

QUALITY DISTRIBUTION INC

Form 10-Q

August 14, 2002

**Table of Contents**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended JUNE 30, 2002

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: 333-98077

**Quality Distribution, LLC**

(Exact name of registrant as specified in its charter)

Delaware

04-3668323

(State or other jurisdiction of incorporation  
or organization)

I.R.S. Employer  
Identification No.)

3802 Corporex Park Drive, Tampa, FL 33619

(Address of Principal Executive Offices) (Zip Code)

(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

**APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY  
PROCEEDINGS DURING THE PRECEDING FIVE YEARS**

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

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes No

### APPLICABLE ONLY TO CORPORATE USERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at JUNE 30, 2002
(Membership Interest, No par value)	100

**TABLE OF CONTENTS**

**PART I FINANCIAL INFORMATION**

**ITEM 1 FINANCIAL STATEMENTS**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**ITEM 2 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

**PART II OTHER INFORMATION**

**ITEM 1. Legal Proceedings**

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

**ITEM 6. (a) Exhibits:**

**Signatures**

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER**

**CERTIFICATION OF CHIEF FINANCIAL OFFICER**

---

**Table of Contents**

**QUALITY DISTRIBUTION, LLC AND SUBSIDIARIES**

**(SUCCESSOR TO QUALITY DISTRIBUTION, INC.)**

**INDEX**

**Page No.**

Part I Financial Information

Item 1	Financial Statements Condensed consolidated balance sheets - June 30, 2002 (unaudited) and December 31, 2001	3-4
	Condensed consolidated statements of operations - Three months and six months ended June 30, 2002 and 2001 (unaudited)	5
	Condensed consolidated statements of cash flows - Six months ended June 30, 2002 and 2001 (unaudited)	6
	Condensed Consolidated Statement of Membership Interest for the period ended June 30, 2002	7
	Notes to condensed consolidated financial statements (unaudited)	8-27
Item 2	Management's Discussion and Analysis of Financial Condition and Results of Operations	28-32
Item 3	Quantitative and Qualitative Disclosures About Market Risk	33
Part II Other Information	Item 1 Legal proceedings	34
Item 4	Submission of matters to a vote of security holders	34
Item 6	Exhibits and Reports	

on Form 8-K  
34 Signatures 35

**Table of Contents**

**FORM 10-Q**  
**PART I FINANCIAL INFORMATION**  
**ITEM 1 FINANCIAL STATEMENTS**  
**QUALITY DISTRIBUTION, LLC AND SUBSIDIARIES,**  
**(SUCCESSOR TO QUALITY DISTRIBUTION, INC.)**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(In thousands)**

	<b>June 30, 2002 (Unaudited)</b>	<b>December 31, 2001</b>
<b>ASSETS</b>		
Current assets:		
Cash	\$3,261	\$2,212
Accounts receivable	98,416	98,173
Allowance for doubtful accounts	(11,130)	(9,272)
Receivable petroleum division sale	3,501	
Inventories	1,034	1,143
Prepaid expenses	5,017	5,767
Prepaid tires	8,482	8,968
Income tax receivable	306	
Other	2,599	2,666
<hr/>		
<hr/>		
Total current assets	111,180	109,963
Property, plant and equipment	339,452	348,688
Less accumulated depreciation and amortization	(179,272)	(171,329)
<hr/>		
<hr/>		
160,180	177,359	
Goodwill, net	130,111	150,510

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Intangibles  
2,570 2,265  
Other assets  
8,826 8,881

---

---

\$412,867 \$448,978

---

---

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

---



**Table of Contents**

**FORM 10-Q**  
**PART I FINANCIAL INFORMATION**  
**ITEM 1 FINANCIAL STATEMENTS**  
**QUALITY DISTRIBUTION, LLC AND SUBSIDIARIES,**  
**(SUCCESSOR TO QUALITY DISTRIBUTION, INC.)**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In thousands)  
(continued)

	<b>June 30,</b>	<b>December</b>
	<b>2002</b>	<b>31,</b>
	<b>(Unaudited)</b>	<b>2001</b>
<b>LIABILITIES AND MEMBERSHIP INTEREST</b>		
Current liabilities:		
Current maturities of indebtedness		
\$2,677	\$2,677	
Accounts payable and accrued expenses		
67,248	62,848	
Affiliates and owner operators payable		
9,491	4,930	
Income taxes payable		
547	1,092	
<hr/>		
<hr/>		
Total current liabilities		
79,963	71,547	
Long term bank debt, less current maturities		
289,343	301,179	
Subordinated debt		
94,419	140,000	
Environmental liabilities		
32,590	36,163	
Other long term obligations		
11,880	13,744	
Deferred taxes		
1,396	1,270	
<hr/>		
<hr/>		
Total liabilities		
509,591	563,903	
Minority interest in subsidiary		
1,833	1,833	
Mandatorily redeemable preferred stock		
16,499		

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Mandatorily redeemable common stock  
(30 shares)  
1,210

MEMBERSHIP INTEREST:

Membership interest, no par value, 1,000  
authorized, 100 issued at June 30, 2002

Common stock, \$.01 par value; 15,000  
shares authorized and issued at  
December 31, 2001

20

Additional paid-in-capital

176,816 105,544

Treasury stock

(402)

Accumulated (deficit)

(77,515) (37,435)

Stock recapitalization

(189,589) (189,589)

Accumulated other comprehensive (loss)

(8,269) (10,829)

Notes receivable

(1,776)

---

---

Total membership interest

(98,557) (134,467)

---

---

\$412,867 \$448,978

---

---

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

**Table of Contents**

**FORM 10-Q**  
**PART I FINANCIAL INFORMATION**  
**ITEM 1 FINANCIAL STATEMENTS**  
**QUALITY DISTRIBUTION, LLC AND SUBSIDIARIES,**  
**(SUCCESSOR TO QUALITY DISTRIBUTION, INC.)**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(Unaudited)(in thousands)**

	<b>Six months ended June 30,</b>		<b>Three months ended June 30,</b>	
	<b>2002</b>	<b>2001</b>	<b>2002</b>	<b>2001</b>
<b>Operating revenues:</b>				
Transportation	\$223,518	\$225,357	\$117,790	\$114,396
Other	33,119	31,049	16,629	15,414
<hr/>				
<hr/>				
<hr/>				
<hr/>				
Total operating revenues	256,637	256,406	134,419	129,810
<b>Operating expenses:</b>				
Purchased transportation	150,120	150,933	79,243	77,141
Depreciation and amortization	15,596	16,659	7,841	8,470
Other operating expenses	74,328	72,085	38,064	36,311
<hr/>				
<hr/>				
<hr/>				
<hr/>				
Operating income	16,593	16,729	9,271	7,888
Interest expense, net	19,484	19,062	9,577	9,621
Interest expense, transaction fees	10,077	10,077		
Other expense (income)				

48 (2) 12 11

---

---

---

---

Loss before taxes  
(13,016) (2,331) (10,395) (1,744)  
Provision for income taxes  
353 710 164 350

---

---

---

---

Net loss from continuing operations  
(13,369) (3,041) (10,559) (2,094)  
Discontinued operations:

Loss from operations of discontinued division (net of tax of \$0)  
(263) (419) (28) (336)  
Loss on disposal of discontinued division (net of tax of \$0)  
(1,431) (1,431)

---

---

---

---

Net loss before Cumulative effect of Change in accounting principle  
(15,063) (3,460) (12,018) (2,430)  
Cumulative effect of a change in accounting principle (net of tax of \$0)  
(23,985)

---

---

---

---

Net loss

(39,048) (3,460) (12,018) (2,430)

Preferred stock dividends and accretions

(1,032) (794) (430) (397)

---

---

---

---

---

Net income attributable to owner s interest

\$(40,080) \$(4,254) \$(12,448) \$(2,827)

---

---

---

---

---

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

**Table of Contents**

**FORM 10-Q**  
**ITEM 1 FINANCIAL STATEMENTS**  
**QUALITY DISTRIBUTION, LLC AND SUBSIDIARIES,**  
**(SUCCESSOR TO QUALITY DISTRIBUTION, INC.)**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited) (In thousands)**

	Six months ended June 30,	
	2002	2001
Cash flows provided by (used in) Operating activities:		
Net loss	\$(39,048)	\$(3,460)
Adjustments for non cash charges	45,705	19,087
Changes in assets and liabilities	3,274	(10,770)
Net cash provided by operating activities	9,931	4,857
Investing activities:		
Capital expenditures	(6,520)	(13,846)
Proceeds from asset dispositions	3,682	1,734
Net cash (used in) investing activities	(2,838)	(12,112)
Financing activities:		
Proceeds from issuance of debt	11,000	
Payment of debt obligations	(1,839)	(1,587)
Preferred stock redemption	(2,600)	
Exchange offer fees	(3,572)	
Other	(691)	499

---

---

Net cash provided by (used in)  
financing activities  
(6,102) 7,312

---

---

Net increase in cash  
991 57  
Effect of exchange rate changes on  
cash  
58 (798)  
Cash, beginning of period  
2,212 2,636

---

---

Cash, end of period  
\$3,261 \$1,895

---

---

Supplemental disclosures of cash  
flow information:

Cash payments for:

Interest  
\$11,529 \$16,891  
Income taxes  
\$153 \$362  
Supplemental disclosures of  
Non-cash activities:

Preferred Stock Accretion  
\$1,032 \$722  
Unrealized gain or (loss) on  
derivative instruments  
\$2,340 \$(1,773)

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

**Table of Contents**

**Quality Distribution LLC and Subsidiaries, successor to Quality Distribution, Inc.  
Condensed Consolidated Statement of Membership interest  
For the Period Ended June 30, 2002  
(In 000 s)**

	Common Stock	Treasury Stock	Additional Paid-in-capital	Accumulated Deficit	Stock Recapitalization	Accumulated Other Comprehensive Loss	Notes Receivable	Total Membership Interest
Balance December 31, 2001	\$ 20	\$(402)	\$ 105,544	\$(37,435)	\$(189,589)	\$(10,829)	\$(1,776)	\$(134,467)
Net Loss				(39,048)				(39,048)
Interest rate swaps								
2,109	2,109							
Stock Subscription Receipts								
(200)	(200)							
Translation Adjustment								
451	451							
Treasury Stock acquired								
(454)	(454)							
Preferred Stock Dividend and Accretion								
(1,032)	(1,032)							
Formation of QDI LLC (see note 2):								
Common Stock								
(20)	20							
Stock Subscription								
(1,976)	1,976							
Treasury Stock								
856	(856)							
Junior PIK Note								
14,830	14,830							
Stock Warrants								
86	86							
Redeemable Common Stock								
1,209	1,209							
Preferred Stock								
57,959	57,959							
Balance June 30, 2002	\$ 176,816	\$(77,515)	\$(189,589)	\$(8,269)	\$ (98,557)			



**Table of Contents**

**FORM 10-Q**  
**Item 1. FINANCIAL STATEMENTS**  
**QUALITY DISTRIBUTION, LLC AND SUBSIDIARIES,**  
**(SUCCESSOR TO QUALITY DISTRIBUTION, INC.)**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:****Basis of Presentation**

Quality Distribution, LLC (the Company) is a Delaware limited liability company formed on April 14, 2002. Our sole member is Quality Distribution, Inc., a Florida corporation (QDI Inc.). On May 30, 2002, QDI Inc. completed an exchange offer for its public debt, at which time QDI Inc. transferred all of its assets (other than certain contract rights which by their terms cannot be assigned without the consent of the other parties thereto) to the Company, consisting principally of the assets of QDI Inc.'s operating subsidiaries. The Company became the successor entity to QDI Inc. The transfer of the net assets to the Company by QDI, Inc. has been accounted for as a transaction between companies under common control. As a result, QDI, Inc.'s historical accounting basis for the net assets has been carried over to the Company. The results of operations for periods prior to the transfer represent the historical operating results for QDI, Inc. Following the exchange offer, QDI Inc. had \$58.0 million of its 13.75% preferred stock outstanding, \$1.2 million of redeemable common stock and issued \$14.8 million of 12% Junior Subordinated Pay-in-Kind Notes (Junior PIK Notes) due 2009. QDI Inc. has no assets other than QDI LLC and no operations and can only repay its obligations through the cash flows of the Company.

The accompanying unaudited condensed, consolidated financial statements of the Company have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and notes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments and accruals) considered necessary for a fair presentation have been included. Certain reclassifications have been made in the fiscal 2001 statements to conform to the 2002 presentation.

For further information, refer to the consolidated financial statements and notes thereto for the year ended December 31, 2001 included in the QDI Inc.'s annual report on Form 10-K.

Operating results for the second quarter ended June 30, 2002 are not necessarily indicative of the results that may be expected for the entire fiscal year.

Historical financial information contained herein has been adjusted to reflect the discontinued operations resulting from the sale of certain non-guarantor subsidiaries' assets in the second quarter 2002. These subsidiaries consisted of the Canadian petroleum division and the internet load brokerage subsidiary of the Company.

The operations and asset disposition information of the discontinued divisions as follows: (dollars in thousands)

	Six months ended June 30,		Three months ended June 30,	
	2002	2001	2002	2001
Revenue	\$5,117	\$8,015	\$2,409	\$4,207
Operating expenses	5,380	8,434	2,437	4,290

---

---

Operating (loss)  
\$(263) \$(419) \$(28) \$(83)

---

---

---

---

**Table of Contents**

Carrying value of assets sold  
At June 30, 2002

Petroleum Division  
\$5,228  
Bulknet  
392  
Operating loss after  
measurement date  
382  
Proceeds  
(4,571)

---

Loss on sale of assets  
\$1,431

---

**2. LIQUIDITY:**

QDI Inc. and its subsidiaries, pursuant to the terms of an Offering Memorandum and Consent Solicitation Statement, dated as of April 10, 2002, as supplemented May 10, 2002 by Supplement No. 1 thereto dated as of May 10, 2002 (as so supplemented, the Offering Memorandum ),

commenced an offer to exchange up to \$87.0 million principal amount of QDI Inc. s outstanding 10% Series B Senior Subordinated Notes due 2006 and Series B Floating Interest Rate Subordinated Term Securities due 2006 (FIRSTS) (together, the QDI Notes ) for a combination of certain debt and equity securities, including the 12 1/2% Senior Subordinated Secured Notes due 2008 of the Company (the New Notes ),

commenced a consent solicitation for certain proposed amendments to the indenture governing the QDI Notes to eliminate many of the restrictive covenants contained in that indenture, and

entered into lock-up agreements with certain affiliates of Apollo Management, L.P., the Company s controlling stockholder ( Apollo ), certain affiliates of Ares Management, L.P. ( Ares ) and certain members of QDI Inc. s management, who collectively held \$53.0 million aggregate principal amount of the QDI Notes.

The exchange offer for the QDI Notes and the consent solicitation were consummated on May 30, 2002. On such date, QDI Inc. accepted for exchange \$61.4 million aggregate principal amount of the QDI Notes (excluding the \$53.0 million aggregate principal amount of the QDI Notes covered by the lock-up agreements). All tendering holders received for each \$1,000 principal amount of QDI Notes tendered, a combination of debt and equity securities consisting of:

\$650 principal amount of the New Notes;

\$150 principal amount of 12% Junior Notes and;

2.0415 warrants, each to purchase one share of QDI Inc. s common stock at an exercise price of \$5 per share.

Pursuant to the terms of the lock-up agreements with Ares, Apollo and QDI Inc. s management, on May 30, 2002,

Ares exchanged its QDI Notes for the same combination of debt and equity securities indicated above for tendering holders,

Apollo and QDI Inc. s management group exchanged their respective QDI Notes for shares of QDI Inc. s 13.75% preferred stock, and

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Apollo purchased for cash an additional \$10 million of QDI Inc.'s 13.75% preferred stock, all of the proceeds of which were used by QDI to retire

**Table of Contents**

certain borrowings under our credit agreement for which Apollo had provided credit support.

In connection with the formation of the Company, all equity and obligations of QDI Inc. were treated as additional paid-in capital of the Company. See Condensed consolidated statement of membership interest at June 30, 2002 for information regarding changes in equity related to the Exchange transaction.

As a result of the transactions, on May 30, 2002, the Company issued \$54.5 million aggregate principal amount of its New Notes to the holders of QDI Notes participating in the transactions and to Ares. The carrying amount of the New Notes has been adjusted by \$14.3 million to reflect accounting under FAS 15 and will be amortized over the life of the New Notes as a reduction in interest expense. After the closing of the transactions, \$25.6 million in aggregate principal amount and carrying amount of the QDI Notes remains outstanding. In addition, as a result of the closing of the transactions, the amendments to the financial covenants contained in the Fifth Amendment to our credit agreement previously entered into by QDI Inc. and the Company became effective as discussed below.

The accounting for the exchange offer followed the requirements of Statement of Financial Accounting Standards No. 15 Accounting by Debtors and Creditors for Troubled Debt Restructurings ( FAS 15 ). A comparison was made between the future cash outflows associated with the New Notes and the Junior PIK Notes (including principal, interest and related costs), and the recorded liabilities related to the QDI Notes. The carrying value of the QDI Notes tendered and exchanged on May , 2002 became the carrying value of the New Notes, less the fair value of the Warrants, Junior PIK Notes and 13.75% preferred stock issued by QDI, Inc. Interest expense associated with the New Notes will be calculated using the effective interest method, which is less than the stated interest rates. There was no gain or loss for accounting purposes in connection with the exchange of the New Notes and the Junior PIK Notes for the QDI notes. In connection with the exchange offering, deferred debt issue costs relating to the fourth amendment to the Company's credit agreement totaling approximately \$4.2 million and legal and advisory fees relating to the exchange offer totaling approximately \$5.9 million were recorded as transaction expenses.

On April 5, 2002, we entered into a fifth amendment (the Fifth Amendment ) to our credit agreement. The Fifth Amendment relates to the financial covenants which were unlikely to be met beginning with the quarter ending March 31, 2003, and further amended those financial covenants through the date of the final maturity of our credit agreement in 2005. Such revised covenants are less restrictive than the previously existing covenants for the period beginning March 31, 2003 through final maturity of our credit agreement. There can be no assurance that we will be able to comply with these revised financial covenants. However, the Company currently believes that it will be in compliance with the covenants through December 31, 2002.

**3. COMPREHENSIVE INCOME:**

Comprehensive income is as follows: (in thousands)

	Six months ended June 30,		Three months ended June 30,	
	2002	2001	2002	2001
Net Income or (loss)	\$ (39,048)	\$ (3,460)	\$ (12,018)	\$ (2,430)
Other comprehensive income (loss):				
Foreign currency translation adjustments				
451 (87) 530 334				
Unrealized gain or (loss) on derivative instruments				
2,340 (1,773) 1,265 (870)				
_____				
_____				
_____				
_____				

Comprehensive income (loss)

\$(36,257) \$(5,320) \$(10,223) \$(2,966)

---

---

---

---

**4. DERIVATIVES:**

The Company utilizes derivative financial instruments to reduce its exposure to market risks from changes in interest rates and foreign exchange rates. The instruments primarily used to mitigate these risks are interest rate swaps and foreign exchange contracts. The Company is exposed to credit related losses in the event of nonperformance by counterparties to these financial instruments; however, counterparties to these agreements are major financial institutions; and the risk of loss due to nonperformance is considered by management to be minimal. The Company does not hold nor issue interest rate swaps or foreign exchange contracts for trading purposes.

The Financial Accounting Standards Board ( FASB ) issued, then subsequently amended, Statement of Financial Accounting Standards ( SFAS ) No. 133,

**Table of Contents**

Accounting for Derivative Instruments and Hedging Activities, which became effective for the Company on January 1, 2001. Under SFAS No. 133, as amended, all derivative instruments (including certain derivative instruments embedded in other contracts) are recognized in the balance sheet at their fair values and changes in fair value are recognized immediately in earnings, unless the derivatives qualify as hedges of future cash flows. For derivatives qualifying as hedges of future cash flows, the effective portion of changes in fair value is recorded temporarily in equity, then recognized in earnings along with the related effects of the hedged items. Any ineffective portion of a hedge is reported in earnings as it occurs.

The Company has approximately \$344 million and \$299.5 million of variable interest debt at December 31, 2001 and June 30, 2002, respectively. The Company has entered into interest rate swap agreements designated as a partial hedge of its variable rate debt. The purpose of these swaps is to fix interest rates on variable rate debt and reduce certain exposures to interest rate fluctuations.

The notional amounts of \$160 million at December 31, 2001 and June 30, 2002 do not represent a measure of exposure of the Company. The Company will pay counterparties interest at a fixed rate ranging from 4.765% to 5.155%, and the counterparties will pay the Company interest at a variable rate equal to LIBOR. The LIBOR rate applicable to these agreements at December 31, 2001 and June 30, 2002 was 1.90% and 2.03%, respectively. These agreements mature and renew every three months and expire at dates ranging from July 2, 2002 to September 22, 2002. A 10% fluctuation in interest rates would have a \$1.4 million impact, net of interest rate swap agreements, on future earnings on an annual basis.

The nature of the Company's business activities necessarily involves the management of various financial and market risks, including those related to changes in interest rates and currency exchange rates. The Company uses derivative financial instruments to mitigate or eliminate certain of those risks. The January 1, 2001 accounting changes of SFAS 133 described above affected only the pattern and the timing of the non-cash accounting recognition.

A reconciliation of current period changes in the component of accumulated other comprehensive income as it relates to derivatives is as follows:

	<u>Six months ended</u>		<u>Three months ended</u>	
	<u>June 30 2002</u>	<u>June 30 2001</u>	<u>June 30 2002</u>	<u>June 30 2001</u>
<b>(In thousands)</b>				
Balance beginning of period	\$ (3,346)	\$ 337	\$ (2,413)	\$ (903)
Current period declines in fair value	(231)	(2,748)	(89)	(1,304)
Reclassifications to earnings	2,340	638	1,265	434
<hr/>				
<hr/>				
<hr/>				
<hr/>				
Balance at end of period	\$ (1,237)	\$ (1,773)	\$ (1,237)	\$ (1,773)
<hr/>				
<hr/>				

Additional disclosures required by SFAS No. 133, as amended, are provided in the following paragraphs.

**Hedges of Future Cash Flows**

Per SFAS 133, the ineffective portion of changes in fair values of hedge positions should be reported in earnings. All hedges were effective at June 30, 2002, and as such, there are no earnings reclassifications at June 30, 2002



**Table of Contents**

or 2001, due to ineffective hedges. There were no amounts excluded from the measure of effectiveness related to the hedge of future cash flows.

For the three months ended June 30, 2002 and 2001, \$1.3 million and \$.4 million, respectively, was reclassified to earnings as interest expense. The \$(1.2) million recorded in accumulated other comprehensive income at June 30, 2002 is expected to be reclassified to future earnings, contemporaneously with and primarily offsetting changes in interest expenses on floating-rate instruments. The actual amounts that will be reclassified to earnings will vary from this amount as a result of changes in market conditions.

**5. ENVIRONMENTAL MATTERS:**

Our activities involve the handling, transportation, storage and disposal of bulk liquid chemicals, many of which are classified as hazardous materials, hazardous substances, or hazardous waste. Our tank wash and terminal operations engage in the storage or discharge of wastewater and storm-water that may have contained hazardous substances, and from time to time we store diesel fuel and other petroleum products at our terminals. As such, we are subject to environmental, health and safety laws and regulation by U.S. federal, state, local and Canadian government authorities. Environmental laws and regulations are complex, change frequently and have tended to become more stringent over time. There can be no assurance that violations of such laws or regulations will not be identified or occur in the future, or that such laws and regulations will not change in a manner that could impose material costs to us.

Facility managers are responsible for environmental compliance. Self-audits along with audits conducted by our internal audit staff are required to assess operations, safety training and procedures, equipment and grounds maintenance, emergency response capabilities and waste management. We may also contract with an independent environmental consulting firm that conducts periodic, unscheduled, compliance assessments which focus on conditions with the potential to result in releases of hazardous substances or petroleum, and which also include screening for evidence of past spills or releases. Our relationship to our affiliates could, under certain circumstances, result in our incurring liability for environmental contamination attributable to an affiliate's operations, although we have not incurred any material derivative liability in the past. Our environmental management program has been extended to our affiliates.

We are staffed with environmental experts who manage our environmental exposure relating to historical operations and develop policies and procedures, including periodic audits of our terminals and tank cleaning facilities, in an effort to avoid circumstances that could lead to future environmental exposure.

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

**Table of Contents**

have identified environmental contamination at certain sites that will require remediation.

We have also been named a potentially responsible party ( PRP ), or have otherwise been alleged to have some level of responsibility, under CERCLA or similar state laws for cleanup of off-site locations at which our waste, or material transported by us, has allegedly been disposed of. We have asserted defenses to such actions and have not incurred significant liability in the CERCLA cases settled to date. While we believe that we will not bear any material liability in any current or future CERCLA matters, there can be no assurance that we will not in the future incur material liability under CERCLA or similar laws.

We are currently solely responsible for remediation of the following two federal Superfund sites:

Bridgeport, New Jersey. During 1991, CLC entered into a Consent Decree with the EPA filed in the U.S. District Court for the District of New Jersey, U.S. v. Chemical Leaman Tank Lines, Inc., Civil Action No. 91-2637 (JFG) (D.N.J.), with respect to its site located in Bridgeport, New Jersey, requiring CLC to remediate groundwater contamination. The Consent Decree required CLC to undertake Remedial Design and Remedial Action ( RD/RA ) related to the groundwater operable unit of the cleanup.

In August 1994, the EPA issued a Record of Decision, selecting a remedy for the wetlands operable unit at the Bridgeport site at a cost estimated by the EPA to be approximately \$7 million. In October 1998, the EPA issued an administrative order that requires CLC to implement the EPA's wetlands remedy. In April 1998, the federal and state natural resource damages trustees indicated their intention to bring claims against CLC for natural resource damages at the Bridgeport site. CLC has finalized a consent decree with the state and federal trustees and has resolved the natural resource damages claims. In addition, the EPA has investigated contamination in site soils. No decision has been made as to the extent of soil remediation to be required, if any.

CLC initiated litigation against its insurers to recover its costs in connection with environmental cleanups at its sites. In a case captioned Chemical Leaman Tank Lines, Inc. v. Aetna Casualty & Surety Co., et al., Civil Action No. 89-1543 (SSB) (D.N.J.), Chemical Leaman sought from its insurers reimbursement of substantially all past and future environmental cleanup costs at the Bridgeport site. In a case captioned The Aetna Casualty and Surety Company v. Chemical Leaman Tank Lines, Inc., et al., Civil Action No. 94-CV-6133 (E.D. Pa.), Chemical Leaman sought from its insurers reimbursement of substantially all past and future environmental cleanup costs at its other sites. In an agreement dated as of November 18, 1999, Chemical Leaman favorably resolved these outstanding insurance claims. In early 2000, we received settlement proceeds of approximately \$11.0 million.

West Caln Township, PA. The EPA has alleged that CLC disposed of hazardous materials at the William Dick Lagoons Superfund Site in West Caln, Pennsylvania. On October 10, 1995, CLC entered into a Consent Decree with the EPA which required CLC to:

- (1) pay the EPA for installation of an alternate water line to provide water to area residents;
- (2) perform an interim groundwater remedy at the site; and

**Table of Contents**

(3) conduct soil remediation. US v. Chemical Leaman Tank Lines, Inc., Civil Action No. 95-CV-4264 (RJB) (E.D. Pa.). CLC has paid all costs associated with installation of the waterline. CLC has completed a hydro-geologic study, and has commenced activities for the design of a groundwater treatment plant to pump and treat groundwater. The EPA anticipates that CLC will operate the plant for about five years, at which time the EPA will evaluate groundwater conditions and determine whether a final groundwater remedy is necessary. Field sampling for soil remediation has been completed and activities for the design of a soil remediation system have commenced. The Consent Decree does not cover the final groundwater remedy or other site remedies or claims, if any, for natural resource damages.

Other Environmental Matters. CLC has been named as PRP under CERCLA and similar state laws at approximately 35 former waste treatment and/or disposal sites including the Helen Kramer Landfill Site where CLC previously settled its liability. In general, CLC is among several PRP s named at these sites. CLC is also named as a co-defendant in two civil toxic tort claims arising from alleged exposure to hazardous substances that were allegedly transported to disposal sites by CLC and other co-defendants. CLC is also incurring expenses resulting from the investigation and/or remediation of certain current and former CLC properties, including its facility in Tonawanda, New York and its former facility in Putnam County, West Virginia, and its facility in Charleston, West Virginia. As a result of our acquisition of CLC, we identified other owned or formerly owned properties that may require investigation and/or remediation, including properties subject to the New Jersey Industrial Sites Recovery Act (ISRA). CLC s involvement at some of the above referenced sites could amount to material liabilities, and there can be no assurance that costs associated with these sites, individually or in the aggregate, will not be material. We have established reserves for liabilities associated with the Helen Kramer Landfill, CLC s facility at Tonawanda, New York and CLC s former facility in Putnam County, West Virginia and other matters discussed above.

**6. NEW ACCOUNTING PRONOUNCEMENTS:**

Effective January 1, 2002, the Company adopted the provisions of Financial Accounting Standards No 142, Goodwill and Other Intangible Assets (Statement 142). As a result of the adoption of Statement 142, the amortization of goodwill ceased, resulting in a decrease of net loss of \$1.9 million through June 30, 2002. Goodwill is subject to an annual impairment test. The Company has completed its initial impairment test. During our initial impairment analysis of goodwill, as outlined under SFAS 142, the Company discovered that approximately \$4 million of goodwill had been classified as an offset against accounts payable and accrued expenses. These amounts have been reclassified into goodwill during the quarter. As a result of our initial impairment test a goodwill adjustment of \$24.0 million was charged to earnings as cumulative effect of a change in accounting principle at January 1, 2002. No tax benefit was recorded in connection with this charge.

Intangible assets consist mainly of non-compete agreements with lives ranging from 2-5 years. Accumulated amortization of intangible assets is \$1.8 million and \$1.6 million at June 30, 2002 and 2001.

The following table presents net loss on a comparable basis, after adjustment for goodwill and intangible amortization (in thousands):

**Table of Contents**

	Six months ended		Three months ended	
	June 30, 2002	June 30, 2001	June 30, 2002	June 30, 2001
<b>Net loss:</b>				
As reported				
	\$(39,048)	\$(3,460)	\$(12,018)	\$(2,430)
Goodwill amortization (net)				
	1,904	952		
<hr/>				
<hr/>				
<hr/>				
<hr/>				

Adjusted net loss  
 \$(39,048) \$(1,556) \$(12,018) \$(1,478)

<hr/>			
<hr/>			
<hr/>			
<hr/>			

In connection with the completion of the initial impairment test, the Company has restated its consolidated statements of operations for the period ended March 31, 2002. The following table presents the restated net loss:

	Three months ended March 31, 2002
<b>Net loss:</b>	
As reported	
	\$(3,045)
Cumulative effect of a change in accounting principle	
	(23,985)
<hr/>	

As restated  
\$(27,030)

---

In July 2001, the FASB issued SFAS 143 Accounting for Asset Retirement Obligations, which requires that companies recognize a liability for retirement obligations of long lived assets in the period the liability occurs. This pronouncement is effective for fiscal years beginning after June 15, 2002. We do not anticipate any significant impact on our financial results from adoption of this standard.

In August 2001, the Financial Accounting Standards Board issued SFAS 144 Accounting for the Impairment or Disposal of Long-Lived Assets, which supersedes SFAS 121. We currently assess whether there has been impairment of long-lived assets and certain intangibles in accordance with SFAS 121 and will continue to do so under the guidance provided by SFAS 144 in 2002. We do not anticipate any significant impact on financial results from adoption of this standard.

In June 2002, the FASB issued SFAS 146 Accounting for Costs Associated with Exit or Disposal Activities. This pronouncement addresses financial accounting and reporting for costs associated with exit or disposal activities not covered under SFAS 144 and also nullifies [AITF 94-3]. This pronouncement is effective for activities initiated after December 31, 2002. We do not anticipate any significant impact on our financial results from adoption of this standard.

## **7. GEOGRAPHIC SEGMENTS**

The Company's 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 the Company's operations in different

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

**Table of Contents**

geographic areas for the quarters and six month periods ended June 30, 2002 and June 30, 2001, is as follows:

	Six months ended June 30, 2002			
	U.S.	INTERNATIONAL	ELIMINATIONS	CONSOLIDATED
Operating revenues	\$252,371	\$ 4,267	\$	\$256,638
Net operating income	16,383	210	16,593	
Identifiable assets	413,830	8,753	(5,131)	417,452
Depreciation and amortization	14,874	722	15,596	
Capital expenditures	6,460	60	6,520	

	Six months ended June 30, 2001			
	U.S.	INTERNATIONAL	ELIMINATIONS	CONSOLIDATED
Operating revenues	\$248,341	\$ 8,015	\$(4,080)	\$256,406
Net operating income	16,941	(212)	16,729	
Identifiable assets	433,940	23,261	(13,072)	444,129
Depreciation and amortization	15,830	829	16,659	
Capital expenditures	12,850	735	13,585	

	Three months ended June 30, 2002			
	U.S.	INTERNATIONAL	ELIMINATIONS	CONSOLIDATED
Operating revenues	\$132,389	\$ 2,090	\$	\$134,419
Net operating income	9,272	9,271		
Identifiable assets	413,830	8,753	(5,131)	417,452
Depreciation and amortization	7,501	340	7,841	
Capital expenditures	6,460	60	6,520	

	Three months ended June 30, 2001			
	U.S.	INTERNATIONAL	ELIMINATIONS	CONSOLIDATED
Operating revenues	\$124,190	\$ 5,620	\$	\$129,810
Net operating income	8,155	(267)	7,888	
Identifiable assets	433,940	23,261	(13,072)	444,129

Depreciation and amortization		
8,069	401	8,470
Capital expenditures		
12,850	735	13,585

**8. GUARANTOR SUBSIDIARIES:**

The 10% Series B senior subordinated notes, series B floating interest rate subordinated term notes and the 12.5% senior subordinated secured notes are unconditionally guaranteed on a senior subordinated basis pursuant to guarantees by all of the Company's direct and indirect domestic subsidiaries, except Bulknet (the Guarantors). Each of the Company's direct and indirect subsidiaries is 100% owned. All non-domestic subsidiaries including Levy Transport Ltd. are non-guarantor subsidiaries. The Guarantors are also guarantors of the QDI Notes.

The Company conducts substantially all of its business through and derives virtually all its income from its subsidiaries. Therefore, the Company's ability to make required principal and interest payments with respect all to the Company's indebtedness, including the New Notes and other obligations, 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 the Company and have fully and unconditionally guaranteed the New Notes on a joint and several basis.

The Company has 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 Notes.

**Table of Contents**

The following condensed consolidating financial information presents:

1. Balance Sheets as of June 30, 2002 and December 31, 2001.
2. Statements of Operations for the three months ended June 30, 2002 and 2001.
3. Statements of Operations for the Six months ended June 30, 2002 and 2001.
4. Statements of Cash Flows for the six months ended June 30, 2002 and 2001.
5. The parent company and combined guarantor subsidiaries.
6. Elimination entries necessary to consolidate the parent company and all its subsidiaries.



**Table of Contents**

**FORM 10-Q**  
**QUALITY DISTRIBUTION, LLC AND SUBSIDIARIES,**  
**(SUCCESSOR TO QUALITY DISTRIBUTION, INC.)**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**CONSOLIDATING BALANCE SHEET**  
**JUNE 30, 2002**  
**(Unaudited)**  
**(In thousands)**

	<u>Parent</u>	<u>Guarantor Subs</u>	<u>Non Guarantor Subs</u>	<u>Eliminations</u>	<u>Consolidated</u>
<b>ASSETS</b>					
Current assets:					
Cash	\$0	\$1,766	\$1,495	\$0	\$3,261
Accounts receivable, net	0	94,487	(3,700)	0	90,787
Inventories	0	847	187	0	1,034
Prepaid expense and other Current assets	0	15,553	545	0	16,098
<hr/>					
<hr/>					
<hr/>					
<hr/>					
<hr/>					
<hr/>					
Total current assets	0	112,653	(1,473)	0	111,180
Property and equipment, net	0	150,197	9,983	0	160,180
Intangibles and goodwill, net	0	132,233	448	0	132,681
Other assets	100,000	8,822	4	(100,000)	8,826
Investment in subsidiaries	182,882	0	0	(182,882)	0
<hr/>					
<hr/>					
<hr/>					
<hr/>					

---

\$282,882 \$403,905 \$8,962 \$(282,882) \$412,867

**Table of Contents**

**FORM 10-Q**  
**QUALITY DISTRIBUTION, LLC AND SUBSIDIARIES,**  
**(SUCCESSOR TO QUALITY DISTRIBUTION, INC.)**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**CONSOLIDATING BALANCE SHEET**  
**JUNE 30, 2002**  
**(Unaudited) (In thousands, continued)**

		<u>Guarant</u>	<u>Non-Guaran-</u>		<u>Consol-</u>	
		<u>Parent</u>	<u>Subs</u>	<u>tor</u> <u>Subs</u>	<u>Elim's</u>	<u>idated</u>
<b>Current liabilities:</b>						
Current maturities of indebtedness	\$2,677	\$0	\$0	0	\$2,677	
Accounts payable and accrued expense	0	65,231	2,017	0	67,248	
Inter-company	0	14,115	(14,115)	0	0	
Affiliates and owner operators payable	0	9,617	(126)	0	9,491	
Other current liabilities	0	0	0	0	0	
Income taxes payable	0	601	(54)	0	547	
<hr/>						
<hr/>						
<hr/>						
<hr/>						
<hr/>						
<hr/>						
Total current liabilities	2,677	89,564	(12,278)	0	79,963	
Long term debt, less current maturities	284,343	0	5,000	0	289,343	
Subordinated debt, less current maturities	94,419	100,000	0	(100,000)	94,419	
Other long term obligations	0	8,474	0	0	8,474	
Environmental liabilities	0	32,590	0	0	32,590	
Deferred taxes	0	(965)	2,361	0	1,396	
Accrued loss and damage claims	0	3,406	0	0	3,406	
<hr/>						

---



---



---



---

Total liabilities  
 \$381,439 \$233,069 \$(4,917) \$(100,000) \$509,591  
 Minority interest in subsidiaries  
 0 1,833 0 0 1,833  
 Membership interest:

Membership interest

Additional paid-in-capital  
 176,816 133,173 15,082 (148,255) 176,816  
 Accumulated (deficit)  
 (77,515) 35,830 (512) (35,318) (77,515)  
 Stock recapitalization  
 (189,589) 0 (55) 55 (189,589)  
 Other comprehensive (loss)  
 (8,269) 0 (636) 636 (8,269)

---



---



---



---



---

Total membership interest  
 (98,557) 169,003 13,879 (182,882) (98,557)

---



---



---



---

\$282,882 \$403,905 \$8,962 \$(282,882) \$412,867

---



---

---

---

---

---

**Table of Contents**

**FORM 10-Q**  
**QUALITY DISTRIBUTION, LLC AND SUBSIDIARIES,**  
**(SUCCESSOR TO QUALITY DISTRIBUTION, INC.)**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**CONSOLIDATING BALANCE SHEET**  
**DECEMBER 31, 2001**  
**(Unaudited)**  
**(In thousands)**

	<u>Parent</u>	<u>Guarantor Subs</u>	<u>Non-Guarantor Subs</u>	<u>Elim's</u>	<u>Consolidated*</u>
<b>ASSETS</b>					
Current assets:					
Cash					
\$ \$1,909 \$303 \$ \$2,212					
Accounts receivable, net					
86,017 2,884 88,901					
Inventories					
874 269 1,143					
Prepaid expenses and other current assets					
17,166 541 17,707					
<hr/>					
<hr/>					
<hr/>					
<hr/>					
<hr/>					
<hr/>					
Total current assets					
105,966 3,997 109,963					
Property and equipment, net					
160,998 16,361 177,359					
Intangibles & goodwill, net					
151,969 806 152,775					
Other assets					
100,000 8,877 4 (100,000) 8,881					
Investment in subsidiaries					
227,098 (227,098)					
<hr/>					
<hr/>					
<hr/>					
<hr/>					

---

\$327,098 \$427,810 \$21,168 \$(327,098) \$448,978

---

---

---

---

---

---

\* Condensed from audited financial statements.

**Table of Contents**

**FORM 10-Q**  
**QUALITY DISTRIBUTION, LLC AND SUBSIDIARIES,**  
**(SUCCESSOR TO QUALITY DISTRIBUTION, INC.)**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**CONSOLIDATING BALANCE SHEET**  
**DECEMBER 31, 2001**  
**(Unaudited, in thousands, continued)**

**GUARANTEEOR GUARANTOR**  
**PARENTSUBSIDIARIESUBSIDIARIESMINATIONSOLIDATED**

Current liabilities:

Current maturities of indebtedness

\$2,677 \$ \$ \$ 2,677

Accounts payable

11,432 1,985 13,417

Inter-company

(1,133) 1,133

Affiliates and owner-operators payable

4,902 28 4,930

Accrued expenses

49,431 49,431

Income taxes payable

663 429 1,092

Total current liabilities

2,677 65,295 3,575 71,547

Long-term debt, less current maturities

441,179 441,179

Environmental liabilities

36,163 36,163

Other long-term liabilities

113,744 (100,000) 13,744

Deferred income tax

(1,189) 2,459 1,270



---

Total liabilities

443,856 214,013 6,034 (100,000) 563,903

---

---

---

---

---

---

Mandatorily redeemable common stock

1,210 1,210

---

---

---

---

---

---

Mandatorily redeemable preferred stock

16,499 16,499

---

---

---

---

---

---

Minority interest in subsidiaries

1,833 1,833

---

---

---

---

---

---

---

Stockholders' Equity (deficit):

Common stock and additional paid-in capital  
105,564 149,653 15,082 (164,735) 105,564  
Retained earnings (deficit)  
(37,435) 62,311 1,195 (63,506) (37,435)  
Treasury stock  
(402) (402)  
Stock recapitalization  
(189,589) (55) 55 (189,589)  
Other comprehensive gain (loss)  
(10,829) (1,088) 1,088 (10,829)  
Note receivable  
(1,776) (1,776)

---

---

---

---

---

---

---

Total stockholders' equity (deficit)  
(134,467) 211,964 15,134 (227,098) (134,467)

---

---

---

---

---

---

---

\$327,098 \$427,810 \$21,168 \$(327,098) \$448,978

---

---

---

---

---

---

---



**Table of Contents**

**FORM 10-Q**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**QUALITY DISTRIBUTION, LLC AND SUBSIDIARIES,**  
**(SUCCESSOR TO QUALITY DISTRIBUTION, INC.)**  
**CONDENSED CONSOLIDATING STATEMENTS OF INCOME**  
**THREE MONTHS ENDED JUNE 30, 2002**  
**(Unaudited) (In thousands)**

	<u>Parent</u>	<u>Guaranto</u>	<u>Non-Guaran-</u>	<u>tor Subs</u>	<u>Elims</u>	<u>Consol-</u>
		<u>Subs</u>	<u>tor Subs</u>			<u>idated</u>
<b>Operating revenues:</b>						
Transportation	\$0	\$115,709	\$2,081	\$0	\$117,790	
Other	0	16,622	7	0	16,629	
<hr/>						
<hr/>						
<hr/>						
<hr/>						
<hr/>						
<hr/>						
Total Revenues	0	132,331	2,088	0	134,419	
<b>Operating Expenses:</b>						
Purchased transportation	0	78,939	304	0	79,243	
Depreciation and amortization	0	7,501	340	0	7,841	
Other operating expenses	0	36,616	1,448	0	38,064	
<hr/>						
<hr/>						
<hr/>						
<hr/>						
<hr/>						
<hr/>						
Operating income (loss)	0	9,275	(4)	0	9,271	
Interest expense, net	19,615	0	39	0	19,654	

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Other expenses

0 12 0 0 12

Equity in earnings of subsidiaries

3,899 0 0 (3,899) 0

---

---

---

---

---

Income (loss) before taxes

(15,716) 9,263 (43) (3,899) (10,395)

Income taxes

(3,698) 3,798 64 0 164

---

---

---

---

---

Income (loss) from continuing operations

(12,018) 5,465 (107) (3,899) (10,559)

Loss from operation and disposal of discontinued segment  
(net of tax)

0 0 (1,459) 0 (1,459)

---

---

---

---

---

Net income (loss)

\$(12,018) \$5,465 \$(1,566) \$(3,899) \$(12,018)

---

---

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

\_\_\_\_\_



Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Interest expense, net  
9,619 2 9,621  
Other expenses  
14 (3) 11  
Equity in earnings (loss) of subsidiaries  
4,355 (4,355)

---

---

---

---

---

Income (loss) before taxes  
(5,264) 7,596 279 (4,355) (1,744)  
Income taxes  
(2,834) 3,114 70 350  
Minority interest

---

---

---

---

---

Income (loss) from continuing operations  
(2,430) 4,482 209 (4,355) (2,094)  
Loss from operation of discontinued segment (net of tax)  
(336) (336)

---

---

---

---

---

Net income (loss)  
\$(2,430) \$4,482 \$(127) \$(4,355) \$(2,430)



\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**Table of Contents**

**FORM 10-Q**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**QUALITY DISTRIBUTION, LLC AND SUBSIDIARIES,**  
**(SUCCESSOR TO QUALITY DISTRIBUTION, INC.)**  
**CONDENSED CONSOLIDATING STATEMENT OF INCOME**  
**SIX MONTHS ENDED JUNE 30, 2002 (Unaudited) (In thousands)**

	Parent	Guarantor Subs	Non-Guarantor Subs	Elim's	Consolidated
Operating revenue:					
Transportation					
\$ 219,690	\$3,828				\$ 223,518
Other					
32,682	437				33,119
<hr/>					
<hr/>					
<hr/>					
<hr/>					
<hr/>					
Total revenues					
252,372	4,265				256,637
Operating expenses:					
Purchased transportation					
149,459	661				150,120
Depreciation and amortization					
14,874	722				15,596
Other operating expenses					
71,655	2,673				74,328
<hr/>					
<hr/>					
<hr/>					
<hr/>					
<hr/>					
Operating income					
16,384	209				16,593
Interest expense, net					
29,466	95				29,561
Other expenses					

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

48	48
Equity in earnings (loss) of subsidiaries	
(16,055)	(16,055)

---

---

---

---

---

Income (loss) before taxes	
(45,521) 16,336 114 (16,055) (13,016)	
Income taxes	
(6,473) 6,698 128 353	

---

---

---

---

---

Income (loss) from continuing operations	
(39,048) 9,638 (14) (16,055) (13,369)	
Loss from operation and disposal of discontinued segment (net of tax)	
(1,694) (1,694)	

---

---

---

---

---

Income (loss) before cumulative effect of a change in accounting principle	
39,048 9,638 (1,708) (16,055) (15,063)	

---

---

---

---

---

Cumulative effect of change in Accounting principle (net of tax)  
(23,985) (23,985)

---

---

---

---

---

---

Net income (loss)  
\$(39,048) \$(14,347) \$(1,708) \$(16,055) \$(39,048)

**Table of Contents**

**FORM 10-Q**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**QUALITY DISTRIBUTION, LLC AND SUBSIDIARIES,**  
**(SUCCESSOR TO QUALITY DISTRIBUTION, INC.)**  
**CONDENSED CONSOLIDATING STATEMENTS OF INCOME**  
**SIX MONTHS ENDED JUNE 30, 2001 (Unaudited) (In thousands)**

	Parent	Guarantor Subs	Non-Guaran- tor Subs	Elim's	Consol- idated
Operating revenue:					
Transportation					
\$ 221,195	\$4,162				\$ 225,357
Other					
30,358	691				31,049
Total revenues					
251,553	4,853				256,406
Operating expenses:					
Purchased transportation					
150,059	874				150,933
Depreciation and amortization					
15,832	827				16,659
Compensation, options and bonus					
Other operating expenses					
69,266	2,819				72,085
Operating income					
16,396	333				16,729
Interest expense, net					

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

19,062	19,062
Other expenses	
(2)	(2)
Equity in earnings of subsidiaries	
9,460	(9,460)

---

---

---

---

---

Income (loss) before taxes				
(9,602)	16,396	335	(9,460)	(2,331)
Income taxes				
(6,142)	6,722	130	710	
Minority interest				

---

---

---

---

---

Income (loss) from continuing operations				
(3,460)	9,674	205	(9,460)	(3,041)
Loss from operation of discontinued segment				
(419)	(419)			

---

---

---

---

---

Net income (loss)				
\$(3,460)	\$9,674	\$(214)	\$(9,460)	\$(3,460)

---

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

\_\_\_\_\_





Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

Proceeds from issuance of long term debt  
(5,219) 5,219  
Payment of debt obligations  
(1,774) (65) (1,839)  
Other  
(4,263) (4,263)  
Net change in inter-company balances  
6,993 (6,993)

---

---

---

---

---

Net cash provided by (used In) financing activities  
(11,256) 5,154 (6,102)  
Net increase (decrease) in cash  
(202) 1,193 991  
Effect of exchange rate changes on cash  
58 58  
Cash, beginning of period  
1,910 302 2,212

---

---

---

---

---

Cash, end of period  
\$ \$1,766 \$1,495 \$3,261

---

---

---

---

---



**Table of Contents**

**FORM 10-Q**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**QUALITY DISTRIBUTION, LLC AND SUBSIDIARIES,**  
**(SUCCESSOR TO QUALITY DISTRIBUTION, INC.)**  
**CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS**  
**SIX MONTHS ENDED June 30, 2001 (Unaudited) (In thousands)**

	Parent	Guarantor Subs	Non-Guarantor Subs	Elim's	Consolidated
Cash flows provided by (used in) Operating activities:					
Net income (loss)					
\$ (3,460) \$ 9,337 \$ (214) \$ (9,123) \$ (3,460)					
Adjustments for non cash charges					
3,460 13,939 1,688 19,087					
Changes in assets and liabilities					
(16,524) (3,369) 9,123 (10,770)					
<hr/>					
<hr/>					
<hr/>					
<hr/>					
<hr/>					
<hr/>					
Net cash provided by (used for) operating activities					
6,752 (1,895) 4,857					
Investing activities:					
Capital expenditures					
(13,110) (736) (13,846)					
Proceeds from asset dispositions					
(247) 1,981 1,734					
<hr/>					
<hr/>					
<hr/>					
<hr/>					
<hr/>					
Net provided by (used in) investing activities					
(13,357) 1,245 (12,112)					
Financing activities:					
Proceeds from issuance of long term debt					

Edgar Filing: QUALITY DISTRIBUTION INC - Form 10-Q

11,000	11,000
Payment of debt obligations	
(1,587)	(1,587)
Preferred stock redemption	
(2,600)	(2,600)
Other	
499	499
Net change in inter-company balances	
(6,813)	6,813

---



---



---



---



---

Net cash provided by (used in) financing activities  
 7,312 7,312

---



---



---



---



---

Net increase (decrease) in cash  
 707 (650) 57  
 Effect of exchange rate changes on cash  
 (798) (798)  
 Cash, beginning of period  
 2,469 167 2,636

---



---



---



---



---

Cash, end of period  
 \$ 2,378 \$(483) \$ 1,895

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**Table of Contents**

**FORM 10-Q**  
**PART I FINANCIAL INFORMATION**  
**QUALITY DISTRIBUTION, LLC AND SUBSIDIARIES,**  
**(SUCCESSOR TO QUALITY DISTRIBUTION, INC.)**

**ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS**

**SECOND QUARTER 2002 COMPARED TO THE SECOND QUARTER 2001**

**RESULTS OF OPERATIONS**

Quality Distribution, LLC (the Company) is a Delaware limited liability company formed on April 14, 2002. Our sole member is Quality Distribution, Inc., a Florida corporation (QDI Inc.). On May 30, 2002, QDI Inc. completed an exchange offer for its public debt, at which time QDI Inc. transferred all of its assets (other than certain contract rights which by their terms cannot be assigned without the consent of the other parties thereto) to the Company, consisting principally of the assets of QDI Inc.'s operating subsidiaries. The Company became the successor entity to QDI Inc.

Our revenue is principally a function of the volume of shipments by the bulk chemical industry, our market share as opposed to that of our competitors and the amount spent on tank truck transportation as opposed to other modes of transportation such as rail. The volume of shipments of chemical products are in turn affected by many other industries, including consumer and industrial products, automotive, paint and coatings, and paper, and tend to vary with changing economic conditions. Additionally we also provide leasing, tank cleaning, and intermodal services presented as other revenue.

The principal components of our operating costs include purchased transportation, salaries, wages, benefits, annual tractor and trailer maintenance costs, insurance and fuel costs. We believe our use of affiliates and owner-operators provides a more flexible cost structure, increases our asset utilization and increases our return on invested capital.

We have historically focused on maximizing cash flow and return on invested capital. Our affiliate program has greatly reduced the amount of capital needed for us to maintain and grow our terminal network. In addition, the extensive use of owner-operators reduces the amount of capital needed to operate our fleet of tractors, which have shorter economic lives than trailers. These factors have allowed us to concentrate our capital spending on our trailer fleet where we can achieve superior returns on invested capital through our transportation operations and leasing to third parties and affiliates.

Historical financial information contained herein has been adjusted to reflect the discontinued operations resulting from the sale of certain non-guarantor subsidiaries' assets in the second quarter 2002. These subsidiaries consist of the Canadian petroleum division and the internet load brokerage subsidiary of the Company.

**THREE MONTHS ENDED JUNE 30, 2002 COMPARED TO THREE MONTHS ENDED JUNE 30, 2001**

For the quarter ended June 30, 2002, revenues totaled \$134.4 million, a 3.6% increase from revenues of \$129.8 million for the same period in 2001. This increase is primarily attributable to increases in demand from shippers.

**Table of Contents**

The second quarter of 2002 showed continued signs that the demand in base business has begun to stabilize.

For the quarter ended June 30, 2002, operating income totaled \$9.3 million, an increase of \$1.4 million compared to \$7.9 million for the same period in 2001. This improvement is primarily the result of increased revenue discussed above, offset by higher insurance expense in 2002. Significant insurance increases began in September 2001 when the Company entered into a new insurance policy period. This increase in expense was partially offset by an increase in operating income of \$0.9 million as a result of the elimination of amortization of goodwill in 2002 due to the adoption of FAS 142.

The operating ratio, which is the ratio of operating expenses to operating revenue, for the quarter ended June 30, 2002 was 93.1% compared to 93.9% for the same period in 2001.

Interest expense, net, went down slightly by 0.1% in 2002 compared to 2001. In the second quarter 2002, \$10.1 million in bond exchange transaction fees and credit facility amendment fees. These transactions resulted in a face value reduction of debt of \$69.9 million dollars and lower overall interest expense going forward.

The pre-tax loss from continuing operations for the quarter ended June 30, 2002 totaled \$10.6 million compared to a \$2.1 million loss for the same period in 2001. This is due to \$10.1 million of transaction fees related to the exchange offer and credit facility amendment.

Provision for income tax decreased from \$0.4 million to \$0.2 million due to the relative impact of non-deductible items on the different pre-tax amounts and the non-recognition of tax benefits.

A charge of \$1.5 million was recorded in 2002 relating to discontinued operations due to the sale of the Canadian petroleum division and the internet load brokerage subsidiary of the Company.

For the quarter ended June 30, 2002, the Company's net loss was \$12.0 million compared with a \$2.4 million loss for the same period last year. This increase was due largely to the recording of the transaction fees and other items discussed above.

The results of 2002 include, and the historical financial information for 2001 have been adjusted to reflect the discontinued operations resulting from sale certain non-guarantor subsidiaries in the second quarter 2002. These subsidiaries consist of the Canadian petroleum division and the internet load brokerage subsidiary of QDI LLC.

As of June 30, 2002, a total of 100 membership units in the Company were outstanding, all of which were held by QDI Inc.

**Table of Contents**

**FORM 10-Q**  
**PART 1 FINANCIAL INFORMATION**  
**QUALITY DISTRIBUTION, LLC AND SUBSIDIARIES,**  
**(SUCCESSOR TO QUALITY DISTRIBUTION, INC.)**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS**

**SIX MONTHS ENDED JUNE 30, 2002 COMPARED TO SIX MONTHS ENDED JUNE 30, 2001**

For the six months ended June 30, 2002, revenues totaled \$256.6 million, a slight increase from revenues of \$256.4 million for the same period in 2001. This increase is primarily attributable to the rising demand for bulk transportation services that has occurred in the first half of 2002. This increase is reflective of the recovering manufacturing sector of the economy, in addition to successful bids for new business during the first half of the year. Operating revenue excluding surcharges on a per service day basis increased 3% versus the same period in 2001.

For the six months ended June 30, 2002, operating income totaled \$16.6 million, a decrease of \$0.1 million compared to \$16.7 million for the same period in 2001. This decline is primarily the result significantly higher insurance costs experienced since the latter part of 2001. The difficult insurance market conditions were further exacerbated the events of September 11. These factors were partially offset by an increase in operating income of \$1.9 million as a result of the elimination of amortization of goodwill in 2002 due to the adoption of FAS 142, cost savings from terminal conversions and other cost cutting measures throughout the end of 2001 and 2002.

The operating ratio for the six months ended June 30, 2002 was 93.5% the same as for the comparable period in 2001.

Interest expense, net, was \$29.6 million in the first half of 2002. This included \$10.1 million in exchange offer and consent solicitation transaction fees and credit facility amendment fees. These transactions resulted in a face value reduction of debt of \$69.9 million dollars and lower overall interest expense going forward. Absent these fees interest expense for the first 6 months of 2002 would have increased by \$0.4 million as a result of higher debt levels than 2001 for strategic asset purchases made in the fourth quarter of 2001.

The pre-tax loss for the first half of 2002 totaled \$13.0 million compared to a \$2.3 million loss for the same period in 2001, due primarily to the fees mentioned above and the increased insurance expense.

Benefit (provision) for income tax decreased to \$0.4 million from \$0.7 million due to the relative impact of non-deductible items on the different pre-tax amounts and the non-recognition of tax benefits.

The results of 2002 include, and the historical financial information for 2001 have been adjusted to reflect the discontinued operations resulting from the sale of certain non-guarantor subsidiaries assets in the second quarter 2002. These subsidiaries consist of the Canadian petroleum division and the internet load brokerage subsidiary of the Company. We recorded a \$1.5 million loss in the second quarter 2002 related to the projected loss on disposal of these operating units.

Effective January 1, 2002, the Company adopted the provisions of Financial Accounting Standards No 142, Goodwill and Other Intangible Assets (Statement 142). As a result of the adoption of Statement 142, the amortization of



**Table of Contents**

goodwill ceased, resulting in an increase in net income for the six months ended June 30, 2002 of \$1.9 million. Goodwill is subject to an annual impairment test. The Company has determined that the overall level of goodwill and intangible assets is impaired at January 1, 2002, and has recorded a \$24.0 million cumulative charge recorded as a cumulative effect of a change in accounting principles to adjust the carrying value. This transaction was recorded effective January 1, 2002.

**LIQUIDITY AND CAPITAL RESOURCES**

The Company's primary sources of liquidity are funds provided by operations and borrowings under various credit arrangements with financial institutions. Net cash provided by operating activities totaled \$9.9 million for the four months ended June 30, 2002, versus \$4.9 million for the same period in 2001. The change in cash provided by operations was due to the timing of cash receipts related to accounts payable and payments of trade and other payables.

Cash used by investing activities totaled \$2.8 million for the six month period ended June 30, 2002, compared to \$12.1 million used for the comparable 2001 period. Capital was used primarily to acquire replacement revenue equipment and for significant upgrades in 2001 to the Company's computer infrastructure and new dispatch system in 2001 and 2002.

Cash used for financing activities totaled \$6.1 million during the six-month period ended June 30, 2002, compared to \$7.3 million provided in the comparable period in 2001. This difference is due to reduced borrowing in the current year and the payment of \$2.6 million to a preferred shareholder in 2001.

The Company has a \$285 million credit facility with a group of banks maturing at various times from June of 2004 to 2006. Additionally, the Company has a revolving credit facility in the amount of \$47.2 million until June 9, 2004. As of June 30, 2002, the Company has available \$17.4 million under this revolving credit facility.

On April 5, 2002, the Company entered into a fifth amendment (the "Fifth Amendment") to the credit agreement. The Fifth Amendment relates to the financial covenants which were unlikely to be met beginning with the quarter ending March 31, 2003 and further amended those financial covenants through the date of the final maturity of the credit agreement. Such revised covenants are less restrictive than the previously existing covenants for the period beginning March 31, 2003 through final maturity of our credit agreement. There can be no assurance that the Company will be able to comply with such revised financial covenants. However, the Company currently believes that it will be in compliance with the covenants through June 30, 2003.

As of June 30, 2002, the Company was in compliance with the financial covenants in the credit agreement. However, continued compliance with these requirements could be effected by changes relating to economic factors, market uncertainties, or other events as described under FORWARD-LOOKING STATEMENTS AND RISK FACTORS. See note 2 for discussion of the exchange offer.

The Company's management believes that borrowings under the credit agreement, together with available cash and internally generated funds, will be sufficient to fund the Company's cash obligations for the remainder of 2002.

**FORWARD-LOOKING STATEMENTS AND RISK FACTORS**

Some of the statements contained in this report discuss future expectations and contain projections of results of operations or financial condition or state

**Table of Contents**

other forward-looking information. Those 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. Please see the risk factors set forth in QDI Inc.'s 2001 Form 10-K which identify important risk factors such as the Company's high leverage, dependence on affiliates and owner-operators, environmental risks and claims exposure.

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 general economic conditions, cost and availability of diesel fuel, adverse weather conditions and competitive rate fluctuations. Future financial and operating results of the Company may fluctuate as a result of these and other risk factors as detailed from time to time in company filings with the Securities and Exchange Commission.

**Table of Contents**

**FORM 10-Q  
PART I FINANCIAL INFORMATION  
QUALITY DISTRIBUTION, LLC AND SUBSIDIARIES,  
(SUCCESSOR TO QUALITY DISTRIBUTION, INC.)**

**ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

See note 4 Derivatives

**Table of Contents**

**FORM 10-Q  
QUALITY DISTRIBUTION, LLC AND SUBSIDIARIES,  
(SUCCESSOR TO QUALITY DISTRIBUTION, INC.)**

**PART II OTHER INFORMATION**

**ITEM 1. Legal Proceedings**

Reference is made to Item 2 on page 17 of QDI Inc. s Form 10-K for the year ended December 31, 2001. There have been no material changes in the Company s legal proceedings since this filing.

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

None

**ITEM 6. (a) Exhibits:**

Exhibit Number	Description
99.1	Certification of Chief Executive Officer Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 of The Sarbanes Oxley Act Of 2002
99.2	Certification of Chief Financial Officer Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 of The Sarbanes Oxley Act Of 2002

**(b) Reports on Form 8-K:**

During the quarter ended June 30, 2002, the Company s predecessor QDI, Inc. filed the following reports on Form 8-K:

Date	Item 5 Other information reported
4/10/02	Commencement of the Exchange Offer pursuant to the Offering Memorandum and Consent Solicitation

5/01/02 Press  
Release  
Announcing  
Financial  
Results for  
the Quarter  
Ended  
March 31,  
20026/06/02  
Consummation  
of Exchange  
Offer  
pursuant to  
Offering  
Memorandum  
and Consent  
Solicitation

No financial statements were filed with any of the above reports.

**Table of Contents**

**Signatures**

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

QUALITY DISTRIBUTION, LLC

---

August 14, 2002 /S/ THOMAS L. FINKBINER

---

THOMAS L. FINKBINER, (PRESIDENT AND  
CHIEF EXECUTIVE OFFICER  
(DULY AUTHORIZED OFFICER) August 14, 2002 /S/ DENNIS R.  
FARNSWORTH

---

DENNIS R. FARNSWORTH (SENIOR VICE  
PRESIDENT AND CHIEF FINANCIAL OFFICER)  
(PRINCIPAL FINANCIAL OFFICER)