

QUALITY DISTRIBUTION INC  
Form 10-Q  
May 06, 2011  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2011

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)

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

|   |  |
|---|--|
| <b>Florida</b><br>(State or other jurisdiction of<br>incorporation or organization)               | <b>59-3239073</b><br>(I.R.S. Employer<br>Identification No.) |
| <b>4041 Park Oaks Boulevard, Suite 200, Tampa, FL</b><br>(Address of Principal Executive Offices) | <b>33610</b><br>(Zip Code)                                   |
| <b>813-630-5826</b><br>(Registrant's telephone number, including area code)                       |  |

N/A

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

|  |   |
|--|---|
| Large accelerated filer <input type="checkbox"/>   | Accelerated filer <input type="checkbox"/>                    |
| Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company <input checked="" type="checkbox"/> |

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

As of May 2, 2011, the registrant had 23,855,990 shares of Common Stock, no par value, outstanding.

**Table of Contents**

**QUALITY DISTRIBUTION, INC.**

**CONTENTS**

|  |           |
|--|-----------|
| <b><u>PART I FINANCIAL INFORMATION</u></b>   | <b>1</b>  |
| <b><u>ITEM 1 FINANCIAL STATEMENTS</u></b>  | <b>1</b>  |
| <b><u>Consolidated Statements of Operations for the Three Months Ended March 31, 2011 and 2010</u></b>           | <b>1</b>  |
| <b><u>Consolidated Balance Sheets as of March 31, 2011 and December 31, 2010</u></b>                             | <b>2</b>  |
| <b><u>Consolidated Statements of Shareholders Deficit for the Three Months Ended March 31, 2011 and 2010</u></b> | <b>3</b>  |
| <b><u>Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2011 and 2010</u></b>           | <b>4</b>  |
| <b><u>Notes to Consolidated Financial Statements</u></b>   | <b>5</b>  |
| <b><u>ITEM 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>       | <b>24</b> |
| <b><u>ITEM 3 Quantitative and Qualitative Disclosures About Market Risk</u></b>                                  | <b>42</b> |
| <b><u>ITEM 4 Controls and Procedures</u></b>   | <b>43</b> |
| <b><u>PART II OTHER INFORMATION</u></b>  | <b>43</b> |
| <b><u>ITEM 1 Legal Proceedings</u></b>   | <b>43</b> |
| <b><u>ITEM 1A Risk Factors</u></b>   | <b>43</b> |
| <b><u>ITEM 2 Unregistered Sale of Equity Securities and Use of Proceeds</u></b>                                  | <b>44</b> |
| <b><u>ITEM 3 Defaults Upon Senior Securities</u></b>   | <b>44</b> |
| <b><u>ITEM 4 [Removed and Reserved.]</u></b>   | <b>44</b> |
| <b><u>ITEM 5 Other Information</u></b>   | <b>44</b> |
| <b><u>ITEM 6 Exhibits</u></b>  | <b>45</b> |
| <b><u>Signatures</u></b>   | <b>46</b> |

**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)**

|   | <b>Three months ended<br/>March 31,</b> |                |
|---|---|----------------|
|   | <b>2011</b>                             | <b>2010</b>    |
| <b>OPERATING REVENUES:</b>                        |   |                |
| Transportation                                    | \$ 124,681                              | \$ 118,917     |
| Service revenue                                   | 26,738                                  | 24,906         |
| Fuel surcharge                                    | 26,491                                  | 17,510         |
| <b>Total operating revenues</b>                   | <b>177,910</b>                          | <b>161,333</b> |
| <b>OPERATING EXPENSES:</b>                        |   |                |
| Purchased transportation                          | 124,722                                 | 109,824        |
| Compensation                                      | 14,883                                  | 13,892         |
| Fuel, supplies and maintenance                    | 11,777                                  | 13,368         |
| Depreciation and amortization                     | 3,492                                   | 4,243          |
| Selling and administrative                        | 5,149                                   | 4,778          |
| Insurance costs                                   | 4,685                                   | 3,337          |
| Taxes and licenses                                | 447                                     | 596            |
| Communication and utilities                       | 802                                     | 1,046          |
| (Gain) loss on disposal of property and equipment | (240)                                   | 418            |
| Restructuring costs                               |   | 1,147          |
| <b>Total operating expenses</b>                   | <b>165,717</b>                          | <b>152,649</b> |
| Operating income                                  | 12,193                                  | 8,684          |
| Interest expense                                  | 7,811                                   | 8,667          |
| Interest income                                   | (139)                                   | (161)          |
| Write-off of debt issuance costs                  | 1,786                                   |                |
| Other (income) expense                            | (36)                                    | 6              |
| <b>Income before income taxes</b>                 | <b>2,771</b>                            | <b>172</b>     |
| Provision for (benefit from) income taxes         | 49                                      | (626)          |
| <b>Net income</b>                                 | <b>\$ 2,722</b>                         | <b>\$ 798</b>  |
| <b>PER SHARE DATA:</b>                            |   |                |
| <b>Net income per common share</b>                |   |                |
| Basic   | \$ 0.12                                 | \$ 0.04        |
| Diluted   | \$ 0.12                                 | \$ 0.04        |

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

**Weighted-average number of shares**

|         |        |        |
|---------|--------|--------|
| Basic   | 22,192 | 19,501 |
| Diluted | 23,505 | 21,470 |

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<br>March 31,<br>2011 | Audited<br>December 31,<br>2010 |
|--|--------------------------------|---------------------------------|
| <b>ASSETS</b>  |                                |                                 |
| Current assets:  |                                |                                 |
| Cash and cash equivalents  | \$ 2,738                       | \$ 1,753                        |
| Accounts receivable, net   | 92,185                         | 80,895                          |
| Prepaid expenses   | 8,993                          | 6,911                           |
| Deferred tax asset   | 4,127                          | 3,848                           |
| Other  | 4,667                          | 4,891                           |
| Total current assets   | 112,710                        | 98,298                          |
| Property and equipment, net  | 111,115                        | 113,419                         |
| Goodwill   | 27,023                         | 27,023                          |
| Intangibles, net   | 16,576                         | 16,924                          |
| Other assets   | 14,009                         | 15,671                          |
| Total assets   | \$ 281,433                     | \$ 271,335                      |
| <b>LIABILITIES, REDEEMABLE NONCONTROLLING INTEREST AND SHAREHOLDERS DEFICIT</b>  |                                |                                 |
| Current liabilities:   |                                |                                 |
| Current maturities of indebtedness   | \$ 3,398                       | \$ 3,991                        |
| Current maturities of capital lease obligations  | 5,219                          | 4,572                           |
| Accounts payable   | 7,945                          | 7,200                           |
| Independent affiliates and independent owner-operators payable   | 13,946                         | 11,059                          |
| Accrued expenses   | 27,819                         | 24,363                          |
| Environmental liabilities  | 4,082                          | 3,687                           |
| Accrued loss and damage claims   | 9,416                          | 8,471                           |
| Total current liabilities  | 71,825                         | 63,343                          |
| Long-term indebtedness, less current maturities  | 283,986                        | 300,491                         |
| Capital lease obligations, less current maturities   | 6,525                          | 8,278                           |
| Environmental liabilities  | 7,085                          | 7,255                           |
| Accrued loss and damage claims   | 10,790                         | 10,454                          |
| Other non-current liabilities  | 25,627                         | 26,060                          |
| Total liabilities  | 405,838                        | 415,881                         |
| Commitments and contingencies - Note 14  |                                |                                 |
| Redeemable noncontrolling interest   |                                | 1,833                           |
| <b>SHAREHOLDERS DEFICIT</b>  |                                |                                 |
| Common stock, no par value; 49,000 shares authorized; 23,856 issued and 23,632 outstanding at March 31, 2011 and 21,678 issued and 21,458 outstanding at December 31, 2010, respectively | 390,272                        | 371,288                         |
| Treasury stock, 224 shares at March 31, 2011 and 220 shares at December 31, 2010   | (1,593)                        | (1,593)                         |
| Accumulated deficit  | (299,252)                      | (301,974)                       |
| Stock recapitalization   | (189,589)                      | (189,589)                       |
| Accumulated other comprehensive loss   | (25,926)                       | (26,194)                        |

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

|   |            |            |
|---|------------|------------|
| Stock purchase warrants   | 1,683      | 1,683      |
| Total shareholders' deficit   | (124,405)  | (146,379)  |
| Total liabilities, redeemable noncontrolling interest and shareholders' deficit | \$ 281,433 | \$ 271,335 |

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

**Table of Contents****QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES****Consolidated Statements of Shareholders Deficit****For the Three Months Ended March 31, 2011 and 2010****Unaudited (In 000 s)**

|   | Shares of<br>Common<br>Stock | Shares of<br>Treasury<br>Stock | Common<br>Stock | Treasury<br>Stock | Accumulated<br>Deficit | Stock<br>Recapitalization | Accumulated<br>Other<br>Comprehensive<br>Loss | Stock<br>Purchase<br>Warrants | Stock<br>Subscription<br>Receivables | Total<br>Shareholders<br>Deficit |
|---|------------------------------|--------------------------------|-----------------|-------------------|------------------------|---------------------------|---|-------------------------------|--------------------------------------|----------------------------------|
| Balance,<br>December 31, 2009   | 20,297                       | (220)                          | \$ 364,046      | \$ (1,580)        | \$ (294,568)           | \$ (189,589)              | \$ (25,587)                                   | \$ 6,696                      | \$ (154)                             | \$ (140,736)                     |
| Net income  |                              |                                |                 |                   | 798                    |                           |   |                               |                                      | 798                              |
| Issuance of restricted<br>stock   | 69                           |                                |                 |                   |                        |                           |   |                               |                                      |                                  |
| Amortization of<br>restricted stock   |                              |                                | 214             |                   |                        |                           |   |                               |                                      | 214                              |
| Amortization of stock<br>options  |                              |                                | 275             |                   |                        |                           |   |                               |                                      | 275                              |
| Amortization of prior<br>service costs and<br>losses (pension plans),<br>net of tax |                              |                                |                 |                   |                        |                           | 323   |                               |                                      | 323                              |
| Foreign currency<br>translation adjustment,<br>net of tax                           |                              |                                |                 |                   |                        |                           | (52)  |                               |                                      | (52)                             |
| Balance, March 31,<br>2010  | 20,366                       | (220)                          | \$ 364,535      | \$ (1,580)        | \$ (293,770)           | \$ (189,589)              | \$ (25,316)                                   | \$ 6,696                      | \$ (154)                             | \$ (139,178)                     |
| Balance,<br>December 31, 2010   | 21,678                       | (220)                          | \$ 371,288      | \$ (1,593)        | \$ (301,974)           | \$ (189,589)              | \$ (26,194)                                   | \$ 1,683                      | \$                                   | \$ (146,379)                     |
| Net income  |                              |                                |                 |                   | 2,722                  |                           |   |                               |                                      | 2,722                            |
| Issuance of restricted<br>stock   | 83                           |                                |                 |                   |                        |                           |   |                               |                                      |                                  |
| Amortization of<br>restricted stock   |                              |                                | 286             |                   |                        |                           |   |                               |                                      | 286                              |
| Amortization of stock<br>options  |                              |                                | 438             |                   |                        |                           |   |                               |                                      | 438                              |
| Stock option exercises  | 95                           |                                | 637             |                   |                        |                           |   |                               |                                      | 637                              |
| Proceeds from equity<br>offering, net of<br>transaction costs                       | 2,000                        |                                | 17,623          |                   |                        |                           |   |                               |                                      | 17,623                           |
| Satisfaction of stock<br>subscription receivable                                    |                              | (4)                            |                 |                   |                        |                           |   |                               |                                      |                                  |
| Amortization of prior<br>service costs and<br>losses (pension plans),<br>net of tax |                              |                                |                 |                   |                        |                           | 318   |                               |                                      | 318                              |
| Foreign currency<br>translation adjustment,   |                              |                                |                 |                   |                        |                           | (50)  |                               |                                      | (50)                             |



Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

net of tax

|                            |        |       |            |            |              |              |             |          |    |              |
|----------------------------|--------|-------|------------|------------|--------------|--------------|-------------|----------|----|--------------|
| Balance, March 31,<br>2011 | 23,856 | (224) | \$ 390,272 | \$ (1,593) | \$ (299,252) | \$ (189,589) | \$ (25,926) | \$ 1,683 | \$ | \$ (124,405) |
|----------------------------|--------|-------|------------|------------|--------------|--------------|-------------|----------|----|--------------|

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)**

|   | <b>Three Months Ended<br/>March 31,</b> |                |
|---|---|----------------|
|   | <b>2011</b>                             | <b>2010</b>    |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |   |                |
| Net income  | \$ 2,722                                | \$ 798         |
| Adjustments to reconcile to net cash and cash equivalents provided by (used in) operating activities: |   |                |
| Depreciation and amortization   | 3,492                                   | 4,243          |
| Bad debt expense  | 328                                     | 132            |
| (Gain) loss on disposal of property and equipment   | (240)                                   | 418            |
| PIK interest on Senior Subordinated Notes   | 147                                     | 558            |
| Write-off of deferred financing costs   | 328                                     |                |
| Write-off of original bond issuance costs   | 1,458                                   |                |
| Stock-based compensation  | 724                                     | 489            |
| Amortization of deferred financing costs  | 542                                     | 676            |
| Amortization of bond discount   | 138                                     | 585            |
| Noncontrolling interest dividends   | 38                                      | 36             |
| Changes in assets and liabilities:  |   |                |
| Accounts and other receivables  | (11,975)                                | (11,106)       |
| Prepaid expenses  | (2,082)                                 | (1,806)        |
| Other assets  | 1,452                                   | (822)          |
| Accounts payable  | 899                                     | 1,897          |
| Accrued expenses  | 3,456                                   | 503            |
| Environmental liabilities   | 224                                     | (175)          |
| Accrued loss and damage claims  | 1,281                                   | (3,193)        |
| Independent affiliates and independent owner-operators payable  | 2,887                                   | 2,857          |
| Other liabilities   | (60)                                    | (295)          |
| Current income taxes  | (95)                                    | 51             |
| <b>Net cash provided by (used in) operating activities</b>  | <b>5,664</b>                            | <b>(4,154)</b> |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |   |                |
| Capital expenditures  | (3,195)                                 | (4,622)        |
| Proceeds from sales of property and equipment   | 2,860                                   | 1,393          |
| <b>Net cash used in investing activities</b>  | <b>(335)</b>                            | <b>(3,229)</b> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |   |                |
| Principal payments on long-term debt  | (28,841)                                | (1,282)        |
| Principal payments on capital lease obligations   | (1,106)                                 | (1,456)        |
| Proceeds from revolver  | 43,300                                  | 14,600         |
| Payments on revolver  | (33,300)                                | (8,600)        |
| Payments on acquisition notes   | (291)                                   | (318)          |
| Deferred financing costs  | (341)                                   |                |
| Change in book overdraft  | (153)                                   | 1,513          |
| Noncontrolling interest dividends   | (38)                                    | (36)           |
| Redemption of noncontrolling interest   | (1,833)                                 |                |
| Proceeds from equity offering, net of transaction costs   | 17,623                                  |                |
| Proceeds from exercise of stock options   | 637                                     |                |

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

|   |          |          |
|---|----------|----------|
| Net cash (used in) provided by financing activities     | (4,343)  | 4,421    |
| Effect of exchange rate changes on cash                 | (1)      | 4        |
| Net increase (decrease) in cash and cash equivalents    | 985      | (2,958)  |
| Cash and cash equivalents, beginning of period          | 1,753    | 5,633    |
| Cash and cash equivalents, end of period                | \$ 2,738 | \$ 2,675 |
| <u>Supplemental Disclosure of Cash Flow Information</u> |          |          |
| Cash paid (received) during the period for:             |          |          |
| Interest  | \$ 1,709 | \$ 3,329 |
| Income Taxes  | 252      | (56)     |

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

---

**Table of Contents**

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

**Quality Distribution, Inc. and Subsidiaries**

**Notes to 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, (iii) the term QD Capital refers to our wholly owned subsidiary, QD Capital Corporation, a Delaware corporation, (iv) the term QCI refers to our wholly owned subsidiary, Quality Carriers, Inc., an Illinois Corporation (v) the term Boasso refers to our wholly owned subsidiary, Boasso America Corporation, a Louisiana corporation and (vi) the term CLC refers to our wholly owned subsidiary, Chemical Leaman Corporation, a Pennsylvania corporation.

We are engaged primarily in transportation of bulk chemicals in North America. We conduct a significant portion of our business through a network of independent affiliates and independent owner-operators. Independent affiliates are companies which enter into various term contracts with the Company. Independent affiliates are responsible for paying for their own power equipment (including debt service), fuel and other operating costs. Most of the independent affiliates lease trailers from us. Independent owner-operators are independent contractors who, through a contract with us, supply one or more tractors and drivers for our use. Contracts with independent owner-operators may be terminated by either party on short notice. We charge independent affiliates and third parties for the use of tractors and trailers as necessary. In exchange for the services rendered, independent affiliates and independent owner-operators are normally paid a percentage of the revenues collected on 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 ( GAAP ) for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments and accruals) considered necessary for a fair statement of consolidated financial position, results of operations and cash flows have been included. The year ended December 31, 2010 consolidated balance sheet data was derived from our audited financial statements, but does not include all the disclosures required by GAAP. For further information, refer to our Annual Report on Form 10-K for the year ended December 31, 2010, including the consolidated financial statements and accompanying notes.

Operating results for the three months ended March 31, 2011 are not necessarily indicative of the results that may be expected for any future period.

***Reclassification***

Certain prior period amounts have been reclassified amongst operating expense line items to conform to the current year presentation.

***New Accounting Pronouncements***

In December 2010, the Financial Accounting Standards Board ( FASB ) issued amended guidance to clarify the acquisition date that should be used for reporting pro forma financial information for business combinations. If comparative financial statements are presented, the pro forma revenue and earnings of the combined entity for the comparable prior reporting period should be reported as though the acquisition date had been completed as of the beginning of the comparable prior annual reporting period. The amendments in this guidance are effective prospectively for business combinations for which the acquisition date is on or after January 1, 2011. Adoption of this amended guidance will not have an impact on the Company's consolidated financial results.

In December 2010, the FASB also issued amendments to the guidance on goodwill impairment testing. The amendments modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform

## Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In making that determination, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. These amendments are effective for fiscal years and interim periods beginning January 1, 2011 and the adoption of these amendments are not expected to have an impact on the Company's financial position, results of operations or cash flows.

**Table of Contents*****Acquisition and Dispositions***

During 2010 and the first three months of 2011, we did not complete any acquisitions or dispositions of businesses or affiliates.

**2. Variable Interest Entities**

At March 31, 2011, we hold a variable interest in one variable interest entity ( VIE ), for which we are not the primary beneficiary. We have concluded, based on our qualitative consideration of our contract with this VIE, the operating structure of the VIE and our role with the VIE, that we do not have the power to direct the activities that most significantly impact their economic performance. Therefore, we are not required to consolidate the operations of this VIE.

The VIE is an independent affiliate that is directly engaged in the dry bulk business through the management of three trucking terminals in the North East region of the U.S. As such, this business is highly seasonal. We are involved with the VIE as a non-controlling interest. Our maximum exposure to loss as a result of our involvement with this unconsolidated VIE, is limited to our recorded loans receivable which aggregated approximately \$2.8 million at March 31, 2011. These loans are secured by a second priority lien on the VIE s assets and a limited personal guarantee from the owner of the VIE.

Severe winter weather created cash flow constraints for this VIE in the first quarter of 2011. We expect their business and cash flow to improve in the near term. However, given our enhanced reliance on collateral for payment of our loans and the potential uncertainties involved with ultimate collection, we have recorded a \$0.5 million reserve against our \$2.8 million of loans receivable in the first quarter of 2011.

**3. Fair Value of Financial Instruments**

The three-level valuation hierarchy for fair value measurements is based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our market assumptions. These two types of inputs create the following fair value hierarchy:

Level 1 Quoted prices for identical instruments in active markets;

Level 2 Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose significant inputs are observable: and

Level 3 Instruments whose significant inputs are unobservable.

Following is a description of the valuation methodologies we used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy.

***Fair Value Measurements on a Nonrecurring Basis***

The fair values of our long-term indebtedness were based on level 2 quoted market prices. As of March 31, 2011, the carrying values and fair values are as follows (in thousands):

|  | Carrying<br>Value | Fair<br>Value |
|--|-------------------|---------------|
| 11.75% Senior Subordinated PIK Notes due 2013        | \$ 5,752          | \$ 5,752      |
| 9.875% Second-Priority Senior Secured Notes due 2018 | 225,000           | 232,472       |
|  | \$ 230,752        | \$ 238,224    |

## Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Our asset-based loan facility (the ABL Facility ) is variable rate debt and approximates fair value.

The carrying amounts reported in the accompanying balance sheets for cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of the immediate or short-term maturities of these financial instruments.

### **4. Goodwill and Intangible Assets**

#### *Goodwill*

Under the FASB guidance, goodwill and intangible assets are subject to an annual impairment test as well as impairment assessments of certain triggering events. We evaluate goodwill for impairment by determining the fair value based on criteria in the FASB guidance for each reporting unit, our logistics segment and our intermodal segment. These reporting units contain goodwill and other identifiable intangible assets as a result of previous business acquisitions. Our annual impairment test is performed during the second quarter with a measurement date of June 30<sup>th</sup>. The methodology applied in the analysis performed at June 30, 2010 was consistent with the methodology applied in prior years, but was based on updated assumptions, as appropriate. As a result of our analysis, we concluded no impairment had occurred as of June 30, 2010. We continued to evaluate indicators of impairment quarterly following our annual goodwill impairment test at June 30, 2010 through year end December 31, 2010, and again in the quarter ended March 31, 2011. There were no indications that a triggering event had occurred following June 30, 2010. As of March 31, 2011, we had total goodwill of \$27.0 million, all of which related to our intermodal segment.

**Table of Contents**

Under the FASB guidance, the process of evaluating the potential impairment of goodwill involves a two-step process and requires significant judgment at many points during the analysis. In the first step, we determine whether there is an indication of impairment by comparing the fair value of a reporting unit to its carrying amount, including goodwill. If, based on the first step, we determine that there is an indication of goodwill impairment, we assess the impairment in step two in accordance with the FASB guidance.

In the first step, we determine the fair value for each reporting unit using a combination of two valuation approaches: the market approach and the income approach. The market approach uses a guideline company methodology which is based upon a comparison of us to similar publicly-traded companies within our industry. We derive a market value of invested capital or business enterprise value for each comparable company by multiplying the price per share of common stock of the publicly traded companies by their total common shares outstanding and adding each company's current level of debt. We calculate a business enterprise multiple based on revenue and earnings from each company, then apply those multiples to each reporting unit's revenue and earnings to conclude a reporting unit business enterprise value. Assumptions regarding the selection of comparable companies are made based on, among other factors, capital structure, operating environment and industry. As the comparable companies were typically larger and more diversified than our reporting units, multiples were adjusted prior to application to our reporting units' revenues and earnings to reflect differences in margins, long-term growth prospects and market capitalization.

The income approach uses a discounted debt-free cash flow analysis to measure fair value by estimating the present value of future economic benefits. To perform the discounted debt-free cash flow analysis, we develop a pro forma analysis of each reporting unit to estimate future available debt-free cash flow and discount estimated debt-free cash flow by an estimated industry weighted average cost of capital based on the same comparable companies used in the market approach. Per the FASB guidance, the weighted average cost of capital is based on inputs (e.g., capital structure, risk, etc.) from a market participant's perspective and not necessarily from the reporting unit's or QDI's perspective. Future cash flow is projected based on assumptions for our economic growth, industry expansion, future operations and the discount rate, all of which require significant judgments by management.

**Intangible Assets**

Intangible assets at March 31, 2011 are as follows (in thousands):

|                        | Gross value | Accumulated amortization | Net book value | Average lives (in years) |
|------------------------|-------------|--------------------------|----------------|--------------------------|
| Tradename              | \$ 7,400    | \$                       | \$ 7,400       | Indefinite               |
| Customer relationships | 11,900      | (3,223)                  | 8,677          | 12                       |
| Non-compete agreements | 2,593       | (2,094)                  | 499            | 3 - 5                    |
|                        | \$ 21,893   | \$ (5,317)               | \$ 16,576      |                          |

Of our total intangibles of \$16.6 million at March 31, 2011, \$16.2 million was allocated to our intermodal segment and \$0.4 million was allocated to our logistics segment.

Amortization expense for the three months ended March 31, 2011 and 2010 was \$0.3 million and \$0.4 million, respectively. Estimated future amortization expense for intangible assets is as follows (in thousands):

|                |          |
|----------------|----------|
| 2011 remaining | \$ 1,021 |
| 2012           | 1,205    |
| 2013           | 996      |
| 2014           | 991      |
| 2015 and after | 4,963    |



---

**Table of Contents****5. Comprehensive Income**

Comprehensive income is as follows (in thousands):

|  | <b>Three months ended</b> |                 |
|--|---------------------------|-----------------|
|  | <b>March 31,</b>          |                 |
|  | <b>2011</b>               | <b>2010</b>     |
| Net income   | \$ 2,722                  | \$ 798          |
| Other comprehensive income:                          |                           |                 |
| Amortization of prior service costs, net of tax      | 318                       | 323             |
| Foreign currency translation adjustments, net of tax | (50)                      | (52)            |
| <b>Comprehensive income</b>                          | <b>\$ 2,990</b>           | <b>\$ 1,069</b> |

**Table of Contents****6. Income Per Share**

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

|   | Three months ended           |                         |                     |                              |                         |                     |
|---|------------------------------|-------------------------|---------------------|------------------------------|-------------------------|---------------------|
|   | March 31, 2011               |                         |                     | March 31, 2010               |                         |                     |
|   | Net<br>income<br>(numerator) | Shares<br>(denominator) | Per-share<br>amount | Net<br>income<br>(numerator) | Shares<br>(denominator) | Per-share<br>amount |
| <b>Basic income available to common shareholders:</b>   |                              |                         |                     |                              |                         |                     |
| Net income  | \$ 2,722                     | 22,192                  | \$ 0.12             | \$ 798                       | 19,501                  | \$ 0.04             |
| <b>Effect of dilutive securities:</b>                   |                              |                         |                     |                              |                         |                     |
| Stock options   |                              | 636                     |                     |                              | 114                     |                     |
| Unvested restricted stock                               |                              | 235                     |                     |                              | 106                     |                     |
| Stock warrants  |                              | 442                     |                     |                              | 1,749                   |                     |
| <b>Diluted income available to common shareholders:</b> |                              |                         |                     |                              |                         |                     |
| Net income  | \$ 2,722                     | 23,505                  | \$ 0.12             | \$ 798                       | 21,470                  | \$ 0.04             |

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 |       |
|---------------------------|--------------------|-------|
|                           | March 31,<br>2011  | 2010  |
| Stock options             | 1,935              | 2,029 |
| Unvested restricted stock | 327                | 538   |

**7. 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 March 31, 2011, we had two active stock-based compensation plans.

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 in the Consolidated Statements of Operations. None of the stock-based compensation was capitalized during the first three months of 2011.

The fair value of options granted during the first three months of 2011 was based upon the Black-Scholes option-pricing model. There were no options granted during the first three months of 2010. 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 2011, expected stock price volatility is based on the historical volatility of our common stock. 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 weighted average assumptions:

Three Months Ended  
March 31,

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

|                   | 2011    | 2010 |
|-------------------|---------|------|
| Risk free rate    | 2.0%    |      |
| Expected life     | 5 years |      |
| Volatility        | 78.0%   |      |
| Expected dividend | nil     | nil  |

**Table of Contents**

The following options and restricted shares were issued during the three months ended:

|                | <b>Options<br/>Issued</b> | <b>Restricted<br/>Shares<br/>Issued</b> |
|----------------|---------------------------|---|
| March 31, 2011 | 222,500                   | 83,189                                  |

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

|                  | <b>Three months ended<br/>March 31,</b> |               |
|------------------|---|---------------|
|                  | <b>2011</b>                             | <b>2010</b>   |
| Stock options    | \$ 438                                  | \$ 275        |
| Restricted stock | 286                                     | 214           |
|                  | <b>\$ 724</b>                           | <b>\$ 489</b> |

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 March 31, 2011 (in thousands):

|                  |                 | <b>Remaining<br/>years</b> |
|------------------|-----------------|----------------------------|
| Stock options    | \$ 3,114        | 3                          |
| Restricted stock | 1,820           | 2                          |
|                  | <b>\$ 4,934</b> |                            |

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 for 94,999 shares were exercised during the three months ended March 31, 2011.

**8. Employee Benefit Plans**

We maintain two noncontributory defined benefit plans resulting from a prior acquisition that cover vested salaried participants and retirees ( CLC Plan ) and certain other vested participants and retirees under a collective bargaining agreement ( TTWU Plan ). 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. Both pension plans have been frozen since prior to January 1, 1998. There are no new participants and no future accruals of benefits from the time the plans were frozen.

We use a December 31<sup>st</sup> measurement date for both of our plans.

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

|               | <b>Three months ended<br/>March 31,</b> |             |
|---------------|---|-------------|
|               | <b>2011</b>                             | <b>2010</b> |
| Service cost  | \$ 44                                   | \$ 51       |
| Interest cost | 605                                     | 644         |

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

|                                    |        |        |
|------------------------------------|--------|--------|
| Amortization of prior service cost | 24     | 23     |
| Amortization of loss               | 294    | 300    |
| Expected return on plan assets     | (575)  | (540)  |
| Net periodic pension cost          | \$ 392 | \$ 478 |

We contributed \$0.4 million to our pension plans during the three months ended March 31, 2011. We expect to contribute an additional \$2.4 million during the remainder of 2011.

***Multi-employer pension plans***

At March 31, 2011, we contributed to three separate multi-employer pension plans for employees under collective bargaining agreements. These agreements cover approximately 2.8% of our total workforce, including our independent affiliates employees and independent owner-operators providing service to us. These multi-employer pension plans provide defined benefits to retired participants. We do not directly or indirectly manage any of these multi-employer pension plans. Trustees, half of whom are appointed by the International Brotherhood of Teamsters (the Teamsters ) and half of whom various contributing employers appoint, manage the trusts covering these plans. Our collective bargaining agreements with the Teamsters determine the amounts of our ongoing contributions to these plans.

**Table of Contents**

In conjunction with our prior restructuring efforts, during the quarter ended September 30, 2010, we notified the trustees of three other plans of our intention to withdraw from these plans. Our withdrawal notifications are expected to result in an aggregate withdrawal liability of approximately \$2.0 million and we recorded a restructuring charge for this full amount in the third quarter of 2010. Approximately \$0.3 million of the total estimated liability was paid in the first quarter of 2011, with the remaining \$1.7 million expected to be paid through 2023.

We do not currently intend to withdraw from the remaining three multi-employer pension plans or take any actions that would subject us to payment of contingent obligations upon withdrawal. Based on information provided to us from the trustees of these plans, we estimate our portion of the contingent liability in the case of a full withdrawal or termination from these remaining plans to be approximately \$58.0 million, of which the largest component relates to the Central States Southeast and Southwest Areas Pension Plan, which is estimated to be \$54.0 million.

These defined benefit plans cover substantially all of our union employees not covered under the TTWU Plan. The actuarial present value of accumulated plan benefits and net assets available for benefits to employees under these multi-employer plans is not readily available.

**Table of Contents****9. Restructuring**

We account for restructuring costs associated with one-time termination benefits, costs associated with lease and contract terminations and other related exit activities in accordance with FASB's guidance. We have made estimates of the costs to be incurred as part of a restructuring plan developed during the quarter ended June 30, 2008 and concluded at the end of 2010. The restructuring plan consisted of various actions including termination of approximately 380 non-driver positions, the consolidation, closure or affiliation of underperforming company terminals, our withdrawal from three multi-employer pension plans and costs associated with the consolidation of our corporate headquarters, and resulted in charges during 2008, 2009 and 2010 primarily related to our logistics segment. At March 31, 2011, \$4.9 million was accrued related to the restructuring charges, which are expected to be paid through 2023.

In the three months ended March 31, 2011, we had the following activity in our restructuring accruals (in thousands):

|                     | Balance at<br>December 31,<br>2010 | Additions | Payments | Reductions | Balance at<br>March 31,<br>2011 |
|---------------------|------------------------------------|-----------|----------|------------|---------------------------------|
| Restructuring costs | \$ 5,449                           | \$        | \$ (556) | \$         | \$ 4,893                        |

**10. Segment Reporting*****Reportable Segments***

We have two reportable business segments for financial reporting purposes that are distinguished primarily on the basis of services offered:

Logistics, which consists primarily of truckload transportation of bulk chemicals primarily through our network of independent affiliates and equipment rentals; and

Intermodal, specifically Boasso's International Organization for Standardization, or intermodal ISO tank container transportation and depot services.

Segment revenues and operating income include the allocation of fuel surcharge to the logistics and intermodal segments. The operating income reported in our segments excludes amounts reported in Other operating income, such as gains and losses on disposal of property and equipment, restructuring costs, and corporate and other unallocated amounts. Corporate and unallocated amounts include depreciation and amortization, impairment charge and other gains and losses. Although these amounts are excluded from the business segment results, they are included in reported consolidated earnings. We have not provided specific asset information by segment, as it is not regularly provided to our chief operating decision maker for review.

During the fourth quarter of 2010, we realigned and renamed our business segments to better reflect our current business and asset-light model due to the shift of our company-operated operations to independent affiliate operations. Our trucking segment was renamed Logistics and our Container Services segment was renamed Intermodal to better describe the services we perform.

Summarized segment data and a reconciliation to loss (income) before income taxes follows (in thousands):

|                     | Three Months Ended March 31, 2011 |            |            |
|---------------------|-----------------------------------|------------|------------|
|                     | Logistics                         | Intermodal | Total      |
| Operating Revenues: |                                   |            |            |
| Transportation      | \$ 110,612                        | \$ 14,069  | \$ 124,681 |
| Service revenue     | 16,508                            | 10,230     | 26,738     |
| Fuel surcharge      | 23,638                            | 2,853      | 26,491     |
| Total               | 150,758                           | 27,152     | 177,910    |

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

|                                   |               |                 |                 |
|-----------------------------------|---------------|-----------------|-----------------|
| Segment operating income          | 10,782        | 4,663           | 15,445          |
| Depreciation & amortization       | 2,695         | 797             | 3,492           |
| Other (income) expense            | (247)         | 7               | (240)           |
| <b>Total</b>                      | <b>8,334</b>  | <b>3,859</b>    | <b>12,193</b>   |
| Interest expense                  | 6,295         | 1,516           | 7,811           |
| Interest income                   | (139)         |                 | (139)           |
| Other expense                     | 1,256         | 494             | 1,750           |
| <b>Income before income taxes</b> | <b>\$ 922</b> | <b>\$ 1,849</b> | <b>\$ 2,771</b> |



**Table of Contents**

|  | Three Months Ended March 31, 2010 |                 |                |
|--|-----------------------------------|-----------------|----------------|
|  | Logistics                         | Intermodal      | Total          |
| <b>Operating Revenues:</b>               |                                   |                 |                |
| Transportation                           | \$ 105,832                        | \$ 13,085       | \$ 118,917     |
| Service revenue                          | 16,640                            | 8,266           | 24,906         |
| Fuel surcharge                           | 15,666                            | 1,844           | 17,510         |
| <b>Total</b>                             | <b>138,138</b>                    | <b>23,195</b>   | <b>161,333</b> |
| Segment operating income                 | 10,818                            | 3,674           | 14,492         |
| Depreciation & amortization              | 3,544                             | 699             | 4,243          |
| Other expense                            | 1,549                             | 16              | 1,565          |
| <b>Total</b>                             | <b>5,725</b>                      | <b>2,959</b>    | <b>8,684</b>   |
| Interest expense                         | 7,149                             | 1,518           | 8,667          |
| Interest income                          | (161)                             |                 | (161)          |
| Other (income) expense                   | (288)                             | 294             | 6              |
| <b>(Loss) Income before income taxes</b> | <b>\$ (975)</b>                   | <b>\$ 1,147</b> | <b>\$ 172</b>  |

**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 months ended March 31, 2011 and 2010 is as follows (in thousands):

|                                   | Three months ended March 31, 2011 |               |              |
|-----------------------------------|-----------------------------------|---------------|--------------|
|                                   | U. S.                             | International | Consolidated |
| Total operating revenues          | \$ 166,632                        | \$ 11,278     | \$ 177,910   |
| Operating income                  | 10,343                            | 1,850         | 12,193       |
| <b>As of March 31, 2011</b>       |                                   |               |              |
| Long-term identifiable assets (1) | \$ 103,963                        | \$ 7,152      | \$ 111,115   |
|                                   | Three months ended March 31, 2010 |               |              |
|                                   | U. S.                             | International | Consolidated |
| Total operating revenues          | \$ 152,177                        | \$ 9,156      | \$ 161,333   |
| Operating income                  | 7,758                             | 926           | 8,684        |
| <b>As of March 31, 2010</b>       |                                   |               |              |
| Long-term identifiable assets (1) | \$ 119,269                        | \$ 7,783      | \$ 127,052   |
| <b>As of December 31, 2010</b>    |                                   |               |              |
| Long-term identifiable assets (1) | \$ 106,148                        | \$ 7,271      | \$ 113,419   |

(1) Includes property and equipment.

**11. Income Taxes**

At December 31, 2010, we had approximately \$1.6 million of total gross unrecognized tax benefits. Of this total, \$1.2 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.

## Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Included in the balance of gross unrecognized tax benefits at December 31, 2010, was \$0.8 million related to tax positions for which it is reasonably possible that the total amounts could significantly change during the next twelve months due to expiration of the statute of limitations.

For the three months ended March 31, 2011, the change in unrecognized tax benefits was a decrease of \$0.1 million. The change was due to an expiration of the statute of limitations. Our total gross unrecognized tax benefit at March 31, 2011 was \$1.5 million.

---

## **Table of Contents**

Our continuing practice is to recognize interest and/or penalties related to income tax matters in income tax expense. We had \$0.6 million (net of federal tax benefit) accrued for interest and \$0.2 million accrued for penalties at December 31, 2010. The total amount accrued for interest and penalties at March 31, 2011 was \$0.7 million.

We are subject to the income tax jurisdictions 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 2006, to international examinations for years before 2006 and, with few exceptions, to state examinations before 2005.

The effective tax rates for the three months ended March 31, 2011 and 2010 were a tax provision of 1.8% and a tax benefit of more than 100%, respectively. The effective tax rate for the current period includes a tax benefit of approximately \$0.2 million from a change in the Company's uncertain tax positions. The company continues to maintain a 100% valuation allowance against the balance of the net deferred tax asset in the current period.

### **12. Redeemable Noncontrolling Interest**

On March 3, 2011, we redeemed 302 outstanding shares of Series C preferred stock of our subsidiary, CLC, which were held by two shareholders that were not affiliated with us. These shareholders received the maximum aggregate redemption value (which was equivalent to par value) of \$1.8 million, plus accrued and unpaid preferred dividends through the redemption date.

### **13. Common Stock Offering**

On February 9, 2011, we sold 2.0 million shares of our common stock in an underwritten public offering, at a gross price of \$9.50 per share, and received net proceeds, after underwriting fees and expenses, of approximately \$17.5 million. Certain affiliates of Apollo also sold 2.6 million shares in the offering. Pursuant to the offering, we sent irrevocable redemption notices to holders of our 2013 PIK Notes to redeem \$17.5 million of these notes at par, plus accrued and unpaid interest. This note redemption was completed on March 11, 2011.

### **14. Commitments and Contingencies**

#### ***Environmental Matters***

It is our policy to comply with all applicable environmental, safety, and health laws. We also are committed to the principles of Responsible Care<sup>®</sup>, an international chemical industry initiative to enhance the industry's responsible management of chemicals. We have obtained independent certification that our management system is in place and functions according to professional standards and we continue to evaluate and continuously improve our Responsible Care<sup>®</sup> Management System performance.

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. Historically, our operations involved the generation, storage, discharge and disposal of wastes that may contain hazardous substances, the inventory and use of cleaning materials that may contain hazardous substances and the control and discharge of storm-water from industrial sites. In addition, we may store diesel fuel, materials containing oil and other hazardous products at our terminals. As such, we and others who operate in our industry 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. Under certain of these laws, we could also be subject to allegations of liability for the activities of our affiliates or independent owner-operators.

We are potentially subject to strict, joint and several liability for investigating and rectifying the consequences of spills and other releases of such substances. 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, predict with certainty the extent of future liabilities and costs under environmental, health, and safety laws, or assure that such liabilities will not result in a material adverse effect on our business, financial condition, operating results or cash flow. We have established reserves for remediation expenses at known contamination sites when it is probable that such efforts will be required of us and the related expenses can be reasonably estimated. We have also incurred in the past, and expect to incur in the future, capital and other expenditures related to environmental compliance for current and planned operations. Such expenditures are generally included in our overall capital and operating budgets and are not accounted for separately. However, we do not anticipate that compliance with existing environmental

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

laws in conducting current and planned operations will have a material adverse effect on our capital expenditures, earnings or competitive position.

---

## **Table of Contents**

### *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 may be impacted by such factors as changes in environmental laws and regulatory requirements, the availability and application of technology, the identification of currently unknown potential remediation sites and the allocation of costs among the potentially responsible parties under the applicable statutes. Our reserves for environmental compliance and remediation are adjusted periodically as remediation efforts progress or as additional technical or legal information becomes available. As of March 31, 2011 and December 31, 2010, we had reserves in the amount of \$11.2 million and \$10.9 million, respectively, for all environmental matters of which the most significant are discussed below.

The balances presented include both long term and current environmental reserves. We expect the estimated environmental obligations to be paid over the next five years. Additions to the environmental liability reserves are classified in our Consolidated Statements of Operations within the Selling and administrative category.

### *Property Contamination Liabilities*

We have been named as (or are alleged to be) a potentially responsible party under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended ( CERCLA ) and similar state laws at approximately 25 sites. At 18 of the 25 sites, we are one of many parties with alleged liability and are negotiating with Federal, State or private parties on the scope of our obligations, if any. At 2 of the 18 sites, we will be participating in the initial studies to determine site remediation objectives. Since our overall liability cannot be estimated at this time, we have set reserves for only the initial remedial investigation phase. At 3 of the 18 sites, we have explicitly denied any liability and since there has been no subsequent demand for payment we have not established a reserve for these matters. We have estimated all future expenditures for these 18 multi-party environmental matters to be paid over the next five years to be in the range of \$2.2 million to \$3.8 million.

At 7 of the 25 sites, we are the only responsible party and are in the process of conducting investigations and/or remediation projects. Four of these projects relate to operations conducted by our subsidiary, CLC, and its subsidiaries prior to our acquisition of CLC in 1998. These four sites are: (1) Bridgeport, New Jersey; (2) William Dick, Pennsylvania; (3) Tonawanda, New York; and (4) Scary Creek, West Virginia. The remaining three sites relate to investigations and potential remediation that were triggered by the New Jersey Industrial Site Recovery Act ( ISRA ), which requires such investigations and remediation following the sale of industrial facilities. Each of these sites is discussed in more detail below. We have estimated future expenditures over the next five years for these seven properties to be in the range of \$9.0 million to \$16.7 million.

### *Bridgeport, New Jersey*

QDI is required under the terms of three federal consent decrees to perform remediation at this operating truck terminal and tank wash site. CLC entered into consent orders with the U.S. Environmental Protection Agency ( USEPA ) in May 1991 for the treatment of groundwater and in October 1998 for the removal of contamination in the wetlands. In addition, we recently entered into a third federal consent decree to assess and remediate contaminated soils at the site.

The groundwater treatment remedy negotiated with USEPA calls for a treatment facility for in-place treatment of groundwater contamination and a local discharge. Treatment facility construction was completed in early 2007. After various start-up issues, the treatment facility began initial operations in June 2010. The plant experienced issues with the treatment of vapor phase emissions and the operation was suspended in July 2010. After the engineering re-design process including an effective pilot treatability study, the plant is being modified to address the treatment of the vapor phase emissions. The plant is expected to resume operations in July 2011. Wetlands contamination has been remediated with localized restoration completed. Monitoring of the restored wetlands is continuing until June 2011, when a five year review will be conducted by USEPA. In regard to contaminated soils, USEPA finalized the feasibility study and issued a record of decision in 2009 for the limited areas that show contamination and warrant additional investigation or work. We entered a consent order with USEPA in 2010 to perform the remediation work, which will consist of in-place thermal treatment. This work is currently in the remedial design phase. We have estimated expenditures over the next five years to be in the range of \$6.3 million to \$8.5 million.

### *William Dick, Pennsylvania*

CLC entered into a consent order with the Pennsylvania Department of Environmental Protection and USEPA in October 1995 obligating it to provide a replacement water supply to area residents, treat contaminated groundwater, and perform remediation of contaminated soils at this former wastewater disposal site. The replacement water supply is complete. We completed construction of a treatment facility with local discharge for groundwater treatment in the fourth quarter of 2007. Plant start-up issues have been resolved and the treatment facility began

## Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

operations in June 2010. The plant experienced issues with the liquid phase carbon treatment process and the operation was suspended in August 2010. After some modification work, the plant was restarted at the end of 2010 and continues to operate in start-up mode. The agencies approved a contaminated soils remedy, which required both thermal treatment of contaminated soils and treatment of residuals via soil vapor extraction. The remedy expanded to include off-site shipment of contaminated soils. Soil treatment was completed in September 2007. Site sampling has been conducted and the results indicate that the soil clean-up objectives have not been fully achieved. Negotiations are on-going with USEPA over further remedial actions that may be needed at the site. We have estimated expenditures over the next five years to be in the range of \$0.9 million to \$3.4 million.

---

## **Table of Contents**

### *Other Properties*

*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. The State issued a record of decision in May 2006. The site is currently in remedial design phase.

*Scary Creek, West Virginia:* CLC received a cleanup notice from the state environmental authority in August 1994. 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.

*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 ISRA, which requires such remediation following the sale of facilities after 1983. These sites are in the process of remedial investigation with projections set in contemplation of limited soil remediation expense for contaminated areas.

We have estimated aggregate future expenditures for Tonawanda, Scary Creek and ISRA to be in the range of \$1.8 million to \$4.8 million.

## **15. Guarantor Subsidiaries**

At and during the three months ended March 31, 2011, there were outstanding our 9.875% Second-Priority Senior Secured Notes due 2018 (the 2018 Notes) and our 11.75% Senior Subordinated PIK Notes due 2013 (the 2013 PIK Notes), which were issued by our subsidiaries, QD LLC and QD Capital. The payment obligations of QD LLC and QD Capital under all of these notes are, or were during the period outstanding, guaranteed by QDI and by all of its domestic subsidiaries other than immaterial subsidiaries as further described below.

The 2018 Notes are our subsidiaries', QD LLC and QD Capital, senior obligations and are secured by a subordinated, second-priority lien on assets that secure our ABL Facility through a collateral agreement that is separate from the indenture under which these notes were issued. Pursuant to an intercreditor agreement, the liens on the collateral securing the 2018 Notes rank junior in right of payment to the ABL Facility and obligations under certain hedging agreements and cash management obligations and certain other first-lien obligations. Decisions regarding the maintenance and release of the collateral secured by the collateral agreement are made by the lenders under our ABL Facility and neither the indenture trustee nor the holders of the 2018 Notes have control of decisions regarding the release of the collateral. The 2018 Notes are also fully and unconditionally guaranteed on a second-priority senior secured basis, jointly and severally, by QDI, our other subsidiary guarantors, and certain of our future U.S. restricted subsidiaries.

The 2013 PIK Notes are our subsidiaries', QD LLC and QD Capital, unsecured and senior subordinated obligations and are fully and unconditionally guaranteed on an unsecured and senior subordinated basis, jointly and severally, by QDI, our other subsidiary guarantors, and certain of our future U.S. restricted subsidiaries.

The subsidiary guarantors of all of the notes are all of our direct and indirect domestic subsidiaries other than immaterial subsidiaries. No non-domestic subsidiaries are guarantor subsidiaries. QD Capital has no material assets or operations. QD LLC, all of its subsidiary guarantors and QD Capital are 100% owned by QDI.

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 payments. The subsidiary guarantors are 100% owned subsidiaries of QD LLC.

QDI has no significant restrictions on its ability to receive funds from its subsidiaries. The ABL Facility and the indentures governing our 2018 Notes and our 2013 PIK Notes contain certain limitations on QD LLC's ability to make distributions to QDI. We do not consider these restrictions to be significant, because QDI is a holding company with no significant operations or assets, other than ownership of 100% of QD LLC's membership units. QD LLC's direct and indirect wholly owned subsidiaries are generally permitted to make distributions to QD LLC, which is the principal obligor under the ABL Facility, the 2018 Notes and the 2013 PIK Notes.

**Table of Contents**

We have not presented separate financial statements and other disclosures concerning QD LLC, QD Capital or the 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:

Condensed consolidating balance sheets at March 31, 2011 and December 31, 2010 and condensed consolidating statements of operations for the three month periods ended March 31, 2011 and 2010 and the condensed consolidating statements of cash flows for each of the three month periods ended March 31, 2011 and 2010.

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



**Table of Contents****Consolidating Statements of Operations****Three Months Ended March 31, 2011****Unaudited - (In 000 s)**

|   | <b>QDI</b>      | <b>QD LLC &amp;<br/>QD Capital</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---|-----------------|------------------------------------|-----------------------------------|---------------------------------------|---------------------|---------------------|
| <b>Operating revenues:</b>                        |                 |                                    |                                   |                                       |                     |                     |
| Transportation                                    | \$              | \$                                 | \$ 124,681                        | \$                                    | \$                  | \$ 124,681          |
| Service revenue                                   |                 |                                    | 26,604                            | 134                                   |                     | 26,738              |
| Fuel surcharge                                    |                 |                                    | 26,491                            |                                       |                     | 26,491              |
| <b>Total operating revenues</b>                   |                 |                                    | <b>177,776</b>                    | <b>134</b>                            |                     | <b>177,910</b>      |
| <b>Operating expenses:</b>                        |                 |                                    |                                   |                                       |                     |                     |
| Purchased transportation                          |                 |                                    | 124,722                           |                                       |                     | 124,722             |
| Compensation                                      |                 |                                    | 14,883                            |                                       |                     | 14,883              |
| Fuel, supplies and maintenance                    |                 |                                    | 11,777                            |                                       |                     | 11,777              |
| Depreciation and amortization                     |                 |                                    | 3,492                             |                                       |                     | 3,492               |
| Selling and administrative                        |                 | 12                                 | 5,117                             | 20                                    |                     | 5,149               |
| Insurance costs                                   |                 |                                    | 4,680                             | 5                                     |                     | 4,685               |
| Taxes and licenses                                |                 |                                    | 447                               |                                       |                     | 447                 |
| Communication and utilities                       |                 |                                    | 802                               |                                       |                     | 802                 |
| Loss on disposal of property and equipment        |                 |                                    | (240)                             |                                       |                     | (240)               |
| <b>Operating (loss) income</b>                    |                 | (12)                               | <b>12,096</b>                     | <b>109</b>                            |                     | <b>12,193</b>       |
| Interest (income) expense, non-related party, net | (14)            | 7,362                              | 325                               | (1)                                   |                     | 7,672               |
| Interest (income) expense, related party, net     |                 | (7,362)                            | 7,464                             | (102)                                 |                     |                     |
| Write-off of debt issuance costs                  |                 | 1,786                              |                                   |                                       |                     | 1,786               |
| Other expense (income)                            |                 | 2                                  | 12                                | (50)                                  |                     | (36)                |
| <b>Income (loss) before income taxes</b>          | <b>14</b>       | <b>(1,800)</b>                     | <b>4,295</b>                      | <b>262</b>                            |                     | <b>2,771</b>        |
| Provision for (benefit from) income taxes         |                 |                                    | 229                               | (180)                                 |                     | 49                  |
| Equity in earnings of subsidiaries                | 2,708           | 4,508                              |                                   |                                       | (7,216)             |                     |
| <b>Net income</b>                                 | <b>\$ 2,722</b> | <b>\$ 2,708</b>                    | <b>\$ 4,066</b>                   | <b>\$ 442</b>                         | <b>\$ (7,216)</b>   | <b>\$ 2,722</b>     |

**Table of Contents****Consolidating Statements of Operations****Three Months Ended March 31, 2010****Unaudited - (In 000 s)**

|   | <b>QDI</b>    | <b>QD LLC &amp;<br/>QD Capital</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---|---------------|------------------------------------|-----------------------------------|---------------------------------------|---------------------|---------------------|
| <b>Operating revenues:</b>                        |               |                                    |                                   |                                       |                     |                     |
| Transportation                                    | \$            | \$                                 | \$ 118,917                        | \$                                    | \$                  | \$ 118,917          |
| Service revenue                                   |               |                                    | 24,753                            | 153                                   |                     | 24,906              |
| Fuel surcharge                                    |               |                                    | 17,510                            |                                       |                     | 17,510              |
| <b>Total operating revenues</b>                   |               |                                    | <b>161,180</b>                    | <b>153</b>                            |                     | <b>161,333</b>      |
| <b>Operating expenses:</b>                        |               |                                    |                                   |                                       |                     |                     |
| Purchased transportation                          |               |                                    | 109,824                           |                                       |                     | 109,824             |
| Compensation                                      |               |                                    | 13,892                            |                                       |                     | 13,892              |
| Fuel, supplies and maintenance                    |               |                                    | 13,368                            |                                       |                     | 13,368              |
| Depreciation and amortization                     |               |                                    | 4,243                             |                                       |                     | 4,243               |
| Selling and administrative                        |               | 23                                 | 4,735                             | 20                                    |                     | 4,778               |
| Insurance costs                                   |               |                                    | 3,332                             | 5                                     |                     | 3,337               |
| Taxes and licenses                                |               |                                    | 596                               |                                       |                     | 596                 |
| Communication and utilities                       |               |                                    | 1,046                             |                                       |                     | 1,046               |
| Loss on disposal of property and equipment        |               |                                    | 418                               |                                       |                     | 418                 |
| Restructuring costs                               |               |                                    | 1,147                             |                                       |                     | 1,147               |
| <b>Operating (loss) income</b>                    |               | (23)                               | <b>8,579</b>                      | <b>128</b>                            |                     | <b>8,684</b>        |
| Interest expense (income), non-related party, net |               | 8,105                              | 415                               | (14)                                  |                     | 8,506               |
| Interest (income) expense, related party, net     |               | (8,105)                            | 8,207                             | (102)                                 |                     |                     |
| Other expense (income)                            |               |                                    | 56                                | (50)                                  |                     | 6                   |
| <b>(Loss) income before income taxes</b>          |               | (23)                               | <b>(99)</b>                       | <b>294</b>                            |                     | <b>172</b>          |
| Provision for (benefit from) income taxes         |               |                                    | 73                                | (699)                                 |                     | (626)               |
| Equity in earnings of subsidiaries                | 798           | 821                                |                                   |                                       | (1,619)             |                     |
| <b>Net income (loss)</b>                          | <b>\$ 798</b> | <b>\$ 798</b>                      | <b>\$ (172)</b>                   | <b>\$ 993</b>                         | <b>\$ (1,619)</b>   | <b>\$ 798</b>       |

**Table of Contents****Consolidating Balance Sheet****March 31, 2011****Unaudited - (In 000 s)**

|  | <b>QDI</b>   | <b>QD LLC and<br/>QD Capital</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|--|--------------|----------------------------------|-----------------------------------|---------------------------------------|---------------------|---------------------|
| <b>ASSETS</b>  |              |                                  |                                   |                                       |                     |                     |
| Current Assets:                                      |              |                                  |                                   |                                       |                     |                     |
| Cash and cash equivalents                            | \$           | \$                               | \$ 2,446                          | \$ 292                                | \$                  | \$ 2,738            |
| Accounts receivable, net                             |              |                                  | 92,133                            | 52                                    |                     | 92,185              |
| Prepaid expenses                                     |              | 188                              | 8,794                             | 11                                    |                     | 8,993               |
| Deferred tax asset                                   |              |                                  | 4,127                             |                                       |                     | 4,127               |
| Other  | (150)        |                                  | 4,830                             | (13)                                  |                     | 4,667               |
| Total current assets                                 | (150)        | 188                              | 112,330                           | 342                                   |                     | 112,710             |
| Property and equipment, net                          |              |                                  | 111,115                           |                                       |                     | 111,115             |
| Goodwill   |              |                                  | 27,023                            |                                       |                     | 27,023              |
| Intangibles, net                                     |              |                                  | 16,576                            |                                       |                     | 16,576              |
| Investment in subsidiaries                           | (153,070)    | 356,313                          | 18,967                            |                                       | (222,210)           |                     |
| Other assets   |              | 8,581                            | 5,428                             |                                       |                     | 14,009              |
| Total assets   | \$ (153,220) | \$ 365,082                       | \$ 291,439                        | \$ 342                                | \$ (222,210)        | \$ 281,433          |
| <b>LIABILITIES AND SHAREHOLDERS (DEFICIT) EQUITY</b> |              |                                  |                                   |                                       |                     |                     |
| Current Liabilities:                                 |              |                                  |                                   |                                       |                     |                     |
| Current maturities of indebtedness                   | \$           | \$                               | \$ 3,398                          | \$                                    | \$                  | \$ 3,398            |
| Current maturities of capital lease obligations      |              |                                  | 5,219                             |                                       |                     | 5,219               |
| Accounts payable                                     |              |                                  | 7,953                             | (8)                                   |                     | 7,945               |
| Intercompany   | (27,808)     | 231,594                          | (178,265)                         | (6,555)                               | (18,966)            |                     |
| Affiliates and independent owner-operators payable   |              |                                  | 13,946                            |                                       |                     | 13,946              |
| Accrued expenses                                     |              | 9,237                            | 18,572                            | 10                                    |                     | 27,819              |
| Environmental liabilities                            |              |                                  | 4,082                             |                                       |                     | 4,082               |
| Accrued loss and damage claims                       |              |                                  | 9,416                             |                                       |                     | 9,416               |
| Total current liabilities                            | (27,808)     | 240,831                          | (115,679)                         | (6,553)                               | (18,966)            | 71,825              |
| Long-term indebtedness, less current maturities      |              | 277,321                          | 6,665                             |                                       |                     | 283,986             |
| Capital lease obligations, less current maturities   |              |                                  | 6,525                             |                                       |                     | 6,525               |
| Environmental liabilities                            |              |                                  | 7,085                             |                                       |                     | 7,085               |
| Accrued loss and damage claims                       |              |                                  | 10,790                            |                                       |                     | 10,790              |
| Other non-current liabilities                        | (1,007)      |                                  | 26,595                            | 39                                    |                     | 25,627              |
| Total liabilities                                    | (28,815)     | 518,152                          | (58,019)                          | (6,514)                               | (18,966)            | 405,838             |
| Shareholders' equity (deficit):                      |              |                                  |                                   |                                       |                     |                     |
| Common Stock   | 390,272      | 354,963                          | 390,760                           | 4,833                                 | (750,556)           | 390,272             |
| Treasury stock                                       | (1,593)      |                                  |                                   |                                       |                     | (1,593)             |
| Accumulated (deficit) retained earnings              | (299,252)    | (294,674)                        | (16,959)                          | 3,187                                 | 308,446             | (299,252)           |
| Stock recapitalization                               | (189,589)    | (189,589)                        |                                   | (55)                                  | 189,644             | (189,589)           |
| Accumulated other comprehensive loss                 | (25,926)     | (25,453)                         | (24,343)                          | (1,109)                               | 50,905              | (25,926)            |
| Stock purchase warrants                              | 1,683        | 1,683                            |                                   |                                       | (1,683)             | 1,683               |

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

|   |              |            |            |        |              |            |
|---|--------------|------------|------------|--------|--------------|------------|
| Total shareholders (deficit) equity                 | (124,405)    | (153,070)  | 349,458    | 6,856  | (203,244)    | (124,405)  |
| Total liabilities and shareholders (deficit) equity | \$ (153,220) | \$ 365,082 | \$ 291,439 | \$ 342 | \$ (222,210) | \$ 281,433 |

**Table of Contents****Consolidating Balance Sheet****December 31, 2010****Unaudited - (In 000 s)**

|  | <b>QDI</b>   | <b>QD LLC and<br/>QD Capital</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|--|--------------|----------------------------------|-----------------------------------|---------------------------------------|---------------------|---------------------|
| <b>ASSETS</b>  |              |                                  |                                   |                                       |                     |                     |
| Current Assets:  |              |                                  |                                   |                                       |                     |                     |
| Cash and cash equivalents  | \$           | \$                               | \$ 1,174                          | \$ 579                                | \$                  | \$ 1,753            |
| Accounts receivable, net   |              |                                  | 80,791                            | 104                                   |                     | 80,895              |
| Prepaid expenses   |              | 231                              | 6,664                             | 16                                    |                     | 6,911               |
| Deferred tax asset, net  |              |                                  | 3,848                             |                                       |                     | 3,848               |
| Other  | (192)        |                                  | 5,134                             | (51)                                  |                     | 4,891               |
| Total current assets   | (192)        | 231                              | 97,611                            | 648                                   |                     | 98,298              |
| Property and equipment, net  |              |                                  | 113,419                           |                                       |                     | 113,419             |
| Goodwill   |              |                                  | 27,023                            |                                       |                     | 27,023              |
| Intangibles, net   |              |                                  | 16,924                            |                                       |                     | 16,924              |
| Investment in subsidiaries   | (156,047)    | 451,537                          | 18,967                            |                                       | (314,457)           |                     |
| Other assets   |              | 9,110                            | 6,561                             |                                       |                     | 15,671              |
| Total assets   | \$ (156,239) | \$ 460,878                       | \$ 280,505                        | \$ 648                                | \$ (314,457)        | \$ 271,335          |
| <b>LIABILITIES, REDEEMABLE NONCONTROLLING INTEREST AND SHAREHOLDERS (DEFICIT) EQUITY</b> |              |                                  |                                   |                                       |                     |                     |
| Current Liabilities:   |              |                                  |                                   |                                       |                     |                     |
| Current maturities of indebtedness   | \$           | \$                               | \$ 3,991                          | \$                                    | \$                  | \$ 3,991            |
| Current maturities of capital lease obligations  |              |                                  | 4,572                             |                                       |                     | 4,572               |
| Accounts payable   |              |                                  | 7,204                             | (4)                                   |                     | 7,200               |
| Intercompany   | (8,853)      | 319,693                          | (285,803)                         | (6,070)                               | (18,967)            |                     |
| Affiliates and independent owner-operators payable                                       |              |                                  | 11,059                            |                                       |                     | 11,059              |
| Accrued expenses   |              | 4,077                            | 20,253                            | 33                                    |                     | 24,363              |
| Environmental liabilities  |              |                                  | 3,687                             |                                       |                     | 3,687               |
| Accrued loss and damage claims   |              |                                  | 8,471                             |                                       |                     | 8,471               |
| Total current liabilities  | (8,853)      | 323,770                          | (226,566)                         | (6,041)                               | (18,967)            | 63,343              |
| Long-term indebtedness, less current maturities  |              | 293,155                          | 7,336                             |                                       |                     | 300,491             |
| Capital lease obligations, less current maturities                                       |              |                                  | 8,278                             |                                       |                     | 8,278               |
| Environmental liabilities  |              |                                  | 7,255                             |                                       |                     | 7,255               |
| Accrued loss and damage claims   |              |                                  | 10,454                            |                                       |                     | 10,454              |
| Other non-current liabilities  | (1,007)      |                                  | 26,841                            | 226                                   |                     | 26,060              |
| Total liabilities  | (9,860)      | 616,925                          | (166,402)                         | (5,815)                               | (18,967)            | 415,881             |
| Redeemable noncontrolling interest in subsidiary   |              |                                  | 1,833                             |                                       |                     | 1,833               |
| Shareholders (deficit) equity:   |              |                                  |                                   |                                       |                     |                     |
| Common Stock   | 371,288      | 354,963                          | 490,761                           | 4,833                                 | (850,557)           | 371,288             |
| Treasury stock   | (1,593)      |                                  |                                   |                                       |                     | (1,593)             |
| Accumulated (deficit) retained earnings  | (301,974)    | (297,382)                        | (21,025)                          | 2,745                                 | 315,662             | (301,974)           |
| Stock recapitalization   | (189,589)    | (189,589)                        |                                   | (55)                                  | 189,644             | (189,589)           |

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

|   |              |            |            |         |              |            |
|---|--------------|------------|------------|---------|--------------|------------|
| Accumulated other comprehensive loss  | (26,194)     | (25,722)   | (24,662)   | (1,060) | 51,444       | (26,194)   |
| Stock purchase warrants   | 1,683        | 1,683      |            |         | (1,683)      | 1,683      |
| Total shareholders (deficit) equity   | (146,379)    | (156,047)  | 445,074    | 6,463   | (295,490)    | (146,379)  |
| Total liabilities, redeemable noncontrolling interest and shareholders (deficit) equity | \$ (156,239) | \$ 460,878 | \$ 280,505 | \$ 648  | \$ (314,457) | \$ 271,335 |

**Table of Contents****Condensed Consolidating Statements of Cash Flows****Three Months Ended March 31, 2011****Unaudited - (In 000 s)**

|  | <b>QDI</b> | <b>QD LLC and<br/>QD Capital</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|--|------------|----------------------------------|-----------------------------------|---------------------------------------|---------------------|---------------------|
| <b>Cash flows from operating activities:</b>                       |            |                                  |                                   |                                       |                     |                     |
| Net income   | \$ 2,722   | \$ 2,708                         | \$ 4,066                          | \$ 442                                | \$ (7,216)          | \$ 2,722            |
| Adjustments for non-cash charges                                   | (1,984)    | (9,257)                          | 11,082                            | (102)                                 | 7,216               | 6,955               |
| Net changes in assets and liabilities                              | (42)       | 5,732                            | (10,418)                          | 715                                   |                     | (4,013)             |
| Intercompany activity  | (696)      | 817                              | 1,221                             | (1,342)                               |                     |                     |
| Net cash provided by (used in) operating activities                |            |                                  | 5,951                             | (287)                                 |                     | 5,664               |
| <b>Cash flows from investing activities:</b>                       |            |                                  |                                   |                                       |                     |                     |
| Capital expenditures   |            |                                  | (3,195)                           |                                       |                     | (3,195)             |
| Proceeds from sales of property and equipment                      |            |                                  | 2,860                             |                                       |                     | 2,860               |
| Net cash used in investing activities                              |            |                                  | (335)                             |                                       |                     | (335)               |
| <b>Cash flows from financing activities:</b>                       |            |                                  |                                   |                                       |                     |                     |
| Principal payments on long-term debt and capital lease obligations |            | (27,578)                         | (2,369)                           |                                       |                     | (29,947)            |
| Proceeds from revolver   |            | 43,300                           |                                   |                                       |                     | 43,300              |
| Payments on revolver   |            | (33,300)                         |                                   |                                       |                     | (33,300)            |
| Deferred financing costs   |            | (341)                            |                                   |                                       |                     | (341)               |
| Redemption of noncontrolling interest                              |            |                                  | (1,833)                           |                                       |                     | (1,833)             |
| Proceeds from equity offering, net of transaction costs            | 17,623     |                                  |                                   |                                       |                     | 17,623              |
| Proceeds from exercise of stock options                            | 637        |                                  |                                   |                                       |                     | 637                 |
| Other  |            |                                  | (482)                             |                                       |                     | (482)               |
| Intercompany activity  | (18,260)   | 17,919                           | 341                               |                                       |                     |                     |
| Net cash used in financing activities                              |            |                                  | (4,343)                           |                                       |                     | (4,343)             |
| Effect of exchange rate changes on cash                            |            |                                  | (1)                               |                                       |                     | (1)                 |
| Net increase (decrease) in cash and cash equivalents               |            |                                  | 1,272                             | (287)                                 |                     | 985                 |
| Cash and cash equivalents, beginning of period                     |            |                                  | 1,174                             | 579                                   |                     | 1,753               |
| Cash and cash equivalents, end of period                           | \$         | \$                               | \$ 2,446                          | \$ 292                                | \$                  | \$ 2,738            |

**Table of Contents****Condensed Consolidating Statements of Cash Flows****Three Months Ended March 31, 2010****Unaudited - (In 000 s)**

|  | <b>QDI</b> | <b>QD LLC and<br/>QD Capital</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|--|------------|----------------------------------|-----------------------------------|---------------------------------------|---------------------|---------------------|
| <b>Cash flows from operating activities:</b>                       |            |                                  |                                   |                                       |                     |                     |
| Net income (loss)  | \$ 798     | \$ 798                           | \$ (172)                          | \$ 993                                | \$ (1,619)          | \$ 798              |
| Adjustments for non-cash charges                                   | (798)      | (7,071)                          | 13,489                            | (102)                                 | 1,619               | 7,137               |
| Net changes in assets and liabilities                              | (1)        | 3,731                            | (16,564)                          | 745                                   |                     | (12,089)            |
| Intercompany activity  | 1          | 2,542                            | (1,084)                           | (1,459)                               |                     |                     |
| Net cash (used in) provided by operating activities                |            |                                  | (4,331)                           | 177                                   |                     | (4,154)             |
| <b>Cash flows from investing activities:</b>                       |            |                                  |                                   |                                       |                     |                     |
| Capital expenditures   |            |                                  | (4,622)                           |                                       |                     | (4,622)             |
| Proceeds from sales of property and equipment                      |            |                                  | 1,393                             |                                       |                     | 1,393               |
| Net cash used in investing activities                              |            |                                  | (3,229)                           |                                       |                     | (3,229)             |
| <b>Cash flows from financing activities:</b>                       |            |                                  |                                   |                                       |                     |                     |
| Principal payments on long-term debt and capital lease obligations |            |                                  | (2,738)                           |                                       |                     | (2,738)             |
| Proceeds from revolver   |            | 14,600                           |                                   |                                       |                     | 14,600              |
| Payments on revolver   |            | (8,600)                          |                                   |                                       |                     | (8,600)             |
| Other  |            | (36)                             | 1,195                             |                                       |                     | 1,159               |
| Intercompany activity  |            | (5,964)                          | 5,964                             |                                       |                     |                     |
| Net cash provided by financing activities                          |            |                                  | 4,421                             |                                       |                     | 4,421               |
| Effect of exchange rate changes on cash                            |            |                                  | 4                                 |                                       |                     | 4                   |
| Net (decrease) increase in cash and cash equivalents               |            |                                  | (3,135)                           | 177                                   |                     | (2,958)             |
| Cash and cash equivalents, beginning of period                     |            |                                  | 3,531                             | 2,102                                 |                     | 5,633               |
| Cash and cash equivalents, end of period                           | \$         | \$                               | \$ 396                            | \$ 2,279                              | \$                  | \$ 2,675            |



---

**Table of Contents**

**ITEM 2 Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion of our results of operations and financial condition should be read in conjunction with our consolidated financial statements and the related notes included elsewhere in this report. The following discussion includes forward-looking statements. For a discussion of important factors that could cause actual results to differ from results discussed in the forward-looking statements, see Forward-Looking Statements and Certain Considerations contained in this Item 2.

***OVERVIEW***

We operate the largest chemical bulk tank truck network in North America through our wholly owned subsidiary, QCI, and are also the largest provider of intermodal ISO tank container and depot services in North America through our wholly owned subsidiary, Boasso. QCI has relationships with 29 independent affiliated trucking operations which provide the physical transportation of chemicals, together with its 3 company-operated trucking terminals.

*Logistics*

The bulk tank truck market in North America includes all products shipped by bulk tank truck carriers and consists primarily of liquid and dry bulk chemicals (including plastics) and bulk dry and liquid food-grade products. We primarily transport a broad range of chemical products and provide our customers with logistics and other value-added services through 29 independent affiliates with 91 trucking terminals and through 3 company-operated trucking terminals. We are a core carrier for many of the major companies engaged in chemical processing, including Arkema, Ashland, BASF, Dow, DuPont, ExxonMobil, Georgia-Pacific, Honeywell, PPG Industries, Procter & Gamble, Sunoco and Unilever, and we provide services to most of the top 100 chemical producers with North American operations. We believe the diversity of our customer base, geography and end-markets provides a competitive advantage.

During the fourth quarter of 2010, we began marketing transportation services to the frac shale natural gas and oil drilling industry. This addressable market is extensive and we believe it is growing at a faster rate than our core chemical market. We expect this new market to be a significant contributor to our revenue growth. In the first quarter of 2011, we began hauling fresh water to drill sites for two customers in the Marcellus Shale region of Pennsylvania and are in contract discussions to provide services to other customers as well.

Our transportation revenue is a function of the volume of shipments by the bulk chemical industry, prices, the average number of miles driven per load, our market share and the allocation of shipments between tank truck transportation and other modes of transportation such as rail. The volume of shipments of chemical products is, in turn, affected by many other industries and end-use markets, including consumer and industrial products, paints and coatings, paper and packaging, agriculture and food products, and tends to vary with changing economic conditions. Due to the nature of our customers' business, our revenues are seasonal. Revenues generally decline during winter months, namely our first and fourth fiscal quarters and over holidays and rise during our second and third fiscal quarters. Highway transportation can be adversely affected depending upon the severity of the weather in various sections of the country during the winter months.

We believe rates in the bulk tank truck industry tend to be more stable than rates in the overall trucking industry. We believe the specialized nature of the bulk tank truck industry, including specifically-licensed drivers, specialized equipment, and more stringent safety requirements create barriers to entry which limit the more drastic swings in supply experienced by the broader trucking industry. Additionally, it is common practice in the bulk tank truck industry for customers to pay fuel surcharges, which helps enable recovery of fuel price increases from customers.

Our bulk tank truck network is comprised largely of independent affiliates and independent owner operators, who are responsible for most of their operating costs, including tractors. This asset-light business model results in a highly variable cost structure with limited capital investment requirements.

*Intermodal*

Boasso is the largest North American provider of intermodal tank container transportation and depot services, with eight terminals located in the eastern half of the United States. In addition to intermodal tank transportation services, Boasso provides tank cleaning, heating, testing, maintenance and storage services to customers. Boasso provides local and over-the-road trucking primarily within the proximity of the port cities where its depots are located and also sells equipment that its customers use for portable alternative storage or office space.

Demand for intermodal ISO tank containers is impacted by the aggregate volume of imports and exports of chemicals through North American ports, and Boasso's revenues are accordingly impacted by this import/export volume. In particular, Boasso's revenues are driven by the number of shipments through ports at which Boasso has terminals, the volume of rail shipments from ports at which Boasso has terminals, and Boasso's

## Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

market share. Global economic conditions and differences among the laws and currencies of foreign nations may also impact the volume of shipments.

---

## **Table of Contents**

### *Our Network*

Our bulk service network consists primarily of independently owned third-party affiliate terminals, independent owner-operator drivers and, to a lesser extent, company operated terminals. Independent affiliates are independent companies we contract with to operate trucking terminals exclusively on our behalf in defined markets. The independent affiliates provide the capital necessary to service their contracted business and are also responsible for most of the operating costs associated with servicing the contracted business. Independent owner-operators are generally individual drivers who own or lease their tractors and agree to provide transportation services to us under contract. We believe the use of independent affiliates and independent owner-operators provides the following key competitive advantages to us in the marketplace:

Locally owned and operated independent affiliate terminals can provide superior, tailored customer service.

Independent affiliates and independent owner-operators generally are paid a fixed, contractual percentage of revenue collected on each load they transport creating a variable cost structure that mitigates against cyclical downturns.

Reliance on independent affiliates and independent owner-operators creates an asset-light business model that generally reduces our capital investment.

Due to several factors, including our ownership of the customer contracts and relationships, the presence of non-compete agreements with the independent affiliates, and our ownership of the trailers, our relationships with the independent affiliates tend to be long-term in nature, with minimal voluntary turnover.

Given the specialty nature of the services we provide and the size of our existing network, we believe there are significant barriers to entry to our industry. During 2009 and 2010, we consolidated certain company-operated terminals and transitioned other company-operated terminals to independent affiliates. These actions have resulted in a larger portion of our revenue being generated by independent affiliates and a substantial reduction in the number of terminals in our network. We believe these actions have reduced certain fixed costs, provide a more variable cost structure and position us with a financially flexible, asset-light business platform.

We believe the most significant factors relevant to our future business growth are the ability to (i) obtain additional business from existing customers, (ii) add new customers, (iii) expand into new markets, (iv) improve the utilization of our trailer fleet and (v) add and retain qualified drivers. While many of our customers source some of their logistics needs with rail, we expect our customers to continue to outsource a greater proportion of their logistics needs to full service tank truck carriers. As a result of our leading market position, strong customer relationships and flexible business model, we believe we are well-positioned to benefit from customers seeking consolidation of their shipping relationships and those opting to outsource a greater portion of their logistics needs to third-party tank truck carriers.

### *Recent Significant Transactions*

#### *2010 Senior Note Offering*

On November 3, 2010, QD, LLC and QD Capital, completed an offering of \$225.0 million in aggregate principal amount of 9.875% Second-Priority Senior Secured Notes due 2018 (the 2018 Notes ) at an issue price of 99.324% of par. Pursuant to the offering, we sent irrevocable redemption notices to holders of our 10% Senior Notes due 2013 (the 2013 Senior Notes ), Senior Floating Rate Notes due 2012 (the 2012 Notes ) and 11.75% Senior Subordinated PIK Notes due 2013 (the 2013 PIK Notes ). On November 15, 2010, we repaid at maturity the remaining 9% Senior Subordinated Notes due 2010 (the 9% Notes ). On December 3, 2010, net proceeds from the offering of the 2018 Notes were used to fully redeem or repay all of the outstanding 2013 Senior Notes and 2012 Notes, plus accrued and unpaid interest. We also utilized proceeds to redeem at par, plus accrued and unpaid interest, \$47.5 million of the 2013 PIK Notes. The balance of the offering proceeds were used to pay down outstanding borrowings under our asset-based loan facility (the ABL Facility ).

#### *2011 Common Stock Offering*

On February 9, 2011, we sold 2.0 million shares of our common stock in an underwritten public offering, at a gross price of \$9.50 per share, and received net proceeds, after underwriting fees and expenses, of approximately \$17.5 million. Certain affiliates of Apollo also sold 2.6 million shares in the offering. Pursuant to the offering, we sent irrevocable redemption notices to holders of our 2013 PIK Notes to redeem \$17.5 million

of these notes at par, plus accrued and unpaid interest. This note redemption was completed on March 11, 2011.

**Table of Contents***Critical Accounting Policies and Estimates*

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with Generally Accepted Accounting Principles ( GAAP ). We believe the following are the more critical accounting policies that impact the financial statements, some of which are based on management's best estimates available at the time of preparation. Actual future experience may differ from these estimates.

*Property and equipment* Property and equipment expenditures, including tractor and trailer rebuilds that extend the useful lives of such equipment, are capitalized and recorded at cost. For financial statement purposes, these assets are depreciated using the straight-line method over the estimated useful lives of the assets to an estimated salvage value.

The asset lives used are presented in the following table:

|                                 | Average Lives<br>(in years) |
|---------------------------------|-----------------------------|
| Buildings and improvements      | 10 - 25                     |
| Tractors and terminal equipment | 5 - 7                       |
| Trailers                        | 15 - 20                     |
| Furniture and fixtures          | 3 - 5                       |
| Other equipment                 | 3 - 10                      |

Tractor and trailer rebuilds, which are recurring in nature and extend the lives of the related assets, are capitalized and depreciated over the period of extension, generally 3 to 10 years, based on the type and extent of these rebuilds. Maintenance and repairs are charged directly to expense as incurred. Management estimates the useful lives of these assets based on historical trends and the age of the assets when placed in service. Any changes in the actual lives could result in material changes in the net book value of these assets. Additionally, we estimate the salvage values of these assets based on historical sales or disposals, and any changes in the actual salvage values could also affect the net book value of these assets. Furthermore, we evaluate the recoverability of our long-lived assets whenever adverse events or changes in the business climate indicate that the expected undiscounted future cash flows from the related asset may be less than previously anticipated. If the net book value of the related asset exceeds the undiscounted future cash flows of the asset, the carrying amount would be reduced to the present value of its expected future cash flows and an impairment loss would be recognized. This analysis requires us to make significant estimates and assumptions in projecting future cash flows, and changes in facts and circumstances could result in material changes in the amount of any write-offs for impairment.

*Goodwill and Intangible Assets* We evaluate goodwill and indefinite-lived intangible assets for impairment at least annually during the second quarter with a measurement date of June 30, and more frequently if indicators of impairment arise, in accordance with FASB's guidance on goodwill and other intangible assets. We evaluate goodwill for impairment by determining the fair value for each reporting unit to which our goodwill relates. At June 30, 2010, our intermodal segment was our only reporting unit that contained goodwill. Our intermodal segment contains goodwill and other identifiable intangible assets associated with our Boasso acquisition in December 2007.

The methodology applied in the analysis performed at June 30, 2010 was consistent with the methodology applied in prior years, but was based on updated assumptions, as appropriate. As a result of our analysis, we concluded no impairment had occurred as of June 30, 2010.

We continued to evaluate indicators of impairment quarterly following our annual goodwill impairment test at June 30, 2010 through year end 2010, and again in the quarter ended March 31, 2011. There were no indications that a triggering event had occurred as of March 31, 2011. As of March 31, 2011, our intermodal segment had goodwill of \$27.0 million. As of March 31, 2011, we had total intangibles of \$16.6 million, of which \$16.2 million was allocated to our intermodal segment and \$0.4 million was allocated to our logistics segment.

Goodwill

Under the FASB guidance, the process of evaluating the potential impairment of goodwill involves a two-step process and requires significant judgment at many points during the analysis. In the first step, we determine whether there is an indication of impairment by comparing the fair value of a reporting unit to its carrying amount, including goodwill. If, based on the first step, we determine that there is an indication of goodwill impairment, we assess the impairment in step two in accordance with the FASB guidance.



## Table of Contents

In the first step, we determine the fair value for each reporting unit using a combination of two valuation approaches: the market approach and the income approach. The market approach uses a guideline company methodology which is based upon a comparison of us to similar publicly-traded companies within our industry. We derive a market value of invested capital or business enterprise value for each comparable company by multiplying the price per share of common stock of the publicly traded companies by their total common shares outstanding and adding each company's current level of debt. We calculate a business enterprise multiple based on revenue and earnings from each company, then apply those multiples to each reporting unit's revenue and earnings to conclude a reporting unit business enterprise value. Assumptions regarding the selection of comparable companies are made based on, among other factors, capital structure, operating environment and industry. As the comparable companies were typically larger and more diversified than our reporting units, multiples were adjusted prior to application to our reporting units' revenues and earnings to reflect differences in margins, long-term growth prospects and market capitalization.

The income approach uses a discounted debt-free cash flow analysis to measure fair value by estimating the present value of future economic benefits. To perform the discounted debt-free cash flow analysis, we develop a pro forma analysis of each reporting unit to estimate future available debt-free cash flow and discounting estimated debt-free cash flow by an estimated industry weighted average cost of capital based on the same comparable companies used in the market approach. Per the FASB guidance, the weighted average cost of capital is based on inputs (e.g., capital structure, risk, etc.) from a market participant's perspective and not necessarily from the reporting unit or QDI's perspective. Future cash flow is projected based on assumptions for our economic growth, industry expansion, future operations and the discount rate, all of which require significant judgments by management.

After computing a separate business enterprise value under the income approach and market approach, we apply a weighting to them to derive the business enterprise value of the reporting unit. The income approach and market approach were both weighted 50% in the analysis performed at June 30, 2010. The weightings are evaluated each time a goodwill impairment assessment is performed and give consideration to the relative reliability of each approach at that time. Given that the business enterprise value derived from the market approach supported what was calculated in the income approach, we believed that both approaches should be equally weighted. Based on these weightings, we calculated a business enterprise value for the reporting unit. We then add debt-free liabilities of the reporting unit to the calculated business enterprise value to derive an implied fair value of the reporting unit. The implied fair value is then compared to the reporting unit's carrying value of total assets. Upon completion of the analysis in step one, we determined that the fair value of our intermodal reporting unit exceeded its carrying value. As such, a step two analysis was not required.

### Intangible assets

To determine the implied fair value of our indefinite-lived intangible assets, we utilize the relief from royalty method, pursuant to which those assets are valued by reference to the amount of royalty income they would generate if licensed in an arm's length transaction. Under the relief from royalty method, similar to the discounted cash flow method, estimated net revenues expected to be generated by the asset during its life are multiplied by a benchmark royalty rate and then discounted by the estimated weighted average cost of capital associated with the asset. The resulting capitalized royalty stream is an indication of the value of owning the asset. Based upon management's review of the value of the indefinite-lived intangible assets in our intermodal segment, we determined that the implied fair value exceeded its carrying value.

If there are changes to the methods used to allocate carrying values, if management's estimates of future operating results change, if there are changes in the identified reporting units or if there are changes to other significant assumptions, the estimated carrying values for each reporting unit and the estimated fair value of our goodwill could change significantly, and could result in future impairment charges, which could materially impact our results of operations and financial condition.

*Deferred Tax Asset* In accordance with FASB guidance, we use the liability method of accounting for income taxes. Significant management judgment is required in determining the provision for income taxes and, in particular, any valuation allowance that is recorded or released against our deferred tax assets.

We continue to evaluate quarterly the positive and negative evidence regarding the realization of net deferred tax assets. The carrying value of our net deferred tax assets is based on our belief that it is more likely than not that we will generate sufficient future taxable income to realize these deferred tax assets. The Company reviews a rolling thirty-six month calculation of U.S. earnings to determine if the Company is in a cumulative loss position.

During the second quarter of 2009, an impairment charge of \$148.6 million was recorded and, as a result, the Company determined that it was in a cumulative loss position. Based on this negative evidence, we concluded that it was no longer more likely than not that the Company's net deferred tax asset was realizable. For purposes of assessing realizability of the deferred tax assets, this cumulative financial reporting loss position is considered significant negative evidence the Company will not be able to fully realize the deferred tax assets in the future. As a result, a \$41.2 million deferred tax valuation allowance was recorded-. Our judgments regarding future taxable income may change due to changes in market conditions, changes in tax laws, operating results or other factors. If any of these factors and related estimates change in the future, it may

## Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

increase or decrease the valuation allowance and related income tax expense in the same period. The Company continues to maintain a 100% valuation allowance against the balance of the net deferred tax asset in the current period.



**Table of Contents**

At December 31, 2010, we had an estimated \$95.7 million in federal net operating loss carryforwards, \$0.6 million of off balance sheet net operating loss related to excess stock compensation deduction, \$2.3 million in alternative minimum tax credit carryforwards and \$3.4 million in foreign tax credit carryforwards. The net operating loss carryforwards will expire in the years 2018 through 2030, while the alternative minimum tax credits may be carried forward indefinitely and the foreign tax credits may be carried forward for 10 years.

*Uncertain Income Tax Positions* In accordance with FASB guidance, we account for uncertainty in income taxes, using a two-step process. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step requires us to estimate and measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement. It is inherently difficult and subjective to estimate such amounts, as we have to determine the probability of various possible outcomes. We re-evaluate these uncertain tax positions on a quarterly basis. This evaluation is based on factors including, but not limited to, changes in facts or circumstances, changes in tax law, effectively settled issues under audit and new audit activity. Such a change in recognition and measurement would result in recognition of a tax benefit and/or an additional charge to the tax provision.

---

**Table of Contents**

*Environmental liabilities* We have reserved for potential environmental liabilities based on the best estimates of potential clean-up and remediation for known environmental sites. We employ a staff of environmental professionals to administer all phases of our environmental programs and use outside experts where needed. These professionals develop estimates of potential liabilities at these sites based on projected and known remediation costs. These cost projections are determined through previous experiences with other sites and through bids from third-party contractors. Management believes current reserves are reasonable based on current information, but estimates of environmental reserves and exposures may be affected by information subsequently received.

*Accrued loss and damage claims* We currently maintain liability insurance for bodily injury and property damage claims, covering all employees, independent owner-operators and independent affiliates, and workers' compensation insurance coverage on our employees and company drivers. This insurance includes deductibles of \$2.0 million per incident for bodily injury and property damage and \$1.0 million for workers' compensation. As such, we are subject to liability as a self-insurer to the extent of these deductibles under the policy. We are self-insured for damage to the equipment we own or lease and for cargo losses. As of March 31, 2011, we had \$25.2 million in an outstanding letter of credit to our insurance administrator to guarantee the self-insurance portion of our liability. If we fail to meet certain terms of our agreement, the insurance administrator may draw down the letter of credit. In developing liability reserves, we rely on professional third party claims administrators, insurance company estimates and the judgment of our own personnel, and independent professional actuaries and attorneys. The most significant assumptions used in the estimation process include determining the trends in loss costs, the expected consistency in the frequency and severity of claims incurred but not yet reported to prior-year claims, and expected costs to settle unpaid claims. Management believes reserves are reasonable given known information, but as each case develops, estimates may change to reflect the effect of new information.

*Revenue recognition* Transportation revenue, including fuel surcharges and related costs, is recognized on the date freight is delivered. Service revenue consists mainly of rental revenues (primarily tractor and trailer rental), intermodal and depot revenues and insurance-related administrative services. Rental revenues from independent affiliates, independent owner-operators and third parties are recognized ratably over the lease period. Intermodal and depot revenues, consisting primarily of repair and storage services, are recognized when the services are rendered. Insurance-related administrative service revenues are recorded ratably over the service period. We recognize all revenues on a gross basis as the principal and primary obligor with risk of loss in relation to our responsibility for completion of services as contracted with our customers.

*Allowance for uncollectible receivables* The allowance for all potentially uncollectible receivables is based on a combination of historical data, cash payment trends, specific customer issues, write-off trends, general economic conditions and other factors. These factors are continuously monitored by our management to arrive at the estimate for the amount of accounts receivable that may be ultimately uncollectible. The receivables analyzed include trade receivables, as well as loans and advances made to independent owner-operators and independent affiliates. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, an additional allowance could be required.

*Stock compensation plans* Stock compensation is determined by the assumptions required under the FASB guidance. The fair values of stock option grants are based upon the Black-Scholes option-pricing model and amortized as compensation expense on a straight-line basis over the vesting period of the grants. Restricted stock awards are issued and measured at market value on the date of grant and related compensation expense is recognized over time on a straight-line basis over the vesting period of the grants. Stock-based compensation expense related to stock options and restricted stock was \$0.7 million for the three months ended March 31, 2011 and \$0.5 million for the three months ended March 31, 2010. As of March 31, 2011, there was approximately \$4.9 million of total unrecognized compensation cost related to the unvested portion of our stock-based awards. The recognition period for the remaining unrecognized stock-based compensation cost generally varies from two to four years. For further discussion on stock-based compensation, see Note 7 to the consolidated financial statements included in Item 1 of this report.

*Pension plans* We maintain two noncontributory defined benefit plans resulting from a prior acquisition that cover certain vested salaried participants and retirees and certain other vested participants and retirees under an expired collective bargaining agreement. Both plans are frozen and, as such, no future benefits accrue. We record annual amounts relating to these plans based on calculations specified by GAAP, which include various actuarial assumptions such as discount rates (5.50% to 5.70%) and assumed rates of return (7.00% to 8.00%) depending on the pension plan. Material changes in pension costs may occur in the future due to changes in these assumptions. Future annual amounts could be impacted by changes in the discount rate, changes in the expected long-term rate of return, changes in the level of contributions to the plans and other factors.

The discount rate is based on a model portfolio of AA-rated bonds with a maturity matched to the estimated payouts of future pension benefits. The expected return on plan assets is based on our expectation of the long-term rates of return on each asset class based on the current asset mix of the funds, considering the historical returns earned on the type of assets in the funds, plus an assumption of future inflation. The current inflation assumption is 3.00%. We review our actuarial assumptions on an annual basis and make modifications to the assumptions based on current rates and trends when appropriate. The effects of the modifications are amortized over future periods.



**Table of Contents**

Assumed discount rates and expected return on plan assets have a significant effect on the amounts reported for the pension plan. At December 31, 2010, our projected benefit obligation ( PBO ) was \$48.6 million. Our projected 2011 net periodic pension expense is \$1.6 million. A 1.0% decrease in our assumed discount rate would increase our PBO to \$53.8 million and decrease our 2011 net periodic pension expense less than \$0.1 million. A 1.0% increase in our assumed discount rate would decrease our PBO to \$44.2 million and increase our 2011 net periodic pension expense less than \$0.1 million. A 1.0% decrease in our assumed rate of return would not change our PBO but would increase our 2011 net periodic pension expense to \$1.9 million. A 1.0% increase in our assumed rate of return would not change our PBO but would decrease our 2011 net periodic pension expense to \$1.3 million.

*Restructuring* We account for restructuring costs associated with one-time termination benefits, costs associated with lease and contract terminations and other related exit activities in accordance with the FASB's guidance. We have made estimates of the costs incurred as part of a restructuring plan developed during 2008 and concluded at the end of 2010. The restructuring consisted of various actions including termination of approximately 380 non-driver positions, the consolidation, closure and affiliation of underperforming company terminals, our withdrawal from three multi-employer pension plans and costs associated with the consolidation of our corporate headquarters and resulted in charges during 2008, 2009 and 2010, primarily related to our logistics segment. As of March 31, 2011, approximately \$4.9 million was accrued related to the restructuring charges which are expected to be paid through 2023.

*New Accounting Pronouncements*

Refer to Note 1, Summary of Significant Accounting Policies New Accounting Pronouncements to the consolidated financial statements included in Item 1 of this report for discussion of recent accounting pronouncements and for additional discussion surrounding the adoption of accounting standards.

*Results of Operations*

The following table presents certain condensed consolidated financial information, as a percentage of revenue, for the three months ended March 31, 2011 and 2010:

|   | <b>Three months ended<br/>March 31,</b> |               |
|---|---|---------------|
|   | <b>2011</b>                             | <b>2010</b>   |
| <b>OPERATING REVENUES:</b>                        |   |               |
| Transportation                                    | 70.1%                                   | 73.7%         |
| Service revenue                                   | 15.0%                                   | 15.4%         |
| Fuel surcharge                                    | 14.9%                                   | 10.9%         |
| <b>Total operating revenues</b>                   | <b>100.0%</b>                           | <b>100.0%</b> |
| <b>OPERATING EXPENSES:</b>                        |   |               |
| Purchased transportation                          | 70.1%                                   | 68.1%         |
| Compensation                                      | 8.4%                                    | 8.6%          |
| Fuel, supplies and maintenance                    | 6.6%                                    | 8.3%          |
| Depreciation and amortization                     | 2.0%                                    | 2.6%          |
| Selling and administrative                        | 2.9%                                    | 3.0%          |
| Insurance costs                                   | 2.6%                                    | 2.1%          |
| Taxes and licenses                                | 0.3%                                    | 0.4%          |
| Communication and utilities                       | 0.5%                                    | 0.6%          |
| (Gain) loss on disposal of property and equipment | (0.1%)                                  | 0.3%          |
| Restructuring costs                               | 0.0%                                    | 0.7%          |
| <b>Total operating expenses</b>                   | <b>93.3%</b>                            | <b>94.7%</b>  |
| <br>Operating income                              | <br>6.7%                                | <br>5.3%      |

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

|   |        |        |
|---|--------|--------|
| Interest expense                          | 4.4%   | 5.4%   |
| Interest income                           | (0.1%) | (0.1%) |
| Write-off of debt issuance costs          | 1.0%   | 0.0%   |
| Income before income taxes                | 1.4%   | 0.0%   |
| Provision for (benefit from) income taxes | 0.0%   | (0.4%) |
| Net income                                | 1.4%   | 0.4%   |

**Table of Contents**

The following table shows the approximate number of terminals, drivers, tractors and trailers, that we managed (including affiliates and independent owner-operators) as of March 31:

|           | 2011  | 2010  |
|-----------|-------|-------|
| Terminals | 104   | 103   |
| Drivers   | 2,717 | 2,630 |
| Tractors  | 2,861 | 2,815 |
| Trailers  | 5,613 | 6,246 |

As of March 31, our network terminals and facilities consisted of the following:

|  | Segment    | 2011<br>Terminals | 2010<br>Terminals |
|--|------------|-------------------|-------------------|
| QCI independent affiliate trucking terminals | Logistics  | 93                | 86                |
| QCI company-operated trucking terminals      | Logistics  | 3                 | 9                 |
| Boasso container services terminals/depots   | Intermodal | 8                 | 8                 |
| Total  |            | 104               | 103               |

**Three Months Ended March 31, 2011 Compared to Three Months Ended March 31, 2010**

For the quarter ended March 31, 2011, total revenues were \$177.9 million, an increase of \$16.6 million, or 10.3%, from revenues of \$161.3 million for the same period in 2010. Transportation revenue increased by \$5.8 million, or 4.8%, primarily due to an increase in pricing and an increase in volume due to adding an affiliate in the second quarter of 2010. In addition, we had a 2.5% increase in loads and a 0.4% increase in the total number of miles driven. We believe that our volume during the quarter ended March 31, 2011 was adversely affected by a high level of driver turnover driven by our implementation of electronic on-board recorders ( EOBRS ) in our fleet. We expect to install these EOBRS in substantially all of our fleet by the end of 2011 in order to improve efficiency and proactively address regulatory requirements that we expect in the future. This could adversely impact our volumes for the remainder of 2011.

Service revenue increased \$1.8 million, or 7.4%. This increase was primarily due to an increase in our intermodal and depot revenues of \$2.0 million.

Fuel surcharge revenue increased \$9.0 million, or 51.3%, due to the increase in fuel prices and linehaul revenue. We have fuel surcharge programs in place with the majority of our customers. These programs typically involve a specified computation based on the changes in fuel prices. As a result, some of these programs may have a time lag between when fuel prices change and when this change is reflected in revenues. It is not meaningful to compare the amount of fuel surcharge revenue or the change in fuel surcharge revenue between reporting periods to fuel expense, or the change of fuel expense between periods, as a significant portion of fuel costs are included in purchased transportation.

Purchased transportation increased by \$14.9 million, or 13.6%, due primarily to the increase in affiliation and linehaul revenue. Total purchased transportation as a percentage of transportation revenue and fuel surcharge revenue increased to 82.5% for the current quarter versus 80.5% for the prior-year quarter due primarily to the conversion of certain company-operated terminals to independent affiliate terminals. Our independent affiliates generated 94.3% of our transportation revenue and fuel surcharge revenue for the three months ended March 31, 2011 compared to 92.9% for the comparable prior-year period. We pay our independent affiliates a greater percentage of transportation revenues generated by them than is paid to independent owner-operators, so our purchased transportation costs will change as revenues generated by independent affiliates change as a percentage of total transportation revenue. During the 2011 and 2010 quarters, we paid our independent affiliates approximately 85% of the transportation revenue while we typically paid independent owner-operators approximately 65% of transportation revenue.

Compensation expense increased \$1.0 million, or 7.1%, primarily due to an increase in health care costs of \$0.7 million and severance costs of \$0.3 million.

## Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Fuel, supplies and maintenance decreased \$1.6 million, or 11.9%, due to lower repairs and maintenance expense of \$1.1 million and lower equipment rent expense of \$0.7 million, partially offset by a slight increase in fuel costs of \$0.2 million. Lower repairs and maintenance expense resulted from aggressive reduction of aged or underutilized specialty equipment over the last 12 months.

Depreciation and amortization expense decreased \$0.8 million, or 17.7%, due to a decrease in depreciation resulting from the sale of revenue equipment.

Selling and administrative expense increased by \$0.4 million or 7.8% due to an increase in professional fees of \$0.5 million and bad debt expense of \$0.2 million partially offset by a decrease of \$0.3 million of expenses related to closed or converted terminals.

Insurance costs increased by \$1.3 million, or 40.4%, due primarily to an increase in the amount of claims and number of miles driven in the current-year quarter. As a percentage of revenue, insurance costs remain within our target range of 2.0% to 3.0%.

**Table of Contents**

We recognized a gain on disposal of revenue equipment of \$0.2 million for the quarter ended March 31, 2011 as compared to a loss on disposal of revenue equipment of \$0.4 million in the comparable prior-year period.

In the first quarter of 2010, we incurred restructuring costs of \$1.1 million resulting from a restructuring plan which began in 2008 and concluded in 2010.

For the quarter ended March 31, 2011, operating income totaled \$12.2 million, an increase of \$3.5 million or 40.4%, compared to \$8.7 million for the same period in 2010. Our operating margin for the quarter ended March 31, 2011, was 6.9% compared to 5.4% for the same period in 2010 as a result of revenue increases and cost controls.

Interest expense decreased by \$0.9 million, or 9.9%, in the quarter ended March 31, 2011 compared to the same period in 2010, primarily due to redemptions of our higher cost 2013 PIK Notes in 2010 and 2011 and lower interest rates on our 2018 Notes as a result of the debt refinancing in the fourth quarter of 2010. As a result of these lower principal balances and lower rates of interest, we expect our interest expense to continue to be lower throughout 2011 than in 2010 unless the principal balance of our indebtedness increases.

In the first quarter of 2011, we wrote off debt issuance costs of \$1.8 million resulting from redemptions of our 2013 PIK Notes in January 2011 and March 2011 in the amounts of \$10.0 million and \$17.5 million, respectively. We had no such debt issuance cost write-off during the first quarter of 2010.

The provision for income taxes was less than \$0.1 million for the quarter ended March 31, 2011 compared to a tax benefit of \$0.6 million for the same period in 2010. The effective tax rates for the three months ended March 31, 2011 and 2010 were 1.8% and a benefit of more than 100%, respectively. The effective tax rates for the three months ended March 31, 2011 and 2010 include an approximately \$0.2 million tax benefit and a \$0.6 million tax benefit, respectively, from a change in previously recorded unrecognized tax benefits.

For the quarter ended March 31, 2011, our net income was \$2.7 million compared to net income of \$0.8 million for the same period in 2010 as a result of the reasons outlined above.

*Segment Operating Results*

We have two reportable business segments for financial reporting purposes that are distinguished primarily on the basis of services offered:

Logistics, which consists primarily of truckload transportation of bulk chemicals primarily through our network of independent affiliates and equipment rentals; and

Intermodal, specifically Boasso's International Organization for Standardization, or intermodal ISO tank container transportation and depot services.

Segment revenues and operating income include the allocation of fuel surcharge to the logistics and intermodal segments. The operating income reported in our segments excludes amounts such as gains and losses on disposal of property and equipment, restructuring costs, and corporate and other unallocated amounts. Corporate and unallocated amounts include depreciation and amortization and other gains and losses. Although these amounts are excluded from the business segment results, they are included in reported consolidated earnings. We have not provided specific asset information by segment, as it is not regularly provided to our chief operating decision maker for review.

Summarized segment operating results are as follows (in thousands):

|                            | Three Months Ended March 31, 2011 |            |            |
|----------------------------|-----------------------------------|------------|------------|
|                            | Logistics                         | Intermodal | Total      |
| <b>Operating Revenues:</b> |                                   |            |            |
| Transportation             | \$ 110,612                        | \$ 14,069  | \$ 124,681 |
| Service revenue            | 16,508                            | 10,230     | 26,738     |
| Fuel surcharge             | 23,638                            | 2,853      | 26,491     |



Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

|                                    |            |           |            |
|------------------------------------|------------|-----------|------------|
| Total operating revenues           | \$ 150,758 | \$ 27,152 | \$ 177,910 |
| Segment revenue % of total revenue | 84.7%      | 15.3%     | 100.0%     |
| Segment operating income           | \$ 10,782  | \$ 4,663  | \$ 15,445  |

**Table of Contents**

|                                    | Three Months Ended March 31, 2010 |                  |                   |
|------------------------------------|-----------------------------------|------------------|-------------------|
|                                    | Logistics                         | Intermodal       | Total             |
| <b>Operating Revenues:</b>         |                                   |                  |                   |
| Transportation                     | \$ 105,832                        | \$ 13,085        | \$ 118,917        |
| Service revenue                    | 16,640                            | 8,266            | 24,906            |
| Fuel surcharge                     | 15,666                            | 1,844            | 17,510            |
| <b>Total operating revenues</b>    | <b>\$ 138,138</b>                 | <b>\$ 23,195</b> | <b>\$ 161,333</b> |
| Segment revenue % of total revenue | 85.6%                             | 14.4%            | 100.0%            |
| Segment operating income           | \$ 10,818                         | \$ 3,674         | \$ 14,492         |
|                                    | <b>2011 vs 2010</b>               | <b>Logistics</b> | <b>Intermodal</b> |
| Segment revenues                   | \$ change                         | 12,620           | 3,957             |
|                                    | % of change                       | 9.1%             | 17.1%             |
| Segment operating income           | \$ change                         | (36)             | 989               |
|                                    | % of change                       | (0.3%)           | 26.9%             |

**Three Months Ended March 31, 2011 Compared to Three Months Ended March 31, 2010 - Segment Results**

Operating revenue:

*Logistics* revenues increased \$12.6 million, or 9.1%, for the quarter ended March 31, 2011 compared to the same period for 2010 due to an increase of \$8.0 million of fuel surcharge and an increase of \$4.6 in linehaul revenue.

*Intermodal* revenues increased \$4.0 million, or 17.1%, for the quarter ended March 31, 2011 compared to the same period for 2010 due to increase of \$3.0 million in intermodal transportation and depot revenue and an increase of \$1.0 million in fuel surcharge.

Operating income:

*Logistics* operating income remained relatively constant at \$10.8 million for the quarters ended March 31, 2011 and 2010.

*Intermodal* operating income increased \$1.0 million, or 26.9%, for the quarter ended March 31, 2011 compared to the same period for 2010 due to increased demand from existing customers.

During the fourth quarter of 2010, we realigned and renamed our business segments to better reflect our current business and asset-light model due to the shift of our company-operated operations to independent affiliate operations. Our trucking segment was renamed Logistics and our Container Services segment was renamed Intermodal to better describe the services we perform.

Segment operating results for 2010 were as follows (in thousands):

|                                    | Three Months Ended March 31, 2010 |                  |                   |
|------------------------------------|-----------------------------------|------------------|-------------------|
|                                    | Logistics                         | Intermodal       | Total             |
| <b>Operating Revenues:</b>         |                                   |                  |                   |
| Transportation                     | \$ 105,832                        | \$ 13,085        | \$ 118,917        |
| Service revenue                    | 16,640                            | 8,266            | 24,906            |
| Fuel surcharge                     | 15,666                            | 1,844            | 17,510            |
| <b>Total operating revenues</b>    | <b>\$ 138,138</b>                 | <b>\$ 23,195</b> | <b>\$ 161,333</b> |
| Segment revenue % of total revenue | 85.6%                             | 14.4%            | 100.0%            |
| Segment operating income           | \$ 10,818                         | \$ 3,674         | \$ 14,492         |



**Table of Contents**

|                                    | Three Months Ended June 30, 2010 |                  |                   |
|------------------------------------|----------------------------------|------------------|-------------------|
|                                    | Logistics                        | Intermodal       | Total             |
| <b>Operating Revenues:</b>         |                                  |                  |                   |
| Transportation                     | \$ 114,728                       | \$ 14,745        | \$ 129,473        |
| Service revenue                    | 17,339                           | 9,134            | 26,473            |
| Fuel surcharge                     | 19,247                           | 2,359            | 21,606            |
| <b>Total operating revenues</b>    | <b>\$ 151,314</b>                | <b>\$ 26,238</b> | <b>\$ 177,552</b> |
| Segment revenue % of total revenue | 85.2%                            | 14.8%            | 100.0%            |
| Segment operating income           | \$ 12,064                        | \$ 4,528         | \$ 16,592         |

|                                    | Three Months Ended September 30, 2010 |                  |                   |
|------------------------------------|---------------------------------------|------------------|-------------------|
|                                    | Logistics                             | Intermodal       | Total             |
| <b>Operating Revenues:</b>         |                                       |                  |                   |
| Transportation                     | \$ 117,763                            | \$ 14,913        | \$ 132,676        |
| Service revenue                    | 18,354                                | 9,824            | 28,178            |
| Fuel surcharge                     | 18,779                                | 2,315            | 21,094            |
| <b>Total operating revenues</b>    | <b>\$ 154,896</b>                     | <b>\$ 27,052</b> | <b>\$ 181,948</b> |
| Segment revenue % of total revenue | 85.1%                                 | 14.9%            | 100.0%            |
| Segment operating income           | \$ 11,573                             | \$ 4,906         | \$ 16,479         |

|                                    | Three Months Ended December 31, 2010 |                  |                   |
|------------------------------------|--------------------------------------|------------------|-------------------|
|                                    | Logistics                            | Intermodal       | Total             |
| <b>Operating Revenues:</b>         |                                      |                  |                   |
| Transportation                     | \$ 104,253                           | \$ 13,127        | \$ 117,380        |
| Service revenue                    | 18,137                               | 9,780            | 27,917            |
| Fuel surcharge                     | 18,361                               | 2,107            | 20,468            |
| <b>Total operating revenues</b>    | <b>\$ 140,751</b>                    | <b>\$ 25,014</b> | <b>\$ 165,765</b> |
| Segment revenue % of total revenue | 84.9%                                | 15.1%            | 100.0%            |
| Segment operating income           | \$ 10,336                            | \$ 3,755         | \$ 14,091         |

|                                    | Year Ended December 31, 2010 |                   |                   |
|------------------------------------|------------------------------|-------------------|-------------------|
|                                    | Logistics                    | Intermodal        | Total             |
| <b>Operating Revenues:</b>         |                              |                   |                   |
| Transportation                     | \$ 442,576                   | \$ 55,870         | \$ 498,446        |
| Service revenue                    | 70,470                       | 37,004            | 107,474           |
| Fuel surcharge                     | 72,053                       | 8,625             | 80,678            |
| <b>Total operating revenues</b>    | <b>\$ 585,099</b>            | <b>\$ 101,499</b> | <b>\$ 686,598</b> |
| Segment revenue % of total revenue | 85.2%                        | 14.8%             | 100.0%            |
| Segment operating income           | \$ 44,791                    | \$ 16,863         | \$ 61,654         |

*Liquidity and Capital Resources*

Our primary cash needs consist of working capital, capital expenditures and debt service. Our working capital needs depend upon the timing of our collections from customers and payments to others as well as our capital and operating lease payment obligations. Our capital expenditures primarily relate to acquiring trailers and maintaining them. We have reduced our capital expenditure requirements by utilizing independent affiliates and independent owner-operators.



**Table of Contents**

Independent affiliates and independent owner-operators typically supply their own tractors, which reduces our capital investment requirements. For the three months ending March 31, 2011, capital expenditures were \$3.2 million and proceeds from sales of property and equipment were \$2.9 million. We expect our future capital expenditures, net of proceeds from property and equipment sales, to generally be approximately 1% of operating revenues annually. We currently expect net capital expenditures for 2011 to be approximately \$8.0 million, although the actual amount could differ materially because of operating needs, growth needs, regulatory changes, covenants in our debt arrangements, other expenses, or other factors. Based on our current trailer fleet, we believe we have the ability to capture additional business volume during 2011 with minimal additional capital expenditures.

Debt service consists of principal and interest payments on the outstanding balance of our ABL Facility as well as our outstanding senior and subordinated notes. These notes are currently comprised primarily of our 2018 Notes and our 2013 PIK Notes, though the aggregate principal balance and composition of notes has changed primarily between the 2010 and 2011 periods. Interest equal to 2.75% on the 2013 PIK Notes is payable through the issuance of additional notes rather than cash.

We have no major debt maturities prior to 2013. In the fourth quarter of 2010, in connection with the issuance of \$225.0 million aggregate principal amount of the 2018 Notes at 99.324% of par, we paid at maturity our 9% Notes, fully redeemed our 2012 Notes and our 2013 Senior Notes, redeemed \$47.5 million of our 2013 PIK Notes and paid down a portion of our outstanding borrowings under the ABL Facility. We repurchased \$2.5 million and redeemed \$10.0 million of our 2013 PIK Notes in December 2010 and January 2011, respectively.

On February 9, 2011, we sold 2.0 million shares of our common stock in an underwritten public offering and received net proceeds, after fees and expenses, of approximately \$17.5 million. Certain affiliates of Apollo also sold 2.6 million shares in the offering. We redeemed \$17.5 million of our 2013 PIK Notes with proceeds from the offering of our common stock in March 2011.

We may from time to time repurchase or redeem additional amounts of our outstanding debt or other securities. Any repurchases or redemptions would depend upon prevailing market conditions, our liquidity requirements, contractual restrictions and other factors we consider important. Future repurchases or redemptions may materially impact our liquidity, future tax liability and results of operations.

Our primary sources of liquidity for operations during the 2011 and 2010 periods have been cash flow from operations and borrowing availability under the ABL Facility. At March 31, 2011, we had \$77.1 million of borrowing availability under the ABL Facility. We believe that, based on current operations and anticipated growth, our cash flow from operations, together with other available sources of liquidity, will be sufficient to fund anticipated capital expenditures, operating expenses and our other anticipated liquidity needs for the next twelve months. Anticipated debt maturities in 2013, the acquisition of another business or other events that we do not foresee may require us to seek alternative financing, such as restructuring or refinancing our long-term debt, selling assets or operations or selling additional debt or equity securities. If these alternatives were not available in a timely manner or on satisfactory terms or were not permitted under any of our debt agreements and we default on our obligations, our debt could be accelerated and our assets might not be sufficient to repay in full all of our obligations.

*Cash Flows*

The following summarizes our cash flows for the three months ended March 31, 2011 and 2010 as reported in our consolidated statements of cash flows in the accompanying consolidated financial statements (in thousands):

|  | <b>Three months ended</b> |             |
|--|---------------------------|-------------|
|  | <b>March 31,</b>          |             |
|  | <b>2011</b>               | <b>2010</b> |
| Net cash provided by (used in) operating activities  | \$ 5,664                  | \$ (4,154)  |
| Net cash used in investing activities                | (335)                     | (3,229)     |
| Net cash (used in) provided by financing activities  | (4,343)                   | 4,421       |
| Effect of exchange rate changes on cash              | (1)                       | 4           |
| <br>   |                           |             |
| Net increase (decrease) in cash and cash equivalents | 985                       | (2,958)     |
| Cash and cash equivalents at beginning of period     | 1,753                     | 5,633       |
| <br>   |                           |             |
| Cash and cash equivalents at end of period           | \$ 2,738                  | \$ 2,675    |



**Table of Contents**

Net cash provided by operating activities was \$5.7 million for the three-month period ended March 31, 2011 compared to \$4.2 million used in the comparable 2010 period. The \$9.9 million increase in cash provided by operating activities was due to a reduction of accrued loss and damage claims and an increase in our restructuring accrual. Our restructuring and cost reduction efforts in 2010 have enabled us to generate stronger operating cash in 2011.

Net cash used in investing activities totaled \$0.3 million for the three-month period ended March 31, 2011 compared to \$3.2 million used in the comparable 2010 period. The \$2.9 million change resulted from an increase in proceeds from sale of property and equipment and a decrease in capital expenditures in the 2011 period.

Net cash used in financing activities was \$4.3 million during the three-month period ended March 31, 2011, compared to \$4.4 million provided by in the comparable 2010 period. In the 2011 period, net cash received from our equity offering of approximately \$17.5 million and increased borrowings of \$10.0 million under our ABL Facility were utilized to redeem \$27.5 million in principal amount of our 2013 PIK Notes, to pay down other debt and capital lease obligations and to redeem for \$1.8 million the preferred shares of our subsidiary, CLC, which we previously reflected on our balance sheet as redeemable noncontrolling interest. In the 2010 period, increased borrowings of \$6.0 million under our ABL facility were used to pay a large insurance claim, pay down debt and capital lease obligations and for capital expenditures.

**Off-Balance Sheet Arrangements**

We have no off-balance sheet arrangements as defined under Item 303(a)(4) of Regulation S-K.

**Contractual Obligations**

The following is a schedule of our long-term contractual commitments, including the current portion of our long-term indebtedness at March 31, 2011 over the periods we expect them to be paid (in thousands):

|                              | Total             | Remainder<br>of 2011 | Years 2012<br>&<br>2013 | Years 2014<br>&<br>2015 | Year 2016<br>and after |
|------------------------------|-------------------|----------------------|-------------------------|-------------------------|------------------------|
| Operating leases (1)         | \$ 27,806         | \$ 7,047             | \$ 12,043               | \$ 5,031                | \$ 3,685               |
| Total indebtedness (2)       | 289,316           | 2,738                | 59,499                  | 1,813                   | 225,266                |
| Capital leases               | 11,744            | 3,403                | 7,741                   | 600                     |                        |
| Interest on indebtedness (3) | 177,417           | 19,801               | 50,094                  | 44,567                  | 62,955                 |
| <b>Total</b>                 | <b>\$ 506,283</b> | <b>\$ 32,989</b>     | <b>\$ 129,377</b>       | <b>\$ 52,011</b>        | <b>\$ 291,906</b>      |

- (1) These obligations represent the minimum rental commitments under all non-cancelable operating leases including the guaranteed residual values at the end of the leases. Commitments also include the operating lease for our corporate headquarters. We expect that some of our operating lease obligations for tractors and trailers will be partially offset by rental revenue from subleasing the tractors to independent affiliates and independent owner-operators and subleasing trailers to independent affiliates.
- (2) Includes aggregate unamortized discount of \$1.9 million.
- (3) Amounts presented for interest payments assume that all long-term debt obligations outstanding as of March 31, 2011 will remain outstanding until maturity and interest rates on variable-rate debt in effect as of March 31, 2011 will remain in effect until maturity.

**Other Liabilities and Obligations**

As of March 31, 2011, we had \$11.2 million of environmental liabilities, \$18.3 million of pension plan obligations and \$20.2 million of insurance claim obligations. The timing of the cash payment for environmental liabilities and insurance claims fluctuates from quarter to quarter. We expect to incur additional environmental costs in the future for environmental studies and remediation efforts that we will be required to undertake related to legacy CLC sites.

As of March 31, 2011, we had \$30.3 million in outstanding letters of credit that may be drawn by third parties to satisfy some of the obligations described above and certain leasing obligations. We are required to provide letters of credit to our insurance administrator to ensure that we pay



## Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

required claims. The letter of credit issued to our insurance administrator had a maximum draw amount of \$25.2 million as of March 31, 2011. If we fail to meet certain terms of our agreement, the insurance administrator may draw down the entire letter of credit. The remaining \$5.1 million of outstanding letters of credit as of March 31, 2011 relates to various other obligations.

**Table of Contents****Long-term Debt**

Long-term debt consisted of the following (in thousands):

|   | March 31,<br>2011 | December 31,<br>2010 |
|---|-------------------|----------------------|
| Capital lease obligations   | \$ 11,744         | \$ 12,850            |
| ABL Facility  | 48,500            | 38,500               |
| 11.75% Senior Subordinated PIK Notes, due 2013                                  | 5,752             | 33,184               |
| 9.875% Second-Priority Senior Secured Notes, due 2018                           | 225,000           | 225,000              |
| Other Notes   | 10,064            | 11,327               |
| Long-term debt, including current maturities                                    | 301,060           | 320,861              |
| Discount on Notes   | (1,932)           | (3,529)              |
|   | 299,128           | 317,332              |
| Less current maturities of long-term debt (including capital lease obligations) | (8,617)           | (8,563)              |
| Long-term debt, less current maturities   | \$ 290,511        | \$ 308,769           |

**Debt Retirement**

The following is a schedule of our indebtedness at March 31, 2011 over the periods we are required to pay such indebtedness (in thousands):

|   | Remainder<br>of 2011 | 2012     | 2013      | 2014     | 2015 and<br>after | Total      |
|---|----------------------|----------|-----------|----------|-------------------|------------|
| Capital lease obligations                                 | \$ 3,403             | 5,163    | \$ 2,578  | 600      | \$                | \$ 11,744  |
| ABL Facility  |                      |          | 48,500    |          |                   | 48,500     |
| 11.75% Senior Subordinated PIK Notes, due 2013 (1)        |                      |          | 5,752     |          |                   | 5,752      |
| 9.875% Second-Priority Senior Secured Notes, due 2018 (1) |                      |          |           |          | 225,000           | 225,000    |
| Other Notes   | 2,738                | 2,658    | 2,589     | 947      | 1,132             | 10,064     |
| Total   | \$ 6,141             | \$ 7,821 | \$ 59,419 | \$ 1,547 | \$ 226,132        | \$ 301,060 |

(1) Amounts do not include the remaining aggregated unamortized original issue discount of \$1.9 million.

The following is a schedule of our debt issuance costs (in thousands):

|   | December<br>31, 2010<br>Balance | Write-off<br>of Debt<br>Issuance<br>Costs | Additional<br>Debt<br>Issuance<br>Costs | 2011<br>Amortization<br>Expense | March 31,<br>2011<br>Balance |
|---|---------------------------------|---|---|---------------------------------|------------------------------|
| ABL Facility  | \$ 3,015                        | \$  | \$                                      | \$ (312)                        | \$ 2,703                     |
| 11.75% Senior Subordinated PIK Notes, due 2013        | 410                             | (328)                                     |   | (17)                            | 65                           |
| 9.875% Second-Priority Senior Secured Notes, due 2018 | 5,685                           |   | 341                                     | (213)                           | 5,813                        |

## Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

|       |          |          |        |          |          |
|-------|----------|----------|--------|----------|----------|
| Total | \$ 9,110 | \$ (328) | \$ 341 | \$ (542) | \$ 8,581 |
|-------|----------|----------|--------|----------|----------|

Amortization expense of deferred issuance costs was \$0.5 million and \$0.7 million for the three months ending March 31, 2011 and 2010, respectively. We are amortizing these costs over the term of the debt instruments.

### ***The ABL Facility***

We entered into our ABL Facility on December 18, 2007. As of March 31, 2011, the ABL Facility consists of a current asset tranche in the amount of \$205.0 million and a fixed asset tranche in the amount of \$20.0 million. Borrowings of revolving loans under the ABL Facility are allocated pro rata to the current asset tranche and the fixed asset tranche based on the respective borrowing bases of the two tranches. The ABL Facility includes a sublimit to issue letters of credit, which are also allocated pro rata between the two tranches based on their respective borrowing bases, and is available for working capital needs and general corporate purposes, including permitted acquisitions. The maturity date of the ABL Facility is June 18, 2013. The maturity date of the ABL Facility may be accelerated if we default on our obligations under the ABL Facility. At March 31, 2011, we had \$77.1 million of borrowing availability under the ABL Facility.

---

## **Table of Contents**

The ABL Facility is required to be prepaid only to the extent that the aggregate amount of outstanding borrowings, unreimbursed letter of credit drawings and undrawn letters of credit under the relevant tranche exceeds the lesser of the applicable commitments and the applicable borrowing base in effect at such time for such tranche. The borrowing base for the current asset tranche consists of eligible accounts receivable, eligible inventory and eligible tractor and trailer fleet, and the borrowing base for the fixed asset tranche consists of eligible real property and certain eligible equipment.

The interest rate under the current asset tranche is based, at our option, on either the administrative agent's base rate plus 1.00% or on the Eurodollar LIBOR rate plus an applicable margin; at March 31, 2011, the applicable margin was 2.00%. The administrative agent's base rate is equal to the greater of the federal funds overnight rate plus 0.50% or the prime rate. The interest rate under the fixed asset tranche is based, at our option, on either the administrative agent's base rate plus 1.25% or on LIBOR plus an applicable margin; at March 31, 2011, the applicable margin was 2.25%. The applicable margin under either tranche is subject to increases or reductions based upon the amounts available for borrowing under the ABL Facility. Interest is generally payable quarterly, but may be payable in periods from one to six months in the case of some LIBOR loans. The interest rate on the ABL Facility at March 31, 2011 and 2010 was 2.4% and 2.5%, respectively.

The ABL Facility provides for payment of the following in respect of outstanding letters of credit:

a letter of credit fee, payable quarterly in arrears, equal to (i) for standby letters of credit, the applicable margin under the current asset tranche, and (ii) for trade letters of credit, the applicable margin under the current asset tranche minus 0.50%, in each case from time to time in effect on the aggregate outstanding stated amounts of such letters of credit;

a fronting fee, payable quarterly in arrears, equal to 0.125% per annum on the aggregate outstanding stated amounts of such letter of credit; and

customary administrative charges.

We pay a commitment fee equal to 0.25% per annum on the available daily undrawn portion of the available commitment under the ABL Facility. This commitment fee is paid quarterly in arrears.

We may request up to \$150.0 million in letters of credit, subject to certain limitations based on availability under the ABL Facility. In the event we prepay all outstanding amounts under the fixed asset tranche of the ABL Facility, and all commitments thereunder are terminated, prior to the termination of the ABL Facility, no less than \$150.0 million under the current asset tranche will be available for letters of credit. At March 31, 2011, we had \$30.3 million of letters of credit issued.

We incurred \$6.9 million in debt issuance costs relating to the ABL Facility. We are amortizing these costs over the term of the ABL Facility.

### ***9.875% Second-Priority Senior Secured Notes Due 2018***

On November 3, 2010 we issued \$225.0 million aggregate principal amount of the 2018 Notes. With the proceeds of the issuance of the 2018 Notes, we repaid at maturity our 9% Notes, fully redeemed our 2012 Notes and our 2013 Senior Notes, redeemed \$47.5 million of our 2013 PIK Notes, and paid down a portion of our outstanding borrowings under the ABL Facility.

The payment obligations of QD LLC and QD Capital under the 2018 Notes are guaranteed by QDI and by all of its domestic subsidiaries other than immaterial subsidiaries. The 2018 Notes are senior obligations of QD LLC and QD Capital and are secured by a second-priority lien on certain assets. Pursuant to an intercreditor agreement, the liens on the collateral securing the 2018 Notes rank junior in right of payment to the ABL Facility and obligations under certain hedging agreements and cash management obligations and certain other first-lien obligations.

In connection with the issuance of the 2018 Notes, we have agreed pursuant to a registration rights agreement to file a registration statement relating to an offer to exchange the 2018 Notes for debt securities which are substantially identical in all material respects to the 2018 Notes, and to use our commercially reasonable efforts to cause the registration statement to be declared effective by the SEC within 365 days after November 3, 2010. If we fail to satisfy these obligations, we will be required to pay additional interest. Interest on the 2018 Notes is payable at a rate of 9.875% per annum, semiannually on May 1 and November 1 of each year, commencing on May 1, 2011.



**Table of Contents**

The 2018 Notes mature on November 1, 2018. Prior to November 1, 2014, we may redeem the 2018 Notes, in whole or in part, at a price equal to 100% of the principal amount of the 2018 Notes redeemed, plus accrued and unpaid interest to the redemption date, plus an additional make-whole premium intended to capture the value of holding 2018 Notes through November 1, 2014, but not less than 1%. During any twelve-month period prior to November 1, 2014, we may also redeem up to 10% of the original aggregate principal amount of the 2018 Notes at a redemption price of 103%, plus accrued and unpaid interest to the redemption date. Additionally, at any time prior to November 1, 2014, we may redeem up to 35% of the principal amount of the 2018 Notes at a redemption price of 109.875%, plus accrued and unpaid interest to the redemption date, with the net proceeds of one or more equity offerings so long as at least 50% of the aggregate original principal amount of the 2018 Notes remains outstanding afterwards. On or after November 1, 2014, we may redeem the 2018 Notes, in whole or in part, at the following prices (expressed as a percentage of principal amount), plus accrued and unpaid interest to the redemption date, if redeemed during the 12-month period commencing on November 1 of the years set forth below:

| Period              | Redemption Price |
|---------------------|------------------|
| 2014                | 104.938%         |
| 2015                | 102.469%         |
| 2016 and thereafter | 100.000%         |

We recorded \$5.8 million in debt issuance costs relating to the 2018 Notes, of which \$5.6 million was related to the new issuance and \$0.2 million of unamortized debt issuance costs related to the 2013 Senior Notes. We are amortizing these costs over the remaining term of the 2018 Notes.

***11.75% Senior Subordinated PIK Notes Due 2013***

On October 15, 2009, we issued \$80.7 million aggregate principal amount of the 2013 PIK Notes. The payment obligations of QD LLC and QD Capital under the 2013 PIK Notes are guaranteed by QDI and by all of its domestic subsidiaries other than immaterial subsidiaries. The 2013 PIK Notes are unsecured senior subordinated obligations of QD LLC and QD Capital. Interest is payable on the 2013 PIK Notes at 11.75% per annum, payable 9% in cash and 2.75% in the form of additional 2013 PIK Notes, quarterly on February 1, May 1, August 1 and November 1 of each year. The 2013 PIK Notes mature on November 1, 2013. We may redeem the 2013 PIK Notes, in whole or part at a price equal to 100% of the principal amount of the 2013 PIK Notes redeemed plus accrued and unpaid interest to the redemption date.

On December 3, 2010 we redeemed \$47.5 million of these notes plus accrued and unpaid interest, in conjunction with the issuance of the 2018 Notes. On December 10, 2010 and December 20, 2010, we repurchased \$2.2 million and \$0.3 million, respectively, of these notes plus accrued and unpaid interest. On January 20, 2011, we redeemed \$10.0 million of these notes plus accrued and unpaid interest. On March 11, 2011, we redeemed \$17.5 million of these notes plus accrued and unpaid interest.

We recorded \$1.5 million in debt issuance costs relating to the 2013 PIK Notes, of which \$0.5 million of unamortized debt issuance costs related to the 9% Notes and \$1.0 million were related to the new issuance. In addition, we recorded \$6.7 million in note issuance discount due to warrants issued concurrently with the issuance of the 2013 PIK Notes. The amount represents the fair market value of the warrants at time of issuance. We are amortizing these costs over the remaining term of the 2013 PIK Notes. In conjunction with the December 3, 2010 redemption and the December 10, 2010 and December 20, 2010 repurchases, we expensed \$7.4 million of unamortized debt issuance costs and unamortized original issue discount in the fourth quarter of 2010. In connection with the January 20, 2011 and March 11, 2011 redemptions, we wrote-off \$1.8 million of unamortized debt issuance costs and unamortized original issue costs in the three months ending March 31, 2011.

***10% Senior Notes Due 2013***

On October 15, 2009, we issued approximately \$134.5 million aggregate principal amount of the 2013 Senior Notes. On December 3, 2010, we fully redeemed the 2013 Senior Notes with a portion of the proceeds of the issuance of \$225.0 million aggregate principal amount of the 2018 Notes.

***Senior Floating Rate Notes Due 2012***

On January 28, 2005, we issued \$85.0 million aggregate principal amount of our 2012 Notes. On December 18, 2007, we issued a second series of 2012 Notes in the original principal amount of \$50.0 million. On December 3, 2010, we fully redeemed the remaining 2012 Notes with a portion of the proceeds of the issuance of \$225.0 million aggregate principal amount of the 2018 Notes.



---

**Table of Contents**

***9% Senior Subordinated Notes Due 2010***

On September 30, 2003, we issued \$125.0 million aggregate principal amount of our 9% Notes. On November 15, 2010, we repaid at maturity the remaining \$16.0 million of 9% Notes with a portion of the proceeds of the issuance of \$225.0 million aggregate principal amount of the 2018 Notes. We incurred \$5.5 million in debt issuance costs relating to the issuance of the 9% Notes. Approximately \$0.5 million of unamortized debt issuance costs were included in debt issuance costs related to the 2013 Senior Notes. All remaining debt issuance costs have been fully amortized.

The note issuance and subsequent note redemptions in November 2010 described above were primarily treated as a debt extinguishment and partially a debt modification in accordance with applicable FASB guidance.

***Collateral, Guarantees and Covenants***

The ABL Facility contains a fixed charge coverage ratio of 1.0 to 1.0 which only needs to be met if borrowing availability is less than \$20.0 million. The ABL Facility contains a number of covenants that, among other things, restrict, subject to certain exceptions, our ability to (i) sell assets; (ii) incur additional debt; (iii) prepay other debt (including the 2018 Notes and the 2013 PIK Notes); (iv) repurchase or pay dividends on QDI's common stock; (v) create liens on assets; (vi) make investments; (vii) make certain acquisitions; (viii) engage in mergers or consolidations; (ix) engage in certain transactions with affiliates; (x) amend certain charter documents and material agreements governing subordinated debt, including the 2018 Notes and the 2013 PIK Notes; (xi) change the business conducted by us and our subsidiaries; and (xii) enter into agreements that restrict dividends from subsidiaries. The ABL Facility also contains certain customary events of default, which, if any of them occurs, may result in the principal, interest and any other monetary obligations under the ABL Facility becoming immediately payable.

The indentures governing the 2018 Notes and the 2013 PIK Notes contain covenants that restrict, subject to certain exceptions, our ability to, among other things: (i) incur additional debt or issue certain preferred shares; (ii) pay dividends on or make other distributions in respect of QDI's common stock or make other restricted payments; (iii) make certain investments; (iv) sell certain assets; (v) create or permit to exist dividend and/or payment restrictions affecting their restricted subsidiaries; (vi) create liens on certain assets to secure debt; (vii) consolidate, merge, sell or otherwise dispose of all or substantially all of their assets; (viii) enter into certain transactions with their affiliates; and (ix) designate their subsidiaries as unrestricted subsidiaries. The indentures also provide certain customary events of default, which, if any of them occurs, may result in the principal, interest and any other monetary obligations on the then outstanding 2018 Notes and 2013 PIK Notes becoming payable immediately.

The payment obligations under the ABL Facility are senior secured obligations of QD LLC and QD Capital and are secured by certain assets and guaranteed by QDI and by all of its domestic subsidiaries other than immaterial subsidiaries. The payment obligations of QD LLC and QD Capital under the 2018 Notes and the 2013 PIK Notes are guaranteed by QDI and by all of its domestic subsidiaries other than immaterial subsidiaries. The 2018 Notes, and the guarantees thereof, are senior obligations of QD LLC and QD Capital and are secured by a second-priority lien on certain assets. Pursuant to an intercreditor agreement, the liens on the collateral securing the 2018 Notes rank junior in right of payment to the ABL Facility and obligations under certain hedging agreements and cash management obligations and certain other first lien obligations. The 2013 PIK Notes, and the guarantees thereof, are unsecured senior subordinated obligations ranking junior in right of payment to all of our existing and future senior debt, and all liabilities of our subsidiaries that do not guarantee the 2013 PIK Notes. The 2013 PIK Notes are effectively junior to all of our existing and future secured debt, including borrowings under the ABL Facility, to the extent of the value of the assets securing such debt.

We believe that we were in compliance with the covenants under the ABL Facility, the 2018 Notes and the 2013 PIK Notes at March 31, 2011.

***Other Issues***

While uncertainties relating to environmental, labor and other regulatory matters exist within the trucking industry, management is not aware of any trends or events likely to have a material adverse effect on liquidity or the accompanying financial statements. Our credit rating is affected by many factors, including our financial results, operating cash flows and total indebtedness.

The ABL Facility and the indentures governing the 2018 Notes and the 2013 PIK Notes contain certain limitations on QD LLC's ability to make distributions to QDI. We do not consider these restrictions to be significant, because QDI is a holding company with no significant operations or assets, other than ownership of 100% of QD LLC's membership units. QD LLC's direct and indirect wholly owned subsidiaries are generally permitted to make distributions to QD LLC, which is the principal obligor under the ABL Facility, the 2018 Notes and the 2013 PIK Notes.





**Table of Contents**

***FORWARD-LOOKING STATEMENTS AND CERTAIN CONSIDERATIONS***

This report, along with other documents that are publicly disseminated by us, contain or might contain forward-looking statements within the meaning of the Securities Exchange Act of 1934, as amended. All statements included in this report and in any subsequent filings made by us with the SEC other than statements of historical fact, that address activities, events or developments that we or our management expect, believe or anticipate will or may occur in the future are forward-looking statements. These statements represent our reasonable judgment on the future based on various factors and using numerous assumptions and are subject to known and unknown risks, uncertainties and other factors that could cause our actual results and financial position to differ materially. We claim the protection of the safe harbor for forward-looking statements provided in the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act and Section 21E of the Exchange Act. Examples of forward-looking statements include: (i) projections of revenue, earnings, capital structure and other financial items, (ii) statements of our plans and objectives, (iii) statements of expected future economic performance, and (iv) assumptions underlying statements regarding us or our business. Forward-looking statements can be identified by, among other things, the use of forward-looking language, such as targets, modes, believes, expects, estimates, may, will, should, could, seeks, plans, intends, anticipates or scheduled to or the other variations of those terms or comparable language, or by discussions of strategy or other intentions.

Forward-looking statements are subject to known and unknown risks, uncertainties and other factors that could cause our actual results to differ materially from those contemplated by the statements. The forward-looking information is based on various factors and was derived using numerous assumptions. Important factors that could cause our actual results to be materially different from the forward-looking statements include the following risks and other factors discussed under the Item 1A Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2010. These factors include:

the effect of local and national economic, credit and capital market conditions on the economy in general, and on the particular industries in which we operate, including excess capacity in the industry, the availability of qualified drivers, changes in fuel and insurance prices, interest rate fluctuations, and downturns in customers' business cycles and shipping requirements;

our substantial leverage, our ability to make required payments and restrictions contained in our debt arrangements;

competition and rate fluctuations;

our reliance on independent affiliates and independent owner-operators;

the loss of or material reduction in the services to one or more of our major customers;

our liability as a self-insurer to the extent of our deductibles as well as changing conditions and pricing in the insurance marketplace;

increased unionization, which could increase our operating costs or constrain operating flexibility;

changes in the future, or our inability to comply with, governmental regulations and legislative changes affecting the transportation industry;

our ability to comply with current and future environmental regulations and the increasing costs relating to environmental compliance;

## Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

potential disruption at U.S. ports of entry;

diesel fuel prices and our ability to recover costs through fuel surcharges;

our ability to attract and retain qualified drivers;

terrorist attacks and the cost of complying with existing and future anti-terrorism security measures;

our dependence on senior management;

the potential loss of our ability to use net operating losses to offset future income;

potential future impairment charges;

the interests of our largest shareholder, which may conflict with your interests;

our ability to successfully identify acquisition opportunities, consummate such acquisitions and integrate acquired businesses;

our success in entering new markets;

adverse weather conditions;

the impact of our restructuring on our operations and costs;

changes in health insurance benefit regulations;

our liability for our proportionate share of unfunded vested benefit liabilities in the event of our withdrawal from any of our multi-employer pension plans; and

**Table of Contents**

changes in planned or actual capital expenditures due to operating needs, changes in regulation, covenants in our debt arrangements and other expenses, including interest expenses.

In addition, there may be other factors that could cause our actual results or financial condition to be materially different from the results referenced in the forward-looking statements. All forward-looking statements contained in this Quarterly Report on Form 10-Q are qualified in their entirety by this cautionary statement. Forward-looking statements speak only as of the date they are made, and we do not intend to update or otherwise revise the forward-looking statements to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q or to reflect the occurrence of unanticipated events.

**ADDITIONAL INFORMATION AVAILABLE ON COMPANY WEBSITE**

Our most recent Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports may be viewed or downloaded electronically or as paper copies from our website: [www.qualitydistribution.com](http://www.qualitydistribution.com) as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Our recent press releases are also available to be viewed or downloaded electronically at [www.qualitydistribution.com](http://www.qualitydistribution.com). We will also provide electronic or paper copies of our SEC filings free of charge on request. We regularly post or otherwise make available information on the Investor Relations section of our website that may be important to investors. Any information on or linked from our website is not incorporated by reference into this Quarterly Report on Form 10-Q.

**ITEM 3 Quantitative and Qualitative Disclosures about Market Risk**

We are subject to market risks from (i) interest rates due to our variable interest rate indebtedness, (ii) foreign currency fluctuations due to our international operations and (iii) increased commodity prices due to the diesel consumption necessary for our operations. During the three months ended March 31, 2011, we have not held derivative instruments or engaged in other hedging transactions to reduce our exposure to such risks.

**Interest Rate Risk**

We are exposed to the impact of interest rate changes through our variable-rate borrowings under the ABL Facility. With regard to the ABL Facility, at QD LLC's option, the applicable margin for borrowings under the current asset tranche at March 31, 2011 was 1.00% with respect to base rate borrowings and 2.00% with respect to LIBOR borrowings. The applicable margin for borrowings under the fixed asset tranche at March 31, 2011 was 1.25% with respect to base rate borrowings and 2.25% with respect to LIBOR borrowings. The applicable margin for such borrowings will be reduced or increased based on aggregate borrowing base availability under the ABL Facility over the life of the ABL Facility. The base rate under the ABL Facility is equal to the higher of the prime rate and the federal funds overnight rate plus 0.50%.

|              | Balance at<br>March 31, 2011<br>(\$ in 000s) | Interest Rate at<br>March 31,<br>2011 | Effect of 1%<br>Increase<br>(\$ in 000s) |
|--------------|--|---------------------------------------|--|
| ABL Facility | \$ 48,500                                    | 2.38%                                 | \$ 485                                   |

At March 31, 2011, a 1% point increase in the current per annum interest rate for each would result in \$0.5 million of additional interest expense during the next year. The foregoing calculation assumes an instantaneous 1% point increase in the rates of all of our indebtedness and that the principal amount of each is the amount outstanding as of March 31, 2011. The calculation therefore does not account for the differences in the market rates upon which the interest rates of our indebtedness are based, our various options to elect the lower of two different interest rates under our borrowings or other possible actions, such as prepayment, that we might take in response to any rate increase.

**Foreign Currency Exchange Rate Risk**

Operating in international markets involves exposure to the possibility of volatile movements in foreign exchange rates. The currencies in each of the countries in which we operate affect:

## Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

the results of our international operations reported in United States dollars; and

the value of the net assets of our international operations reported in United States dollars.

These exposures may impact future earnings or cash flows. Revenue from foreign locations (Canada and Mexico) represented approximately 6.3% of our consolidated revenue for the three months ended March 31, 2011 and 5.7% of our consolidated revenue for the three months ended March 31, 2010. The economic impact of foreign exchange rate movements is complex because such changes are often linked to variability in real growth, inflation, interest rates, governmental actions and other factors. These changes, if material, could cause us to adjust our financing and operating strategies. Therefore, to isolate the effect of changes in currency does not accurately portray the effect of these other important economic factors. As foreign exchange rates change, translation of the income statements of our international subsidiaries into U.S. dollars affects year-over-year comparability of operating results. While we may hedge specific transaction risks, we generally do not hedge translation risks because we believe there is no long-term economic benefit in doing so.

---

## **Table of Contents**

Assets and liabilities for our Canadian operations are matched in the local currency, which reduces the need for dollar conversion. Our Mexican operations use the United States dollar as their functional currency. Any foreign currency impact on translating assets and liabilities into dollars is included as a component of shareholders' equity. Our revenue results for the three months ended March 31, 2011 were positively impacted by a \$0.6 million foreign currency movement, primarily due to the strengthening of the Canadian dollar against the United States dollar.

Changes in foreign exchange rates that had the largest impact on translating our international operating profits for the first three months of 2011 related to the Canadian dollar versus the United States dollar. We estimate that a 1% adverse change in the Canadian dollar foreign exchange rate would have decreased our revenues by approximately \$0.1 million for the three months ended March 31, 2011, assuming no changes other than the exchange rate itself. Our intercompany loans are subject to fluctuations in exchange rates primarily between the United States dollar and the Canadian dollar. Based on the outstanding balance of our intercompany loans at March 31, 2011, a change of 1% in the exchange rate for the Canadian dollar would cause a change in our foreign exchange result of less than \$0.1 million.

### ***Commodity Price Risk***

The price and availability of diesel fuel are subject to fluctuations due to changes in the level of global oil production, seasonality, weather, global politics and other market factors. Historically, we have been able to recover a majority of fuel price increases from our customers in the form of fuel surcharges. The price and availability of diesel fuel can be unpredictable as well as the extent to which fuel surcharges can be collected to offset such increases. In the three months ended March 31, 2011 and 2010, a majority of fuel costs were covered through fuel surcharges.

## **ITEM 4 Controls and Procedures**

### ***Evaluation of disclosure controls and procedures***

As required by Exchange Act Rules 13a-15(b) and 15d-15(b), management has evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on their evaluation, management concluded our disclosure controls and procedures (as defined in Securities Exchange Act Rules 13a-15(e) and 15d-15(e)) were effective as of March 31, 2011 to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and were effective as of March 31, 2011 to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure.

### ***Changes in Internal Control Over Financial Reporting***

There were no changes in our internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) during the quarter ended March 31, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II OTHER INFORMATION**

## **ITEM 1 Legal Proceedings**

Other than reported in Item 3 - Legal Proceedings of our Annual Report on Form 10-K for the year ended December 31, 2010, Note 20. Commitments and Contingencies to our audited consolidated financial statements contained in such Form 10-K and Note 12. Commitments and Contingencies to our unaudited consolidated financial statements included in this report, we are not currently a party to any material pending legal proceedings other than routine matters incidental to our business and no material developments have occurred in any proceedings described in such Form 10-K.

## **ITEM 1A Risk Factors**

You should carefully consider the factors disclosed in our Annual Report on Form 10-K for the year ended December 31, 2010 included under Item 1A Risk Factors in addition to the other information set forth in this report. The risks described in our Annual Report on Form 10-K and our Quarterly Reports on Form 10-Q are not the only risks facing our Company.



**Table of Contents**

**ITEM 2 Unregistered Sale of Equity Securities and Use of Proceeds**

None.

**ITEM 3 Defaults Upon Senior Securities**

None.

**ITEM 4 [Removed and Reserved.]**

**ITEM 5 Other Information**

None.



**Table of Contents**

**ITEM 6 Exhibits**

| <b>Exhibit No.</b> | <b>Description</b>   |
|--------------------|--|
| 31.1               | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2               | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 32.1               | Certification of Chief Executive Officer and Chief Financial Officer pursuant To 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

May 6, 2011

QUALITY DISTRIBUTION, INC.

/s/ GARY R. ENZOR  
**GARY R. ENZOR,**

**CHIEF EXECUTIVE OFFICER**

**(PRINCIPAL EXECUTIVE OFFICER)**

May 6, 2011

/s/ JOSEPH J. TROY  
**JOSEPH J. TROY,**

**EXECUTIVE VICE PRESIDENT AND CHIEF FINANCIAL OFFICER**

**(PRINCIPAL FINANCIAL AND ACCOUNTING OFFICER)**