateral for insurance claims that are secured by investments totaling $66,666,000 at July 1, 2017. Investments, all of which are carried at fair value, include primarily investment-grade bonds and U.S. Treasury obligations having maturities of up to five years. Fair value of investments is based primarily on quoted market prices. See Notes to Consolidated Financial Statements included herein for further discussion on measurement of fair value of investments.

Historically, the Company has generated sufficient operating cash flow to meet its debt service requirements, fund continued growth, both organic and through acquisitions, complete or execute share purchases of its common stock under authorized share purchase programs, pay dividends and meet working capital needs. As an asset-light provider of integrated transportation management solutions, the Company s annual capital requirements for operating property are generally for trailing equipment and information technology hardware and software. In addition, a significant portion of the trailing equipment used by the Company is provided by third party capacity providers, thereby reducing the Company s capital requirements. During the 2017 twenty-six-week period, the Company purchased $6,628,000 of operating property. Included in the $6,628,000 of purchases of operating property during the 2017 twenty-six-week period is $4,255,000 related to a new freight staging and transload facility in Laredo, Texas for which the Company accrued a corresponding liability in accounts payable as of December 31, 2016. Landstar also acquired $945,000 of operating property relating to the completion of the Laredo property for which the Company accrued a corresponding liability in accounts payable as of July 1, 2017. Landstar anticipates acquiring either by purchase or lease financing during the remainder of fiscal year 2017 approximately $35,000,000 in operating property, consisting primarily of new trailing equipment to replace older trailing equipment and information technology equipment.

Management believes that cash flow from operations combined with the Company s borrowing capacity under the 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 program and meet working capital needs.

LEGAL MATTERS

The Company is involved in certain claims and pending litigation arising from the normal conduct of business. Many of these claims are covered in whole or in part by insurance. 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 claims and pending litigation and that the ultimate outcome, after provisions therefor, 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, 2017 is appropriate, a prolonged period of low or no economic growth may adversely affect the collection of these receivables. In addition, liquidity concerns and/or unanticipated bankruptcy proceedings at any of the Company s larger customers in which the Company is carrying a significant receivable could result in an increase in the provision for uncollectible receivables and have a significant impact on the Company s results of operations in a given quarter or year. However, it is not expected that an uncollectible accounts receivable resulting from an individual customer would have a significant impact on the Company s financial condition. Conversely, a more robust economic environment or the recovery of a previously provided for uncollectible receivable from an individual customer 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 applicable balance sheet date. The ultimate resolution of these claims may be for an amount greater or less than the amount estimated by management. The Company continually revises its existing claim estimates as new or revised information becomes available on the status of each claim. Historically, the Company has experienced both favorable

and unfavorable development of prior years claims estimates. During the 2017 and 2016 twenty-six-week periods, insurance and claims costs included $203,000 and $2,816,000 of net unfavorable adjustments to prior years claims estimates, respectively. 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, 2017.

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

Table of Contents

Significant variances from management s estimates for the amount of uncollectible receivables, the ultimate resolution of self-insured claims and the provision for uncertainty in income tax positions could each 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 in excess of historic trends might have an adverse effect on the Company s results of operations in the future.

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 for the quarters ending June, September and December.

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 its revolving credit facility, and investing activities with respect to investments held by the insurance segment.

On June 2, 2016, Landstar entered into a credit agreement with a syndicate of banks and JPMorgan Chase Bank, N.A., as administrative agent (the Credit Agreement). The Credit Agreement, which matures on June 2, 2021, provides $250,000,000 of borrowing capacity in the form of a revolving credit facility, $50,000,000 of which may be utilized in the form of letter of credit guarantees. The Credit Agreement includes an accordion feature providing for a possible increase up to an aggregate borrowing amount of $400,000,000.

Depending upon the specific type of borrowing, borrowings under the Credit Agreement bear interest based on either (a) the prime rate, (b) the Federal Reserve Bank of New York rate plus 0.5% or (c) the London Interbank Offered Rate, plus 1.25%. As of July 1, 2017 and during the entire 2017 second quarter, the Company had no borrowings outstanding under the Credit Agreement.

Long-term investments, all of which are available-for-sale and are carried at fair value, include primarily investment-grade bonds and U.S. Treasury obligations having maturities of up to five years. Assuming that the long-term portion of investments remains at $59,169,000, the balance at July 1, 2017, 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 corporate bonds and U.S. Treasury obligations. Accordingly, any future interest rate risk on these short-term investments would not be material to the Company s operating results.

Assets and liabilities of the Company s Canadian operations are translated from their functional currency to U.S. dollars using exchange rates in effect at the balance sheet date and revenue and expense accounts are translated at average monthly exchange rates during the period. Adjustments resulting from the translation process are included in accumulated other comprehensive income. Transactional gains and losses arising from receivable and payable balances, including intercompany balances, in the normal course of business that are denominated in a currency other than the functional currency of the operation are recorded in the statements of income when they occur. The assets held at the Company s Canadian subsidiary at July 1, 2017 were, as translated to U.S. dollars, approximately 2% of

total consolidated assets. Accordingly, any translation gain or loss related to the Canadian operation would not be material.

Item 4. Controls and Procedures

As of the end of the period covered by this quarterly report on Form 10-Q, 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, 2017 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.

Table of Contents

There were no significant changes in the Company s internal control over financial reporting during the Company s fiscal quarter ended July 1, 2017 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

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

PART II

OTHER INFORMATION

Item 1. Legal Proceedings

The Company is involved in certain claims and pending litigation arising from the normal conduct of business. Many of these claims are covered in whole or in part by insurance. 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 claims and pending litigation and that the ultimate outcome, after provisions therefor, 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 additional 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, 2016 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.

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

Purchases of Equity Securities by the Company

The Company did not purchase any shares of its common stock during the period from April 2, 2017 to July 1, 2017, the Company s second fiscal quarter.

On May 19, 2015, the Landstar System, Inc. Board of Directors authorized the Company to increase the number of shares of the Company s common stock that the Company is authorized to purchase from time to time in the open market and in privately negotiated transactions under a previously announced purchase program to 3,000,000 shares. As of July 1, 2017, the Company has authorization to purchase 1,036,125 shares of its common stock under this program. No specific expiration date has been assigned to the May 19, 2015 authorization.

Dividends

During the twenty-six-week period ended July 1, 2017, Landstar paid dividends as follows:

Dividend Amount per Share	Declaration Date	Record Date	Payment Date
$0.09	January 30, 2017	February 20, 2017	March 17, 2017
$0.09	April 25, 2017	May 11, 2017	June 2, 2017

Table of Contents

On June 2, 2016, Landstar entered into a credit agreement with a syndicate of banks and JPMorgan Chase Bank, N.A., as administrative agent (the Credit Agreement). The Credit Agreement provides for a restriction on cash dividends and other distributions to stockholders on the Company s capital stock in the event there is a default under the Credit Agreement. In addition, the Credit Agreement, under certain circumstances, limits the amount of such cash dividends and other distributions to stockholders to the extent that, after giving effect to any payment made to effect such cash dividend or other distribution, the Leverage Ratio, as defined in the Credit Agreement, would exceed 2.5 to 1 on a pro forma basis as of the end of the Company s most recently completed fiscal quarter.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

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
10.1	Landstar System, Inc. Executive Incentive Compensation Plan (Incorporated by reference to Appendix A to the Registrant s Definitive Proxy Statement filed on April 11, 2017 (Commission File No. 0-21238))
(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.
101.INS*	XBRL Instance Document
101.SCH*	XBRL Schema Document
101.CAL*	XBRL Calculation Linkbase Document
101.DEF*	XBRL Definition Linkbase Document
101.LAB*	XBRL Labels Linkbase Document
101.PRE*	XBRL Presentation Linkbase Document

* 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: August 4, 2017	/s/ James B. Gattoni James B. Gattoni President and Chief Executive Officer
Date: August 4, 2017	/s/ L. Kevin Stout L. Kevin Stout Vice President and Chief Financial Officer