

QUALITY DISTRIBUTION INC  
Form 10-Q  
May 09, 2006

---

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

Washington, D.C. 20549

---

**FORM 10-Q**

---

(Mark One)

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

For the quarterly period ended March 31, 2006

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-24180

---

**Quality Distribution, Inc.**

(Exact name of registrant as specified in its charter)

---

Florida  
(State or other jurisdiction of  
incorporation or organization)

3802 Corporex Park Drive,

Tampa, FL

59-3239073  
(I.R.S. Employer

Identification No.)

33619

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

(Address of Principal Executive Offices)

(Zip Code)

813-630-5826

(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 is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Exchange Act Rule 12b-2).

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

As of May 1, 2006, the registrant had 19,061,412, outstanding shares of Common Stock, no par value, outstanding.

---

---

QUALITY DISTRIBUTION, INC.

CONTENTS

<i><u>PART I FINANCIAL INFORMATION</u></i>	<i>1</i>
<i><u>ITEM 1 FINANCIAL STATEMENTS</u></i>	<i>1</i>
<i><u>Consolidated Statements of Operations for the Three Months ended March 31, 2006 and 2005</u></i>	<i>1</i>
<i><u>Consolidated Balance Sheets as of March 31, 2006 and December 31, 2005</u></i>	<i>2</i>
<i><u>Consolidated Statements of Shareholders Deficit and Comprehensive Loss as of March 31, 2006 and 2005</u></i>	<i>3</i>
<i><u>Consolidated Statements of Cash Flows for the Three Months ended March 31, 2006 and 2005</u></i>	<i>4</i>
<i><u>Notes to Condensed Consolidated Financial Statements</u></i>	<i>5</i>
<i><u>ITEM 2 Management s Discussion and Analysis of Financial Condition and Results of Operations</u></i>	<i>21</i>
<i><u>ITEM 3 Quantitative and Qualitative Disclosures About Market Risk</u></i>	<i>32</i>
<i><u>ITEM 4 Controls and Procedures</u></i>	<i>34</i>
<i><u>PART II OTHER INFORMATION</u></i>	<i>34</i>
<i><u>ITEM 1 Legal Proceedings</u></i>	<i>34</i>
<i><u>ITEM 1A Risk Factors</u></i>	<i>34</i>
<i><u>ITEM 2 Unregistered Sale of Equity Securities and Use of Proceeds</u></i>	<i>35</i>
<i><u>ITEM 3 Defaults Upon Senior Securities</u></i>	<i>35</i>
<i><u>ITEM 4 Submission of Matters to a Vote of Security Holders</u></i>	<i>35</i>
<i><u>ITEM 5 Other Information</u></i>	<i>35</i>
<i><u>ITEM 6 Exhibits</u></i>	<i>35</i>
<i><u>Signatures</u></i>	<i>36</i>

---

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

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
<b>OPERATING REVENUES</b>		
Transportation	\$ 142,312	\$ 133,214
Other service revenue	18,104	16,854
Fuel surcharge	18,334	11,070
<b>Total operating revenues</b>	<b>178,750</b>	<b>161,138</b>
<b>OPERATING EXPENSES</b>		
Purchased transportation	121,581	110,983
Compensation	17,881	14,575
Fuel, supplies and maintenance	10,943	7,157
Depreciation and amortization	3,937	4,453
Selling and administrative	5,265	6,271
Insurance claims	3,884	3,802
Taxes and licenses	790	617
Communication and utilities	2,548	2,056
Gain on disposal of property and equipment	(157)	(28)
PPI class action settlement and related expenses		509
<b>Total operating expenses</b>	<b>166,672</b>	<b>150,395</b>
Operating income	12,078	10,743
Interest expense, net	7,134	6,313
Write-off of debt issuance costs		1,110
Other (income)/expense	(138)	33
Income before income taxes	5,082	3,287
Provision for income taxes	(602)	(371)
<b>Net income attributable to common shareholders</b>	<b>\$ 4,480</b>	<b>\$ 2,916</b>
<b>PER SHARE DATA</b>		
<b>Net income per common share</b>		
Basic	\$ 0.24	\$ 0.15
Diluted	\$ 0.23	\$ 0.15
<b>Weighted average number of shares</b>		

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Basic	18,963	18,929
Diluted	19,515	19,302

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

## QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

## Quality Distribution, Inc and Subsidiaries

## Consolidated Balance Sheets

(In 000 s)

Unaudited

	March 31, 2006	December 31, 2005
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 2,000	\$ 1,636
Accounts receivable, net	102,314	101,353
Current maturities of notes receivable from affiliates	126	145
Prepaid expenses	8,376	5,336
Prepaid tires	7,647	7,360
Other	10,577	4,872
<b>Total current assets</b>	<b>131,040</b>	<b>120,702</b>
Property and equipment, net	115,108	115,199
Assets held-for-sale	147	158
Goodwill	133,593	133,138
Intangibles, net	1,116	1,165
Notes receivable from affiliates, net	79	112
Other assets	11,429	11,931
<b>Total assets</b>	<b>\$ 392,512</b>	<b>\$ 382,405</b>
<b>LIABILITIES, MINORITY INTEREST AND SHAREHOLDERS DEFICIT</b>		
Current liabilities:		
Current maturities of indebtedness	\$ 1,516	\$ 1,515
Accounts payable	11,983	16,609
Affiliates and independent owner-operators payable	14,661	11,979
Accrued expenses	26,364	22,046
Environmental liabilities	6,685	8,516
Accrued loss and damage claims	9,657	9,598
<b>Total current liabilities</b>	<b>70,866</b>	<b>70,263</b>
Long-term indebtedness, less current maturities	292,001	287,601
Environmental liabilities	8,643	8,643
Accrued loss and damage claims	25,032	25,032
Other non-current liabilities	10,176	10,213
Deferred tax liability	792	930
<b>Total liabilities</b>	<b>407,510</b>	<b>402,682</b>
Commitments and contingencies (Note 7)		
Minority interest in subsidiary	1,833	1,833
<b>SHAREHOLDERS DEFICIT</b>	<b>358,526</b>	<b>359,772</b>

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Common stock, no par value; 29,000 shares authorized; 19,133 issued at March 31, 2006 and 19,123 issued at December 31, 2005		
Treasury stock, 74 and 93 shares at March 31, 2006 and December 31, 2005	(766)	(1,042)
Accumulated deficit	(164,506)	(168,710)
Stock recapitalization	(189,589)	(189,589)
Accumulated other comprehensive loss	(19,005)	(19,079)
Stock purchase warrants	50	54
Unearned compensation, restricted stock and stock units		(1,975)
Stock subscriptions receivable	(1,541)	(1,541)
<b>Total shareholders' deficit</b>	<b>(16,831)</b>	<b>(22,110)</b>
<b>Total liabilities, minority interest and shareholders' deficit</b>	<b>\$ 392,512</b>	<b>\$ 382,405</b>

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

## QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

## Consolidated Statements of Shareholders Deficit and Comprehensive Loss

For the Three Months Ended March 31, 2006 and 2005

Unaudited (In 000 s)

	Comprehensive Income (Loss)	Shares of		Common Stock	Treasury Stock	Accumulated Deficit	Other Stock Recapitalization	Accumulated Other Comprehensive Loss	Purchase Warrants	Unearned Compensation Restricted Stock	Subscription Receivables	Total Shareholders Deficit
		Common Stock	Treasury Stock									
Balance, December 31, 2004		19,152	73	\$ 357,777	\$ (743)	\$ (180,854)	\$ (189,589)	\$ (18,042)	\$ 73	\$ (1,077)	\$ (1,645)	\$ (34,100)
Net income	\$ 2,916					2,916						2,916
Issuance of restricted stock		14	(14)	120						(120)		
Amortization of restricted stock										133		133
Forfeiture of restricted stock		(1)	1	(17)						17		
Stock warrant exercise												
Payment of stock subscriptions receivable											76	76
Acquisition of treasury stock												31
Amortization of below market options				31								
Translation adjustment, net of a deferred tax provision of nil	1							1				1
Pension plan minimum liability, net of a deferred tax benefit of nil												
Balance, March 31, 2005	\$ 2,917	19,165	60	\$ 357,911	\$ (743)	\$ (177,938)	\$ (189,589)	\$ (18,041)	\$ 73	\$ (1,047)	\$ (1,569)	\$ (30,943)
Balance, December 31, 2005		19,123	93	\$ 359,772	\$ (1,042)	\$ (168,710)	\$ (189,589)	\$ (19,079)	\$ 54	\$ (1,975)	\$ (1,541)	\$ (22,110)



Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Net income	\$ 4,480				4,480					4,480	
Reclass of Unearned Compensation Restricted Stock			(1,975)						1,975		
Issuance of restricted stock		(19)		276	(276)						
Amortization of restricted stock			94							94	
Amortization of restricted stock units			362							362	
Amortization of below market options			31							31	
Amortization of stock options			238							238	
Stock warrant exercise		10		4				(4)			
Acquisition of treasury stock											
Payment of stock subscription receivable											
Translation adjustment, net of a deferred tax provision of nil		74						74		74	
Pension plan minimum liability, net of a deferred tax benefit of nil											
Balance, March 31, 2006	\$ 4,554	19,133	74	\$ 358,526	\$ (766)	\$ (164,506)	\$ (189,589)	\$ (19,005)	\$ 50	\$ (1,541)	\$ (16,831)

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

---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**
**Quality Distribution, Inc and Subsidiaries****Consolidated Statements of Cash Flows****(Unaudited In 000 s)**

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 4,480	\$ 2,916
Adjustments to reconcile to net cash and cash equivalents used in operating activities:		
Depreciation and amortization	3,937	4,453
Bad debt expense	(420)	633
Foreign currency transaction loss	75	11
Gain on disposal of property and equipment	(157)	(28)
Write-off of deferred financing costs		1,110
Stock based compensation	725	164
Amortization of deferred financing costs	454	445
Amortization of bond discount	61	51
Minority dividends	36	36
Changes in assets and liabilities:		
Accounts and other receivables	(541)	(6,600)
Notes receivable from affiliates	52	94
Prepaid expenses	(3,040)	(3,206)
Prepaid tires	(287)	(385)
Other assets	(5,772)	(981)
Accounts payable and accrued expenses	(3,945)	(133)
Environmental liabilities	(1,831)	(73)
Accrued loss and damage claims	59	(3,626)
Affiliates and independent owner-operators payable	2,682	4,270
Other liabilities	(36)	(63)
Net cash used in operating activities	(3,468)	(912)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Capital expenditures	(3,309)	(2,623)
Acquisition of business assets	(3,414)	
Proceeds from sales of property and equipment	2,633	799
Net cash used in investing activities	(4,090)	(1,824)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from issuance of long-term debt and capital lease obligations		83,300
Principal payments on long-term debt and capital lease obligations	(378)	(77,850)
Proceeds from revolver	58,200	28,300
Payments on revolver	(53,500)	(34,100)
Deferred financing costs		(2,759)
Change in book overdraft	3,637	4,093
Minority dividends	(36)	(36)
Other stock transactions		76

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Net cash provided by financing activities	7,923	1,024
Net increase / (decrease) in cash and cash equivalents	365	(1,712)
Effect of exchange rate changes on cash	(1)	3
Cash and cash equivalents, beginning of year	1,636	2,700
Cash and cash equivalents, end of period	\$ 2,000	\$ 991

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

---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

**Quality Distribution, Inc. and Subsidiaries**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**1. Summary of Significant Accounting Policies**

**Basis of Presentation**

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

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

Our accompanying unaudited condensed, consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and notes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments and accruals) considered necessary for a fair presentation have been included. For further information, refer to our Annual Report on Form 10-K for the year ended December 31, 2005, including the consolidated financial statements and accompanying notes. Certain prior period amounts have been reclassified to conform to the current year presentation.

Operating results for the three months ended March 31, 2006, are not necessarily indicative of the results that may be expected for the entire fiscal year.

**New Accounting Pronouncements**

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Corrections ( SFAS No. 154 ). SFAS No. 154 replaces APB Opinion No. 20, Accounting Changes and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements and changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS No. 154 also provides guidance on the accounting for and reporting of error corrections. The January 2006 adoption of SFAS No. 154 had no material affect on our financial position, results of operations or cashflows.

Prior to the January 1, 2006 adoption of Financial Accounting Standards Board ( FASB ) Statement No. 123(R), Share-Based Payment ( SFAS 123R ), we accounted for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board ( APB ) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, because the stock option grant price generally equaled the market price on the date of grant, no compensation expense was normally recognized for Company-issued stock options. As permitted by SFAS 123, Accounting for Stock-Based Compensation ( SFAS 123 ), stock-based compensation was included as a pro forma disclosure in the Notes to the Consolidated Financial Statements.

Effective January 1, 2006, we adopted SFAS 123R using the modified prospective transition method and, as a result, did not retroactively adjust results from prior periods. Under this transition method, stock-based compensation was recognized for: 1) expense related to the remaining unvested portion of all stock option awards granted prior to January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123; and 2) expense related to all stock option awards granted on or subsequent to January 1, 2006, based on the grant date



---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

fair value estimated in accordance with the provisions of SFAS 123R. We apply the Black-Scholes valuation model in determining the fair value of share-based payments to employees, which is then amortized on a straight-line basis over the requisite service period. See Note 4 of the Notes to Consolidated Financial Statements in this Form 10-Q for further discussion of stock-based compensation.

**Acquisition of Business**

We acquired the business of a transportation company on January 21, 2006, for approximately \$3.4 million. We expect to pay an additional \$0.5 million, based on defined criteria, for this acquisition during the third quarter of fiscal year 2006.

**Goodwill and Intangible Assets**

*Goodwill*

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

We selected the second quarter to perform our annual impairment test. Projections for future cash flows were based on our recent operating trends. EBITDA multiples were derived from other comparable publicly traded companies. The discount rate used to discount cash flows was based on our weighted average cost of capital. No impairment was determined to have occurred as of June 30, 2005, since the calculated fair value exceeded the carrying amount. The factors used in deriving the estimate of the fair value included improving economic conditions, increasing revenues and operating income during 2004 and the knowledge that we were able to renegotiate our debt structure to extend the maturity.

Our goodwill assets as of March 31, 2006 and December 31, 2005 were \$133.6 million and \$133.1 million, respectively. Goodwill increased \$0.5 million due to the purchase of a business in January 2006.

*Intangible Assets*

Net intangible assets consist of a \$0.9 million intangible pension plan asset and \$0.2 million in total of non-compete agreements with remaining lives of 3 years, customer lists and customer contracts acquired from a competitor with lives of 5 years. Accumulated amortization of the remaining non-pension intangible assets was \$0.2 million and \$0.2 million at March 31, 2006 and December 31, 2005, respectively. The gross amount of intangible assets at March 31, 2006 and December 31, 2005 was \$1.4 million.

Amortization expense for the non-pension intangible assets for the three months ended March 31, 2006 and 2005 was less than \$0.1 million in all periods.

---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**
**2. Comprehensive Income**

Comprehensive income is as follows (in thousands):

	Three months ended	
	March 31, 2006	2005
Net income	\$ 4,480	\$ 2,916
Other comprehensive income:		
Foreign currency translation adjustments	74	1
Comprehensive income	\$ 4,554	\$ 2,917

**3. Earnings Per Share**

A reconciliation of the numerators and denominators of the basic and diluted earnings per earnings per share computations follows:

	Net income (numerator)	March 31, 2006 Shares (denominator)	Three months ended		March 31, 2005 Shares (denominator)	Per-share amount
			Per-share amount	Net income (numerator)		
<b>(In 000 s except pershare amounts)</b>						
<b>Basic income available to common shareholders:</b>						
Net earnings	\$ 4,480	18,963	\$ .24	\$ 2,916	18,929	\$ .15
<b>Effect of dilutive securities:</b>						
Stock options		167			188	
Unvested restricted stock		51			14	
Stock units		181				
Stock warrants		153			171	
<b>Diluted income available to common shareholders:</b>						
Net earnings	\$ 4,480	19,515	\$ .23	\$ 2,916	19,302	\$ .15

The effect of our stock options, restricted stock, stock units and stock warrants which represent the shares shown in the table above are included in the computation of diluted earnings per share for the three month periods ended March 31, 2006 and 2005.

The following securities were not included in the calculation of diluted EPS because such inclusion would be anti-dilutive:

(in 000 s)	Three Months ended	
	March 31, 2006	2005
Stock options	1,173	1,708
Unvested Restricted Stock		58

**4. Stock-Based Compensation**

We maintain performance incentive plans under which stock options, restricted shares, and stock units may be granted to employees and non-employee directors.



---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

Effective January 1, 2006, we adopted Financial Accounting Standards Board ( FASB ) Statement No. 123(R), Share-Based Payment ( SFAS 123R ), using the modified prospective transition method, and as a result, did not retroactively adjust results from prior periods. Under this transition method, stock-based compensation was recognized for: 1) expense related to the remaining unvested portion of all stock option awards granted prior to January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123; and 2) expense related to all stock option awards granted on or subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. 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 option vesting term of four years. Prior to fiscal 2006, stock-based compensation was included as a pro forma disclosure in the Notes to the Consolidated Financial Statements as permitted by SFAS 123.

Compensation expense is recognized only for those options expected to vest, with forfeitures estimated based on our historical experience and future expectations. Prior to the adoption of SFAS 123R, the effect of forfeitures on the pro forma expense amounts was recognized as the forfeitures occurred.

As a result of adopting SFAS 123R, the impact to the Consolidated Statement of Operations for the quarter ended March 31, 2006 on income before income taxes and net income was \$0.2 million and \$0.2 million, respectively, and \$0.01 and \$0.01 on basic and diluted earnings per share, respectively. In addition, prior to the adoption of SFAS 123R, we presented the tax benefit resulting from the exercise of stock options as operating cash inflows in the Consolidated Statements of Cash Flows. Upon the adoption of SFAS 123R, any excess tax benefits for those options will be classified as financing cash inflows and operating cash outflows.

The table below reflects net income and basic and diluted net income per share for the first quarter of fiscal 2005, had we applied the fair value recognition provisions of SFAS 123R (in thousands, except per share data):

	<b>Three months ended March 31, 2005</b>
Net income	\$ 2,916
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects of nil for all periods	(380)
Restricted stock compensation expense and stock option expense included in net income (loss) attributable to common stockholders as reported	164
Pro forma net income attributable to common stockholders	\$ 2,700
<b>Income per common share:</b>	
As reported basic	\$ 0.15
Pro forma basic	\$ 0.14
As reported diluted	\$ 0.15
Pro forma diluted	\$ 0.14

Pro forma disclosure for the quarter ended March 31, 2006 is not presented because the amounts are recognized in the consolidated financial statements.

The pro forma fair value of options granted during the first three months of 2006 and 2005 was based upon the Black-Scholes option-pricing model. The expected term of the options represents the estimated period of time until exercise giving consideration to the contractual terms, vesting schedules and expectations of future employee behavior. For fiscal 2006, expected stock price volatility is based on the historical volatility of our 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 near future. The Black-Scholes model was used with the following assumptions:



---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

	2006	2005
Risk free rate	4.3%	3.7%
Expected life	4 years	6 years
Volatility	71.3%	64.0%
Expected dividend	nil	nil

As of March 31, 2006, we have three stock-based compensation plans. There is also an agreement to issue stock units which applies solely to Mr. Detter, our Chief Executive Officer. During the three months ending March 31, 2006, we recognized compensation expense of approximately \$269,000 for all options, approximately \$94,000 for all restricted stock and approximately \$362,000 for all restricted stock units. During the three months ending March 31, 2005, we recognized compensation expense of approximately \$31,000 for all options and approximately \$133,000 for all restricted stock. All stock-based compensation expense is classified within Compensation on the Consolidated Statement of Operations.

There were no modifications to stock option awards during 2006. The remaining unrecognized compensation cost related to unvested option awards at March 31, 2006 is \$3.2 million and the weighted-average period of time over which this cost will be recognized is 3.4 years. This amount does not include the cost of any additional options that may be granted in future periods nor any changes in the Company's forfeiture rate. There was no exercise of options in the first quarter of 2006.

Due to the issuance of stock options, representing 200,000 shares to an executive who joined us in November 2004, we recognized \$31,000 of compensation expense for the three months ended March 31, 2006 and will recognize approximately \$219,000 of compensation expense over the next 21 months.

We issued options for 417,500 shares on January 3, 2006 with an exercise price of \$7.94. The total compensation that will be recognized over four years for these options is approximately \$1.9 million. We also issued 18,890 shares of restricted stock to certain directors as part of their annual compensation package. We will recognize approximately \$150,000 as compensation over four years.

### 2003 Stock Option Plan

The 2003 Stock Option Plan was adopted on November 5, 2003 in connection with our IPO and expires 10 years after adoption. It provides for the grant of nonqualified stock options that become exercisable, with limited exceptions, in 25% increments on each of the first four anniversaries of the date upon which the options are granted. On December 5, 2005, the Compensation Committee of the Board of Directors approved the vesting on December 31, 2005 of all unvested options under the 2003 Stock Option Plan with an exercise price of \$8.00 or higher. As a result of the accelerated vesting, approximately 744,000 options became exercisable on December 31, 2005. The number of shares available for issuance under this plan automatically increases on January 1 of each year commencing with January 1, 2004 unless otherwise determined by the Board of Directors. The increase is 2.5% of the outstanding shares as of December 31 of the prior year. No more than 6,500,000 shares of common stock may be issued under the 2003 Stock Option Plan.

---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

Stock option activity for the 2003 Stock Plan for the quarter ended March 31, 2006 is as follows (in thousands, except per share data):

	Number of Shares Available	Number of Shares Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term(in years)	Aggregate Intrinsic Value (in thousands) (a)
Options outstanding at December 31, 2005	733	2,143	12.60		
2006 option activity:					
Additional shares reserved	475				
Granted	(417)	417	7.94		
Canceled	2	(2)	17.00		
Options outstanding at March 31, 2006	793	2,558	11.76	8.45	8,018
Options exercisable at March 31, 2006		1,586	14.47	7.95	2,333

(a) The intrinsic value of a stock option is the amount by which the market value of the underlying stock, as of March 31, 2006, exceeds the exercise price of the option.

As of March 31, 2006, total unrecognized stock-based compensation expense for the 2003 Stock Plan related to nonvested stock options was approximately \$3.2 million, which is expected to be recognized over a weighted average period of approximately 3.4 years.

**1998 Stock Option Plan**

Until adoption of the 2003 Stock Option Plan, we administered the 1998 Stock Option Plan pursuant to which a total of 377,400 shares of our common stock were available for grant. The maximum term of granted options was ten years. Fifty percent of each new option granted vested in equal increments over four years. The remaining fifty percent of each new option will vest in nine years from grant date, subject to acceleration if certain per-share equity value targets are achieved or in the event of a sale of us. Vesting of the new options occurs only during an employee's term of employment. The new options will become fully vested in the event of a termination of employment without cause or for good reason within six months following a sale of the Company.

Stock option activity for the 1998 Stock Plan for the quarter ended March 31, 2006 is as follows (in thousands, except per share data):

	Number of Shares Available	Number of Shares Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term(in years)	Aggregate Intrinsic Value (in thousands) (a)
Options outstanding at December 31, 2005	306	71	23.00		
2006 option activity:					
Granted					
Canceled					
Options outstanding at March 31, 2006	306	71	23.00	4.0	

---

(a)

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

The intrinsic value of a stock option is the amount by which the market value of the underlying stock, as of March 31, 2006, exceeds the exercise price of the option.

As of March 31, 2006, there was no unrecognized stock-based compensation expense for the 1998 Stock Plan related to nonvested stock options.

---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

**Restricted Incentive Stock Plan**

On November 5, 2003, our Board of Directors approved the 2003 Restricted Incentive Stock Plan, which terminates ten years from the approval date. The restricted stock issuances to persons initially receiving a grant generally vest by December 31, 2008 regardless of when issued. The vesting periods for other grant recipients are at the discretion of the Compensation Committee of the Board of Directors. In subsequent years, participants in the plan may be granted an annual, aggregate amount of up to \$1 million of shares, valued at our common stock closing price at the date of grant, at the direction of the Board of Directors. No more than 700,000 shares of common stock may be issued under this plan nor more than \$7.5 million of stock may be issued under this plan.

In the first quarter of fiscal year 2006, we vested 2,622 shares of restricted stock with a fair value of \$34,000 and granted 18,890 shares of restricted stock for which we will recognize \$150,000 of total compensation expense over four years. Compensation expense for the first quarter related to the issuance of restricted shares was \$94,000 and \$133,000 in 2006 and 2005, respectively.

As of March 31, 2006, total unrecognized stock-based compensation expense for the Restricted Stock Plan was approximately \$432,000, which is expected to be recognized over a weighted average period of approximately 3.2 years. We recognize compensation for restricted stock based on Financial Interpretation Number 28.

**Stock Unit Grant Agreement**

In 2005 in connection with his employment agreement, our Chief Executive Officer, Gerald L. Detter, was granted 300,000 stock units and \$50,000 in value of stock units annually with the first annual grant made upon execution of his employment agreement and subsequent grants on each anniversary. Under the Stock Unit Grant Agreement, the 300,000 unit grant ( Initial Grant ) vests on December 31, 2006 if Mr. Detter is still an employee on that date.

Annual grants are determined by dividing \$50,000 by the fair market value of the common stock on the date of grant. Stock units subject to each annual award vest (i) 14.2% on December 31 of the year in which such Annual Award is granted; and (ii) 28.6% on December 31 of each successive year.

The stock units are credited to an unfunded account and dividends, if any, paid on Company stock are paid on stock units in additional stock units rather than in cash. Stock units credited will be paid out in a single lump sum in an equivalent whole number of shares of common stock. We have discretion to pay stock units attributable to dividend equivalents in cash. Fractional share interests shall be disregarded, but may be cumulated, or, in our discretion, paid in cash. The Initial Grant will be distributed upon the first to occur of: (1) December 31, 2008, (2) termination of employment, (3) disability or (4) a change in control event. Annual awards shall be distributed upon the first to occur of: (1) termination of employment, (2) disability or (3) a change in control event.

As of March 31, 2006, total unrecognized stock-based compensation expense for the Stock Unit Grant Agreement was approximately \$1.1 million, which is expected to be recognized over a weighted average period of approximately 0.8 years. We recognize compensation for the stock unit grant agreement on a straight-line basis.

**5. Employee Benefit Plans**

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

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

---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

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

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
Service cost	\$ 64	\$ 68
Interest cost	675	670
Prior service cost	23	23
Amortization	148	256
Expected return on plan assets	(768)	(704)
 Net periodic pension cost	 \$ 142	 \$ 313

We have contributed \$0.4 million to our pension plans during the three months ended March 31, 2006, and expect to contribute \$2.0 million during the remainder of 2006.

#### 6. Geographic Segments

Our operations are located primarily in the United States, Canada and Mexico. Inter-area sales are not significant to the total revenue of any geographic area. Information about our operations in different geographic areas for the three months ended March 31, 2006 and 2005 is as follows (in thousands):

	<b>Three Months Ended March 31, 2006</b>			
	<b>U. S.</b>	<b>International</b>	<b>Eliminations</b>	<b>Consolidated</b>
Total operating revenues	\$ 166,945	\$ 11,805	\$	\$ 178,750
Operating income	10,352	1,726		12,078
Depreciation and Amortization	3,494	443		3,937
Capital Expenditures	6,723			6,723
		<b>As of March 31, 2006</b>		
Identifiable Assets	382,572	9,940		392,512
		<b>Three Months Ended March 31, 2005</b>		
	<b>U. S.</b>	<b>International</b>	<b>Eliminations</b>	<b>Consolidated</b>
Total operating revenues	\$ 149,325	\$ 11,813	\$	\$ 161,138
Operating income	9,035	1,708		10,743
Depreciation and Amortization	3,965	488		4,453
Capital Expenditures	2,623			2,623
		<b>As of December 31, 2005</b>		
Identifiable Assets	371,670	10,735		382,405

---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

**7. Commitments and Contingencies**

*Environmental Matters*

It is our policy and the policy of each of our subsidiaries to be in compliance 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.

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

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

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

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

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

**Reserves**

Our policy is to accrue remediation expenses when it is probable that such efforts will be required and the related expenses can be reasonably estimated. Estimates of costs for future environmental compliance and remediation are necessarily imprecise due to such factors as the continuing evolution of environmental laws and regulatory requirements, the availability and application of technology, the identification of currently unknown remediation sites and the allocation of costs among the potentially responsible parties under applicable statutes. As of March 31, 2006 and December 31, 2005, we had reserves in the amount of \$15.3 million and \$17.2 million, respectively, for all environmental matters discussed above.



---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

The activity in the environmental liability reserves is as follows at March 31, 2006 (in thousands):

	<b>2006</b>
Reserve at beginning of year	\$ 17,159
Payments	(2,431)
Additions	600
 Reserve at end of period	 \$ 15,328

We increased our environmental reserves by \$0.6 million due to developments at our Bridgeport, New Jersey OU3 site. The balances presented include both long term and current environmental reserves. We expect these environmental obligations to be paid over the next five years. Additions to the environmental liability reserves are classified on the Consolidated Statements of Operations within the Selling and administrative category.

We are currently responsible for remediating and investigating five properties under federal and state Superfund programs where we are the only responsible party. Each of these five remediation projects relates to operations conducted by Chemical Leaman Corporation ( CLC ) prior to our acquisition of and merger with CLC in 1998. The two most significant Superfund sites are:

**Bridgeport, New Jersey**

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

In connection with OU1, USEPA originally required us to construct a large treatment plant with discharge via a two mile pipeline to the Delaware River watershed with construction to be completed by the end of 2001. We have negotiated an alternative remedy with USEPA which would call for a significantly smaller treatment facility, in place treatment of groundwater contamination via in-situ treatment and a local discharge. The treatment facility has been approved and construction started in July, 2005. USEPA has also approved an OU3 remedy for approximately 2.5 acres of affected wetland. This reflects a reduction from an approximate seven acre area that had been under negotiation. Site mobilization for the OU3 work took place in late May 2004 but was delayed due to weather related issues. Field work was re-started in May 2005 and remediation work is on-going. Additional contamination has been identified since December 31, 2006. In regard to OU2, USEPA is now requiring a Feasibility Study for the limited areas that show contamination and warrant additional investigation or work. USEPA also wants to include in OU2 the in-situ treatment previously described as part of OU1. The environmental projections for OU1 and OU2 have been changed to reflect the reallocation of the in-situ costs to OU2 and the proposed contract amount for the OU1 work. We have estimated expenditures to be in the range of \$7.4 million to \$10.2 million.

**William Dick, Pennsylvania**

CLC entered into a consent order with the Pennsylvania DEP (PADEP) and USEPA in October 1995 obligating it to provide a replacement water supply to area residents (OU1), treat contaminated groundwater (OU2), and perform remediation of contaminated soils (OU3) at this former wastewater disposal site. OU1 is complete. PADEP and USEPA had previously been unable to agree on the final interim remedy design for OU2; specifically, the discharge location for the treated groundwater. We have projected an interim remedy, which involves the construction of a treatment facility and discharge locally. A preliminary engineering design, which includes a discharge to a local tributary, was submitted in August 2004 to USEPA and PADEP for their review and comment. Agency comments have been received and a final design has been submitted to the agency and is pending final approval. Based on recent data showing reduction in site groundwater contamination due to natural attenuation and the more extensive handling and removal of contaminated soils, we believe that the groundwater project can be completed over the five-year term of this interim remedy. The agencies have approved an OU3 remedy, which requires both thermal treatment of contaminated soils and treatment of residuals via soil vapor extraction (SVE). The OU3 remedy expanded in April 2004 to off-site shipment of contaminated soils because these soils were found to be incompatible with the thermal treatment unit, which started full-scale operation in May 2004. We determined in June 2004 that we would incur increased expense due to the off-site



---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

additional contaminated soil that was found to be incompatible with the thermal treatment unit, the increased volume of soil subject to thermal treatment based on an increase in the lateral extent of contamination, and the discovery of buried drums and associated contaminated material and soils, which required off-site disposal. In the third quarter of 2004, we determined that a latex liner waste material was present in the third pond, which needed to be excavated and removed for disposal offsite. This work was completed in early 2005. We also determined that the soils in pond three needed to be excavated to determine if they will be suitable for the originally planned SVE treatment. We excavated the pond's three soils into discrete piles and determined the best approach to treat these soil piles. It was determined that most of the soil piles could be treated on site using SVE as originally planned. However, some modifications to the design will have to be made in order to treat a limited number of soil piles. We have estimated expenditures to be in the range of \$2.1 million to \$3.1 million.

**Other Owned Property**

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

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

Charleston, WV: CLC completed a remediation of a former drum disposal area in 1995 at its active truck terminal and tank wash site under the terms of a State hazardous waste permit. The State has required supplemental groundwater monitoring in connection with the same permit and we are performing the same and believe that no additional remediation will be required.

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

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

We have estimated expenditures for these other owned properties to be in the range of \$2.5 million to \$3.8 million.

**Other Environmental Matters**

We have been named as a potentially responsible party ( PRP ) under CERCLA and similar state laws at 18 other multi-party sites.

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

---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

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

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

We have estimated expenditures for these other environmental matters to be in the range of \$1.4 million to \$3.8 million.

**Routine Legal Matters**

Other than reported in this Note and in the Item 3 - Legal Proceedings of our Annual Report on Form 10-K for the year ended December 31, 2005 and in Note 19. Commitments and Contingencies to our audited consolidated financial statements contained in such Form 10-K, 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.

**8. Guarantor Subsidiaries**

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

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 wholly owned subsidiaries of QD LLC and have fully and unconditionally guaranteed the 9% Senior Subordinated Notes and the Series B Floating Interest Rate Subordinated Term Notes on a joint and several basis.

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

Condensed consolidating balance sheets at March 31, 2006 and December 31, 2005 and condensed consolidating statements of operations and of cash flows for each of the three months ended March 31, 2006 and March 31, 2005.

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

## QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

## Condensed Consolidating Statement of Operations

For the Three Months Ended March 31, 2006

Unaudited - (In 000 s)

	QDI	QD LLC and QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Operating revenues:						
Transportation	\$	\$	\$ 142,312	\$	\$	\$ 142,312
Other service revenue			17,826	278		18,104
Fuel surcharge			18,334			18,334
Total operating revenues			178,472	278		178,750
Operating expenses:						
Purchased transportation			121,581			121,581
Compensation			17,881			17,881
Fuel, supplies and maintenance			10,931	12		10,943
Depreciation and amortization			3,763	174		3,937
Selling and administrative			5,157	108		5,265
Insurance claims			3,884			3,884
Taxes and Licenses			790			790
Communication and utilities			2,548			2,548
(Gain)/loss on disposal of property and equipment			(157)			(157)
PPI class action settlement and related expenses						
Operating income (loss)			12,094	(16)		12,078
Interest expense, net		7,237	20	(123)		7,134
Write-off of debt issuance costs						
Other (income) expense			(138)			(138)
Income (loss) before taxes		(7,237)	12,212	107		5,082
Income tax (provision) benefit		615	(1,221)	4		(602)
Equity in earnings (loss) of subsidiaries	4,480	11,102			(15,582)	
Net income (loss)	\$ 4,480	\$ 4,480	\$ 10,991	\$ 111	\$ (15,582)	\$ 4,480

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Consolidating Statements of Operations

Three Months Ended March 31, 2005

Unaudited - (In 000 s)

	QDI	QD LLC and QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Operating revenues:						
Transportation	\$	\$	\$ 132,815	\$ 399	\$	\$ 133,214
Other service revenue			16,629	225		16,854
Fuel surcharge			11,020	50		11,070
<b>Total operating revenues</b>			<b>160,464</b>	<b>674</b>		<b>161,138</b>
Operating expenses:						
Purchased transportation			110,952	31		110,983
Compensation			14,406	169		14,575
Fuel, supplies and maintenance			6,936	221		7,157
Depreciation and amortization			4,283	170		4,453
Selling and administrative			6,234	37		6,271
Insurance claims			3,802			3,802
Taxes and Licenses			605	12		617
Communication and utilities			2,056			2,056
(Gain)/loss on disposal of property and equipment			(28)			(28)
PPI class action settlement and related expenses			509			509
<b>Operating income</b>			<b>10,709</b>	<b>34</b>		<b>10,743</b>
Interest expense, net	(7)	6,475		(155)		6,313
Write-off of debt issuance costs			1,110			1,110
Other (income) expense			20	13		33
<b>Income (loss) before taxes</b>	<b>7</b>	<b>(6,475)</b>	<b>9,579</b>	<b>176</b>		<b>3,287</b>
Income tax (provision) benefit		481	(718)	(134)		(371)
Equity in earnings (loss) of subsidiaries	2,909	8,903			(11,812)	
<b>Net income (loss)</b>	<b>\$ 2,916</b>	<b>\$ 2,909</b>	<b>\$ 8,861</b>	<b>\$ 42</b>	<b>\$ (11,812)</b>	<b>\$ 2,916</b>

## QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

## CONSOLIDATING BALANCE SHEET

March 31, 2006

Unaudited (In 000 s)

	QDI	QD LLC & QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>ASSETS</b>						
Current assets:						
Cash and cash equivalents	\$	\$	\$ 616	\$ 1,384	\$	\$ 2,000
Accounts receivable, net			102,226	88		102,314
Current maturities of notes receivable from affiliates			126			126
Prepaid expenses		58	8,318			8,376
Prepaid tires			7,606	41		7,647
Other			10,926	(349)		10,577
Total current assets		58	129,818	1,164		131,040
Property and equipment, net			113,586	1,522		115,108
Assets held-for-sale			147			147
Goodwill			133,593			133,593
Intangibles, net			1,116			1,116
Notes receivable from affiliates, net			79			79
Investment in subsidiaries	(16,831)	528,054			(511,223)	
Other assets		8,061	3,368			11,429
Total assets	\$ (16,831)	\$ 536,173	\$ 381,707	\$ 2,686	\$ (511,223)	\$ 392,512
<b>LIABILITIES, MINORITY INTEREST, SHAREHOLDERS EQUITY (DEFICIT)</b>						
Current liabilities:						
Current maturities of indebtedness	\$	\$ 1,400	\$ 116	\$	\$	\$ 1,516
Accounts payable			11,983			11,983
Intercompany		253,268	(249,833)	(3,435)		
Affiliates and independent owner-operators payable			14,661			14,661
Accrued expenses		6,943	19,426	(5)		26,364
Environmental liabilities			6,685			6,685
Accrued loss and damage claims			9,657			9,657
Total current liabilities		261,611	(187,305)	(3,440)		70,866
Long-term indebtedness, less current maturities		291,393	608			292,001
Environmental liabilities			8,643			8,643
Accrued loss and damage claims			25,032			25,032
Other non-current liabilities			10,176			10,176
Deferred tax liability				792		792
Total liabilities		553,004	(142,846)	(2,648)		407,510
Minority interest in subsidiary			1,833			1,833
Shareholders' equity (deficit):						

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Common stock	358,526	356,269	444,722	7,630	(808,621)	358,526
Treasury stock	(766)					(766)
(Accumulated deficit)/retained earnings	(164,506)	(164,506)	96,860	(2,098)	69,744	(164,506)
Stock recapitalization	(189,589)	(189,589)		(55)	189,644	(189,589)
Accumulated other comprehensive loss	(19,005)	(19,005)	(18,862)	(143)	38,010	(19,005)
Stock purchase warrants	50					50
Unearned compensation, restricted stock and stock units						
Stock subscription receivable	(1,541)					(1,541)
<b>Total shareholders equity (deficit)</b>	<b>(16,831)</b>	<b>(16,831)</b>	<b>522,720</b>	<b>5,334</b>	<b>(511,223)</b>	<b>(16,831)</b>
<b>Total liabilities, minority interest and shareholders equity (deficit)</b>	<b>\$ (16,831)</b>	<b>\$ 536,173</b>	<b>\$ 381,707</b>	<b>\$ 2,686</b>	<b>\$ (511,223)</b>	<b>\$ 392,512</b>



## QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

## CONSOLIDATING BALANCE SHEET

December 31, 2005

Audited - (In 000 s)

	QDI	QD LLC & QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>ASSETS</b>						
Current assets:						
Cash and cash equivalents	\$	\$	\$ 607	\$ 1,029	\$	\$ 1,636
Accounts receivable, net			101,346	7		101,353
Current maturities of notes receivable from affiliates			145			145
Prepaid expenses		83	5,253			5,336
Prepaid tires			7,319	41		7,360
Other			5,028	(156)		4,872
<b>Total current assets</b>		83	119,698	921		120,702
Property and equipment, net			113,503	1,696		115,199
Assets held-for-sale			158			158
Goodwill			133,138			133,138
Intangibles, net			1,165			1,165
Notes receivable from affiliates, net			112			112
Investment in subsidiaries	(22,110)	513,380			(491,270)	
Other assets		8,509	3,422			11,931
<b>Total assets</b>	\$ (22,110)	\$ 521,972	\$ 371,196	\$ 2,617	\$ (491,270)	\$ 382,405
<b>LIABILITIES, MINORITY INTEREST, SHAREHOLDERS EQUITY (DEFICIT)</b>						
Current liabilities:						
Current maturities of indebtedness	\$	\$ 1,400	\$ 115	\$	\$	\$ 1,515
Accounts payable			16,609			16,609
Intercompany		252,188	(248,730)	(3,458)		
Affiliates and independent owner-operators payable			11,979			11,979
Accrued expenses		3,511	18,537	(2)		22,046
Environmental liabilities			8,516			8,516
Accrued loss and damage claims			9,598			9,598
<b>Total current liabilities</b>		257,099	(183,376)	(3,460)		70,263
Long-term indebtedness, less current maturities		286,983	618			287,601
Environmental liabilities			8,643			8,643
Accrued loss and damage claims			25,032			25,032
Other non-current liabilities			10,213			10,213
Deferred tax liability				930		930
<b>Total liabilities</b>		544,082	(138,870)	(2,530)		402,682
Minority interest in subsidiary			1,833			1,833

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Shareholders' equity (deficit):

Common stock	359,772	355,275	441,224	7,629	(804,128)	359,772
Treasury stock	(1,042)					(1,042)
(Accumulated deficit)/retained earnings	(168,710)	(168,717)	85,869	(2,209)	85,057	(168,710)
Stock recapitalization	(189,589)	(189,589)		(55)	189,644	(189,589)
Accumulated other comprehensive loss	(19,079)	(19,079)	(18,860)	(218)	38,157	(19,079)
Stock purchase warrants	54					54
Unearned compensation, restricted stock and stock units	(1,975)					(1,975)
Stock subscription receivable	(1,541)					(1,541)
<b>Total shareholders' equity (deficit)</b>	<b>(22,110)</b>	<b>(22,110)</b>	<b>508,233</b>	<b>5,147</b>	<b>(491,270)</b>	<b>(22,110)</b>
<b>Total liabilities, minority interest and shareholders' equity (deficit)</b>	<b>\$ (22,110)</b>	<b>\$ 521,972</b>	<b>\$ 371,196</b>	<b>\$ 2,617</b>	<b>\$ (491,270)</b>	<b>\$ 382,405</b>

## QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

## Condensed Consolidating Statements of Cash Flows

Three months Ended March 31, 2006

Unaudited - (In 000 s)

	QDI	QD LLC and QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Cash flows from operating activities:						
Net income (loss)	\$ 4,480	\$ 4,480	\$ 10,991	\$ 111	\$ (15,582)	\$ 4,480
Adjustments for non-cash charges	(4,480)	(10,512)	3,947	174	15,582	4,711
Net Changes in assets and liabilities		2,790	(15,496)	47		(12,659)
Intercompany activity		3,242	(3,265)	23		
Net cash provided by (used in) operating activities			(3,823)	355		(3,468)
Cash flows from investing activities:						
Capital expenditures			(3,309)			(3,309)
Acquisition of business assets			(3,414)			(3,414)
Proceeds from sales of property and equipment			2,633			2,633
Other						
Net cash used in investing activities			(4,090)			(4,090)
Cash flows from financing activities:						
Net proceeds (payments) on revolver		4,700				4,700
Proceeds from issuance of long-term debt						
Principal payments of long-term debt and capital lease obligations		(378)				(378)
Deferred financing fees						
Other			3,601			3,601
Intercompany activity		(4,322)	4,322			
Net cash provided by financing activities			7,923			7,923
Net increase in cash and cash equivalents			10	355		365
Effect of exchange rate changes on cash			(1)			(1)
Cash, beginning of period			607	1,029		1,636
Cash, end of period	\$	\$	\$ 616	\$ 1,384	\$	\$ 2,000

## Condensed Consolidating Statements of Cash Flows

Three months Ended March 31, 2005

Unaudited - (In 000 s)

	QDI	QD LLC and QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
--	-----	--------------------------	---------------------------	-------------------------------	--------------	--------------

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Cash flows from operating activities:						
Net income (loss)	\$ 2,916	\$ 2,909	\$ 9,971	\$ 42	\$ (12,922)	\$ 2,916
Adjustments for non-cash charges	(2,909)	(8,885)	5,577	170	12,922	6,875
Net Changes in assets and liabilities		3,455	(14,085)	(73)		(10,703)
Intercompany activity	(7)	2,521	(793)	(1,721)		
Net cash provided by (used in) operating activities			670	(1,582)		(912)
Cash flows from investing activities:						
Capital expenditures			(2,623)			(2,623)
Acquisition of business assets						
Proceeds from sales of property and equipment			799			799
Other						
Net cash used in investing activities			(1,824)			(1,824)
Cash flows from financing activities:						
Net proceeds (payments) on revolver		(5,800)				(5,800)
Proceeds from issuance of long-term debt		83,300				83,300
Principal payments of long-term debt and capital lease obligations		(77,850)				(77,850)
Deferred financing fees		(2,759)				(2,759)
Other			4,133			4,133
Intercompany activity		3,109	(3,109)			
Net cash provided by financing activities			1,024			1,024
Net decrease in cash and cash equivalents			(130)	(1,582)		(1,712)
Effect of exchange rate changes on cash			3			3
Cash, beginning of period			730	1,970		2,700
Cash, end of period	\$	\$	\$ 603	\$ 388	\$	\$ 991

---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

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

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

**Overview**

We operate the largest dedicated bulk tank truck network in North America based on bulk service revenues as reported in Bulk Transporter's 2004 Annual Gross Revenue Report. The bulk tank truck market in North America includes all items shipped by bulk tank truck carriers and consists primarily of the shipping of chemicals, gasoline and food-grade products. We transport a broad range of chemical products and provide our customers with value-added services. We extensively utilize third-party affiliate terminals and owner-operator drivers in our core bulk service network. We are a core carrier for many of the Fortune 500 companies engaged in chemical processing, including: The Dow Chemical Company, Procter & Gamble Company, E.I. duPont and PPG Industries, and we provide services to most of the top 100 chemical producers in the world with U.S. operations. We expect to grow as our customers continue to outsource more of their logistic needs to full-service carriers.

Our revenue is principally a function of the volume of shipments by the bulk chemical industry, 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 are, in turn, affected by many other industries, including consumer and industrial products, automotive, paint and coatings, and paper, and tend to vary with changing economic conditions. Additionally, we also provide leasing, tank cleaning, transloading and warehousing, which are presented as other service revenue. We also facilitate insurance products for drivers and affiliates through an independent third party. The principal components of our operating costs include purchased transportation, salaries, wages, benefits, annual tractor and trailer maintenance costs, insurance, technology infrastructure and fuel costs.

We believe the most significant factors to achieving future business growth are the ability to (a) recruit and retain drivers, (b) add new customers and (c) obtain additional business from existing customers. We expect our customers to continue to outsource more of their logistic needs to full-service carriers.

Our bulk service network comprises third-party affiliate terminals and owner-operator drivers in addition to Company-owned terminals and trucks. We believe the judicious use of affiliates and owner-operators results in a more variable operating cost structure because affiliates and owner-operators are paid a fixed, contractual percentage of revenue. This structure provides us some protection against cyclical downturns, while providing superior localized customer service. We continually evaluate our mix of affiliate and Company terminals.

As previously noted in our Annual Report on Form 10-K for the year ended December 31, 2005, we acquired the business of a transportation company on January 21, 2006, for approximately \$3.4 million. We expect to pay an additional \$0.5 million, based on defined criteria, for this acquisition during the third quarter of fiscal year 2006.

---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

As of March 31, 2006, we have unrecognized stock compensation expense of \$4.7 million of which \$3.2 million is for awards under the 2003 Stock Option Plan and is expected to be recognized over a weighted average period of approximately 3.4 years, \$0.4 million is for awards under the 2003 Restricted Incentive Stock Plan and is expected to be recognized over a weighted average period of approximately 3.2 years, and \$1.1 million is for the stock units granted in 2005 and is expected to be recognized over a weighted average period of approximately 0.8 years.

We have entered into a program to provide tractors to both affiliates and owner-operators by leasing such tractors and then sub-leasing the tractors to the affiliates and owner-operators. We anticipate that this program will increase our operating lease commitments.

**Critical Accounting Policies and Estimates**

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

*Property and Equipment* Property and equipment expenditures, including tractor and trailer rebuilds that extend the useful lives of such equipment, are capitalized and recorded at cost. For financial statement purposes, these assets are depreciated using the straight-line method over the estimated useful lives of the assets to an estimated salvage value. Annual depreciable lives are 10-25 years for buildings and improvements, 5-7 years for tractors and 15-20 years for trailers, 5-7 years for terminal equipment, 3-5 years for furniture and fixtures and 3-10 years for other equipment and software. 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 5 to 10 years, based on the type and extent of these rebuilds. Maintenance and repairs are charged directly to expense as incurred. Management estimates the useful lives of these assets based on historical trends and the age of the assets when placed in service, and any changes in the actual lives could result in material changes in the periodic depreciation and resulting net book value of these assets. Additionally, we estimate the salvage values of these assets based on historical sales of disposals, and any changes in the actual salvage values could also affect the periodic depreciation and resulting 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 category of assets may be less than previously anticipated. If the net book value of the related category of assets exceeds the undiscounted future cash flows of the category of assets, the carrying amount would be reduced to the 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 impairment losses.

*Goodwill* Goodwill is reviewed for impairment annually and whenever events or circumstances indicate that the book value of the asset may not be recoverable. We periodically evaluate whether events or circumstances indicate possible impairment. We identified three reporting units: transportation operations, insurance operations and Mexican operations. We allocated goodwill to the transportation operation as it principally resulted from the acquisition of CLC in 1998. If the fair value of the reporting unit is less than its carrying amount, an impairment loss is recorded to the extent the carrying amount of the goodwill within the reporting unit is greater than the implied fair value of goodwill. We performed our annual assessment during the second quarter of 2005. We used a combination of discounted cash flows and valuation of our capital structure to estimate the fair value. Projections for future cash flows were based on our recent operating trends. If actual cash flows turn out to be significantly less than projections, then the impairment analysis could change, possibly resulting in future impairment charges.

*Deferred tax assets* We use the liability method of accounting for income taxes. If, on the basis of available evidence, it is more likely than not that all or a portion of the deferred tax assets will not be realized, the assets must be reduced by a valuation allowance. Since realization is not assured as of March 31, 2006, management has deemed it appropriate to establish a valuation allowance against the deferred tax assets. Any change in the actual future results of operations could impact the valuation of the net deferred tax assets.

*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.



---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

*Accident claims reserves* We currently maintain liability insurance for bodily injury and property damage claims, covering all employees, owner-operators and affiliates, and workers' compensation insurance coverage on our employees and company drivers. This insurance includes deductibles of \$5 million per incident for bodily injury and property damage and \$1 million for workers' compensation for periods after September 15, 2002. As such, we are subject to liability as a self-insurer to the extent of these deductibles under the policy. We are self-insured for damage to the equipment we own or lease and for cargo losses. In developing liability reserves, we rely on professional third party claims administrators, insurance company estimates and the judgment of our own safety department personnel, and independent professional actuaries and attorneys. The most significant assumptions used in the estimation process include determining the trends in loss costs, the expected consistency in the frequency and severity of claims incurred but not yet reported to prior year claims and expected costs to settle unpaid claims. Management believes reserves are reasonable given known information, but as each case develops, estimates may change to reflect the effect of new information.

*Revenue recognition* Transportation revenues, including fuel surcharges and related costs, are recognized on the date the freight is delivered. Other service revenues, consisting primarily of lease revenues from affiliates, owner-operators and third parties, are recognized ratably over the lease period. Tank wash revenues are recognized when the wash is completed. Insurance brokerage revenues are recorded as a contractual percentage of premiums received ratably over the period that the insurance covers. We have recognized all revenues on a gross basis as the principal and primary obligor with risk of loss in relation to our responsibility for completion of services as contracted by our customers.

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

*Pension Plans* We maintain two noncontributory defined-benefit plans resulting from a prior acquisition that cover certain full-time salaried employees and certain other employees under a collective bargaining agreement. Both plans are frozen and, as such, no future benefits accrue. We record annual amounts relating to these plans based on calculations specified by GAAP, which include various actuarial assumptions such as discount rates (5.5%) and assumed rates of return (7.50% to 8.00%) depending on the pension plan. Material changes in pension costs may occur in the future due to changes in these assumptions. Future annual amounts could be impacted by changes in the discount rate, changes in the expected long-term rate of return, changes in the level of contributions to the plans and other factors.

The discount rate is based on a model portfolio of AA rated bonds with a maturity matched to the estimated payouts of future pension benefits. The expected return on plan assets is based on our expectation of the long-term rates of return on each asset class based on the current asset mix of the funds, considering the historical returns earned on the type of assets in the funds, plus an assumption of future inflation. The current investment policy target asset allocation differs between our two plans, but it is between 50% to 67% for equities and 33% to 50% for bonds, and the current inflation assumption is 2.5%. We review our actuarial assumptions on an annual basis and make modifications to the assumptions based on current rates and trends when appropriate. As required by GAAP in the United States, the effects of the modifications are amortized over future periods. Based on the information provided by our independent actuaries and other relevant sources, we believe that the assumptions used are reasonable.

Assumed discount rates and expected return on plan assets have a significant effect on the amounts reported for the pension plan. At December 31, 2005, our projected benefit obligation ( PBO ) was \$50.8 million. Our projected 2006 net periodic pension expense is \$567,000. A 1.0% decrease in our assumed discount rate would increase our PBO to \$56.8 million and increase our 2006 net periodic pension expense to \$590,000. A 1.0% increase in our assumed discount rate would decrease our PBO to \$46.0 million and decrease our 2006 net periodic pension expense to \$548,000. A 1.0% decrease in our assumed rate of return would not change our PBO but would increase our 2006 net periodic pension expense to \$959,000. A 1.0% increase in our assumed rate of return would not change our PBO and would decrease our 2006 net periodic pension expense to \$176,000.



---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

**New Accounting Pronouncements**

Beginning January 1, 2006, we adopted SFAS No. 123(R), as amended, using the modified prospective method which requires that all share-based payments to employees, including grants of employee equity incentives, are to be recognized in the consolidated statement of operations based on their fair values. The modified prospective method requires compensation costs to be recognized, beginning with the effective date of adoption, for a) all share-based payments granted after the effective date and b) awards granted to employees prior to the effective date of the statement that remain unvested on the effective date.

In prior years, we used Accounting Principles Board Opinion No. 25, Accounting for Stock-Based Compensation, and the related interpretations to account for our stock option plans. Except as described below, no compensation cost had been recorded at the grant dates, as the option price has been greater than or equal to the market price of the common stock on the applicable measurement date for all options issued. The pro forma fair value of options granted during the first three months of 2006 was based upon the Black-Scholes option-pricing model using certain defined criteria. See Note 4 for more information on stock-based compensation.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Corrections (SFAS No. 154). SFAS No. 154 replaces APB Opinion No. 20, Accounting Changes and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements and changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS No. 154 also provides guidance on the accounting for and reporting of error corrections. The January 2006 adoption of SFAS No. 154 had no material affect on our financial position, results of operations or cashflows.

**Results of Operations**

The following table presents certain condensed consolidated financial information, as a percentage of revenue, for the three months ended March 31, 2006 and March 31, 2005:

## QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

	Three months ended March 31,	
	2006	2005
<b>OPERATING REVENUES:</b>		
Transportation	79.6%	82.7%
Other service revenue	10.1%	10.4%
Fuel surcharge	10.3%	6.9%
<b>Total operating revenues</b>	<b>100.0%</b>	<b>100.0%</b>
<b>OPERATING EXPENSES:</b>		
Purchased transportation	68.0%	68.9%
Compensation	10.0%	9.0%
Fuel, supplies and maintenance	6.1%	4.4%
Depreciation and amortization	2.2%	2.8%
Selling and administrative	3.0%	3.9%
Insurance claims	2.2%	2.3%
Taxes and licenses	0.4%	0.4%
Communication and utilities	1.4%	1.3%
Gain on disposal of property and equipment	-0.1%	0.0%
PPI class action settlement and related expenses	0.0%	0.3%
<b>Total operating expenses</b>	<b>93.2%</b>	<b>93.3%</b>
<b>Operating income</b>	<b>6.8%</b>	<b>6.7%</b>
Interest expense, net	4.0%	3.9%
Write-off of debt issuance costs	0.0%	0.7%
Other (income)/expense	0.0%	0.1%
<b>Income before income taxes</b>	<b>2.8%</b>	<b>2.0%</b>
Provision for income taxes	-0.3%	-0.2%
<b>Income from continuing operations</b>	<b>2.5%</b>	<b>1.8%</b>

The following table shows the approximate number of terminals, drivers, trailers and tractors that we managed (including affiliates and owner-operators) as of March 31, 2006 and 2005:

	As of March 31,	
	2006	2005
Terminals *	170	162
Drivers	3,347	3,195
Tractors **	3,744	3,509
Trailers ***	7,642	7,410

\* excludes transload facilities

\*\* includes 139 tractors on a sales-type lease for 2006

\*\*\* excludes 310 and 550 trailers that are held-for-sale for 2006 and 2005, respectively

---

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

**Three Months Ended March 31, 2006 Compared to Three Months Ended March 31, 2005**

*Revenues.* For the quarter ended March 31, 2006, total revenues were \$178.8 million, an increase of \$17.6 million, or 10.9%, from revenues of \$161.1 million for the same period in 2005. Transportation revenue increased \$9.1 million, or 6.8%, primarily due to rate increases incorporated into our contracts over the past twelve months and an increase in the total number of miles offset by a reduction in loads from the prior-year period. Our loads decreased during the quarter due to reduced rail diversions and reduced overall demand, while the number of miles for each load increased over the prior year.

Other service revenues increased \$1.3 million, or 7.4%. This increase was primarily due to a \$0.8 million increase in revenues at our tank wash business. Fuel surcharge revenue increased \$7.3 million, or 65.6%. This increase was primarily due to an increase in the price of fuel and an increase in the number of miles driven.

*Operating expenses.* Purchased transportation increased by \$10.6 million, or 9.5%, due primarily to higher revenues and increased fuel costs passed on to our drivers and affiliates. Total purchased transportation as a percentage of transportation revenue and fuel surcharge revenue decreased to 75.7% for the current quarter versus 76.9% for the prior year quarter due partially to the conversion of affiliate terminals to Company terminals. We pay our affiliates a greater percentage of revenues generated by them than are paid to company owner-operators, so our purchased transportation costs will change as revenues generated by affiliates change as a percentage of total transportation revenue. While we paid our affiliates approximately 85% of the transportation revenue during the 2006 and prior year quarters, we paid owner-operators approximately 65% of transportation revenue during the current quarter compared to approximately 62% of transportation revenue in the comparable prior year quarter because of rate increases and fuel surcharges paid to owner-operators.

Compensation expense increased \$3.3 million, or 22.7%, primarily due to 13 new or converted company terminals added over the prior year and an increase of stock-based compensation expense. This increase was offset in part by a \$0.2 million decrease in pension costs. Total stock-based compensation expense for the current quarter was \$0.7 million compared with the prior year of \$0.2 million, which is largely due to the implementation of SFAS 123R on January 1, 2006 and the issuance of restricted stock and stock units since March 2005.

Fuel, supplies and maintenance increased \$3.8 million, or 52.9%, due to higher fuel costs and increased trailer and tractor maintenance as we increase our capacity, increased cleaning of our trailers, and increased trailer rent as we fund the expansion of our trailer fleet through the use of operating leases versus capital expenditures. Depreciation expense decreased \$0.5 million, or 11.6%, due primarily to the sale of tractors in prior quarters as well as a number of assets becoming fully depreciated throughout 2005.

Selling and administrative expenses decreased by \$1.0 million, or 16.0%, primarily due to reduced professional costs associated in part with our initial efforts to comply with Section 404 of the Sarbanes-Oxley Act of 2004 in the prior year and due to a \$1.2 million decrease in our bad debt expense resulting from improved collection efforts offset in part by a \$0.6 million increase in our environmental reserves for activity at our Bridgeport, New Jersey site. Insurance expense increased slightly by \$0.1 million, or 2.2%, due primarily to normal recurring insurance expense offset by a reduction in claims on insurance policies retained by our insurance subsidiary.

Communication and utilities costs increased by \$0.5 million, or 23.9%, primarily due to the increased costs of natural gas passed on to our tank wash facility from utility companies. Due to the court approval of the settlement agreement by the parties in October and November 2005, the PPI class action settlement and related expenses decreased \$0.5 million.

*Operating income and margin.* For the quarter ended March 31, 2006, operating income totaled \$12.1 million, an increase of \$1.3 million or 12.4%, compared to \$10.7 million for the same period in 2005. The operating margin for the quarter ended March 31, 2006, was 6.8% compared to 6.7% for the same period in 2005 as a result of the above items.

*Interest expense, net.* Interest expense, net increased by \$0.8 million or 13.0% in the first quarter of 2006 compared to the same period in 2005, as a result of the use of increased variable debt and the concurrent increase in interest rates over the prior year.

*Write-off of Debt Issuance Costs.* We wrote off \$1.1 million of debt issuance costs in the first quarter of 2005 that were associated with the \$70 million repayment of a term loan.

---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

*Income taxes.* The provision for income taxes increased by \$0.2 million for the three months ended March 31, 2006 from the same period in 2005 primarily due to alternative minimum taxes, state franchise and foreign taxes. The provision in the prior year period represents state franchise and foreign taxes.

*Net income.* For the quarter ended March 31, 2006, our net income was \$4.5 million, an increase of \$1.6 million or 53.6% compared to \$2.9 million for the same period last year.

**Liquidity and Capital Resources**

The following summarizes our cash flows for the three months ended 2006 and 2005 as reported in our Consolidated Statements of Cash Flows in the accompanying Consolidated Financial Statements:

(In Thousands)	Three Months ended March 31,	
	2006	2005
Net cash (used in) operating activities	\$ (3,468)	\$ (912)
Net cash (used in) investing activities	(4,090)	(1,824)
Net cash provided by financing activities	7,923	1,024
Net increase/(decrease) in cash	365	(1,712)
Effect of exchange rate changes on cash	(1)	3
Cash and cash equivalents at beginning of year	1,636	2,700
Cash and cash equivalents at end of period	\$ 2,000	\$ 991

Historically, our primary source of liquidity has been cash flow from operations and borrowing availability under our credit agreement. Our revolving credit agreement terminates in November, 2008. Our primary cash needs consist of capital expenditures and debt service including our variable term loan due in 2009, our 9% Senior Subordinated Notes due 2010 ( 9% Senior Subordinated Notes ) and our Senior Floating Rate Notes due 2012 ( Senior Floating Rate Notes ) (which were issued in January 2005 and were used to pay off borrowings under our revolver and our Series B floating interest rate notes, and to pay down our term loan). We incur capital expenditures for the purpose of purchasing tractors and trailers to meet our strategic needs during the year, and maintaining and improving our infrastructure. We plan to reduce our capital expenditures by entering into operating leases which will result in increased operating expenses in future periods.

We have accrued \$15.3 million for environmental claims and \$34.7 million for loss and damage claims, and the timing of cash payment for such claims fluctuates from quarter to quarter.

We used \$3.5 million in cash for operating activities for the three-month period ended March 31, 2006 compared to \$0.9 million used for the comparable 2005 period. The \$2.6 million increase in cash used in operating activities was primarily due to the utilization of cash for the purchase of tractors to be held for resale to new drivers, accounts payable, affiliate and owner-operator payables and environmental claims offset in part by increased profitability, improved accounts receivable collections and reduced payments for accrued loss and damage claims.

Cash used in investing activities totaled \$4.1 million for the three-month period ended March 31, 2006, compared to \$1.8 million used in the comparable 2005 period. The increase of \$2.3 million is primarily the result of the purchase of business assets for \$3.4 million and a \$0.7 million increase in capital expenditures for tractors and trailers in 2006 versus 2005, offset by a \$1.8 million increase in proceeds from the sale of property and equipment.

Cash provided by financing activities increased to \$7.9 million during the three-month period ended March 31, 2006, compared to net cash provided by financing activities of \$1.0 million for the same period in 2005 due primarily to the utilization of our revolving credit facility to fund our growth in 2006. In the comparable prior year, we refinanced some of our debt and incurred debt financing costs.



---

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

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

*Contractual Obligations and Commitments*

The following is a schedule of our long-term contractual commitments, including the current portion of our long-term indebtedness at March 31, 2006, over the periods we expect them to be paid (dollars in thousands):

	Total	Remainder of Fiscal Year 2006	Years 2007 & 2008	Years 2009 & 2010	The Five Years after 2010
Operating leases (1)	\$ 31,808	\$ 4,807	\$ 14,301	\$ 3,791	\$ 8,909
Unconditional purchase commitments (2)	3,495	3,495			
Total indebtedness (3)	294,200	1,050	20,500	187,650	85,000
Capital leases	723	105	277	325	16
Interest on indebtedness (4)	131,697	20,971	52,355	44,647	13,724
Total	\$ 461,923	\$ 30,428	\$ 87,433	\$ 236,413	\$ 107,649

- 
- (1) These obligations represent the minimum rental commitments under all non-cancelable operating leases.
- (2) These obligations represent firm purchase commitments for the purchase of specified assets. We have also committed to leasing trailers that have a cost of approximately \$8.9 million in 2006.
- (3) Excludes a discount of \$1.4 million.
- (4) Amounts presented for interest payments assume that all long-term debt obligations outstanding as of March 31, 2006 will remain outstanding until maturity and interest rates on variable-rate debt in effect as of March 31, 2006 will remain in effect until maturity. Additionally, we have \$8.6 million of environmental liabilities, \$8.4 million of pension plan obligations and \$25.0 million of other long-term insurance claim obligations we expect to pay out over the next four to seven years. We also have \$50.1 million in outstanding letters of credit. We are required to provide letters of credit to our insurance administrator to cover the payment of claims. The outstanding letters of credit as of March 31, 2006 for our insurance administrator totaled \$41.1 million. If we fail to meet certain terms of our agreement, the insurance administrator may draw down the letters of credit.

*Senior Floating Rate Notes*

On January 28, 2005, we consummated the private offering of \$85 million in Senior Floating Rate Notes by QD LLC and QD Capital and guaranteed by QDI and domestic subsidiaries at 98% of the face value of the notes. The Notes, due January 15, 2012, pay interest quarterly on January 15, April 15, July 15, and October 15. Interest accrues at a floating rate per annum, reset quarterly, equal to LIBOR plus 4.5%. The net proceeds were used to repay approximately \$70 million of the term loan and to make a distribution to QDI, which in turn used such proceeds to redeem all \$7.5 million principal amount of outstanding Series B Notes. The balance was used for general corporate purposes, including the repayment of \$5.8 million of indebtedness under the revolving credit portion of our credit facility. The credit facility was amended to incorporate this reduction in the term-loan portion of the facility and to modify the covenants. The interest rate on the Senior Floating Rate Notes at March 31, 2006 and 2005 was 9.1% and 7.2%, respectively.

We incurred \$2.5 million in debt issuance costs relating to the Senior Floating Rate Notes. We are amortizing these costs over the term of the notes. The balance of the debt issuance costs as of March 31, 2006 was \$2.1 million.

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

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

<b>Year</b>	<b>Percentage</b>
2007	102.00%
2008	101.00%
2009 and thereafter	100.00%

---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

*Term Loan*

On November 13, 2003, QD LLC and QD Capital, issued a private offering of \$125 million aggregate principal amount of 9% Senior Subordinated Notes and entered into a new credit agreement consisting of a \$140 million delayed draw term-loan, a \$75 million revolver and a \$20 million pre-funded letter of credit facility. On March 10, 2005, we completed the conversion of the 9% Senior Subordinated Notes from private debt to public debt.

The term loan bears interest at our option at (a) 2.00% in excess of the defined Base Rate or (b) 3.00% in excess of the Eurodollar rate for Eurodollar Loans, subject in each case, to adjustment based upon the achievement of certain financial ratios. The principal payments are payable quarterly on March 15, June 15, September 15 and December 15. The term loan matures on November 12, 2009. The interest rate on the term loan at March 31, 2006 and 2005 was 7.8% and 5.6%, respectively.

We incurred \$2.3 million in debt-issuance costs relating to the term loan. We are amortizing these costs over the term of the term loan to interest expense using the effective-interest method. The balance of these debt issuance costs as of March 31, 2006 was \$1.2 million.

*Revolving Credit Facility*

The revolver comprises a \$75.0 million revolver that is available until November 12, 2008 and a \$20 million pre-funded letter of credit facility that is available until November 12, 2009. The revolver can be used for working capital and general corporate purposes, including permitted acquisitions and additional letters of credit. At March 31, 2006, we had \$27.4 million available under the revolver and \$30.1 million in outstanding letters of credit.

Interest on the revolver is, at our option, (a) 2.50% in excess of the Base Rate provided in the credit agreement, or (b) 3.50% in excess of the Eurodollar rate for Eurodollar Loans, subject in each case, to adjustments based upon the achievement of certain financial ratios. The interest rate on the revolver at March 31, 2006 and 2005 was 8.5% and 8.0%, respectively.

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

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

We incurred \$1.5 million in debt-issuance costs relating to the revolver. We are amortizing these costs over the term of the revolver. The balance of the debt-issuance costs as of March 31, 2006 was \$0.9 million.

*9% Senior Subordinated Notes*

The 9% Senior Subordinated Notes are unsecured obligations, due 2010, guaranteed on a senior subordinated basis by us and all of our direct and indirect domestic subsidiaries. The guarantees are full, unconditional, joint and several obligations of the guarantors.



---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

We incurred \$5.5 million in debt-issuance costs relating to the 9% Senior Subordinated Notes. We are amortizing these costs over the term of the 9% Senior Subordinated Notes. The balance of the debt issuance costs as of March 31, 2006 was \$3.6 million.

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

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

*Collateral, Guarantees and Covenants*

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

The credit agreement contains restrictions on debt incurrence, investments, transactions with affiliates, creation of liens, asset dispositions, redeemable common stock, preferred stock issuance, capital expenditures, and the payment of dividends. At March 31, 2006, we were in compliance with all these debt covenants. The credit agreement includes one financial covenant, the ratio of Senior Secured Debt (as defined) to Consolidated EBITDA (as defined), which must be maintained. As of March 31, 2006, QD LLC was in compliance with this financial covenant.

*Debt Retirement*

The following is a schedule of our indebtedness at March 31, 2006 over the periods we are required to pay such indebtedness (dollars in thousands):

(in 000 s)	Remainder of 2006	2007	2008	2009	2010 and after	Total
Variable term loan due 2009	\$ 1,050	\$ 1,400	\$ 1,400	\$ 62,650	\$	\$ 66,500
Capital lease obligations	105	126	151	155	186	723
Revolver			17,700			17,700
9% Senior Subordinated Notes, due 2010					125,000	125,000
Senior Floating Rate Notes, due 2012					85,000	85,000
Total	\$ 1,155	\$ 1,526	\$ 19,251	\$ 62,805	\$ 210,186	\$ 294,923

The above table does not include the remaining unamortized original issue discount of \$1.4 million relating to the Senior Floating Rate Notes.

QD LLC, has the ability to incur additional debt, subject to limitations imposed by the credit facility and the indentures governing the 9% Senior Subordinated Notes and the Senior Floating Rate Notes. Under the indentures governing the notes, in addition to specified permitted indebtedness, QD LLC will be able to incur additional indebtedness so long as, on a pro forma basis, QD LLC's consolidated fixed charge coverage ratio (the ratio of Consolidated EBITDA (as defined in the respective indentures for the QD LLC Notes) to consolidated fixed charges) is 2.25 to 1.0 or less. As of March 31, 2006, we were in compliance with this covenant.

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

We believe that, based on current operations and anticipated growth, our cash flow from operations, together with available sources of liquidity, including borrowings under the revolver, will be sufficient to fund anticipated capital expenditures, make required payments of principal and interest on our debt, including obligations under our credit agreement, and satisfy other long-term contractual commitments for the next twelve months.

---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

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

*Other Issues*

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

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

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

**FORWARD-LOOKING STATEMENTS AND CERTAIN CONSIDERATIONS**

This report along with other documents that are publicly disseminated by us contain or might contain forward-looking statements within the meaning of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended (the Exchange Act). All statements included in this report and in any subsequent filings made by us with the SEC, other than statements of historical fact, that address activities, events or developments that we or our management expect, believe or anticipate will or may occur in the future, are forward-looking statements. These statements represent our reasonable judgment on the future based on various factors and using numerous assumptions and are subject to known and unknown risks, uncertainties and other factors that could cause our actual results and financial position to differ materially. We claim the protection of the safe harbor for forward-looking statements provided in the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act and Section 21E of the Exchange Act. Examples of forward-looking statements include: (i) projections of revenue, earnings, capital structure and other financial items, (ii) statements of our plans and objectives, (iii) statements of expected future economic performance, and (iv) assumptions underlying statements regarding us or our business. Forward-looking statements can be identified by, among other things, the use of forward-looking language, such as believes, expects, estimates, may, will, should, could, seeks, plans, i or scheduled to or the negatives of those terms, or other variations of those terms or comparable language, or by discussions of strategy or other intentions.

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

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

results to be materially different from the forward-looking statements include the following risks and other factors discussed under the Section 1A Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2005 as well as of this Quarterly Report on 10-Q. These factors include:

general economic conditions,

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,

competitive rate fluctuations,

the availability and cost of diesel fuel,

adverse weather conditions,

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

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

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

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

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

our substantial leverage and restrictions contained in our debt agreements, including our credit facility and our indentures,

our ability or inability to reduce our claims exposure through insurance due to changing conditions and pricing in the insurance marketplace,

the loss of one or more significant customers,

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

changes in senior management,

our ability to successfully integrate acquired businesses,

our ability to achieve anticipated operating results in fiscal 2006,

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

the potential loss of our ability to use net operating losses to offset future income due to a change of control.

In addition, there may be other factors that could cause our actual results to be materially different from the results referenced in the forward-looking statements.

All forward-looking statements contained in this Quarterly Report on Form 10-Q are qualified in their entirety by this cautionary statement. Forward-looking statements speak only as of the date they are made, and we do not intend to update or otherwise revise the forward-looking statements to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q or to reflect the occurrence of unanticipated events.

#### **ADDITIONAL INFORMATION AVAILABLE ON COMPANY WEB-SITE**

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

#### **ITEM 3 Quantitative and Qualitative Disclosures About Market Risk**

##### **Market Risk**

We are subject to market risks from interest rates due to our variable interest rate indebtedness, foreign currency fluctuations due to our international operations and increased commodity prices due to the diesel consumption necessary for our operations. During the quarters ended March 31, 2006 and 2005, we did not hold derivative instruments or engage in other hedging transactions to reduce our exposure to such risks.

---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**
**Interest Rate Risk**

We are exposed to the impact of interest rate changes primarily through our variable-rate borrowings under QD LLC's credit facility. Interest rates for the revolver are based, at QD LLC's option, on either the administrative agent's base rate plus 2.50% or upon the Eurodollar rate plus 3.50%, and interest rates for the term loan are based, at QD LLC's option, upon the administrative agent's base rate plus 2.0% or upon the Eurodollar rate plus 3.0%, in each case subject to reductions in the applicable margins for the revolver and term loan only if we reduce our total consolidated leverage below certain levels. The base rate for the revolver is equal to the higher of the prime rate or the federal funds overnight rate plus 0.5%. The base rate for our Senior Floating Rate Notes is LIBOR plus 4.50%.

<b>\$ in 000s</b>	<b>Balance at March 31, 2006</b>	<b>Interest Rate at March 31, 2006</b>	<b>Effect of 1% Change</b>
Revolver	\$ 17,700	8.5%	\$ 177
Term Loan	66,500	7.8%	665
Senior Floating Rate Notes	85,000	9.1%	850
Total	\$ 169,200		\$ 1,692

At March 31, 2006, a 1% point increase in the current per annum interest rate for each would result in \$1.7 million of additional interest expense during the next year. The foregoing calculation assumes an instantaneous one percentage point increase in the rates of all of our indebtedness and that the principal amount of each is the amount outstanding as of March 31, 2006. The calculation therefore does not account for the differences in the market rates upon which the interest rates of our indebtedness are based, our various options to elect the lower of two different interest rates under our borrowings or other possible actions, such as prepayment, that we might take in response to any rate increase.

**Foreign Currency Exchange Rate Risk**

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

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

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

These exposures may impact future earnings or cash flows. Revenue from foreign locations (Canada and Mexico) represented approximately 6.6% of our consolidated revenue in the quarter ended March 31, 2006 and 7.3% of our consolidated revenue in the quarter ended March 31, 2005. 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 quarter ended March 31, 2006 were positively impacted by a \$0.7 million foreign currency movement, primarily due to the strengthening of the Canadian dollar against the United States dollar.

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

Changes in foreign exchange rates that had the largest impact on translating our international operating profits for 2006 related to the Canadian dollar versus the United States dollar. We estimate that a 1% adverse change in the Canadian dollar foreign exchange rate would have decreased our revenues by approximately \$0.1 million in the quarter ended March 31, 2006, assuming no changes other than the exchange rate itself. Our inter-company loans are subject to

---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

fluctuations in exchange rates primarily between the United States dollar and the Canadian dollar. Based on the outstanding balance of our inter-company loans at March 31, 2006, a change of 1% in the exchange rate for the Canadian dollar would cause a change in our foreign exchange result of less than \$0.1 million.

**Commodity Price Risk**

The price and availability of diesel fuel are subject to fluctuations due to changes in the level of global oil production, seasonality, weather, global politics and other market factors. Historically, we have been able to recover a majority of fuel price increases from our customers in the form of fuel surcharges. The price and availability of diesel fuel can be unpredictable as well as the extent to which fuel surcharges could be collected to offset such increases. In the quarter ended March 31, 2006, a majority of fuel price fluctuations were covered through fuel surcharges.

**ITEM 4 Controls and Procedures**

*Evaluation of disclosure controls and procedures*

As required by Rules 13a-15(b) and 15d-15(b) under the Securities Exchange Act of 1934, management has evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on their evaluation, management concluded our disclosure controls and procedures (as defined in Securities Exchange Act Rules 13a-15(e) and 15d-15(e)) were effective as of March 31, 2006 to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and were effective as of March 31, 2006 to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure.

*Changes in Internal Control Over Financial Reporting*

There were no changes in our internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) during the quarter ended March 31, 2006 that materially affected, or were reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION**

**ITEM 1 Legal Proceedings**

Other than reported in Item 3 - Legal Proceedings of our Annual Report on Form 10-K for the year ended December 31, 2005, Note 19. Commitments and Contingencies to our audited consolidated financial statements contained in such Form 10-K and Note 7. 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-Q.

**ITEM 1A Risk Factors**

We have identified the material changes from the risk factors disclosed in the Item 1A Risk Factors section of our Annual Report on Form 10-K for the year ended December 31, 2005 filed on March 16, 2006 set forth below. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

**Increased fuel prices could adversely affect our business, financial condition and results of operations.**

During the first quarter of 2006, fuel prices rose to near record levels. We have historically been able to pass along any increases in fuel prices as a fuel surcharge to our customers. If we are unable to pass along fuel cost increases to our customers in the future, it may materially adversely affect our business, financial condition and operating results.





---

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

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

In the first quarter of fiscal year 2006, we issued 10,427 shares of our common stock upon the cashless exercise of outstanding warrants. The shares were not registered under the Securities Act of 1933 and were sold pursuant to an exemption under Section 4(2) of the Securities Act and the rules of the SEC promulgated thereunder. These warrants were a part of the warrants issued to bondholders in 2002 in connection with an exchange offer. Warrants to purchase approximately 213,000 shares of our common stock at an exercise price of \$2.94 per share were outstanding at March 31, 2006. These warrants expire January 15, 2007.

**ITEM 3 Defaults Upon Senior Securities**

None

**ITEM 4 Submission of Matters to a Vote of Security Holders**

None

**ITEM 5 Other Information**

None

**ITEM 6 EXHIBITS**

<b>Exhibit No.</b>	<b>Description</b>
31.1	Certification of Chief Executive Officer Pursuant To Section 302 of The Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant To Section 302 of The Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 of The Sarbanes-Oxley Act of 2002

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

**SIGNATURES**

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

QUALITY DISTRIBUTION, INC.

May 9, 2006

/s/ GERALD L. DETTER  
GERALD L. DETTER,  
CHIEF EXECUTIVE OFFICER  
(PRINCIPAL EXECUTIVE OFFICER)

May 9, 2006

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