

QUALITY DISTRIBUTION INC
Form 10-Q
August 09, 2007
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 June 30, 2007

or

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

For the transition period from _____ to _____

Commission File Number: 000-24180

Quality Distribution, Inc.

(Exact name of registrant as specified in its charter)

Florida
(State or other jurisdiction of

incorporation or organization)

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

813-630-5826

59-3239073
(I.R.S. Employer

Identification No.)

33610
(Zip Code)

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

(Registrant's telephone number, including area code)

3802 Corporex Park Drive, Tampa, FL 33619

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

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

Table of Contents

QUALITY DISTRIBUTION, INC.

CONTENTS

<u>PART I FINANCIAL INFORMATION</u>	<u>1</u>
<u>ITEM 1 FINANCIAL STATEMENTS</u>	<u>1</u>
<u>Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2007 and 2006</u>	<u>1</u>
<u>Consolidated Balance Sheets as of June 30, 2007 and December 31, 2006</u>	<u>2</u>
<u>Consolidated Statements of Shareholders' Equity/(Deficit) for the Six Months Ended June 30, 2007 and 2006</u>	<u>3</u>
<u>Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2007 and 2006</u>	<u>4</u>
<u>Notes to Consolidated Financial Statements</u>	<u>5</u>
<u>ITEM 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>24</u>
<u>ITEM 3 Quantitative and Qualitative Disclosures About Market Risk</u>	<u>37</u>
<u>ITEM 4 Controls and Procedures</u>	<u>39</u>
<u>PART II OTHER INFORMATION</u>	<u>39</u>
<u>ITEM 1 Legal Proceedings</u>	<u>39</u>
<u>ITEM 1A Risk Factors</u>	<u>39</u>
<u>ITEM 2 Unregistered Sale of Equity Securities and Use of Proceeds</u>	<u>40</u>
<u>ITEM 3 Defaults Upon Senior Securities</u>	<u>40</u>
<u>ITEM 4 Submission of Matters to a Vote of Security Holders</u>	<u>40</u>
<u>ITEM 5 Other Information</u>	<u>40</u>
<u>ITEM 6 Exhibits</u>	<u>41</u>
<u>Signatures</u>	<u>42</u>

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

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

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Diluted	19,480	19,734	19,478	19,616
---------	--------	--------	--------	--------

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

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

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

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

SHAREHOLDERS EQUITY

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

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

Table of Contents

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

Consolidated Statements of Shareholders' Equity/(Deficit)

For the Six Months Ended June 30, 2007 and 2006

Unaudited (In 000 \$)

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

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

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

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

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

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

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

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

Supplemental disclosures of non-cashflow information:

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

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

Table of Contents

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

Quality Distribution, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Summary of Significant Accounting Policies

Basis of Presentation

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

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

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

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

New Accounting Pronouncements

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

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

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

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

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

Goodwill and Intangible Assets*Goodwill*

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

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

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

Intangible Assets

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

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

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

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

Comprehensive income is as follows (in thousands):

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

3. Earnings Per Share

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

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

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

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

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

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

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

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

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

4. Stock-Based Compensation

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

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

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

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

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

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

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

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

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

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

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

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

5. Employee Benefit Plans

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

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

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

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

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

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

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

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

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

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

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

7. Income Taxes

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

Table of Contents

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

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

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

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

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

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

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

8. Commitments and Contingencies

Environmental Matters

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

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

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

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

Table of Contents

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

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

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

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

Reserves

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

Property Contamination Liabilities

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

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

Bridgeport, New Jersey

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

Table of Contents

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

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

William Dick, Pennsylvania

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

Other Owned Property

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

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

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

Table of Contents

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

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

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

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

Other Environmental Matters

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

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

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

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

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

9. Subsequent Events

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

10. Guarantor Subsidiaries

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

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

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

Table of Contents

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

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

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

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

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

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

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

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

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

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

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

	QDI	QD LLC and QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Operating revenues:						
Transportation	\$	\$	\$ 293,756	\$	\$	\$ 293,756
Other service revenue			35,590	443		36,033
Fuel surcharge			42,938			42,938
Total operating revenues			372,284	443		372,727
Operating expenses:						
Purchased transportation			239,374			239,374
Compensation			40,275	(19)		40,256
Fuel, supplies and maintenance			35,549			35,549
Depreciation and amortization			7,887	343		8,230
Selling and administrative			13,801	71		13,872
Insurance claims			11,094	(12)		11,082
Taxes and Licenses			1,624			1,624
Communication and utilities			5,129			5,129
Loss on disposal of property and equipment			176	23		199
Operating income			17,375	37		17,412
Interest expense		(14,835)	(1,155)		238	(15,752)
Interest income	(4)		345	272	(238)	375
Other income (expense)	(7)		146	220		359
Income (loss) before taxes	(11)	(14,835)	16,711	529		2,394
Income tax provision (benefit)	(1,007)		1,137	117		247
Equity in (loss) earnings of subsidiaries	1,151	15,986			(17,137)	
Net (loss) income	\$ 2,147	\$ 1,151	\$ 15,574	\$ 412	\$ (17,137)	\$ 2,147

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

	QDI	QD LLC and QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Operating revenues:						
Transportation	\$	\$	\$ 291,626	\$	\$	\$ 291,626
Other service revenue			34,669	538		35,207
Fuel surcharge			42,195			42,195
Total operating revenues			368,490	538		369,028
Operating expenses:						
Purchased transportation			251,390			251,390
Compensation			36,274			36,274
Fuel, supplies and maintenance			23,722	17		23,739
Depreciation and amortization			7,460	328		7,788
Selling and administrative			10,577	174		10,751
Insurance claims			7,928			7,928
Taxes and Licenses			1,644	1		1,645
Communication and utilities			4,855			4,855
Gain on disposal of property and equipment			(223)			(223)
Operating income			24,863	18		24,881
Interest expense		(15,081)	(406)		222	(15,265)
Interest income	739		346	247	(222)	1,110
Other income (expense)			270	87		357
Income (loss) before taxes	739	(15,081)	25,073	352		11,083
Income tax provision (benefit)		(1,400)	2,407	62		1,069
Equity in earnings (loss) of subsidiaries	9,275	22,956			(32,231)	
Net income (loss)	\$ 10,014	\$ 9,275	\$ 22,666	\$ 290	\$ (32,231)	\$ 10,014

Table of Contents**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES****Consolidating Balance Sheet****June 30, 2007****Unaudited (In 000 s)**

	QDI	QD LLC & QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS						
Current assets:						
Cash and cash equivalents	\$	\$	\$ 942	\$ 1,936	\$	\$ 2,878
Accounts receivable, net	55		95,121	180		95,356
Prepaid expenses		33	7,848			7,881
Prepaid tires			7,446	42		7,488
Deferred tax asset			18,320			18,320
Other	5		5,904	13		5,922
Total current assets	60	33	135,581	2,171		137,845
Property and equipment, net			115,113	641		115,754
Assets held-for-sale			367			367
Goodwill			140,404			140,404
Intangibles, net			1,370			1,370
Investment in subsidiaries	33,565	610,871			(644,436)	
Non-current deferred tax asset	1,007		19,733			20,740
Other assets		5,751	3,174			8,925
Total assets	\$ 34,632	\$ 616,655	\$ 415,742	\$ 2,812	\$ (644,436)	\$ 425,405
LIABILITIES, MINORITY INTEREST, SHAREHOLDERS' EQUITY (DEFICIT)						
Current liabilities:						
Current maturities of indebtedness	\$	\$ 1,400	\$	\$	\$	\$ 1,400
Current maturities of capital leases			1,264			1,264
Accounts payable			13,382			13,382
Intercompany	(3,063)	305,320	(297,606)	(4,651)		
Affiliates and independent owner-operators payable			14,927			14,927
Accrued expenses	2	3,623	17,959	1		21,585
Environmental liabilities			7,021			7,021
Accrued loss and damage claims			9,468			9,468
Total current liabilities	(3,061)	310,343	(233,585)	(4,650)		69,047
Long-term indebtedness, less current maturities		272,747				272,747
Long-term capital leases, less current maturities			4,044			4,044
Environmental liabilities			4,337			4,337
Accrued loss and damage claims			18,232			18,232
Other non-current liabilities			16,116	569		16,685
Deferred tax liability				787		787

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Total liabilities	(3,061)	583,090	(190,856)	(3,294)		385,879
Minority interest in subsidiary			1,833			1,833
Shareholders' equity (deficit):						
Common stock	360,862	354,963	437,796	7,629	(800,388)	360,862
Treasury stock	(1,494)					(1,494)
(Accumulated deficit)/retained earnings	(113,047)	(113,110)	185,222	(1,022)	(71,090)	(113,047)
Stock recapitalization	(189,589)	(189,589)		(55)	189,644	(189,589)
Accumulated other comprehensive loss	(18,699)	(18,699)	(18,253)	(446)	37,398	(18,699)
Stock purchase warrants						
Stock subscription receivable	(340)					(340)
Total shareholders' equity (deficit)	37,693	33,565	604,765	6,106	(644,436)	37,693
Total liabilities, minority interest and shareholders' equity (deficit)	\$ 34,632	\$ 616,655	\$ 415,742	\$ 2,812	\$ (644,436)	\$ 425,405

Table of Contents**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES****Consolidating Balance Sheet****December 31, 2006****Unaudited (In 000 s)**

	QDI	QD LLC & QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS						
Current assets:						
Cash and cash equivalents	\$	\$	\$ 5,386	\$ 1,455	\$	\$ 6,841
Accounts receivable, net	58		85,052	372		85,482
Prepaid expenses		84	5,987	30		6,101
Prepaid tires			7,475	42		7,517
Deferred tax asset			18,320			18,320
Other	(6)		9,471	(251)		9,214
Total current assets	52	84	131,691	1,648		133,475
Property and equipment, net			115,917	1,047		116,964
Assets held-for-sale			381			381
Goodwill			138,980			138,980
Intangibles, net			635			635
Investment in subsidiaries	32,909	595,379			(628,288)	
Non-current deferred tax asset			19,578			19,578
Other assets		6,649	4,600			11,249
Total assets	\$ 32,961	\$ 602,112	\$ 411,782	\$ 2,695	\$ (628,288)	\$ 421,262
LIABILITIES, MINORITY INTEREST, SHAREHOLDERS' EQUITY (DEFICIT)						
Current liabilities:						
Current maturities of indebtedness	\$	\$ 1,400	\$	\$	\$	\$ 1,400
Current maturities of capital leases			1,178			1,178
Accounts payable			13,914	43		13,957
Intercompany	(2,937)	291,341	(284,055)	(4,349)		
Affiliates and independent owner-operators payable			11,025			11,025
Accrued expenses	735	3,636	16,784	42		21,197
Environmental liabilities			5,995			5,995
Accrued loss and damage claims			11,533			11,533
Total current liabilities	(2,202)	296,377	(223,626)	(4,264)		66,285
Long-term indebtedness, less current maturities		272,826				272,826
Long-term capital leases, less current maturities			3,718			3,718
Environmental liabilities			5,831			5,831
Accrued loss and damage claims			20,633			20,633
Other non-current liabilities			14,249			14,249
Deferred tax liability				724		724
Total liabilities	(2,202)	569,203	(179,195)	(3,540)		384,266

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Minority interest in subsidiary			1,833			1,833
Shareholders' equity (deficit):						
Common stock	359,995	354,963	437,796	7,629	(800,388)	359,995
Treasury stock	(1,527)					(1,527)
(Accumulated deficit)/retained earnings	(114,866)	(113,934)	169,648	(1,107)	(54,607)	(114,866)
Stock recapitalization	(189,589)	(189,589)		(55)	189,644	(189,589)
Accumulated other comprehensive loss	(18,531)	(18,531)	(18,300)	(232)	37,063	(18,531)
Stock purchase warrants	21					21
Stock subscription receivable	(340)					(340)
Total shareholders' equity (deficit)	35,163	32,909	589,144	6,235	(628,288)	35,163
Total liabilities, minority interest and shareholders' equity (deficit)	\$ 32,961	\$ 602,112	\$ 411,782	\$ 2,695	\$ (628,288)	\$ 421,262

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

	QDI	QD LLC and QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Cash flows from operating activities:						
Net income (loss)	\$ 2,147	\$ 1,151	\$ 15,574	\$ 412	\$ (17,137)	\$ 2,147
Adjustments for non-cash charges	(2,147)	(14,916)	10,136	119	17,137	10,329
Net changes in assets and liabilities		(14)	(11,308)	121		(11,201)
Intercompany activity	(72)	13,779	(13,405)	(302)		
Net cash provided by (used in) operating activities	(72)		997	350		1,275
Cash flows from investing activities:						
Capital expenditures			(4,395)	(20)		(4,415)
Acquisition of businesses and assets			(3,032)			(3,032)
Proceeds from sales of property and equipment			4,141	102		4,243
Other						
Net cash (used in) investing activities			(3,286)	82		(3,204)
Cash flows from financing activities:						
Proceeds from issuance of long-term debt						
Principal payments of long-term debt		(700)				(700)
Principal payments of capital lease obligations			(603)			(603)
Proceeds from revolver		26,800				26,800
Payments on revolver		(26,300)				(26,300)
Deferred financing fees						
Other	72		(1,356)			(1,284)
Intercompany activity		200	(200)			
Net cash used in financing activities	72		(2,159)			(2,087)
Effect of exchange rate changes on cash			4	49		53
Net increase (decrease) in cash and cash equivalents			(4,444)	481		(3,963)
Cash and cash equivalents, beginning of period			5,386	1,455		6,841
Cash and cash equivalents, end of period	\$	\$	\$ 942	\$ 1,936	\$	\$ 2,878

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

	QDI	QD LLC and QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Cash flows from operating activities:						
Net income (loss)	\$ 10,014	\$ 9,275	\$ 22,666	\$ 290	\$ (32,231)	\$ 10,014
Adjustments for non-cash charges	(10,014)	(21,884)	8,368	328	32,231	9,029
Net Changes in assets and liabilities		(1,252)	(11,807)	(3,773)		(16,832)
Intercompany activity						
		13,861	(17,330)	3,469		
Net cash provided by (used in) operating activities			1,897	314		2,211
Cash flows from investing activities:						
Capital expenditures			(8,095)			(8,095)
Acquisition of business assets			(4,630)			(4,630)
Proceeds from sales of property and equipment			3,330			3,330
Other						
Net cash used in investing activities			(9,395)			(9,395)
Cash flows from financing activities:						
Proceeds from issuance of long-term debt						
Principal payments of long-term debt		(700)				(700)
Principal payments capital lease obligations			(57)			(57)
Proceeds from revolver		113,900				113,900
Payments on revolver		(115,100)				(115,100)
Deferred financing fees						
Other			9,431			9,431
Intercompany activity		1,900	(1,900)			
Net cash provided by financing activities			7,474			7,474
Net increase in cash and cash equivalents			(24)	314		290
Effect of exchange rate changes on cash			93	(23)		70
Cash, beginning of period			607	1,029		1,636
Cash, end of period	\$	\$	\$ 676	\$ 1,320	\$	\$ 1,996

Table of Contents

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

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 dedicated bulk tank truck network in North America based on revenues as reported by Bulk Transporter in its 2006 Annual Gross Revenue Report. 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 (which includes plastics), gasoline and related fuel products and bulk dry and liquid food-grade products. We primarily transport a broad range of chemical products and provide our customers with tank wash facilities, logistics and other value-added services. We are a core carrier for many of the Fortune 500 companies engaged in chemical processing, including The Dow Chemical Company, Procter & Gamble Company, E.I. duPont and PPG Industries, and we provide services to most of the top 100 chemical producers with U.S. operations.

Our revenue is principally a function of the volume of shipments by the bulk chemical industry, the 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, including consumer and industrial products, automotive, paints and coatings, and paper, and tends to vary with changing economic conditions.

Our bulk service network consists primarily of independently owned third-party affiliate terminals and independent owner-operator drivers, supplemented by company operated terminals and trucks. Affiliates are independent companies we contract with to operate trucking terminals and tank washes exclusively on our behalf in defined markets. The 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. This relationship is governed by an extensive contract that sets, among other things, the markets and customers to be served by the affiliate, the revenue and cost sharing arrangement, and non-competition terms. Owner-operators are generally individual drivers who own or lease their tractors and agree to drive exclusively for us and our affiliate partners. We believe the use of affiliates and independent owner-operators provides three key competitive advantages to us in the marketplace. First, we believe that some well managed, locally owned and operated affiliate terminals can provide superior, tailored customer service. Second, affiliates and independent owner-operators are paid a contractually-fixed percentage of revenue for each load they transport creating a variable cost structure that provides protection against cyclical downturns. Third, our heavy reliance on affiliate and independent owner-operators creates an asset-light business model by generally reducing our capital investment, as our affiliate and independent owner-operators directly invest a substantial amount of the capital necessary to support the business they service. We continually evaluate our mix of affiliate and company terminals to optimize customer service, revenue growth, profitability and return on investment.

We believe the most significant factors relevant to our future business growth are the ability to (i) recruit and retain drivers, (ii) add new customers, (iii) obtain additional business from existing customers, (iv) acquire existing transportation related businesses in strategic markets, and (v) continue to leverage our variable cost, asset-light business model. Revenue has been partially driven by pricing increases and we expect pricing increases to continue to positively impact our revenue growth. While a number of our customers operate their own private tank truck fleets and 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 logistic 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 logistic needs to third-party tank truck carriers.

During 2007, we acquired the business of a leading tank wash operation with annual revenues of approximately \$12 million for \$2.4 million. In addition, we have acquired the business of two affiliates for \$2.1 million in the aggregate.

Table of Contents

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

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 United States 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. Annual depreciable lives are 10-25 years for buildings and improvements, 5-7 years for tractors and 15-20 years for trailers, 5-20 years for terminal equipment, 3-7 years for furniture and fixtures, and 3-10 years for other equipment. 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, and 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 of 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 - Goodwill is reviewed for impairment annually and whenever events or circumstances indicate that the book value of the asset may not be recoverable. We periodically evaluate whether events or circumstances indicate possible impairment. We identified three reporting units: transportation operations, insurance operations and foreign operations. We allocated goodwill to the transportation operation as it principally resulted from the acquisition of Chemical Leaman Corporation in 1998. If the fair value of the reporting unit is less than its carrying amount, an impairment loss is recorded to the extent the carrying amount of the goodwill within the reporting unit is greater than the implied fair value of goodwill. We performed our annual assessment during the second quarter of fiscal year 2007. We used a combination of discounted cash flows and valuation of our capital structure to estimate the fair value. Projections for future cash flows were based on our recent operating trends and projected average growth rate for revenue of approximately 5.2% over 5 years. The discount rate used to discount cash flows was based on our weighted average cost of capital of approximately 12.1%. Even if our revenue projections were to decline by 10%, we would not have an impairment of our goodwill. If actual cash flows turn out to be significantly less than projections, then the impairment analysis could change, possibly resulting in future impairment charges.

Deferred tax asset - We use the liability method of accounting for income taxes as prescribed by SFAS No. 109. 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.

Valuation allowances related to United States ("U.S.") tax jurisdictions were reversed during the third and fourth quarter of 2006 based on our assessment that it was more likely than not that those deferred tax assets will be realizable based on income projections of future taxable income and the expiration dates and amounts of net operating loss carryforwards. These estimates of projected taxable income include price and volume increases as well as expected expansion of market share. These projections are based on assumptions which management believes to be reasonable and consistent with current operating results although the actual results achieved may differ materially from these projections

Table of Contents

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

We continue to evaluate quarterly, the positive and negative evidence regarding the realization of net deferred tax assets in accordance with SFAS No. 109, Accounting for Income Taxes. Included in this assessment are estimates of projected future taxable income. Significant management judgment is required in this process and although realization is not assured, based on our assessment, we concluded it is more likely than not, such assets will continue to be realized.

At December 31, 2006 positive evidence included having achieved profitability for financial reporting purposes for eight consecutive quarters beginning with the first quarter of fiscal 2005. Additionally, we were no longer in a U.S. cumulative loss position at the third quarter of fiscal 2006. We determine cumulative losses on a rolling thirty six months basis.

We project both aggregate U.S. pre-tax income as well as aggregate U.S. taxable income for the years 2007 through 2010 sufficient to absorb existing net operating loss carryforwards. At December 31, 2006 we had estimated \$74 million in Federal net operating loss carryforwards, \$2.6 million in alternative minimum tax credit carryforwards and \$1.5 million in foreign tax credit carryforwards. The net operating loss carryforwards will expire in the years 2012 through 2025, while the alternative minimum tax credits may be carried forward indefinitely and the foreign tax credits may be carried forward for ten years. We do not have a history of net operating loss or tax credit carryforwards expiring unused.

We continue to believe it is more likely than not that the net deferred tax assets will be realizable because we are projecting positive pre-tax income for the year and our projection of future taxable income is adequate to absorb current net operating loss carryforwards. We will review our forecast quarterly in relation to actual results and expected trends on an ongoing basis. Failure to achieve our operating income targets may change our assessment regarding the recoverability of our net deferred tax assets and such change could result in a valuation allowance being recorded against some or all of our deferred tax assets. Any increase in a valuation allowance would result in additional income tax expense.

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.

Accident claims reserves - We currently maintain liability insurance for bodily injury and property damage claims, covering all employees, owner-operators and affiliates, and workers compensation insurance coverage on our employees and company drivers. This insurance includes deductibles of \$5 million per incident for bodily injury and property damage and \$1 million per incident for workers compensation for periods after September 15, 2002. 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. In developing liability reserves, we rely on professional third party claims administrators, insurance company estimates, the judgment of our own claims and safety departments 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 revenues, including fuel surcharges and related costs are recognized on the date the freight is delivered. Other service revenues, consisting primarily of lease revenues from affiliates, owner-operators and third parties, are recognized ratably over the lease period. Tank wash revenues are recognized when the wash is completed. Service revenues on insurance policies are recorded as a contractual percentage of premiums received ratably over the period that the insurance covers. We have recognized 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 by 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

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

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 owner-operators and 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. Absent a change in our collection efforts, a \$50 million increase in our receivables (aged between 90 days and 61 days) resulting from transportation billings would increase our allowance for uncollectible receivables by approximately \$0.8 million.

Stock compensation plans - Stock compensation for our 2003 Stock Option Plan is determined by the assumptions required under FASB Statement No. 123(R) Share Based Payment (SFAS 123R), which includes, volatility, expected life, risk-free interest rate, dividend rate and expected forfeiture rate. The total stock compensation that is expected to be recognized over the life of the 226,250 net options issued in January 2007 and the 20,000 options issued in March 2007 is \$1.9 million. If the expected life of the options were to increase by one year, then the total compensation would increase to \$2.0 million. If our risk-free interest rate were to increase by 1% point, then the total compensation would stay constant at approximately \$1.9 million. If our volatility rate were to increase by 1% point, then the total compensation would stay constant at approximately \$1.9 million.

Pension plans - We maintain two noncontributory defined-benefit plans resulting from a prior acquisition that cover certain full-time salaried employees and certain other employees under a collective bargaining agreement. 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 (5.5% to 5.75%) and assumed rates of return (7.50% 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 investment policy target asset allocation differs between our two plans, but it is between 50% to 67% for equities and 33% to 50% for bonds, and the current inflation assumption is 2.5%. We review our actuarial assumptions on an annual basis and make modifications to the assumptions based on current rates and trends when appropriate. As required by GAAP in the United States, the effects of the modifications are amortized over future periods. We believe that the assumptions used are reasonable.

Assumed discount rates and expected return on plan assets have a significant effect on the amounts reported for the pension plan. At December 31, 2006, our projected benefit obligation (PBO) was \$49.8 million. Our projected 2007 net periodic pension expense is \$161,000. A 1.0% decrease in our assumed discount rate would increase our PBO to \$55.4 million and decrease our 2007 net periodic pension expense to \$140,000. A 1.0% increase in our assumed discount rate would decrease our PBO to \$45.1 million and increase our 2007 net periodic pension expense to \$187,000. A 1.0% decrease in our assumed rate of return would not change our PBO but would increase our 2007 net periodic pension expense to \$579,000. A 1.0% increase in our assumed rate of return would not change our PBO but would decrease our 2007 net periodic pension expense to a credit of \$256,000.

New Accounting Pronouncements

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

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities-Including an Amendment of FASB Statement No. 115* , which permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 also includes an amendment to

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

SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, which applies to all entities with available-for-sale and trading securities. This statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. We are currently assessing the potential impacts of implementing this standard.

Results of Operations

The following table presents certain condensed consolidated financial information, as a percentage of revenue, for the three and six months ended June 30, 2007 and June 30, 2006:

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
OPERATING REVENUES:				
Transportation	77.9%	78.5%	78.8%	79.0%
Other service revenue	9.8%	9.0%	9.7%	9.6%
Fuel surcharge	12.3%	12.5%	11.5%	11.4%
Total operating revenues	100.0%	100.0%	100.0%	100.0%
OPERATING EXPENSES:				
Purchased transportation	63.4%	68.2%	64.2%	68.1%
Compensation	10.6%	9.7%	10.8%	9.8%
Fuel, supplies and maintenance	10.0%	6.7%	9.5%	6.5%
Depreciation and amortization	2.1%	2.0%	2.2%	2.1%
Selling and administrative	3.8%	2.9%	3.7%	2.9%
Insurance claims	2.3%	2.1%	3.0%	2.2%
Taxes and licenses	0.4%	0.5%	0.4%	0.5%
Communication and utilities	1.3%	1.2%	1.4%	1.3%
Loss (gain) on disposal of property and equipment	0.0%	0.0%	0.1%	-0.1%
Total operating expenses	93.9%	93.3%	95.3%	93.3%
Operating income	6.1%	6.7%	4.7%	6.7%
Interest expense	-4.1%	-4.2%	-4.2%	-4.1%
Interest income	0.1%	0.5%	0.1%	0.3%
Other income	0.2%	0.1%	0.1%	0.1%
Income before income taxes	2.3%	3.1%	0.7%	3.0%
Provision for income taxes	1.1%	0.2%	0.1%	0.3%
Net income	1.2%	2.9%	0.6%	2.7%

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

The following table shows the approximate number of terminals, drivers, tractors and trailers, that we managed (including affiliates and owner-operators) as of June 30:

	2007	2006
Terminals ⁽¹⁾	165	168
Drivers	3,349	3,397
Tractors ⁽²⁾	3,737	3,664
Trailers ⁽³⁾	7,628	7,594
Transportation billed miles (in thousands) ⁽⁴⁾	78,530	80,492

(1) excludes transload facilities

(2) excludes 14 and 80 tractors held as inventory for sale as of June 30, 2007 and 2006, respectively

(3) excludes 209 and 353 trailers that are held-for-sale as of June 30, 2007 and 2006, respectively

(4) for the six months ended June 30, 2007 and 2006, respectively

Three Months Ended June 30, 2007 Compared to Three Months Ended June 30, 2006

For the quarter ended June 30, 2007, total revenues were \$194.6 million, an increase of \$4.4 million, or 2.3%, from revenues of \$190.3 million for the same period in 2006. Transportation revenue increased by \$2.4 million or 1.6%. We had a 1.3% decrease in the total number of miles driven as the average number of miles per load decreased slightly over the prior year period along with a decrease in overall loads. This decrease in volume was offset by rate increases of 3.0% as compared to the prior year period.

Other service revenue increased \$1.8 million, or 10.6%. This increase was primarily due to a \$0.6 million increase in revenue generated by our tank wash business resulting from the acquisition of a tank wash business on May 1, 2007, a \$0.5 million increase in other miscellaneous revenue, including transloading revenues and a \$0.7 million increase in rental revenues. Fuel surcharge revenue increased \$0.2 million, or 0.7% primarily due to an increase in the price of fuel offset in part by a decrease in the total number of miles driven.

Purchased transportation decreased by \$6.4 million, or 4.9%, due primarily to the conversion of affiliates to company owned operations partially offset by increased fuel surcharge revenues paid to our drivers and affiliates. Total purchased transportation as a percentage of transportation revenue and fuel surcharge revenue decreased to 70.3% for the current quarter versus 75.0% for the prior-year quarter due primarily to the conversion of affiliate terminals to Company terminals. The percentage of our total transportation revenue (excluding fuel surcharge) generated by our affiliates and owner-operators decreased to 58% for the second quarter of 2007 versus 68% for the 2006 quarter. Overall, these conversions resulted in our affiliate transportation revenue (excluding fuel surcharges) decreasing 9.3% from the comparable prior year quarter while the transportation revenue for Company terminals increased by 10.9%. We pay our affiliates a greater percentage of revenues generated by them than is paid to Company owner-operators, so our purchased transportation costs will change as revenues generated by affiliates change as a percentage of total transportation revenue. During the 2007 and 2006 quarters, we paid our affiliates approximately 85% of the transportation revenue and paid owner-operators approximately 65% of transportation revenue.

Compensation expense increased \$2.2 million, or 11.9%, primarily due to new or converted Company terminals added over the prior year, company-wide compensation increases, and a \$0.3 million increase in healthcare costs. This increase was offset in part by a \$0.5 million decrease for incentive accruals and a \$0.3 million decrease in stock-based compensation expense. This decrease in stock compensation is due to the compensation costs for stock units being fully recognized in 2006 of which \$0.4 million was recognized in the second quarter of 2006.

Fuel, supplies and maintenance increased \$6.6 million, or 51.4%, due to higher fuel costs, costs associated with the shift of revenue from affiliates to company owned terminals, increased lease costs as we fund the expansion of our trailer fleet through the use of operating leases, costs associated with the purchase of tires as we expand our fleet, increased maintenance as we increase the capacity of our equipment and increased cleaning of our trailers.

Table of Contents

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

Selling and administrative expenses increased by \$1.9 million, or 35.0%, due primarily to \$0.5 million of additional professional environmental fees and \$0.5 million in additional costs for facilities resulting from the affiliate conversions and \$0.3 million of costs associated with the relocation of our corporate headquarters.

Insurance expense increased by \$0.4 million, or 9.9%, due primarily to an increase in the total number of claims. In the comparable prior year period, we recorded a \$0.5 million reduction for the refund of certain fees.

For the quarter ended June 30, 2007, operating income totaled \$11.9 million, a decrease of \$0.9 million or 7.2%, compared to \$12.8 million for the same period in 2006. The operating margin for the quarter ended June 30, 2007, was 6.1% compared to 6.7% for the same period in 2006 as a result of the above-mentioned items.

Interest expense increased by \$0.2 million or 2.0% in the second quarter of 2007 compared to the same period in 2006, primarily due to an increase in the interest rates for our variable term debt as compared to the prior year period and an increase in interest expense associated with the increase in our capital lease obligations. Interest income was down \$0.7 million primarily due to the realization in the prior year of \$0.7 million of interest income arising from the payment in stock of two subscription notes.

The provision for income taxes was \$2.1 million for the quarter ended June 30, 2007 compared to \$0.5 million for the same period in 2006. The \$2.1 million provision was primarily due to a change in our expected effective tax rate. In the comparable prior year period, our effective tax rate was lower as a result of recognizing tax benefits resulting from the realization of part of our valuation allowance on the net operating loss estimated to be utilized against our 2006 taxable income. Our effective tax rates for the three months ended June 30, 2007 and 2006 were approximately 48.8% and 7.8%, respectively. We expect our effective annual income tax rate for the year ended December 31, 2007 to range from 36% to 39%.

For the quarter ended June 30, 2007, our net income was \$2.2 million, compared to net income of \$5.5 million for the same period last year.

Six Months Ended June 30, 2007 Compared to Six Months Ended June 30, 2006

For the six months ended June 30, 2007, total revenues were \$372.7 million, an increase of \$3.7 million, or 1.0%, from revenues of \$369.0 million for the same period in 2006. Transportation revenue increased by \$2.1 million or 0.7%. We had a 2.4% decrease in the total number of miles driven as the average number of miles per load decreased slightly over the prior year period along with a decrease in overall loads. This decrease in volume was offset by rate increases of 2.7% over the comparable prior year.

Other service revenue increased \$0.8 million, or 2.3%. This increase was primarily due to a \$0.9 million increase in rental revenues, a \$0.3 million increase in other miscellaneous revenue, including transloading revenues, offset in part by a \$0.4 million decrease in revenue generated by our tank wash business. The total number of tank washes decreased for the first half of 2007 as compared to 2006 even after the inclusion of the tankwash business acquired on May 1, 2007. Fuel surcharge revenue increased \$0.7 million, or 1.8% primarily due to an increase in the price of fuel offset in part by a decrease in the total number of miles driven.

Purchased transportation decreased by \$12.0 million, or 4.8%, due primarily to the conversion of affiliates to company owned operations partially offset by increased fuel surcharge revenues paid to our drivers and affiliates. Total purchased transportation as a percentage of transportation revenue and fuel surcharge revenue decreased to 71.1% for the current six months versus 75.3% for the prior-year comparable period due primarily to the conversion of affiliate terminals to Company terminals. The percentage of our total transportation revenue (excluding fuel surcharge) generated by our affiliates and owner-operators decreased to 59.5% for the first half of 2007 versus 69.8% for the 2006 comparable period. Overall, these conversions resulted in our affiliate transportation revenue (excluding fuel surcharges) decreasing 10.0% from the comparable prior year period while the transportation revenue for Company terminals increased by 10.8%. We pay our affiliates a greater percentage of revenues generated by them than is paid to Company owner-operators, so our purchased transportation costs will change as revenues generated by affiliates change as a percentage of total transportation revenue. During the 2007 and 2006 periods, we paid our affiliates approximately 85% of the transportation revenue and paid owner-operators approximately 65% of transportation revenue.

Compensation expense increased \$4.0 million, or 11.0%, primarily due to new or converted Company terminals added over the prior year, company-wide compensation increases, and a \$0.7 million increase in healthcare costs. This increase was offset in part by a \$1.0 million decrease for incentive accruals and a \$0.7 million decrease in stock-based compensation expense. This decrease in stock compensation is due to

the compensation costs for stock units being fully recognized in 2006 of which \$0.7 million was recognized in the first half of 2006.

Table of Contents

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

Fuel, supplies and maintenance increased \$11.8 million, or 49.7%, due to higher fuel costs, costs associated with the shift of revenue from affiliates to company owned terminals, increased lease costs as we fund the expansion of our trailer fleet through the use of operating leases, costs associated with the purchase of tires as we expand our fleet, increased maintenance as we increase the capacity of our equipment and increased cleaning of our trailers.

Selling and administrative expenses increased by \$3.1 million, or 29.0%, due primarily to a \$0.4 million bad debt expense in the current year versus a \$0.2 million reversal of part of our bad debt allowance in the prior year as a result of our improved collection efforts. We also incurred in the current year \$0.9 million of additional environmental costs and related professional fees and a \$0.9 million increase in facility costs associated with the affiliate conversions and \$0.3 million of costs associated with the relocation of our corporate headquarters.

Insurance expense increased by \$3.2 million, or 39.8%, due primarily to the number and severity of accidents that occurred during the six months ended June 30, 2007. In the comparable prior year period, we recorded a \$1.7 million reduction in claims on insurance policies retained by our insurance subsidiary and a \$0.5 million refund of certain fees.

Loss on disposal of property and equipment was \$0.2 million in 2007 as compared to a gain of \$0.2 million in 2006. This change was primarily due to the loss on disposal of equipment associated with our tankwash business in the current year period as opposed to a net gain resulting from trailers sold in the prior year period.

For the six months ended June 30, 2007, operating income totaled \$17.4 million, a decrease of \$7.5 million or 30.0%, compared to \$24.9 million for the same period in 2006. The operating margin for the six months ended June 30, 2007, was 4.7% compared to 6.7% for the same period in 2006 as a result of the above items.

Interest expense increased by \$0.5 million or 3.2% in the first half of 2007 compared to the same period in 2006, primarily due to an increase in the interest rates for our variable term debt as compared to the prior year and an increase in interest expense associated with the increase in our capital lease obligations. Interest income was down \$0.7 million primarily due to the realization in the prior year of \$0.7 million of interest income arising from the payment in stock of two subscription notes.

The provision for income taxes was \$0.2 million for the six months ended June 30, 2007 compared to \$1.1 million for the same period in 2006. The \$0.2 million provision includes the recognition of a \$1.0 million tax benefit in the first quarter. This benefit arose from the identification of previously unrecognized deferred tax assets and a change in our expected effective tax rate. In the comparable prior year period, our effective tax rate was lower as a result of recognizing tax benefits resulting from the realization of part of our valuation allowance on the net operating loss estimated to be utilized against our 2006 taxable income.

For the six months ended June 30, 2007, our net income was \$2.1 million, compared to net income of \$10.0 million for the same period last year.

Table of Contents**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES****Liquidity and Capital Resources**

The following summarizes our cash flows for the six months ended June 30, 2007 and 2006 as reported in our Consolidated Statements of Cash Flows in the accompanying Consolidated Financial Statements (in thousands):

	Six months ended June 30,	
	2007	2006
Net cash provided by operating activities	\$ 1,275	\$ 2,211
Net cash used in investing activities	(3,204)	(9,395)
Net cash (used in) provided by financing activities	(2,087)	7,474
Effect of exchange rate changes on cash	53	70
Net (decrease) increase in cash	(3,963)	360
Cash and cash equivalents at beginning of year	6,841	1,636
Cash and cash equivalents at end of period	\$ 2,878	\$ 1,996

Historically, our primary source of liquidity has been cash flow from operations and borrowing availability under our credit agreement. Our revolving credit agreement terminates in November 2008. Our primary cash needs consist of capital expenditures and debt service including our variable term loan due in 2009, our 9% Senior Subordinated Notes due 2010 (9% Senior Subordinated Notes) and our Senior Floating Rate Notes due 2012 (Senior Floating Rate Notes). We incur capital expenditures for the purpose of purchasing tractors and trailers to meet our strategic needs during the year, and maintaining and improving our infrastructure. We plan to reduce our capital expenditures by entering into operating leases which will result in increased operating expenses in future periods. During the first half of 2007, we reduced our capital expenditures required for our tractor and trailer acquisitions by entering into operating leases for equipment valued at \$13.1 million which will increase operating expenses in future periods. We plan to continue to enter into operating leases to reduce capital expenditures in 2007.

Net cash provided by operating activities was \$1.3 million for the six-month period ended June 30, 2007 compared to \$2.2 million provided by the comparable 2006 period. The \$0.9 million change in cash provided by operating activities was due in part to the discontinuance of purchasing tractors as inventory, the improvement in our accounts payable offset by the payment of claims classified under accrued loss and damage claims and a decrease in accounts receivable collections. The usage of cash for accounts receivable in the 2007 period was primarily due to increased billings late in the second quarter of 2007. However, our average day sales outstanding has actually declined from 47 days at June 30, 2006 to 44 days at June 30, 2007. In the comparable 2006 period, we utilized cash to purchase tractors to be held for resale to new drivers, paid for environmental costs and paid down our accounts payable which included a large accident claim.

Cash used in investing activities totaled \$3.2 million for the six-month period ended June 30, 2007, compared to \$9.4 million used in the comparable 2006 period. The decrease of \$6.2 million results from a reduction in capital expenditures and a reduction in business assets purchased in 2007 as compared to 2006. Proceeds from the sale of real property, tractors and trailers increased by \$0.9 million since we collected on a note receivable that was issued upon the sale of real property in the prior year.

Cash used in financing activities was \$2.1 million during the six-month period ended June 30, 2007, compared to net cash provided by financing activities of \$7.5 million for the same period in 2006 due primarily to the pay down of our revolver and the reduction in our book overdraft which results in cash used during the period. In the comparable prior year period, we utilized our revolver to fund business acquisitions and capital acquisitions.

Table of Contents**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES***Off-Balance Sheet Arrangements*

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

Contractual Obligations and Commitments

The following is a schedule of our long-term contractual commitments, including the current portion of our long-term indebtedness at June 30, 2007 over the periods we expect them to be paid (in thousands):

	Total	Remainder of 2007	Year 2008	Year 2009	Year 2010	Year 2011	Year 2012 and after
Operating leases (1)	\$ 92,323	\$ 10,325	\$ 20,814	\$ 19,009	\$ 13,710	10,097	\$ 18,368
Total indebtedness (2)	275,250	700	1,900	62,650	125,000		85,000
Capital leases	5,308	624	1,302	1,433	1,228	485	236
Interest on indebtedness (3)	101,179	13,803	27,416	24,275	20,420	10,484	4,781
Total	\$ 474,060	\$ 25,452	\$ 51,432	\$ 107,367	\$ 160,358	21,066	\$ 108,385

- (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.
- (2) Excludes an unamortized original issue discount of \$1.1 million.
- (3) Amounts presented for interest payments assume that all long-term debt obligations outstanding as of June 30, 2007 will remain outstanding until maturity and interest rates on variable-rate debt in effect as of June 30, 2007 will remain in effect until maturity.

Other Liabilities and Obligations

We have \$11.4 million of environmental liabilities, \$10.7 million of pension plan obligations and \$27.7 million of other insurance claim obligations. We expect to pay these various obligations over the next eleven years. We also have \$55.1 million in outstanding letters of credit. We are required to provide letters of credit to our insurance administrator to cover the payment of claims. The outstanding letters of credit as of June 30, 2007 for our insurance administrator totaled \$47.1 million. If we fail to meet certain terms of our agreement, the insurance administrator may draw down the letters of credit. Our FIN 48 liability is \$3.5 million and represents total gross unrecognized tax benefits that may be paid in future periods. We also expect to pay \$1.5 million of interest and penalties.

Long-term Debt

Our principal debt sources at June 30, 2007, comprise \$125 million principal amount of 9% Senior Subordinated Notes, \$85 million principal amount of Senior Floating Rate Notes, a credit agreement consisting of a delayed draw term loan, a \$75 million revolver and a \$20 million pre-funded letter of credit facility, all of which were issued or entered into by QD LLC and QD Capital.

Senior Floating Rate Notes

The \$85 million in Senior Floating Rate Notes were issued by QD LLC and QD Capital and guaranteed by QDI and domestic subsidiaries. The Notes, due January 15, 2012, pay interest quarterly on January 15, April 15, July 15, and October 15. Interest accrues at a floating rate per annum, reset quarterly, equal to LIBOR plus 4.5%. The interest rate on the Senior Floating Rate Notes at June 30, 2007 and 2006 was 9.9% and 9.6%, respectively.

We incurred \$2.4 million in debt issuance costs relating to the Senior Floating Rate Notes. We are amortizing these costs over the term of the notes. The balance of the debt issuance costs as of June 30, 2007 was \$1.6 million.

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

We may redeem the Senior Floating Rate Notes, in whole or in part from time to time, upon not less than 30 nor more than 60 days notice at the following redemption prices, expressed as percentages of the principal amount thereof, if redeemed during the twelve-month period commencing on January 15 of the year set forth below, plus, in each case, accrued and unpaid interest thereon, if any, to the date of redemption:

Year	Percentage
2007	102.00%
2008	101.00%
2009 and thereafter	100.00%

Table of Contents

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

Term Loan

The term loan bears interest at our option at (a) 2.00% in excess of the defined base rate or (b) 3.00% in excess of the Eurodollar rate for Eurodollar Loans, subject in each case, to adjustment based upon the achievement of certain financial ratios. The principal payments are payable quarterly on March 15, June 15, September 15 and December 15. The term loan matures on November 12, 2009. The principal payments are payable quarterly on March 15, June 15, September 15 and December 15. The term loan matures on November 12, 2009. The interest rate on the term loan at June 30, 2007 and 2006 was 8.3%.

We incurred \$2.3 million in debt-issuance costs relating to the term loan. We are amortizing these costs over the term of the term loan to interest expense using the effective-interest method. The balance of these debt issuance costs as of June 30, 2007 was \$0.8 million.

Revolving Credit Facility

The revolver facility comprises a \$75.0 million revolver that is available until November 12, 2008 and a \$20 million pre-funded letter of credit facility that is available until November 12, 2009. The revolver can be used for working capital and general corporate purposes, including permitted acquisitions and additional letters of credit. At June 30, 2007, we had \$39.4 million available under the revolver and \$55.1 million in outstanding letters of credit.

Interest on the revolver is, at our option, (a) 2.50% in excess of the Base Rate provided in the credit agreement, or (b) 3.50% in excess of the Eurodollar rate for Eurodollar Loans, subject in each case, to adjustments based upon the achievement of certain financial ratios. The interest rate on the revolver at June 30, 2007 and 2006 was 10.75% and 9.3%, respectively.

The credit facility provides for payment by us in respect of outstanding letters of credit of an annual fee equal to the spread over the Eurodollar rate for Eurodollar Loans under the revolver from time to time in effect on the aggregate outstanding stated amounts of such letters of credit and a fronting fee equal to $\frac{1}{4}$ of 1.0% on the aggregate outstanding stated amounts of such letters of credit. We pay a commitment fee equal to $\frac{1}{2}$ of 1.0% per annum on the undrawn portion of the available commitment under the revolver, subject to decreases based on the achievement of certain financial ratios.

Voluntary prepayments and commitment reductions will be permitted in whole or in part, subject to minimum prepayment or reduction requirements, without premium or penalty, provided that voluntary prepayments of Eurodollar Loans on a date other than the last day of the relevant interest period will be subject to payment of customary breakage costs, if any.

We incurred \$2.0 million in debt-issuance costs relating to the revolver and letter of credit. We are amortizing these costs over the term of the revolver. The balance of the debt-issuance costs as of June 30, 2007 was \$0.8 million.

9% Senior Subordinated Notes

The 9% Senior Subordinated Notes are unsecured obligations, due 2010, issued by QD LLC and QD Capital and guaranteed on a senior subordinated basis by QDI and domestic subsidiaries. The guarantees are full, unconditional, joint and several obligations of the guarantors. The Senior Subordinated Notes pay interest semi-annually on May 15, and November 15.

We incurred \$5.5 million in debt-issuance costs relating to the 9% Senior Subordinated Notes. We are amortizing these costs over the term of the 9% Senior Subordinated Notes. The balance of the debt issuance costs as of June 30, 2007 was \$2.6 million.

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

We may redeem the 9% Senior Subordinated Notes, in whole or in part from time to time, upon not less than 30 nor more than 60 days notice at the following redemption prices, expressed as percentages of the principal amount thereof, if redeemed during the twelve-month period commencing on November 15 of the year set forth below, plus, in each case, accrued and unpaid interest thereon, if any, to the date of redemption:

Year	Percentage
2007	104.50%
2008	102.25%
2009 and thereafter	100.00%

Collateral, Guarantees and Covenants

The term loan and revolver are guaranteed by all of our existing and future direct and indirect domestic subsidiaries (collectively, the subsidiary guarantors). Our obligations under the term loan and revolver and our subsidiary guarantor obligations are collateralized by a first priority perfected lien on substantially all of our properties and assets and the subsidiary guarantors, now owned or subsequently acquired, including a pledge of all capital stock and notes owned by us and the subsidiary guarantors, subject to certain exceptions. In addition, in certain cases, no more than 65.0% of the stock of our foreign subsidiaries is required to be pledged. Such assets pledged also collateralize certain interest rate protection and other hedging agreements permitted by the credit facility that may be entered into from time to time by us.

The credit agreement contains restrictions on debt incurrence, investments, transactions with affiliates, creation of liens, asset dispositions, redeemable common stock, and preferred stock issuance, capital expenditures, and the payment of dividends. The credit agreement includes one financial covenant, the ratio of Senior Secured Debt (as defined) to Consolidated EBITDA (as defined), which must be maintained. As of June 30, 2007, we were in compliance with all debt covenants.

Debt Retirement

The following is a schedule of our indebtedness at June 30, 2007 over the periods we are required to pay such indebtedness (in thousands):

	Remainder of 2007	2008	2009	2010	2011	Year 2012 and after	Total
Variable term loan due 2009	\$ 700	\$ 1,400	\$ 62,650	\$	\$	\$	\$ 64,750
Capital lease obligations	624	1,302	1,433	1,228	485	236	5,308
Revolver due 2008		500					500
9% Senior Subordinated Notes, due 2010				125,000			125,000
Senior Floating Rate Notes, due 2012						85,000	85,000
Total	\$ 1,324	\$ 3,202	\$ 64,083	\$ 126,228	\$ 485	\$ 85,236	\$ 280,558

The above table does not include the remaining unamortized original issue discount of \$1.1 million relating to the Senior Floating Rate Notes.

QD LLC, has the ability to incur additional debt, subject to limitations imposed by the credit facility and the indentures governing the 9% Senior Subordinated Notes and the Senior Floating Rate Notes. Under the indentures governing the notes, in addition to specified permitted indebtedness, QD LLC will be able to incur additional indebtedness so long as, on a pro forma basis, QD LLC's consolidated fixed charge coverage ratio (the ratio of Consolidated EBITDA (as defined in the respective indentures for the QD LLC Notes) to consolidated fixed charges) is 2.00 to 1.0 or less. As of June 30, 2007, we were in compliance with this covenant.

We believe that, based on current operations and anticipated growth, our cash flow from operations, together with available sources of liquidity, including borrowings under the revolver, will be sufficient to fund anticipated capital expenditures, make required payments of principal and

interest on our debt, including obligations under our credit agreement, and satisfy other long-term contractual commitments for the next twelve months.

Table of Contents

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

However, for periods extending beyond twelve months, if our operating cash flow and borrowings under the revolving credit facility are not sufficient to satisfy our capital expenditures, debt service and other long-term contractual commitments, we would be required to seek alternative financing. These alternatives would likely include another restructuring or refinancing of our long-term debt, the sale of a portion or all of our assets or operations, or the sale of additional debt or equity securities. If these alternatives were not available in a timely manner or on satisfactory terms, or were not permitted under our existing agreements, we might default on some or all of our obligations. If we default on our obligations, including our financial covenants required to be maintained under the credit facility, and the debt under the indentures for the new notes were to be accelerated, our assets might not be sufficient to repay in full all of our indebtedness, and we might be forced into bankruptcy.

Other Issues

We have historically sought to acquire smaller local operators as part of our program of strategic growth. We continue to evaluate potential accretive acquisitions in order to capitalize on the consolidation occurring in the industry and expect to fund such acquisitions from available sources of liquidity, including borrowings under the revolver.

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.

As a holding company with no significant assets other than ownership of 100% of QD LLC's membership units, QDI also depends upon QD LLC's cash flows to service our debt. QD LLC's ability to make distributions to QDI is restricted by the covenants contained in the revolving credit facility and the indentures governing the notes. However, Apollo as our controlling shareholder may have an interest in pursuing reorganizations, restructurings or other transactions involving us that, in their judgment, could enhance their equity investment even though those transactions might involve increasing QD LLC's leverage or impairing QD LLC's creditworthiness in order to decrease QDI's leverage. While the restrictions in the revolving credit facility cover a wide variety of arrangements that have traditionally been used to effect highly leveraged transactions, the revolving credit facility and the indentures may not afford the holders of our debt protection in all circumstances from the adverse aspects of a highly leveraged transaction, reorganization, restructuring, merger or similar transaction.

Subsequent Events

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

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 Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended (the Exchange Act). 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 believes, expects, projects, estimates, may, will, should, could, seeks, anticipates or scheduled to or the negatives of those terms, or other variations of those terms or comparable language, or by discussions of strategy or other intentions.

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Forward-looking statements are subject to known and unknown risks, uncertainties and other factors that could cause the 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 in our Annual Report on Form 10-K for the year ended December 31, 2006, included under Item 1A Risk Factors , the Quarterly Report on Form 10-Q for the quarter ended March 31, 2007, as well as this Quarterly Report on Form 10-Q. These factors include:

general economic conditions,

Table of Contents

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

the cyclical nature of the transportation industry due to various economic factors such as 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 liability as a self-insurer to the extent of our deductibles as well as our ability to reduce our claims exposure through insurance due to changing conditions and pricing in the insurance marketplace,

competitive rate fluctuations,

the availability and cost of diesel fuel,

adverse weather conditions,

loss of qualified personnel, which could limit our growth and negatively affect operations,

our dependence on affiliates and owner-operators and our ability to attract and retain owner-operators, affiliates and Company drivers,

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

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

our obligations under both historical and future environmental regulations and the increasing costs of environmental compliance,

our substantial leverage and restrictions contained in our debt agreements, including our credit facility and our indentures, and interest rate fluctuations in our floating rate indebtedness,

the loss of one or more significant customers,

the cost of complying with existing and future anti-terrorism security measures enacted by federal, state and municipal authorities,

changes in senior management,

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

our failure to consummate any acquisition to which we have agreed, including the inability to obtain the financing requisite to consummate the acquisition,

our ability to successfully integrate acquired businesses,

our ability to achieve anticipated operating results in fiscal 2007, and

interests of Apollo Management, our largest shareholder, which may conflict with your interests.

In addition, there may be other factors that could cause our actual results 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 WEB-SITE

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: <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 <http://www.qualitydistribution.com>. We will also provide electronic or paper copies of our SEC filings free of charge on request. 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 six months ended June 30, 2007, we did not hold derivative instruments or engage in other hedging transactions to reduce our exposure to such risks.

Table of Contents**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES****Interest Rate Risk**

We are exposed to the impact of interest rate changes primarily through our variable-rate borrowings under QD LLC's credit facility. The term loan bears interest at our option at (a) 2.00% in excess of the defined base rate or (b) 3.00% in excess of the Eurodollar rate for Eurodollar Loans, subject in each case, to adjustment based upon the achievement of certain financial ratios. Interest rates for the revolver are based, at QD LLC's option, on either the administrative agent's base rate plus 2.50% or upon the Eurodollar rate plus 3.50%, subject to reduction if we reduce our total consolidated leverage below certain levels. The base rate for the revolver is equal to the higher of the prime rate or the federal funds overnight rate plus 0.5%. The base rate for our Senior Floating Rate Notes is LIBOR plus 4.50%.

(in thousands)	Balance at June 30, 2007	Interest Rate at June 30, 2007	Effect of 1% Change
Revolver	\$ 500	10.8%	\$ 5
Term Loan	64,750	8.3%	648
Senior Floating Rate Notes	85,000	9.9%	850
Total	\$ 150,250		\$ 1,503

At June 30, 2007, a 1% point increase in the current per annum interest rate for each would result in \$1.5 million of additional interest expense during the next year. The foregoing calculation assumes an instantaneous one percentage point increase in the rates of all of our indebtedness and that the principal amount of each is the amount outstanding as of June 30, 2007. 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:

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 7.4% of our consolidated revenue for the six months ended June 30, 2007 and 6.8% of our consolidated revenue for the six months ended June 30, 2006. 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.

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 six months ended June 30, 2007 were positively impacted by a \$0.1 million foreign currency movement, primarily due to the strengthening of the Canadian dollar against the United States dollar.

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Changes in foreign exchange rates that had the largest impact on translating our international operating profits for the first six months of 2007 related to changes in the Canadian dollar versus the United States dollar. We

Table of Contents

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

estimate that a 1% adverse change in the Canadian dollar foreign exchange rate would have decreased our revenues by less than \$0.3 million for the six months ended June 30, 2007, assuming no changes other than the exchange rate itself. Our inter-company 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 inter-company loans at June 30, 2007, 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 could be collected to offset such increases. In the six months ended June 30, 2007, a majority of fuel price increases were covered through fuel surcharges.

ITEM 4 Controls and Procedures

Evaluation of disclosure controls and procedures

As required by Rules 13a-15(b) and 15d-15(b) under the Securities Exchange Act of 1934, 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 June 30, 2007 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 June 30, 2007 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 June 30, 2007 that materially affected, or were 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, 2006, "Note 17. Commitments and Contingencies" to our audited consolidated financial statements contained in such Form 10-K and "Note 8. 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, 2006 included under Item 1A Risk Factors in addition to the other information set forth in this report (including the risk identified below). 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. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Table of Contents

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

Our use of our debt to finance acquisitions and our ability to integrate acquired businesses may adversely affect our operations and financial condition.

Integrating acquired businesses poses operating risks, including:

diverting management's time and resources;

disrupting relationships with customers and drivers of the acquired company;

unexpected costs in connection with the integration of the business; and

contingent liabilities, environmental liabilities or labor issues that were not identified in the due diligence process.

The occurrence of these or other unexpected losses or the inability to successfully integrate the acquired business could have a material adverse effect on our results and operations. Furthermore, the use of our debt to finance acquisitions could restrict our flexibility in the future because we are highly leveraged.

ITEM 2 Unregistered Sale of Equity Securities and Use of Proceeds

None

ITEM 3 Defaults Upon Senior Securities

None

ITEM 4 Submission of Matters to a Vote of Security Holders

The annual general meeting of the shareholders of Quality Distribution, Inc. was held on May 17, 2007. At the meeting, the following actions were approved by the shareholders. There were no broker non-votes.

1. Twelve individuals were elected as directors of the Company. The voting was as follows:

	For	Withheld
Marc E. Becker	15,745,596	1,213,217
Gerald L. Detter	15,840,114	1,118,699
Robert H. Falk	15,786,068	1,172,745
Robert E. Gadomski	16,433,907	524,906
Joshua J. Harris	14,753,739	2,205,074
Richard B. Marchese	15,790,455	1,168,358
Thomas R. Miklich	16,433,507	524,906
Donald C. Orris	16,433,407	525,406
Eric L. Press	15,784,705	1,174,108
M. Ali Rashid	15,785,467	1,173,346
Alan H. Schumacher	16,433,907	524,906

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

John J. Suydam

15,787,968 1,170,845

2. The voting on the following resolution was as follows:

	For	Withheld	Abstain
Ratification of PricewaterhouseCoopers as Independent Registered Certified Public Accounting Firm	15,915,814	1,402	1,041,596
ITEM 5 Other Information			

None

Table of Contents

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

ITEM 6 Exhibits

Exhibit No.	Description
10.1	Letter Agreement with Gerald L. Detter
10.3	Amendment to Employment Agreement with Gary R. Enzor
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

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

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.

QUALITY DISTRIBUTION, INC.

August 9, 2007

/s/ Gary R. Enzor
GARY R. ENZOR,
PRESIDENT AND CHIEF EXECUTIVE OFFICER
(PRINCIPAL EXECUTIVE OFFICER)

August 9, 2007

/s/ Timothy B. Page
TIMOTHY B. PAGE,
SENIOR VICE PRESIDENT AND CHIEF FINANCIAL OFFICER
(PRINCIPAL FINANCIAL AND ACCOUNTING OFFICER)