

QUALITY DISTRIBUTION INC  
Form 10-Q  
May 07, 2010  
Table of Contents

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

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2010

or

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

For the transition period from            to

Commission File Number: 000-24180

**Quality Distribution, Inc.**

(Exact name of registrant as specified in its charter)

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

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

N/A

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

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

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

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

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

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

As of May 4, 2010, the registrant had 20,146,138 shares of Common Stock, no par value, outstanding.

**Table of Contents**

**QUALITY DISTRIBUTION, INC.**

**CONTENTS**

<b><u>PART I FINANCIAL INFORMATION</u></b>	<b><u>1</u></b>
<b><u>ITEM 1 FINANCIAL STATEMENTS</u></b>	<b><u>1</u></b>
<b><u>Consolidated Statements of Operations for the Three Months Ended March 31, 2010 and 2009</u></b>	<b><u>1</u></b>
<b><u>Consolidated Balance Sheets as of March 31, 2010 and December 31, 2009</u></b>	<b><u>2</u></b>
<b><u>Consolidated Statements of Shareholders' Equity for the Three Months Ended March 31, 2010 and 2009</u></b>	<b><u>3</u></b>
<b><u>Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2010 and 2009</u></b>	<b><u>4</u></b>
<b><u>Notes to Consolidated Financial Statements</u></b>	<b><u>5</u></b>
<b><u>ITEM 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	<b><u>22</u></b>
<b><u>ITEM 3 Quantitative and Qualitative Disclosures About Market Risk</u></b>	<b><u>39</u></b>
<b><u>ITEM 4 Controls and Procedures</u></b>	<b><u>40</u></b>
<b><u>PART II OTHER INFORMATION</u></b>	<b><u>40</u></b>
<b><u>ITEM 1 Legal Proceedings</u></b>	<b><u>40</u></b>
<b><u>ITEM 1A Risk Factors</u></b>	<b><u>40</u></b>
<b><u>ITEM 2 Unregistered Sale of Equity Securities and Use of Proceeds</u></b>	<b><u>44</u></b>
<b><u>ITEM 3 Defaults Upon Senior Securities</u></b>	<b><u>44</u></b>
<b><u>ITEM 4 [Removed and Reserved.]</u></b>	<b><u>44</u></b>
<b><u>ITEM 5 Other Information</u></b>	<b><u>44</u></b>
<b><u>ITEM 6 Exhibits</u></b>	<b><u>44</u></b>
<b><u>Signatures</u></b>	<b><u>45</u></b>

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

	<b>Three months ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>OPERATING REVENUES:</b>		
Transportation	\$ 118,917	\$ 111,027
Other service revenue	24,906	27,608
Fuel surcharge	17,510	11,097
<b>Total operating revenues</b>	<b>161,333</b>	<b>149,732</b>
<b>OPERATING EXPENSES:</b>		
Purchased transportation	110,904	81,891
Compensation	13,892	23,211
Fuel, supplies and maintenance	12,288	17,540
Depreciation and amortization	4,243	5,335
Selling and administrative	4,778	7,145
Insurance costs	3,337	4,049
Taxes and licenses	596	1,337
Communication and utilities	1,046	2,734
Loss (gain) on disposal of property and equipment	418	(103)
Restructuring costs	1,147	600
<b>Total operating expenses</b>	<b>152,649</b>	<b>143,739</b>
Operating income	8,684	5,993
Interest expense	8,667	7,000
Interest income	(161)	(103)
Gain on extinguishment of debt		(675)
Other expense	6	143
Income (loss) before income taxes	172	(372)
Benefit from income taxes	(626)	(70)
<b>Net income (loss)</b>	<b>\$ 798</b>	<b>\$ (302)</b>
<b>PER SHARE DATA:</b>		
<b>Net income (loss) per common share</b>		
Basic	\$ 0.04	\$ (0.02)
Diluted	\$ 0.04	\$ (0.02)
<b>Weighted-average number of shares</b>		
Basic	19,501	19,215

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Diluted

21,470

19,215

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**

	<b>March 31, 2010</b>	<b>December 31, 2009</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 2,675	\$ 5,633
Accounts receivable, net	80,541	69,625
Prepaid expenses	10,390	8,584
Deferred tax asset, net	4,626	5,506
Other	4,725	4,420
Total current assets	102,957	93,768
Property and equipment, net	127,052	127,329
Goodwill	27,023	27,023
Intangibles, net	18,069	18,467
Other assets	12,818	13,029
Total assets	\$ 287,919	\$ 279,616
<b>LIABILITIES, REDEEMABLE NONCONTROLLING INTEREST AND SHAREHOLDERS DEFICIT</b>		
Current liabilities:		
Current maturities of indebtedness	\$ 19,498	\$ 19,866
Current maturities of capital lease obligations	4,900	5,322
Accounts payable	9,591	6,182
Affiliates and independent owner-operators payable	12,591	9,734
Accrued expenses	21,883	21,378
Environmental liabilities	3,733	3,408
Accrued loss and damage claims	7,525	8,862
Total current liabilities	79,721	74,752
Long-term indebtedness, less current maturities	291,240	284,253
Capital lease obligations, less current maturities	10,809	11,843
Environmental liabilities	7,740	8,241
Accrued loss and damage claims	8,679	10,534
Other non-current liabilities	27,075	28,896
Total liabilities	425,264	418,519
Commitments and contingencies - Note 11		
Redeemable noncontrolling interest	1,833	1,833
<b>SHAREHOLDERS DEFICIT</b>		
Common stock, no par value; 29,000 shares authorized; 20,366 issued and 20,146 outstanding at March 31, 2010 and 20,297 issued and 20,077 outstanding at December 31, 2009, respectively	364,535	364,046
Treasury stock, 220 shares at March 31, 2010 and December 31, 2009	(1,580)	(1,580)
Accumulated deficit	(293,770)	(294,568)
Stock recapitalization	(189,589)	(189,589)

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Accumulated other comprehensive loss	(25,316)	(25,587)
Stock purchase warrants	6,696	6,696
Stock subscriptions receivable	(154)	(154)
Total shareholders' deficit	(139,178)	(140,736)
Total liabilities, redeemable noncontrolling interest and shareholders' deficit	\$ 287,919	\$ 279,616

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****For the Three Months Ended March 31, 2010 and 2009****Unaudited (In 000 \$)**

	Shares of Common Stock	Shares of Treasury Stock	Common Stock	Treasury Stock	Accumulated Deficit	Stock Recapitalization	Accumulated Other Comprehensive Loss	Stock Purchase Warrants	Stock Subscription Receivables	Total Shareholders' Equity
Balance, December 31, 2008	19,754	(205)	\$ 362,945	\$ (1,580)	\$ (114,034)	\$ (189,589)	\$ (26,488)	\$	\$ (234)	\$ 31,020
Net loss					(302)					(302)
Issuance of restricted stock	95									
Amortization of restricted stock			63							63
Amortization of stock options			93							93
Amortization of prior service costs and losses, net of tax							312			312
Translation adjustment, net of tax							126			126
Balance, March 31, 2009	19,849	(205)	\$ 363,101	\$ (1,580)	\$ (114,336)	\$ (189,589)	\$ (26,050)		\$ (234)	\$ 31,312
Balance, December 31, 2009	20,297	(220)	\$ 364,046	\$ (1,580)	\$ (294,568)	\$ (189,589)	\$ (25,587)	6,696	\$ (154)	\$ (140,736)
Net income					798					798
Issuance of restricted stock	69									
Amortization of restricted stock			214							214
Amortization of stock options			275							275
Amortization of prior service costs and losses (pension plans), net of tax							323			323
Foreign currency translation adjustment, net of tax							(52)			(52)
Balance, March 31, 2010	20,366	(220)	\$ 364,535	\$ (1,580)	\$ (293,770)	\$ (189,589)	\$ (25,316)	6,696	\$ (154)	\$ (139,178)



Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

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

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

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$ 798	\$ (302)
Adjustments to reconcile to net cash and cash equivalents provided by (used in) operating activities:		
Deferred income tax benefit		(18)
Depreciation and amortization	4,243	5,335
Bad debt expense	132	602
Loss (gain) on disposal of property and equipment	418	(103)
PIK interest on Senior Subordinated Notes	558	
Gain on extinguishment of long-term debt		(675)
Stock-based compensation	489	156
Amortization of deferred financing costs	676	701
Amortization of bond discount	585	275
Redeemable noncontrolling interest dividends	36	36
Changes in assets and liabilities:		
Accounts and other receivables	(11,106)	4,539
Prepaid expenses	(1,806)	(178)
Other assets	(822)	365
Accounts payable	1,897	958
Accrued expenses	503	(2,281)
Environmental liabilities	(175)	391
Accrued loss and damage claims	(3,193)	153
Affiliates and independent owner-operators payable	2,857	3,506
Other liabilities	(295)	402
Current income taxes	51	(208)
<b>Net cash (used in) provided by operating activities</b>	<b>(4,154)</b>	<b>13,654</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Capital expenditures	(4,622)	(1,758)
Proceeds from sales of property and equipment	1,393	2,166
<b>Net cash (used in) provided by investing activities</b>	<b>(3,229)</b>	<b>408</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Principal payments on long-term debt	(1,282)	(4,626)
Principal payments on capital lease obligations	(1,456)	(1,877)
Proceeds from revolver	14,600	8,000
Payments on revolver	(8,600)	(13,000)
Payments on acquisition notes	(318)	(227)
Change in book overdraft	1,513	(1,985)
Redeemable noncontrolling interest dividends	(36)	(36)
<b>Net cash provided by (used in) financing activities</b>	<b>4,421</b>	<b>(13,751)</b>
Effect of exchange rate changes on cash	4	(6)

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

Net (decrease) increase in cash and cash equivalents	(2,958)	305
Cash and cash equivalents, beginning of period	5,633	6,787
Cash and cash equivalents, end of period	\$ 2,675	\$ 7,092
<u>Supplemental Disclosure of Cash Flow Information</u>		
Cash paid (received) during the period for:		
Interest	\$ 3,329	\$ 4,805
Income Taxes	(56)	114

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

---

**Table of Contents**

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

**Quality Distribution, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

**(Unaudited)**

**1. Summary of Significant Accounting Policies**

***Basis of Presentation***

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

We are primarily engaged in truckload transportation of bulk chemicals and are also engaged in International Organization Standardization, or ISO, tank container transportation and depot services, logistics and other value-added services. We conduct a significant portion of our business through a network of affiliates and independent owner-operators. Affiliates are independent companies which enter into various term contracts with the Company. Affiliates are responsible for paying for their own power equipment (including debt service), fuel and other operating costs. Certain affiliates lease trailers from us. Independent owner-operators are independent contractors, who, through a contract with us, supply one or more tractors and drivers for our use. Contracts with independent owner-operators may be terminated by either party on short notice. We charge affiliates and third parties for the use of tractors and trailers as necessary. In exchange for the services rendered, affiliates and independent owner-operators are normally paid a percentage of the revenues collected on each load hauled.

Our accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and do not include all of the information and notes required by accounting principles generally accepted in the United States ( GAAP ) for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments and accruals) considered necessary for a fair statement of consolidated financial position, results of operations and cash flows have been included. The year ended consolidated balance sheet data was derived from audited financial statements, but does not include all the disclosures required by GAAP. For further information, refer to our Annual Report on Form 10-K for the year ended December 31, 2009, including the consolidated financial statements and accompanying notes.

Operating results for the three months ended March 31, 2010 are not necessarily indicative of the results that may be expected for the entire fiscal year.

***New Accounting Pronouncements***

In June 2009, FASB issued new guidance which revises and updates previously issued guidance related to variable interest entities. The new guidance eliminates the exceptions to consolidating qualifying special-purpose entities that were included in the prior guidance. The new guidance contains new criteria for determining the primary beneficiary and increases the frequency of required reassessments to determine whether a company is the primary beneficiary of a variable interest entity. The guidance also contains a new requirement that any term, transaction, or arrangement that does not have a substantive effect on an entity's status as a variable interest entity, a company's power over a variable interest entity, or a company's obligation to absorb losses or its right to receive benefits of an entity must be disregarded. The elimination of the qualifying special-purpose entity concept and its consolidation exceptions means more entities will be subject to consolidation assessments and reassessments. The new guidance became effective for our fiscal year beginning January 1, 2010. The Company has concluded its relationship with affiliates does not represent variable interests and that the Company is not in a position to direct the significant economic activities of the affiliates.

In June 2009, the FASB issued guidance that eliminates the concept of a qualifying special-purpose entity, creates more stringent conditions for reporting a transfer of a portion of a financial asset as a sale, clarifies other sale-accounting criteria, and changes the initial measurement of a transferor's interest in transferred financial assets. This guidance became effective for our fiscal year beginning January 1, 2010 and had no impact on our consolidated financial statements.

*Acquisition and Dispositions*

During 2009 and the first three months of 2010, we did not complete any acquisitions or dispositions of businesses or affiliates except as described below.

**Table of Contents**

On October 10, 2009, we sold substantially all of the operating assets of our tank wash subsidiary, Quala Systems, Inc. ( QSI ), for \$13.0 million, of which \$10.0 million was paid in cash and the remaining \$3.0 million in a subordinated note. The subordinated note is a five year non-amortizing note which matures on December 31, 2014. The principal is payable in a lump sum at maturity. Interest is payable quarterly at 7% per annum commencing December 31, 2009. In connection with the sale, QSI entered into various agreements with the purchaser, which is not affiliated with us, including long-term leases of real estate used in the tank wash business and various operating agreements. The assets sold had a net book value of \$4.9 million which included \$4.3 million of equipment, \$0.4 million of inventory, and \$0.2 million of intangibles. The sold QSI business generated approximately \$19.5 million of revenue in 2009 from tank wash and related operations. Following the sale of the QSI business, we have purchased tank wash services (which were previously provided by QSI) from the acquirer of QSI's tank wash assets and we expect to continue to do so in the future. Since we expect these continuing cash outflows to be significant, the sold QSI business does not qualify as a discontinued operation under FASB guidance. Therefore, we recorded a pre-tax gain of \$7.1 million in the fourth quarter of 2009 as part of our operating income.

**2. Fair Value of Financial Instruments**

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

Level 1 Quoted prices for identical instruments in active markets;

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

Level 3 Instruments whose significant inputs are unobservable.

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

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

The following tables summarize assets measured at fair value on a nonrecurring basis subsequent to initial recognition:

	March 31, 2010	Significant Unobservable Inputs (Level 3)	Total Loss
<b>Assets</b>			
Goodwill	\$ 27,023	\$ 27,023	\$ (146,230)
Intangibles	18,069	18,069	(2,400)
<b>Total</b>	\$ 45,092	\$ 45,092	\$ (148,630)

We review the carrying value of our assets measured at fair value on a nonrecurring basis when events and circumstances warrant. This review requires the comparison of the fair value of our assets to their respective carrying values. The fair value of our assets is determined based on valuation techniques using the best information that is available, and may include quoted market prices, market comparables, and discounted cash flow projections. An impairment charge is recorded whenever a decline in fair value below the carrying value is determined to be other than temporary.

***Goodwill and Intangibles***

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

Goodwill and intangible assets may become impaired as a result of declines in profitability due to changes in volume, pricing or costs. Fair value is determined using a combination of two valuation approaches: the market approach and the income approach. As of March 31, 2010, the carrying value of our goodwill was \$27.0 million, and the carrying value of our intangibles was \$18.1 million. These values reflect adjustments to fair value made as of June 30, 2009 as a result of our annual impairment analysis.

### *Long-term indebtedness*

The fair values of our 9% Senior Subordinated Notes ( 9% Notes ), our Senior Floating Rate Notes ( 2012 Notes ), our 10% Senior Notes ( 2013 Senior Notes ) and our 11.75% Senior Subordinated PIK Notes ( 2013 PIK Notes ) were based on quoted market prices. As of March 31, 2010, the carrying value of our 9% Notes was \$16.0 million with a fair value of \$14.6 million. As of March 31, 2010, the carrying value of our 2012 Notes was \$0.5 million with a fair value of \$0.4 million. As of March 31, 2010, the carrying value of our 2013 Senior Notes was \$134.5 million with a fair value of \$122.4 million. As of March 31, 2010, the carrying value of our 2013 PIK Notes was \$81.8 million with a fair value of \$67.9 million. Our asset-based loan facility (the ABL Facility ) is variable rate debt and approximates fair value.

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

---

**Table of Contents****3. Goodwill and Intangible Assets*****Goodwill***

Under the FASB guidance, goodwill and intangible assets are subject to an annual impairment test as well as impairment assessments of certain triggering events. We evaluate goodwill for impairment by determining the fair value based on criteria in the FASB guidance for each reporting unit, our trucking segment and our container services segment. These reporting units contain goodwill and other identifiable intangible assets as a result of previous business acquisitions. Our annual impairment test is performed during the second quarter with a measurement date of June 30<sup>th</sup>. The methodology applied in the analysis performed at June 30, 2009 was consistent with the methodology applied in prior years, but was based on updated assumptions, as appropriate. As a result of our analysis we concluded a total impairment charge to goodwill of \$146.2 million was necessary at June 30, 2009, of which \$144.3 million was related to our trucking segment, eliminating 100% of the carrying amount of goodwill of that segment, and \$1.9 million was related to our container services segment. We continued to evaluate indicators of impairment quarterly following our annual goodwill impairment test at June 30, 2009 through year end 2009, and again in the quarter ended March 31, 2010. There were no indications that a triggering event had occurred following June 30, 2009. As of March 31, 2010, we had total goodwill of \$27.0 million, all of which relates to our container services segment.

We have evaluated at least quarterly whether indicators of impairment exist in accordance with applicable guidance. Prior to our June 30, 2009 analysis, we did not believe that factors attributable to the economic downturn would impact the recoverability of our goodwill. Our performance since the prior period's goodwill impairment test at June 30, 2008 through year end 2008 trended positive and there were no indications from our quarterly reviews that a triggering event had occurred. The first quarter of 2009 showed improved operating income year over year and strong operating cash flow; however, due to the continuing economic downturn, we reviewed not only our market capitalization, but also performed a discounted cash flow analysis based on assumptions adjusted to reflect the current economic environment and which we believed to be appropriate at the time. The conclusions from our extended analysis at March 31, 2009 did not indicate a trend in operating results that would foretell of impairment to our goodwill. For our June 30, 2009 analysis, we adjusted further our assumptions used, such as growth and discount rates, in the annual impairment test to reflect the persistence of the downward economic trend.

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

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

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

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



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

As of March 31, 2010 and December 31, 2009, the goodwill balance was \$27.0 million for both periods which relates to our container services segment.

**Table of Contents****Intangible Assets**

Intangible assets at March 31, 2010 are as follows (in thousands):

	Gross value	Accumulated amortization	Net book value	Average lives (in years)
Tradename	\$ 7,400	\$	\$ 7,400	Indefinite
Customer relationships	11,900	(2,231)	9,669	12
Non-compete agreements	2,593	(1,593)	1,000	3 5
	\$ 21,893	\$ (3,824)	\$ 18,069	

Amortization expense for the three months ended March 31, 2010 and 2009 was \$0.4 million in both periods. Estimated amortization expense for intangible assets is as follows (in thousands):

2010 remaining	\$ 1,145
2011	1,369
2012	1,205
2013	996
2014 and after	\$ 5,954

**4. Comprehensive Income (Loss)**

Comprehensive income (loss) is as follows (in thousands):

	Three months ended	
	2010	2009
Net income (loss)	\$ 798	\$ (302)
Other comprehensive income (loss):		
Amortization of prior service costs, net of tax	323	312
Foreign currency translation adjustments, net of tax	(52)	126
Comprehensive income (loss)	\$ 1,069	\$ 136

**Table of Contents****5. Income (Loss) Per Share**

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

	March 31, 2010		Three months ended		March 31, 2009	
	Net income (numerator)	Shares (denominator)	Per-share amount	Net loss (numerator)	Shares (denominator)	Per-share amount
<b>Basic income (loss) available to common shareholders:</b>						
Net income (loss)	\$ 798	19,501	\$ 0.04	\$ (302)	19,215	\$ (0.02)
<b>Effect of dilutive securities:</b>						
Stock options		114				
Unvested restricted stock		106				
Stock warrants		1,749				
<b>Diluted income (loss) available to common shareholders:</b>						
Net income (loss)	\$ 798	21,470	\$ 0.04	\$ (302)	19,215	\$ (0.02)

There is no effect of our stock options and restricted stock in the computation of diluted earnings per share for the three months ended March 31, 2009 due to a net loss in the quarter.

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

	Three months ended	
	March 31, 2010	2009
Stock options	2,029	1,699
Unvested restricted stock	538	216

**6. Stock-Based Compensation**

We maintain performance incentive plans under which stock options, restricted shares, and stock units may be granted to employees, non-employee directors, consultants and advisors. As of March 31, 2010, we had two active stock-based compensation plans.

We recognize expense for stock-based compensation based upon estimated grant date fair value. We apply the Black-Scholes valuation model in determining the fair value of share-based payments to employees. The resulting compensation expense is recognized over the requisite service period, which is generally the awards' vesting term. Compensation expense is recognized only for those awards expected to vest, with forfeitures estimated based on our historical experience and future expectations. All stock-based compensation expense is classified within Compensation on the Consolidated Statement of Operations. None of the stock-based compensation was capitalized during the first three months of 2010.

The fair value of options granted during the first three months of 2009 was based upon the Black-Scholes option-pricing model. There were no options granted during the first three months of 2010. The expected term of the options represents the estimated period of time until exercise giving consideration to the contractual terms, vesting schedules and expectations of future employee behavior. For 2010, expected stock price volatility is based on the historical volatility of our common stock. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant with an equivalent remaining term. The Company has not paid dividends in the past and does not currently plan to pay any dividends in the foreseeable future. The Black-Scholes model was used with the following weighted average assumptions:

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

	2010	2009
Risk free rate		1.57%
Expected life		5 years
Volatility		78.7%
Expected dividend	nil	nil

**Table of Contents**

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

	Options Issued	Restricted Shares Issued
March 31, 2010		68,621

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

	Three months ended March 31,	
	2010	2009
Stock options	\$ 275	\$ 93
Restricted stock	214	63
	\$ 489	\$ 156

The following table summarizes unrecognized stock-based compensation and the weighted average period over which such stock-based compensation is expected to be recognized as of March 31, 2010 (in thousands):

		Remaining years
Stock options	\$ 2,727	4
Restricted stock	2,200	4
	\$ 4,927	

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. No options were exercised during the three months ended March 31, 2010.

**7. 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. Both pension plans have been frozen since prior to January 1, 1998. There are no new participants and no future accruals of benefits from the time the plans were frozen.

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

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

	Three months ended March 31,	
	2010	2009
Service cost	\$ 51	\$ 51
Interest cost	644	688

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Amortization of prior service cost	23	23
Amortization of loss	300	288
Expected return on plan assets	(540)	(509)
Net periodic pension cost	\$ 478	\$ 541

We contributed \$0.3 million to our pension plans during the three months ended March 31, 2010. We expect to contribute an additional \$2.3 million during the remainder of 2010.

**Table of Contents****8. Restructuring**

We account for restructuring costs associated with one-time termination benefits, costs associated with lease and contract terminations and other related exit activities in accordance with the FASB's guidance. We have made estimates of the costs to be incurred as part of our restructuring plan. During the quarter ended June 30, 2008, we committed to a plan of restructure resulting in the termination of non-driver positions and the consolidation, closure or affiliation of underperforming company terminals. We continued our plan of restructure throughout 2009 which resulted in charges of \$3.5 million of which the majority related to our trucking segment. Our restructuring plan continued in 2010 and resulted in charges of \$1.1 million in the quarter ended March 31, 2010, of which the majority related to our trucking segment. The charges in 2009 and 2010 related to employee termination benefits and other related exit activities, and included the termination of approximately 360 non-driver positions. We expect to conclude our restructuring plan in 2010 and to take additional related charges during the year.

In the three months ended March 31, 2010, we had the following activity in our restructuring accruals:

	Balance at December 31, 2009	Additions	Payments	Reductions	Balance at March 31, 2010
Restructuring costs	\$ 1,063	\$ 1,147	\$ (1,067)	\$	\$ 1,143

**9. Segment Reporting****Reportable Segments**

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

Trucking, which consists of truckload transportation of bulk chemicals, and

Container Services, specifically ISO tank container transportation and depot services.

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

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

	Three months ended March 31,	
	2010	2009
<b>Operating revenues:</b>		
Trucking	\$ 121,783	\$ 111,148
Container Services	23,195	19,901
Other revenue	16,355	18,683
<b>Total</b>	<b>161,333</b>	<b>149,732</b>
<b>Operating income:</b>		
Trucking	10,533	7,585
Container Services	3,674	3,289

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Other operating income	285	951
Total segment operating income	14,492	11,825
Depreciation and amortization expense	4,243	5,335
Other expense	1,565	497
Total	8,684	5,993
Interest expense	8,667	7,000
Interest income	(161)	(103)
Other expense (income)	6	(532)
Income (loss) before income taxes	\$ 172	\$ (372)



**Table of Contents****Geographic Segments**

Our operations are located primarily in the United States, Canada and Mexico. Inter-area sales are not significant to the total revenue of any geographic area. Information about our operations in different geographic areas for the three months ended March 31, 2010 and 2009 is as follows (in thousands):

	<b>Three months ended March 31, 2010</b>		
	<b>U. S.</b>	<b>International</b>	<b>Consolidated</b>
Total operating revenues	\$ 152,177	\$ 9,156	\$ 161,333
Operating income	7,758	926	8,684
	<b>As of March 31, 2010</b>		
Long-term identifiable assets (1)	\$ 137,338	\$ 7,783	\$ 145,121
	<b>Three months ended March 31, 2009</b>		
	<b>U. S.</b>	<b>International</b>	<b>Consolidated</b>
Total operating revenues	\$ 141,114	\$ 8,618	\$ 149,732
Operating income	5,217	776	5,993
	<b>As of December 31, 2009</b>		
Long-term identifiable assets (1)	\$ 137,807	\$ 7,989	\$ 145,796

(1) Includes property and equipment and intangible assets.

**10. Income Taxes**

At December 31, 2009, we had approximately \$1.8 million of total gross unrecognized tax benefits. Of this total, \$1.2 million (net of federal benefit on state tax issues) represents the amount of unrecognized tax benefits that, if recognized would favorably affect the effective income tax rate in any future periods.

Included in the balance of gross unrecognized tax benefits at December 31, 2009, was \$0.7 million related to tax positions for which it is reasonably possible that the total amounts could significantly change during the next twelve months due to expiration of the statute of limitations.

For the three months ended March 31, 2010, the change in unrecognized tax benefits was a decrease of \$0.3 million. The change was due to an expiration of the statute of limitations. Our total gross unrecognized tax benefit at March 31, 2010 was \$1.5 million.

Our continuing practice is to recognize interest and/or penalties related to income tax matters in income tax expense. We had \$0.7 million (net of federal tax benefit) accrued for interest and \$0.3 million accrued for penalties at December 31, 2009. The total amount accrued for interest and penalties at March 31, 2010 was \$0.7 million.

We are subject to the income tax jurisdictions of the U.S., Canada, and Mexico, as well as income tax of multiple state jurisdictions. We believe we are no longer subject to U.S. federal income tax examinations for years before 2006, to international examinations for years before 2005 and with few exceptions, to state examinations before 2005.

The effective tax rates for the three months ended March 31, 2010 and 2009 were a benefit of more than 100.0% and 18.8%, respectively. The effective tax rate for the current period includes a tax benefit of approximately \$0.7 million from a change in the Company's uncertain tax positions. This represents an unusual or infrequently occurring item largely influencing our effective tax rate, which otherwise would be proximate to our estimated annual effective tax rate.

---

**Table of Contents****11. Commitments and Contingencies*****Environmental Matters***

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

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

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

***Reserves***

Our policy is to accrue remediation expenses when it is probable that such efforts will be required and the related expenses can be reasonably estimated. Estimates of costs for future environmental compliance and remediation may be adversely affected by such factors as changes in environmental laws and regulatory requirements, the availability and application of technology, the identification of currently unknown potential remediation sites and the allocation of costs among the potentially responsible parties under the applicable statutes. The recorded liabilities are adjusted periodically as remediation efforts progress or as additional technical or legal information becomes available. As of March 31, 2010 and December 31, 2009, we had reserves in the amount of \$11.5 million and \$11.6 million, respectively, for all environmental matters of which the more significant are discussed below.

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

***Property Contamination Liabilities***

We have been named as (or are alleged to be) a potentially responsible party under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended ( CERCLA ) and similar state laws at approximately 24 sites. At 17 of the 24 sites, we are one of many parties with alleged liability and are negotiating with Federal, State or private parties on the scope of our obligations, if any. At 2 of the 17 sites, we will be participating in the initial studies to determine site remediation objectives. Since our overall liability cannot be estimated at this time, we have set reserves for only the initial remedial investigation phase. At 3 of the 17 sites, we have explicitly denied any liability and since there has been no subsequent demand for payment we have not established a reserve for these matters. We have estimated future expenditures for these off-site multi-party environmental matters to be in the range of \$2.6 million to \$3.8 million.

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

At 7 of the 24 sites, we are the only responsible party and are in the process of conducting investigations and/or remediation projects. Four of these projects relate to operations conducted by our subsidiary, Chemical Leaman Corporation ( CLC ), and its subsidiaries prior to our acquisition of CLC in 1998. These four sites are: (1) Bridgeport, New Jersey; (2) William Dick, Pennsylvania;

---

**Table of Contents**

(3) Tonawanda, New York; and (4) Scary Creek, West Virginia. The remaining three sites relate to investigations and potential remediation that were triggered by the New Jersey Industrial Site Remediation Act ( ISRA ), which requires such investigations and remediation following the sale of industrial facilities. Each of these sites is discussed in more detail below. We have estimated future expenditures for these seven properties to be in the range of \$8.9 million to \$16.7 million.

*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 the U.S. Environmental Protection Agency ( USEPA ) in May 1991 for the treatment of groundwater and in October 1998 for the removal of contamination in the wetlands. In addition, we were required to assess the remediation of contaminated soils.

The groundwater treatment remedy negotiated with USEPA calls for a treatment facility for in-place treatment of groundwater contamination and a local discharge. Treatment facility construction was completed in early 2007. After various start-up issues, we expect the treatment facility to begin operating in 2010. Wetlands contamination has been remediated with localized restoration completed. Monitoring of the restored wetlands is continuing. In regard to contaminated soils, USEPA finalized the feasibility study and issued a record of decision in 2009 for the limited areas that show contamination and warrant additional investigation or work. We are in negotiations with USEPA to enter a consent order to perform the remediation work. We have estimated expenditures to be in the range of \$5.5 million to \$8.5 million.

*William Dick, Pennsylvania*

CLC entered into a consent order with the Pennsylvania DEP and USEPA in October 1995 obligating it to provide a replacement water supply to area residents, treat contaminated groundwater, and perform remediation of contaminated soils at this former wastewater disposal site. The replacement water supply is complete. We completed construction of a treatment facility with local discharge for groundwater treatment in the fourth quarter of 2007. Plant start-up issues are on-going but we expect the treatment facility to begin operating in 2010. The agencies approved a contaminated soils remedy, which required both thermal treatment of contaminated soils and treatment of residuals via soil vapor extraction. The remedy expanded to include off-site shipment of contaminated soils. Soil treatment was completed in September 2007. Site sampling has been conducted and the results indicate that the soil clean-up objectives have not been fully achieved. Negotiations are on-going with USEPA over further remedial actions that may be needed at the site. We have estimated expenditures to be in the range of \$1.0 million to \$3.4 million.

*Other Properties*

*Scary Creek, West Virginia:* CLC received a cleanup notice from the State environmental authority in August 1994. The State and we have agreed that remediation can be conducted under the State's voluntary clean-up program (instead of the state superfund enforcement program). We are currently completing the originally planned remedial investigation and the additional site investigation work.

*Tonawanda, New York:* CLC entered into a consent order with the New York Department of Environmental Conservation on June 22, 1999 obligating it to perform soil and groundwater remediation at this former truck terminal and tank wash site. We have completed a remedial investigation and a feasibility study. The State issued a record of decision in May 2006. The site is currently in remedial design phase.

*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. These sites are in the process of remedial investigation with projections set in contemplation of limited soil remediation expense for contaminated areas.

We have estimated future expenditures for Scary Creek, Tonawanda and ISRA to be in the range of \$2.4 million to \$4.8 million.

**Table of Contents**

**12. Guarantor Subsidiaries**

The 2013 Senior Notes and 2012 Notes are our subsidiaries, QD LLC and QD Capital, senior unsecured obligations and are fully and unconditionally guaranteed on a senior unsecured basis, jointly and severally, by QDI, our other subsidiary guarantors, and certain of our future U.S. restricted subsidiaries. The 2013 PIK Notes and 9% Notes are our subsidiaries, QD LLC and QD Capital Corporation, unsecured and senior subordinated obligations and are fully and unconditionally guaranteed on an unsecured and senior subordinated basis, jointly and severally, by QDI, our other subsidiary guarantors, and certain of our future U.S. restricted subsidiaries. The subsidiary guarantors of all of the notes are all of our direct and indirect domestic subsidiaries. All non-domestic subsidiaries including Levy Transport, Ltd. are not guarantor subsidiaries. QD Capital has no material assets or operations. QD LLC, all its subsidiary guarantors and QD Capital are 100% owned by QDI.

QD LLC conducts substantially all of its business through and derives virtually all of its income from its subsidiaries. Therefore, its ability to make required principal and interest payments with respect to its indebtedness depends on the earnings of subsidiaries and its ability to receive funds from its subsidiaries through dividend and other payments. The subsidiary guarantors are 100% owned subsidiaries of QD LLC and have fully and unconditionally guaranteed the 9% Notes and the 2012 Notes, and the 2013 Senior Notes and the 2013 PIK Notes on a joint and several basis.

QDI has no significant restrictions on its ability to receive funds from its subsidiaries. The ABL Facility and the indentures governing our 2013 Senior Notes and our 2013 PIK Notes contain certain limitations on QD LLC's ability to make distributions to QDI. We do not consider these restrictions to be significant, because QDI is a holding company with no significant operations or assets, other than ownership of 100% of QD LLC's membership units. QD LLC's direct and indirect wholly owned subsidiaries are generally permitted to make distributions to QD LLC, which is the principal obligor under the ABL Facility, the 9% Notes, the 2012 Notes, the 2013 Senior Notes and the 2013 PIK Notes.

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:

Condensed consolidating balance sheets at March 31, 2010 and December 31, 2009 and condensed consolidating statements of operations for the three month periods ended March 31, 2010 and 2009 and the condensed consolidating statements of cash flows for each of the three month periods ended March 31, 2010 and 2009.

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

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

	QDI	QD LLC & QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Operating revenues:						
Transportation	\$	\$	\$ 118,917	\$	\$	\$ 118,917
Other service revenue			24,753	153		24,906
Fuel surcharge			17,510			17,510
<b>Total operating revenues</b>			<b>161,180</b>	<b>153</b>		<b>161,333</b>
Operating expenses:						
Purchased transportation			110,904			110,904
Compensation			13,892			13,892
Fuel, supplies and maintenance			12,288			12,288
Depreciation and amortization			4,243			4,243
Selling and administrative		23	4,735	20		4,778
Insurance costs			3,332	5		3,337
Taxes and licenses			596			596
Communication and utilities			1,046			1,046
Loss on disposal of property and equipment			418			418
Restructuring costs			1,147			1,147
<b>Operating (loss) income</b>		(23)	<b>8,579</b>	<b>128</b>		<b>8,684</b>
Interest expense (income), non-related party, net		8,105	415	(14)		8,506
Interest (income) expense, related party, net		(8,105)	8,207	(102)		
Gain on extinguishment of debt						
Other expense (income)			56	(50)		6
<b>(Loss) income before income taxes</b>		(23)	<b>(99)</b>	<b>294</b>		<b>172</b>
Provision for (benefit from) income taxes			73	(699)		(626)
Equity in earnings of subsidiaries	798	821			(1,619)	
<b>Net income (loss)</b>	<b>\$ 798</b>	<b>\$ 798</b>	<b>\$ (172)</b>	<b>\$ 993</b>	<b>\$ (1,619)</b>	<b>\$ 798</b>

**Table of Contents****Consolidating Statements of Operations****Three Months Ended March 31, 2009****Unaudited - (In 000 s)**

	<b>QDI</b>	<b>QD LLC and QD Capital</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Operating revenues:</b>						
Transportation	\$	\$	\$ 111,027	\$	\$	\$ 111,027
Other service revenue			27,560	48		27,608
Fuel surcharge			11,097			11,097
<b>Total operating revenues</b>			<b>149,684</b>	<b>48</b>		<b>149,732</b>
<b>Operating expenses:</b>						
Purchased transportation			81,891			81,891
Compensation			23,211			23,211
Fuel, supplies and maintenance			17,540			17,540
Depreciation and amortization			5,335			5,335
Selling and administrative		22	7,113	10		7,145
Insurance costs			4,044	5		4,049
Taxes and licenses			1,337			1,337
Communication and utilities			2,734			2,734
Gain on disposal of property and equipment			(103)			(103)
Restructuring costs			600			600
<b>Operating (loss) income</b>		(22)	<b>5,982</b>	<b>33</b>		<b>5,993</b>
Interest expense (income), non-related party, net		6,231	682	(16)		6,897
Interest (income) expense, related party, net		(6,231)	6,332	(101)		(675)
Gain on extinguishment of debt		(675)				(675)
Other expense			24	119		143
<b>Income (loss) before income taxes</b>		<b>653</b>	<b>(1,056)</b>	<b>31</b>		<b>(372)</b>
(Benefit from) provision for income taxes			(123)	53		(70)
Equity in loss of subsidiaries	(302)	(955)			1,257	
<b>Net loss</b>	<b>\$ (302)</b>	<b>\$ (302)</b>	<b>\$ (933)</b>	<b>\$ (22)</b>	<b>\$ 1,257</b>	<b>\$ (302)</b>

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

	<b>QDI</b>	<b>QD LLC and QD Capital</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>ASSETS</b>						
Current Assets:						
Cash and cash equivalents	\$	\$	\$ 396	\$ 2,279	\$	\$ 2,675
Accounts receivable, net	52		80,426	63		80,541
Prepaid expenses		71	10,309	10		10,390
Deferred tax asset, net			4,626			4,626
Other	(103)		4,716	112		4,725
Total current assets	(51)	71	100,473	2,464		102,957
Property and equipment, net			127,052			127,052
Goodwill			27,023			27,023
Intangibles, net			18,069			18,069
Investment in subsidiaries	(142,759)	457,280	21,229		(335,750)	
Other assets		8,527	4,291			12,818
Total assets	\$ (142,810)	\$ 465,878	\$ 298,137	\$ 2,464	\$ (335,750)	\$ 287,919
<b>LIABILITIES, REDEEMABLE NONCONTROLLING INTEREST AND SHAREHOLDERS (DEFICIT) EQUITY</b>						
Current Liabilities:						
Current maturities of indebtedness	\$	16,031	\$ 3,467	\$	\$	\$ 19,498
Current maturities of capital lease obligations			4,900			4,900
Accounts payable			9,591			9,591
Intercompany	(2,625)	301,854	(272,216)	(5,784)	(21,229)	
Affiliates and independent owner-operators payable			12,591			12,591
Accrued expenses		8,082	13,782	19		21,883
Environmental liabilities			3,733			3,733
Accrued loss and damage claims			7,525			7,525
Total current liabilities	(2,625)	325,967	(216,627)	(5,765)	(21,229)	79,721
Long-term indebtedness, less current maturities		282,670	8,570			291,240
Capital lease obligations, less current maturities			10,809			10,809
Environmental liabilities			7,740			7,740
Accrued loss and damage claims			8,679			8,679
Other non-current liabilities	(1,007)		27,874	208		27,075
Total liabilities	(3,632)	608,637	(152,955)	(5,557)	(21,229)	425,264
Redeemable noncontrolling interest			1,833			1,833
Shareholders' equity (deficit):						
Common Stock	364,535	354,963	493,861	6,933	(855,757)	364,535
Treasury stock	(1,580)					(1,580)
Accumulated (deficit) retained earnings	(293,770)	(289,986)	(20,783)	2,167	308,602	(293,770)
Stock recapitalization	(189,589)	(189,589)		(55)	189,644	(189,589)
Accumulated other comprehensive loss	(25,316)	(24,843)	(23,819)	(1,024)	49,686	(25,316)
Stock purchase warrants	6,696	6,696			(6,696)	6,696
Stock subscriptions receivable	(154)					(154)



Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Total shareholders (deficit) equity	(139,178)	(142,759)	449,259	8,021	(314,521)	(139,178)
Total liabilities, redeemable noncontrolling interest and shareholders (deficit) equity	\$ (142,810)	\$ 465,878	\$ 298,137	\$ 2,464	\$ (335,750)	\$ 287,919

**Table of Contents****Consolidating Balance Sheet****December 31, 2009****Unaudited - (In 000 s)**

	QDI	QD LLC and QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>ASSETS</b>						
Current Assets:						
Cash and cash equivalents	\$	\$	\$ 3,531	\$ 2,102	\$	\$ 5,633
Accounts receivable, net	52		69,477	96		69,625
Prepaid expenses		96	8,473	15		8,584
Deferred tax asset, net			5,506			5,506
Other	(104)		4,460	64		4,420
Total current assets	(52)	96	91,447	2,277		93,768
Property and equipment, net			127,329			127,329
Goodwill			27,023			27,023
Intangibles, net			18,467			18,467
Investment in subsidiaries	(143,830)	456,186	21,229		(333,585)	
Other assets		9,204	3,825			13,029
Total assets	\$ (143,882)	\$ 465,486	\$ 289,320	\$ 2,277	\$ (333,585)	\$ 279,616
<b>LIABILITIES, REDEEMABLE NONCONTROLLING INTEREST AND SHAREHOLDERS (DEFICIT) EQUITY</b>						
Current Liabilities:						
Current maturities of indebtedness	\$	\$ 16,031	\$ 3,835	\$	\$	\$ 19,866
Current maturities of capital lease obligations			5,322			5,322
Accounts payable			6,182			6,182
Intercompany	(2,139)	312,705	(283,664)	(5,673)	(21,229)	
Affiliates and independent owner-operators payable			9,734			9,734
Accrued expenses		5,053	16,313	12		21,378
Environmental liabilities			3,408			3,408
Accrued loss and damage claims			8,862			8,862
Total current liabilities	(2,139)	333,789	(230,008)	(5,661)	(21,229)	74,752
Long-term indebtedness, less current maturities		275,527	8,726			284,253
Capital lease obligations, less current maturities			11,843			11,843
Environmental liabilities			8,241			8,241
Accrued loss and damage claims			10,534			10,534
Other non-current liabilities	(1,007)		29,044	859		28,896
Total liabilities	(3,146)	609,316	(161,620)	(4,802)	(21,229)	418,519
Redeemable noncontrolling interest in subsidiary			1,833			1,833
Shareholders (deficit) equity:						
Common Stock	364,046	354,963	493,861	6,933	(855,757)	364,046
Treasury stock	(1,580)					(1,580)
Accumulated (deficit) retained earnings	(294,568)	(290,784)	(20,611)	1,174	310,221	(294,568)
Stock recapitalization	(189,589)	(189,589)		(55)	189,644	(189,589)
Accumulated other comprehensive loss	(25,587)	(25,116)	(24,143)	(973)	50,232	(25,587)
Stock purchase warrants	6,696	6,696			(6,696)	6,696
Stock subscriptions receivable	(154)					(154)

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Total shareholders (deficit) equity	(140,736)	(143,830)	449,107	7,079	(312,356)	(140,736)
Total liabilities, redeemable noncontrolling interest and shareholders (deficit) equity	\$ (143,882)	\$ 465,486	\$ 289,320	\$ 2,277	\$ (333,585)	\$ 279,616

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

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

**Table of Contents****Condensed Consolidating Statements of Cash Flows****Three Months Ended March 31, 2009****Unaudited - (In 000 s)**

	<b>QDI</b>	<b>QD LLC and QD Capital</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Cash flows from operating activities:</b>						
Net loss	\$ (302)	\$ (302)	\$ (933)	\$ (22)	\$ 1,257	\$ (302)
Adjustments for non-cash charges	302	(5,894)	13,158		(1257)	6,309
Net changes in assets and liabilities	(163)	1,636	6,109	65		7,647
Intercompany activity	163	4,560	(4,704)	(19)		
Net cash provided by operating activities			13,630	24		13,654
<b>Cash flows from investing activities:</b>						
Capital expenditures			(1,758)			(1,758)
Proceeds from sales of property and equipment			2,166			2,166
Net cash provided by investing activities			408			408
<b>Cash flows from financing activities:</b>						
Proceeds from issuance of long-term debt						
Principal payments on long-term debt and capital lease obligations		(2,825)	(3,678)			(6,503)
Proceeds from revolver		8,000				8,000
Payments on revolver		(13,000)				(13,000)
Other		(36)	(2,212)			(2,248)
Intercompany activity		7,861	(7,861)			
Net cash used in financing activities			(13,751)			(13,751)
Effect of exchange rate changes on cash			(6)			(6)
Net increase in cash and cash equivalents			281	24		305
Cash and cash equivalents, beginning of period			4,725	2,062		6,787
Cash and cash equivalents, end of period	\$	\$	\$ 5,006	\$ 2,086	\$	\$ 7,092

---

**Table of Contents**

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

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

***OVERVIEW***

We operate the largest chemical bulk tank truck network in North America through our wholly owned subsidiary QCI and are a leading provider of ISO (International Organization for Standardization) container and depot services through our wholly owned subsidiary Boasso.

The bulk tank truck market in North America includes all products shipped by bulk tank truck carriers and consists primarily of liquid and dry bulk chemicals (including plastics) and bulk dry and liquid food-grade products. We primarily transport a broad range of chemical products and provide our customers with logistics and other value-added services. We are a core carrier for many of the major companies engaged in chemical processing, including BASF, Dow, DuPont, ExxonMobil, Georgia-Pacific, Honeywell, Procter & Gamble, Rohm & Haas, Sunoco and Unilever, and we provide services to most of the top 100 chemical producers with United States operations.

Our transportation revenue is a function of the volume of shipments by the bulk chemical industry, prices, the average number of miles driven per load, our market share, and the allocation of shipments between tank truck transportation and other modes of transportation such as rail. The volume of shipments of chemical products is, in turn, affected by many other industries and end use markets, including consumer and industrial products, paints and coatings, paper and packaging, agriculture and food products, and tends to vary with changing economic conditions.

Due to the nature of our customers' business, our revenues generally decline during winter months, namely the first and fourth fiscal quarters and over holidays. Highway transportation can be adversely affected depending upon the severity of the weather in various sections of the country during the winter months. Our operating expenses also are somewhat higher in the winter months, due primarily to decreased fuel efficiency, increased utility costs and increased maintenance costs of equipment in colder months.

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

Demand for ISO tank containers is impacted by the volume of imports and exports of chemicals through United States ports. Boasso's revenues are accordingly impacted by this import/export volume in particular the number of shipments through ports at which Boasso has terminals, the volume of rail shipments to and from ports at which Boasso has terminals and by Boasso's market share. Economic conditions and differences among the laws and currencies of nations may impact the volume of shipments as well.

Our bulk service network consists primarily of independently owned third-party affiliate terminals, company operated terminals and independent owner-operator drivers. Affiliates are independent companies we contract with to operate trucking terminals 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. Independent owner-operators are generally individual drivers who own or lease their tractors and agree to provide transportation services to us under contract. We believe the use of affiliates and independent owner-operators provides the following key competitive advantages to us in the marketplace:

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

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

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

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

In the first quarter of 2009, we began consolidating certain company-operated terminals and transitioning other company-operated terminals to affiliates. These actions have continued during the first quarter of 2010 and have resulted in a larger portion of our revenue being generated by affiliates and a substantial reduction in the number of terminals in our network. We believe these actions will reduce certain fixed costs, provide a more variable cost structure and position us with a financially flexible business platform.

## **Table of Contents**

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

On October 15, 2009, we received approximately \$134.5 million of our 2012 Notes in exchange for new 2013 Senior Notes. We also received approximately \$83.6 million for our 9% Notes in exchange for approximately \$80.7 million aggregate principal amount of our new 2013 PIK Notes, approximately 1.75 million warrants and \$1.8 million in cash. The warrants are exercisable to purchase shares of our common stock at an exercise price of \$0.01 per share, during the period beginning April 16, 2010 and ending on November 1, 2013.

### *Affiliation*

On May 1, 2010, we added F. T. Silfies ( Silfies ) to our affiliate network. Headquartered in Allentown, Pennsylvania, Silfies specializes in bulk cement and lime transport primarily servicing the East Coast markets. In connection with this affiliation, we loaned Silfies \$3.0 million in cash. This loan bears interest at seven percent per annum, is repayable in equal weekly installments of principal and interest over three and one-half years and is secured by all of the assets of Silfies and a personal guarantee. We expect this affiliation to generate approximately \$20.0 million of revenue annually following the date of affiliation. This relationship did not impact revenues for the quarter ended March 31, 2010.

### *Disposition*

On October 10, 2009, we sold substantially all of the operating assets of our tank wash subsidiary, QSI, for \$13.0 million, of which \$10.0 million was paid in cash and the remaining \$3.0 million in a subordinated note. The subordinated note is a five year non-amortizing note which matures on December 31, 2014. The principal is payable in a lump sum at maturity. Interest is payable quarterly at 7% per annum commencing December 31, 2009. In connection with the sale, QSI entered into various agreements with the purchaser, which is not affiliated with us, including long-term leases of real estate used in the tank wash business and various operating agreements. The assets sold had a net book value of \$4.9 million which included \$4.3 million of equipment, \$0.4 million of inventory, and \$0.2 million of intangibles. The sold QSI business generated approximately \$19.5 million of revenue in 2009 from tank wash and related operations. We recorded a pre-tax gain of \$7.1 million in the fourth quarter of 2009 as part of our operating income.



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

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

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

The asset lives used are presented in the following table:

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

Tractor and trailer rebuilds, which are recurring in nature and extend the lives of the related assets, are capitalized and depreciated over the period of extension, generally 3 to 10 years, based on the type and extent of these rebuilds. Maintenance and repairs are charged directly to expense as incurred. Management estimates the useful lives of these assets based on historical trends and the age of the assets when placed in service. Any changes in the actual lives could result in material changes in the net book value of these assets. Additionally, we estimate the salvage values of these assets based on historical sales or disposals, and any changes in the actual salvage values could also affect the net book value of these assets.

Furthermore, we evaluate the recoverability of our long-lived assets whenever adverse events or changes in the business climate indicate that the expected undiscounted future cash flows from the related asset may be less than previously anticipated. If the net book value of the related asset exceeds the undiscounted future cash flows of the asset, the carrying amount would be reduced to the present value of its expected future cash flows and an impairment loss would be recognized. This analysis requires us to make significant estimates and assumptions in projecting future cash flows, and changes in facts and circumstances could result in material changes in the amount of any write-offs for impairment.

*Goodwill and Intangible Assets* We evaluate goodwill and indefinite-lived intangible assets for impairment at least annually during the second quarter with a measurement date of June 30, and more frequently if indicators of impairment arise, in accordance with FASB's guidance on goodwill and other intangible assets. At June 30, 2009, we evaluated goodwill for impairment by determining the fair value for each reporting unit: our trucking segment and our container services segment. These reporting units contain goodwill and other identifiable intangible assets as a result of previous business acquisitions.

We have evaluated at least quarterly whether indicators of impairment exist in accordance with applicable guidance. Prior to our June 30, 2009 analysis, we did not believe that factors attributable to the economic downturn would impact the recoverability of our goodwill. Our performance since the prior period's goodwill impairment test at June 30, 2008 through year end 2008 trended positive and there were no indications from our quarterly reviews that a triggering event had occurred. The first quarter of 2009 showed improved operating income year over year and strong operating cash flow; however, due to the continuing economic downturn, we reviewed not only our market capitalization, but also performed a discounted cash flow analysis based on assumptions adjusted to reflect the current economic environment and which we believed to be appropriate at the time. The conclusions from our extended analysis at March 31, 2009 did not indicate a trend in operating results that would foretell of impairment to our goodwill. For our June 30, 2009 analysis, we adjusted further our assumptions used, such as growth and discount rates, in the annual impairment test to reflect the persistence of the downward economic trend. We continued to evaluate indicators of impairment quarterly following our annual goodwill impairment test at June 30, 2009 through year end 2009, and again in the quarter ended March 31, 2010. There were no indications that a triggering event had occurred as of March 31, 2010.

**Goodwill**

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

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

## **Table of Contents**

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

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

After computing a separate business enterprise value under the income approach and market approach, we apply a weighting to them to derive the business enterprise value of the reporting unit. The income approach and market approach were both weighted 50% in the analysis performed at June 30, 2009. The weightings are evaluated each time a goodwill impairment assessment is performed and give consideration to the relative reliability of each approach at that time. Given that the business enterprise value derived from the market approach supported what was calculated in the income approach, we believed that both approaches should be equally weighted. Based on these weightings we concluded a business enterprise value for each reporting unit. We then add debt-free liabilities of the reporting unit to the concluded business enterprise value to derive an implied fair value of the reporting unit. The implied fair value is compared to the reporting unit's carrying value of total assets. Upon completion of the analysis in step one, we determined that the carrying amount of our trucking reporting unit exceeded its fair value and the carrying amount of our container services reporting unit was nearly breakeven with its fair value, requiring a step two analysis to be performed for both reporting units.

In step two of the goodwill impairment test, the amount of impairment loss is determined by comparing the implied fair value of each reporting unit's goodwill with the carrying value of the reporting unit's goodwill. This involves testing the definite-lived assets in accordance with the FASB guidance using undiscounted cash flows. Then a fair value allocation is performed in accordance with the FASB guidance for each reporting unit based on the business enterprise value obtained in step one. From that we determine the actual goodwill impairment for each reporting unit based on the goodwill residual amount. If the carrying amount of reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss must be recognized in an amount equal to the excess. The loss recognized cannot exceed the carrying amount of goodwill. After a goodwill impairment loss is recognized, the adjusted carrying amount of goodwill will be its new accounting basis. Upon completion of step two of the analysis, an impairment charge was determined of \$146.2 million in 2009, related to our trucking and container services segments.

### **Intangible assets**

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

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

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

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

We continue to evaluate quarterly the positive and negative evidence regarding the realization of net deferred tax assets. The carrying value of our net deferred tax assets is based on our belief that it is more likely than not that we will generate sufficient future taxable income to realize these deferred tax assets. A valuation allowance has been established for 100% of our net deferred tax asset

---

**Table of Contents**

as we no longer believe it meets the more likely than not criteria. Our judgments regarding future taxable income may change due to changes in market conditions, changes in tax laws or other factors. If any of the assumptions and related estimates change in the future, it may increase or decrease the valuation allowance and related income tax expense in the same period.

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

At December 31, 2009 we had an estimated \$95.7 million in federal net operating loss carryforwards, \$2.3 million in alternative minimum tax credit carryforwards and \$3.1 million in foreign tax credit carryforwards. The net operating loss carryforwards will expire in the years 2018 through 2027, while the alternative minimum tax credits may be carried forward indefinitely and the foreign tax credits may be carried forward for 10 years.

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

*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.

*Accrued loss and damage claims* We currently maintain liability insurance for bodily injury and property damage claims, covering all employees, independent owner-operators and affiliates, and workers' compensation insurance coverage on our employees and company drivers. This insurance includes deductibles of \$2.0 million per incident for bodily injury and property damage and \$1.0 million for workers' compensation. As such, we are subject to liability as a self-insurer to the extent of these deductibles under the policy. We are self-insured for damage to the equipment we own or lease and for cargo losses. As of March 31, 2010, we had \$29.7 million in an outstanding letter of credit to our insurance administrator to guarantee the self-insurance portion of our liability. If we fail to meet certain terms of our agreement, the insurance administrator may draw down the letter of credit. In developing liability reserves, we rely on professional third party claims administrators, insurance company estimates and the judgment of our own personnel, and independent professional actuaries and attorneys. The most significant assumptions used in the estimation process include determining the trends in loss costs, the expected consistency in the frequency and severity of claims incurred but not yet reported to prior-year claims, and expected costs to settle unpaid claims. Management believes reserves are reasonable given known information, but as each case develops, estimates may change to reflect the effect of new information.

*Revenue recognition* Transportation revenue, including fuel surcharges and related costs, are recognized on the date freight is delivered. Other service revenue consists primarily of rental revenues, container revenues and tank wash revenues. Rental revenues from affiliates, independent owner-operators and third parties are recognized ratably over the lease period. Container revenues, consisting primarily of repair and storage services, are recognized when the services are rendered. 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 recognize all revenues on a gross basis as the principal and primary obligor with risk of loss in relation to our responsibility for completion of services as contracted with our customers.

*Allowance for uncollectible receivables* The allowance for all potentially uncollectible receivables is based on a combination of historical data, cash payment trends, specific customer issues, write-off trends, general economic conditions and other factors. These factors are continuously monitored by our management to arrive at the estimate for the amount of accounts receivable that may be ultimately uncollectible. The receivables analyzed include trade receivables, as well as loans and advances made to independent



**Table of Contents**

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.

*Stock compensation plans* Stock compensation is determined by the assumptions required under the FASB guidance. The fair values of stock option grants are based upon the Black-Scholes option-pricing model and amortized as compensation expense on a straight-line basis over the vesting period of the grants. Restricted stock awards are issued and measured at market value on the date of grant and related compensation expense is recognized over time on a straight-line basis over the vesting period of the grants. Stock-based compensation expense related to stock options and restricted stock was \$0.5 million for the three months ended March 31, 2010 and \$0.2 million for the three months ended March 31, 2009. As of March 31, 2010, there was approximately \$4.9 million of total unrecognized compensation cost related to the unvested portion of our stock-based awards. The recognition period for the remaining unrecognized stock-based compensation cost generally varies from two to four years. For further discussion on stock-based compensation, see Note 6 to the consolidated financial statements included in Item 1 of this report.

*Pension plans* We maintain two noncontributory defined-benefit plans resulting from a prior acquisition that cover certain 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 (6.25% to 6.30%) and assumed rates of return (7.00% to 8.00%) depending on the pension plan. Material changes in pension costs may occur in the future due to changes in these assumptions. Future annual amounts could be impacted by changes in the discount rate, changes in the expected long-term rate of return, changes in the level of contributions to the plans and other factors.

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

Assumed discount rates and expected return on plan assets have a significant effect on the amounts reported for the pension plan. At December 31, 2009, our projected benefit obligation ( PBO ) was \$47.3 million. Our projected 2010 net periodic pension expense is \$1.9 million. A 1.0% decrease in our assumed discount rate would increase our PBO to \$52.3 million and increase our 2010 net periodic pension expense less than \$0.1 million. A 1.0% increase in our assumed discount rate would decrease our PBO to \$43.1 million and decrease our 2010 net periodic pension expense less than \$0.1 million. A 1.0% decrease in our assumed rate of return would not change our PBO but would increase our 2010 net periodic pension expense to \$2.2 million. A 1.0% increase in our assumed rate of return would not change our PBO but would decrease our 2010 net periodic pension expense to \$1.6 million.

*Restructuring* We account for restructuring costs associated with one-time termination benefits, costs associated with lease and contract terminations and other related exit activities in accordance with the FASB s guidance. We have made estimates of the costs to be incurred as part of our restructuring plan. During the quarter ended June 30, 2008, we committed to a plan of restructure resulting in the termination of non-driver positions and the consolidation, closure or affiliation of underperforming company terminals. We continued our plan of restructure throughout 2009 which resulted in charges of \$3.5 million of which the majority related to our trucking segment. Our restructuring plan continued in 2010 and resulted in charges of \$1.1 million in the quarter ended March 31, 2010, of which the majority related to our trucking segment. The charges in 2009 and 2010 related to employee termination benefits and other related exit activities, and included the termination of approximately 360 non-driver positions. We expect to conclude our restructuring plan in 2010 and to take additional related charges during the year. As of March 31, 2010, approximately \$1.1 million was accrued related to the restructuring charges which are expected to be paid through 2010.

*New Accounting Pronouncements*

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

**Table of Contents***Results of Operations*

The following table presents certain condensed consolidated financial information, as a percentage of revenue, for the three months ended March 31, 2010 and 2009:

	<b>Three months ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>OPERATING REVENUES:</b>		
Transportation	73.7%	74.2%
Other service revenue	15.4%	18.4%
Fuel surcharge	10.9%	7.4%
<b>Total operating revenues</b>	<b>100.0%</b>	<b>100.0%</b>
<b>OPERATING EXPENSES:</b>		
Purchased transportation	68.7%	54.7%
Compensation	8.6%	15.5%
Fuel, supplies and maintenance	7.6%	11.7%
Depreciation and amortization	2.6%	3.6%
Selling and administrative	3.0%	4.8%
Insurance costs	2.1%	2.7%
Taxes and licenses	0.4%	0.9%
Communication and utilities	0.6%	1.8%
Loss (gain) on disposal of property and equipment	0.3%	-0.1%
Restructuring costs	0.7%	0.4%
<b>Total operating expenses</b>	<b>94.6%</b>	<b>96.0%</b>
Operating income	5.4%	4.0%
Interest expense	5.4%	4.7%
Interest income	-0.1%	-0.1%
Gain on extinguishment of debt	0.0%	-0.5%
Other expense	0.0%	0.1%
<b>Income (loss) before income taxes</b>	<b>0.1%</b>	<b>-0.2%</b>
Benefit from income taxes	-0.4%	-0.1%
<b>Net income (loss)</b>	<b>0.5%</b>	<b>-0.1%</b>

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

	<b>2010</b>	<b>2009</b>
Terminals	103	144
Drivers	2,630	2,863
Tractors	2,815	3,077
Trailers	6,246	6,930



---

**Table of Contents**

*Three Months Ended March 31, 2010 Compared to Three Months Ended March 31, 2009*

For the quarter ended March 31, 2010, total revenues were \$161.3 million, an increase of \$11.6 million, or 7.7%, from revenues of \$149.7 million for the same period in 2009. Transportation revenue increased by \$7.9 million, or 7.1%, primarily due to an increase in linehaul revenue due to an increase in miles driven. We had a 3.1% increase in the total number of miles driven and a less than 1.0% decrease in loads from the prior-year quarter.

Other service revenue decreased \$2.7 million, or 9.8%. This decrease was primarily due to reductions in tank wash revenue of \$4.2 million due to the sale of our tank wash business in the fourth quarter of 2009 and a decrease in our container services revenue of \$0.6 million. These decreases were offset by a \$2.9 million increase in rental revenues generated from the conversion of certain company-operated terminals to affiliate terminals. Fuel surcharge revenue increased \$6.4 million, or 57.8%, due to the increase in linehaul revenue and fuel prices.

Purchased transportation increased by \$29.0 million, or 35.4%, due primarily to the conversion of certain company-owned terminals to affiliate terminals. Total purchased transportation as a percentage of transportation revenue and fuel surcharge revenue increased to 81.3% for the current quarter versus 67.1% for the prior-year quarter due primarily to the conversion of certain company-operated terminals to affiliate terminals. Our affiliates generated 92.9% of our transportation revenue and fuel surcharge revenue for the three months ended March 31, 2010 compared to 59.1% for the comparable prior-year period. We pay our affiliates a greater percentage of transportation revenues generated by them than is paid to independent owner-operators, so our purchased transportation costs will change as revenues generated by affiliates change as a percentage of total transportation revenue. During the 2010 and 2009 quarters, we paid our affiliates approximately 85% of the transportation revenue while we typically paid independent owner-operators approximately 65% of the invoiced linehaul amount.

In 2009 and 2010, we consolidated certain company-operated terminals, and transitioned other company-operated terminals to affiliates. We expect these actions to result in a larger portion of our revenue being generated by affiliates throughout 2010. We believe these actions will continue to reduce certain fixed costs throughout 2010.

Compensation expense decreased \$9.3 million, or 40.1%, primarily due to \$7.8 million of reduced expense from corporate headcount reductions, terminal consolidations, and conversions of company-operated terminals to affiliate terminals and \$1.5 million of reduced expense due to the sale of our tank wash business in the fourth quarter of 2009.

Fuel, supplies and maintenance decreased \$5.3 million, or 29.9%, due to lower fuel costs of \$1.6 million, lower repairs and maintenance expense of \$2.0 million, the shift of revenue from company-operated terminals to affiliates and \$1.7 million of reduced expense due to the sale of our tank wash business in the fourth quarter of 2009.

Depreciation and amortization expense decreased \$1.1 million, or 20.5%, due to a decrease in depreciation from disposals of revenue equipment and the sale of our tank wash assets in the fourth quarter of 2009.

Selling and administrative expenses decreased by \$2.4 million, or 33.1%, primarily due to a \$0.5 million reduction in building rent expense for closed or converted terminals. In addition, we had a decrease of \$0.7 million in professional fees, \$0.5 million in bad debt expense and \$0.4 million of reduced expense due to the sale of our tank wash business in the fourth quarter of 2009.

Insurance costs decreased by \$0.7 million, or 17.6%, due primarily to a reduction in the number and severity of accidents in the current-year quarter.

Communication and utilities expense decreased \$1.7 million, or 61.7%, primarily due to reduced expense from terminal consolidations, conversions of company-operated terminals to affiliate terminals and due to the sale of our tank wash business in the fourth quarter of 2009.

We incurred a loss on disposal of assets of \$0.4 million for the quarter ended March 31, 2010 as compared to a gain of \$0.1 million in the comparable prior-year period. The loss in the 2010 quarter and the gain in the 2009 quarter resulted primarily from the disposal of revenue equipment.

In the first quarter of 2010, we incurred additional restructuring costs of \$1.1 million due to the continuation of our restructuring plan which began during the second quarter of 2008. These costs consisted of employee termination benefits and other related exit activities.

For the quarter ended March 31, 2010, operating income totaled \$8.7 million, an increase of \$2.7 million or 44.9%, compared to \$6.0 million for the same period in 2009. The operating margin for the quarter ended March 31, 2010, was 5.4% compared to 4.0% for the same period in 2009 as a result of the above-mentioned items.



**Table of Contents**

Interest expense increased by \$1.7 million, or 23.8%, in the quarter ended March 31, 2010 compared to the same period in 2009, primarily due to the higher interest rates on our 2013 Senior Notes and 2013 PIK Notes than the rates on the notes for which they were exchanged in the fourth quarter of 2009. As a result of these higher rates of interest, we expect our interest expense to continue to be higher throughout 2010 unless the principal balances of our indebtedness are reduced substantially.

In the first quarter of 2009, gain on debt extinguishment of \$0.7 million resulted from the repurchase of \$1.0 million of our 9% Notes. We did not repurchase any of our 9% Notes in the quarter ended March 31, 2010.

The benefit from income taxes was \$0.6 million for the quarter ended March 31, 2010 compared to \$0.1 million for the same period in 2009. The effective tax rates for the three months ended March 31, 2010 and 2009 were a benefit of more than 100.0% and 18.8%, respectively. The effective tax rate and associated income tax benefit for these two periods are not readily comparable primarily due to a benefit generated from a change in previously recorded unrecognized tax benefits, the effect of a full valuation allowance recorded against our net deferred tax assets and due to the relative underlying book income or loss for each period. Our estimated annual effective tax rate otherwise is comparable to the same period in 2009.

For the quarter ended March 31, 2010, our net income was \$0.8 million compared to a net loss of \$0.3 million for the same period last year.

**Segment Operating Results**

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

Trucking, which consists of truckload transportation of bulk chemicals, and

Container Services, specifically ISO tank container transportation and depot services.

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

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

	Three months ended March 31,				Change	
	2010	% of Total	2009	% of Total	\$	%
<b>Operating revenues:</b>						
Trucking	\$ 121,783	75.5%	\$ 111,148	74.2%	10,635	9.6%
Container Services	23,195	14.4%	19,901	13.3%	3,294	16.6%
Other revenue	16,355	10.1%	18,683	12.5%	(2,328)	(12.5%)
<b>Total</b>	<b>\$ 161,333</b>	<b>100.0%</b>	<b>\$ 149,732</b>	<b>100.0%</b>		
<b>Operating income:</b>						
Trucking	\$ 10,533	72.7%	\$ 7,585	64.1%	2,948	38.9%
Container Services	3,674	25.3%	3,289	27.8%	385	11.7%
Other operating income	285	2.0%	951	8.1%	(666)	(70.0%)
<b>Total</b>	<b>\$ 14,492</b>	<b>100.0%</b>	<b>\$ 11,825</b>	<b>100.0%</b>		

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

*Three Months Ended March 31, 2010 Compared to Three Months Ended March 31, 2009*

Operating revenue:

*Trucking* revenues increased \$10.6 million, or 9.6%, for the quarter ended March 31, 2010 compared to the same period for 2009 due to an increase of \$5.5 million of fuel surcharge and an increase of \$5.1 in linehaul revenue.

*Container Services* revenues increased \$3.3 million, or 16.6%, for the quarter ended March 31, 2010 compared to the same period for 2009 due to higher revenue from expanded terminal operations.

**Table of Contents**

*Other revenue* revenues decreased \$2.3 million, or 12.5%, for the quarter ended March 31, 2010 compared to the same period for 2009 due primarily to a decrease in our tank wash revenue from the sale of substantially all of our tank wash business in the fourth quarter of 2009.

Operating income:

*Trucking* operating income increased \$2.9 million, or 38.9%, for the quarter ended March 31, 2010 compared to the same period for 2009 due to higher revenue, cost savings initiatives and the conversion of certain company-operated terminals to affiliate terminals.

*Container Services* operating income increased \$0.4 million, or 11.7%, for the quarter ended March 31, 2010 compared to the same period for 2009 due to higher revenue from expanded terminal operations.

*Other operating income* operating income decreased \$0.7 million, or 70.0%, for the quarter ended March 31, 2010 compared to the same period for 2009, primarily due to reduced tank wash revenue from the sale of substantially all of our tank wash business in the fourth quarter of 2009.

*Liquidity and Capital Resources*

We believe that our liquidity, asset-light business model and streamlined operations will provide us with the flexibility and competitive positioning to take advantage of opportunities as the economy recovers and volumes in our industry rebound. Additionally, at March 31, 2010, we had \$54.1 million of borrowing availability under our asset-based loan facility (the ABL Facility).

The following summarizes our cash flows for the three months ended March 31, 2010 and 2009 as reported in our consolidated statements of cash flows in the accompanying consolidated financial statements (in thousands):

	<b>Three months ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
Net cash (used in) provided by operating activities	\$ (4,154)	\$ 13,654
Net cash (used in) provided by investing activities	(3,229)	408
Net cash provided by (used in) financing activities	4,421	(13,751)
Effect of exchange rate changes on cash	4	(6)
Net (decrease) increase in cash and cash equivalents	(2,958)	305
Cash and cash equivalents at beginning of period	5,633	6,787
Cash and cash equivalents at end of period	\$ 2,675	\$ 7,092

Historically, our primary source of liquidity has been cash flow from operations and borrowing availability under our ABL Facility. Our primary cash needs consist of working capital, capital expenditures and debt service including our ABL Facility and our 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 expect capital expenditures for 2010 to be approximately \$9.0 million, although the actual amount of capital expenditures could differ materially because of operating needs, regulatory changes, covenants in our debt arrangements, other expenses, including interest expense, or other factors.

On October 15, 2009, we completed exchange and tender offers for our 2012 Notes and our 9% Notes. In connection with the exchange and tender offers, we received approximately \$134.5 million of our 2012 Notes in exchange for \$134.5 million of our new 2013 Senior Notes. We received approximately \$83.6 million of our 9% Notes in exchange for approximately \$80.7 million aggregate principal amount of our new 2013 PIK Notes, approximately 1.75 million warrants to purchase our common stock and \$1.8 million in cash.

In the fourth quarter of 2010, \$16.0 million of our 9% Notes mature in addition to our regular payment obligations on capital leases, other notes and other indebtedness. We expect cash from operations to be sufficient to fund payment of the maturing notes, redemption obligations under our 2013 Senior Notes, and our increased interest expense. The cash required to pay in 2010 on our higher rate 2013 Senior Notes and 2013 PIK Notes will be mitigated in part because interest equal to 2.75% payable on the 2013 PIK Notes is payable through the issuance of additional notes rather than cash. We expect to fund any cash needs for our operations during this period from borrowings under our ABL Facility.



**Table of Contents**

We have accrued \$11.5 million for environmental claims and \$16.2 million for loss and damage claims and the timing of the cash payment for such claims fluctuates from quarter to quarter.

Net cash used in operating activities was \$4.2 million for the three-month period ended March 31, 2010 compared to \$13.6 million provided by the comparable 2009 period. The \$17.8 million decrease in cash used in operating activities was due to the increased sales and related accounts receivable which increased in the latter portion of the first quarter of 2010, and an increase in loss and damage claims paid in the current quarter.

Net cash used in investing activities totaled \$3.2 million for the three-month period ended March 31, 2010 compared to \$0.4 million provided by the comparable 2009 period. The \$3.6 million change resulted from an increase in capital expenditures in 2010.

Net cash provided by financing activities was \$4.4 million during the three-month period ended March 31, 2010, compared to \$13.8 million used in the comparable 2009 period. In 2010, increased borrowings of \$6.0 million under our ABL facility were used to pay a large insurance claim, pay down debt and capital lease obligations, and for capital expenditures. In 2009, cash was utilized to repay \$5.0 million of borrowings under our ABL Facility, to pay down debt and capital lease obligations, and repurchase \$1.0 million in principal amount of our 9% Notes.

**Off-Balance Sheet Arrangements**

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

**Contractual Obligations**

The following is a schedule of our long-term contractual commitments, including the current portion of our long-term indebtedness at March 31, 2010 over the periods we expect them to be paid (in thousands):

	Total	Remainder of 2010	Years 2011 & 2012	Years 2013 & 2014	Year 2015 and after
Operating leases (1)	\$ 41,106	\$ 11,162	\$ 17,147	\$ 6,579	\$ 6,218
Total indebtedness (2)	318,836	18,839	5,419	293,446	1,132
Capital leases	15,709	3,803	9,061	2,845	
Interest on indebtedness (3)	92,969	23,326	54,355	15,188	100
Total	\$ 468,620	\$ 57,130	\$ 85,982	\$ 318,058	\$ 7,450

- (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. Includes lease for our corporate headquarters. We expect that some of our operating lease obligations for tractors will be partially offset by rental revenue from sub-leasing the tractors to independent owner-operators or affiliates.
- (2) Includes aggregate unamortized discount of \$8.1 million.
- (3) Amounts presented for interest payments assume that all long-term debt obligations outstanding as of March 31, 2010 will remain outstanding until maturity and interest rates on variable-rate debt in effect as of March 31, 2010 will remain in effect until maturity. As discussed below, the maturity date of the ABL Facility may be accelerated if we default on our obligations under the ABL Facility.

**Other Liabilities and Obligations**

As of March 31, 2010, we have \$11.5 million of environmental liabilities, \$18.7 million of pension plan obligations and \$16.2 million of insurance claim obligations. We expect to incur additional environmental costs in the future for environmental studies and remediation efforts that we will be required to undertake related to legacy sites related to our subsidiary, CLC. As of March 31, 2010, we had \$36.0 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 letter of credit as of March 31, 2010 for our insurance administrator was \$29.7 million. If we fail to meet certain terms of our agreement, the insurance administrator may draw down the entire letter of credit. The remaining \$6.3 million of outstanding letters of credit relates to various leasing obligations and to satisfy certain USEPA requirements. As of March 31, 2010, we have a reserve related to uncertain tax positions of \$1.9 million which includes total unrecognized tax benefits and interest and penalties that may be paid in future periods.





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

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

	March 31, 2010	December 31, 2009
Capital lease obligations	\$ 15,709	\$ 17,165
ABL Facility	74,000	68,000
Senior Floating Rate Notes, due 2012	501	501
9% Senior Subordinated Notes, due 2010	16,031	16,031
10% Senior Notes, due 2013	134,499	134,499
11.75% Senior Subordinated PIK Notes, due 2013	81,769	81,211
Other Notes	12,036	12,560
Long-term debt, including current maturities	334,545	329,967
Discount on Notes	(8,098)	(8,683+)
	326,447	321,284
Less current maturities of long-term debt (including capital lease obligations)	(24,398)	(25,188)
Long-term debt, less current maturities	\$ 302,049	\$ 296,096

**The ABL Facility**

The ABL Facility which was effective December 18, 2007, consists of a current asset-based revolving facility in an amount of \$200.0 million (the current asset tranche) and a fixed asset-based revolving facility in an amount of \$25.0 million (the fixed asset tranche). The total commitments under the fixed asset tranche will be reduced and the total commitments under the current asset tranche correspondingly increased by \$5.0 million on December 18, 2010. Borrowings of revolving loans under the ABL Facility are allocated pro rata to the current asset tranche and the fixed asset tranche based on the then-current asset borrowing base and the then-current fixed asset borrowing base. The ABL Facility matures June 18, 2013. The maturity date of the ABL Facility may be accelerated if we default on our obligations under the ABL Facility.

The ABL Facility includes borrowing capacity of up to \$150.0 million for letters of credit, which are allocated pro rata between the two tranches based on the then-current borrowing base for each tranche (or, if the credit extensions under the fixed asset tranche are repaid and the commitments thereunder are terminated prior to the termination of the ABL Facility, to the current asset tranche), and up to \$10.0 million for swingline borrowings on same-day notice, which are allocated under the current asset tranche. The proceeds of the ABL Facility were used, together with the proceeds from other indebtedness, to finance a portion of the Boasso acquisition. The ABL Facility contains a fixed charge coverage ratio of 1.0 to 1.0 which only needs to be met if borrowing availability is less than \$20 million. At March 31, 2010, we had \$54.1 million of borrowing availability under the ABL Facility.

Borrowings under the ABL Facility bear interest at a rate equal to an applicable margin plus, at our option, either a base rate or LIBOR. The applicable margin for borrowings under the current asset tranche at March 31, 2010 was 1.00% with respect to base rate borrowings and 2.00% with respect to LIBOR borrowings. The applicable margin for borrowings under the fixed asset tranche at March 31, 2010 was 1.25% with respect to base rate borrowings and 2.25% with respect to LIBOR borrowings. The applicable margin for such borrowings will be reduced or increased based on the aggregate borrowing base availability under the ABL Facility over the life of the ABL Facility. The base rate for the ABL Facility is the higher of the prime rate and the federal funds overnight rate plus 0.50%. We are also required to pay a fee for utilized commitments under the ABL Facility at a rate equal to 0.25% per annum. The ABL Facility is required to be prepaid only to the extent that the aggregate amount of outstanding borrowings, unreimbursed letter of credit drawings and undrawn letters of credit under the relevant tranche exceed the lesser of the applicable commitments and the applicable borrowing base in effect at such time for such tranche. The borrowing base for the current asset tranche consists of eligible accounts receivable, eligible inventory and eligible truck and trailer fleet, and the borrowing base for the fixed asset tranche consists of eligible real property and certain eligible equipment. We may voluntarily repay outstanding loans under the ABL Facility at any time without premium or penalty, other than customary breakage costs with respect to LIBOR loans. The interest rate on the ABL Facility at March 31, 2010 and 2009 was 2.5% and 2.6%, respectively.

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

All obligations under the ABL Facility are guaranteed by QDI and each of our wholly-owned domestic restricted subsidiaries (other than our immaterial subsidiaries). Obligations under the current asset tranche, and the guarantees of those obligations (as well as cash management obligations and any interest hedging or other swap agreements), are secured by a first priority lien on certain assets of QD LLC and the guarantors, including eligible accounts, eligible inventory and eligible truck and trailer fleet ( current asset tranche priority collateral ) and a second priority lien on all other assets of QD LLC and the guarantors, including eligible real property and certain eligible equipment ( fixed asset tranche priority collateral ). Obligations under the fixed asset tranche, and the guarantees of those obligations, are secured by a first-priority lien on fixed asset tranche priority collateral and a second priority lien on current asset tranche priority collateral.

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

---

**Table of Contents*****9% Senior Subordinated Notes Due 2010***

On September 30, 2003, we issued \$125.0 million aggregate principal amount of our 9% Notes. During the fourth quarter of 2008 and the first quarter of 2009, we repurchased \$25.2 million in principal amount of the 9% Notes. On October 15, 2009, we completed exchange and tender offers to exchange approximately \$80.7 million of our 9% Notes for \$80.7 million aggregate principal amount of our new 2013 PIK Notes and approximately 1.75 million warrants to purchase our common stock and retired an additional \$2.9 million of our 9% Notes for \$1.8 million in cash. Upon the completion of the exchange and tender offer, we also amended the 9% Notes to eliminate or waive substantially all of the restrictive covenants, to eliminate certain events of default, to modify covenants regarding mergers and consolidations and modify or eliminate certain other provisions contained in the indentures governing the 9% Notes. As of March 31, 2010, approximately \$16.0 million total principal amount of the 9% Notes remained outstanding.

The 9% Notes are the unsecured and senior subordinated obligations of QD LLC and QD Capital and are fully and unconditionally guaranteed on an unsecured and senior subordinated basis, jointly and severally, by QDI and certain of our U.S. restricted subsidiaries. We have the right to redeem the 9% Notes in whole or in part from time to time at 100% of the principal amount plus accrued and unpaid interest if any, to the date of redemption. The 9% Notes will mature on November 15, 2010. Interest on the 9% Notes is payable at the rate of 9% per annum and is payable semi-annually in cash on each May 15 and November 15.

We incurred \$5.5 million in debt issuance costs relating to the issuance of the 9% Notes. During 2008 and 2009, we wrote-off approximately \$0.3 million in debt issuance costs relating to repurchases of 9% Notes. Additionally \$0.5 million of unamortized debt issuance costs relating to the 9% Notes are included in debt issuance costs related to the 2013 PIK Notes following their exchange for the 9% Notes. We are amortizing the remaining \$0.1 million of debt issuance costs over the remaining term of the 9% Notes.

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

On January 28, 2005, we issued \$85.0 million aggregate principal amount of our 2012 Notes. On December 18, 2007, we issued a second series of 2012 Notes in the original principal amount of \$50.0 million. On October 15, 2009, we completed exchange and tender offers to exchange approximately \$134.5 million of 2012 Notes for \$134.5 million of our 2013 Senior Notes. Upon the completion of the exchange offer, we amended the 2012 Notes to eliminate or waive substantially all of the restrictive covenants, to eliminate certain events of default, to modify covenants regarding mergers and consolidations and modify or eliminate certain other provisions contained in the indentures governing the 2012 Notes. As of March 31, 2010, approximately \$0.5 million total principal amount of the 2012 Notes remained outstanding.

The 2012 Notes are the unsecured and unsubordinated obligations of QD LLC and QD Capital and are fully and unconditionally guaranteed on an unsecured and unsubordinated basis, jointly and severally, by QDI and certain of its U.S. restricted subsidiaries. We may redeem all or any portion of the 2012 Notes upon not less than 30, nor more than 60, days notice at 100% of the principal amount plus accrued and unpaid interest if any, to the date of redemption. The 2012 Notes will mature on January 15, 2012. Interest on the 2012 Notes is payable quarterly in cash in arrears on each January 15, April 15, July 15 and October 15. The interest rate on the 2012 Notes at March 31, 2010 and 2009 was 4.8% and 5.6%, respectively.

We incurred \$2.5 million in debt issuance costs relating to the initial \$85.0 million of the 2012 Notes and \$2.3 million related to the second \$50.0 million of the 2012 Notes. All of these unamortized debt issuance costs are included in debt issuance costs related to the 2013 Senior Notes following their exchange for the 2012 Notes.

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

On October 15, 2009, we issued approximately \$134.5 million aggregate principal amount of our 2013 Senior Notes. The 2013 Senior Notes are the unsecured and unsubordinated obligations of QD LLC and QD Capital and are fully and unconditionally guaranteed on an unsecured and unsubordinated basis, jointly and severally, by QDI and certain of our U.S. restricted subsidiaries.

Interest on the 2013 Senior Notes is payable at a rate of 10% per annum, semiannually on June 1 and December 1 of each year, commencing on June 1, 2010. The 2013 Senior Notes mature on June 1, 2013. In connection with the issuance of the 2013 Senior Notes, we agreed pursuant to a registration rights agreement to file a registration statement, relating to an offer to exchange the 2013 Senior Notes for new debt securities which are substantially identical in all material respects. If we do not consummate this exchange offer by May 23, 2010, we will be required to pay additional interest.



**Table of Contents**

We may redeem the 2013 Senior Notes, in whole or part, at any time at a price equal to 100% of the principal amount of the 2013 Senior Notes redeemed plus accrued and unpaid interest to the redemption date. Subject to certain conditions, we are obligated to redeem \$6.0 million of 2013 Senior Notes on each June 1 and December 1, commencing December 1, 2010. Beginning in 2011, promptly following the delivery of our Annual Report on Form 10-K for each fiscal year, the 2013 Senior Notes are subject to additional mandatory redemption in an amount equal to 50% of the excess cash flow we generate minus \$12.0 million. Both required redemption amounts will be reduced to the extent necessary so that:

the sum of borrowing availability under the ABL Facility, plus unrestricted cash and cash equivalents, is at least \$37.5 million;

the minimum borrowing availability requirements under the ABL Facility are satisfied;

there is fixed charge coverage ratio of at least 1.0 to 1.0 as calculated under the ABL Facility; and

no other event of default is otherwise caused under the ABL Facility by the redemption.

The required redemption amounts are also reduced by any optional redemptions and repurchases during the redemption period.

We recorded \$3.6 million in debt issuance costs relating to the 2013 Senior Notes, of which \$2.0 million of unamortized debt issuance costs related to the 2012 Notes and \$1.6 million was related to the new issuance. We are amortizing these costs over the remaining term of the 2013 Senior Notes.

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

On October 15, 2009, we issued \$80.7 million aggregate principal amount of our 2013 PIK Notes. The 2013 PIK Notes are the unsecured and senior subordinated obligations of QD LLC and QD Capital and are fully and unconditionally guaranteed on an unsecured and senior subordinated basis, jointly and severally, by QDI and certain of our U.S. restricted subsidiaries.

Interest is payable on the 2013 PIK Notes at 11.75% per annum, payable 9% in cash and 2.75% in the form of additional 2013 PIK Notes, quarterly on February 1, May 1, August 1 and November 1 of each year, commencing on February 1, 2010. In connection with the issuance of the 2013 PIK Notes, we agreed pursuant to a registration rights agreement to file a registration statement, relating to an offer to exchange the 2013 PIK Notes for new debt securities which are substantially identical in all material respects. If we do not consummate this exchange offer by May 23, 2010, we will be required to pay additional interest.

The 2013 PIK Notes mature on November 1, 2013. We may redeem the 2013 PIK Notes, in whole or part, at any time prior to October 15, 2010, at a price equal to 100% of the principal amount of the 2013 PIK Notes redeemed plus accrued and unpaid interest to the redemption date plus an additional make-whole premium. After October 15, 2010, we may redeem the 2013 PIK Notes, in whole or part, at any time at a price equal to 100% of the principal amount of the Subordinated Notes redeemed plus accrued and unpaid interest to the redemption date. Additionally, at any time prior to October 15, 2010, we may redeem up to 35% of the principal amount of the 2013 PIK Notes at a redemption premium equal to 11.75% of the face amount thereof with the net proceeds of one or more equity offerings so long as at least 65% of the aggregate original principal amount of the 2013 PIK Notes remains outstanding afterwards.

We recorded \$1.5 million in debt issuance costs relating to the 2013 PIK Notes, of which \$0.5 million of unamortized debt issuance costs related to the 9% Notes and \$1.0 million were related to the new issuance. In addition, we recorded \$6.7 million in note issuance discount due to the warrants issued. The amount represents the fair market value of the warrants at time of issuance. We are amortizing these costs over the remaining term of the 2013 PIK Notes.

The note exchanges described above were treated as a debt modification in accordance with applicable FASB guidance.

***Boasso Note***

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

The promissory note issued in connection with our acquisition of the stock of Boasso was a \$2.5 million 7% promissory note with a maturity on December 18, 2009 issued as part of the purchase price of the Boasso acquisition. The holder of the Boasso note had the option to require prepayment of the Boasso note, which he exercised on December 18, 2008. The Boasso note was paid in full in January 2009.

### ***Collateral, Guarantees and Covenants***

The ABL Facility contains a number of covenants that, among other things, restrict, subject to certain exceptions, our ability to (i) sell assets; (ii) incur additional indebtedness; (iii) prepay other indebtedness (including the 2013 Senior Notes, the 2012 Notes, the 2013 PIK Notes and the 9% Notes); (iv) repurchase or pay dividends on QDI's common stock; (v) create liens on assets; (vi) make investments; (vii) make certain acquisitions; (viii) engage in mergers or consolidations; (ix) engage in certain transactions with affiliates; (x) amend certain charter documents and material agreements governing subordinated indebtedness, including the 2013 Senior Notes, the 2012 Notes, the 2013 PIK Notes and the 9% Notes; (xi) change the business conducted by us and our subsidiaries;

**Table of Contents**

and (xii) enter into agreements that restrict dividends from subsidiaries. The ABL Facility also contains certain customary events of default, which, if any of them occurs, may result in the principal, interest and any other monetary obligations under the ABL Facility becoming immediately payable.

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

The payment obligations under the ABL Facility are senior secured obligations of QD LLC and QD Capital and are secured by certain assets and its subsidiaries. The payment obligations of QD LLC and QD Capital under the 9% Notes, the 2012 Notes, the 2013 Senior Notes and the 2013 PIK Notes are guaranteed by QDI, and by all of its domestic subsidiaries. The 9% Notes and the 2013 PIK Notes, and the guarantees thereof are senior subordinated unsecured obligations ranking junior in right of payment to all of our existing and future senior debt, and all liabilities of our subsidiaries that do not guarantee the 9% Notes the 2013 PIK Notes, as applicable. All of the notes are effectively junior to all of our existing and future secured debt, including borrowings under the ABL Facility, to the extent of the value of the assets securing such debt.

We were in compliance with the covenants under the ABL Facility, the 2013 Senior Notes and the 2013 PIK Notes at March 31, 2010.

*Debt Retirement*

The following is a schedule of our indebtedness at March 31, 2010 over the periods we are required to pay such indebtedness (in thousands):

	Remainder of 2010	2011	2012	2013	2014 and after	Total
Capital lease obligations	\$ 3,803	4,281	\$ 4,780	2,276	\$ 569	\$ 15,709
ABL Facility				74,000		74,000
9% Senior Subordinated Notes, due 2010	16,031					16,031
Senior Floating Rate Notes, due 2012			501			501
10% Senior Notes, due 2013 (1)				134,499		134,499
11.75% Senior Subordinated PIK Notes, due 2013 (1)				81,769		81,769
Other Notes	2,808	2,588	2,330	2,231	2,079	12,036
Total	\$ 22,642	\$ 6,869	\$ 7,611	\$ 294,775	\$ 2,648	\$ 334,545

(1) Amounts do not include the remaining aggregated unamortized original issue discount of \$8.1 million.

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

	December 31, 2009 Balance	Accumulated Amortization	March 31, 2010 Balance
ABL Facility	\$ 4,284	\$ (312)	\$ 3,972
9% Senior Subordinated Notes, due 2010	69	(20)	49
10% Senior Notes, due 2013	3,425	(251)	3,174
11.75% Senior Subordinated PIK Notes, due 2013	1,426	(93)	1,333
Total	\$ 9,204	\$ (676)	\$ 8,528

Amortization expense of deferred issuance costs was \$0.7 million for the three months ending March 31, 2010 and 2009. We are amortizing these costs over the term of the debt instruments.

*Liquidity*

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 ABL Facility, 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 12 months.



---

**Table of Contents**

However, for periods extending beyond 12 months, if our operating cash flow and borrowings under the ABL 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 any of our debt agreements and we default on our obligations, our indebtedness could be accelerated and our assets might not be sufficient to repay in full all of our indebtedness.

***Other Issues***

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

The ABL Facility and the indentures governing our 2013 Senior Notes and our 2013 PIK Notes contain certain limitations on QD LLC's ability to make distributions to QDI. We do not consider these restrictions to be significant, because QDI is a holding company with no significant operations or assets, other than ownership of 100% of QD LLC's membership units. QD LLC's direct and indirect wholly owned subsidiaries are generally permitted to make distributions to QD LLC, which is the principal obligor under the ABL Facility, the 9% Notes, the 2012 Notes, the 2013 Senior Notes and the 2013 PIK Notes.

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 our leverage or impairing our creditworthiness in order to decrease our leverage. While the restrictions in our ABL Facility cover a wide variety of arrangements that have traditionally been used to effect highly leveraged transactions, the ABL Facility and the indentures governing our 2013 Senior Notes and our 2013 PIK Notes 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.

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

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

**Table of Contents**

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 discussed under the Item 1A Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2009. These factors include:

the effect of local and national economic, credit and capital market conditions on the economy in general, and on the particular industries in which we operate,

turmoil in credit and capital markets,

access to available and reasonable financing on a timely basis,

availability and price of diesel fuel,

adverse weather conditions,

competition and rate fluctuations,

our substantial leverage and restrictions contained in our debt arrangements and interest rate fluctuations in our floating rate indebtedness,

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,

potential disruption at U.S. ports of entry,

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

the loss of one or more of our major customers or a material reduction in services we perform for such customers,

our ability to effectively manage terminal operations that are converted from company-operated to affiliate,

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

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

our ability to comply with current and future environmental regulations and the increasing costs relating to environmental compliance including those relating to the control of greenhouse gas emissions, such as market-based (cap and-trade) mechanisms,

our liability as a self-insurer to the extent of our deductibles, as well as our ability or inability to reduce our claims exposure through insurance due to changing conditions and pricing in the insurance marketplace,

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

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

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

changes in senior management,

our ability to successfully manage workforce restructurings,

our ability to effectively manage terminal operations that are converted from company-operated to affiliate,

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

potential future impairment charges,

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

the interests of our largest shareholder may conflict with your interests.

In addition, there may be other factors that could cause our actual results and financial condition to be materially different from the results referenced in the forward-looking statements. For example, the cost estimates and expected cost savings for our recent reduction in workforce were determined based upon the operating information and upon certain assumptions that we believe to be reasonable. The estimates are subject to a number of assumptions, which depend upon the actions of persons other than us or other factors beyond our control.

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.

**Table of Contents****ADDITIONAL INFORMATION AVAILABLE ON COMPANY WEBSITE**

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

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

We are subject to market risks from (i) interest rates due to our variable interest rate indebtedness, (ii) foreign currency fluctuations due to our international operations and (iii) increased commodity prices due to the diesel consumption necessary for our operations. During the three months ended March 31, 2010, we did not hold derivative instruments or engage in other hedging transactions to reduce our exposure to such risks.

**Interest Rate Risk**

We are exposed to the impact of interest rate changes through our variable-rate borrowings under the ABL Facility and the 2012 Notes. With regard to the ABL Facility at QD LLC's option, the applicable margin for borrowings under the current asset tranche at March 31, 2010 was 1.00% with respect to base rate borrowings and 2.00% with respect to LIBOR borrowings. The applicable margin for borrowings under the fixed asset tranche at March 31, 2010 was 1.25% with respect to base rate borrowings and 2.25% with respect to LIBOR borrowings. The applicable margin for such borrowings will be reduced or increased based on aggregate borrowing base availability under the ABL Facility over the life of the ABL Facility. The base rate under the ABL Facility is equal to the higher of the prime rate and the federal funds overnight rate plus 0.50%. The base rate for our 2012 Notes is LIBOR plus 4.50%.

	Balance at March 31, 2010 (\$ in 000s)	Interest Rate at March 31, 2010	Effect of 1% Increase (\$ in 000s)
ABL Facility	\$ 74,000	2.53%	\$ 740
Senior Floating Rate Notes, due 2012	501	4.75%	5
<b>Total</b>	<b>\$ 74,501</b>		<b>\$ 745</b>

At March 31, 2010, a 1% point increase in the current per annum interest rate for each would result in \$0.7 million of additional interest expense during the next year. The foregoing calculation assumes an instantaneous 1% point increase in the rates of all of our indebtedness and that the principal amount of each is the amount outstanding as of March 31, 2010. 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.

We reduced our exposure to variable borrowings on October 15, 2009, when we exchanged substantially all of our floating rate 2012 Notes for our fixed rate 2013 Senior Notes.

**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

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

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 5.7% of our consolidated revenue for the three months ended March 31, 2010 and 5.8% of our consolidated revenue for the three months ended March 31, 2009. The economic impact of foreign exchange rate movements is complex because such changes are often linked to variability in real growth, inflation, interest rates, governmental actions and other factors. These changes, if material, could cause us to adjust our financing and operating strategies. Therefore, to isolate the effect of changes in currency does not accurately portray the effect of these other important economic factors. As foreign exchange rates change, translation of the income statements of our international subsidiaries into U.S. dollars affects year-over-year comparability of operating results. While we may hedge specific transaction risks, we generally do not hedge translation risks because we believe there is no long-term economic benefit in doing so.

---

## **Table of Contents**

Assets and liabilities for our Canadian operations are matched in the local currency, which reduces the need for dollar conversion. Our Mexican operations use the United States dollar as their functional currency. Any foreign currency impact on translating assets and liabilities into dollars is included as a component of shareholders' equity. Our revenue results for the three months ended March 31, 2010 were positively impacted by a \$1.5 million foreign currency movement, primarily due to the strengthening of the Canadian dollar against the United States dollar.

Changes in foreign exchange rates that had the largest impact on translating our international operating profits for the first three months of 2010 related to the Canadian dollar versus the United States dollar. We estimate that a 1% adverse change in the Canadian dollar foreign exchange rate would have decreased our revenues by approximately \$0.1 million for the three- months ended March 31, 2010, assuming no changes other than the exchange rate itself. Our intercompany loans are subject to fluctuations in exchange rates primarily between the United States dollar and the Canadian dollar. Based on the outstanding balance of our intercompany loans at March 31, 2010, a change of 1% in the exchange rate for the Canadian dollar would cause a change in our foreign exchange result of less than \$0.1 million.

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

The price and availability of diesel fuel are subject to fluctuations due to changes in the level of global oil production, seasonality, weather, global politics and other market factors. Historically, we have been able to recover a majority of fuel price increases from our customers in the form of fuel surcharges. The price and availability of diesel fuel can be unpredictable as well as the extent to which fuel surcharges can be collected to offset such increases. In the three months ended March 31, 2010 and 2009, a majority of fuel costs were covered through fuel surcharges.

## **ITEM 4 Controls and Procedures**

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

As required by Exchange Act Rules 13a-15(b) and 15d-15(b), management has evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on their evaluation, management concluded our disclosure controls and procedures (as defined in Securities Exchange Act Rules 13a-15(e) and 15d-15(e)) were effective as of March 31, 2010 to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and were effective as of March 31, 2010 to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure.

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

There were no changes in our internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) during the quarter ended March 31, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II OTHER INFORMATION**

## **ITEM 1 Legal Proceedings**

Other than reported in Item 3 - Legal Proceedings of our Annual Report on Form 10-K for the year ended December 31, 2009, Note 19. Commitments and Contingencies to our audited consolidated financial statements contained in such Form 10-K and Note 11. 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, 2009 included under Item 1A Risk Factors in addition to the other information set forth in this report. The risks described in our Annual Report on Form 10-K and our Quarterly Reports on Form 10-Q are not the only risks facing our Company.



**Table of Contents**

We may be subject to the risks set forth below:

*Despite our substantial indebtedness, we may incur significantly more indebtedness, which could have a material adverse effect on our business, financial condition, results of operations or cash flows.*

The ABL Facility and the indentures governing the 2013 Senior Notes and the 2013 PIK Notes contain restrictions on our ability to incur additional indebtedness. These restrictions are subject to a number of important qualifications and exceptions, and the indebtedness incurred in compliance with these restrictions could be substantial. Accordingly, we or our subsidiaries could incur significant additional indebtedness in the future. As of March 31, 2010, we had availability for additional borrowing under the ABL Facility, and the covenants under our debt agreements would allow us to borrow a significant amount of additional indebtedness. Additional leverage could have a material adverse effect on our business, financial condition, results of operations or cash flows and could increase other risks related to our indebtedness.

*We are self-insured and have exposure to certain claims and are subject to the insurance marketplace, all of which could affect our profitability.*

The primary accident risks associated with our business are:

motor-vehicle related bodily injury and property damage;

workers' compensation claims;

environmental pollution liability claims;

cargo loss and damage; and

general liability claims.

We currently maintain insurance for:

motor-vehicle related bodily injury and property damage claims, covering all employees, owner operators and affiliates;

workers' compensation insurance coverage on our employees and company drivers;

environmental pollution liability claims; and

general liability claims.

Our insurance program includes a self insured deductible of \$2.0 million per incident for bodily injury and property damage and a \$1.0 million deductible for workers' compensation. In addition, we currently maintain insurance policies with a total limit of \$40.0 million, of which \$35.0 million is provided under an umbrella liability policy and \$5.0 million is provided under a truckers' liability policy. The \$2.0 million deductible per incident could adversely affect our profitability, particularly in the event of an increase in the number or severity of incidents. Additionally, we are self-insured for damage to the equipment that we own and lease, as well as for cargo losses and such self-insurance is not subject to any maximum limitation. We also extend insurance coverage to our affiliates for (i) motor vehicle related bodily injury, (ii) property damage and (iii) cargo loss and damage. Under this extended coverage, affiliates are responsible for only a small portion of the applicable deductibles.



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

We are subject to changing conditions and pricing in the insurance marketplace and we cannot assure you that the cost or availability of various types of insurance may not change dramatically in the future. To the extent these costs cannot be passed on to our customers through increased freight rates, increases in insurance costs could reduce our future profitability and cash flow.

***The trucking industry is extremely competitive and fragmented.***

The trucking industry is extremely competitive and fragmented. No single truckload carrier has a significant market share. We compete with many other truckload carriers of varying sizes, customers' private fleets, and, to a lesser extent, with railroads, which may limit our growth opportunities and reduce profitability. Historically, competition has created downward pressure on the trucking industry's pricing structure. Some trucking companies with which we compete have greater financial resources.

We believe that the most significant competitive factor that impacts demand for our products is rates, and we may be forced to lower our rates based on our competitors' pricing decisions, which would reduce our profitability. In fact, certain markets that we serve have experienced fierce price competition in recent years. This has been further magnified through the impact of the recent global economic recession as trucking companies have focused more on price to retain business and market share. With respect to certain aspects of our business, we also compete with intermodal transportation and railroads. Intermodal transportation has increased in recent years. Growth in such forms of transport could adversely affect our market share, net sales and profit margins. Competition from non-trucking modes of transportation and from intermodal transportation would likely increase if state or federal fuel taxes were to increase without a corresponding increase in taxes imposed upon other modes of transportation.

## **Table of Contents**

Additional trends include current and anticipated consolidation among our competitors which may cause us to lose market share as well as put downward pressure on pricing. Some of our competitors are larger, have greater financial resources and have less debt than we do. As a result, those competitors may be better able to withstand a change in conditions within our industry and in the economy as a whole. If we do not compete successfully, our operating margins, financial condition, cash flows and profitability could be adversely affected.

### ***Changes in laws and regulations regarding health insurance benefits could adversely affect our cost of operations, employee relations and profitability.***

The recently enacted federal healthcare reform legislation could significantly increase our employee costs by requiring us either to provide health insurance coverage to our employees or to pay certain penalties for electing not to provide such coverage. Because these new requirements are broad, complex, subject to certain phase-in rules and may be challenged by legal actions in the coming months and years, it is difficult to predict the ultimate impact that this legislation will have on our business and operating costs. We cannot assure you that this legislation or any alternative version that may ultimately be implemented will not materially increase our operating costs. This legislation could also adversely affect our employee relations and ability to compete for new employees if our response to this legislation is considered less favorable than the responses or health benefits offered by employers with whom we compete for talent.

### ***The trucking industry is subject to regulation, and changes in trucking regulations may increase costs.***

As a motor carrier, we are subject to regulation by the Federal Motor Carrier Safety Administration ( FMCSA ) and the U.S. Department of Transportation ( DOT ), and by various federal, state, and provincial agencies. These regulatory authorities exercise broad powers governing various aspects such as operating authority, safety, hours of service, hazardous materials transportation, financial reporting and acquisitions. There are additional regulations specifically relating to the trucking industry, including testing and specification of equipment, product-handling requirements and drug testing of drivers. Beginning November 30, 2010, the FMCSA, for the first time, will rate individual driver safety performance inclusive of all driver violations over 3-year time periods under new regulations known as the Comprehensive Safety Analysis 2010 ( CSA ). CSA is an FMCSA initiative designed to provide motor carriers and drivers with attention from FMCSA and state partners about their potential safety problems with an ultimate goal of achieving a greater reduction in large truck and bus crashes, injuries, and fatalities. Prior to these regulations, only carriers were rated by the DOT and the rating only included out-of-service violations and ticketed offenses associated with out-of-service violations. The trucking industry is subject to possible regulatory and legislative changes that may affect the economics of the industry by requiring changes in operating practices, emissions or by changing the demand for common or contract carrier services or the cost of providing truckload services. Possible changes include:

increasingly stringent environmental regulations, including changes intended to address climate change;

restrictions, taxes or other controls on emissions;

increasing control over the transportation of hazardous materials;

changes in the hours-of-service regulations, which govern the amount of time a driver may drive in any specific period;

electronic on-board recorders;

requirements leading to accelerated purchases of new trailers;

mandatory limits on vehicle weight and size; and

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

mandatory regulations imposed by the Department of Homeland Security.

From time to time, various legislative proposals are introduced, including proposals to increase federal, state, or local taxes, including taxes on motor fuels and emissions, which may increase our operating costs, require capital expenditures or adversely impact the recruitment of drivers.

Restrictions on emissions or other climate change laws or regulations could also affect our customers that use significant amounts of energy or burn fossil fuels in producing or delivering the products we carry. We could also lose revenue if our customers divert business from us because we have not complied with their sustainability requirements.

**Table of Contents**

***Increased unionization could increase our operating costs or constrain operating flexibility.***

Although only approximately 3.1% of our driver population, including independent owner-operators and employees of affiliates, was subject to collective bargaining agreements at December 31, 2009, unions such as the International Brotherhood of Teamsters have traditionally been active in the U.S. trucking industry. Unionized workers could disrupt our operations by strike, work stoppage or other slowdown. In addition, our non-union workforce has been subject to unionization efforts in the past, and we could be subject to future unionization. The potential for unionization could increase if the U.S. Congress passes proposed legislation called the Employee Free Choice Act in which unions can organize based on card check authorization rather than by secret ballot election. This proposed legislation also provides for third-party arbitration of collective bargaining agreements. Increased unionization of our workforce could result in higher compensation and working condition demands that could increase our operating costs or constrain our operating flexibility.

***We may be unable to successfully realize all of the intended benefits from future acquisitions, and we may be unable to identify or realize the intended benefits of potential future acquisition candidates.***

We may be unable to realize all of the intended benefits of any future acquisitions. As part of our business strategy, we will evaluate potential future acquisitions, some of which could be material, and engage in discussions with acquisition candidates. We cannot assure you that suitable acquisition candidates will be identified and acquired in the future, that the financing of any such acquisition will be available on satisfactory terms, that we will be able to complete any such acquisition or that we will be able to accomplish our strategic objectives as a result of any such acquisition. Nor can we assure you that our acquisition strategies will be viewed positively by customers or achieve their intended benefits. Often acquisitions are undertaken to improve the operating results of either or both of the acquirer and the acquired company and we cannot assure you that we will be successful in this regard. We will encounter various risks in acquiring other companies, including the possible inability to integrate an acquired business into our operations, diversion of management's attention and unanticipated problems or liabilities, some or all of which could have a material adverse effect on our business, financial condition, results of operations or cash flows.

***The loss of qualified drivers or other personnel could limit our growth and negatively affect operations.***

During periods of high trucking volumes, there is substantial competition for qualified drivers in the trucking industry. Regulatory requirements, including CSA (discussed above), and an improvement in the economy could reduce the number of eligible drivers. Furthermore, certain geographic areas have a greater shortage of qualified drivers than other areas. We operate in many of the geographic areas where there have been driver shortages in the past and have turned down new business opportunities as a result of the lack of qualified new drivers. We expect this to occur again as the economy begins to improve. Difficulty in attracting qualified personnel, particularly qualified drivers, could require us to increase driver compensation, forego available customer opportunities and underutilize the tractors and trailers in our network. These actions could result in increased costs and decreased revenues. In addition, we may not be able to recruit other qualified personnel in the future.

In addition, risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially adversely affect our business, financial condition and/or operating results.

**Table of Contents**

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

None

**ITEM 3 Defaults Upon Senior Securities**

None

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

**ITEM 5 Other Information**

None

**ITEM 6 Exhibits**

<b>Exhibit No.</b>	<b>Description</b>
10.1	Employment Agreement dated March 12, 2010 between Quality Distribution, Inc. and Randall Strutz. Incorporated herein by reference to Exhibit 10.23 to the Registration Statement on Amendment No. 3 to Form S-4 dated April 7, 2010 (Registration No. 333-163868).
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant To 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**Table of Contents**

**SIGNATURES**

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

QUALITY DISTRIBUTION, INC.

May 7, 2010

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

**PRESIDENT AND CHIEF EXECUTIVE OFFICER**

**(PRINCIPAL EXECUTIVE OFFICER)**

May 7, 2010

/s/ STEPHEN R. ATTWOOD  
STEPHEN R. ATTWOOD,

**SENIOR VICE PRESIDENT AND CHIEF FINANCIAL OFFICER**

**(PRINCIPAL FINANCIAL AND ACCOUNTING OFFICER)**