

KNIGHT TRANSPORTATION INC
Form 10-Q
August 08, 2006

**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 June 30, 2006

or

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

For the transition period from _____ to _____

Commission File Number: 0-24946

KNIGHT TRANSPORTATION, INC.
(Exact name of registrant as specified in its charter)

Arizona
(State or other jurisdiction of
incorporation or organization)

86-0649974
(I.R.S. Employer
Identification No.)

**5601 West Buckeye Road
Phoenix, Arizona
85043**
(Address of Principal Executive Offices)
(Zip Code)

Registrant's telephone number, including area code: **602-269-2000**

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

Edgar Filing: KNIGHT TRANSPORTATION INC - Form 10-Q

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

The number of shares outstanding of registrant's Common Stock, par value \$0.01 per share, as of June 30, 2006 was 85,863,811 shares.

KNIGHT TRANSPORTATION, INC.**INDEX**

PART I - FINANCIAL INFORMATION		Page Number
Item 1.	Financial Statements	
	Condensed Consolidated Balance Sheets as of June 30, 2006 and December 31, 2005 (Unaudited)	3
	Condensed Consolidated Statements of Income for the three and six months ended June 30, 2006 and 2005 (Unaudited)	5
	Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2006 and 2005 (Unaudited)	6
	Notes to Condensed Consolidated Financial Statements (Unaudited)	8
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operation	13
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	20
Item 4.	Controls and Procedures	21
Part II - OTHER INFORMATION		
Item 1.	Legal Proceedings	22
Item 1A.	Risk Factors	22
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	22
Item 3.	Defaults Upon Senior Securities	22
Item 4.	Submission of Matters to a Vote of Security Holders	22
Item 5.	Other Information	23
Item 6.	Exhibits	23

INDEX**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements**

KNIGHT TRANSPORTATION, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets (unaudited)
As of June 30, 2006 and December 31, 2005
(In thousands)

	June 30, 2006	December 31, 2005
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 17,973	\$ 18,809
Short-term investments	5,176	2,278
Accounts receivable, net	77,983	79,848
Notes receivable, net	277	241
Inventories and supplies	3,656	3,355
Prepaid expenses	8,670	7,156
Restricted cash	-	211
Deferred tax asset	8,244	8,533
Total current assets	121,979	120,431
Property and Equipment:		
Land and improvements	20,145	18,163
Buildings and improvements	35,528	34,482
Furniture and fixtures	6,418	7,518
Shop and service equipment	3,192	2,803
Revenue equipment	461,513	430,048
Leasehold improvements	422	378
	527,218	493,392
Less: Accumulated depreciation and amortization	(141,465)	(141,053)
Property and equipment, net	385,753	352,339
Notes receivable - long-term	376	344
Goodwill	8,439	8,119
Other assets & restricted cash	4,400	2,594
	\$ 520,947	\$ 483,827

The accompanying notes are an integral part of these condensed consolidated financial statements.

INDEX

KNIGHT TRANSPORTATION, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets (unaudited) (continued)
As of June 30, 2006 and December 31, 2005
(In thousands, except par values)

June 30, 2006

December 31, 2005

LIABILITIES AND SHAREHOLDERS' EQUITY

Current Liabilities:

Accounts payable	\$ 9,668	\$ 7,464
Accrued payroll	6,641	5,452
Accrued liabilities	16,468	13,307
Claims accrual	23,049	26,155
Other current liabilities	-	211
Dividend payable	-	1,713

Total current liabilities	55,826	54,302
---------------------------	--------	--------

Deferred tax liabilities	78,149	76,597
--------------------------	--------	--------

Total liabilities	133,975	130,899
-------------------	---------	---------

Commitments and Contingencies

Shareholders' Equity:

Preferred stock, \$0.01 par value; 50,000 shares authorized; none issued and outstanding	-	-
--	---	---

Common stock, \$0.01 par value; 100,000 shares authorized; 85,864 and 85,666 shares issued and outstanding at June 30, 2006 and December 31, 2005, respectively	859	857
--	-----	-----

Additional paid-in capital	90,672	87,148
----------------------------	--------	--------

Retained earnings	295,441	264,923
-------------------	---------	---------

Total shareholders' equity	386,972	352,928
----------------------------	---------	---------

	\$ 520,947	\$ 483,827
--	------------	------------

The accompanying notes are an integral part of these condensed consolidated financial statements (unaudited).

INDEX

KNIGHT TRANSPORTATION, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Income (unaudited)
(In thousands, except per share data)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
REVENUE:				
Revenue, before fuel surcharge	\$ 140,372	\$ 119,722	\$ 269,711	\$ 230,797
Fuel surcharge	25,395	14,145	45,108	25,252
Total revenue	165,767	133,867	314,819	256,049
OPERATING EXPENSES:				
Salaries, wages and benefits	47,861	39,196	91,063	76,114
Fuel	43,224	30,192	79,247	56,033
Operations and maintenance	8,286	8,171	17,714	15,803
Insurance and claims	6,108	5,940	11,862	12,304
Operating taxes and licenses	3,341	2,964	6,592	5,894
Communications	1,428	952	2,737	1,927
Depreciation and amortization	14,993	12,786	29,593	25,096
Lease expense - revenue equipment	108	-	217	-
Purchased transportation	9,832	7,127	17,738	13,611
Miscellaneous operating expenses	658	1,725	2,030	3,305
Total operating expenses	135,839	109,053	258,793	210,087
Income from operations	29,928	24,814	56,026	45,962
Interest and investment income	293	143	577	253
Income before income taxes	30,221	24,957	56,603	46,215
Income taxes	(12,100)	(10,000)	(22,650)	(18,500)
Net income	\$ 18,121	\$ 14,957	\$ 33,953	\$ 27,715
Earnings per common share and common share equivalent:				
Basic	\$ 0.21	\$ 0.18	\$ 0.40	\$ 0.33
Diluted	\$ 0.21	\$ 0.17	\$ 0.39	\$ 0.32
Weighted average number of common shares and common share equivalents outstanding:				
Basic	85,830	85,223	85,788	85,172
Diluted	87,113	86,966	87,141	87,020

The accompanying notes are an integral part of these condensed consolidated financial statements (unaudited).

INDEX

KNIGHT TRANSPORTATION, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows (unaudited)
(In thousands)

	Six Months Ended June 30,	
	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 33,953	\$ 27,715
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	29,593	25,096
Gain on sales of equipment	(4,726)	(1,320)
Non-cash compensation expense for issuance of stock to certain members of board of directors	33	15
Provision for allowance for doubtful accounts	(57)	(65)
Tax benefit on stock option exercises	-	844
Tax benefits related to stock-based compensation	(733)	-
Stock option expense	1,604	-
Deferred income taxes	1,842	(965)
Changes in assets and liabilities:		
(Increase) in short-term investments	(2,898)	-
Decrease (increase) in trade receivables	1,922	(5,840)
(Increase) in inventories and supplies	(301)	(745)
(Increase) in prepaid expenses	(1,514)	(1,469)
Decrease in income tax receivable	-	3,216
(Increase) decrease in other assets	(126)	598
Increase (decrease) in accounts payable	1,340	(1,781)
Increase in accrued liabilities, claims accrual and other	1,766	7,986
Net cash provided by operating activities	61,698	53,285
CASH FLOW FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(83,390)	(43,646)
Proceeds from sales of equipment	25,974	6,050
Increase in notes receivable	(69)	(180)
Acquisition-related contingent payment	(320)	-
(Increase) in restricted cash	(384)	-
TRP investment	(1,085)	-
Net cash used in investing activities	(59,274)	(37,776)

Continued

6

INDEX

KNIGHT TRANSPORTATION, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows (unaudited)
(In thousands)

	Six Months Ended June 30,	
	2006	2005
CASH FLOW FROM FINANCING ACTIVITIES:		
Dividends paid	(5,148)	(1,136)
Tax benefits related to stock-based compensation	733	-
Proceeds from exercise of stock options	1,155	1,193
Net cash (used in) provided by financing activities	(3,260)	57
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(836)	15,566
CASH AND CASH EQUIVALENTS, beginning of period	18,809	25,357
CASH AND CASH EQUIVALENTS, end of period	\$ 17,973	\$ 40,923
SUPPLEMENTAL DISCLOSURES:		
Non-cash investing and financing transactions:		
Equipment acquired in accounts payable	\$ 2,765	\$ 1,277
Cash Flow Information:		
Income taxes paid	\$ 21,294	\$ 10,851

The accompanying notes are an integral part of these condensed consolidated financial statements (unaudited).

INDEX

KNIGHT TRANSPORTATION, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1. Financial Information

References in this Report on Form 10-Q to "we," "us," "our," "Knight," or the "Company" or similar terms refer to Knight Transportation, Inc. and its consolidated subsidiaries. All material inter-company balances and transactions have been eliminated in consolidation.

The accompanying condensed consolidated financial statements of Knight Transportation, Inc. and subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America and Regulation S-X, instructions to Form 10-Q, and other relevant rules and regulations of the Securities and Exchange Commission (the "SEC"), as applicable to the preparation and presentation of interim financial information. Certain information and footnote disclosures have been omitted or condensed pursuant to such rules and regulations. We believe all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Results of operations in interim periods are not necessarily indicative of results for a full year. These condensed consolidated financial statements and notes thereto should be read in conjunction with our consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2005.

Note 2. Stock-Based Compensation

Stock-Based Compensation - At June 30, 2006, we had one stock-based employee compensation plan known as the Knight Transportation, Inc. 2003 Stock Option Plan, dated June 1, 2003, as amended from time to time (the "2003 Plan"). On January 1, 2006 we adopted Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including employee stock options and employee stock purchases related to the 2003 Plan, based on estimated fair values.

For the three-month and six-month periods ended June 30, 2006, the adoption of SFAS 123R resulted in stock-based compensation charges of approximately \$928,000 and \$1,604,000, respectively, which reduced income from operations accordingly. Stock-based compensation expense recognized for the six months ended June 30, 2006 is based on awards ultimately expected to vest, and has been reduced for estimated forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The stock-based compensation expense caused net income to decrease by approximately \$570,000 and \$970,000, and basic and diluted earnings per share to decrease by \$0.007 and \$0.011 per share for the three-month and six-month periods ended June 30, 2006, respectively.

We received \$1,155,000 cash from the exercise of stock options during the six-month periods ended June 30, 2006. The actual tax benefit realized for the tax deductions from option exercise of the share-based payment arrangements for the three-month and six-month periods ended June 30, 2006 was approximately \$303,000 and \$733,000, respectively. The actual tax benefit realized in 2006 also decreased cash provided by operating activities, and increased cash provided by financing activities by the same amount. Pursuant to SFAS 123R prior period amounts have not been restated.

INDEX

Prior to SFAS 123R, we applied the intrinsic-value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations, including Financial Accounting Standards Board (FASB) Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation, an interpretation of APB Opinion No. 25," issued in March 2000, to account for our fixed-plan stock options. Under this method, compensation expense was recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. No stock-based employee compensation cost was reflected in net income, as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of the grant. SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123, during prior periods we elected to apply the intrinsic-value-based method of accounting described above, and adopted only the disclosure requirements of SFAS No. 123.

The following table illustrates the effect on net income if the fair-value-based method had been applied to all outstanding and unvested awards for the three-month and six-month periods ended June 30, 2005 (in thousands, except per share data):

	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Net income, as reported	\$ 14,957	\$ 27,715
Deduct total stock-based compensation expense determined under fair-value based method for all awards, net of tax	(646)	(930)
Pro forma net income	\$ 14,311	\$ 26,785
Basic earnings per share:		
As reported	\$ 0.18	\$ 0.33
Pro forma	\$ 0.17	\$ 0.31
Diluted earnings per share:		
As reported	\$ 0.17	\$ 0.32
Pro forma	\$ 0.16	\$ 0.31

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option valuation model that uses the assumptions noted in the following table:

	Quarter Ended June 30,	
	2006	2005
Dividend yield ⁽¹⁾	.43%	.30%
Expected volatility ⁽²⁾	32.38%	48.00%

Edgar Filing: KNIGHT TRANSPORTATION INC - Form 10-Q

Risk-free interest rate ⁽³⁾	5.08%	4.00%
Expected terms ⁽⁴⁾	8.11 years	6.40 years
Weighted average fair value of options granted	\$ 8.65	\$ 7.23

⁽¹⁾ The dividend yield is based on our historical experience and future expectation of dividend payouts.

⁽²⁾ We analyzed the volatility of our stock using historical data from January 1, 2003 through the end of the most recent period to estimate the expected volatility.

INDEX

- (3) The risk-free interest rate assumption is based on U.S. Treasury securities at a constant maturity with a maturity period that most closely resembles the expected term of the stock option award.
- (4) The expected terms of employee stock options represents the weighted-average period the stock options are expected to remain outstanding and has been determined based on an analysis of historical exercise behavior.

The 2003 Plan is administered by the Compensation Committee of the Board of Directors (the "Committee"). The Committee has discretion to determine the number of shares subject to option and the terms and conditions of each option, subject to the general limitations of the 2003 Plan, but no single option may exceed 650,000 shares in any calendar year. The Committee may award incentive stock options, non-qualified stock options and restricted stock grants. Vesting schedules for options are set by the Committee. The term of a stock option may not exceed ten years. Stock options must be issued at fair market value, which is equal to the closing price of the stock on the date the option is granted, as reported by the New York Stock Exchange. Stock options are subject to a vesting schedule which is set by the Committee and generally ranges from three to eight years based upon graded vesting, depending upon the recipient. Most stock options cannot be exercised until three years after the date of grant and are forfeited upon termination of employment for reasons other than death, disability or retirement. Stock options may not be repriced. The 2003 Plan originally reserved 1,500,000 shares for the grant of options, as adjusted for stock splits. In 2005, the Board of Directors and shareholders authorized an increase in the number of shares reserved for the issuance of stock options to 6,000,000 shares, as adjusted for stock splits. The 2003 Plan will terminate on February 5, 2013. We currently have no policy regarding the repurchase of shares on the open market.

As of June 30, 2006, there was \$18.9 million of unrecognized compensation cost related to unvested share-based compensation awards granted under the 2003 Plan. That cost is expected to be recognized over a weighted-average period of three years, and a total period of seven years.

A summary of the award activity under the 2003 Plan as of June 30, 2006, and changes during the six-month period is presented below:

	Option Totals	Weighted Average Exercise Price Per Share (\$)
Outstanding 12/31/2005	4,562,511	10.68
Granted	780,960	18.70
Exercised	(196,136)	6.00
Forfeited	(149,338)	10.95
Outstanding as of 6/30/06	4,997,997	12.26

A summary of the activity for unvested share awards as of June 30, 2006, and changes during the three-month period is presented below:

Weighted Average Exercise

	Unvested Option Totals	Price Per Share (\$)
Unvested Outstanding 3/31/06	2,684,259	11.64
Granted	768,960	18.67
Vested	(178,079)	9.48
Forfeited	(13,839)	12.87
Unvested Outstanding as of 6/30/06	3,261,301	13.42

INDEX

The following table summarizes information about the stock options to purchase our common stock at June 30, 2006:

Range of Exercise Prices (\$)	Number Outstanding	Weighted Avg. Contractual Years Remaining	Weighted Avg. Exercise Price Per Share (\$)	Number Vested and Exercisable	Weighted Avg. Exercise Price Per Share for Vested and Exercisable (\$)
0.00 - 10.00	1,230,739	4.56	5.19	854,994	4.67
10.01 - 15.00	1,921,972	7.83	12.12	91,201	12.05
15.01 - 25.00	1,845,286	9.44	17.11	790,501	15.70
Overall Total	4,997,997	7.62	12.26	1,736,696	10.08

As of June 30, 2006, the total intrinsic value of options exercised during the six month period was approximately \$2.0 million. Based on the market price as of June 30, 2006, the total intrinsic value of options outstanding at the end of the current reporting period is approximately \$39.7 million, and the total intrinsic value of options exercisable as of June 30, 2006 is approximately \$17.6 million.

Note 3. Earnings Per Share (in thousands, except per share data)

A reconciliation of the basic and diluted income per share computations for the three and six months ended June 30, 2006 and 2005, respectively, is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Weighted average common shares outstanding - basic	85,830	85,223	85,788	85,172
Effect of stock options	1,283	1,743	1,353	1,848