

QUALITY DISTRIBUTION INC  
Form 10-Q  
November 07, 2008  
[Table of Contents](#)

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

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2008

or

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

For the transition period from to

Commission File Number: 000-24180

**Quality Distribution, Inc.**

(Exact name of registrant as specified in its charter)

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

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

(Registrant's telephone number, including area code)

N/A

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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  (Do not check if a smaller reporting company)  
Smaller reporting company

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

As of November 3, 2008, the registrant had 19,528,071 shares of Common Stock, no par value, outstanding.

**Table of Contents**

**QUALITY DISTRIBUTION, INC.**

**CONTENTS**

<b><u>PART I FINANCIAL INFORMATION</u></b>	<b>1</b>
<b><u>ITEM 1 FINANCIAL STATEMENTS</u></b>	<b>1</b>
<b><u>Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2008 and 2007</u></b>	<b>1</b>
<b><u>Consolidated Balance Sheets as of September 30, 2008 and December 31, 2007</u></b>	<b>2</b>
<b><u>Consolidated Statements of Shareholders' Equity for the Nine Months Ended September 30, 2008 and 2007</u></b>	<b>3</b>
<b><u>Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2008 and 2007</u></b>	<b>4</b>
<b><u>Notes to Consolidated Financial Statements</u></b>	<b>5</b>
<b><u>ITEM 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	<b>26</b>
<b><u>ITEM 3 Quantitative and Qualitative Disclosures About Market Risk</u></b>	<b>43</b>
<b><u>ITEM 4 Controls and Procedures</u></b>	<b>45</b>
<b><u>PART II OTHER INFORMATION</u></b>	<b>46</b>
<b><u>ITEM 1 Legal Proceedings</u></b>	<b>46</b>
<b><u>ITEM 1A Risk Factors</u></b>	<b>46</b>
<b><u>ITEM 2 Unregistered Sale of Equity Securities and Use of Proceeds</u></b>	<b>47</b>
<b><u>ITEM 3 Defaults Upon Senior Securities</u></b>	<b>47</b>
<b><u>ITEM 4 Submission of Matters to a Vote of Security Holders</u></b>	<b>47</b>
<b><u>ITEM 5 Other Information</u></b>	<b>47</b>
<b><u>ITEM 6 Exhibits</u></b>	<b>47</b>
<b><u>Signatures</u></b>	<b>48</b>

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

	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>OPERATING REVENUES:</b>				
Transportation	\$ 144,774	\$ 148,900	\$ 445,798	\$ 442,656
Other service revenue	25,494	18,736	78,916	54,847
Fuel surcharge	44,473	24,545	122,490	67,483
<b>Total operating revenues</b>	<b>214,741</b>	<b>192,181</b>	<b>647,204</b>	<b>564,986</b>
<b>OPERATING EXPENSES:</b>				
Purchased transportation	124,800	118,653	376,378	358,027
Compensation	27,519	22,302	83,518	62,558
Fuel, supplies and maintenance	30,031	21,146	93,199	56,545
Depreciation and amortization	5,207	4,468	15,435	12,960
Selling and administrative	8,699	7,442	26,515	21,314
Insurance claims	3,202	3,239	11,629	14,321
Taxes and licenses	1,583	1,105	4,042	2,729
Communication and utilities	3,104	2,952	10,109	8,081
(Gain) loss on disposal of property and equipment	(867)	219	(2,832)	418
Restructuring costs	1,700		4,075	
<b>Total operating expenses</b>	<b>204,978</b>	<b>181,526</b>	<b>622,068</b>	<b>536,953</b>
Operating income	9,763	10,655	25,136	28,033
Interest expense	8,455	7,651	26,246	23,403
Interest income	(128)	(198)	(333)	(573)
Other expense (income)	15	(279)	171	(638)
Income (loss) before income taxes	1,421	3,481	(948)	5,841
Provision for (benefit from) income taxes	704	1,982	(98)	2,229
<b>Net income (loss)</b>	<b>\$ 717</b>	<b>\$ 1,499</b>	<b>\$ (850)</b>	<b>\$ 3,612</b>
<b>PER SHARE DATA:</b>				
<b>Net income (loss) per common share</b>				
Basic	\$ 0.04	\$ 0.08	\$ (0.04)	\$ 0.19
Diluted	\$ 0.04	\$ 0.08	\$ (0.04)	\$ 0.19

**Weighted average number of shares**

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Basic	19,387	19,357	19,377	19,353
Diluted	19,556	19,488	19,377	19,488

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

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

	<b>September 30, 2008</b>	<b>December 31, 2007</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 23,443	\$ 9,711
Accounts receivable, net	106,352	99,081
Prepaid expenses	9,607	8,150
Deferred tax assets, net	20,483	20,483
Other	6,970	6,258
Total current assets	166,855	143,683
Property and equipment, net	154,178	121,992
Goodwill	173,143	173,575
Intangibles, net	23,124	24,167
Non-current deferred tax assets, net	17,095	16,203
Other assets	11,669	14,356
Total assets	\$ 546,064	\$ 493,976
<b>LIABILITIES, MINORITY INTEREST AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Current maturities of indebtedness	\$ 7,213	\$ 413
Current maturities of capital lease obligations	7,892	1,451
Accounts payable	17,485	17,428
Affiliates and independent owner-operators payable	16,349	12,597
Accrued expenses	30,008	25,957
Environmental liabilities	3,875	4,751
Accrued loss and damage claims	9,842	13,438
Income tax payable		555
Total current liabilities	92,664	76,590
Long-term indebtedness, less current maturities	371,671	343,575
Capital lease obligations, less current maturities	17,810	3,832
Environmental liabilities	6,636	6,418
Accrued loss and damage claims	13,831	18,474
Other non-current liabilities	13,652	15,954
Total liabilities	516,264	464,843
Commitments and contingencies - Note 9		
Minority interest in subsidiary	1,833	1,833
<b>SHAREHOLDERS EQUITY</b>		
Common stock, no par value; 29,000 shares authorized; 19,732 issued and 19,528 outstanding at September 30, 2008 and 19,334 issued and 19,176 outstanding at December 31, 2007	362,760	361,617

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Treasury stock, 204 and 158 shares at September 30, 2008 and December 31, 2007	(1,580)	(1,564)
Accumulated deficit	(126,996)	(126,146)
Stock recapitalization	(189,589)	(189,589)
Accumulated other comprehensive loss	(16,394)	(16,748)
Stock subscriptions receivable	(234)	(270)
<b>Total shareholders' equity</b>	<b>27,967</b>	<b>27,300</b>
Total liabilities, minority interest and shareholders' equity	\$ 546,064	\$ 493,976

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

**Table of Contents****QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES****Consolidated Statements of Shareholders' Equity****For the Nine Months Ended September 30, 2008 and 2007****Unaudited (In 000 s)**

	Shares of Common Stock	Shares of Treasury Stock	Common Stock	Treasury Stock	Accumulated Deficit	Stock Recapitalization	Accumulated Other Comprehensive Loss	Stock Purchase Warrants	Stock Subscription Receivables	Total Shareholders' Equity
Balance, December 31, 2006	19,210	(172)	\$ 359,995	\$ (1,527)	\$ (118,255)	\$ (189,589)	\$ (18,531)	\$ 21	\$ (340)	\$ 31,774
Net income					3,612					3,612
Issuance of restricted stock	47	11	(25)	25						
Forfeiture of restricted stock		(2)	11	(11)						
Amortization of restricted stock			253							253
Amortization of non-employee options			94							94
Amortization of stock options			880							880
Stock warrant exercise	79		21					(21)		
Stock option exercise	8	8	52	19						71
Acquisition of treasury stock		(3)		(70)					70	
FIN 48 Adjustment					(328)					(328)
Amortization of prior service costs, net of tax provision							70			70
Translation adjustment, net of tax provision							(314)			(314)
Balance, September 30, 2007	19,344	(158)	\$ 361,281	\$ (1,564)	\$ (114,971)	\$ (189,589)	\$ (18,775)	\$	\$ (270)	\$ 36,112
Balance, December 31, 2007	19,334	(158)	\$ 361,617	\$ (1,564)	\$ (126,146)	\$ (189,589)	\$ (16,748)	\$	\$ (270)	\$ 27,300
Net loss					(850)					(850)
Issuance of restricted stock	398									
Forfeiture of restricted stock		(45)								
Amortization of restricted stock			189							189
Amortization of non-employee options			94							94
Amortization of stock options			860							860



Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Other stock transactions		(1)		(16)					36	20
Amortization of prior service costs and losses, net of tax						241				241
Translation adjustment, net of tax						113				113
Balance, September 30, 2008	19,732	(204)	\$ 362,760	\$ (1,580)	\$ (126,996)	\$ (189,589)	\$ (16,394)	\$	\$ (234)	\$ 27,967

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

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

	<b>Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net (loss) income	\$ (850)	\$ 3,612
Adjustments to reconcile to net cash and cash equivalents (used in) provided by operating activities:		
Deferred income tax (benefit) expense	(892)	848
Depreciation and amortization	15,435	12,960
Bad debt expense	1,000	792
(Gain) Loss on disposal of property and equipment	(2,832)	418
Stock based compensation	1,143	1,227
Amortization of deferred financing costs	2,235	1,375
Amortization of bond discount	825	182
Minority dividends	109	109
Changes in assets and liabilities:		
Accounts and other receivables	(7,915)	(9,228)
Prepaid expenses	2,692	(286)
Other assets	1,935	(87)
Accounts payable	1,830	(1,918)
Accrued expenses	4,050	5,754
Environmental liabilities	(658)	(1,270)
Accrued loss and damage claims	(8,239)	(6,500)
Affiliates and independent owner-operators payable	3,752	3,925
Other liabilities	(2,418)	939
Current income taxes	(537)	(551)
<b>Net cash provided by operating activities</b>	<b>10,665</b>	<b>12,301</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Capital expenditures	(14,967)	(7,368)
Acquisition of businesses and assets	(1,397)	(4,004)
Boasso purchase adjustment	1,318	
Proceeds from sales of property and equipment	4,598	5,471
<b>Net cash used in investing activities</b>	<b>(10,448)</b>	<b>(5,901)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from issuance of long-term debt	1,049	
Principal payments on long-term debt	(3,316)	(1,050)
Principal payments on capital lease obligations	(1,949)	(899)
Proceeds from revolver	110,700	35,700
Payments on revolver	(89,830)	(35,700)
Payments on acquisition notes	(631)	(321)
Deferred financing costs	(623)	(153)
Stock offering costs		(787)
Change in book overdraft	(1,782)	(70)
Minority dividends	(109)	(109)

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Other stock transactions	20	70
Net cash provided by (used in) financing activities	13,529	(3,319)
Effect of exchange rate changes on cash	(14)	59
Net increase in cash and cash equivalents	13,732	3,140
Cash and cash equivalents, beginning of period	9,711	6,841
Cash and cash equivalents, end of period	\$ 23,443	\$ 9,981

Supplemental Disclosure of Cash Flow Information

Cash paid during the year for:

Interest	\$ 20,308	\$ 19,055
Income Taxes	1,684	1,460

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

---

**Table of Contents**

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

**Quality Distribution, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

**(Unaudited)**

**1. Summary of Significant Accounting Policies**

**Basis of Presentation**

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

We are primarily engaged in truckload transportation of bulk chemicals and are also engaged in ISO tank container transportation and depot services, tank wash facility services, logistics and other value-added services. We conduct a significant portion of our business through a network of company terminals, affiliates and independent owner-operators. Affiliates are independent companies, which enter into various term contracts with the Company. Affiliates are responsible for paying for their own power equipment (including debt service), fuel and other operating costs. Certain affiliates lease trailers from us. 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. In exchange for the services rendered, affiliates and owner-operators are normally paid a percentage of the revenues generated for each load hauled.

Our accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and do not include all of the information and notes required by accounting principles generally accepted in the United States ( U.S. GAAP ) for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments and accruals) considered necessary for a fair statement of consolidated financial position, results of operations and cash flows have been included. The year ended consolidated balance sheet data was derived from audited financial statements, but does not include all the disclosures required by U.S. GAAP. For further information, refer to our Annual Report on Form 10-K for the year ended December 31, 2007, including the consolidated financial statements and accompanying notes. Certain prior-period amounts have been reclassified to conform to the current year's presentation.

Operating results for the three and nine months ended September 30, 2008 are not necessarily indicative of the results that may be expected for the entire fiscal year.

**New Accounting Pronouncements**

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* ( SFAS 141R ). This statement significantly changes the financial accounting and reporting of business combination transactions. The provisions of this statement are to be applied prospectively to business combination transactions in the first annual reporting period beginning on or after December 15, 2008. The impact of adopting SFAS 141R will depend on the nature, terms and size of business combinations completed after the effective date.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51* ( SFAS 160 ). SFAS 160 establishes accounting and reporting standards for noncontrolling interests in subsidiaries. This statement requires the reporting of all noncontrolling interests as a separate component of stockholders' equity, the reporting of consolidated net income (loss) as the amount attributable to both the parent and the noncontrolling interests and the separate disclosure of net income (loss) attributable to the parent and to the noncontrolling interests. In addition, this statement provides accounting and reporting guidance related to changes in noncontrolling ownership interests. Other than the reporting requirements described above which require retrospective application, the provisions of SFAS 160 are to be applied prospectively in the first annual reporting period beginning on or after December 15, 2008. We are currently evaluating the impact of this standard on our consolidated financial statements.



---

**Table of Contents**

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

In April 2008 the FASB issued FASB Staff Position No. FAS 142-3, *Determination of the Useful Life of Intangible Assets* ( FSP FAS 142-3 ). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, *Goodwill and Other Intangible Assets*. More specifically, FSP FAS 142-3 removes the requirement under paragraph 11 of SFAS 142 to consider whether an intangible asset can be renewed without substantial cost or material modifications to the existing terms and conditions and instead, requires an entity to consider its own historical experience in renewing similar arrangements. FSP FAS 142-3 also requires expanded disclosure related to the determination of intangible asset useful lives. We are currently evaluating the potential impact the adoption of FSP FAS 142-3 will have on our consolidated financial statements.

In May 2008, the FASB issued SFAS No.162, *The Hierarchy of Generally Accepted Accounting Principles* ( SFAS 162 ), which identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with U.S. GAAP. SFAS 162 is effective 60 days following the Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. We do not expect the adoption of SFAS 162 to have a material effect on our financial statements or related disclosures.

In June 2008, the FASB Issued EITF No. 08-3, *Accounting by Lessees for Nonrefundable Maintenance Deposits* ( EITF No. 08-3 ). EITF No. 08-3 requires that nonrefundable maintenance deposits paid by a lessee under an arrangement accounted for as a lease be accounted for as a deposit asset until the underlying maintenance is performed. When the underlying maintenance is performed, the deposit may be expensed or capitalized in accordance with the lessee's maintenance accounting policy. Upon adoption entities must recognize the effect of the change as a change in accounting principle. The adoption of EITF No. 08-3 will not impact the Company's financial condition, results of operations or cash flows.

In June 2008, the Financial Accounting Standards Board ( FASB ) issued FASB Staff Position No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* ( FSP EITF 03-6-1 ), which addresses whether unvested equity-based awards are participating securities and, therefore, need to be included in the earnings allocation in computing earnings per share under the two-class method described in FASB Statement No. 128, *Earnings per Share* . FSP EITF 03-6-1 is effective for the Company beginning December 1, 2009 and cannot be adopted early. All prior period earnings per share data presented in financial statements that are issued after the effective date shall be adjusted retrospectively to conform to the new guidance. We are currently evaluating the potential impact of the adoption of FSP EITF 03-6-1 will have on our consolidated financial statements.

**Adoption of Statement of Financial Accounting Standards No. 157 and No. 159**

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Liabilities*, ( SFAS 159 ). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. If the fair value option is elected, unrealized gains and losses will be recognized in earnings at each subsequent reporting date. On January 1, 2008, we did not elect to adopt the provisions of SFAS 159.

On January 1, 2008, we adopted the provisions of Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, ( SFAS 157 ). SFAS 157 defines fair value and provides guidance for measuring fair value and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but rather applies to all other accounting pronouncements that require or permit fair value measurements. In February 2008, the FASB issued final Staff Position No. FAS 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements that Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13*, which amended SFAS 157 to exclude FASB Statement No. 13 and its related interpretive accounting pronouncements that address leasing transactions. In February 2008, the FASB also issued final Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157*, to allow a one-year deferral of adoption of SFAS 157 for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. We have elected this one-year deferral and thus will not apply the provisions of SFAS 157 to nonfinancial assets and nonfinancial liabilities that are recognized at fair value in the financial statements on a nonrecurring basis until our fiscal year beginning January 1, 2009.

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

SFAS 157 enables the reader of the financial statements to assess the inputs used to develop fair value measurements by establishing a hierarchy for ranking the quality and reliability of the information used to determine fair values. SFAS 157 requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

We have no financial assets or financial liabilities that require application of SFAS 157.

We generally apply fair value techniques on a nonrecurring basis associated with (1) valuing potential impairment loss related to goodwill and indefinite-lived intangible assets accounted for pursuant to SFAS No. 142 and (2) valuing potential impairment loss related to long-lived assets accounted for pursuant to SFAS No. 144.

**Acquisition of Business Assets***Acquisition of Boasso America Corporation*

On December 18, 2007, we acquired 100% of the stock of Boasso. The results of Boasso have been included in our results since the date of acquisition.

The purchase price of Boasso was initially allocated to the assets acquired and liabilities assumed according to their estimated fair values at the time of the acquisition. In April 2008, pursuant to the stock purchase agreement, and based on an evaluation of the net working capital as of the date of acquisition, approximately \$1.3 million was refunded to us. The allocation of the purchase price is as follows (in thousands):

Working capital, net of cash	\$ 8,312
Property and equipment	7,209
Other long-term assets	81
Non-compete agreements	400
Customer related intangibles	11,900
Tradename	9,800
Long-term debt and capital lease obligations	(4,512)
Deferred tax liabilities	(9,435)
Goodwill	29,983
	\$ 53,738

The customer-related intangible assets relate to acquired customer relationships, and are being amortized over a twelve-year weighted-average useful life on a straight-line basis. The tradename has an indefinite useful life. The allocation of the purchase price to the assets acquired and liabilities assumed may be subject to further adjustment. The goodwill acquired in this acquisition is not tax deductible, and has been allocated to the Container Services segment.

*Other Acquisitions*

During 2008, we purchased two transportation companies and an affiliate for \$2.1 million, in the aggregate, of which \$1.4 million was paid in cash at closing and the remaining \$0.7 million is payable over future periods. Of the total \$2.1 million, we allocated \$1.0 million to property and equipment, \$0.9 million to goodwill, and \$0.2 million to other intangible assets such as non-compete agreements.

**Goodwill and Intangible Assets**

*Goodwill*

Under SFAS 142, Goodwill and Other Intangible Assets, goodwill is subject to an annual impairment test as well as impairment assessments of certain triggering events. SFAS 142 requires us to compare the fair value of the reporting



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

unit to its carrying amount to determine if there is a potential impairment. If the fair value of the reporting unit is less than its carrying amount, an impairment loss is recorded to the extent the carrying amount of the goodwill within the reporting unit is greater than the implied fair value of goodwill.

We perform our impairment test annually during the second quarter with a measurement date of June 30th. No impairment was determined to have occurred as of June 30, 2008, since the calculated fair value exceeded the carrying amount.

Our goodwill assets as of September 30, 2008 and December 31, 2007, were \$173.1 million and \$173.6 million, respectively. In 2008, goodwill increased \$0.9 million due to the acquisition of three businesses offset by a decrease of \$1.3 million related to a purchase price adjustment based upon net working capital as of the date of the acquisition of Boasso.

*Intangible Assets*

Intangible assets at September 30, 2008 were as follows (in thousands):

	Gross value	Accumulated amortization	Net book value	Average lives (in years)
Tradename	\$ 9,800	\$	\$ 9,800	Indefinite
Customer relationships	11,998	(744)	11,254	12
Non-compete agreements	3,053	(983)	2,070	3
	\$ 24,851	\$ (1,727)	\$ 23,124	5

Amortization expense for the nine months ended September 30, 2008 and 2007 was \$1.3 million and \$0.2 million, respectively. Remaining intangible assets will be amortized to expense as follows (in thousands):

2008 remaining	\$ 433
2009	1,665
2010	1,615
2011	1,439
2012 and after	8,172
Total	\$ 13,324

**2. Comprehensive Income (Loss)**

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

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2008	2007	2008	2007
Net income (loss)	\$ 717	\$ 1,499	\$ (850)	\$ 3,612
Other comprehensive income (loss):				
Amortization of prior service costs	112	23	241	70

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Foreign currency translation adjustments	53	(99)	113	(314)
Comprehensive income (loss)	\$ 882	\$ 1,423	\$ (496)	\$ 3,368

**Table of Contents****QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES****3. Income (Loss) Per Share**

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

	September 30, 2008			September 30, 2007		
	Net income (numerator)	Shares (denominator)	Per-share amount	Net income (numerator)	Shares (denominator)	Per-share amount
<b>Basic earnings available to common shareholders:</b>						
Net income	\$ 717	19,387	\$ 0.04	\$ 1,499	19,357	\$ 0.08
<b>Effect of dilutive securities:</b>						
Stock options		28			79	
Unvested restricted stock		141			48	
Stock units					4	

<b>Diluted earnings available to common shareholders:</b>						
Net income	\$ 717	19,556	\$ 0.04	\$ 1,499	19,488	\$ 0.08

	September 30, 2008			September 30, 2007		
	Net loss (numerator)	Shares (denominator)	Per-share amount	Net income (numerator)	Shares (denominator)	Per-share amount
<b>Basic (loss) earnings available to common shareholders:</b>						
Net (loss) income	\$ (850)	19,377	\$ (0.04)	\$ 3,612	19,353	\$ 0.19
<b>Effect of dilutive securities:</b>						
Stock options					92	
Unvested restricted stock					39	
Stock units					4	

<b>Diluted (loss) earnings available to common shareholders:</b>						
Net (loss) income	\$ (850)	19,377	\$ (0.04)	\$ 3,612	19,488	\$ 0.19

There is no effect of our stock options and restricted stock in the computation of diluted earnings per share for the nine months ended September 30, 2008 due to a net loss.

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

	Three months ended		Nine months ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Stock options	2,041	1,687	2,069	1,685

Unvested restricted stock

33

141

45

**Table of Contents****QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES****4. Stock-Based Compensation**

We maintain performance incentive plans under which stock options, restricted shares, and stock units may be granted to employees, non-employee directors, consultants and advisors. As of September 30, 2008, we have three stock-based compensation plans.

We recognize expense for stock-based compensation based upon estimated grant date fair value. We apply the Black-Scholes valuation model in determining the fair value of share-based payments to employees. The resulting compensation expense is recognized over the requisite service period, which is generally the awards' vesting term. Compensation expense is recognized only for those awards expected to vest, with forfeitures estimated based on our historical experience and future expectations. All stock-based compensation expense is classified within Compensation on the Consolidated Statement of Operations. None of the stock-based compensation was capitalized during 2008.

The fair value of options granted during the first nine months of 2008 and 2007 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 2008, expected stock price volatility is based on the historical volatility of our common stock, which began trading on November 13, 2003. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant with an equivalent remaining term. The Company has not paid dividends in the past and does not currently plan to pay any dividends in the foreseeable future. The Black-Scholes model was used with the following weighted average assumptions:

	<b>2008</b>	<b>2007</b>
Risk free rate	3.21%	4.65%
Expected life	5 years	5 years
Volatility	67.3%	68.5%
Expected dividend	nil	nil

The following options and restricted shares were issued during the nine months ended September 30, 2008:

	<b>Options Issued</b>	<b>Restricted Shares Issued</b>
Quarter ended March 31, 2008	227,000	73,326
Quarter ended June 30, 2008	105,000	17,910
Quarter ended September 30, 2008	50,000	

On July 28, 2008, we issued options for 50,000 shares to our Chief Financial Officer. The exercise price of options granted was based on the fair market value of our stock at the date of the grant.

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

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

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Stock options	\$ 319	\$ 306	\$ 868	\$ 974
Restricted stock	89	128	267	253
Stock units		(14)		
	\$ 408	\$ 420	\$ 1,135	\$ 1,227

The following table summarizes unrecognized stock-based compensation and the weighted average period over which such stock-based compensation is expected to be recognized as of September 30, 2008 (in thousands):

	In \$	Remaining years
Stock options	\$ 2,299	4
Restricted stock	650	4
	\$ 2,949	

These amounts do not include the cost of any additional awards that may be granted in future periods nor any changes in our forfeiture rate. No options were exercised during the nine months ended September 30, 2008.

**5. Employee Benefit Plans**

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

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

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

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Service cost	\$ 54	\$ 64	\$ 160	\$ 192
Interest cost	682	670	2,047	2,010
Amortization of prior service cost	23	23	70	70
Amortization of loss	88	104	265	312
Expected return on plan assets	(800)	(821)	(2,401)	(2,463)
Net periodic pension cost	\$ 47	\$ 40	\$ 141	\$ 121

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

We have contributed \$0.9 million to our pension plans during the nine months ended September 30, 2008. The amount we expect to contribute during the remainder of 2008 is minimal.

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

During the quarter ended June 30, 2008, we committed to a plan of restructure resulting in the termination of approximately 75 employees and certain contracts. As a result, we recorded a restructuring charge in the second quarter of \$2.4 million of which the majority related to our trucking segment. During the third quarter, we recorded a restructuring charge of \$1.7 million of which the majority related to our trucking segment for additional contract termination costs and related exit costs as we continued with our plan of restructure. As of September 30, 2008, approximately \$1.1 million was accrued related to the restructuring charges, which is expected to be paid through the remainder of 2008 and 2009.

We account for restructuring costs associated with one-time termination benefits, costs associated with lease and contract terminations and other related exit activities in accordance with SFAS No. 146 Accounting for Costs Associated with Exit or Disposal Activities .

In the nine months ended September 30, 2008, we had the following activity in our restructuring accruals:

	Balance at December 31, 2007	Additions	Payments	Reductions	Balance at September 30, 2008
Restructuring costs	\$	\$ 4,075	\$ (2,233)	\$ (756)	\$ 1,086

**7. Segment Reporting***Reportable Segments*

Prior to 2008, we reported our financial information as a single segment. Beginning January 1, 2008, we have two reportable business segments for financial reporting purposes that are distinguished primarily on the basis of services offered:

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

Container Services, specifically International Organization for Standardization, or ISO tank container transportation and depot services.

Due to the acquisition of Boasso in December 2007, we further enhanced our scope of services in the ISO tank container transportation and depot services market so that management now evaluates isolated revenues associated with these services and with trucking.

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



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

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

	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Operating revenues:</b>				
Trucking	\$ 174,222	\$ 171,101	\$ 524,145	\$ 503,672
Container Services	22,660	2,538	66,930	7,042
Other revenue	17,859	18,542	56,129	54,272
<b>Total</b>	<b>214,741</b>	<b>192,181</b>	<b>647,204</b>	<b>564,986</b>
<b>Operating income:</b>				
Trucking	12,165	13,322	31,040	36,887
Container Services	3,125	(48)	7,198	(256)
Other operating income	513	2,068	3,576	4,780
<b>Total segment operating income</b>	<b>15,803</b>	<b>15,342</b>	<b>41,814</b>	<b>41,411</b>
Depreciation and amortization expense	5,207	4,468	15,435	12,960
Other (income) expense	833	219	1,243	418
<b>Total</b>	<b>9,763</b>	<b>10,655</b>	<b>25,136</b>	<b>28,033</b>
Interest expense	8,455	7,651	26,246	23,403
Interest income	(128)	(198)	(333)	(573)
Other expense (income)	15	(279)	171	(638)
<b>Income (loss) before income taxes</b>	<b>\$ 1,421</b>	<b>\$ 3,481</b>	<b>\$ (948)</b>	<b>\$ 5,841</b>

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

Our operations are located primarily in the United States, Canada and Mexico. Inter-area sales are not significant to the total revenue of any geographic area. Information about our operations in different geographic areas for the three and nine months ended September 30, 2008 and 2007 is as follows (in thousands):

	<b>Three months ended September 30, 2008</b>		
	<b>U. S.</b>	<b>International</b>	<b>Consolidated</b>
Total operating revenues	\$ 200,883	\$ 13,858	\$ 214,741
Operating income	9,134	629	9,763
	<b>Three months ended September 30, 2007</b>		
	<b>U. S.</b>	<b>International</b>	<b>Consolidated</b>
Total operating revenues	\$ 178,588	\$ 13,593	\$ 192,181
Operating income	9,329	1,326	10,655
	<b>Nine months ended September 30, 2008</b>		
	<b>U. S.</b>	<b>International</b>	<b>Consolidated</b>
Total operating revenues	\$ 604,752	\$ 42,452	\$ 647,204
Operating income	21,373	3,763	25,136
	<b>As of September 30, 2008</b>		
Long-term identifiable assets (1)	\$ 169,524	\$ 7,778	\$ 177,302
	<b>Nine months ended September 30, 2007</b>		
	<b>U. S.</b>	<b>International</b>	<b>Consolidated</b>
Total operating revenues	\$ 523,877	\$ 41,109	\$ 564,986
Operating income	23,015	5,018	28,033
	<b>As of December 31, 2007</b>		
Long-term identifiable assets (1)	\$ 138,827	\$ 7,332	\$ 146,159

(1) Includes property and equipment and intangible assets.

---

**Table of Contents**

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

**8. Income Taxes**

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

At December 31, 2007, we had approximately \$3.2 million of total gross unrecognized tax benefits. Of this total, \$2.2 million (net of federal benefit on state tax issues) represents the amount of unrecognized tax benefits that, if recognized would favorably affect the effective income tax rate in any future periods. Included in the balance of gross unrecognized tax benefits at December 31, 2007, is \$0.8 million related to tax positions for which it is reasonably possible that the total amounts could significantly change during the next twelve months due to expiration of statute of limitations. For the three months ended September 30, 2008, the net change to our gross unrecognized tax benefits was \$(0.1) million. Of this amount, \$0.2 million relates to additional tax reserves and \$(0.3) million relates to the expiration of statute of limitations for state tax reserves. Our total gross unrecognized tax benefit at September 30, 2008 is \$2.5 million.

Our continuing practice is to recognize interest and/or penalties related to income tax matters in income tax expense. We had \$1.3 million (net of federal tax benefit) accrued for interest and \$0.5 million accrued for penalties at December 31, 2007. Total amount accrued for interest and penalties at September 30, 2008 is \$1.8 million.

We are subject to the income tax jurisdictions of the U.S., Canada, and Mexico, as well as income tax of multiple state jurisdictions. We believe we are no longer subject to U.S. federal income tax examinations for years before 2005, to international examinations for years before 2003 and with few exceptions, to state examinations before 2004.

The effective tax rates for the three months ended September 30, 2008 and 2007 were approximately 49.5% and 60.0%, respectively. The effective tax rates for the nine months ended September 30, 2008 and 2007 were approximately 10.4% and 38.2%, respectively. The difference in the effective tax rate can be attributed to the Company's pre-tax book loss position as of September 30, 2008 versus the Company's pre-tax book income position as of September 30, 2007 and an increase in the year to date discrete tax benefit items over the same period in 2007. Income taxes for the nine months ended September 30, 2007 includes the recognition of a previously unrecognized \$1.0 million deferred tax asset related to prior periods. We believe this item was not material to any of the prior periods affected.

**9. Commitments and Contingencies**

*Environmental Matters*

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

We are potentially subject to strict, joint and several liability for investigating and rectifying the consequences of spills and other releases of such substances under expansive federal, state and foreign environmental laws. Under certain of these laws, we could also be subject to allegations of liability for the activities of our affiliates or owner-operators.

From time to time, we have incurred remedial costs and regulatory penalties with respect to chemical or wastewater spills and releases at our facilities and on the road, and, notwithstanding the existence of our environmental management program, we cannot assure that such obligations will not be incurred in the future, predict with certainty the extent of future liabilities and costs under environmental, health, and safety laws, or assure that such liabilities will not result in a material adverse effect on our business, financial condition, operating results or cash flow.

**Reserves**

Our policy is to accrue remediation expenses when it is probable that such efforts will be required and the related expenses can be reasonably estimated. Estimates of costs for future environmental compliance and remediation may be adversely affected by such factors as changes in

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

environmental laws and regulatory requirements, the availability and application of technology, the identification of currently unknown potential remediation sites and the allocation of costs among the potentially responsible parties under the applicable statutes. The recorded liabilities are adjusted periodically

---

**Table of Contents**

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

as remediation efforts progress or as additional technical or legal information becomes available. As of September 30, 2008 and December 31, 2007, we had reserves in the amount of \$10.5 million and \$11.2 million, respectively, for all environmental matters discussed below.

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

**Property Contamination Liabilities**

We have been named as (or are alleged to be) a potentially responsible party under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended ( CERCLA ) and similar state laws at approximately 27 sites. At two of the 27 sites, we will be participating in the initial studies to determine site remediation objectives. Since our overall liability cannot be estimated at this time, we have set reserves for only the initial remedial investigation phase. At 21 of the 27 sites, we are one of many parties with alleged liability and are negotiating with Federal, State or private parties on the scope of our obligations, if any. At four of the 21 sites, we have explicitly denied any liability and since there has been no subsequent demand for payment we have not established a reserve for these matters. We have estimated future expenditures for these off-site multi-party environmental matters to be in the range of \$2.2 million to \$3.8 million.

At six sites, we are the only responsible party and are in the process of conducting investigations and/or remediation projects. Four of these projects relate to operations conducted by Chemical Leaman Corporation and its subsidiaries ( CLC ) prior to our acquisition of and merger with CLC in 1998. These four sites are: (1) Bridgeport, New Jersey; (2) William Dick, Pennsylvania; (3) Tonawanda, New York; and (4) Scary Creek, West Virginia. The remaining two investigations and potential remediation were triggered by the New Jersey Industrial Site Remediation Act ( ISRA ), which requires such investigations and remediation following the sale of industrial facilities. Each of these sites is discussed in more detail below. We have estimated future expenditures for these four properties to be in the range of \$8.3 million to \$16.7 million.

*Bridgeport, New Jersey*

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

The groundwater treatment remedy negotiated with USEPA calls for a treatment facility for in place treatment of groundwater contamination via in-situ treatment and a local discharge. Treatment facility construction was completed in early 2007. Wetlands contamination has been remediated with localized restoration expected to be completed shortly. In regard to contaminated soils, we believe that USEPA is now in the process of finalizing a feasibility study for the limited areas that show contamination and warrant additional investigation or work. We have estimated expenditures to be in the range of \$5.1 million to \$8.5 million.

*William Dick, Pennsylvania*

CLC entered into a consent order with the Pennsylvania DEP and USEPA in October 1995 obligating it to provide a replacement water supply to area residents, treat contaminated groundwater, and perform remediation of contaminated soils at this former wastewater disposal site. The replacement water supply is complete. We completed construction of a treatment facility with local discharge for groundwater treatment in the fourth quarter of 2007. Plant start-up issues are on-going. The agencies have approved a contaminated soils remedy, which requires both thermal treatment of contaminated soils and treatment of residuals via soil vapor extraction. The remedy expanded to include off-site shipment of contaminated soils. Soil treatment was completed in September 2007. Site sampling has been conducted and the results indicate that the soil clean-up objectives have not been fully achieved. Negotiations are on-going with USEPA over further remedial actions that may be needed at the site. We have estimated expenditures to be in the range of \$0.7 million to \$3.4 million.

**Table of Contents**

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

*Other Properties*

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

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

ISRA New Jersey Facilities: We are obliged to conduct investigations and remediation at two current or former New Jersey tank wash and terminal sites pursuant to the state's Industrial Sites Remediation Act, which requires such remediation following the sale of facilities after 1983. These sites are in the process of remedial investigation with projections set in contemplation of limited soil remediation expense for contaminated areas. The former owner of a third site has agreed to take responsibility for it so we are not currently taking action under ISRA for the site.

We have estimated future expenditures for Scary Creek, Tonawanda and ISRA to be in the range of \$2.5 million to \$4.8 million.

**Other Legal Matters**

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

**10. Guarantor Subsidiaries**

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

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 Senior Floating Rate Notes on a joint and several basis.

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

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

Condensed consolidating balance sheets at September 30, 2008 and December 31, 2007 and condensed consolidating statements of operations for the three and nine-month periods ended September 30, 2008 and September 30, 2007 and the condensed consolidating statements of cash flows for each of the nine-month periods ended September 30, 2008 and September 30, 2007.

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



**Table of Contents****QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES****Consolidating Statements of Operations****Three Months Ended September 30, 2008****Unaudited - (In 000 s)**

	<b>QDI</b>	<b>QD LLC and QD Capital</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Operating revenues:</b>						
Transportation			144,774			144,774
Other service revenue			25,422	72		25,494
Fuel surcharge			44,473			44,473
<b>Total operating revenues</b>			<b>214,669</b>	<b>72</b>		<b>214,741</b>
<b>Operating expenses:</b>						
Purchased transportation			124,800			124,800
Compensation			27,519			27,519
Fuel, supplies and maintenance			30,031			30,031
Depreciation and amortization			5,229	(22)		5,207
Selling and administrative		69	8,616	14		8,699
Insurance claims			3,193	9		3,202
Taxes and Licenses			1,582	1		1,583
Communication and utilities			3,104			3,104
(Gain)/loss on disposal of property and equipment			(842)	(25)		(867)
Restructuring costs			1,700			1,700
<b>Operating (loss) income</b>		<b>(69)</b>	<b>9,737</b>	<b>95</b>		<b>9,763</b>
Interest expense (income), non-related party, net		8,024	332	(29)		8,327
Interest (income) expense, related party, net		(1,500)	1,630	(130)		
Other expense			31	(16)		15
<b>(Loss) income before taxes</b>		<b>(6,593)</b>	<b>7,744</b>	<b>270</b>		<b>1,421</b>
Income tax provision			650	54		704
Equity in earnings of subsidiaries	717	7,310			(8,027)	
<b>Net income</b>	<b>717</b>	<b>717</b>	<b>7,094</b>	<b>216</b>	<b>(8,027)</b>	<b>717</b>



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

	<b>QDI</b>	<b>QD LLC and QD Capital</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Operating revenues:</b>						
Transportation	\$	\$	\$ 148,900	\$	\$	\$ 148,900
Other service revenue			18,570	166		18,736
Fuel surcharge			24,545			24,545
<b>Total operating revenues</b>			<b>192,015</b>	<b>166</b>		<b>192,181</b>
<b>Operating expenses:</b>						
Purchased transportation			118,653			118,653
Compensation			22,301	1		22,302
Fuel, supplies and maintenance			21,146			21,146
Depreciation and amortization			4,312	156		4,468
Selling and administrative			7,411	31		7,442
Insurance claims			3,238	1		3,239
Taxes and Licenses			1,105			1,105
Communication and utilities			2,952			2,952
(Gain)/loss on disposal of property and equipment			211	8		219
<b>Operating income</b>			<b>10,686</b>	<b>(31)</b>		<b>10,655</b>
Interest expense		7,218	556	(1)	(122)	7,651
Interest income	(6)		(176)	(138)	122	(198)
Other (income) expense	(2)		(106)	(171)		(279)
<b>Income (loss) before taxes</b>	<b>8</b>	<b>(7,218)</b>	<b>10,412</b>	<b>279</b>		<b>3,481</b>
<b>Income tax provision</b>			<b>1,931</b>	<b>51</b>		<b>1,982</b>
<b>Equity in earnings (loss) of subsidiaries</b>	<b>1,344</b>	<b>8,562</b>			<b>(9,906)</b>	
<b>Net income (loss)</b>	<b>\$ 1,352</b>	<b>\$ 1,344</b>	<b>\$ 8,481</b>	<b>\$ 228</b>	<b>\$ (9,906)</b>	<b>\$ 1,499</b>

**Table of Contents****QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES****Consolidating Statements of Operations****Nine Months Ended September 30, 2008****Unaudited - (In 000 s)**

	QDI	QD LLC and QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Operating revenues:						
Transportation	\$	\$	\$ 445,798	\$	\$	\$ 445,798
Other service revenue			78,582	334		78,916
Fuel surcharge			122,490			122,490
<b>Total operating revenues</b>			<b>646,870</b>	<b>334</b>		<b>647,204</b>
Operating expenses:						
Purchased transportation			376,378			376,378
Compensation			83,518			83,518
Fuel, supplies and maintenance			93,199			93,199
Depreciation and amortization			15,457	(22)		15,435
Selling and administrative		181	26,287	47		26,515
Insurance claims			11,599	30		11,629
Taxes and Licenses			4,041	1		4,042
Communication and utilities			10,109			10,109
(Gain)/loss on disposal of property and equipment			(2,807)	(25)		(2,832)
Restructuring costs			4,075			4,075
<b>Operating (loss) income</b>		(181)	<b>25,014</b>	<b>303</b>		<b>25,136</b>
Interest (income) expense, non-related party, net	(21)	24,698	1,314	(78)		25,913
Interest (income) expense, related party, net		(4,608)	4,997	(389)		
Other expense (income)			222	(51)		171
<b>Income (loss) before taxes</b>	<b>21</b>	<b>(20,271)</b>	<b>18,481</b>	<b>821</b>		<b>(948)</b>
Income tax (benefit) provision			(360)	262		(98)
Equity in (loss) earnings of subsidiaries	(871)	19,400			(18,529)	
<b>Net (loss) income</b>	<b>\$ (850)</b>	<b>\$ (871)</b>	<b>\$ 18,841</b>	<b>\$ 559</b>	<b>\$ (18,529)</b>	<b>\$ (850)</b>

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

	<b>QDI</b>	<b>QD LLC and QD Capital</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Operating revenues:</b>						
Transportation	\$	\$	\$ 442,656	\$	\$	\$ 442,656
Other service revenue			54,238	609		54,847
Fuel surcharge			67,483			67,483
<b>Total operating revenues</b>			<b>564,377</b>	<b>609</b>		<b>564,986</b>
<b>Operating expenses:</b>						
Purchased transportation			358,027			358,027
Compensation			62,576	(18)		62,558
Fuel, supplies and maintenance			56,545			56,545
Depreciation and amortization			12,461	499		12,960
Selling and administrative			21,212	102		21,314
Insurance claims			14,332	(11)		14,321
Taxes and Licenses			2,729			2,729
Communication and utilities			8,081			8,081
(Gain)/loss on disposal of property and equipment			387	31		418
<b>Operating income</b>			<b>28,027</b>	<b>6</b>		<b>28,033</b>
Interest expense		22,053	1,711	(1)	(360)	23,403
Interest income	(2)		(521)	(410)	360	(573)
Other expense (income)	5		(252)	(391)		(638)
Income (loss) before taxes	(3)	(22,053)	27,089	808		5,841
Income tax (benefit) provision	(1,007)		3,068	168		2,229
Equity in earnings (loss) of subsidiaries	2,608	24,661			(27,269)	
<b>Net income (loss)</b>	<b>\$ 3,612</b>	<b>\$ 2,608</b>	<b>\$ 24,021</b>	<b>\$ 640</b>	<b>\$ (27,269)</b>	<b>\$ 3,612</b>

**Table of Contents****QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES****Consolidating Balance Sheet****September 30, 2008****Unaudited - (In 000 s)**

	QDI	QD LLC and QD Captial	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>ASSETS</b>						
Current Assets:						
Cash and cash equivalents	\$	\$	\$ 20,933	\$ 2,510		\$ 23,443
Accounts receivable, net	75		106,208	69		106,352
Prepaid expenses		21	9,586			9,607
Deferred taxes asset, net			20,483			20,483
Other	10		7,061	(101)		6,970
Total current assets	85	21	164,271	2,478		166,855
Property and equipment, net			154,178			154,178
Goodwill			173,143			173,143
Intangibles, net			23,124			23,124
Investment in Subsidiaries	6,231	668,939	21,234		(696,404)	
Non-current deferred tax assets, net	1,007		16,088			17,095
Other assets		10,312	1,357			11,669
Total assets	\$ 7,323	\$ 679,272	\$ 553,395	\$ 2,478	\$ (696,404)	\$ 546,064
<b>LIABILITIES, MINORITY INTEREST AND SHAREHOLDERS EQUITY</b>						
Current Liabilities:						
Current maturities of indebtedness		2,500	4,713			7,213
Current maturities of capital lease obligations			7,892			7,892
Accounts payable			17,440	45		17,485
Intercompany	(20,644)	302,416	(255,397)	(5,141)	(21,234)	
Affiliates and independent owner-operators payable			16,349			16,349
Accrued expenses		6,746	23,270	(8)		30,008
Environmental liabilities			3,875			3,875
Accrued loss and damage claims			9,842			9,842
Income taxes payable						
Total current liabilities	(20,644)	311,662	(172,016)	(5,104)	(21,234)	92,664
Long-term indebtedness, less current maturities		361,379	10,292			371,671
Long-term capital leases, less current maturities			17,810			17,810
Environmental liabilities			6,636			6,636
Accrued loss and damage claims			13,831			13,831
Other non-current liabilities			12,993	659		13,652
Total liabilities	(20,644)	673,041	(110,454)	(4,445)	(21,234)	516,264
Minority interest in subsidiary			1,833			1,833

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Shareholders' equity							
Common Stock	362,760	354,963	493,866	7,629	(856,458)	362,760	
Treasury stock	(1,580)					(1,580)	
Accumulated deficit	(126,996)	(142,749)	183,392	(175)	(40,468)	(126,996)	
Stock recapitalization	(189,589)	(189,589)		(55)	189,644	(189,589)	
Accumulated other comprehensive loss	(16,394)	(16,394)	(15,242)	(476)	32,112	(16,394)	
Stock subscriptions receivable	(234)					(234)	
<b>Total shareholders' equity</b>	<b>27,967</b>	<b>6,231</b>	<b>662,016</b>	<b>6,923</b>	<b>(675,170)</b>	<b>27,967</b>	
Total liabilities, minority interest and shareholders' equity	\$ 7,323	\$ 679,272	\$ 553,395	\$ 2,478	\$ (696,404)	\$ 546,064	

**Table of Contents****QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES****Consolidating Balance Sheet****December 31, 2007****Unaudited - (In 000 s)**

	QDI	QD LLC and QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>ASSETS</b>						
Current Assets:						
Cash and cash equivalents	\$	\$	\$ 7,339	\$ 2,372		\$ 9,711
Accounts receivable, net	64		98,916	101		99,081
Prepaid expenses		96	8,024	30		8,150
Deferred taxes asset			20,483			20,483
Other	6		6,248	4		6,258
Total current assets	70	96	141,010	2,507		143,683
Property and equipment, net			122,014	(22)		121,992
Goodwill			173,575			173,575
Intangibles			24,167			24,167
Investment in subsidiaries	26,148	648,835	21,234		(696,217)	
Non-current deferred tax	1,007		15,196			16,203
Other assets		11,923	2,433			14,356
	\$ 27,225	\$ 660,854	\$ 499,629	\$ 2,485	\$ (696,217)	\$ 493,976

**LIABILITIES, MINORITY INTEREST AND  
SHAREHOLDERS EQUITY (DEFICIT)**

Current Liabilities:						
Current maturities of indebtedness			413			413
Current maturities of capital leases			1,451			1,451
Accounts payable			17,385	43		17,428
Intercompany	(75)	288,656	(262,349)	(4,998)	(21,234)	
Affiliates and independent owner-operators payable			12,597			12,597
Accrued expenses		3,866	21,994	97		25,957
Environmental liabilities			4,751			4,751
Accrued loss and damage claims			13,438			13,438
Income taxes payable			90	465		555
Total current liabilities	(75)	292,522	(190,230)	(4,393)	(21,234)	76,590
Long-term indebtedness, less current maturities		342,184	764	627		343,575
Long-term capital leases, less current maturities			3,832			3,832
Environmental liabilities			6,418			6,418
Accrued loss and damage claims			18,474			18,474
Other non-current liabilities			15,954			15,954
Total liabilities	(75)	634,706	(144,788)	(3,766)	(21,234)	464,843
Minority interest in subsidiaries			1,833			1,833
Shareholders equity (deficit):						

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Common Stock	361,617	354,963	493,866	7,629	(856,458)	361,617
Treasury stock	(1,564)					(1,564)
Accumulated deficit (retained earnings)	(126,146)	(122,478)	164,551	(408)	(41,665)	(126,146)
Stock recapitalization	(189,589)	(189,589)		(55)	189,644	(189,589)
Accumulated other comprehensive income	(16,748)	(16,748)	(15,833)	(915)	33,496	(16,748)
Stock subscription receivable	(270)					(270)
Total shareholders equity (deficit)	27,300	26,148	642,584	6,251	(674,983)	27,300
Total liabilities, minority interest and shareholders equity (deficit)	\$ 27,225	\$ 660,854	\$ 499,629	\$ 2,485	\$ (696,217)	\$ 493,976

**Table of Contents****QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES****Condensed Consolidating Statements of Cash Flows****Nine Months Ended September 30, 2008****Unaudited - (In 000 s)**

	<b>QDI</b>	<b>QD LLC and QD Capital</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Cash flows from operating activities:</b>						
Net (loss) income	\$ (850)	\$ (871)	\$ 18,841	\$ 559	\$ (18,529)	\$ (850)
Adjustments for non-cash charges	850	(1,439)	(482)	(435)	18,529	17,023
Net changes in assets and liabilities	(15)	4,566	(10,280)	221		(5,508)
Intercompany activity	15	(2,256)	2,426	(185)		
Net cash (used in) provided by operating activities			10,505	160		10,665
<b>Cash flows from investing activities:</b>						
Capital expenditures			(14,967)			(14,967)
Acquisition of businesses and assets			(1,397)			(1,397)
Boasso purchase adjustment			1,318			1,318
Proceeds from sales of property and equipment			4,620	(22)		4,598
Net cash (used in) provided by investing activities			(10,426)	(22)		(10,448)
<b>Cash flows from financing activities:</b>						
Proceeds from the issuance of debt			1,049			1,049
Principal payments of long-term debt			(3,316)			(3,316)
Principal payments of capital lease obligations			(1,949)			(1,949)
Proceeds from revolver		110,700				110,700
Payments on revolver		(89,830)				(89,830)
Deferred financing fees		(623)				(623)
Other		(109)	(2,393)			(2,502)
Intercompany activity		(20,138)	20,138			
Net cash provided by financing activities			13,529			13,529
Effect of exchange rate changes on cash			(14)			(14)
Net (decrease) increase in cash and cash equivalents			13,594	138		13,732
Cash and cash equivalents, beginning of period			7,339	2,372		9,711
Cash and cash equivalents, end of period	\$	\$	\$ 20,933	\$ 2,510	\$	\$ 23,443



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

	<b>QDI</b>	<b>QD LLC and QD Capital</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Cash flows from operating activities:</b>						
Net income (loss)	\$ 3,612	\$ 2,608	\$ 24,021	\$ 640	\$ (27,269)	\$ 3,612
Adjustments for non-cash charges	(3,612)	(23,030)	17,001	283	27,269	17,911
Net changes in assets and liabilities	787	2,547	(12,620)	64		(9,222)
Intercompany activity	(787)	17,875	(16,643)	(445)		
Net cash provided by (used in) operating activities			11,759	542		12,301
<b>Cash flows from investing activities:</b>						
Capital expenditures			(7,348)	(20)		(7,368)
Acquisition of businesses and assets			(4,004)			(4,004)
Proceeds from sales of property and equipment			5,357	114		5,471
Net cash provided by (used in) investing activities			(5,995)	94		(5,901)
<b>Cash flows from financing activities:</b>						
Proceeds from issuance of long-term debt						
Principal payments of long-term debt		(1,050)				(1,050)
Principal payments of capital lease obligations			(899)			(899)
Proceeds from revolver		35,700				35,700
Payments on revolver		(35,700)				(35,700)
Payments on acquisition notes			(321)			(321)
Deferred financing fees		(153)				(153)
Stock offering costs	(787)					(787)
Other	(109)					(109)
Intercompany activity	896	1,203	(2,099)			
Net cash provided by (used in) financing activities			(3,319)			(3,319)
Effect of exchange rate changes on cash			(20)	79		59
Net increase (decrease) in cash and cash equivalents			2,425	715		3,140
Cash and cash equivalents, beginning of period			5,386	1,455		6,841
Cash and cash equivalents, end of period	\$	\$	\$ 7,811	\$ 2,170	\$	\$ 9,981

---

**Table of Contents**

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

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

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

**Overview**

We operate the largest for-hire chemical bulk tank truck network in North America based on bulk service revenues, and we believe we have more than twice the revenues of our closest competitor in our primary chemical bulk transport market in the U.S. The bulk tank truck market in North America includes all products shipped by bulk tank truck carriers and consists primarily of liquid and dry bulk chemicals (which includes plastics) and bulk dry and liquid food-grade products. We are primarily engaged in truckload transportation of bulk chemicals and also engaged in ISO tank container transportation and depot services, tank wash facility services, logistics and other value-added services. We are a core carrier for many of the Fortune 500 companies engaged in chemical processing, including Dow Chemical, Procter & Gamble, DuPont and PPG Industries, and we provide services to most of the top 100 chemical producers with U.S. operations.

Our revenue is principally a function of the volume of shipments by the bulk chemical industry, the number of miles driven per load, our market share and the allocation of shipments between tank truck transportation and other modes of transportation such as rail. The volume of shipments of chemical products is, in turn, affected by many other industries, including consumer and industrial products, automotive, paints and coatings and paper, and tends to vary with changing economic conditions. Additionally, we provide leasing, tank cleaning, logistics and transloading services.

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

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

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

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

We believe the most significant factors relevant to our future business growth are the ability to (i) obtain additional business from existing customers, (ii) acquire existing transportation related businesses in strategic markets, (iii) add new customers and (iv) recruit and retain drivers. Historically, revenue has been partially driven by pricing increases and we expect pricing increases to continue to positively impact our revenue growth. However, the trucking industry continues to experience a slowdown in 2008 due to a slowing general economy. In order to mitigate the impact of the economic downturn on our earnings, we have taken initiatives to improve our profitability, reduce costs and adjust our business model. In the longer term, while a number of our customers operate their own private tank truck fleets and many of our customers source some of their logistics needs with rail, we expect our customers to continue to outsource a greater proportion of their logistics needs to full service tank truck carriers. As a result of our leading market position, strong customer relationships and a flexible business model that can adjust to changing economic conditions, we believe we are well-positioned to operate in the current economy and still benefit from customers seeking consolidation of their shipping relationships and outsourcing.



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

In December 2007, we acquired all of the outstanding capital stock of Boasso America Corporation ( Boasso ) for an aggregate purchase price of (i) \$58.8 million in cash less the outstanding long-term indebtedness of Boasso, subject to a working capital adjustment, and (ii) a \$2.5 million 7% promissory note with a two-year maturity for the benefit of Boasso's principal stockholder, Walter J. Boasso (the Boasso Note ) excluding fees and direct costs. In April 2008, approximately \$1.3 million was refunded to us pursuant to a working capital adjustment, as provided for in the stock purchase agreement.

During 2008, we purchased two transportation companies and an affiliate for \$2.1 million, in the aggregate, of which \$1.4 million was paid in cash at closing and the remaining \$0.7 million is payable over future periods. Of the total \$2.1 million, we allocated \$1.0 million to property and equipment, \$0.9 million to goodwill, and \$0.2 million to other intangible assets such as non-compete agreements.

*Restructuring*

During the quarter ended June 30, 2008, we committed to a plan of restructure resulting in the termination of approximately 75 employees and certain contracts. As a result, we recorded a restructuring charge in the second quarter of \$2.4 million of which the majority related to our trucking segment. During the third quarter, we recorded a restructuring charge of \$1.7 million of which the majority related to our trucking segment for additional contract termination costs and related exit costs as we continued with our plan of restructure. As of September 30, 2008, approximately \$1.1 million was accrued related to the restructuring charges, which is expected to be paid through the remainder of 2008 and 2009.

**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. We believe the following are the more critical accounting policies that impact the financial statements, some of which are based on management's best estimates available at the time of preparation. Actual future experience may differ from these estimates.

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

The asset lives used are presented in the following table:

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

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



**Table of Contents**

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

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

*Goodwill* - We evaluate goodwill for impairment at least annually during the second quarter with a measurement date of June 30, or more frequently if indicators of impairment arise, in accordance with the provisions of Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). We have identified three reporting units: trucking, container services and other. Our evaluation of goodwill is measured through a two-step impairment test. The first step compares the fair value of a reporting unit to its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired, thus the second step of the impairment test is unnecessary. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test shall be performed to measure the amount of impairment loss. The second step compares the implied fair value of reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss must be recognized in an amount equal to the excess. The loss recognized cannot exceed the carrying amount of goodwill. After a goodwill impairment loss is recognized, the adjusted carrying amount of goodwill will be its new accounting basis. Subsequent reversal of a previously recognized goodwill impairment loss is prohibited once the measurement of that loss is completed. We determined no impairment to have occurred as of June 30, 2008, since the calculated fair value exceeded the carrying amount.

*Deferred tax assets* - We use the liability method of accounting for income taxes as prescribed by SFAS No. 109. Significant management judgment is required in determining the provision for income taxes and, in particular, any valuation allowance that is recorded or released against our deferred tax assets.

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

We project both aggregate U.S. pre-tax income as well as aggregate U.S. taxable income for the years 2008 through 2011 sufficient to absorb \$74.0 million of the \$101.0 million existing net operating loss carryforwards. At December 31, 2007 we had estimated \$101.0 million in Federal net operating loss carryforwards, \$2.6 million in alternative minimum tax credit carryforwards and \$2.6 million in foreign tax credit carryforwards. The net operating loss carryforwards will expire in the years 2018 through 2027, while the alternative minimum tax credits may be carried forward indefinitely and the foreign tax credits may be carried forward for ten years. We do not have a history of net operating loss or tax credit carryforwards expiring unused; however, we determined based on the weight of available evidence that it is more likely than not that some portion of our \$2.6 million foreign tax credits may not be realized. As a result, at December 31, 2007, a valuation allowance of \$1.6 million was established against our foreign tax credit deferred tax asset. At September 30, 2008, our valuation allowance was \$1.7 million.

We continue to believe it is more likely than not that the net deferred tax assets will be realizable. We will continue to review our forecast quarterly in relation to actual results and expected trends on an ongoing basis. Failure to achieve our operating income targets may change our assessment regarding the recoverability of our net deferred tax assets and such change could result in a valuation allowance being recorded against some or all of our deferred tax assets. Any increase in a valuation allowance would result in additional income tax expense.

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

**Table of Contents**

**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 included deductibles of \$5.0 million per incident for bodily injury and property damage and \$1.0 million for workers' compensation for periods after September 15, 2002. Auto and general liability claims incurred on or after March 31, 2008 are subject to a deductible of \$2.0 million per incident. 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 evaluate historical loss run data and actuarial calculations to develop our insurance reserve estimates. The most significant assumptions used in the estimation process include determining the trends in loss costs, the expected consistency in the frequency and severity of claims incurred but not yet reported to prior year claims and expected costs to settle unpaid claims. Management believes reserves are reasonable given known information, but as each case develops, estimates may change to reflect the effect of new information.

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

*Allowance for uncollectible receivables* - The allowance for all potentially uncollectible receivables is based on a combination of historical data, cash payment trends, specific customer issues, write-off trends, general economic conditions and other factors. These factors are continuously monitored by our management to arrive at the estimate for the amount of accounts receivable that may be ultimately uncollectible. The receivables analyzed include trade receivables, as well as loans and advances made to owner-operators and affiliates. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, an additional allowance could be required. Absent a change in our collection efforts, a \$50 million increase in our receivables (aged less than 30 days) resulting from transportation billings would increase our allowance for uncollectible receivables by approximately \$0.2 million.

*Stock compensation plans* - Stock compensation is determined by the assumptions required under Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123(R)). The fair values of stock option grants are based upon the Black-Scholes option-pricing model and amortized as compensation expense on a straight-line basis over the vesting period of the grants. Restricted stock awards are issued and measured at market value on the date of grant and related compensation expense is recognized on a straight-line basis over the vesting period of the grants. Stock-based compensation expense related to stock options and restricted stock was \$0.4 million and \$0.4 million, respectively, for the quarters ended September 30, 2008 and 2007. As of September 30, 2008, there was approximately \$2.9 million of total unrecognized compensation cost related to the unvested portion of our stock-based awards. The recognition period for the remaining unrecognized stock-based compensation cost is approximately four years. For further discussion on stock-based compensation, see Note 4 of Notes to Consolidated Financial Statements included in Item 1 of this report.

*Pension plans* - We maintain two noncontributory defined-benefit plans resulting from a prior acquisition that cover certain full-time salaried employees and certain other employees under a collective bargaining agreement. Both plans are frozen and, as such, no future benefits accrue. We record annual amounts relating to these plans based on calculations specified by U.S. GAAP, which include various actuarial assumptions such as discount rates (5.50% to 5.75%) and assumed rates of return (7.50% to 8.00%) depending on the pension plan. Material changes in pension costs may occur in the future due to changes in these assumptions. Future annual amounts could be impacted by changes in the discount rate, changes in the expected long-term rate of return, changes in the level of contributions to the plans and other factors.

The discount rate is based on a model portfolio of AA-rated bonds with a maturity matched to the estimated payouts of future pension benefits. The expected return on plan assets is based on our expectation of the long-term rates of return on each asset class based on the current asset mix of the funds, considering the historical returns earned on the type of assets in the funds, plus an assumption of future inflation. The current investment policy target asset allocation differs between our two plans, but it is between 50% to 67% for equities and 33% to 50% for bonds. The current inflation assumption is 3.0%. We review our actuarial assumptions on an annual basis and make modifications to the assumptions based on current rates and trends when appropriate. The effects of the modifications are amortized over future periods.

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

Assumed discount rates and expected return on plan assets have a significant effect on the amounts reported for the pension plan. At December 31, 2007, our projected benefit obligation ( PBO ) was \$45.8 million. Our projected 2008 net periodic pension expense is \$189,000. A 1.0% decrease in our assumed discount rate would increase our PBO to \$50.6 million and decrease our 2008 net periodic pension expense to \$169,000. A 1.0% increase in our assumed discount rate would decrease our PBO to \$41.8 million and increase our 2008 net periodic pension expense to \$191,000. A 1.0% decrease in our assumed rate of return would not change our PBO but would increase our 2008 net periodic pension expense to \$596,000. A 1.0% increase in our assumed rate of return would not change our PBO but would decrease our 2008 net periodic pension expense to a credit of \$219,000.

*Restructuring* - We account for restructuring costs associated with one-time termination benefits, costs associated with lease and contract terminations and other related exit activities in accordance with SFAS No. 146 Accounting for Costs Associated with Exit or Disposal Activities. We have made estimates of the costs to be incurred as part of our restructuring plan. During the quarter ended June 30, 2008, we committed to a plan of restructure resulting in the termination of approximately 75 employees and certain contracts. As a result, we recorded a restructuring charge in our second quarter of \$2.4 million of which the majority relates to our trucking segment. During the third quarter, we incurred additional contract termination and related exit costs of \$1.7 million of which the majority related to our trucking segment as we continued with our plan of restructure. As of September 30, 2008, approximately \$1.1 million was accrued related to these restructuring charges, which is expected to be paid through the remainder of 2008 and 2009.

**New Accounting Pronouncements**

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* ( SFAS 141R ). This statement significantly changes the financial accounting and reporting of business combination transactions. The provisions of this statement are to be applied prospectively to business combination transactions in the first annual reporting period beginning on or after December 15, 2008. The impact of adopting SFAS 141R will depend on the nature, terms and size of business combinations completed after the effective date.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an amendment of ARB No. 51* ( SFAS 160 ). SFAS 160 establishes accounting and reporting standards for noncontrolling interests in subsidiaries. This statement requires the reporting of all noncontrolling interests as a separate component of stockholders' equity, the reporting of consolidated net income (loss) as the amount attributable to both the parent and the noncontrolling interests and the separate disclosure of net income (loss) attributable to the parent and to the noncontrolling interests. In addition, this statement provides accounting and reporting guidance related to changes in noncontrolling ownership interests. Other than the reporting requirements described above which require retrospective application, the provisions of SFAS 160 are to be applied prospectively in the first annual reporting period beginning on or after December 15, 2008. We are currently evaluating the impact of this standard on our consolidated financial statements.

In April 2008 the FASB issued FASB Staff Position No. FAS 142-3, *Determination of the Useful Life of Intangible Assets* ( FSP FAS 142-3 ). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, *Goodwill and Other Intangible Assets*. More specifically, FSP FAS 142-3 removes the requirement under paragraph 11 of SFAS 142 to consider whether an intangible asset can be renewed without substantial cost or material modifications to the existing terms and conditions and instead, requires an entity to consider its own historical experience in renewing similar arrangements. FSP FAS 142-3 also requires expanded disclosure related to the determination of intangible asset useful lives. We are currently evaluating the potential impact the adoption of FSP FAS 142-3 will have on our consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* ( SFAS 162 ), which identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with U.S. GAAP. SFAS 162 is effective 60 days following the Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. We do not expect the adoption of SFAS 162 to have a material effect on our financial statements or related disclosures.



---

**Table of Contents**

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

In June 2008 the FASB Issued EITF No. 08-3, *Accounting by Lessees for Nonrefundable Maintenance Deposits* ( EITF No. 08-3 ). EITF No. 08-3 requires that nonrefundable maintenance deposits paid by a lessee under an arrangement accounted for as a lease be accounted for as a deposit asset until the underlying maintenance is performed. When the underlying maintenance is performed, the deposit may be expensed or capitalized in accordance with the lessee's maintenance accounting policy. Upon adoption entities must recognize the effect of the change as a change in accounting principle. The adoption of EITF No. 08-3 will not impact the Company's financial condition, results of operations or cash flows.

In June 2008, the Financial Accounting Standards Board ( FASB ) issued FASB Staff Position No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* ( FSP EITF 03-6-1 ), which addresses whether unvested equity-based awards are participating securities and, therefore, need to be included in the earnings allocation in computing earnings per share under the two-class method described in FASB Statement No. 128, *Earnings per Share* . FSP EITF 03-6-1 is effective for the Company beginning December 1, 2009 and cannot be adopted early. All prior period earnings per share data presented in financial statements that are issued after the effective date shall be adjusted retrospectively to conform to the new guidance. We are currently evaluating the potential impact of the adoption of FSP EITF 03-6-1 will have on our consolidated financial statements.

**Adoption of Statement of Financial Accounting Standards No. 157 and No. 159**

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Liabilities*, ( SFAS 159 ). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. If the fair value option is elected, unrealized gains and losses will be recognized in earnings at each subsequent reporting date. On January 1, 2008, we did not elect to adopt the provisions of SFAS 159.

On January 1, 2008, we adopted the provisions of Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, ( SFAS 157 ). SFAS 157 defines fair value and provides guidance for measuring fair value and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but rather applies to all other accounting pronouncements that require or permit fair value measurements. In February 2008, the FASB issued final Staff Position No. FAS 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements that Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13*, which amended SFAS 157 to exclude FASB Statement No. 13 and its related interpretive accounting pronouncements that address leasing transactions. In February 2008, the FASB also issued final Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157*, to allow a one-year deferral of adoption of SFAS 157 for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. We have elected this one-year deferral and thus will not apply the provisions of SFAS 157 to nonfinancial assets and nonfinancial liabilities that are recognized at fair value in the financial statements on a nonrecurring basis until our fiscal year beginning January 1, 2009.

SFAS 157 enables the reader of the financial statements to assess the inputs used to develop fair value measurements by establishing a hierarchy for ranking the quality and reliability of the information used to determine fair values. SFAS 157 requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

We have no financial assets or financial liabilities that require application of SFAS 157.

We generally apply fair value techniques on a non-recurring basis associated with (1) valuing potential impairment loss related to goodwill and indefinite-lived intangible assets accounted for pursuant to SFAS No. 142 and (2) valuing potential impairment loss related to long-lived assets accounted for pursuant to SFAS No. 144.



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

The following table presents certain condensed consolidated financial information, as a percentage of revenue, for the three and nine months ended September 30, 2008 and September 30, 2007:

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
<b>OPERATING REVENUES:</b>				
Transportation	67.4%	77.5%	68.9%	78.3%
Other service revenue	11.9%	9.7%	12.2%	9.8%
Fuel surcharge	20.7%	12.8%	18.9%	11.9%
<b>Total operating revenues</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
<b>OPERATING EXPENSES:</b>				
Purchased transportation	58.1%	61.7%	58.2%	63.4%
Compensation	12.8%	11.6%	12.9%	11.1%
Fuel, supplies and maintenance	14.0%	11.1%	14.4%	10.0%
Depreciation and amortization	2.4%	2.2%	2.4%	2.3%
Selling and administrative	4.1%	3.9%	4.1%	3.8%
Insurance claims	1.5%	1.7%	1.8%	2.5%
Taxes and licenses	0.7%	0.6%	0.6%	0.5%
Communication and utilities	1.5%	1.5%	1.6%	1.4%
(Gain) loss on disposal of property and equipment	-0.4%	0.1%	-0.4%	0.1%
Restructuring costs	0.8%	0.0%	0.6%	0.0%
<b>Total operating expenses</b>	<b>95.5%</b>	<b>94.4%</b>	<b>96.2%</b>	<b>95.1%</b>
Operating income	4.5%	5.6%	3.8%	4.9%
Interest expense	3.9%	4.0%	4.1%	4.1%
Interest income	-0.1%	-0.1%	-0.1%	-0.1%
Other (expense) income	0.0%	-0.1%	0.0%	-0.1%
Income (loss) before income taxes	0.7%	1.8%	-0.2%	1.0%
Provision for (benefit from) for income taxes	0.2%	1.0%	0.0%	0.4%
Net income (loss)	0.5%	0.8%	-0.2%	0.6%

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

	2008	2007
Terminals <sup>(1)</sup>	157	164
Drivers	3,244	3,356
Tractors	3,485	3,775

Trailers <sup>(2)</sup>

7,562 7,518

- (1) excludes transload facilities
- (2) excludes 108 and 169 trailers that are held-for-sale as of September 30, 2008 and 2007, respectively

---

**Table of Contents**

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

**Three Months Ended September 30, 2008 Compared to Three Months Ended September 30, 2007**

For the quarter ended September 30, 2008, total revenues were \$214.7 million, an increase of \$22.6 million, or 11.7%, from revenues of \$192.2 million for the same period in 2007. Transportation revenue decreased by \$4.1 million or 2.8% primarily due to an \$11.6 million increase from the newly acquired Boasso operations offset by a \$15.7 million decrease in our pre-existing business. In addition, we had a 14.2% decrease in the total number of miles driven and a 7.7% decrease in loads.

Other service revenue increased \$6.8 million, or 36.1%. This increase was primarily due to a \$7.4 million increase in revenue generated by the newly acquired Boasso operations partially offset by reductions in tank wash revenue caused in part by the closure of four tank wash terminals in June 2008. Fuel surcharge revenue increased \$19.9 million, or 81.2%, primarily due to the increase in fuel prices and to the acquisition of Boasso offset in part by a decrease in the total number of billed miles.

Purchased transportation increased by \$6.1 million, or 5.2%, due primarily to \$7.5 million of expense from the newly acquired Boasso operations. Total purchased transportation as a percentage of transportation revenue and fuel surcharge revenue decreased to 65.9% for the current quarter versus 68.4% for the prior-year quarter due primarily to the conversion of affiliate terminals to company-owned terminals. Our affiliates generated 50.8% of our transportation revenue and fuel surcharge revenue for the three months ended September 30, 2008 compared to 54.5% for the comparable prior year period. We pay our affiliates a greater percentage of transportation revenues generated by them than is paid to Company owner-operators, so our purchased transportation costs will change as revenues generated by affiliates change as a percentage of total transportation revenue. During the 2008 and 2007 quarters, we paid our affiliates approximately 85% of the transportation revenue while we typically paid Company owner-operators approximately 65% of the invoiced linehaul amount.

Compensation expense increased \$5.2 million, or 23.4%, primarily due to a \$4.8 million increase from the newly acquired Boasso operations.

Fuel, supplies and maintenance increased \$8.9 million, or 42.0%, due to \$5.5 million of expense from the newly acquired Boasso operations and \$3.4 million of increased fuel costs due to costs associated with the shift of revenue from affiliates to company-owned terminals.

Selling and administrative expenses increased by \$1.3 million, or 16.9%, primarily due to \$1.0 million of expense from the newly acquired Boasso operations.

Insurance expense decreased by less than \$0.1 million, or 1.1%, due primarily to a reduction in the number and severity of accidents in the current-year quarter.

We generated a gain on disposal of assets of \$0.9 million as compared to a loss of less than \$0.2 million in the comparable prior-year period. The gain in the 2008 quarter resulted primarily from the sale of land not used in our business.

In the third quarter 2008, we incurred restructuring costs of \$1.7 million primarily due to the continuation of our restructuring plan which began during the second quarter of 2008.

For the quarter ended September 30, 2008, operating income totaled \$9.8 million, a decrease of \$0.9 million or 8.4%, compared to \$10.7 million for the same period in 2007. The operating margin for the quarter ended September 30, 2008, was 4.6% compared to 5.6% for the same period in 2007 as a result of the above-mentioned items.

Interest expense increased by \$0.8 million, or 10.5%, in the quarter ended September 30, 2008 compared to the same period in 2007, primarily due to interest on our new \$50 million of Senior Floating Rate Notes issued in December 2007. These notes, along with our entry into a new asset-based lending facility, were issued primarily to fund the acquisition of Boasso, and to repay a portion of the term loan under our previous credit facility. In conjunction with these notes, we are incurring increased amortization of the original issue discount related to these notes. In addition, the amortization of deferred financing costs has increased due to the refinancing of our senior credit facility in December 2007.

---

**Table of Contents**

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

The provision for income taxes was \$0.7 million for the quarter ended September 30, 2008 compared to a tax provision of \$2.0 million for the same period in 2007. Our effective tax rates for the three months ended September 30, 2008 and 2007 were approximately 49.6% and 56.9%, respectively.

For the quarter ended September 30, 2008, our net income was \$0.7 million, compared to net income of \$1.5 million for the same period last year.

**Nine Months Ended September 30, 2008 Compared to Nine Months Ended September 30, 2007**

For the nine months ended September 30, 2008, total revenues were \$647.2 million, an increase of \$82.2 million, or 14.6%, from revenues of \$565.0 million for the same period in 2007. Transportation revenue increased by \$3.1 million or 0.7%, primarily due to a \$32.9 million increase from the newly acquired Boasso operations offset by a \$29.7 million decrease in our pre-existing business. We had a 8.9% decrease in the total number of miles driven as the average number of miles per load decreased slightly over the prior year period along with a 3.9% decrease in overall loads.

Other service revenue increased \$24.1 million, or 43.9%. This increase was primarily due to a \$22.2 million increase in revenue generated by the newly acquired Boasso operations. Fuel surcharge revenue increased \$55.0 million, or 81.5% primarily due to an increase in the fuel prices, and to the acquisition of Boasso, offset in part by a decrease in the total number of miles driven.

Purchased transportation increased by \$18.4 million, or 5.1%, due primarily to \$20.8 million of expense from the newly acquired Boasso operations partially offset by a reduction due to the conversion of affiliates to company-owned operations. Total purchased transportation as a percentage of transportation revenue and fuel surcharge revenue decreased to 66.2% for the current nine months versus 70.2% for the prior-year comparable period due primarily to the conversion of affiliate terminals to Company terminals. Our affiliates generated 50.4% of our transportation revenue and fuel surcharge revenue for the nine months ended 2008 compared to 57.8% for the comparable prior year period. We pay our affiliates a greater percentage of transportation revenues generated by them than is paid to Company owner-operators, so our purchased transportation costs will change as revenues generated by affiliates change as a percentage of total transportation revenue. During the 2008 and 2007 periods, we paid our affiliates approximately 85% of the transportation revenue and paid owner-operators approximately 65% of transportation revenue.

Compensation expense increased \$21.0 million, or 33.5%, due to \$14.0 million of expense from the newly acquired Boasso operations. In addition, we had an increase of \$6.4 million due to new or converted Company terminals added over the prior year and \$1.0 million increase in healthcare costs partially offset by a reduction of approximately \$1.2 million from wages and payroll taxes for positions eliminated in our plan of restructure.

Fuel, supplies and maintenance increased \$36.7 million, or 64.8%, due to \$16.2 million of expense from the newly acquired Boasso operations, increased fuel costs of \$12.4 million, costs associated with the shift of revenue from affiliates to company-owned terminals, increased equipment lease costs of \$2.1 million and increased maintenance of \$2.8 million as we increase the capacity of our equipment.

Selling and administrative expenses increased by \$5.2 million, or 24.4%, due to \$3.0 million of expense from the newly acquired Boasso operations. We also incurred in the current year an increase of \$1.6 million in facility costs associated with the affiliate conversions.

---

**Table of Contents**

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

Insurance expense decreased by \$2.7 million, or 18.8%, due primarily to a reduction in the number and severity of accidents that occurred during the nine months ended September 30, 2008.

Gain on disposal of property and equipment was \$2.8 million in 2008 as compared to a loss of \$0.4 million in 2007. The gain in the current year period resulted from the sale of land not used in our business compared with a loss in the prior year period resulting from the disposals of certain tank wash equipment.

In 2008, we incurred restructuring costs of \$4.1 million primarily due to one-time employee termination benefits and costs associated with contract terminations related to our restructuring plan.

For the nine months ended September 30, 2008, operating income totaled \$25.1 million, a decrease of \$2.9 million or 10.3%, compared to \$28.0 million for the same period in 2007. The operating margin for the nine months ended September 30, 2008, was 3.9% compared to 5.0% for the same period in 2007 as a result of the above items.

Interest expense increased by \$2.8 million, or 12.1%, for the nine months ended September 30, 2008 compared to the same period in 2007, primarily due to interest on our new \$50 million of Senior Floating Rate Notes issued in December 2007. These notes, along with our entry into a new asset-based lending facility, were issued primarily to fund the acquisition of Boasso, and to repay a portion of the term loan under our previous credit facility. In conjunction with these notes, we are incurring increased amortization of the original issue discount related to these notes. In addition, the amortization of deferred financing costs has increased due to the refinancing of our senior credit facility in December 2007.

The benefit from income taxes was \$0.1 million for the nine months ended September 30, 2008 compared to a provision of \$2.2 million for the same period in 2007. The difference in the effective tax rate can be attributed to the Company's pre-tax book loss position as of September 30, 2008 versus the Company's pre-tax book income position as of September 30, 2007 and an increase in the year to date discrete tax benefit items over the same period in 2007. In prior year period, the \$2.2 million provision included the recognition of a \$1.0 million tax benefit in the first quarter. This benefit arose from the identification of previously unrecognized deferred tax assets and a change in our expected effective tax rate.

For the nine months ended September 30, 2008, our net loss was \$0.9 million, compared to net income of \$3.6 million for the same period last year.

**Segment Operating Results**

Prior to 2008, we reported our financial information as a single segment. Beginning January 1, 2008, we have two reportable business segments for financial reporting purposes that are distinguished primarily on the basis of services offered:

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

Container Services, specifically International Organization for Standardization, or ISO tank container transportation and depot services.

Due to the acquisition of Boasso in December 2007, we further enhanced our scope of services in the ISO tank container transportation and depot services market so that management now evaluates isolated revenues associated with these services and with trucking.

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





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

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

	Three months ended September 30,				Change	
	2008	% of Total	2007	% of Total	\$	%
<b>Operating revenues:</b>						
Trucking	174,222	81.1%	171,101	89.1%	3,121	1.8%
Container Services	22,660	10.6%	2,538	1.3%	20,122	792.8%
Other revenue	17,859	8.3%	18,542	9.6%	(683)	(3.7)%
<b>Total</b>	<b>214,741</b>	<b>100.0%</b>	<b>192,181</b>	<b>100.0%</b>		
<b>Operating income:</b>						
Trucking	12,165	75.4%	13,322	86.7%	(1,157)	(8.7)%
Container Services	3,125	21.0%	(48)	(0.3)%	3,173	(6,610.4)%
Other operating income	513	3.6%	2,068	13.6%	(1,555)	(75.9)%
<b>Total</b>	<b>15,803</b>	<b>100.0%</b>	<b>15,342</b>	<b>100.0%</b>		

	Nine months ended September 30,				Change	
	2008	% of Total	2007	% of Total	\$	%
<b>Operating revenues:</b>						
Trucking	524,145	81.0%	503,672	89.2%	20,473	4.1%
Container Services	66,930	10.3%	7,042	1.2%	59,888	850.4%
Other revenue	56,129	8.7%	54,272	9.6%	1,857	3.4%
<b>Total</b>	<b>647,204</b>	<b>100.0%</b>	<b>564,986</b>	<b>100.0%</b>		
<b>Operating income:</b>						
Trucking	31,040	74.2%	36,887	89.1%	(5,847)	(15.9)%
Container Services	7,198	17.2%	(256)	(0.6)%	7,454	(2911.7)%
Other operating income	3,576	8.6%	4,780	11.5%	(1,204)	(25.2)%
<b>Total</b>	<b>41,814</b>	<b>100.0%</b>	<b>41,411</b>	<b>100.0%</b>		

**Three Months Ended September 30, 2008 Compared to Three Months Ended September 30, 2007**

Operating revenue:

*Trucking* revenues increased \$3.1 million, or 1.8%, for the quarter ended September 30, 2008 compared to the same period for 2007 due to an increase of \$19.9 million of fuel surcharge offset by a decrease of \$16.8 million due to fewer driven miles.

*Container Services* revenues increased \$20.1 million, or more than 100.0%, for the quarter ended September 30, 2008 compared to the same period for 2007 due to the newly acquired Boasso operations.

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

*Other revenue* revenues decreased \$0.7 million, or 3.7%, for the quarter ended September 30, 2008 compared to the same period for 2007 due primarily to a decrease in our tank wash revenue.

Operating income:

*Trucking* operating income decreased \$1.2 million, or 8.7%, for the quarter ended September 30, 2008 compared to the same period for 2007 primarily due to fewer billed miles and the conversion of affiliates which increased facility, leasing, and maintenance costs.

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

*Container Services* - operating income increased \$3.2 million, or more than 100.0%, for the quarter ended September 30, 2008 compared to the same period for 2007 due to the newly acquired Boasso operations.

*Other operating income* - operating income decreased \$1.6 million, or 75.9%, for the quarter ended September 30, 2008 compared to the same period for 2007, primarily due to reduced tank wash revenue.

**Nine Months Ended September 30, 2008 Compared to Nine Months Ended September 30, 2007**

Operating revenue:

*Trucking* - revenues increased \$20.5 million, or 4.1%, for the nine months ended September 30, 2008 compared to the same period for 2007 due to an increase of \$55.0 million of fuel surcharge offset by a decrease of \$34.5 million due to fewer driven miles.

*Container Services* - revenues increased \$59.9 million, or more than 100.0%, for the nine months ended September 30, 2008 compared to the same period for 2007 due to the newly acquired Boasso operations.

*Other revenue* - revenues increased \$1.9 million, or 3.4%, for the nine months ended September 30, 2008 compared to the same period for 2007 due to an increase in our tank wash revenue, which includes the acquisition of a tank wash business acquired in May 2007.

Operating income:

*Trucking* - operating income decreased \$5.8 million, or 15.9%, for the nine months ended September 30, 2008 compared to the same period for 2007 due to fewer billed miles and the conversion of affiliates which increased facility, leasing, and maintenance costs.

*Container Services* - operating income increased \$7.5 million, or more than 100.0%, for the nine months ended September 30, 2008 compared to the same period for 2007 due to the newly acquired Boasso operations.

*Other operating income* - operating income decreased \$1.2 million, or 25.2%, for the nine months ended September 30, 2008 compared to the same period for 2007.

**Liquidity and Capital Resources**

The following summarizes our cash flows for the nine months ended September 30, 2008 and 2007 as reported in our Consolidated Statements of Cash Flows in the accompanying Consolidated Financial Statements (in thousands):

	<b>Nine months ended September 30,</b>	
	<b>2008</b>	<b>2007</b>
Net cash provided by operating activities	\$ 10,665	\$ 12,301
Net cash used in investing activities	(10,448)	(5,901)
Net cash provided by (used in) financing activities	13,529	(3,319)
Effect of exchange rate changes on cash	(14)	59
Net increase in cash and cash equivalents	13,732	3,140
Cash and cash equivalents at beginning of period	9,711	6,841
Cash and cash equivalents at end of period	\$ 23,443	\$ 9,981

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

Historically, our primary source of liquidity has been cash flow from operations and borrowing availability under our credit agreement. Our primary cash needs consist of capital expenditures and debt service including our asset-based loan facility ( ABL Facility ), our 9% Senior Subordinated Notes due 2010 ( 9% Notes ) and our Senior Floating Rate Notes due 2012 ( 2012 Notes ). We incur capital expenditures for the purpose of purchasing tractors and trailers to meet our strategic needs during the year, and maintaining and improving our infrastructure. In addition, we may from time to time repurchase or redeem our outstanding

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

securities. Any repurchases or redemptions would depend upon prevailing market conditions, our liquidity requirements, contractual restrictions and other factors we consider important. Future repurchases or redemptions may materially impact on our liquidity, future tax liability and results of operations.

Net cash provided by operating activities was \$10.7 million for the nine-month period ended September 30, 2008 compared to \$12.3 million in the comparable 2007 period. The \$1.6 million decrease in cash provided by operating activities was due in part to the payment of four large claims classified under accrued loss and damage claims, gains from sales of land not used in our business and to the net loss in 2008.

Cash used in investing activities totaled \$10.4 million for the nine-month period ended September 30, 2008 compared to \$5.9 million used in the comparable 2007 period. The \$4.5 million change resulted from an increase in capital expenditures due in part to development costs associated with our new terminal in Newark, New Jersey, offset in part by reduced cash paid for business assets purchased and a cash refund due to a downward adjustment of the purchase price for Boasso.

Cash provided by financing activities was \$13.5 million during the nine-month period ended September 30, 2008, compared to net cash used in financing activities of \$3.3 million for the same period in 2007. The increase was primarily due to \$20.9 million of increased borrowings under our ABL Facility. Of these borrowings, \$15.0 million was used to increase our cash reserves due to the recent turmoil in the credit markets (see Item IA. Risk Factors). The remainder was used to pay accrued loss and damage claims and for capital expenditures.

*Off-Balance Sheet Arrangements*

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

*Contractual Obligations and Commitments*

The following is a schedule of our long-term contractual commitments, including the current portion of our long-term indebtedness at September 30, 2008 over the periods we expect them to be paid (in thousands):

	Total	Remainder of 2008	Year 2009	Year 2010	Year 2011	Year 2012	Year 2013 and after
Operating leases (1)	\$ 70,803	\$ 4,859	\$ 18,249	\$ 15,602	\$ 10,596	\$ 7,526	\$ 13,971
Total indebtedness (2)	382,504	5,040	3,980	127,223	2,260	137,382	106,619
Capital leases	25,702	1,922	7,991	4,795	4,001	5,452	1,541
Interest on indebtedness (3)	91,917	7,289	29,618	27,688	17,437	7,163	2,722
Total	\$ 570,926	\$ 19,110	\$ 59,838	\$ 175,308	\$ 34,294	\$ 157,523	\$ 124,853

- (1) These obligations represent the minimum rental commitments under all non-cancelable operating leases including the guaranteed residual values at the end of the leases.
- (2) Includes an unamortized original issue discount of \$3.6 million.
- (3) Amounts presented for interest payments assume that all long-term debt obligations outstanding as of September 30, 2008 will remain outstanding until maturity and interest rates on variable-rate debt in effect as of September 30, 2008 will remain in effect until maturity.

*Other Liabilities and Obligations*

We have \$10.5 million of environmental liabilities, \$2.6 million of pension plan obligations and \$23.7 million of other insurance claim obligations. We expect to pay these various obligations over the next ten years. We also have \$47.8 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 September 30, 2008 for our insurance administrator totaled \$40.1 million. If we fail to meet certain terms of our agreement, the insurance

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

administrator may draw down the letters of credit. As of September 30, 2008, our FIN 48 liability is \$2.5 million and represents total gross unrecognized tax benefits that may be paid in future periods. In addition, we have accrued \$1.8 million of interest and penalties that may be paid in future periods.

**Table of Contents****QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES***Long-term Debt*

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

	September 30, 2008	December 31, 2007
Capital lease obligations	\$ 25,702	\$ 5,283
ABL Facility	105,000	84,130
Senior Floating Rate Notes due 2012	135,000	135,000
9% Senior Subordinated Notes due 2010	125,000	125,000
Boasso Note	2,500	2,500
Other Notes	15,004	1,805
Long-term debt, including current maturities	408,206	353,718
Discount on Senior Floating Rate Notes	(3,620)	(4,447)
	404,586	349,271
Less current maturities of long-term debt (including capital lease obligations)	(15,105)	(1,864)
Long-term debt, less current maturities	\$ 389,481	\$ 347,407

*The ABL Facility*

The ABL Facility, which was effective December 18, 2007, consists of a current asset-based revolving facility in an initial amount of \$195.0 million (the current asset tranche) and a fixed asset-based revolving facility in an initial amount of \$30.0 million (the fixed asset tranche), with the total commitments under the fixed asset tranche to be reduced, and the total commitments under the current asset tranche correspondingly increased by \$5.0 million on December 18, 2009 and 2010. Borrowings of revolving loans under the ABL Facility are allocated pro rata to the current asset tranche and the fixed asset tranche based on the then-current current asset borrowing base and the then-current fixed asset borrowing base. The ABL Facility matures June 18, 2013. The maturity date of the ABL Facility may be accelerated if we default on our obligations under the ABL Facility. The maturity date of the ABL Facility is also advanced to a date 91 days prior to the maturity date of the 2012 Notes or the 9% Notes (and replacement indebtedness) if the aggregate principal amount of the notes maturing in the 91-day period exceeds \$50.0 million.

The ABL Facility includes borrowing capacity of up to \$150.0 million for letters of credit, which are allocated pro rata between the two tranches based on the then-current borrowing base for each tranche (or, if the credit extensions under the fixed asset tranche are repaid and the commitments thereunder are terminated prior to the termination of the ABL Facility, to the current asset tranche), and up to \$10.0 million for swingline borrowings on same-day notice, which are allocated under the current asset tranche. The proceeds of the ABL Facility were used, together with the proceeds from an additional private offering of \$50 million of the 2012 Notes, to finance a portion of the Boasso acquisition. The ABL Facility contains a fixed charge coverage ratio of 1.0 to 1.0 which only needs to be met if borrowing availability is less than \$20 million. At September 30, 2008, we had \$42.2 million of borrowing availability under the ABL Facility.

Borrowings under the ABL Facility bear interest at a rate equal to an applicable margin plus, at our option, either a base rate or LIBOR. The applicable margin for borrowings under the current asset tranche at September 30, 2008 is 1.00% with respect to base rate borrowings and 2.00% with respect to LIBOR borrowings. The applicable margin for borrowings under the fixed asset tranche at September 30, 2008 is 1.25% with respect to base rate borrowings and 2.25% with respect to LIBOR borrowings. The applicable margin for such borrowings will be reduced or increased based on aggregate borrowing base availability under the ABL Facility over the life of the ABL Facility. The base rate for the ABL Facility is the higher of the prime rate and the federal funds overnight rate plus 0.50%. We are also required to pay a fee for utilized commitments under the ABL Facility at a rate equal to 0.25% per annum. The ABL Facility is required to be prepaid only to the extent that the aggregate amount of outstanding borrowings, unreimbursed letter of credit drawings and undrawn letters of credit under the relevant tranche exceeds the lesser of the applicable commitments and the applicable borrowing base in effect at such time for such tranche. The borrowing base

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

for the current asset tranche consists of eligible accounts receivable, eligible inventory and eligible truck and trailer fleet, and the borrowing base for the fixed asset tranche consists of eligible real property and certain eligible equipment. We may voluntarily repay outstanding loans under the ABL Facility at any time without premium or penalty, other than customary breakage costs with respect to LIBOR loans. The interest rate on the ABL Facility at September 30, 2008 was 5.3%.



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

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

We incurred \$6.6 million in debt issuance costs relating to the ABL Facility. We are amortizing these costs over the term of the ABL Facility.

*Senior Floating Rate Notes*

On January 28, 2005, QD LLC and QD Capital sold \$85 million in Senior Floating Rate Notes, guaranteed by QDI and domestic subsidiaries at 98% of the face value of the notes. On December 18, 2007, QD LLC and QD Capital sold \$50 million in Senior Floating Rate Notes, guaranteed by QDI and domestic subsidiaries at 93% of the face value of the notes. On June 4, 2008, we satisfied our contractual obligation to exchange the Senior Floating Rate Notes sold in December 2007 for Senior Floating Rate Notes registered under the Securities Act. The Senior Floating Rate 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 of the \$85 million offering were used to repay approximately \$70 million of a previous term loan and to make a distribution to QDI, which in turn used such proceeds to redeem all \$7.5 million principal amount of previous outstanding debt. The balance was used for general corporate purposes, including the repayment of \$5.8 million of indebtedness under the revolving credit portion of our previous credit facility. The net proceeds of the \$50 million offering were used to repay a portion of the term loan under our previous credit facility. The interest rate on the \$85 million of the 2012 Notes at September 30, 2008 and 2007 was 7.3% and 9.9%, respectively. The interest rate on the \$50 million of the 2012 Notes at September 30, 2008 was 7.3%.

We incurred \$2.5 million in debt issuance costs relating to the \$85 million of the 2012 Notes and \$2.3 million related to the \$50 million of the 2012 Notes. We are amortizing these costs over the term of the notes.

We may redeem the 2012 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:

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

*9% Senior Subordinated Notes*

The 9% Notes are unsecured obligations of QD LLC and QD Capital 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.

We incurred \$5.5 million in debt issuance costs relating to the 9% Notes. We are amortizing these costs over the term of the 9% Notes.

We may redeem the 9% 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:

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

Year	Percentage
2008	102.25
2009 and thereafter	100.00

*Boasso Note*

Included in the aggregate purchase price of the Boasso acquisition is a \$2.5 million 7% promissory note with a maturity on December 18, 2009 for the benefit of a former Boasso shareholder. The shareholder has the right to demand payment on December 18, 2008, and has notified us of his intent to demand payment. The Boasso Note is convertible into shares of our common stock following the first anniversary of the acquisition at the election of the holder at a price of \$4.47 per share (the closing price of the shares reported on NASDAQ on the day before the acquisition). If the conversion option is exercised, we have the right, instead of issuing shares, to pay the holder a cash amount equal to the number of shares of common stock into which the Boasso Note is then convertible multiplied by the average closing price plus any accrued and unpaid interest.

*Collateral, Guarantees and Covenants*

The ABL Facility contains a number of covenants that, among other things, restrict, subject to certain exceptions, our ability, and the ability of our subsidiaries, to sell assets; incur additional indebtedness; prepay other indebtedness (including the notes); pay dividends and distributions or repurchase capital stock; create liens on assets; make investments; make certain acquisitions; engage in mergers or consolidations; engage in certain transactions with affiliates; amend certain charter documents and material agreements governing subordinated indebtedness, including the Existing Subordinated Notes; change the business conducted by it and its subsidiaries; and enter into agreements that restrict dividends from subsidiaries. The ABL Facility also contains certain customary affirmative covenants and events of default.

QD LLC has the ability to incur additional debt, subject to limitations imposed by the indentures governing the 9% Notes and the 2012 Notes. Under the indentures governing the 9% Notes and 2012 Notes, in addition to specified permitted indebtedness, QD LLC will be able to incur additional indebtedness so long as, on a pro forma basis, QD LLC's consolidated fixed charge coverage ratio (the ratio of Consolidated EBITDA (as defined in the respective indentures for the QD LLC Notes) to consolidated fixed charges) is 2.00 to 1.0 or less. As of September 30, 2008 we were in compliance with this covenant.

We are in compliance with all covenants at September 30, 2008.

**Debt Retirement**

The following is a schedule of our indebtedness at September 30, 2008 over the periods we are required to pay such indebtedness (in thousands):

	Remainder of 2008	2009	2010	2011	2012 and after	Total
Boasso Note (1)	\$ 2,500	\$	\$	\$	\$	\$ 2,500
Capital lease obligations	1,922	7,991	4,795	4,001	6,993	25,702
ABL Facility (2)					105,000	105,000
9% Senior Subordinated Notes, due 2010			125,000			125,000
Senior Floating Rate Notes, due 2012 (3)					135,000	135,000
Other Notes	2,539	3,980	2,223	2,260	4,002	15,004
<b>Total</b>	<b>\$ 6,961</b>	<b>\$ 11,971</b>	<b>\$ 132,018</b>	<b>\$ 6,261</b>	<b>\$ 250,995</b>	<b>\$ 408,206</b>

(1) The holder of the Boasso Note has the option to convert the Boasso Note into shares of our common stock following the first anniversary of the acquisition. QD LLC has the option to pay the holder in cash in lieu of stock.

(2)

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

The maturity date of the ABL Facility may be accelerated if we default on our obligations under the ABL Facility. The maturity date of the ABL Facility is also advanced to a date 91 days prior to the maturity date of the 2012 Notes or the 9% Notes (and replacement indebtedness) if the aggregate principal amount of the notes maturing in the 91-day period exceeds \$50.0 million.

- (3) Amounts do not include the remaining unamortized original issue discount of \$3.6 million relating to the 2012 Notes.

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

The following is a schedule of our debt issuance costs at September 30, 2008 (in thousands):

	Issuance Costs	Accumulated Amortization	Balance
ABL Facility	\$ 6,625	\$ (964)	\$ 5,661
9% Senior Subordinated Notes, due 2010	5,496	(3,873)	1,623
Senior Floating Rate Notes, due 2012	4,796	(1,768)	3,028
Total	\$ 16,917	\$ (6,605)	\$ 10,312

We are amortizing these costs over the term of the debt instruments.

**FORWARD-LOOKING STATEMENTS AND CERTAIN CONSIDERATIONS**

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

Forward-looking statements are subject to known and unknown risks, uncertainties and other factors that could cause the actual results to differ materially from those contemplated by the statements. The forward-looking information is based on various factors and was derived using numerous assumptions. Important factors that could cause our actual results to be materially different from the forward-looking statements include the following risks and other factors discussed under the Item 1A Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2007, as well as those discussed in the Quarterly Report on Form 10-Q for the quarter ended March 31, 2008, and in this Quarterly Report on Form 10-Q. These factors include:

general economic conditions,

recent turmoil in the credit and capital markets,

the availability of diesel fuel,

adverse weather conditions,

competitive rate fluctuations,

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

the cyclical nature of the transportation industry due to various economic factors such as excess capacity in the industry, the availability of qualified drivers, changes in fuel and insurance prices, interest rate fluctuations, and downturns in customers' business cycles and shipping requirements,

changes in demand for our services due to the cyclical nature of our customers' businesses,

**Table of Contents**

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

potential disruption at U.S. ports of entry could adversely affect our business, financial condition and results of operations,

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

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

our material exposure to both historical and changing environmental regulations and the increasing costs relating to environmental compliance,

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

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

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

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

changes in senior management,

our ability to successfully manage workforce restructurings,

our ability to successfully integrate acquired businesses and converted affiliates, and

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

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

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

**ADDITIONAL INFORMATION AVAILABLE ON COMPANY WEBSITE**

Our most recent Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports may be viewed or downloaded electronically or as paper copies from our website: <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. Any information on or linked from our website is not incorporated by reference into this Quarterly Report on Form 10-Q.

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

We are subject to market risks from (i) interest rates due to our variable interest rate indebtedness, (ii) foreign currency fluctuations due to our international operations and (iii) increased commodity prices due to the diesel consumption necessary for our operations. During the nine months ended September 30, 2008, we did not hold derivative instruments or engage in other hedging transactions to reduce our exposure to such risks.

**Interest Rate Risk**

We are exposed to the impact of interest rate changes primarily through our variable-rate borrowings under the ABL Facility and the 2012 Notes. With regard to the ABL Facility at QD LLC's option, the applicable margin for borrowings under the current asset tranche at September 30, 2008 is 1.00% with respect to base rate borrowings and 2.00% with respect to LIBOR borrowings. The applicable margin for borrowings under the fixed asset tranche at September 30, 2008 is 1.25% with respect to base rate borrowings and 2.25% with respect to LIBOR borrowings. The applicable margin for such borrowings will be reduced or increased based on aggregate borrowing base availability under the ABL Facility over the life of the ABL Facility. The base rate under the ABL Facility is equal to the higher of the prime rate and the federal funds overnight rate plus 0.50%. The base rate for our 2012 Notes is LIBOR plus 4.50%.

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

	Balance at September 30, 2008 (\$ in 000s)	Interest Rate at September 30, 2008	Effect of 1% Increase (\$ in 000s)
ABL Facility	\$ 105,000	5.34%	\$ 1,050
Senior Floating Rate Notes - \$50M	50,000	7.29%	500
Senior Floating Rate Notes - \$85M	85,000	7.29%	850
Total	\$ 240,000		\$ 2,400

At September 30, 2008, a 1% point increase in the current per annum interest rate for each would result in \$2.4 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 September 30, 2008. 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 U.S. dollars; and

the value of the net assets of our international operations reported in U.S. 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 for the nine months ended September 30, 2008 and 7.3% of our consolidated revenue for the nine months ended September 30, 2007. 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 U.S. dollar as their functional currency. Any foreign currency impact on translating assets and liabilities into dollars is included as a component of shareholders' equity. Our revenue results for the nine months ended September 30, 2008 were positively impacted by a \$3.3 million foreign currency movement, primarily due to the strengthening of the Canadian dollar against the United States dollar.

Changes in foreign exchange rates that had the largest impact on translating our international operating profits for the first nine months of 2008 related to the Canadian dollar versus the U.S. dollar. We estimate that a 1% adverse change in the Canadian dollar foreign exchange rate would have decreased our revenues by approximately \$0.4 million for the nine months ended September 30, 2008, assuming no changes other than the exchange rate itself. Our inter-company loans are subject to fluctuations in exchange rates primarily between the U.S. dollar and the Canadian dollar. Based on the outstanding balance of our intercompany loans at September 30, 2008, 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.



**Table of Contents**

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

**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. The national average diesel fuel price reported by the U.S. Department of Energy continued to rise to record levels during the first six months of 2008 and, while trending downward during the third quarter of 2008, was still higher at September 30, 2008 than at January 7, 2008. Historically, we have been able to recover a majority of fuel price increases from our customers in the form of fuel surcharges. The price and availability of diesel fuel can be unpredictable as well as the extent to which fuel surcharges can be collected to offset such increases. In the nine months ended September 30, 2008 and 2007, a majority of fuel costs were covered through fuel surcharges.

**ITEM 4 Controls and Procedures**

*Evaluation of disclosure controls and procedures*

As required by Exchange Act Rules 13a-15(b) and 15d-15(b), management has evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on their evaluation, management concluded our disclosure controls and procedures (as defined in Securities Exchange Act Rules 13a-15(e) and 15d-15(e)) were effective as of September 30, 2008 to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and were effective as of September 30, 2008 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*

Since the acquisition of Boasso in December 2007, we have been diligently working to integrate and assimilate Boasso's operations into our internal operating procedures, information systems and accounting controls. While in this transition phase during the nine months ended September 30, 2008, we reviewed the financial information obtained from Boasso and performed additional procedures with respect to such information in order to determine its accuracy and reliability. There were no changes in our internal control over financial reporting during the quarter ended September 30, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

In accordance with guidance from the Division of Corporation Finance and Office of the Chief Accountant of the Securities and Exchange Commission, the Company will include an assessment of Boasso in management's report on the effectiveness of the Company's internal control over financial reporting in the Form 10-K for the year ended December 31, 2008.

---

**Table of Contents**

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

**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, 2007, Note 17. Commitments and Contingencies to our audited consolidated financial statements contained in such Form 10-K and Note 9. Commitments and Contingencies to our unaudited consolidated financial statements included in this report, we are not currently a party to any material pending legal proceedings other than routine matters incidental to our business and no material developments have occurred in any proceedings described in such Form 10-K.

**ITEM 1A Risk Factors**

You should carefully consider the factors disclosed in our Annual Report on Form 10-K for the year ended December 31, 2007 and our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2008 and June 30, 2008 included under Item 1A Risk Factors in addition to the other information set forth in this report. The risks described in our Annual Report on Form 10-K and our Quarterly Reports on Form 10-Q are not the only risks facing our Company.

Additionally, we may be subject to the risk set forth below:

*Recent turmoil in the credit and capital markets and in the financial services industry may increase our borrowing costs and may negatively impact our liquidity.*

Recently, the credit markets, capital markets and the financial services industry have been experiencing a period of unprecedented turmoil and upheaval characterized by the bankruptcy, failure, collapse or sale of various financial institutions and an unprecedented level of intervention from the United States federal government. While the ultimate outcome of these events cannot be predicted, they may have a material adverse effect on our liquidity and financial condition if our ability to borrow money to finance our operations from our existing lenders under our bank credit agreements or obtain credit from trade creditors were to be impaired. In addition, the recent economic crisis could also adversely impact our customers' ability to finance their operations, which may negatively impact our business and results of operations.

One consequence of these upheavals has been sudden and dramatic changes in LIBOR. At September 30, 2008, \$240 million in principal amount of our outstanding borrowings have interest based solely or alternatively on a margin over LIBOR. Increases in LIBOR could therefore materially increase the cost of our borrowings. In addition, capital markets have recently experienced significant volatility and disruption. A majority of our existing indebtedness was sold through capital markets transactions. We anticipate that the capital markets could be a source of refinancing of our existing indebtedness in the future. This source of refinancing may not be available if capital markets volatility and disruption continues, which could have a material adverse effect on our liquidity.

*Restructuring plans involve risks to our business operations and may not reduce our costs.*

During 2008, we have implemented a restructuring plan that involves terminating approximately 75 employees in the aggregate and certain contract terminations. These steps have placed, and will continue to place, pressures on our management, administrative and operational infrastructure as well as on our results of operations. Employees that departed in connection with the restructuring possessed knowledge of our business, skills and relationships with our customers, affiliates, drivers and other employees that were not replaced. As a result, our remaining employees may be required to serve new operational roles in which they have limited experience, which may reduce employee satisfaction and productivity. New relationships may also reduce customer, affiliate or driver satisfaction. Additionally, our restructuring plans and related efforts may divert management's and other employee's attention from other business concerns.

Due to the restructuring, we have taken pre-tax charges in the second and third quarters which represent our estimates of severance-related and termination costs, of which the majority were cash expenditures paid during these quarters or that we expect to pay in the future. Actual costs may exceed our estimates. Furthermore, we have formulated this restructuring plan with the goal of reducing our future operating expenses. Our future operating expenses may not be reduced as we expect, or reductions may be offset in the future by other expenses.



**Table of Contents**

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

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

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

None

**ITEM 3 Defaults Upon Senior Securities**

None

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

None

**ITEM 5 Other Information**

None

**ITEM 6 Exhibits**

<b>Exhibit No.</b>	<b>Description</b>
10.1	Agreement and Release, effective as of July 25, 2008, between Quality Distribution, Inc. and Timothy B. Page.
10.2	Employment Agreement, effective as of July 28, 2008, between Quality Distribution, Inc. and Stephen R. Attwood.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant To 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

**Table of Contents**

**QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES**

**SIGNATURES**

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

QUALITY DISTRIBUTION, INC.

November 7, 2008

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

November 7, 2008

/s/ Stephen R. Attwood  
STEPHEN R. ATTWOOD,  
SENIOR VICE PRESIDENT AND CHIEF FINANCIAL OFFICER  
(PRINCIPAL FINANCIAL AND ACCOUNTING OFFICER)