

QUALITY DISTRIBUTION INC
Form 10-Q
August 09, 2007
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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, 2007

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: 000-24180

Quality Distribution, Inc.

(Exact name of registrant as specified in its charter)

Florida
(State or other jurisdiction of

incorporation or organization)

4041 Park Oaks Boulevard, Suite 200, Tampa, FL
(Address of Principal Executive Offices)

813-630-5826

59-3239073
(I.R.S. Employer

Identification No.)

33610
(Zip Code)

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(Registrant's telephone number, including area code)

3802 Corporex Park Drive, Tampa, FL 33619

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

As of August 1, 2007, the registrant had 19,344,537 outstanding shares of Common Stock, no par value, outstanding.

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QUALITY DISTRIBUTION, INC.

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Table of Contents**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES****PART I FINANCIAL INFORMATION****ITEM 1 FINANCIAL STATEMENTS****Consolidated Statements of Operations****(Unaudited in 000 s, Except Per Share Amounts)**

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
OPERATING REVENUES:				
Transportation	\$ 151,683	\$ 149,317	\$ 293,756	\$ 291,626
Other service revenue	19,065	17,237	36,033	35,207
Fuel surcharge	23,884	23,724	42,938	42,195
Total operating revenues	194,632	190,278	372,727	369,028
OPERATING EXPENSES:				
Purchased transportation	123,427	129,809	239,374	251,390
Compensation	20,587	18,393	40,256	36,274
Fuel, supplies and maintenance	19,375	12,796	35,549	23,739
Depreciation and amortization	4,183	3,851	8,230	7,788
Selling and administrative	7,406	5,486	13,872	10,751
Insurance claims	4,444	4,044	11,082	7,928
Taxes and licenses	843	855	1,624	1,645
Communication and utilities	2,497	2,307	5,129	4,855
(Gain) loss on disposal of property and equipment	(10)	(66)	199	(223)
Total operating expenses	182,752	177,475	355,315	344,147
Operating income	11,880	12,803	17,412	24,881
Interest expense	(8,075)	(7,913)	(15,752)	(15,265)
Interest income	176	892	375	1,110
Other income	396	219	359	357
Income before income taxes	4,377	6,001	2,394	11,083
Provision for income taxes	2,135	467	247	1,069
Net income	\$ 2,242	\$ 5,534	\$ 2,147	\$ 10,014
PER SHARE DATA:				
Net income per common share				
Basic	\$ 0.12	\$ 0.29	\$ 0.11	\$ 0.53
Diluted	\$ 0.12	\$ 0.28	\$ 0.11	\$ 0.51
Weighted average number of shares				
Basic	19,354	18,895	19,351	18,929

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Diluted	19,480	19,734	19,478	19,616
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The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES****Consolidated Balance Sheets****(In 000 s)****Unaudited**

	June 30, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 2,878	\$ 6,841
Accounts receivable, net	95,356	85,482
Prepaid expenses	7,881	6,101
Prepaid tires	7,488	7,517
Deferred tax asset, net	18,320	18,320
Other	5,922	9,214
Total current assets	137,845	133,475
Property and equipment, net	115,754	116,964
Assets held-for-sale	367	381
Goodwill	140,404	138,980
Intangibles, net	1,370	635
Non-current deferred tax asset, net	20,740	19,578
Other assets	8,925	11,249
Total assets	\$ 425,405	\$ 421,262
LIABILITIES, MINORITY INTEREST AND SHAREHOLDERS EQUITY		
Current liabilities:		
Current maturities of indebtedness	\$ 1,400	\$ 1,400
Current maturities of capital lease obligations	1,264	1,178
Accounts payable	13,382	13,957
Affiliates and independent owner-operators payable	14,927	11,025
Accrued expenses	21,585	21,197
Environmental liabilities	7,021	5,995
Accrued loss and damage claims	9,468	11,533
Total current liabilities	69,047	66,285
Long-term indebtedness, less current maturities	272,747	272,826
Capital lease obligations, less current maturities	4,044	3,718
Environmental liabilities	4,337	5,831
Accrued loss and damage claims	18,232	20,633
Other non-current liabilities	16,685	14,249
Deferred tax liability	787	724
Total liabilities	385,879	384,266
Commitments and contingencies - Note 8		
Minority interest in subsidiary	1,833	1,833

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SHAREHOLDERS EQUITY

Common stock, no par value; 29,000 shares authorized; 19,337 issued at June 30, 2007 and 19,210 issued at December 31, 2006	360,862	359,995
Treasury stock, 155 and 172 shares at June 30, 2007 and December 31, 2006	(1,494)	(1,527)
Accumulated deficit	(113,047)	(114,866)
Stock recapitalization	(189,589)	(189,589)
Accumulated other comprehensive loss	(18,699)	(18,531)
Stock purchase warrants		21
Stock subscriptions receivable	(340)	(340)
 Total shareholders equity	 37,693	 35,163
 Total liabilities, minority interest and shareholders equity	 \$ 425,405	 \$ 421,262

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

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

Consolidated Statements of Shareholders' Equity/(Deficit)

For the Six Months Ended June 30, 2007 and 2006

Unaudited (In 000 \$)

	Shares of		Accumulated								Total
	Common Stock	Treasury Stock	Common Stock	Treasury Stock	Accumulated Deficit	Stock Recapitalization	Other Comprehensive Loss	Stock Purchase Warrants	Unearned Compensation Restricted Stock	Subscription Receivable	
Balance, December 31, 2005	19,123	93	\$ 359,772	\$ (1,042)	\$ (168,710)	\$ (189,589)	\$ (19,079)	\$ 54	\$ (1,975)	\$ (1,541)	\$ (22,110)
Net income					10,014						10,014
Reclass of unearned compensation restricted stock			(1,975)						1,975		
Issuance of restricted stock		(21)		319	(319)						
Issuance of stock units											
Amortization of restricted stock			186								186
Amortization of stock units			727								727
Amortization of non-employee options			63								63
Amortization of stock options			497								497
Stock warrant exercise	27		11					(11)			
Stock option exercise	12		101							1,200	101
Acquisition of treasury stock		129		(1,890)							(690)
Translation adjustment, net of a tax provision of nil								(84)			(84)
Balance, June 30, 2006	19,162	201	\$ 359,382	\$ (2,613)	\$ (159,015)	\$ (189,589)	\$ (19,163)	\$ 43	\$	\$ (341)	\$ (11,296)
Balance, December 31,	19,210	172	\$ 359,995	\$ (1,527)	\$ (114,866)	\$ (189,589)	\$ (18,531)	\$ 21	\$	\$ (340)	\$ 35,163

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2006										
Net income									2,147	2,147
Issuance of restricted stock	40	(11)	(25)	25						
Forfeiture of restricted stock		2	11	(11)						
Amortization of restricted stock			125							125
Amortization of stock units			14							14
Amortization of non-employee options			63							63
Amortization of stock options			606							606
Stock warrant exercise	79		21				(21)			
Stock option exercise	8	(8)	52	19						71
FIN 48 adjustment							(328)			(328)
Amortization of prior service costs, net of a tax provision of nil								47		47
Translation adjustment, net of a tax provision of nil								(215)		(215)
Balance, June 30, 2007	19,337	155	\$ 360,862	\$ (1,494)	\$ (113,047)	\$ (189,589)	\$ (18,699)	\$	\$	(340) \$ 37,693

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

Table of Contents**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES****Consolidated Statements of Cash Flows****(Unaudited In 000 s)**

	Six Months Ended June 30,	
	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 2,147	\$ 10,014
Adjustments to reconcile to net cash and cash equivalents provided by (used in) operating activities:		
Depreciation and amortization	8,230	7,788
Bad debt expense (recoveries)	441	(236)
Foreign currency transaction gain	(247)	(178)
Loss (gain) on disposal of property and equipment	199	(223)
Interest income on repayment of stock subscription		(690)
Stock based compensation	807	1,473
Amortization of deferred financing costs	899	901
Amortization of bond discount	121	122
Minority dividends	72	72
Deferred taxes	(193)	
Changes in assets and liabilities:		
Accounts and other receivables	(10,315)	1,355
Prepaid expenses	(1,650)	(159)
Prepaid tires	(106)	(465)
Other assets	51	(4,921)
Accounts payable	709	(11,266)
Accrued expenses	389	(841)
Environmental liabilities	(468)	(3,616)
Accrued loss and damage claims	(4,466)	150
Affiliates and independent owner-operators payable	3,902	2,751
Other liabilities	733	180
Net cash provided by operating activities	1,275	2,211
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(4,415)	(8,095)
Acquisition of businesses and assets	(3,032)	(4,630)
Proceeds from sales of property and equipment	4,243	3,330
Net cash used in investing activities	(3,204)	(9,395)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments on long-term debt	(700)	(700)
Principal payments on capital lease obligations	(603)	(57)
Proceeds from revolver	26,800	113,900
Payments on revolver	(26,300)	(115,100)
Change in book overdraft	(1,284)	9,402
Minority dividends	(72)	(72)
Other stock transactions	72	101

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Net cash (used in) provided by financing activities	(2,087)	7,474
Effect of exchange rate changes on cash	(26)	70
Net (decrease) increase in cash and cash equivalents	(3,963)	360
Cash and cash equivalents, beginning of period	6,841	1,636
Cash and cash equivalents, end of period	\$ 2,878	\$ 1,996

Supplemental disclosures of non-cashflow information:

Original capital lease obligations	\$ 1,015	\$ 181
Note issued to seller for purchase of business assets	1,453	
Deferred tax adjustment	972	
Transfer of tractors from other assets to fixed assets	2,089	

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

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

Quality Distribution, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Summary of Significant Accounting Policies

Basis of Presentation

In this quarterly report, unless the context otherwise requires or indicates, (i) the terms *the Company*, *our Company*, *Quality Distribution*, *QDI*, *we*, *us* and *our* refer to Quality Distribution, Inc. and its consolidated subsidiaries and their predecessors, (ii) the terms *Quality Distribution, LLC* and *QD LLC* refer to our wholly owned subsidiary, Quality Distribution, LLC, a Delaware limited liability company, and its consolidated subsidiaries and their predecessors, and (iii) the term *QD Capital* refers to our wholly owned subsidiary, QD Capital Corporation, a Delaware corporation.

We are engaged primarily in truckload transportation of bulk chemicals in North America with a significant portion of our business conducted through a network of company terminals, affiliates and independent owner-operators. Affiliates are independent companies, which enter into one-year renewable contracts with us. Affiliates are responsible for paying for their own power equipment (including debt service), fuel and other operating costs. Certain affiliates lease trailers from us. Owner-operators are independent contractors, who, through a contract with us, supply one or more tractors and drivers for our use. Contracts with owner-operators may be terminated by either party on short notice. We charge affiliates and third parties for the use of tractors and trailers as necessary and occasionally sell or lease tractors to them. In exchange for the services rendered, affiliates and owner-operators are normally paid a percentage of the revenues generated for each load hauled.

Our accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and do not include all of the information and notes required by accounting principles generally accepted in the United States (*U.S. GAAP*) for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments and accruals) considered necessary for a fair presentation have been included. For further information, refer to our Annual Report on Form 10-K for the year ended December 31, 2006, including the consolidated financial statements and accompanying notes. Certain prior-period amounts have been reclassified to conform to the current year *s* presentation.

Operating results for the three and six months ended June 30, 2007, are not necessarily indicative of the results that may be expected for the entire fiscal year.

New Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (*FASB*) issued SFAS No. 157, *Fair Value Measurements* . SFAS No. 157 establishes a common definition for fair value to be applied to U.S. GAAP guidance requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. We are currently assessing the impact of SFAS No. 157 on our consolidated financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities-Including an Amendment of FASB Statement No. 115* , which permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 also includes an amendment to SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, which applies to all entities with available-for-sale and trading securities. This statement is effective as of the beginning of an entity *s* first fiscal year that begins after November 15, 2007. We are currently assessing the potential impacts of implementing this standard.

Table of Contents**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES****Acquisition of Business Assets**

During 2007, we acquired, for \$2.4 million, the business of a leading tank wash operation with annual revenues of approximately \$12 million, and facilities located in Carteret, New Jersey; Bensalem, Pennsylvania; Houston, Texas and Chicago, Illinois. The aggregate purchase price was allocated as follows: \$0.5 million to fixed assets and parts, \$1.5 million to goodwill, and \$0.4 million to other intangible assets such as non-compete agreements and customer lists.

During 2007, we also purchased the business of two affiliates for \$2.1 million in the aggregate, of which, we allocated \$0.7 million to fixed assets and parts, \$0.9 million to goodwill, and \$0.5 million to other intangible assets such as non-compete agreements.

Goodwill and Intangible Assets*Goodwill*

Under SFAS 142, Goodwill and Other Intangible Assets, goodwill is subject to an annual impairment test as well as impairment assessments of certain triggering events. SFAS 142 requires us to compare the fair value of the reporting unit to its carrying amount to determine if there is a potential impairment. If the fair value of the reporting unit is less than its carrying amount, an impairment loss is recorded to the extent the carrying amount of the goodwill within the reporting unit is greater than the implied fair value of goodwill.

We perform our impairment test annually during the second quarter with a measurement date of June 30th. Projections for future cash flows were based on our recent operating trends which projected an average growth rate for revenue of approximately 5.2% over 5 years. EBITDA multiples were derived from other comparable publicly traded companies. The discount rate used to discount cash flows was based on our weighted average cost of capital of approximately 12.1%. No impairment was determined to have occurred as of June 30, 2007, since the calculated fair value exceeded the carrying amount. The factors used in deriving the estimate of the fair value included improving economic conditions, increasing revenues and operating income.

Our goodwill assets as of June 30, 2007 and December 31, 2006, were \$140.4 million and \$139.0 million, respectively. We reclassified \$1.0 million of goodwill to deferred taxes in the first quarter of 2007 as a result of the FIN 48 analysis. Additional goodwill of \$2.4 million resulted from the three businesses acquired in fiscal year 2007.

Intangible Assets

Net intangible assets consist of \$1.4 million of non-compete agreements with remaining lives of 4 to 5 years, and customer lists and customer contracts acquired from a competitor with remaining lives of 2 to 5 years. Accumulated amortization of the remaining intangible assets was \$0.2 million and \$0.3 million at June 30, 2007 and December 31, 2006, respectively. The gross amount of intangible assets at June 30, 2007 and December 31, 2006 was \$1.6 million and \$1.0 million, respectively. We also added \$0.8 million of intangibles resulting from the acquisition of three businesses in fiscal year 2007.

Amortization expense for the six months ended June 30, 2007 and 2006 was \$0.1 million and less than \$0.1 million, respectively. Remaining intangible assets will be amortized to expense as follows (in thousands):

2007 - remaining	\$ 174
2008	322
2009	282
2010	282
2011 and after	310

Table of Contents**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES****2. Comprehensive Income**

Comprehensive income is as follows (in thousands):

	Three months ended		Six months ended	
	June 30, 2007	June 30, 2006	June 30, 2007	June 30, 2006
Net income	\$ 2,242	\$ 5,534	\$ 2,147	\$ 10,014
Other comprehensive income (loss):				
Amortization of prior service costs	47		47	
Foreign currency translation adjustments	(211)	(158)	(215)	(84)
Comprehensive income	\$ 2,078	\$ 5,376	\$ 1,979	\$ 9,930

3. Earnings Per Share

A reconciliation of the numerators and denominators of the basic and diluted earnings per share computations follows (in thousands except per share amounts):

	Net income (numerator)	June 30, 2007 Shares (denominator)	Three months ended		June 30, 2006 Shares (denominator)	Per-share amount
			Per-share amount	Net income (numerator)		
Basic earnings available to common shareholders:						
Net income	\$ 2,242	19,354	\$ 0.12	\$ 5,534	18,895	\$ 0.29
Effect of dilutive securities:						
Stock options		85			399	
Unvested restricted stock		39			64	
Stock units		2			225	
Stock warrants					151	
Diluted earnings available to common shareholders:						
Net income	\$ 2,242	19,480	\$ 0.12	\$ 5,534	19,734	\$ 0.28

	Net income (numerator)	June 30, 2007 Shares (denominator)	Six months ended		June 30, 2006 Shares (denominator)	Per-share amount
			Per-share amount	Net income (numerator)		
Basic earnings available to common shareholders:						
Net income	\$ 2,147	19,351	\$ 0.11	\$ 10,014	18,929	\$ 0.53
Effect of dilutive securities:						
Stock options		86			268	
Unvested restricted stock		39			59	
Stock units		2			214	

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Stock warrants							146
Diluted earnings available to common shareholders:							
Net income	\$ 2,147	19,478	\$ 0.11	\$ 10,014	19,616	\$ 0.51	

Table of Contents**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

The effect of our stock options, restricted stock, stock units and stock warrants, which represent the shares shown in the table above are included in the computation of diluted earnings per share for the three and six months ended June 30, 2007 and 2006, respectively.

The following securities were not included in the calculation of diluted earnings per share because such inclusion would be anti-dilutive (in thousands):

	Three months ended		Six months ended	
	June 30,		June 30,	
	2007	2006	2007	2006
Stock options	1,740	1,168	1,736	1,566
Unvested restricted stock	34		27	
Stock units	3		3	

4. Stock-Based Compensation

We maintain performance incentive plans under which stock options, restricted shares, and stock units may be granted to employees, non-employee directors, consultants and advisors. As of June 30, 2007, we have three stock-based compensation plans. There is also an agreement relating to stock units which applies solely to Mr. Gerald L. Detter, Chairman.

We recognize expense for stock-based compensation based upon estimated grant date fair value. We apply the Black-Scholes valuation model in determining the fair value of share-based payments to employees. The resulting compensation expense is recognized over the requisite service period, which is generally the awards' vesting term. Compensation expense is recognized only for those awards expected to vest, with forfeitures estimated based on our historical experience and future expectations. All stock-based compensation expense is classified within Compensation on the Consolidated Statement of Operations. None of the stock-based compensation was capitalized during 2007.

The fair value of options granted during the first six months of 2007 and 2006 was based upon the Black-Scholes option-pricing model. The expected term of the options represents the estimated period of time until exercise giving consideration to the contractual terms, vesting schedules and expectations of future employee behavior. For fiscal 2007, expected stock price volatility is based on the historical volatility of our common stock, which began trading on November 13, 2003. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant with an equivalent remaining term. The Company has not paid dividends in the past and does not currently plan to pay any dividends in the foreseeable future. The Black-Scholes model was used with the following assumptions:

	2007	2006
Risk free rate	4.65%	4.50%
Expected life	5 years	4 years
Volatility	68.5%	71.2%
Expected dividend	nil	nil

Due to the issuance of stock options representing 200,000 shares to an executive who joined us in November 2004, we recognized approximately \$63,000 of compensation expense for the six months ended June 30, 2007 and will recognize approximately \$0.2 million of compensation expense over the next 17 months.

We issued options for 240,950 shares to various employees with an exercise price of \$13.06 on January 3, 2007. The total compensation expense that will be recognized over four years for these options (net of estimated shares forfeited) is approximately \$1.8 million. We issued options for 20,000 shares to an officer with an exercise price of \$8.65 on March 30, 2007. The exercise price of the options was based on the fair market value of our stock at the date of the grant. The total compensation expense that will be recognized over four years for these options (net of estimated shares forfeited) is approximately \$0.1 million. We also issued 11,485 shares of restricted stock in January 2007 to certain directors as part of their annual compensation package and 40,000 shares of restricted stock in June 2007 to our newly appointed Chief Executive Officer. We will recognize approximately \$0.5 million as compensation expense over four years for all of these restricted shares (net of estimated shares forfeited).

Table of Contents**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

The following table summarizes stock based compensation expense (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Stock options	\$ 339	\$ 290	\$ 668	\$ 560
Restricted stock, net	60	92	125	186
Stock units	7	366	14	727
	\$ 406	\$ 748	\$ 807	\$ 1,473

The following table summarizes unrecognized stock-based compensation and the weighted average period over which such stock-based compensation is expected to be recognized as of June 30, 2007 (in thousands):

	In \$	Remaining years
Stock options	\$ 4,087	2.8
Restricted stock, net	717	3.2
Stock units	49	2.6
	\$ 4,853	

These amounts do not include the cost of any additional awards that may be granted in future periods nor any changes in our forfeiture rate. Options representing 8,500 shares were exercised during the three months ended June 30, 2007. We recognize compensation expense for restricted stock based on Financial Interpretation Number 28.

5. Employee Benefit Plans

We maintain two noncontributory defined benefit plans resulting from a prior acquisition that cover certain full-time salaried employees and certain other employees under a collective bargaining agreement. Retirement benefits for employees covered by the salaried plan are based on years of service and compensation levels. The monthly benefit for employees under the collective bargaining agreement plan is based on years of service multiplied by a monthly benefit factor. Pension costs are funded in accordance with the provisions of the applicable law.

We use a December 31st measurement date for both of our plans.

The components of estimated net periodic pension cost are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Service cost	\$ 64	\$ 64	\$ 128	\$ 128
Interest cost	670	675	1,340	1,350
Amortization of prior service cost	24	24	47	47
Amortization of loss	104	148	208	296

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Expected return on plan assets	(822)	(769)	(1,642)	(1,537)
Net periodic pension cost	40	142	81	284

We have contributed \$0.5 million to our pension plans during the six months ended June 30, 2007, and are not required to make any additional contributions for the remainder of 2007.

Table of Contents**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES****6. Geographic Segments**

Our operations are located primarily in the United States, Canada and Mexico. Inter-area sales are not significant to the total revenue of any geographic area. Information about our operations in different geographic areas for the three and six months ended June 30, 2007 and 2006 is as follows (in thousands):

	Three Months Ended		
	U. S.	June 30, 2007	
		International	Consolidated
Total operating revenues	\$ 180,073	\$ 14,559	\$ 194,632
Operating income	10,038	1,842	11,880
	Three Months Ended		
	U. S.	June 30, 2006	
		International	Consolidated
Total operating revenues	\$ 177,031	\$ 13,247	\$ 190,278
Operating income	10,761	2,042	12,803
	Six Months Ended		
	U. S.	June 30, 2007	
		International	Consolidated
Total operating revenues	\$ 345,211	\$ 27,516	\$ 372,727
Operating income	13,702	3,710	17,412
	As of June 30, 2007		
Identifiable assets (1)	109,808	7,683	117,491
	Six Months Ended		
	U. S.	June 30, 2006	
		International	Consolidated
Total operating revenues	\$ 343,761	\$ 25,267	\$ 369,028
Operating income	21,145	3,736	24,881
	As of December 31, 2006		
Identifiable assets (1)	109,530	8,450	117,980

(1) Includes property and equipment, assets held-for-sale and intangible assets.

7. Income Taxes

We adopted FASB Interpretation 48, Accounting for Uncertain Income Tax Positions (FIN 48), at the beginning of fiscal year 2007. As a result of the implementation, we recognized an increase to reserves for uncertain tax positions of \$0.3 million. The increase to the reserve was accounted for as an adjustment to the beginning balance of retained earnings on the balance sheet.

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At January 1, 2007, we had approximately \$3.5 million of total gross unrecognized tax benefits. Of this total, \$2.5 million (net of federal benefit on state tax issues) represents the amount of unrecognized tax benefits that, if recognized would favorably affect the effective income tax rate in any future periods. Included in the balance of gross unrecognized tax benefits at January 1, 2007, is \$0.5 million related to tax positions for which it is reasonably possible that the total amounts could significantly change during the next twelve months. This amount represents a decrease in unrecognized tax benefits due to expiring statutes.

Our continuing practice is to recognize interest and/or penalties related to income tax matters in income tax expense. We had \$1.1 million (net of federal tax benefit) accrued for interest and \$0.4 million accrued for penalties at January 1, 2007. There have been no material changes in the amount of our unrecognized tax benefits or interest and penalties related to uncertain tax positions since we adopted FIN 48.

We are subject to the income tax jurisdiction of the U.S., Canada, and Mexico, as well as income tax of multiple state jurisdictions. We believe we are no longer subject to U.S. federal income tax examinations for years before 2003, to international examinations for years before 2001 and with few exceptions, to state exams before 2002.

In accordance with FIN 48, we updated the presentation of our deferred tax asset and valuation allowance to remove any unrecognized tax benefit. In the first quarter of 2007, we reversed the remaining \$0.9 million deferred tax valuation allowance and the associated deferred tax asset on state tax NOLs that contained unrecognized tax benefits.

We recognized a \$1.0 million income tax benefit in the first quarter of 2007 from the identification of previously unrecognized deferred tax assets relating to prior periods. We believe these items are not considered material to any of the prior periods affected or material to our expected results for 2007.

The effective tax rates for the three months ended June 30, 2007 and 2006 were approximately 48.8% and 7.8%, respectively. The effective tax rates for the six months ended June 30, 2007 and 2006 were approximately 10.3% and 9.7%, respectively. The lower effective tax rate for both the three month and six month 2006 period was because of the realization of part of the valuation allowance on the net operating loss estimated to be utilized against 2006 taxable income. Additionally, the income tax expense for the six months ended June 30, 2007 includes the recognition in the first quarter of 2007 of a previously unrecognized \$1.0 million deferred tax asset described in the above paragraph. We expect our effective annual income tax rate for the year ended December 31, 2007 to range from approximately 36% to 39%.

8. Commitments and Contingencies

Environmental Matters

It is our policy to be in compliance with all applicable environmental, safety, and health laws. We also are committed to the principles of Responsible Care[®], an international chemical industry initiative to enhance the industry's responsible management of chemicals.

Our activities involve the handling, transportation and storage of bulk chemicals, both liquid and dry, many of which are classified as hazardous materials or hazardous substances. Our tank wash and terminal operations engage in the creation, storage or discharge and proper disposal of wastewater that may contain hazardous substances, the inventory and use of cleaning materials that may be hazardous substances and the control and discharge of storm-water from industrial sites. In addition, we may store diesel fuel and other petroleum products at our terminals. As such, we and others who operate in our industry or own and operate real property, are subject to environmental, health and safety laws and regulation by U.S. federal, state and local agencies as well as foreign governmental authorities. Environmental laws and regulations are complex, and address emissions to the air, discharge onto land or water, and the generation, handling, storage, transportation, treatment and disposal of waste materials. These laws change frequently and generally require us to obtain and maintain various licenses and permits. Environmental laws have tended to become more stringent over time, and most provide for substantial fines and potential criminal sanctions for violations. Some of these laws and regulations are subject to varying and conflicting interpretations.

Facility managers are responsible for environmental compliance at each operating location. Audits conducted by our staff assess operations, safety training and procedures, equipment and grounds maintenance, emergency response capabilities and waste management. We may also, if circumstances warrant, contract with independent environmental consulting firms to conduct periodic, unscheduled, compliance assessments that focus on unsafe conditions with the potential to result in releases of hazardous substances or petroleum, and that also include screening for evidence of past spills or releases. Our staff includes environmental professionals who develop guidelines and procedures, including periodic

audits of our terminals, tank cleaning facilities, and certain historical operations.

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We are potentially subject to strict, joint and several liability for investigating and rectifying the consequences of spills and other environmental releases of such substances under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended (CERCLA), the Resource Conservation and Recovery Act of 1976 (RCRA), the Superfund Amendments and Reauthorization Act of 1986, and comparable state and foreign laws. Under certain of these laws, we could also be subject to allegations of liability for the activities of our affiliates or owner-operators. From time to time, we have incurred remedial costs and regulatory penalties with respect to chemical or wastewater spills and releases at our facilities and on the road, and, notwithstanding the existence of our environmental management program, we cannot assure that such obligations will not be incurred in the future, nor predict with certainty the extent of future liabilities and costs under environmental, health, and safety laws, nor that such liabilities will not result in a material adverse effect on our financial condition, results of operations or business reputation.

In addition, we may face liability for alleged personal injury or property damage due to exposure to chemicals and other hazardous substances at our facilities or as the result of accidents and spills. Although these types of claims have not historically had a material impact on our operations, a significant increase in these claims could have a material adverse effect on our business, financial condition, operating results or cash flow.

As the result of environmental studies conducted at our facilities or third party sites in conjunction with our environmental management program, we have identified environmental contamination at certain sites that will require remediation.

Reserves

Our policy is to accrue remediation expenses when it is probable that such efforts will be required and the related expenses can be reasonably estimated. Estimates of costs for future environmental compliance and remediation are necessarily imprecise due to such factors as the continuing evolution of environmental laws and regulatory requirements, the availability and application of technology, the identification of currently unknown remediation sites and the allocation of costs among the potentially responsible parties under applicable statutes. As of June 30, 2007 and December 31, 2006, we had reserves in the amount of \$11.4 million and \$11.8 million, respectively, for all environmental matters discussed below.

Property Contamination Liabilities

We have been named as (or are alleged to be) a potentially responsible party (PRP) under CERCLA and similar state laws at approximately 30 sites. Of these, there are eight sites with respect to which we received information requests but have denied liability. There has been no demand for payment and therefore we consider the matters to be inactive. For sixteen of these sites, we are one of many parties with alleged liability and are negotiating with either Federal, State or private parties on the scope of our obligations, if any. For example, we were notified in August, 2004 of potential liabilities involving the Lower Passaic River Study Area in New Jersey and the Malone Superfund Site in Texas. We will be participating in the initial studies of these two sites to determine site remediation objectives, goals and technologies. Since our overall liability cannot be estimated at this time, we have set reserves for only the initial remedial investigation phase at the two sites. As discussed below, at eight of these sites we are the only responsible party and are in the process of conducting investigations and/or remediation projects.

We are responsible for remediation projects at six sites as a result of operations conducted by Chemical Leaman Corporation (CLC) prior to our acquisition of and merger with CLC in 1998. These six sites are: Bridgeport, New Jersey; William Dick, Pennsylvania; Charleston, West Virginia; Tonawanda, New York; Scary Creek, West Virginia; and East Rutherford, New Jersey. Each of these sites is discussed below, of which the first two are anticipated to require the most significant expenditures.

Bridgeport, New Jersey

QDI is required under the terms of two federal consent decrees to perform remediation at this operating truck terminal and tank wash site. CLC entered into consent orders with USEPA in May 1991 for the treatment of groundwater (operable unit one or OU1) and October 1998 for the removal of contamination in the wetlands (OU3). In addition, we were required to assess the removal of contaminated soils (OU2).

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In connection with OU1, USEPA originally required us to construct a large treatment plant with discharge via a two mile pipeline to the Delaware River watershed with construction to be completed by the end of 2001. We have negotiated an alternative remedy with USEPA which would call for a significantly smaller treatment facility, in place treatment of groundwater contamination via in-situ treatment and a local discharge. The treatment facility has been approved and construction was substantially completed in early 2007 with start-up pending. USEPA has also approved an OU3 remedy for approximately 2.5 acres of affected wetland. This reflects a reduction from an approximate seven acre area that had been under negotiation. Site mobilization for the OU3 work took place in late May 2004 but was delayed due to weather-related issues. Field work was re-started in May 2005 and remediation work has been completed. In regard to OU2, USEPA is now in the process of finalizing a Feasibility Study for the limited areas that show contamination and warrant additional investigation or work. USEPA also wants to include in OU2 the in-situ treatment previously described as part of OU1. The environmental projections for OU1 and OU2 have been changed to reflect the reallocation of the in-situ costs to OU2 and the proposed contract amount for the OU1 work. We have estimated expenditures to be in the range of \$4.5 million to \$8.5 million.

William Dick, Pennsylvania

CLC entered into a consent order with the Pennsylvania DEP (PADEP) and USEPA in October 1995 obligating it to provide a replacement water supply to area residents (OU1), treat contaminated groundwater (OU2), and perform remediation of contaminated soils (OU3) at this former wastewater disposal site. OU1 is complete. PADEP and USEPA have approved an interim remedy, which involves the construction of a treatment facility and discharge locally. We began construction of this facility in November 2006. Based on recent data showing reduction in site groundwater contamination due to natural attenuation and the more extensive handling and removal of contaminated soils, we believe that the groundwater project can be completed over the five-year term of this interim remedy. The agencies have approved an OU3 remedy, which requires both thermal treatment of contaminated soils and treatment of residuals via soil vapor extraction (SVE). The OU3 remedy expanded in April 2004 to off-site shipment of contaminated soils because these soils were found to be incompatible with the thermal treatment unit, which started full-scale operation in May 2004. In 2004, we also discovered buried drums and associated contaminated material and soils, which required off-site disposal. In the third quarter of 2004, we determined that a latex liner waste material was present in the third pond, which needed to be excavated and removed for disposal offsite. This work was completed in early 2005. We also determined that the soils in pond three needed to be excavated to determine if they will be suitable for the originally planned SVE treatment. We excavated the pond's soils into three discrete piles and determined the best approach to treat these soil piles. It was determined that most of the soil piles could be treated on site using SVE as originally planned. However, some modifications to the design had to be made in order to treat a limited number of soil piles. The SVE work began in 2006 and is on-going. We have estimated expenditures to be in the range of \$2.4 million to \$3.4 million.

Other Owned Property

Scary Creek, West Virginia: CLC received a clean up notice from the state authority in August 1994 requiring remediation of contaminated soils and groundwater at this former wastewater disposal facility. However, the state and we have agreed that remediation can be conducted under the state's voluntary clean-up program (instead of the state superfund enforcement program). We are currently completing the originally planned remedial investigation and the additional site investigation work that was required to completely delineate the extent of site contamination. Upon completion of the site investigation phase, a remedial feasibility study and design will be prepared to address contaminated soils, and, if applicable, groundwater. The expectation is that a remedy utilizing primarily in-situ treatment with limited soil removal will be conducted.

Tonawanda, New York: CLC entered into a consent order with the New York Department of Environmental Conservation on June 22, 1999 obligating it to perform soil and groundwater remediation at this former truck terminal and tank wash site. We have completed a remedial investigation and a feasibility study with the expectation that we will conduct a remedy that may include in-situ treatment, limited soil removal and monitored natural attenuation of the groundwater.

Charleston, West Virginia: CLC completed a remediation of a former drum disposal area in 1995 at its active truck terminal and tank wash site under the terms of a state hazardous waste permit. The state has required supplemental groundwater monitoring in connection with the same permit. We have completed this work and believe that no additional remediation will be required.

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

East Rutherford, New Jersey: CLC entered into a Memorandum of Agreement with the State of New Jersey on June 11, 1996 obligating it to perform a Remedial Investigation and Remedial Action with respect to a subsurface loss of an estimated 7,000 gallons of fuel oil at this active truck terminal and tank wash site. We have completed the recovery of free product and conducted groundwater monitoring and are awaiting final approval of a plan to terminate further remedial action with some limited contamination left in place.

ISRA New Jersey Facilities: We are obliged to conduct investigations and remediation at three current or former New Jersey tank wash and terminal sites pursuant to the state's Industrial Sites Remediation Act, which requires such remediation following the sale of facilities after 1983. The former owner has agreed to take responsibility for one of the sites and the other two are in the process of remedial investigation with projections set in contemplation of limited soil remediation expense for contaminated areas.

We have estimated future expenditures for these other owned properties to be in the range of \$2.6 million to \$4.8 million.

Other Environmental Matters

We have been named in three civil actions seeking contribution for remediation at offsite treatment, storage and disposal facilities (TSDs) or privately owned properties. We have also received notices of potential liability at eighteen other TSDs and are negotiating with Federal, state and private parties on the scope of our obligations (if any) in connection with remedies at these sites. In addition, there are about eight sites with respect to which we received information requests but have denied liability and there has been no demand for payment (considered inactive). Our financial projection is established with respect to those sites where a financial demand is made or an allocation of financial liability is reasonably ascertainable.

We were notified in August 2004 of potential liabilities involving the Lower Passaic River Study Area in New Jersey and the Malone Superfund Site in Texas. We will be participating in the initial studies of these two sites to determine site remediation objectives, goals and technologies. Since the overall liability cannot be estimated at this time, we have set reserves for only the initial remedial investigation phase at the two sites.

We were also notified in August 2004 of our potential liability for remedial measures to be undertaken by the EPA at the Mobile Tank Wash Facility Superfund Site in Mobile, Alabama. Liability cannot be estimated at this time. We have asserted claims against the site owner (currently in bankruptcy) and the owner's insurers.

We have estimated future expenditures for these other environmental matters to be in the range of \$1.6 million to \$3.8 million.

There can be no assurance that additional sites for which we are responsible will not be discovered, nor that violations by us of environmental laws or regulations will not be identified or occur in the future, or that environmental, health and safety laws and regulations will not change in a manner that could impose material costs on us.

9. Subsequent Events

We entered into a Stock Purchase Agreement on August 2, 2007 to acquire (the Acquisition) all of the outstanding capital stock of Boasso America Corporation (Boasso) for an aggregate purchase price of (i) \$57,350,000 in cash less the outstanding long-term indebtedness of Boasso, subject to a working capital adjustment, and (ii) a \$2,500,000 promissory note for the benefit of Walter J. Boasso. For its most recent fiscal year ended March 31, 2007, Boasso reported revenues of approximately \$71 million. Boasso provides ISO tank container and depot services, with facilities located in Chalmette, Louisiana; Houston, Texas; Charleston, South Carolina; Chicago, Illinois; Detroit, Michigan and Jacksonville, Florida. Consummation of the Acquisition is subject to customary closing conditions, any of which may not be satisfied. This transaction is expected to close in the fourth quarter of 2007.

10. Guarantor Subsidiaries

The 9% Senior Subordinated Notes due 2010 and the Senior Floating Interest Rate Subordinated Term Notes due 2012 issued by QD LLC and QD Capital are unconditionally guaranteed on a senior subordinated basis pursuant to guarantees by all of our direct and indirect domestic subsidiaries, and by QDI. Each of our direct and indirect subsidiaries, including QD LLC, is 100% owned. All non-domestic subsidiaries including Levy Transport, Ltd. are non-guarantor subsidiaries. QD Capital has no material assets or operations.

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QD LLC conducts substantially all of its business through and derives virtually all of its income from its subsidiaries. Therefore, its ability to make required principal and interest payments with respect to its indebtedness depends on the earnings of subsidiaries and its ability to receive funds from its subsidiaries through dividend and other

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

payments. The subsidiary guarantors are wholly owned subsidiaries of QD LLC and have fully and unconditionally guaranteed the 9% Senior Subordinated Notes and the Senior Floating Interest Rate Subordinated Term Notes on a joint and several basis.

We have not presented separate financial statements and other disclosures concerning subsidiary guarantors because management has determined such information is not material to the holders of the above-mentioned notes.

The following condensed consolidating financial information for QDI, QD LLC, QD Capital (which has no assets or operations), non-guarantor subsidiaries and combined guarantor subsidiaries presents:

Consolidating balance sheets at June 30, 2007 and December 31, 2006 and consolidating statements of operations for each of the three and six month periods ended June 30, 2007 and June 30, 2006 and the consolidating statements of cash flows for each of the six month periods ended June 30, 2007 and June 30, 2006.

Elimination entries necessary to consolidate the parent company and all its subsidiaries.

Table of Contents**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES****Consolidating Statements of Operations****Three Months Ended June 30, 2007****Unaudited (In 000 s)**

	QDI	QD LLC and QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Operating revenues:						
Transportation	\$	\$	\$ 151,683	\$	\$	\$ 151,683
Other service revenue			18,854	211		19,065
Fuel surcharge			23,884			23,884
Total operating revenues			194,421	211		194,632
Operating expenses:						
Purchased transportation			123,427			123,427
Compensation			20,606	(19)		20,587
Fuel, supplies and maintenance			19,375			19,375
Depreciation and amortization			4,013	170		4,183
Selling and administrative			7,372	34		7,406
Insurance claims			4,467	(23)		4,444
Taxes and Licenses			843			843
Communication and utilities			2,497			2,497
(Gain)/loss on disposal of property and equipment			(33)	23		(10)
Operating income			11,854	26		11,880
Interest expense		(7,480)	(714)		119	(8,075)
Interest income	(9)		167	137	(119)	176
Other income (expense)	(7)		175	228		396
Income (loss) before taxes	(16)	(7,480)	11,482	391		4,377
Income tax provision			2,078	57		2,135
Equity in (loss) earnings of subsidiaries	2,258	9,738			(11,996)	
Net (loss) income	\$ 2,242	\$ 2,258	\$ 9,404	\$ 334	\$ (11,996)	\$ 2,242

Table of Contents**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES****Consolidating Statements of Operations****Three Months Ended June 30, 2006****Unaudited (In 000 s)**

	QDI	QD LLC and QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Operating revenues:						
Transportation	\$	\$	\$ 149,317	\$	\$	\$ 149,317
Other service revenue			16,977	260		17,237
Fuel surcharge			23,724			23,724
Total operating revenues			190,018	260		190,278
Operating expenses:						
Purchased transportation			129,809			129,809
Compensation			18,393			18,393
Fuel, supplies and maintenance			12,791	5		12,796
Depreciation and amortization			3,697	154		3,851
Selling and administrative			5,420	66		5,486
Insurance claims			4,044			4,044
Taxes and Licenses			854	1		855
Communication and utilities			2,307			2,307
Gain on disposal of property and equipment			(66)			(66)
Operating income			12,769	34		12,803
Interest expense		(7,844)	(182)		113	(7,913)
Interest income	739		142	124	(113)	892
Other income (expense)			132	87		219
Income (loss) before taxes	739	(7,844)	12,861	245		6,001
Income tax provision (benefit)		(785)	1,186	66		467
Equity in earnings (loss) of subsidiaries	4,795	11,854			(16,649)	
Net income (loss)	\$ 5,534	\$ 4,795	\$ 11,675	\$ 179	\$ (16,649)	\$ 5,534

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

Consolidating Statements of Operations

Six Months Ended June 30, 2007

Unaudited (In 000 s)

	QDI	QD LLC and QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Operating revenues:						
Transportation	\$	\$	\$ 293,756	\$	\$	\$ 293,756
Other service revenue			35,590	443		36,033
Fuel surcharge			42,938			42,938
Total operating revenues			372,284	443		