

QUALITY DISTRIBUTION INC  
Form 10-Q  
November 09, 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 September 30, 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 November 1, 2010, the registrant had 21,457,930 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 and Nine Months Ended September 30, 2010 and 2009</u></b>	<b><u>1</u></b>
<b><u>Consolidated Balance Sheets as of September 30, 2010 and December 31, 2009</u></b>	<b><u>2</u></b>
<b><u>Consolidated Statements of Shareholders Deficit for the Nine Months Ended September 30, 2010 and 2009</u></b>	<b><u>3</u></b>
<b><u>Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 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>25</u></b>
<b><u>ITEM 3 Quantitative and Qualitative Disclosures About Market Risk</u></b>	<b><u>45</u></b>
<b><u>ITEM 4 Controls and Procedures</u></b>	<b><u>47</u></b>
<b><u>PART II OTHER INFORMATION</u></b>	<b><u>47</u></b>
<b><u>ITEM 1 Legal Proceedings</u></b>	<b><u>47</u></b>
<b><u>ITEM 1A Risk Factors</u></b>	<b><u>47</u></b>
<b><u>ITEM 2 Unregistered Sale of Equity Securities and Use of Proceeds</u></b>	<b><u>48</u></b>
<b><u>ITEM 3 Defaults Upon Senior Securities</u></b>	<b><u>48</u></b>
<b><u>ITEM 4 [Removed and Reserved.]</u></b>	<b><u>48</u></b>
<b><u>ITEM 5 Other Information</u></b>	<b><u>48</u></b>
<b><u>ITEM 6 Exhibits</u></b>	<b><u>49</u></b>
<b><u>Signatures</u></b>	<b><u>50</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</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
<b>OPERATING REVENUES:</b>				
Transportation	\$ 132,676	\$ 120,444	\$ 381,066	\$ 343,554
Other service revenue	28,178	26,793	79,557	80,241
Fuel surcharge	21,094	15,568	60,210	38,528
<b>Total operating revenues</b>	<b>181,948</b>	<b>162,805</b>	<b>520,833</b>	<b>462,323</b>
<b>OPERATING EXPENSES:</b>				
Purchased transportation	127,506	102,393	361,481	273,269
Compensation	14,107	19,040	42,979	61,791
Fuel, supplies and maintenance	12,665	16,129	37,007	49,591
Depreciation and amortization	3,929	5,055	12,239	15,694
Selling and administrative	5,893	5,592	15,120	19,614
Insurance costs	3,810	3,081	11,687	11,076
Taxes and licenses	418	1,023	1,688	3,096
Communication and utilities	1,070	1,977	3,308	6,785
Loss on disposal of property and equipment	339	279	991	14
Impairment charge				148,630
Restructuring costs	2,374	340	4,589	2,105
<b>Total operating expenses</b>	<b>172,111</b>	<b>154,909</b>	<b>491,089</b>	<b>591,665</b>
Operating income (loss)	9,837	7,896	29,744	(129,342)
Interest expense	8,734	6,462	26,041	19,980
Interest income	(158)	(25)	(475)	(211)
Gain on extinguishment of debt				(675)
Other (income) expense	(2)	(8)	224	(284)
Income (loss) before income taxes	1,263	1,467	3,954	(148,152)
Provision for income taxes	842	41	679	36,951
<b>Net income (loss)</b>	<b>\$ 421</b>	<b>\$ 1,426</b>	<b>\$ 3,275</b>	<b>\$ (185,103)</b>
<b>PER SHARE DATA:</b>				
<b>Net income (loss) per common share</b>				
Basic	\$ 0.02	\$ 0.07	\$ 0.16	\$ (9.55)

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Diluted	\$ 0.02	\$ 0.07	\$ 0.15	\$ (9.55)
<b>Weighted-average number of shares</b>				
Basic	20,833	19,458	20,200	19,373
Diluted	21,678	19,653	21,610	19,373

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>September 30, 2010</b>	<b>December 31, 2009</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 4,041	\$ 5,633
Accounts receivable, net	88,488	69,625
Prepaid expenses	3,959	8,584
Deferred tax asset, net	5,648	5,506
Other	5,516	4,420
Total current assets	107,652	93,768
Property and equipment, net	118,490	127,329
Goodwill	27,023	27,023
Intangibles, net	17,290	18,467
Other assets	13,848	13,029
Total assets	\$ 284,303	\$ 279,616
<b>LIABILITIES, REDEEMABLE NONCONTROLLING INTEREST AND SHAREHOLDERS DEFICIT</b>		
Current liabilities:		
Current maturities of indebtedness	\$ 18,914	\$ 19,866
Current maturities of capital lease obligations	4,325	5,322
Accounts payable	8,670	6,182
Independent affiliates and independent owner-operators payable	13,906	9,734
Accrued expenses	23,440	21,378
Environmental liabilities	3,530	3,408
Accrued loss and damage claims	7,964	8,862
Total current liabilities	80,749	74,752
Long-term indebtedness, less current maturities	284,171	284,253
Capital lease obligations, less current maturities	8,818	11,843
Environmental liabilities	7,015	8,241
Accrued loss and damage claims	9,852	10,534
Other non-current liabilities	26,623	28,896
Total liabilities	417,228	418,519
Commitments and contingencies - Note 12		
Redeemable noncontrolling interest	1,833	1,833
<b>SHAREHOLDERS DEFICIT</b>		
Common stock, no par value; 49,000 shares authorized; 21,678 issued and 21,458 outstanding at September 30, 2010 and 20,297 issued and 20,077 outstanding at December 31, 2009, respectively	370,720	364,046

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

Treasury stock, 220 shares at September 30, 2010 and December 31, 2009	(1,593)	(1,580)
Accumulated deficit	(291,293)	(294,568)
Stock recapitalization	(189,589)	(189,589)
Accumulated other comprehensive loss	(24,686)	(25,587)
Stock purchase warrants	1,683	6,696
Stock subscriptions receivable		(154)
Total shareholders' deficit	(134,758)	(140,736)
Total liabilities, redeemable noncontrolling interest and shareholders' deficit	\$ 284,303	\$ 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 Deficit

For the Nine Months Ended September 30, 2010 and 2009

Unaudited (In 000 s)

	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 Deficit
Balance, December 31, 2008	19,754	(205)	\$ 362,945	\$ (1,580)	\$ (114,034)	\$ (189,589)	\$ (26,488)	\$	\$ (234)	\$ 31,020
Net loss					(185,103)					(185,103)
Issuance of restricted stock	103									
Amortization of restricted stock			147							147
Amortization of stock options			273							273
Amortization of prior service costs and losses (pension plans), net of tax							936			936
Foreign currency translation adjustment, net of tax							(98)			(98)
Balance, September 30, 2009	19,857	(205)	\$ 363,365	\$ (1,580)	\$ (299,137)	\$ (189,589)	\$ (25,650)		\$ (234)	\$ (152,825)
Balance, December 31, 2009	20,297	(220)	\$ 364,046	\$ (1,580)	\$ (294,568)	\$ (189,589)	\$ (25,587)	\$ 6,696	\$ (154)	\$ (140,736)
Net income					3,275					3,275
Issuance of restricted stock	69									
Amortization of restricted stock			695							695
Amortization of stock options			1,010							1,010
Stock warrant exercises	1,311		5,013					(5,013)		
Stock option exercises	1		3							3



Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Forgiveness of stock subscriptions receivable									21	21
Satisfaction of stock subscriptions receivable	(47)	(13)							60	
Other stock transactions									73	73
Amortization of prior service costs and losses (pension plans), net of tax								970		970
Foreign currency translation adjustment, net of tax								(69)		(69)
Balance, September 30, 2010	21,678	(220)	\$ 370,720	\$ (1,593)	\$ (291,293)	\$ (189,589)	\$ (24,686)	\$ 1,683	\$	\$ (134,758)

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>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2010</b>	<b>2009</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$ 3,275	\$ (185,103)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Deferred income tax benefit		(5,138)
Depreciation and amortization	12,239	15,694
Bad debt (recoveries) expense	(222)	1,811
Loss on disposal of property and equipment	991	14
Impairment charge		148,630
PIK interest on Senior Subordinated Notes	1,686	
Gain on extinguishment of long-term debt		(675)
Financing costs	171	
Stock-based compensation	1,705	420
Amortization of deferred financing costs	2,052	2,126
Amortization of bond discount	1,755	825
Redeemable noncontrolling interest dividends	109	109
Provision for deferred tax asset valuation allowance		42,482
Changes in assets and liabilities:		
Accounts and other receivables	(18,641)	(1,092)
Prepaid expenses	5,582	6,633
Other assets	(3,834)	2,071
Accounts payable	1,572	222
Accrued expenses	1,545	(2,420)
Environmental liabilities	(1,103)	403
Accrued loss and damage claims	(1,580)	(1,294)
Independent affiliates and independent owner-operators payable	4,172	3,403
Other liabilities	(714)	146
Current income taxes	598	(54)
Net cash provided by operating activities	11,358	29,213
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Capital expenditures	(8,144)	(7,125)
Proceeds from sales of property and equipment	5,543	6,495
Net cash used in investing activities	(2,601)	(630)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Principal payments on long-term debt	(3,390)	(6,928)
Principal payments on capital lease obligations	(4,073)	(6,153)
Proceeds from revolver	43,300	28,600
Payments on revolver	(46,100)	(40,600)
Payments on acquisition notes	(729)	(711)
Financing costs	(171)	

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Change in book overdraft	917	(6,673)
Redeemable noncontrolling interest dividends	(109)	(109)
Proceeds from exercise of stock options	3	
Net cash used in financing activities	(10,352)	(32,574)
Effect of exchange rate changes on cash	3	35
Net decrease in cash and cash equivalents	(1,592)	(3,956)
Cash and cash equivalents, beginning of period	5,633	6,787
Cash and cash equivalents, end of period	\$ 4,041	\$ 2,831

Supplemental Disclosure of Cash Flow Information

Cash paid during the period for:

Interest	\$ 18,542	\$ 15,867
Income taxes	353	392

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 operate the largest chemical bulk tank truck network in North America through our wholly owned subsidiary, QCI, and are the largest North American provider of intermodal tank container and depot services through our wholly owned subsidiary, Boasso. We conduct a significant portion of (approximately 95%) our business through a network of independent affiliates and independent owner-operators. Independent affiliates are independent companies which enter into various term contracts with the Company to haul chemicals and other materials. Independent affiliates are responsible for paying for their own power equipment (including debt service), fuel and other operating costs. The vast majority of our independent affiliates lease trailers from us. Independent owner-operators are independent contractors, who, through a contract with us, supply one or more tractors and drivers for our use. Contracts with independent owner-operators may be terminated by either party on short notice. We lease tractors and trailers to independent affiliates and third parties as needed. In exchange for the services rendered, independent affiliates and independent owner-operators are normally paid a percentage of the revenues collected on each load hauled.

Our accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and do not include all of the information and notes required by accounting principles generally accepted in the United States ( GAAP ) for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments and accruals) considered necessary for a fair statement of consolidated financial position, results of operations and cash flows have been included. The consolidated balance sheet data for the year ended December 31, 2009, 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 and nine months ended September 30, 2010 are not necessarily indicative of the results that may be expected for any period in the future.

***New Accounting Pronouncements***

In June 2009, the 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 that a vast majority of its relationships with independent affiliates do not represent variable interests and that the Company is not in a position to direct the significant economic activities of any of its independent affiliates.

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

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 nine months of 2010, we did not complete any acquisitions or dispositions of businesses or independent 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 intangible assets. 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 did 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. Variable Interest Entities**

Generally under FASB guidance, a variable interest entity is an entity with one or more of the following characteristics: (a) the total equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support; (b) as a group the holders of the equity investment at risk lack (i) the ability to make decisions about an entity's activities through voting or similar rights, (ii) the obligation to absorb the expected losses of the entity, or (iii) the right to receive the expected residual returns of the entity; or (c) the equity investors have voting rights that are not proportional to their economic interests and substantially all of the entity's activities either involve, or are conducted on behalf of, an investor that has disproportionately few voting rights. The primary beneficiary of a VIE is generally the entity that has (a) the power to direct the activities of the VIE that most significantly impact the VIE's economic performance, and (b) the obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE.

In determining whether we are the primary beneficiary of a VIE, we consider qualitative and quantitative factors, including, but not limited to: which activities most significantly impact the VIE's economic performance and which party controls such activities; the characteristics of our involvement; or the obligation or likelihood for us to provide financial support. Significant judgments or estimates related to these determinations include review of contract arrangements, capitalization, and day-to-day operations.

At September 30, 2010, we hold a variable interest in one VIE for which we are not the primary beneficiary. We have concluded, based on our qualitative consideration of our contract with the VIE, the operating structure of the VIE and our role with the VIE that we do not have the power to direct activities of the VIE that most significantly impact the VIE's economic performance. Therefore, we are not required to consolidate the operations of this VIE.

The one VIE at September 30, 2010 is an independent affiliate that is directly engaged with the management of three trucking terminals. We are involved with this VIE as a non-controlling interest. Our maximum exposure to loss as a result of our involvement with this unconsolidated VIE is limited to our recorded loan receivable from this VIE, which was approximately \$2.7 million at September 30, 2010.

**3. Fair Value of Financial Instruments**

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

Level 1 Quoted prices for identical instruments in active markets;

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

Level 3 Instruments whose significant inputs are unobservable.

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

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.

**Table of Contents*****Fair Value Measurements on a Nonrecurring Basis******Long-term indebtedness***

The fair values of our long-term indebtedness were based on level 2 quoted market prices. As of September 30, 2010, the carrying values and fair values are as follows (in thousands):

	<b>Carrying Value</b>	<b>Fair Value</b>
9% Senior Subordinated Notes ( 9% Notes )	\$ 16,031	\$ 16,031
Senior Floating Rate Notes ( 2012 Notes )	501	407
10% Senior Notes ( 2013 Senior Notes )	134,499	135,172
11.75% Senior Subordinated PIK Notes ( 2013 PIK Notes )	82,897	81,239
	<b>\$ 233,928</b>	<b>\$ 232,849</b>

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

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

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

Under the FASB guidance, goodwill and indefinite-lived intangible assets are subject to an annual impairment test as well as impairment assessments when certain triggering events occur. We evaluate goodwill for impairment by determining the fair value based on criteria in the FASB guidance for each reporting unit to which our goodwill relates. These reporting units may 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. The methodology applied in the analysis performed at June 30, 2010 was consistent with the methodology applied in prior years, but was based on updated assumptions, as appropriate. As a result of our analysis, we concluded no impairment had occurred as of June 30, 2010. As a result of our analysis as of June 30, 2009, we recorded a total impairment charge to goodwill of \$146.2 million, 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.

As the result of the June 30, 2009 impairment, 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 changes 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



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

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.

**Table of Contents**

As of September 30, 2010 and December 31, 2009, the goodwill balance was \$27.0 million, all of which relates to our container services segment.

**Intangible Assets**

Intangible assets at September 30, 2010 are as follows (in thousands):

	Gross value	Accumulated amortization	Net book value	Average lives (in years)
Tradename (1)	\$ 7,400	\$	\$ 7,400	Indefinite
Customer relationships	11,900	(2,727)	9,173	12
Non-compete agreements	2,593	(1,876)	717	3 5
	\$ 21,893	\$ (4,603)	\$ 17,290	

(1) The gross value includes an impairment of \$2.4 million related to our container services segment recorded during the quarter ended June 30, 2009.

Amortization expense for the nine months ended September 30, 2010 and 2009 was \$1.2 million. Estimated amortization expense for intangible assets is as follows (in thousands):

2010 remaining	\$ 366
2011	1,369
2012	1,205
2013	996
2014 and after	5,954

**5. Comprehensive Income (Loss)**

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

	Three months ended		Nine months ended	
	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009
Net income (loss)	\$ 421	\$ 1,426	\$ 3,275	\$ (185,103)
Other comprehensive income (loss):				
Amortization of prior service costs	323	312	970	936
Foreign currency translation adjustments	(65)	(103)	(69)	(98)
Comprehensive income (loss)	\$ 679	\$ 1,635	\$ 4,176	\$ (184,265)

**Table of Contents****6. 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):

	September 30, 2010			Three months ended September 30, 2009		
	Net income (numerator)	Shares (denominator)	Per-share amount	Net income (numerator)	Shares (denominator)	Per-share amount
<b>Basic income available to common shareholders:</b>						
Net income	\$ 421	20,833	\$ 0.02	\$ 1,426	19,458	\$ 0.07
<b>Effect of dilutive securities:</b>						
Stock options		197				
Unvested restricted stock		205			195	
Stock warrants outstanding		443				
<b>Diluted income available to common shareholders:</b>						
Net income	\$ 421	21,678	\$ 0.02	\$ 1,426	19,653	\$ 0.07

	September 30, 2010			Nine months ended September 30, 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)	\$ 3,275	20,200	\$ 0.16	\$ (185,103)	19,373	\$ (9.55)
<b>Effect of dilutive securities:</b>						
Stock options		176				
Unvested restricted stock		172				
Stock warrants outstanding		1,062				
<b>Diluted income (loss) available to common shareholders:</b>						
Net income (loss)	\$ 3,275	21,610	\$ 0.15	\$ (185,103)	19,373	\$ (9.55)

There is no effect of our stock options, unvested restricted stock and stock warrants in the computation of diluted earnings per share for the nine months ended September 30, 2009 due to a net loss in the period.

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

<b>Three months ended September 30,</b>	<b>Nine months ended September 30,</b>
---	--

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

	2010	2009	2010	2009
Stock options	2,159	1,687	2,180	1,687
Unvested restricted stock	419		451	195

**7. Stock-Based Compensation**

We maintain performance incentive plans under which stock options, restricted shares, and stock units may be granted to employees, non-employee directors, consultants and advisors. As of September 30, 2010, we had two active stock-based compensation plans.

**Table of Contents**

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 Statements of Operations. None of the stock-based compensation was capitalized during the nine months ended September 30, 2010.

The fair value of options granted during the first nine months of 2010 was based upon the Black-Scholes option-pricing model. The expected term of the options represents the estimated period of time until exercise giving consideration to the contractual terms, vesting schedules and expectations of future employee behavior. For 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:

	2010	2009
Risk free rate	1.95%	1.57%
Expected life	5 years	5 years
Volatility	77.5%	78.7%
Expected dividend	nil	nil

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

	Options Issued	Restricted Shares Issued
March 31, 2010		68,621
June 30, 2010	85,000	
September 30, 2010	160,000	

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

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Stock options	\$ 396	\$ 68	\$ 1,010	\$ 274
Restricted stock	232	40	695	146
	\$ 628	\$ 108	\$ 1,705	\$ 420

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 September 30, 2010 (in thousands):

		Remaining years
Stock options	\$ 3,131	4

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

Restricted stock	1,731	3
	\$ 4,862	

These amounts do not include the cost of any additional awards that may be granted in future periods nor any changes in our forfeiture rate. Options for 1,250 shares were exercised during the nine months ended September 30, 2010.

### **8. Employee Benefit Plans**

#### *Noncontributory defined 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.

**Table of Contents**

We use a December 31 measurement date for both of our defined benefit and pension plans.

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

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2010	2009	2010	2009
Service cost	\$ 51	\$ 51	\$ 152	\$ 152
Interest cost	644	688	1,931	2,064
Amortization of prior service cost	23	23	70	70
Amortization of loss	300	288	900	865
Expected return on plan assets	(540)	(509)	(1,620)	(1,528)
Net periodic pension cost	\$ 478	\$ 541	\$ 1,433	\$ 1,623

We contributed \$2.1 million in aggregate to our pension plans during the nine months ended September 30, 2010. We expect to contribute an additional \$0.5 million during the remainder of 2010.

**Multi-employer pension plans**

At September 30, 2010, we contributed to six separate multi-employer pension plans for employees under collective bargaining agreements. These agreements cover approximately 4% of our total workforce including our affiliates' employees and independent owner-operators providing service to us. These multi-employer pension plans provide defined benefits to retired participants. We do not directly or indirectly manage any of these multi-employer pension plans. Trustees, half of whom are appointed by the International Brotherhood of Teamsters (the "Teamsters") and half of whom various contributing employers appoint, manage the trusts covering these plans. Our collective bargaining agreements with the Teamsters determine the amounts of our ongoing contributions to these plans.

In conjunction with our restructuring efforts, during the quarter ended September 30, 2010, we notified the trustees of three of these plans of our intention to withdraw from the plans. Our withdrawal notifications are expected to result in an aggregate withdrawal liability of approximately \$2.0 million and we recorded a restructuring charge for this full amount in the third quarter of fiscal 2010. Approximately \$0.2 million of the total estimated liability is expected to be paid within one year of the effective date of our withdrawal from the plans with the remaining \$1.8 million expected to be paid over the twelve years following the effective date of our withdrawal from the plans.

We do not currently intend to withdraw from the remaining three multi-employer pension plans or take any actions that would subject us to payment of contingent obligations. Based on information provided to us from the trustees of these plans, we estimate that our portion of the contingent liability in the case of a full withdrawal or termination from these remaining plans is estimated to be in the range of \$54 million to \$60 million of which the largest component relates to the Central States Southeast and Southwest Areas Pension Plan, which is estimated to be in the range of \$50 million to \$56 million.

During the nine months ended September 30, 2010 and 2009, we charged to operations payments to multi-employer pension plans required by collective bargaining agreements of \$2.0 million in both periods.

**9. Restructuring**

We account for restructuring costs associated with one-time termination benefits, costs associated with lease and contract terminations and other related exit activities in accordance with 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. In 2008, we recorded restructuring charges of \$5.3 million. We continued our plan of restructure throughout 2009 which resulted in charges of \$3.5 million. Our restructuring plan continued in 2010 and resulted in charges of \$4.6 million for the nine-month period ended September 30, 2010, of which \$2.0 million relates to our estimated

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

withdrawal liability from three multi-employer pension plans. The majority of the restructuring charges related to our trucking segment which consisted of employee termination benefits and other related exit activities, and included the termination of approximately 380 non-driver positions. We expect to conclude our restructuring plan in 2010 and to take additional related charges during the remainder of the year.



**Table of Contents**

In the nine months ended September 30, 2010, we had the following activity in our restructuring accruals:

	<b>Balance at December 31, 2009</b>	<b>Additions</b>	<b>Payments</b>	<b>Reductions</b>	<b>Balance at September 30, 2010</b>
Restructuring costs	\$ 1,063	\$ 4,589	\$ (2,627)	\$	\$ 3,025

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

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

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

Container Services, specifically intermodal 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, and corporate and other unallocated amounts. Corporate and unallocated amounts include depreciation and amortization and other gains and losses. Although these amounts are excluded from the business segment results, they are included in reported consolidated earnings. Included in Other revenue are revenues from our equipment rental, our tank wash services for periods we operated our tank wash business 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.

**Table of Contents**

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

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
<b>Operating revenues:</b>				
Trucking	\$ 137,043	\$ 123,053	\$ 393,306	\$ 347,671
Container Services	27,052	20,248	76,485	58,027
Other revenue	17,853	19,504	51,042	56,625
<b>Total</b>	<b>181,948</b>	<b>162,805</b>	<b>520,833</b>	<b>462,323</b>
<b>Operating income (loss):</b>				
Trucking	10,900	9,803	32,611	25,492
Container Services	4,906	2,754	13,108	8,044
Other operating income	673	1,013	1,844	3,565
Total segment operating income	16,479	13,570	47,563	37,101
Depreciation and amortization expense	3,929	5,055	12,239	15,694
Impairment charge (1)				148,630
Other expense	2,713	619	5,580	2,119
<b>Total</b>	<b>9,837</b>	<b>7,896</b>	<b>29,744</b>	<b>(129,342)</b>
Interest expense	8,734	6,462	26,041	19,980
Interest income	(158)	(25)	(475)	(211)
Other (income) expense	(2)	(8)	224	(959)
<b>Income (loss) before income taxes</b>	<b>\$ 1,263</b>	<b>\$ 1,467</b>	<b>\$ 3,954</b>	<b>\$ (148,152)</b>

- (1) The nine months ended September 30, 2009, include an impairment charge of \$144.3 million related to our trucking segment and an impairment charge of \$4.3 million related to our container services segment.

**Geographic Segments**

Our operations are located primarily in the United States, Canada and Mexico. Inter-area sales are not significant to the total revenue of any geographic area. Information about our operations in different geographic areas for the three and nine months ended September 30, 2010 and 2009 is as follows (in thousands):

	Three months ended September 30, 2010		
	U. S.	International	Consolidated
Total operating revenues	\$ 172,268	\$ 9,680	\$ 181,948
Operating income	8,467	1,370	9,837
	Three months ended September 30, 2009		
	U. S.	International	Consolidated
Total operating revenues	\$ 152,301	\$ 10,504	\$ 162,805

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Operating income	7,060	836	7,896
------------------	-------	-----	-------

**As of September 30, 2010**

Long-term identifiable assets (1)	\$ 111,112	\$ 7,378	\$ 118,490
-----------------------------------	------------	----------	------------

**Nine months ended September 30, 2010**

	<b>U. S.</b>	<b>International</b>	<b>Consolidated</b>
Total operating revenues	\$ 492,120	\$ 28,713	\$ 520,833
Operating income	26,209	3,535	29,744

**Nine months ended September 30, 2009**

	<b>U. S.</b>	<b>International</b>	<b>Consolidated</b>
Total operating revenues	\$ 433,592	\$ 28,731	\$ 462,323
Operating (loss) income	(132,284)	2,942	(129,342)

**As of December 31, 2009**

Long-term identifiable assets (1)	\$ 119,340	\$ 7,989	\$ 127,329
-----------------------------------	------------	----------	------------

(1) Includes property and equipment.

---

## **Table of Contents**

### **11. 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 12 months due to expiration of the statute of limitations.

For the three months ended September 30, 2010, there was no material net change to our gross unrecognized tax benefits. Our total gross unrecognized tax benefit at September 30, 2010 was \$1.6 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 September 30, 2010 was \$0.8 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 September 30, 2010 and 2009 were approximately 66.7% and 2.8%, respectively. The effective tax rates for the nine months ended September 30, 2010 and 2009 were approximately 17.2% and (24.9%) respectively. The difference in the effective tax rate for the three months and nine months ended September 30, 2010 differs from the previous periods due to the tax expense adjustments related to an impairment charge recorded during the second quarter of 2009 of deductible and non-deductible goodwill, as well as the recording of a 100% valuation allowance against the net deferred tax assets.

### **12. 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 independent 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

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

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.

---

**Table of Contents***Reserves*

Our policy is to accrue remediation expenses when it is probable that such efforts will be required and the related expenses can be reasonably estimated. Estimates of costs for future environmental compliance and remediation may be 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 September 30, 2010 and December 31, 2009, we had reserves in the amount of \$10.5 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 the estimated environmental obligations to be paid over the next five years. Additions to the environmental liability reserves are classified in our Consolidated Statements of Operations within the Selling and administrative category.

*Property Contamination Liabilities*

We have been named as (or are alleged to be) a potentially responsible party under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended ( CERCLA ) and similar state laws at approximately 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 multi-party environmental matters over the next five years to be in the range of \$2.1 million to \$3.8 million.

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; (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 over the next five years for these seven properties to be in the range of \$8.4 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, the treatment facility began initial operations in June 2010. The plant experienced issues with the treatment of vapor phase emissions and operation was suspended in July 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 September 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 over the next five years to be in the range of \$5.8 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 have been resolved and the treatment facility began operations in June 2010. The plant experienced issues with the liquid phase carbon treatment process and the operation was suspended in August 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

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

expanded to include off-site shipment of contaminated soils. Soil treatment was completed in September 2007. Site sampling has been conducted and the results indicate that the soil clean-up objectives have not been fully achieved. Negotiations are on-going with USEPA over further remedial actions that may be needed at the site. We have estimated expenditures over the next five years to be in the range of \$1.0 million to \$3.4 million.

---

**Table of Contents**

*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 aggregate future expenditures for Scary Creek, Tonawanda and ISRA to be in the range of \$1.6 million to \$4.8 million.

***Other Legal Matters***

We are from time to time involved in routine litigation incidental to the conduct of our business. We believe that no such routine litigation currently pending against us, if adversely determined, would have a material adverse effect on our consolidated financial position, results of operations or cash flows.

**13. 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:



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

Condensed consolidating balance sheets at September 30, 2010 and December 31, 2009 and condensed consolidating statements of operations for the three and nine- month periods ended September 30, 2010 and September 30, 2009 and the condensed consolidating statements of cash flows for each of the nine-month periods ended September 30, 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 September 30, 2010****Unaudited - (In 000 s)**

	<b>QDI</b>	<b>QD LLC &amp; QD Capital</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Operating revenues:</b>						
Transportation	\$	\$	\$ 132,676	\$	\$	\$ 132,676
Other service revenue			28,038	140		28,178
Fuel surcharge			21,094			21,094
<b>Total operating revenues</b>			<b>181,808</b>	<b>140</b>		<b>181,948</b>
<b>Operating expenses:</b>						
Purchased transportation			127,506			127,506
Compensation			14,107			14,107
Fuel, supplies and maintenance			12,664	1		12,665
Depreciation and amortization			3,929			3,929
Selling and administrative	73	53	5,753	14		5,893
Insurance costs			3,805	5		3,810
Taxes and licenses			418			418
Communication and utilities			1,070			1,070
Loss on disposal of property and equipment			339			339
Restructuring costs			2,374			2,374
<b>Operating (loss) income</b>	<b>(73)</b>	<b>(53)</b>	<b>9,843</b>	<b>120</b>		<b>9,837</b>
Interest expense (income), non-related party, net		8,259	335	(18)		8,576
Interest expense (income), related party, net	37	(8,259)	8,340	(118)		
Other expense		78	(8)	(72)		(2)
<b>(Loss) income before income taxes</b>	<b>(110)</b>	<b>(131)</b>	<b>1,176</b>	<b>328</b>		<b>1,263</b>
Provision for income taxes			698	144		842
Equity in earnings of subsidiaries	531	662			(1,193)	
<b>Net income</b>	<b>\$ 421</b>	<b>\$ 531</b>	<b>\$ 478</b>	<b>\$ 184</b>	<b>\$ (1,193)</b>	<b>\$ 421</b>

**Table of Contents****Consolidating Statements of Operations****Three Months Ended September 30, 2009****Unaudited - (In 000 s)**

	<b>QDI</b>	<b>QD LLC &amp; QD Capital</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Operating revenues:</b>						
Transportation	\$	\$	\$ 120,444	\$	\$	\$ 120,444
Other service revenue			26,741	52		26,793
Fuel surcharge			15,568			15,568
<b>Total operating revenues</b>			<b>162,753</b>	<b>52</b>		<b>162,805</b>
<b>Operating expenses:</b>						
Purchased transportation			102,393			102,393
Compensation			19,040			19,040
Fuel, supplies and maintenance			16,129			16,129
Depreciation and amortization			5,055			5,055
Selling and administrative		176	5,411	5		5,592
Insurance costs			3,076	5		3,081
Taxes and licenses			1,023			1,023
Communication and utilities			1,977			1,977
Loss on disposal of property and equipment			279			279
Restructuring costs			340			340
<b>Operating (loss) income</b>		<b>(176)</b>	<b>8,030</b>	<b>42</b>		<b>7,896</b>
Interest expense (income), non-related party, net		5,836	613	(12)		6,437
Interest (income) expense, related party, net		(5,836)	5,945	(109)		
Other (income) expense	(3)		(22)	17		(8)
<b>Income (loss) before income taxes</b>	<b>3</b>	<b>(176)</b>	<b>1,494</b>	<b>146</b>		<b>1,467</b>
Provision for income taxes			15	26		41
Equity in earnings of subsidiaries	1,423	1,599			(3,022)	
<b>Net income (loss)</b>	<b>\$ 1,426</b>	<b>\$ 1,423</b>	<b>\$ 1,479</b>	<b>\$ 120</b>	<b>\$ (3,022)</b>	<b>\$ 1,426</b>

**Table of Contents****Consolidating Statements of Operations****Nine Months Ended September 30, 2010****Unaudited - (In 000 s)**

	<b>QDI</b>	<b>QD LLC &amp; QD Capital</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Operating revenues:</b>						
Transportation	\$	\$	\$ 381,066	\$	\$	\$ 381,066
Other service revenue			79,109	448		79,557
Fuel surcharge			60,210			60,210
<b>Total operating revenues</b>			<b>520,385</b>	<b>448</b>		<b>520,833</b>
<b>Operating expenses:</b>						
Purchased transportation			361,481			361,481
Compensation			42,979			42,979
Fuel, supplies and maintenance			37,006	1		37,007
Depreciation and amortization			12,239			12,239
Selling and administrative	73	147	14,823	77		15,120
Insurance costs			11,672	15		11,687
Taxes and licenses			1,688			1,688
Communication and utilities			3,308			3,308
Loss on disposal of property and equipment			991			991
Impairment charge						
Restructuring costs			4,589			4,589
<b>Operating (loss) income</b>	<b>(73)</b>	<b>(147)</b>	<b>29,609</b>	<b>355</b>		<b>29,744</b>
Interest expense (income), non-related party, net		24,475	1,138	(47)		25,566
Interest expense (income), related party, net	37	(24,475)	24,760	(322)		
Other expense		172	111	(59)		224
<b>(Loss) income before income taxes</b>	<b>(110)</b>	<b>(319)</b>	<b>3,600</b>	<b>783</b>		<b>3,954</b>
Provision for (benefit from) income taxes			1,193	(514)		679
Equity in earnings of subsidiaries	3,385	3,704			(7,089)	
<b>Net income</b>	<b>\$ 3,275</b>	<b>\$ 3,385</b>	<b>\$ 2,407</b>	<b>\$ 1,297</b>	<b>\$ (7,089)</b>	<b>\$ 3,275</b>

**Table of Contents****Consolidating Statements of Operations****Nine Months Ended September 30, 2009****Unaudited - (In 000 s)**

	<b>QDI</b>	<b>QD LLC &amp; QD Capital</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Operating revenues:</b>						
Transportation	\$	\$	\$ 343,554	\$	\$	\$ 343,554
Other service revenue			80,090	151		80,241
Fuel surcharge			38,528			38,528
<b>Total operating revenues</b>			<b>462,172</b>	<b>151</b>		<b>462,323</b>
<b>Operating expenses:</b>						
Purchased transportation			273,269			273,269
Compensation			61,791			61,791
Fuel, supplies and maintenance			49,591			49,591
Depreciation and amortization			15,694			15,694
Selling and administrative		208	19,386	20		19,614
Insurance costs			11,061	15		11,076
Taxes and licenses			3,096			3,096
Communication and utilities			6,785			6,785
Loss on disposal of property and equipment			14			14
Impairment charge			148,630			148,630
Restructuring costs			2,105			2,105
<b>Operating (loss) income</b>		(208)	(129,250)	116		(129,342)
Interest expense (income), non-related party, net		17,926	1,879	(36)		19,769
Interest (income) expense, related party, net		(17,926)	18,241	(315)		(675)
Gain on extinguishment of debt		(675)				(675)
Other (income) expense	(3)		(286)	5		(284)
<b>Income (loss) before income taxes</b>	<b>3</b>	<b>467</b>	<b>(149,084)</b>	<b>462</b>		<b>(148,152)</b>
Provision for income taxes			36,831	120		36,951
Equity in loss of subsidiaries	(185,106)	(185,573)			370,679	
<b>Net (loss) income</b>	<b>\$ (185,103)</b>	<b>\$ (185,106)</b>	<b>\$ (185,915)</b>	<b>\$ 342</b>	<b>\$ 370,679</b>	<b>\$ (185,103)</b>

**Table of Contents****Consolidating Balance Sheet****September 30, 2010****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	\$	\$	\$ 1,592	\$ 2,449	\$	\$ 4,041
Accounts receivable, net			88,381	107		88,488
Prepaid expenses		21	3,938			3,959
Deferred tax asset, net			5,648			5,648
Other	614		4,889	13		5,516
Total current assets	614	21	104,448	2,569		107,652
Property and equipment, net			118,490			118,490
Goodwill			27,023			27,023
Intangibles, net			17,290			17,290
Investment in subsidiaries	(144,556)	457,692	21,046		(334,182)	
Other assets		7,152	6,696			13,848
Total assets	\$ (143,942)	\$ 464,865	\$ 294,993	\$ 2,569	\$ (334,182)	\$ 284,303
<b>LIABILITIES, REDEEMABLE NONCONTROLLING INTEREST AND SHAREHOLDERS (DEFICIT) EQUITY</b>						
Current Liabilities:						
Current maturities of indebtedness	\$	16,031	\$ 2,883	\$	\$	\$ 18,914
Current maturities of capital lease obligations			4,325			4,325
Accounts payable			8,670			8,670
Intercompany	(8,909)	310,857	(274,928)	(5,974)	(21,046)	
Independent affiliates and independent owner-operators payable			13,906			13,906
Accrued expenses	732	6,365	16,327	16		23,440
Environmental liabilities			3,530			3,530
Accrued loss and damage claims			7,964			7,964
Total current liabilities	(8,177)	333,253	(217,323)	(5,958)	(21,046)	80,749
Long-term indebtedness, less current maturities		276,168	8,003			284,171
Capital lease obligations, less current maturities			8,818			8,818
Environmental liabilities			7,015			7,015
Accrued loss and damage claims			9,852			9,852
Other non-current liabilities	(1,007)		27,410	220		26,623
Total liabilities	(9,184)	609,421	(156,225)	(5,738)	(21,046)	417,228
Redeemable noncontrolling interest			1,833			1,833
Shareholders' equity (deficit):						
Common Stock	370,720	354,963	490,761	6,933	(852,657)	370,720
Treasury stock	(1,593)					(1,593)
Accumulated (deficit) retained earnings	(291,293)	(287,399)	(18,204)	2,471	303,132	(291,293)
Stock recapitalization	(189,589)	(189,589)		(55)	189,644	(189,589)

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Accumulated other comprehensive loss	(24,686)	(24,214)	(23,172)	(1,042)	48,428	(24,686)
Stock purchase warrants	1,683	1,683			(1,683)	1,683
Total shareholders (deficit) equity	(134,758)	(144,556)	449,385	8,307	(313,136)	(134,758)
Total liabilities, redeemable noncontrolling interest and shareholders (deficit) equity	\$ (143,942)	\$ 464,865	\$ 294,993	\$ 2,569	\$ (334,182)	\$ 284,303

**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)	
Independent 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)



Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

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)
<b>Total shareholders (deficit) equity</b>	<b>(140,736)</b>	<b>(143,830)</b>	<b>449,107</b>	<b>7,079</b>	<b>(312,356)</b>	<b>(140,736)</b>
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****Nine Months Ended September 30, 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	\$ 3,275	\$ 3,385	\$ 2,407	\$ 1,297	\$ (7,089)	3,275
Adjustments for non-cash charges	(1,607)	(22,406)	37,732	(322)	7,089	20,486
Net changes in assets and liabilities	66	3,439	(16,899)	991		(12,403)
Intercompany activity	(1,734)	15,582	(12,229)	(1,619)		
<b>Net cash provided by operating activities</b>			<b>11,011</b>	<b>347</b>		<b>11,358</b>
<b>Cash flows from investing activities:</b>						
Capital expenditures			(8,144)			(8,144)
Proceeds from sales of property and equipment			5,543			5,543
<b>Net cash used in investing activities</b>			<b>(2,601)</b>			<b>(2,601)</b>
<b>Cash flows from financing activities:</b>						
Principal payments on long-term debt and capital lease obligations			(7,463)			(7,463)
Proceeds from revolver		43,300				43,300
Payments on revolver		(46,100)				(46,100)
Other	3	(280)	188			(89)
Intercompany activity	(3)	3,080	(3,077)			
<b>Net cash used in financing activities</b>			<b>(10,352)</b>			<b>(10,352)</b>
Effect of exchange rate changes on cash			3			3
<b>Net (decrease) increase in cash and cash equivalents</b>			<b>(1,939)</b>	<b>347</b>		<b>(1,592)</b>
Cash and cash equivalents, beginning of period			3,531	2,102		5,633
<b>Cash and cash equivalents, end of period</b>	<b>\$</b>	<b>\$</b>	<b>\$ 1,592</b>	<b>\$ 2,449</b>	<b>\$</b>	<b>\$ 4,041</b>

**Table of Contents****Condensed Consolidating Statements of Cash Flows****Nine Months Ended September 30, 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) income	\$ (185,103)	\$ (185,106)	\$ (185,915)	\$ 342	\$ 370,679	\$ (185,103)
Adjustments for non-cash charges	185,106	170,032	222,154	(315)	(370,679)	206,298
Net changes in assets and liabilities	(1,034)	2,734	6,026	292		8,018
Intercompany activity	1,031	12,340	(13,247)	(124)		
Net cash provided by operating activities			29,018	195		29,213
<b>Cash flows from investing activities:</b>						
Capital expenditures			(7,125)			(7,125)
Proceeds from sales of property and equipment			6,495			6,495
Net cash used in investing activities			(630)			(630)
<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)	(10,256)			(13,081)
Proceeds from revolver		28,600				28,600
Payments on revolver		(40,600)				(40,600)
Other		(109)	(7,384)			(7,493)
Intercompany activity		14,934	(14,934)			
Net cash used in financing activities			(32,574)			(32,574)
Effect of exchange rate changes on cash			35			35
Net (decrease) increase in cash and cash equivalents			(4,151)	195		(3,956)
Cash and cash equivalents, beginning of period			4,725	2,062		6,787
Cash and cash equivalents, end of period	\$	\$	\$ 574	\$ 2,257	\$	\$ 2,831

**14. Subsequent Events**

Subsequent events have been evaluated and disclosed herein relating to events that have occurred from September 30, 2010 through the filing date of this Quarterly Report on Form 10-Q, November 9, 2010.

On November 3, 2010, our wholly owned subsidiaries, Quality Distribution, LLC and QD Capital Corporation, completed an offering of \$225.0 million in aggregate principal amount of 9.875% Second-Priority Senior Secured Notes due 2018 (the "2018 Notes") at an issue price of 99.324% of par. On November 2, 2010, we sent irrevocable redemption notices to holders of our 2013 Senior Notes, 2012 Notes and 2013 PIK Notes. The net proceeds from the offering of the 2018 Notes are expected to be used to fully redeem or repay all of the outstanding 2013 Senior Notes, 9%

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

Notes and 2012 Notes. We also intend to apply proceeds to redeem at par, plus accrued and unpaid interest, the principal amount of our 2013 PIK Notes sufficient to reduce the outstanding principal amount of such 2013 PIK Notes to \$35.0 million. The balance of the offering proceeds is expected to be used to pay down outstanding borrowings under the ABL Facility.

## **Table of Contents**

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

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

#### ***OVERVIEW***

We operate the largest chemical bulk tank truck network in North America through our wholly owned subsidiary, QCI, and are the largest North American provider of intermodal tank container and depot services through our wholly owned subsidiary, Boasso.

##### *Trucking Services*

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 Ashland, BASF, Dow, DuPont, ExxonMobil, Georgia-Pacific, Honeywell, PPG Industries, Procter & Gamble, Sunoco and Unilever, and we provide services to most of the top 100 chemical producers with United States operations. We believe the diversity of our customer base, geography and end-markets provides a competitive advantage.

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. We have recently experienced some year-over-year volume improvements and believe this trend could continue as the economy recovers. 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.

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

##### *Container Services*

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

Demand for intermodal tank containers is driven 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 and volume of shipments through ports at which Boasso has terminals, as well as 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 Network*

Our bulk service network consists primarily of independently owned third-party affiliate terminals, independent owner-operator drivers and company-operated terminals. Independent affiliates are independent companies we contract with to operate trucking terminals on our behalf in defined markets generally on an exclusive basis. The independent affiliates provide the capital necessary to service their contracted business and are also responsible for most of the operating costs associated with servicing the contracted business. Independent owner-operators are generally

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

individual drivers who own or lease their tractors and agree to provide transportation services to us under contract. We believe the use of independent affiliates and independent owner-operators provides the following key competitive advantages to us in the marketplace:

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

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

---

## **Table of Contents**

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

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

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

We believe the most significant factors relevant to our future business growth are the ability to (i) obtain additional business from existing customers, (ii) add new customers, (iii) 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 with major chemical shippers and flexible business model, we believe we are well-positioned to benefit from customers seeking consolidation of their shipping relationships.

### *Note Exchange*

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 of our 9% Notes in exchange for approximately (a) \$80.7 million aggregate principal amount of our new 2013 PIK Notes; (b) 1.75 million warrants; and (c) \$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. As of September 30, 2010, approximately 1.3 million warrants have been exercised.

### *Senior Note Offering*

On November 3, 2010, our wholly owned subsidiaries, Quality Distribution, LLC and QD Capital Corporation, completed an offering of \$225.0 million in aggregate principal amount of 9.875% Second-Priority Senior Secured Notes due 2018 (the 2018 Notes ) at an issue price of 99.324% of par. On November 2, 2010, we sent irrevocable redemption notices to holders of our 10% Senior Notes due 2013 (the 2013 Senior Notes ), Senior Floating Rate Notes due 2012 (the 2012 Notes ) and 11.75% Senior Subordinated PIK Notes due 2013 (the 2013 PIK Notes ). The net proceeds from the offering of the 2018 Notes are expected to be used to fully redeem or repay all of the outstanding 2013 Senior Notes, 9% Senior Subordinated Notes due 2010 (the 9% Notes ) and 2012 Notes. We also intend to apply proceeds to redeem at par, plus accrued and unpaid interest, the principal amount of our 2013 PIK Notes sufficient to reduce the outstanding principal amount of such 2013 PIK Notes to \$35.0 million. The balance of the offering proceeds is expected to be used to pay down outstanding borrowings under the ABL Facility.

### *Affiliation*

On May 1, 2010, we added F. T. Silfies ( Silfies ) to our independent 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 is subordinated to Silfies senior debt and bears interest at 7% per annum. The loan is repayable over three and one-half years and is secured by a second priority position in all of the assets of Silfies and a limited personal guarantee. We expect this affiliation to generate approximately \$15.0 million of revenue annually following the date of affiliation.

### *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





**Table of Contents**

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. We believe the changes in our business activities as a result of the sale of the tank wash business will reduce our environmental compliance costs going forward.

*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 fair value and an impairment loss would be recognized. This analysis requires us to make significant estimates and assumptions in projecting future cash flows, and changes in facts and circumstances could result in material changes in the amount of any write-offs for impairment.

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

The methodology applied in the analysis performed at June 30, 2010 was consistent with the methodology applied in prior years, but was based on updated assumptions, as appropriate. As a result of our analysis, we concluded no impairment had occurred as of June 30, 2010. As a result of our analysis at June 30, 2009, a total impairment charge to goodwill of \$146.2 million was necessary, 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.

**Goodwill**

Under the FASB guidance, the process of evaluating the potential impairment of goodwill involves a two-step process and requires significant judgment at many points during the analysis. In the first step, we determine whether there is an indication of impairment by comparing the fair

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

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

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

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

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.

### 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.

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

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

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

deferred tax asset was realizable. As a result, a \$41.2 million deferred tax valuation allowance was recorded in 2009. For purposes of assessing realizability of the deferred tax assets, a 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. The

## **Table of Contents**

Company reviews a rolling thirty-six month calculation of U.S. earnings to determine if the Company is in a cumulative loss position. As of September 30, 2010, the Company is in a net cumulative loss position. Our judgments regarding future taxable income may change due to changes in market conditions, changes in tax laws, operating results or other factors.

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 independent affiliates, and workers' compensation insurance coverage on our employees and company drivers. This insurance includes deductibles of \$2.0 million per incident for bodily injury and property damage and \$1.0 million for workers' compensation. As such, we are subject to liability as a self-insurer to the extent of these deductibles under the policy. We are self-insured for damage to the equipment we own or lease and for cargo losses. As of September 30, 2010, we had \$25.2 million in an outstanding letter of credit to our insurance administrator to guarantee the self-insurance portion of our liability. If we fail to meet certain terms of our agreement, the insurance administrator may draw down the letter of credit. In developing liability reserves, we rely on professional third party claims administrators, insurance company estimates and the judgment of our own personnel, and independent professional actuaries and attorneys. The most significant assumptions used in the estimation process include determining the trends in loss costs, the expected consistency in the frequency and severity of claims incurred but not yet reported to prior-year claims, and expected costs to settle unpaid claims. Management believes reserves are reasonable given known information, but as each case develops, estimates may change to reflect the effect of new information.

*Revenue recognition* Transportation revenue, including fuel surcharges and related costs, 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 independent 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. During the periods that we operated our tank wash business, tank wash revenues were recognized when the wash was 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 owner-operators and independent affiliates. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, an additional allowance could be required.

*Stock compensation plans* Stock compensation is determined by the assumptions required under the FASB guidance. The fair values of stock option grants are based upon the Black-Scholes option-pricing model and amortized as compensation expense on a straight-line basis over the vesting period of the grants. Restricted stock awards are issued and measured at market value on the date of grant and related compensation expense is recognized over time on a straight-line basis over the vesting period of the grants. Stock-based compensation expense related to stock options and restricted stock was \$1.7 million for the nine months ended September 30, 2010 and \$0.4 million for the nine months ended

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

September 30, 2009. As of September 30, 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.

---

**Table of Contents**

*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. In 2008, we recorded restructuring charges of \$5.3 million. We continued our plan of restructure throughout 2009 which resulted in charges of \$3.5 million. Our restructuring plan continued in 2010 and resulted in charges of \$4.6 million for the nine-month period ended September 30, 2010 of which \$2.0 million relates to our estimated withdrawal liability from three multi-employer pension plans. The majority of the restructuring charges related to our trucking segment and were for charges related to employee termination benefits, other related exit activities and the termination of approximately 380 non-driver positions. We expect to conclude our restructuring plan in 2010 and to take additional related charges during the year. As of September 30, 2010, approximately \$3.0 million was accrued related to the restructuring charges of which the majority is expected to be paid through 2022.

*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 and nine months ended September 30, 2010 and 2009:

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
<b>OPERATING REVENUES:</b>				
Transportation	72.9%	74.0%	73.2%	74.3%
Other service revenue	15.5	16.4	15.2	17.4
Fuel surcharge	11.6	9.6	11.6	8.3
<b>Total operating revenues</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>OPERATING EXPENSES:</b>				
Purchased transportation	70.1	62.9	69.4	59.1
Compensation	7.8	11.7	8.3	13.4
Fuel, supplies and maintenance	7.0	9.9	7.1	10.7
Depreciation and amortization	2.2	3.1	2.4	3.4
Selling and administrative	3.2	3.4	2.9	4.2
Insurance costs	2.1	1.9	2.2	2.4
Taxes and licenses	0.2	0.6	0.3	0.6
Communication and utilities	0.5	1.3	0.6	1.4
Loss on disposal of property and equipment	0.2	0.2	0.2	0.0
Impairment of goodwill and intangibles	0.0	0.0	0.0	32.1
Restructuring costs	1.3	0.2	0.9	0.5
<b>Total operating expenses</b>	<b>94.6</b>	<b>95.2</b>	<b>94.3</b>	<b>127.8</b>
<b>Operating income (loss)</b>	<b>5.4</b>	<b>4.8</b>	<b>5.7</b>	<b>(27.8)</b>
Interest expense	4.8	4.0	5.0	4.3
Interest income	(0.1)	0.0	(0.1)	0.0
Gain on extinguishment of debt	0.0	0.0	0.0	(0.1)
Other expense	0.0	0.0	0.1	0.0
<b>Income (loss) before income taxes</b>	<b>0.7</b>	<b>0.8</b>	<b>0.7</b>	<b>(32.0)</b>
<b>Provision for income taxes</b>	<b>0.5</b>	<b>0.0</b>	<b>0.1</b>	<b>8.0</b>
<b>Net income (loss)</b>	<b>0.2%</b>	<b>0.8%</b>	<b>0.6%</b>	<b>(40.0)%</b>

The following table shows the approximate number of terminals, drivers, tractors and trailers, in our network (including independent affiliates and independent owner-operators) as of September 30:

	2010	2009
Terminals	106	139



Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Drivers	2,839	2,735
Tractors	3,031	2,975
Trailers	6,127	6,455

As of September 30, our network terminals consisted of the following:

	Segment	2010 Terminals	2009 Terminals
QCI independent affiliate trucking terminals	Trucking	92	82
QCI company-operated trucking terminals	Trucking	6	20
Boasso container services terminals	Container Services	8	8
QSI tank wash facilities	Other		29
<b>Total</b>		<b>106</b>	<b>139</b>

**Table of Contents**

We reduced our total number of terminals by 37% from 169 to 106 during 2008, 2009 and 2010, while transitioning most of the business from these under-performing terminals to our remaining terminals and affiliating many company-owned terminals. At September 30, 2010, 92 of our 98 trucking terminals were affiliate operated, compared with 55 of 121 at December 31, 2007. The strength of our affiliates has led to a simpler, more efficient business model with improved customer service.

We own or lease approximately 5,200 tank or specialty trailers, the majority of which we lease or sublease to our independent affiliates who have significant contractual limitations on their ability to lease or purchase trailers from sources other than us. We prefer to own the trailers as they provide us with a stable source of lease income, as well as access to attractive capital through our asset-based loan facility (the ABL Facility). We view the trailer leasing business as attractive given the low upfront costs, long useful life, limited maintenance and attractive return on investment. The tank and specialty trailers generally have long useful lives and we believe that increasing their utilization can significantly improve our operating income due to high operating leverage. Through proper maintenance, we are typically able to extend the useful lives of trailers beyond 15-20 years, leading to operational flexibility.

**Three Months Ended September 30, 2010 Compared to Three Months Ended September 30, 2009**

For the quarter ended September 30, 2010, total revenues were \$181.9 million, an increase of \$19.1 million, or 11.8%, from revenues of \$162.8 million for the same period in 2009. Transportation revenue increased by \$12.2 million, or 10.2%, primarily due to higher linehaul revenue resulting from an increase in demand, predominantly from existing customers. Revenue increases were primarily driven by an increase in volume, which resulted in a 6.2% increase in the total number of miles driven and a 7.7% increase in loads versus the prior-year quarter. To a lesser extent, revenues were positively affected by a modest increase in average rates.

Other service revenue increased \$1.4 million, or 5.2%. This increase was primarily due to the increase in rental revenue of \$3.5 million due to the conversion of certain company-operated terminals to independent affiliate terminals and an increase in container services revenues of \$2.4 million. This was partially offset by a reduction in tank wash revenue of \$4.5 million due to the sale of our tank wash business in the fourth quarter of 2009. Fuel surcharge revenue increased \$5.5 million, or 35.5%, due to the increase in linehaul revenue and fuel prices.

Purchased transportation increased by \$25.1 million, or 24.5%, due primarily to the increase in linehaul revenue, miles driven and loads. Total purchased transportation as a percentage of transportation revenue and fuel surcharge revenue increased to 82.9% for the current quarter versus 75.3% for the prior-year quarter due primarily to the conversion of certain company-operated terminals to independent affiliate terminals. Our independent affiliates generated 94.3% of our transportation revenue and fuel surcharge revenue for the three months ended September 30, 2010 compared to 76.8% for the comparable prior-year period. We pay our independent affiliates a greater percentage of transportation revenues generated by them than is paid to independent owner-operators, so our purchased transportation costs will change as revenues generated by independent affiliates change as a percentage of total transportation revenue. During the three-month period ended September 30, 2010 and 2009, we paid our affiliates approximately 85% of the revenue (excluding fuel surcharges) generated on loads hauled, while we typically paid independent owner-operators approximately 65% of the invoiced linehaul amount. We believe that the greater proportion of operating revenue derived from independent affiliate operations during the three-month period ended September 30, 2010 is likely to be indicative of the proportion of operating revenue derived from independent affiliate operations in the future due to the sale of our tank wash business in the fourth quarter of 2009, our addition of a new affiliate during the second quarter of 2010, and our affiliation of company owned terminals during 2009 and 2010.

In 2009 and 2010, we transitioned certain company-operated terminals to independent affiliates which resulted in a larger portion of our revenue being generated by independent affiliates. We believe these actions have reduced certain fixed costs and provided a more variable cost structure.

Compensation expense decreased \$4.9 million, or 25.9%, primarily due to \$4.0 million of reduced expense from corporate headcount reductions, terminal consolidations, and conversions of company-operated terminals to independent affiliate terminals, partially offset by an increase in Boasso operations of \$0.6 million. In addition, we had a reduction in compensation expense of \$1.5 million due to the sale of our tank wash business.

Fuel, supplies and maintenance decreased \$3.5 million, or 21.5%, due to lower fuel costs of \$1.3 million, lower repairs and maintenance of \$1.2 million related to our trucking segment and lower equipment rent expense of \$0.4 million due to the shift of revenue from company-operated terminals to independent affiliates. In addition, tank wash operations had a decrease of \$2.2 million due to the sale of this business offset by an increase of \$1.6 million of repairs and maintenance related to our container services segment.

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

Depreciation and amortization expense decreased \$1.1 million, or 22.3%, 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.

## Table of Contents

Selling and administrative expenses increased by \$0.3 million, or 5.4%, primarily due to an increase in professional fees of \$1.4 million partially offset by a decrease in bad debt expense of \$0.3 million and a \$0.4 million reduction in building rent expense and other expenses related to closed or converted terminals. In addition, tank wash operations had a decrease of \$0.4 million due to the sale of this business.

Insurance expense increased by \$0.7 million, or 23.7%, due primarily to a slight increase in the amount of claims incurred in the current quarter ended September 30, 2010.

Communication and utilities expense decreased \$0.9 million, or 45.9%, primarily due to reduced expense from terminal consolidations, conversions of company-operated terminals to independent affiliate terminals and due to the sale of our tank wash business.

We incurred a loss on disposal of assets of \$0.3 million in each of the quarters ended September 30, 2010 and 2009. These losses resulted primarily from the disposal of equipment.

In the third quarter of 2010 we incurred additional restructuring costs of \$2.4 million as compared to \$0.3 million in the third quarter of 2009 primarily due to the continuation of our restructuring plan which began during the second quarter of 2008. For the quarter ended September 30, 2010, these costs consisted primarily of \$2.0 million for an estimated withdrawal liability from three multi-employer pension plans, as well as an additional \$0.4 million of other expenses related to exit activities. For the quarter ended September 30, 2009, these costs consisted of employee termination benefits and other related exit activities.

For the quarter ended September 30, 2010, operating income totaled \$9.8 million, an increase of \$1.9 million, or 24.6%, compared to operating income of \$7.9 million for the same period in 2009. The operating margin for the quarter ended September 30, 2010, was 5.4% compared to 4.8% for the same period in 2009 as a result of the above-mentioned items.

Interest expense increased by \$2.3 million, or 35.2%, in the quarter ended September 30, 2010 as compared to the same period in 2009, due to the higher interest rates on our 2013 Senior Notes and 2013 PIK Notes as compared to the rates on the notes for which they were exchanged in the fourth quarter of 2009.

The provision for income taxes was \$0.8 million for the quarter ended September 30, 2010 compared to less than \$0.1 million for the same period in 2009. The effective tax rates for the quarters ended September 30, 2010 and 2009 were approximately 66.7% and 2.8%, respectively. The change in income taxes was primarily due to the recording of a deferred tax valuation allowance during 2009.

For the quarter ended September 30, 2010, our net income was \$0.4 million, compared to net income of \$1.4 million for the same period last year.

### **Nine Months Ended September 30, 2010 Compared to Nine Months Ended September 30, 2009**

For the nine months ended September 30, 2010, total revenues were \$520.8 million, an increase of \$58.5 million, or 12.7%, from revenues of \$462.3 million for the same period in 2009. Transportation revenue increased by \$37.5 million, or 10.9%, primarily due to an increase in linehaul revenue due to an increase in demand. We had a 6.5% increase in the total number of miles driven and a 5.5% increase in loads from the prior-year nine months.

Other service revenue decreased \$0.7 million, or 0.9%. This decrease was primarily due to reductions in tank wash revenue of \$13.0 million offset by an increase of \$8.6 million in rental revenue and \$3.7 million in container services revenues. Fuel surcharge revenue increased \$21.7 million, or 56.3%, due to the increase in linehaul revenue and a slight increase in fuel prices.

Purchased transportation increased by \$88.2 million, or 32.3%, due primarily to the increase in affiliation, linehaul revenue, miles driven and loads. Total purchased transportation as a percentage of transportation revenue and fuel surcharge revenue increased to 81.9% for the current nine months versus 71.5% for the prior-year nine months due primarily to the conversion of certain company-operated terminals to independent affiliate terminals. Our independent affiliates generated 93.5% of our transportation revenue and fuel surcharge revenue for the nine months ended September 30, 2010 compared to 68.0% for the comparable prior-year period.

Compensation expense decreased \$18.8 million, or 30.4%, primarily due to \$16.3 million of reduced expense from corporate headcount reductions, terminal consolidations, and conversions of company-operated terminals to independent affiliate terminals offset by a \$2.0 million

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

increase in Boasso operations. In addition, tank wash operations had a decrease of \$4.5 million due to the sale of this business.

Fuel, supplies and maintenance decreased \$12.6 million, or 25.4%, due to lower fuel costs of \$4.3 million, lower repairs and maintenance of \$4.1 million related to our trucking segment and lower equipment rent expense of \$0.9 million due to the shift of revenue from company-operated terminals to independent affiliates. In addition, tank wash operations had a decrease of \$5.5 million due to the sale of this business offset by an increase of \$2.2 million of repairs and maintenance related to our container services segment.

## Table of Contents

Depreciation and amortization expense decreased \$3.5 million, or 22.0%, 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 \$4.5 million, or 22.9%, primarily due to a decrease in our bad debt reserve of \$2.1 million and a \$1.2 million reduction in building rent expense and other expenses related to closed or converted terminals. In addition, tank wash operations had a decrease of \$1.2 million due to the sale of this business.

Insurance expense increased by \$0.6 million, or 5.5%, due primarily to a slight increase in the amount of claims incurred in the current year period.

Communication and utilities expense decreased \$3.5 million, or 51.2%, primarily due to reduced expense from terminal consolidations, and conversions of company-operated terminals to independent affiliate terminals.

We incurred a loss on disposal of assets of \$1.0 million for the nine months ended September 30, 2010, as compared to a loss of less than \$0.1 million in the comparable prior-year period resulting primarily from the disposal of equipment.

For the nine months ended September 30, 2009, we recorded a non-cash impairment charge to goodwill and intangibles totaling \$148.6 million as a result of our impairment analysis, which is performed at least annually every June 30 on both our trucking and container services segments. We recorded a charge of \$144.3 million for the impairment of goodwill in our trucking segment. We also recorded a charge of \$1.9 million for the impairment of goodwill in our container services segment and a charge of \$2.4 million for the impairment of the trade name in our container services segment. We incurred no such charges for the nine months ended September 30, 2010.

For the nine months ended September 30, 2010, we incurred additional restructuring costs of \$4.6 million as compared to \$2.1 million during the nine months ended September 30, 2009, primarily due to the continuation of our restructuring plan which began during the second quarter of 2008. For the nine months ended September 30, 2010, these costs consisted primarily of \$2.0 million for an estimated withdrawal liability from three multi-employer pension plans, as well as an additional \$2.6 million of other expenses related to exit activities. For the nine months ended September 30, 2009, these costs consisted of employee termination benefits and other related exit activities.

For the nine months ended September 30, 2010, operating income totaled \$29.7 million, an increase of \$159.0 million or more than 100.0%, compared to an operating loss of \$129.3 million for the same period in 2009 primarily due to the non-cash impairment charge to goodwill and intangibles in 2009. The operating margin for the nine months ended September 30, 2010, was 5.7% compared to (27.8%) for the same period in 2009 as a result of the above-mentioned items.

Interest expense increased by \$6.1 million, or 30.3%, in the nine months ended September 30, 2010 compared to the same period in 2009, 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. In 2009, gain on debt extinguishment of \$0.7 million resulted from the repurchase of \$1.0 million of our 9% Notes.

The provision for income taxes was \$0.7 million for the nine months ended September 30, 2010 compared to a provision for income taxes of \$37.0 million for the same period in 2009. The effective tax rates for the nine months ended September 30, 2010 and 2009 were approximately 17.2% and (24.9%), respectively. The change in income taxes was primarily due to the recording of a deferred tax valuation allowance during 2009.

For the nine months ended September 30, 2010, our net income was \$3.3 million, compared to a net loss of \$185.1 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 intermodal tank container transportation and depot services.

**Table of Contents**

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, impairment charge, restructuring costs, and corporate and other unallocated amounts. Corporate and unallocated amounts include depreciation and amortization and other gains and losses. Although these amounts are excluded from the business segment results, they are included in reported consolidated earnings. Included in Other revenue are revenues from our equipment rental, our tank wash services for periods we operated our tank wash business 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 September 30,				Change	
	2010	% of Total	2009	% of Total	\$	%
<b>Operating revenues:</b>						
Trucking	\$ 137,043	75.3%	\$ 123,053	75.6%	13,990	11.4%
Container Services	27,052	14.9%	20,248	12.4%	6,804	33.6%
Other revenue	17,853	9.8%	19,504	12.0%	(1,651)	(8.5%)
<b>Total</b>	<b>\$ 181,948</b>	<b>100.0%</b>	<b>\$ 162,805</b>	<b>100.0%</b>		

	Three months ended September 30,				Change	
	2010	% of Total	2009	% of Total	\$	%
<b>Operating income:</b>						
Trucking	\$ 10,900	66.1%	\$ 9,803	72.2%	1,097	11.2%
Container Services	4,906	29.8%	2,754	20.3%	2,152	78.1%
Other operating income	673	4.1%	1,013	7.5%	(340)	(33.6%)
<b>Total</b>	<b>\$ 16,479</b>	<b>100.0%</b>	<b>\$ 13,570</b>	<b>100.0%</b>		

	Nine months ended September 30,				Change	
	2010	% of Total	2009	% of Total	\$	%
<b>Operating revenues:</b>						
Trucking	\$ 393,306	75.5%	\$ 347,671	75.2%	45,635	13.1%
Container Services	76,485	14.7%	58,027	12.6%	18,458	31.8%
Other revenue	51,042	9.8%	56,625	12.2%	(5,583)	(9.9%)
<b>Total</b>	<b>\$ 520,833</b>	<b>100.0%</b>	<b>\$ 462,323</b>	<b>100.0%</b>		

	Nine months ended September 30,				Change	
	2010	% of Total	2009	% of Total	\$	%
<b>Operating income:</b>						
Trucking	\$ 32,611	68.5%	\$ 25,492	68.7%	7,119	27.9%
Container Services	13,108	27.6%	8,044	21.7%	5,064	63.0%
Other operating income	1,844	3.9%	3,565	9.6%	(1,721)	(48.3%)
<b>Total</b>	<b>\$ 47,563</b>	<b>100.0%</b>	<b>\$ 37,101</b>	<b>100.0%</b>		

**Three Months Ended September 30, 2010 Compared to Three Months Ended September 30, 2009**

Operating revenue:



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

*Trucking* revenues increased \$14.0 million, or 11.4%, for the quarter ended September 30, 2010 compared to the same period for 2009, due to an increase of \$9.4 million in linehaul revenue and an increase of \$4.6 million of fuel surcharge.

*Container Services* revenues increased \$6.8 million, or 33.6%, for the quarter ended September 30, 2010 compared to the same period for 2009, due to an increase of \$5.9 million in linehaul and depot revenue and an increase of \$0.9 million of fuel surcharge.

*Other revenue* revenues decreased \$1.7 million, or 8.5%, for the quarter ended September 30, 2010 compared to the same period for 2009, due primarily to a decrease in our tank wash revenue due to the sale of our tank wash business partially offset by an increase in trailer rental income.

**Table of Contents**

Operating income:

*Trucking* operating income increased \$1.1 million, or 11.2%, for the quarter ended September 30, 2010 compared to the same period for 2009, due to an increase in linehaul revenue and cost savings initiatives including conversion of company-operated terminals to independent affiliate terminals.

*Container Services* operating income increased \$2.2 million, or 78.1%, for the quarter ended September 30, 2010 compared to the same period for 2009, due to increased demand from existing customers.

*Other operating income* operating income decreased \$0.3 million, or 33.6%, for the quarter ended September 30, 2010 compared to the same period for 2009, due primarily to reduced tank wash revenue due to the sale of our tank wash business.

**Nine Months Ended September 30, 2010 Compared to Nine Months Ended September 30, 2009**

Operating revenue:

*Trucking* revenues increased \$45.6 million, or 13.1%, for the nine months ended September 30, 2010 compared to the same period for 2009 due to an increase of \$27.2 million in linehaul revenue and an increase of \$18.4 million of fuel surcharge.

*Container Services* revenues increased \$18.5 million, or 31.8%, for the nine months ended September 30, 2010 compared to the same period for 2009 due to an increase of \$15.3 million in linehaul and depot revenue and an increase of \$3.2 million of fuel surcharge.

*Other revenue* revenues decreased \$5.6 million, or 9.9%, for the nine months ended September 30, 2010 compared to the same period for 2009 due primarily to a decrease in our tank wash revenue partially offset by an increase in trailer rental income.

Operating income:

*Trucking* operating income increased \$7.1 million, or 27.9%, for the nine months ended September 30, 2010 compared to the same period for 2009 due to an increase in linehaul revenue and cost savings initiatives including conversion of company-operated terminals to independent affiliate terminals.

*Container Services* operating income increased \$5.1 million, or 63.0%, for the nine months ended September 30, 2010 compared to the same period for 2009 due to increased demand.

*Other operating income* operating income decreased \$1.7 million, or 48.3%, for the nine months ended September 30, 2010 compared to the same period for 2009, primarily due to reduced tank wash revenue due to the sale of our tank wash business.

*Liquidity and Capital Resources*

We believe that our liquidity, expected cash flow from our asset-light business model and reduced spending from 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. At September 30, 2010, we had \$65.3 million of borrowing availability under the ABL Facility; we consider our ABL Facility availability to be a key measurement of liquidity.

The following summarizes our cash flows for the nine months ended September 30, 2010 and 2009 as reported in our consolidated statements of cash flows in the accompanying consolidated financial statements (in thousands):

Nine months ended September 30,	
2010	2009

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

Net cash provided by operating activities	\$ 11,358	\$ 29,213
Net cash used in investing activities	(2,601)	(630)
Net cash used in financing activities	(10,352)	(32,574)
Effect of exchange rate changes on cash	3	35
Net decrease in cash and cash equivalents	(1,592)	(3,956)
Cash and cash equivalents at beginning of period	5,633	6,787
Cash and cash equivalents at end of period	\$ 4,041	\$ 2,831

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. Our extensive use of independent affiliates and independent owner-operators results in a

**Table of Contents**

highly variable cost structure with relatively minimal capital investment requirements. Based on our current trailer fleet, we believe we have the ability to capture any additional business volume with minimal capital expenditures. Due to our recent transition to a predominantly affiliate-based business model, we expect our net capital expenditures to generally amount to approximately 1% of operating revenues annually. Capital expenditures for the nine months ended September 30, 2010 were \$8.1 million and sales of equipment for the nine months ended September 30, 2010 were \$5.5 million. We expect capital expenditures for 2010 to be approximately \$11.0 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.

As noted above, we expect to redeem or repay our 9% Notes, our 2012 Notes, our 2013 Senior Notes and \$47.9 million of our 2013 PIK Notes with proceeds from the offering of our 2018 Notes. We expect to incur increased interest expense of approximately \$2.0 million during the fourth quarter of 2010 as our 2018 Senior Notes, 2013 Senior Notes, 2013 PIK Notes and 2012 Notes will all remain outstanding until the redemptions described above are completed. We also expect to incur charges during the fourth quarter related to the write off of unamortized original issue discount and debt issuance costs to be in the range of \$6.0 million to \$8.0 million.

We expect cash from operations to be sufficient to fund anticipated financing expenditures in the fourth quarter of 2010. In this regard, our working capital at September 30, 2010 was \$7.9 million higher than our net working capital at December 31, 2009. We expect to fund any cash needs for our operations during the remainder of 2010 from borrowings under our ABL Facility to the extent these needs cannot be funded with cash from operations.

As of September 30, 2010, we have accrued \$10.5 million for environmental claims and \$17.8 million for loss and damage claims and the timing of the cash payment for such claims fluctuates from quarter to quarter.

Net cash provided by operating activities was \$11.4 million for the nine-month period ended September 30, 2010 compared to \$29.2 million provided by operating activities in the comparable 2009 period. The \$17.8 million decrease in cash provided by operating activities was primarily due to an increase in accounts receivable in the 2010 period resulting from higher revenue.

Net cash used in investing activities totaled \$2.6 million for the nine-month period ended September 30, 2010 compared to \$0.6 million used in the comparable 2009 period. The \$2.0 million change resulted from an increase in capital expenditures, partially offset by a decrease in property and equipment sales proceeds received in 2010.

Net cash used in financing activities was \$10.4 million during the nine-month period ended September 30, 2010, compared to \$32.6 million used in financing activities in the comparable 2009 period. In the 2010 period, cash was primarily utilized to repay \$2.8 million under our ABL Facility, to pay a large insurance claim, issue a loan to a new independent affiliate and to pay down debt and capital lease obligations totaling \$7.5 million. In the 2009 period, cash was primarily utilized to repay \$12.0 million of borrowings under our ABL Facility, to pay down other debt and capital lease obligations totaling \$13.5 million and to 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 and Commitments**

The following is a schedule of our long-term contractual commitments, including the current portion of our long-term indebtedness at September 30, 2010 over the periods we expect them to be paid (in thousands):

		Years 2011	Years 2013	
Total	Remainder of 2010	& 2012	& 2014	Year 2015 and after

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Operating leases (1)	\$ 35,378	\$ 4,567	\$ 16,099	\$ 8,188	\$ 6,524
Total indebtedness (2)	310,013	16,733	6,005	286,144	1,131
Capital leases	13,143	1,090	9,147	2,906	
Interest on indebtedness (3)	78,872	8,828	53,998	15,946	100
Total	\$ 437,406	\$ 31,218	\$ 85,249	\$ 313,184	\$ 7,755

- (1) These obligations represent the minimum rental commitments under all non-cancelable operating leases including the guaranteed residual values at the end of the leases. Commitments also include the operating lease for our corporate headquarters. We expect that some of our operating lease obligations for tractors and trailers will be partially offset by rental revenue from subleasing the tractors to independent affiliates and independent owner-operators and subleasing trailers to independent affiliates.

**Table of Contents**

- (2) Amounts do not include the remaining aggregate unamortized original issue discount of \$6.9 million.
- (3) Amounts presented for interest payments assume that all long-term debt obligations outstanding as of September 30, 2010 will remain outstanding until maturity and interest rates on variable-rate debt in effect as of September 30, 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.

The following is a schedule of our long-term contractual commitments, including the current portion of our long-term indebtedness, at September 30, 2010, over the periods we expect them to be paid (dollars in thousands), after giving effect to the sale of 2018 Notes described above and the application of the offering net proceeds to repay or redeem all of our outstanding 2012 Notes, 2013 Senior Notes and 9% Notes and to redeem a portion of the 2013 PIK Notes and partially repay amounts outstanding under our ABL Facility:

	Total	Remainder of 2010	Years 2011 & 2012	Years 2013 & 2014	Year 2015 and after
Operating leases (1)	\$ 35,378	\$ 4,567	\$ 16,099	\$ 8,188	\$ 6,524
Total indebtedness (2)	314,885	702	5,504	82,548	226,131
Capital leases	13,143	1,090	9,147	2,906	
Interest on indebtedness (3)	206,376	9,423	59,985	49,845	87,123
<b>Total</b>	<b>569,782</b>	<b>15,782</b>	<b>90,735</b>	<b>143,487</b>	<b>319,778</b>

- (1) These obligations represent the minimum rental commitments under all non-cancelable operating leases including the guaranteed residual values at the end of the leases. Commitments also include the operating lease for our corporate headquarters. We expect that some of our operating lease obligations for tractors and trailers will be partially offset by rental revenue from subleasing the tractors to independent affiliates and independent owner-operators and subleasing trailers to independent affiliates.
- (2) Amounts do not include the remaining aggregate unamortized original issue discount.
- (3) Amounts presented for interest payments assume that all long-term debt obligations outstanding as of September 30, 2010 on a proforma basis will remain outstanding until maturity and interest rates on variable-rate debt in effect as of September 30, 2010 (excluding amounts repaid with proceeds from the 2018 Senior Notes issuance) 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 September 30, 2010, we have \$10.5 million of environmental liabilities, \$17.2 million of pension plan obligations and \$17.8 million of accrued loss and damage claims. 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 associated with our subsidiary, CLC. We believe the changes in our business activities as a result of the sale of the tank wash business will reduce our exposure to environmental compliance costs going forward. As of September 30, 2010, we had \$30.6 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 September 30, 2010 for our insurance administrator was \$25.2 million. If we fail to meet certain terms of our agreement, the insurance administrator may draw down the entire letter of credit. The remaining \$5.4 million of outstanding letters of credit relates to various leasing obligations and to satisfy certain federal and state environmental agency requirements. As of September 30, 2010, we have a reserve related to uncertain tax positions of \$2.3 million which includes total unrecognized tax benefits and interest and penalties that may be paid in future periods.

**Long-term Debt**

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

	September 30, 2010	December 31, 2009
Capital lease obligations	\$ 13,143	\$ 17,165
ABL Facility	65,200	68,000

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

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	82,897	81,211
Other Notes	10,885	12,560

**Table of Contents**

	September 30, 2010	December 31, 2009
Long-term debt, including current maturities	323,156	329,967
Discount on Notes	(6,928)	(8,683)
	316,228	321,284
Less current maturities of long-term debt (including capital lease obligations)	(23,239)	(25,188)
Long-term debt, less current maturities	\$ 292,989	\$ 296,096

Following September 30, 2010, our long-term debt balances will be impacted by the sale of the 2018 Notes, the expected repayment of the 9% Notes and partial repayment of amounts outstanding under our ABL Facility described above and are expected to be further impacted by the redemptions of our 2012 Notes, our 2013 Senior Notes and \$47.9 million of our 2013 PIK Notes, for which we have given notice as described above but not yet consummated.

**The ABL Facility**

The ABL Facility, which was effective December 18, 2007, consists of \$225.0 million of aggregate revolving credit commitments. The commitments are comprised of two tranches (i) a current asset-based revolving facility in an amount of \$200.0 million (the current asset tranche) and (ii) 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. There are no other scheduled changes to the committed facilities. 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. A portion of 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 September 30, 2010, we had \$65.3 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 September 30, 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 September 30, 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 September 30, 2010 and 2009 was 2.3%.

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.





---

**Table of Contents**

In connection with the issuance of the 2018 Notes, the ABL Facility was amended October 22, 2010 to permit our issuance of the 2018 Notes, which included the granting of a second-priority lien on certain of our assets. All of the liens securing the ABL Facility will be senior to the liens securing the 2018 Notes and will be treated as first priority obligations for such purposes.

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

***9% 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 and retire approximately \$83.6 million of our 9% Notes for \$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. 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 September 30, 2010, approximately \$16.0 million total principal amount of the 9% Notes remained outstanding and will be repaid on or before November 15, 2010.

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. The 9% Notes have a maturity date of 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 balance (less than \$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 September 30, 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 have a maturity date of 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 September 30, 2010 and 2009 was 5.0%.

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 have a maturity date of June 1, 2013. On May 17, 2010, we satisfied our contractual obligation to exchange the 2013 Senior Notes sold in October 2009

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

for 2013 Senior Notes registered under the Securities Act.

## **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.

### ***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. On May 17, 2010, we satisfied our contractual obligation to exchange the 2013 PIK Notes sold in October 2009 for 2013 PIK Notes registered under the Securities Act.

The 2013 PIK Notes mature on November 1, 2013. We may redeem the 2013 PIK Notes, in whole or in part, at any time 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. 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 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.

Each note exchange completed October 15, 2009 described above was treated as a debt modification in accordance with applicable FASB guidance.

### ***Boasso Note***

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 was exercised on December 18, 2008. The Boasso note was paid in full in January 2009.

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

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

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 independent 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; 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.

**Table of Contents**

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 independent 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 September 30, 2010.

Following September 30, 2010, the instruments governing our long-term debt will be impacted by the issuance of the 2018 Notes and the repayment of the 9% Notes described above and are expected to be impacted by the redemptions of our 2012 Notes, 2013 Senior Notes and 2013 PIK Notes, for which we have given notice as described above but not yet consummated. The indenture governing our 2018 Notes contains covenants with restrictions on our ability to take certain actions and entitles the holders of such notes to a second-priority lien on certain of our assets. Upon the expected redemption in full of our 2013 Senior Notes, we will no longer be subject to the restrictions contained in the indentures governing these notes. We do not anticipate that any of these changes will have a material impact on our operations for the remainder of 2010.

*Debt Retirement*

The following is a schedule of our indebtedness at September 30, 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	\$ 1,090	\$ 4,313	\$ 4,834	\$ 2,322	\$ 584	\$ 13,143
ABL Facility				65,200		65,200
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)				82,897		82,897
Other Notes	702	2,848	2,656	2,601	2,078	10,885
Total	\$ 17,823	\$ 7,161	\$ 7,991	\$ 287,519	\$ 2,662	\$ 323,156

(1) Amounts do not include the remaining aggregated unamortized original issue discount of \$6.9 million.

The following is a schedule of our indebtedness at September 30, 2010, over the periods we are required to pay such indebtedness, after giving effect to the sale of 2018 Notes described above and the application of the offering net proceeds to repay or redeem all of our outstanding 2012 Notes, 2013 Senior Notes and 9% Notes and to redeem a portion of the 2013 PIK Notes and partially repay amounts outstanding under our ABL Facility:

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

	<b>Remainder of 2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014 and after</b>	<b>Total</b>
Capital lease obligations	\$ 1,090	\$ 4,313	\$ 4,834	\$ 2,322	\$ 584	\$ 13,143
ABL Facility				44,000		44,000
9% Senior Subordinated Notes, due 2010						
Senior Floating Rate Notes, due 2012						
10% Senior Notes, due 2013						

**Table of Contents**

	Remainder of 2010	2011	2012	2013	2014 and after	Total
11.75% Senior Subordinated PIK Notes, due 2013 (1)				35,000		35,000
9.875% Senior Notes due 2018 (1)					225,000	225,000
Other Notes	702	2,848	2,656	2,601	2,078	10,885
Total	\$ 1,792	\$ 7,161	\$ 7,490	\$ 83,923	\$ 227,662	\$ 328,028

(1) Amounts do not include the remaining unamortized original issue discount. The following is a schedule of our debt issuance costs (in thousands):

	December 31, 2009 Balance	Amortization Expense	September 30, 2010 Balance
ABL Facility	\$ 4,284	\$ (946)	\$ 3,338
9% Senior Subordinated Notes, due 2010	69	(61)	8
10% Senior Notes, due 2013	3,425	(762)	2,663
11.75% Senior Subordinated PIK Notes, due 2013	1,426	(283)	1,143
Total	\$ 9,204	\$ (2,052)	\$ 7,152

Amortization expense of debt issuance costs was \$2.1 million for the nine months ending September 30, 2010 and 2009. We are amortizing these costs over the term of the debt instruments but expect to write off a substantial portion of our unamortized debt issuance costs in connection with the anticipated redemptions described above.

**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.

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 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.

The ABL Facility and the indentures governing our 2013 Senior Notes, our 2013 PIK Notes and our 2018 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, the 2013 PIK Notes and the 2018 Notes.



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

Apollo, as our largest 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, our 2013 PIK Notes and our 2018 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

**Table of Contents**

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 negatives of those terms, or other variations of those terms or comparable language, or by discussions of strategy or other intentions.

Forward-looking statements are subject to known and unknown risks, uncertainties and other factors that could cause 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 and our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2010 and June 30, 2010. These factors include:

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

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

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

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 independent affiliate,

changes in required obligations or contributions to multi-employer pension plans,

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

our ability to comply with current and future environmental regulations and the increasing costs relating to environmental compliance 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 successfully identify acquisition opportunities, consummate said acquisitions and integrate acquired businesses,

**Table of Contents**

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.

**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 nine months ended September 30, 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 September 30, 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 September 30, 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 September 30, 2010 (\$ in 000s)	Interest Rate at September 30, 2010	Effect of 1% Increase (\$ in 000s)
ABL Facility	\$ 65,200	2.3%	\$ 652
Senior Floating Rate Notes, due 2012	501	5.0%	5

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

Total	\$ 65,701	657
-------	-----------	-----

At September 30, 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 September 30, 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.

**Table of Contents**

*Foreign Currency Exchange Rate Risk*

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

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

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

These exposures may impact future earnings or cash flows. Revenue from foreign locations (Canada and Mexico) represented approximately 5.5% of our consolidated revenue for the nine months ended September 30, 2010 and 6.2% of our consolidated revenue for the nine months ended September 30, 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.

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 nine months ended September 30, 2010 were positively impacted by a \$3.2 million foreign currency movement, primarily due to the strengthening of the Canadian dollar against the United States dollar.

---

**Table of Contents**

Changes in foreign exchange rates that had the largest impact on translating our international operating profits for the first nine 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 \$0.3 million for the nine months ended September 30, 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.

***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 nine months ended September 30, 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 September 30, 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 September 30, 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 September 30, 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 12. Commitments and Contingencies to our unaudited consolidated financial statements included in this report, we are not currently a party to any material pending legal proceedings other than routine matters incidental to our business and no material developments have occurred in any proceedings described in such Form 10-K.

**ITEM 1A Risk Factors**

You should carefully consider the factors disclosed in our Annual Report on Form 10-K for the year ended December 31, 2009 and in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2010 included under Item 1A Risk Factors, in addition to the other information set forth in this report. The risks described in our Annual Report on Form 10-K and our Quarterly Reports on Form 10-Q are not the only risks facing our Company.

We may be subject to the risks set forth below:

*If we withdraw from any of our multi-employer pension plans, we may be liable for a proportionate share of such plan's unfunded vested benefit liabilities upon our withdrawal.*

At September 30, 2010, we contribute to six multi-employer pension plans for employees under collective bargaining agreements. In conjunction with our restructuring efforts, in the third quarter of fiscal 2010, we notified the trustees of three of these plans of our intention to withdraw from the plans. These three withdrawal notifications are expected to result in an aggregate withdrawal liability of approximately \$2.0 million. Therefore, we recorded a restructuring charge for this amount in the third quarter of fiscal 2010. Approximately \$0.2 million of the total estimated withdrawal liability is expected to be paid within one year of the effective date of our withdrawal from the plans with the remaining \$1.8 million expected to be paid over the next twelve years following the effective date of our withdrawal from the plans.



**Table of Contents**

We do not currently intend to withdraw from the remaining three multi-employer pension plans or take any actions that would trigger a withdrawal liability. Recently proposed FASB accounting standards updates will, if adopted, require additional disclosure regarding our participation in multiemployer pension plans. In this regard and based on information provided to us from the trustees of these plans, we estimate that our portion of the current contingent liability in the case of a complete withdrawal from these plans would be estimated to be in the range of \$54 million to \$60 million. The largest component of this contingent liability is related to the Central States Southeast and Southwest Areas Pension Plan, which is estimated to be in the range of \$50 to \$56 million.

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

None

**ITEM 3 Defaults Upon Senior Securities**

None

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

**ITEM 5 Other Information**

None

**Table of Contents**

**ITEM 6 Exhibits**

**Exhibit**

<b>No.</b>	<b>Description</b>
10.1	Employment Agreement, dated July 16, 2010 between Quality Distribution, Inc. and Joseph J. Troy. Incorporated herein by reference to Exhibit 10.1 to Quality Distribution, Inc.'s Current Report on Form 8-K filed on July 22, 2010.
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.

November 9, 2010

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

November 9, 2010

/s/ JOSEPH J. TROY  
**JOSEPH J. TROY,**  
**EXECUTIVE VICE PRESIDENT AND CHIEF FINANCIAL OFFICER**  
**(PRINCIPAL FINANCIAL AND ACCOUNTING OFFICER)**