

HUB GROUP INC
Form 10-Q
October 26, 2006
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE
SECURITIES AND EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2006 or

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

For the transition period from _____ to _____

Commission file number: 0-27754

HUB GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction
incorporation or organization)

36-4007085
(I.R.S. Employer
Identification No.)

3050 Highland Parkway, Suite 100

Downers Grove, Illinois 60515

(Address, including zip code, of principal executive offices)

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(630) 271-3600

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12-b 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 12-b-2 of the Exchange Act). Yes No

On October 20, 2006, the registrant had 39,090,050 outstanding shares of Class A common stock, par value \$.01 per share, and 662,296 outstanding shares of Class B common stock, par value \$.01 per share.

HUB GROUP, INC.

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HUB GROUP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)

| | September 30, 2006 (Unaudited) | December 31, 2005 |
|--|---|------------------------------|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 32,936 | \$ 36,133 |
| Restricted investments | 2,550 | 1,387 |
| Accounts receivable | | |
| Trade, net | 166,801 | 147,004 |
| Other | 6,570 | 10,603 |
| Prepaid taxes | 141 | 6,040 |
| Deferred taxes | 454 | - |
| Prepaid expenses and other current assets | 5,355 | 3,860 |
| Assets of discontinued operations | - | 17,855 |
| TOTAL CURRENT ASSETS | 214,807 | 222,882 |
| Property and equipment, net | 25,192 | 12,767 |
| Other intangibles, net | 7,614 | - |
| Goodwill, net | 220,448 | 208,150 |
| Other assets | 390 | 619 |
| TOTAL ASSETS | \$ 468,451 | \$ 444,418 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | | |
| Trade | \$ 126,534 | \$ 114,094 |
| Other | 7,131 | 3,668 |
| Accrued expenses | | |
| Payroll | 18,810 | 20,909 |
| Other | 31,525 | 18,917 |
| Deferred taxes | - | 960 |
| Liabilities of discontinued operations | - | 5,341 |
| TOTAL CURRENT LIABILITIES | 184,000 | 163,889 |
| DEFERRED TAXES | 39,930 | 38,454 |
| STOCKHOLDERS' EQUITY: | | |
| Preferred stock, \$.01 par value, 2,000,000 shares authorized; no shares issued or outstanding in 2006 and 2005 | - | - |
| Common stock | | |
| Class A: \$.01 par value; 47,337,700 shares authorized; 41,224,792 shares issued and 39,090,050 outstanding in 2006; 41,224,792 shares issued and 39,962,484 outstanding in 2005 | 412 | 412 |
| Class B: \$.01 par value; 662,300 shares authorized; 662,296 shares issued and outstanding in 2006 and 2005 | 7 | 7 |
| Additional paid-in capital | 174,273 | 183,524 |
| Purchase price in excess of predecessor basis, net of tax benefit of \$10,306 | (15,458) | (15,458) |
| Retained earnings | 132,724 | 97,557 |
| Unearned compensation | - | (6,259) |
| Treasury stock; at cost 2,134,742 shares in 2006 and 1,262,308 shares in 2005 | (47,437) | (17,708) |
| TOTAL STOCKHOLDERS' EQUITY | 244,521 | 242,075 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 468,451 | \$ 444,418 |

See notes to unaudited condensed consolidated financial statements.

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HUB GROUP, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share amounts)

| | Three Months Ended September 30, 2006 | | Nine Months Ended September 30, 2005 | |
|---|--|----------|---|-----------|
| | \$ | \$ | \$ | \$ |
| Revenue | 432,009 | 387,434 | 1,184,069 | 1,078,661 |
| Transportation costs | 374,673 | 342,173 | 1,023,869 | 949,472 |
| Gross margin | 57,336 | 45,261 | 160,200 | 129,189 |
| Costs and expenses: | | | | |
| Salaries and benefits | 23,965 | 20,985 | 71,271 | 62,125 |
| General and administrative | 9,890 | 8,367 | 28,585 | 26,589 |
| Depreciation and amortization | 1,642 | 2,262 | 5,029 | 6,736 |
| Total costs and expenses | 35,497 | 31,614 | 104,885 | 95,450 |
| Operating income | 21,839 | 13,647 | 55,315 | 33,739 |
| Other income (expense): | | | | |
| Interest expense | (22) | (17) | (65) | (109) |
| Interest income | 670 | 217 | 1,668 | 601 |
| Other, net | 7 | 60 | 63 | 91 |
| Total other income | 655 | 260 | 1,666 | 583 |
| Income from continuing operations before provision for income taxes | 22,494 | 13,907 | 56,981 | 34,322 |
| Provision for income taxes | 9,000 | 5,481 | 22,795 | 13,953 |
| Income from continuing operations | 13,494 | 8,426 | 34,186 | 20,369 |
| Discontinued operations: | | | | |
| Income from discontinued operations of HGDS (including loss on disposal of \$70 in 2006) | - | 1,954 | 1,634 | 4,228 |
| Provision for income taxes | - | 770 | 653 | 1,714 |
| Income from discontinued operations | - | 1,184 | 981 | 2,514 |
| Net income | \$ 13,494 | \$ 9,610 | \$ 35,167 | \$ 22,883 |
| Basic earnings per common share | | | | |
| Income from continuing operations | \$ 0.34 | \$ 0.21 | \$ 0.85 | \$ 0.51 |
| Income from discontinued operations | - | 0.03 | 0.02 | 0.06 |
| Net income | \$ 0.34 | \$ 0.24 | \$ 0.87 | \$ 0.57 |
| Diluted earnings per common share | | | | |
| Income from continuing operations | \$ 0.33 | \$ 0.21 | \$ 0.83 | \$ 0.49 |
| Income from discontinued operations | - | 0.03 | 0.02 | 0.06 |
| Net income | \$ 0.33 | \$ 0.24 | \$ 0.85 | \$ 0.55 |
| Basic weighted average number of shares outstanding | 39,773 | 39,280 | 40,246 | 39,932 |
| Diluted weighted average number of shares outstanding | 40,572 | 40,812 | 41,161 | 41,572 |

See notes to unaudited condensed consolidated financial statements.

HUB GROUP, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY
For the nine months ended September 30, 2006
(in thousands, except shares)

| | September 30, 2006 |
|--|-------------------------------|
| Class A & B Common Stock Shares Outstanding | |
| Beginning of year | 40,624,780 |
| Purchase of treasury shares | (1,965,627) |
| Treasury shares issued under restricted stock and stock option plans | 1,093,193 |
| Ending balance | 39,752,346 |
| Class A & B Common Stock Amount | |
| Beginning of year | \$ 419 |
| Issuance of restricted stock and exercise of stock options | - |
| Ending balance | 419 |
| Additional Paid-in Capital | |
| Beginning of year | 183,524 |
| Equity reclassification impact of adopting SFAS No. 123 (R) | (6,259) |
| Exercise of non-qualified stock options | (12,250) |
| Share-based compensation expense | 2,649 |
| Issuance of restricted stock awards, net of forfeitures | (1,288) |
| Tax benefit of share-based compensation plans | 7,897 |
| Ending balance | 174,273 |
| Purchase Price in Excess of Predecessor Basis, Net of Tax | |
| Beginning of year | (15,458) |
| Ending balance | (15,458) |
| Retained Earnings | |
| Beginning of year | 97,557 |
| Net income | 35,167 |
| Ending balance | 132,724 |
| Unearned Compensation | |
| Beginning of year | (6,259) |
| Equity reclassification impact of adopting SFAS No. 123 (R) | 6,259 |
| Ending balance | - |
| Treasury Stock | |
| Beginning of year | (17,708) |
| Purchase of treasury shares | (45,191) |
| Issuance of restricted stock and exercise of stock options | 15,462 |
| Ending balance | (47,437) |
| Total stockholders equity | \$ 244,521 |
| See notes to unaudited condensed consolidated financial statements. | |

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HUB GROUP, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

| | Nine Months Ended September 30, | |
|--|--|-------------|
| | 2006 | 2005 |
| Cash flows from operating activities: | | |
| Income from continuing operations | \$ 34,186 | \$ 20,369 |
| Adjustments to reconcile income from continuing operations to net cash provided by operating activities: | | |
| Depreciation and amortization | 6,410 | 7,031 |
| Deferred taxes | 12 | 8,810 |
| Compensation expense related to share-based compensation plans | 2,649 | 1,581 |
| Gain on sale of assets | (31) | (271) |
| Other assets | 234 | 530 |
| Changes in working capital excluding effects of purchase transaction: | | |
| Restricted investments | (1,163) | (1,173) |
| Accounts receivable, net | (6,325) | (22,251) |
| Prepaid taxes | 5,295 | - |
| Prepaid expenses and other current assets | (1,202) | 379 |
| Accounts payable | 13,904 | 17,119 |
| Accrued expenses | 9,152 | (664) |
| Net cash provided by operating activities | 63,121 | 31,460 |
| Cash flows from investing activities: | | |
| Proceeds from sale of equipment | 228 | 573 |
| Purchases of property and equipment | (5,247) | (3,188) |
| Cash used in acquisition of Comtrak, Inc. | (39,942) | - |
| Proceeds from the disposal of discontinued operations | 12,203 | - |
| Net cash used in investing activities | (32,758) | (2,615) |
| Cash flows from financing activities: | | |
| Proceeds from stock options exercised | 1,924 | 4,304 |
| Purchase of treasury stock | (45,191) | (30,571) |
| Excess tax benefits from share-based compensation | 7,897 | - |
| Net cash used in financing activities | (35,370) | (26,267) |
| Cash flows from operating activities of discontinued operations | 1,848 | 7,752 |
| Cash flows used in investing activities of discontinued operations | (38) | (289) |
| Net cash provided by discontinued operations | 1,810 | 7,463 |
| Net (decrease) increase in cash and cash equivalents | (3,197) | 10,041 |
| Cash and cash equivalents beginning of period | 36,133 | 16,806 |
| Cash and cash equivalents end of period | \$ 32,936 | \$ 26,847 |
| Supplemental disclosures of cash flow information | | |
| Cash paid for: | | |
| Interest | \$ 64 | \$ 59 |
| Income taxes | \$ 6,573 | \$ 3,310 |

See notes to unaudited condensed consolidated financial statements.

HUB GROUP, INC.

NOTES TO UNAUDITED CONDENSED

CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. Interim Financial Statements

The accompanying unaudited condensed consolidated financial statements of Hub Group, Inc. (we, us or our) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in annual financial statements have been condensed or omitted pursuant to those rules and regulations. However, we believe that the disclosures contained herein are adequate to make the information presented not misleading.

The financial statements reflect, in our opinion, all material adjustments (which include only normal recurring adjustments) necessary to fairly present our financial position at September 30, 2006 and results of operations for the three months and nine months ended September 30, 2006 and 2005.

These unaudited condensed consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2005. Results of operations in interim periods are not necessarily indicative of results to be expected for a full year due partially to seasonality.

Certain prior year amounts have been reclassified to conform to the current year presentation.

NOTE 2. Share-Based Compensation

In 1996, we adopted a Long-Term Incentive Plan (the 1996 Incentive Plan). The number of shares of Class A Common Stock reserved for issuance under the 1996 Incentive Plan was 1,800,000. In 1997, we adopted a second Long-Term Incentive Plan (the 1997 Incentive Plan). The number of shares of Class A Common Stock reserved for issuance under the 1997 Incentive Plan was 600,000. In 1999 we adopted a third Long-Term Incentive Plan (the 1999 Incentive Plan). The number of shares of Class A Common Stock reserved for issuance under the 1999 Incentive Plan was 2,400,000. In 2002, we adopted a fourth Long-Term Incentive Plan (the 2002 Incentive Plan). The number of shares of Class A Common Stock reserved for issuance under the 2002 Incentive Plan was 2,400,000. In 2003, we amended our 2002 Incentive Plan to add an additional 2,000,000 shares of Class A Common Stock that are reserved for issuance. Under the 1996, 1997, 1999 and 2002 Incentive Plans, stock options, stock appreciation rights, restricted stock and performance units may be granted for the purpose of attracting and motivating our key employees and non-employee directors. The options granted to non-employee directors vest ratably over a three-year period and expire 10 years after the date of grant. The options granted to employees vest over a range of three to five years and expire 10 years after the date of grant. Restricted stock vests over a three to five year period. At September 30, 2006, 920,021 shares are available for future grant.

Prior to January 1, 2006, we accounted for our share-based compensation plans under the recognition and measurement provisions of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations, as permitted by Statement of Financial Accounting Standard (SFAS) No. 123 Accounting for Stock-Based Compensation. No stock-option based employee compensation cost was recognized in the income statement prior to 2006, as all stock options granted had an exercise price equal to the market value of the underlying common stock on the date of grant. Effective January 1, 2006, we adopted the fair value recognition provisions of FASB Statement No. 123 (R) Share-Based Payment (SFAS No. 123 (R)), using the modified-prospective transition method. Under that transition method, compensation cost recognized in 2006 includes: (a) compensation costs for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant

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date fair value estimated in accordance with the original provisions of SFAS No. 123 and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123 (R). Results for prior periods have not been restated. We have not granted any stock options since 2003.

We recognize the cost of all share-based awards on a straight-line basis over the vesting period of the award. Share-based compensation expense for the three months ended September 30, 2006 and 2005 was \$0.9 million and \$0.5 million or \$0.6 million and \$0.3 million net of taxes, respectively. Share-based compensation expense for the nine months ended September 30, 2006 and 2005 was \$2.6 million and \$1.6 million or \$1.6 million and \$1.0 million net of taxes, respectively. Share-based compensation is included in salaries and benefits in the accompanying statements of income.

We have elected to calculate our initial pool of excess benefits under FASB Staff Position 123 (R)-3 (FSP). Prior to the adoption of SFAS No. 123 (R), we presented all benefits of tax deductions resulting from the exercise of share-based compensation as operating cash flows in the Statement of Cash Flows. Beginning on January 1, 2006, we changed our cash flow presentation in accordance with the FSP which requires benefits of tax deductions in excess of the compensation cost recognized (excess tax benefits) to be classified as a financing cash in-flow and an operating cash out-flow. The results for the nine months ended September 30, 2006 include \$7.9 million of excess tax benefits as a financing cash in-flow and an operating cash out-flow.

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The following table illustrates the effect on the net income and net income per share if we had applied the fair value recognition provisions of SFAS No. 123, to share-based employee compensation during the three and nine months ended September 30, 2005 (in thousands, except per share data):

| | <u>Three Months Ended</u> <u>September 30,</u> <u>2005</u> | <u>Nine Months Ended</u> <u>September 30,</u> <u>2005</u> |
|---|--|---|
| Income from continuing operations, as reported | \$ 8,426 | \$ 20,369 |
| Income from discontinued operations, as reported | <u>1,184</u> | <u>2,514</u> |
| Total net income | \$ 9,610 | \$ 22,883 |
| Add: Total share based compensation included in net income, net of related tax effects | 328 | 951 |
| Deduct: Total share-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | <u>(398)</u> | <u>(1,193)</u> |
| Income from continuing operations, pro forma | \$ 8,356 | \$ 20,127 |
| Income from discontinued operations, pro forma | <u>1,184</u> | <u>2,514</u> |
| Total net income, pro forma | \$ <u>9,540</u> | \$ <u>22,641</u> |
| Earnings per share: | | |
| Basic from continuing operations, as reported | \$0.21 | \$0.51 |
| Basic from discontinued operations, as reported | \$0.03 | \$0.06 |
| Basic pro forma from continuing operations | \$0.21 | \$0.50 |
| Basic pro forma from discontinued operations | \$0.03 | \$0.06 |
| Diluted from continuing operations, as reported | \$0.21 | \$0.49 |
| Diluted from discontinued operations, as reported | \$0.03 | \$0.06 |
| Diluted pro forma from continuing operations | \$0.20 | \$0.48 |
| Diluted pro forma from discontinued operations | \$0.03 | \$0.06 |

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The following table summarizes the stock option activity for the quarters ended March 31, 2006, June 30, 2006 and September 30, 2006:

| Stock Options | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life | Aggregate Intrinsic Value |
|-----------------------------------|---------------|--|--|--|
| Outstanding at December 31, 2005 | 1,783,228 | \$2.06 | | |
| Options exercised | (610,532) | \$1.87 | | |
| Options forfeited | (4,000) | \$4.69 | | |
| Outstanding at March 31, 2006 | 1,168,696 | \$2.15 | 6.04 | \$ 24,121,300 |
| Options exercised | (391,200) | \$1.95 | | |
| Options forfeited | (1,600) | \$1.22 | | |
| Outstanding at June 30, 2006 | 775,896 | \$2.25 | 5.76 | \$ 17,285,063 |
| Options exercised | (7,600) | \$2.54 | | |
| Options forfeited | - | \$0.00 | | |
| Outstanding at September 30, 2006 | 768,296 | \$2.25 | 5.52 | \$ 15,773,448 |
| Exercisable at September 30, 2006 | 604,296 | \$2.40 | 5.29 | \$ 12,315,932 |

Intrinsic value for stock options is defined as the difference between the current market value and the grant price. The total intrinsic value of options exercised during the quarters ended September 30, 2006 and September 30, 2005 was \$0.2 million and \$4.8 million, respectively. The total intrinsic value of options exercised during the nine months ended September 30, 2006 and September 30, 2005 was \$20.9 million and \$16.0 million, respectively. Cash received from stock options exercised during the nine months ended September 30, 2006 was \$1.9 million and the tax benefit realized for tax deductions from stock options exercised was \$7.9 million.

The following table summarizes the non-vested restricted stock activity for the quarters ended March 31, 2006, June 30, 2006 and September 30, 2006:

| Non-vested restricted stock | Shares | Weighted Average Grant Date Fair Value |
|------------------------------------|-----------------|---|
| Non-vested December 31, 2005 | 743,504 | \$ 8.93 |
| Granted | 93,504 | \$ 21.39 |
| Vested | (4,808) | \$ 7.99 |
| Forfeited | <u>(10,732)</u> | \$ 9.17 |
| Non-vested at March 31, 2006 | 821,468 | \$ 10.35 |
| Granted | 11,798 | \$ 22.91 |
| Vested | (17,142) | \$ 10.71 |
| Forfeited | <u>(10,748)</u> | \$ 8.12 |
| Non-vested at June 30, 2006 | 805,376 | \$ 10.56 |
| Granted | 1,517 | \$ 23.09 |
| Vested | (2,300) | \$ 10.11 |
| Forfeited | <u>(1,478)</u> | \$ 16.92 |
| Non-vested at September 30, 2006 | 803,115 | \$ 10.57 |

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The fair value of non-vested restricted stock is equal to the market price of our stock at the date of grant.

The weighted average grant date fair value of non-vested restricted stock granted in the quarter ended September 30, 2005 was \$16.59. The weighted average grant date fair value of non-vested restricted stock granted in the nine months ended September 30, 2005 was \$15.01. The total fair value of shares vested in the quarters ending September 30, 2006 and 2005 was \$0.1 million and \$0.0 million, respectively. The total fair value of shares vested in the nine months ending September 30, 2006 and 2005 was \$0.5 million and \$1.5 million, respectively.

As of September 30, 2006, there was \$5.7 million of unrecognized compensation cost related to non-vested share-based compensation that is expected to be recognized over a weighted average period of 0.78 years.

In May 2006, the Board of Directors granted certain of our officers 593,542 performance units. The performance units entitle the recipients to receive restricted shares of our Class A Common Stock contingent upon the achievement of an operating income earnings target. The aggregate operating income for the three year period ending December 31, 2008 must meet a specified target amount in order for these performance units to be earned and converted to restricted stock. Should the employees earn restricted stock under this program, the restricted stock will be granted in early 2009 and then vests ratably as of the first business day of January in each of 2010, 2011 and 2012 provided the officer remains an employee on each of the vesting dates. The maximum amount that would be recorded as salary expense over this 68 month period assuming the targets are met is \$13.8 million, which is calculated based on the stock price on the date the performance units were granted which was \$23.25.

NOTE 3. Earnings Per Share

The following is a reconciliation of our earnings per share (in thousands, except for per share data):

| | Three Months Ended September 30, 2006 | | | Three Months Ended September 30, 2005 | | |
|--------------------------------------|--|--------|---------------------|--|--------|---------------------|
| | Income | Shares | Per Share Amount | Income | Shares | Per Share Amount |
| Basic EPS | | | | | | |
| Income from continuing operations | \$13,494 | 39,773 | \$ 0.34 | \$ 8,426 | 39,280 | \$ 0.21 |
| Income from discontinued operations | - | 39,773 | - | 1,184 | 39,280 | 0.03 |
| Net Income | \$13,494 | 39,773 | \$ 0.34 | \$ 9,610 | 39,280 | \$ 0.24 |
| Effect of Dilutive Securities | | | | | | |
| Stock options and restricted stock | | 799 | | | 1,532 | |
| Diluted EPS | | | | | | |
| Income from continuing operations | \$13,494 | 40,572 | \$ 0.33 | \$ 8,426 | 40,812 | \$ 0.21 |
| Income from discontinued operations | - | 40,572 | - | 1,184 | 40,812 | 0.03 |
| Net Income | \$13,494 | 40,572 | \$ 0.33 | \$ 9,610 | 40,812 | \$ 0.24 |

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| | Nine Months Ended September 30, 2006 | | Per Share Amount | Nine Months Ended September 30, 2005 | | Per Share Amount |
|--------------------------------------|---|--------|---------------------|---|--------|---------------------|
| | Income | Shares | | Income | Shares | |
| Basic EPS | | | | | | |
| Income from continuing operations | \$34,186 | 40,246 | \$ 0.85 | \$ 20,369 | 39,932 | \$ 0.51 |
| Income from discontinued operations | 981 | 40,246 | 0.02 | 2,514 | 39,932 | 0.06 |
| Net Income | \$35,167 | 40,246 | \$ 0.87 | \$ 22,883 | 39,932 | \$ 0.57 |
| Effect of Dilutive Securities | | | | | | |
| Stock options and restricted stock | | 915 | | | | |