QUALITY DISTRIBUTION INC
Form 10-Q
August 16, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2004

or

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

For the transition period from __________ to __________

Commission File Number: 000-24180

Quality Distribution, Inc.

(Exact name of registrant as specified in its charter)

Florida	**59-3239073**
(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)**

813-630-5826

(Registrant s telephone number, including area code)

N/A

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

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 August 11, 2004
Common Stock (no par value per share)	18,995,701

QUALITY DISTRIBUTION, INC.

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CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited - In 000 s)

	June 30, 2004	December 31, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,355	$ 955
Accounts receivable, net of allowance of $7,771 and $6,893	86,575	74,944
Current maturities of notes receivable from affiliates	1,335	676
Prepaid expenses	3,921	3,566
Prepaid tires	7,960	7,978
Other	2,247	2,055
Total current assets	103,393	90,174
Property and equipment, net of accumulated depreciation of $187,674 and $203,816	130,392	137,961
Goodwill	131,363	131,232
Intangibles, net	1,497	1,402
Notes receivable from affiliates	741	1,051
Other assets	9,268	9,871
Total assets	$ 376,654	$ 371,691
LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS DEFICIT		
Current liabilities:		
Current maturities of indebtedness	$ 1,630	$ 1,759
Accounts payable	20,664	18,988
Affiliates and independent owner-operators payable	10,790	7,319
Accrued expenses	60,693	54,242
Income taxes payable	339	518
Total current liabilities	94,116	82,826
Long-term indebtedness, less current maturities	273,550	272,750
Environmental liabilities	20,771	19,689
Other non-current liabilities	12,457	13,712
Deferred tax liability	1,462	1,552
Total liabilities	402,356	390,529
Commitments and contingencies (Note 6)		
Minority interest in subsidiary	1,833	1,833
Stockholders deficit:		
Common stock, no par value; 29,000 authorized, 19,113 issued at June 30, 2004 and 19,080 issued at December 31, 2003	356,091	356,078
Treasury stock, 113 and 111 shares at June 30, 2004 and December 31, 2003, respectively	(1,310)	(1,258)

Accumulated deficit	(176,469)	(169,569)
Stock recapitalization	(189,589)	(189,589)
Accumulated other comprehensive loss	(14,670)	(14,689)
Stock purchase warrants	73	86
Stock subscriptions receivable	(1,661)	(1,730)
Total stockholders deficit	(27,535)	(20,671)
Total liabilities, minority interest and stockholders deficit	$ 376,654	$ 371,691

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

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited In 000 s, Except Per Share Amounts)

	Three months ended June 30,		Six months ended June 30,	
	2004	2003	2004	2003
				(Restated)
Operating revenues:				
Transportation	$ 132,771	$ 121,813	$ 260,628	$ 236,622
Other service revenues	18,009	17,758	36,422	35,349
Fuel surcharge	6,649	4,061	11,564	8,676
Total operating revenues	157,429	143,632	308,614	280,647
Operating expenses:				
Purchased transportation	106,269	90,134	207,043	174,066
Compensation	15,651	14,934	30,200	31,386
Fuel, supplies and maintenance	9,558	9,874	19,100	20,601
Depreciation and amortization	5,874	7,630	11,894	15,124
Selling and administrative	7,638	3,181	11,379	6,294
Insurance	11,260	5,141	15,588	9,263
PPI professional fees	811		4,053	
Other operating expenses	2,578	3,197	5,321	5,779
Operating income (loss)	(2,210)	9,541	4,036	18,134
Interest expense	5,395	6,314	10,612	12,958
Foreign currency transaction loss		937		937
Other expense (income)	126	(21)	154	(45)
Income (loss) before taxes	(7,731)	2,311	(6,730)	4,284
Provision for income taxes	131	102	170	240
Net income (loss)	(7,862)	2,209	(6,900)	4,044
Distributions to minority interest/preferred stock dividends and accretions		(2,272)		(4,463)
Net loss attributable to common stockholders	$ (7,862)	$ (63)	$ (6,900)	$ (419)
Per share data:				
Net loss per common share basic	$ (0.42)	$ (0.02)	$ (0.37)	$ (0.13)
Net loss per common share diluted	$ (0.42)	$ (0.02)	$ (0.37)	$ (0.13)
Weighted average number of shares basic	18,915	3,337	18,900	3,337

Weighted average number of shares diluted	18,915	3,337	18,900	3,337

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

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited In 000 s)

	Six months ended June 30,	
	2004	**2003**
		(Restated)
Cash flows from operating activities:		
Net income (loss)	$ (6,900)	$ 4,044
Adjustments for non-cash charges	13,190	20,308
Changes in assets and liabilities	(2,230)	(12,695)
Net cash provided by operating activities	4,060	11,657
Cash flows from investing activities:		
Capital expenditures	(4,277)	(3,836)
Acquisition of assets	(781)	
Proceeds from asset dispositions	363	765
Net cash used in investing activities	(4,695)	(3,071)
Cash flows from financing activities:		
Net draws (payments) on the revolver	1,500	(7,000)
Payments of debt obligations	(830)	(1,532)
Deferred financing fees	(369)	
Increase in bank overdraft	619	1,814
Other	17	236
Net cash provided by (used in) financing activities	937	(6,482)
Net increase in cash	302	2,104
Effect of exchange rate changes on cash	98	(533)
Cash, beginning of period	955	661
Cash, end of period	$ 1,355	$ 2,232
Supplemental disclosures of non-cash activities:		
Preferred stock accretions	$	$ 4,386

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Basis of Presentation

Quality Distribution, Inc. (the Company or QDI) and its subsidiaries are engaged primarily in truckload transportation of bulk chemicals in North America. The Company conducts a significant portion of its business through a network of company terminals, affiliates and independent owner-operators. Affiliates are independent companies, which enter into one to five year renewable 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 the Company. Owner-operators are independent contractors, who, through a contract with the Company, supply one or more tractors and drivers for the Company s use. Contracts with owner-operators may be terminated by either party on short notice. The Company also charges affiliates and third parties for the use of tractors and trailers as necessary. In exchange for the services rendered, affiliates and owner-operators are generally paid a percentage of the revenues generated for each load hauled.

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. For further information, refer to the Quality Distribution, Inc. Annual Report on Form 10-K for the year ended December 31, 2003, including the consolidated financial statements and accompanying notes.

Operating results for the three and six months ended June 30, 2004 are not necessarily indicative of the results that may be expected for the entire fiscal year.

PPI Restatement

As previously disclosed in Note 1. Business Organization PPI Irregularities to the consolidated financial statements contained in the Company s Annual Report on Form 10-K, amounts for the six months ended June 30, 2003 reflect adjustments relating to matters at Power Purchasing, Inc., a non-core insurance subsidiary. On February 2, 2004, we filed a Form 8-K with the Securities and Exchange Commission disclosing that we had discovered irregularities at Power Purchasing, Inc. Power Purchasing, Inc., through its subsidiary American Transinsurance Group, Inc. (collectively, PPI), primarily assists independent contractors in obtaining various lines of insurance for which PPI derives fees as an insurance broker. The irregularities resulted from unauthorized actions by the former vice president of PPI, including failing to obtain or renew certain insurance policies for PPI s customers yet continuing to collect premiums in violation of state insurance laws. The Company concluded that the irregularities affected the results of all periods since and including 1998.

As a result of our investigation noted above, the Company recorded $11.8 million of adjustments through June 30, 2003. In total, the Company recorded $23.4 million of adjustments through December 31, 2003 to write-off uncollectible receivables, to establish reserves for lines of coverage the Company was providing that had no underlying third-party insurance, to record expenses for claims paid during the year and to accrue an estimate for costs relating to the state insurance regulatory proceedings. The restatement of previously issued financial statements increased the Company s net loss and basic and diluted net loss per share by approximately $2.2 million and $0.67, respectively, in the six months ended June 30, 2003.

Accordingly, the Company has restated herein the financial statements for the six months ended June 30, 2003 previously contained in the Company s Registration Statement on Form S-1 (No. 333-108344) and amendments thereto. The quarterly reports on Form 10-Q previously filed by us or QD LLC and the financial statements included in the Registration Statement on Form S-1 (No. 333-108344) and amendments thereto filed by the Company in connection with the initial public offering of shares of the Company s common stock, relating to these periods should no longer be relied upon.

The following table summarizes the impact of the corrections to the statements of operations for the six months ended June 30, 2003 (in thousands):

Statement of Operations Data:

	For the six months ended June 30, 2003		
	As reported	Restatement	Restated
Other service revenue	$ 35,074	$ 275	$ 35,349
Total operating revenue	280,372	275	280,647
Insurance expense	6,758	2,505	9,263
Operating income	20,364	(2,230)	18,134
Income before taxes	6,514	(2,230)	4,284
Net income	6,274	(2,230)	4,044

Goodwill and Intangible Assets

The Company uses the provisions of FAS 142, Goodwill and Other Intangible Assets to account for its goodwill and intangibles. Under FAS 142, goodwill is subject to an annual impairment test as well as impairment assessments of triggering events. FAS 142 requires the Company to compare the fair value of the reporting unit to its carrying amount to determine if there is 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. The implementation of FAS 142 required the use of judgments, estimates and assumptions in the identification of reporting units and the determination of fair market value and impairment amounts related to the required testing. The Company has three reporting units: transportation operations, insurance operations and Mexican operations. The Company allocated the goodwill to the transportation operations as it mainly resulted from the acquisition of Chemical Leaman Corporation in 1998.

The Company selected the second quarter to perform its annual impairment test. The Company used a combination of discounted cash flows and valuation of its capital structure to estimate the fair value. Projections for future cash flows were based on recent operating trends of the Company. No impairment was determined to have occurred as of June 30, 2004, since the calculated fair value exceeded the carrying amount. The factors used in deriving the estimate of the fair value included improving economic conditions and increasing revenues during 2004. Additionally, the Company consummated an initial public offering of its common stock in November 2003, favorably restructuring the Company s debt and capital structure.

Intangible assets consist of a pension plan related intangible asset, non-compete agreements with lives ranging from 1 10 years, and customer lists and customer contracts with lives of 5 years. Accumulated amortization of intangible assets was $0.2 million and $0.1 million at June 30, 2004 and December 31, 2003, respectively. The gross amount of intangible assets at June 30, 2004 and December 31, 2003 was $1.6 million and $1.5 million, respectively.

New Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46, Consolidation of Variable Interest Entities (FIN 46). FIN 46 provides guidance in determining (1) whether consolidation is required under the controlling financial interest model of Accounting Research Bulletin No. 51, Consolidated Financial Statements, (or other existing authoritative guidance) or, (2) whether the variable interest model under FIN 46 should be used to account for existing and new entities. In December 2003, the FASB released a revised version of FIN 46 (FIN 46R) clarifying certain aspects of FIN 46 and providing certain entities with exemptions from its requirements. Adoption of this standard during the first quarter of 2004 did not have a material impact on the Company s financial reporting.

In May 2003, the Emerging Issues Task Force issued Consensus No. 03-6, Participating Securities and the Two-class Method under FASB No. 128, Earnings Per Share (EITF 03-6). EITF 03-6 considers how a participating security should be defined for purposes of applying paragraphs 60 and 61 of FASB Statement No. 128, and whether paragraph 61 of FASB Statement No. 128 requires an entity to use the two-class method in computing EPS based on the presence of a participating security, regardless of the characteristics of that participating security. EITF 03-6 is effective for fiscal periods beginning after March 31, 2004. The adoption of EITF 03-6 did not have a material impact on the Company s financial reporting.

2. COMPREHENSIVE INCOME (LOSS):

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

	Three months ended June 30,		Six months ended June 30,	
	2004	2003	2004	2003
				(Restated)
Net income (loss)	$ (7,862)	$ 2,209	$ (6,900)	$ 4,044
Other comprehensive income:				
Foreign currency translation adjustments	(15)	(464)	19	158
Comprehensive income (loss)	$ (7,877)	$ 1,745	$ (6,881)	$ 4,202

3. EARNINGS PER SHARE:

The June 30, 2004 common shares outstanding include 7,875,000 shares issued in November 2003 in connection with the Company s initial public offering and 7,654,235 shares issued in November 2003 in connection with the conversion of all of the Company s 13.75% Mandatorily Redeemable Preferred Stock to common stock.

For the three and six months ended June 30, 2004 and 2003, 2,088,000 and 106,000 options, respectively, were not included in the calculation as the exercise of these options would have had an anti-dilutive effect on the earnings per share calculation. For the three and six months ended June 30, 2004 and 2003, 265,000 and 291,000 warrants, respectively, were not included in the calculation as the exercise of these warrants would have had an anti-dilutive effect on the earnings per share calculation. For the three and six months ended June 30, 2004 and 2003, 86,000 and 0 shares of restricted stock, respectively, were not included in the calculation as these shares would have had an anti-dilutive effect on the earnings per share calculation.

4. STOCK-BASED COMPENSATION:

The Company uses Accounting Principles Board Opinion No. 25, Accounting for Stock-Based Compensation, and the related interpretations to account for its stock option plans. No compensation cost has been recorded at the grant dates, as the option price has been greater than or equal to the market price of the common stock on the applicable measurement date for all options issued. The Company adopted the disclosure provisions of FAS 148, Accounting for Stock-Based Compensation - Transition and Disclosure and amendment of FAS 123, Accounting for Stock-Based Compensation, for disclosure purposes in 2002.

The following table illustrates the effect on net earnings if the Company had recognized compensation expense upon issuance of the options (in thousands):

	Three months ended June 30,	Six months ended June 30,

	2004	2003	2004	2003 (Restated)
Net loss attributable to common stockholders as reported	$ (7,862)	$ (63)	$ (6,900)	$ (419)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects of $0 for all periods	(406)	(38)	(861)	(76)
Pro forma net loss attributable to common stockholders	$ (8,268)	$ (101)	$ (7,761)	$ (495)
Loss per common share:				
As reported basic	$ (0.42)	$ (0.02)	$ (0.37)	$ (0.13)
Pro forma basic	$ (0.44)	$ (0.03)	$ (0.41)	$ (0.15)
As reported diluted	$ (0.42)	$ (0.02)	$ (0.37)	$ (0.13)
Pro forma diluted	$ (0.44)	$ (0.03)	$ (0.41)	$ (0.15)

5. EMPLOYEE BENEFIT PLANS

The Company maintains 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. Assets of the plans are invested primarily in equity securities and fixed income investments. Pension costs are funded in accordance with the provisions of the applicable law.

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

	Three months ended June 30,		Six months ended June 30,	
	2004	2003	2004	2003
Service cost	$ 69	$ 69	$ 138	$ 138
Interest cost	687	705	1,373	1,411
Expected return on plan assets	(439)	(334)	(879)	(669)
Net periodic pension cost	$ 317	$ 440	$ 632	$ 880

During April 2004, new legislation, the Pension Funding Equity Act, was enacted allowing companies to use higher-yield corporate bond rates instead of Treasury bonds to calculate their pensions projected assets. Utilizing the new formula, the Company reduced its estimate of expected contributions to $4.2 million during fiscal 2004. The company had paid $1.7 million as of June 30, 2004.

6. COMMITMENTS AND CONTINGENCIES:

Environmental Matters

Our activities involve the handling, transportation and storage 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 that may contain hazardous substances, and the discharge of stormwater from industrial activities. In addition, we may store diesel fuel and other petroleum type 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 at each operating location. Self-audits conducted by our internal 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 to conduct 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 staff includes environmental experts who develop policies and procedures, including periodic audits of our terminals, tank cleaning facilities, and historic operations, in an effort to avoid circumstances that could lead to future environmental exposure.

As a handler of hazardous substances, we are potentially subject to strict, joint and several liability for investigating and rectifying the consequences of spills and other environmental releases of such substances under the Comprehensive Environmental Response Compensation and Liability Act of 1980, as amended (CERCLA) and 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 have identified environmental contamination at certain sites that will require remediation.

We are currently responsible for remediating and investigating five properties under federal and state Superfund programs where we are the only responsible party. Each of these five remediation projects relates to operations conducted by CLC prior to our acquisition of and merger with CLC in 1998. The following is a brief discussion of two such 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. A groundwater remedy design has subsequently been approved by the EPA and will be under construction shortly.

In August 1994, the EPA issued a Record of Decision, selecting a remedy for the wetlands operable unit at the Bridgeport site. In October 1998, the EPA issued an administrative order that requires CLC to implement the EPA s wetlands remedy. A remedial design for this remedy has been approved by the EPA and the State of New Jersey. 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 finalized a consent decree on March 16, 2001 with the state and federal trustees and has resolved the natural resource damages claims. In addition, the EPA has investigated contamination in site soils. However, no decision has been made as to the extent of soil remediation to be required, if any. The Company estimates the range of possible expenditures for this site is $11.4 million to $18.4 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 contains these elements: (1) payment to the EPA for installation of an alternate water line to provide water to affected area residents; (2) performance of an interim groundwater remedy at the site; and (3) soil remediation. US v. Chemical Leaman Tank Lines, Inc., Civil Action No. 95-CV-4264 (RJB) (E.D. Pa.). During the quarter ended June 30, 2004, the extent of contaminated soils was expanded requiring more extensive remediation than previously projected. In response, the Company increased its reserves for this site by $4.1 million. The Company s increased estimate of the range of possible expenditures for this site is $7.4 million to $8.2 million.

CLC has paid all costs associated with installation of the waterline. CLC has completed a groundwater study and has submitted preliminary designs for a groundwater treatment plant to pump and treat groundwater. The EPA anticipates that CLC will conduct the groundwater remedy over the course of five years, at which time the EPA will evaluate groundwater conditions and determine whether further groundwater remedy is necessary. Field sampling for soil remediation and activities for the design of a soil remediation system have been completed and approved by the EPA. Soil remediation has started and includes the use of both a low temperature thermal treatment unit and a soil vapor extraction system. The Consent Decree does not cover the final groundwater remedy or other site remedies or claims, if any, for natural resource damages.

OTHER OWNED PROPERTY REMEDIATION. 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, 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 currently subject to the New Jersey Industrial Sites Recovery Act (ISRA) cleanup requirements. 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. The Company estimates the range of possible expenditures for these sites is $3.1 million to $7.2 million.

OTHER ENVIRONMENTAL MATTERS. CLC has been named as a potentially responsible party (PRP) under CERCLA and similar state laws at approximately 37 other 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. The Company estimates the range of possible expenditures for these sites is $1.2 million to $3.8 million.

RESERVES. As of June 30, 2004 and December 31, 2003, the Company had reserves in the amount of $29.9 million and $29.2 million for all environmental matters discussed above.

Litigation

On February 24, 2004, a putative class action lawsuit titled, *Meigs v. Quality Distribution, Inc., et al.*, was filed in the United States District Court for the Middle District of Florida, Tampa Division, against the Company, Thomas L. Finkbiner, the Company s President, Chief Executive Officer and Chairman of the Board, and Samuel M. Hensley, the Company s Senior Vice President and Chief Financial Officer. The plaintiff purports to represent a class of purchasers of the Company s common stock traceable to its November 2003 initial public offering. The complaint alleges that, in connection with the IPO, the Company filed a registration statement with the SEC that incorporated a materially false or misleading prospectus. Specifically, the complaint alleges that the prospectus materially overstated the Company s financial results for the years ended December 31, 2001, December 31, 2002, and the nine months ended September 30, 2003. In addition, the complaint alleges that these financial statements were not prepared consistently with generally accepted accounting principles.

Accordingly, it asserts claims (and seeks unspecified damages) against all defendants based on the alleged violations of Section 11 of the Securities Act of 1933 and against Mr. Finkbiner and Mr. Hensley as control persons, under the Securities Act s Section 15 by virtue of their positions at the Company.

On May 11, 2004, the Court consolidated *Meigs* with a substantially identical action titled *Cochran v. Quality Distribution, Inc.*, also pending in the United States District Court for the Middle District of Florida.

On June 28, 2004, the Court appointed Jemmco Investment Management LLC as lead plaintiff under the Private Securities Litigation Reform Act of 1995. Plaintiffs must file a consolidated amended complaint on or before August 27, 2004.

A second suit, *Steamfitters Local 449 Pension & Retirement Security Funds v. Quality Distribution, Inc., et al.*, was filed in the Circuit Court for the Thirteenth Judicial Circuit in and for Hillsborough County, Florida, on March 26, 2004. In addition to the Company, Mr. Finkbiner and Mr. Hensley, the suit names as defendants the other signatories to the registration statement, namely Company directors Anthony R. Ignaczak, Joshua J. Harris, Michael D. Weiner, Marc J. Rowan, Marc E. Becker, and Donald C. Orris, and three of the Company s IPO underwriters, Credit Suisse First Boston LLC, Bear, Stearns & Co., Inc., and Deutsche Bank Securities Inc. The *Steamfitters* complaint alleges substantially identical facts to those in the *Meigs* complaint and also includes the same claims, plus an additional claim for rescission or damages based on an alleged violation of Section 12 of the Securities Act.

On April 28, 2004, the defendants removed the action to the United States District Court for the Middle District of Florida, where *Meigs* was already pending. On May 28, 2004, *Steamfitters* moved to remand the case to state court. On June 25, 2004, the court remanded the case to state court. Defendants filed a notice of appeal of the court s remand order on July 23, 2004. Plaintiff moved to dismiss the appeal for lack of jurisdiction on August 6, 2004. That motion is currently being briefed to the Eleventh Circuit. The parties have agreed that the defendants response to the complaint is currently due on or before October 31, 2004.

The actions allegations stem from the disclosures in a Form 8-K that the Company filed on February 2, 2004, stating that the Company had discovered irregularities at Power Purchasing, Inc., a non-core subsidiary that, through its subsidiary, American Transinsurance Group, Inc. (collectively, PPI), primarily assists independent contractors in obtaining various lines of insurance, for which PPI derives fees as an insurance broker. The 8-K stated that the irregularities resulted from unauthorized actions by PPI s former vice president and would result in a restatement of the Company s financial statements. The Company will timely respond to all complaints and expects that the individual defendants will do the same. The Company carries management liability and company reimbursement insurance policies for the relevant period, which provide for aggregate coverage of $20 million, and has notified the insurance carriers of the lawsuits. The carriers have not yet confirmed or denied coverage, and the Company makes no comment as to whether the insurance will be sufficient to cover all alleged damages claimed by plaintiffs or any as yet unasserted claims by others against the Company. These cases are at an early stage, and it is therefore impossible to determine the likelihood of any outcome or the amount or range of any loss or possible loss, if any.

On May 13, 2004, a complaint styled *Quality Food Grade Carriers, Inc., et al. v. Quality Carriers, Inc., et al.,* No. 04-4515, was filed in the Circuit Court for the Sixth Judicial Circuit in and for Hillsborough County, Florida, naming as defendants Quality Carriers, Inc., (QCI), the Company s wholly-owned subsidiary, and Thomas L. Finkbiner, QCI s President and Chief Executive Officer. The complaint alleges (among other things) that QCI (i) breached a series of purported agreements with plaintiffs to pursue jointly a food transportation business; (ii) fraudulently induced the agreements because it intended to sell its food distribution business at the time it executed the agreements; (iii) converted plaintiffs assets, including trucks, trailers, tools, truck parts and other materials; and (iv) misappropriated Quality Food s corporate name and credit. The complaint seeks unspecified damages exceeding $30 million. QCI filed a motion to dismiss the complaint on May 27, 2004, and no hearing date for the motion has been set. On July 19, 2004, the plaintiffs filed an amended complaint containing substantially identical allegations and adding counts seeking equitable relief for the return of a laptop computer containing plaintiffs financial records and an injunction against Quality Distribution s alleged use of plaintiffs names to obtain credit. The Company believes that the complaint s allegations are meritless, and it intends to contest the action vigorously. This case is at an early stage, and it is therefore impossible to determine the likelihood of any outcome or the amount or range of any loss or possible loss, if any.

There can be no assurance that the actions described above will not have a material adverse effect on the Company.

The Company is from time to time involved in routine litigation incidental to the conduct of its business. The Company believes that no such routine litigation currently pending against it, if adversely determined, would have a material adverse effect on its consolidated financial position, results of operations or cash flows.

PPI Investigation

In connection with the irregularities discovered at PPI, the Company anticipates paying costs relating to state insurance regulatory proceedings. The Company accrued $2.7 million as its estimate of these potential charges based on information available at such time, which is subject to change as more information is obtained. Additionally, during the three and six months ended June 30, 2004, the Company recorded $0.8 million and $4.1 million, respectively, in accounting and legal fees relating to the investigation at PPI, which are recorded in PPI professional fees.

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 geographic areas for the three and six months ended June 30, 2004 and 2003, is as follows (in thousands):

	Three months ended June 30, 2004			
	U.S.	INTERNATIONAL	ELIMINATIONS	CONSOLIDATED
Operating revenues	$ 145,612	$ 11,817	$	$ 157,429
Operating income (loss)	(3,952)	1,742		(2,210)
Identifiable assets	345,942	43,232	(12,520)	376,654
Depreciation and amortization	5,154	720		5,874
Capital expenditures	2,741	9		2,750

	Three months ended June 30, 2003			
	U.S.	INTERNATIONAL	ELIMINATIONS	CONSOLIDATED
Operating revenues	$ 136,470	$ 7,162	$	$ 143,632
Operating income	8,603	938		9,541
Depreciation and amortization	7,044	586		7,630
Capital expenditures	1,152	514		1,666

	Six months ended June 30, 2004			
	U.S.	INTERNATIONAL	ELIMINATIONS	CONSOLIDATED
Operating revenues	$ 286,629	$ 21,985	$	$ 308,614
Operating income	1,210	2,826		4,036
Identifiable assets	345,942	43,232	(12,520)	376,654
Depreciation and amortization	10,467	1,427		11,894
Capital expenditures	5,037	21		5,058

	Six months ended June 30, 2003 (Restated)			
	U.S.	INTERNATIONAL	ELIMINATIONS	CONSOLIDATED
Operating revenues	$ 271,326	$ 9,321	$	$ 280,647
Operating income	17,203	931		18,134
Depreciation and amortization	14,124	1,000		15,124
Capital expenditures	3,322	514		3,836

	As of December 31, 2003			
	U.S.	INTERNATIONAL	ELIMINATIONS	CONSOLIDATED
Identifiable assets	364,608	19,796	(12,713)	371,691

8. SUBSEQUENT EVENTS

On July 13, 2004, the Company sold certain assets of PPI including accounts, customer lists, client lists and insurance contracts. These assets were related to the business of offering insurance to individuals who are not owner-operators, affiliates and fleet owners doing business regularly with the Company (QDI Persons). The sales price was $0.6 million with $0.5 million paid at closing and the remaining $0.1 million to be paid in equal monthly installments over twelve months. The Company may receive an additional amount of up to $0.4 million in September of 2006 based on the excess of the buyer s annual revenues from this business, as defined in the sales document, over $0.5 million.

For the retained business, which encompasses the on-going transactions with QDI Persons, the Company entered into a three-year outsourcing agreement whereby the outside insurance brokerage company shall provide the administrative responsibilities for insurance-related services offered to QDI Persons. The Company will receive a percentage of certain commissions, underwriting profits, administrative and other defined revenues related to the outsourced administrative responsibilities for insurance-related services. The Company is retaining certain assets and liabilities of PPI including the reserves established on the uninsured policies identified during the investigation of irregularities at PPI.

Additionally, on August 15, 2004, the Company sold its orange juice transportation operations.

9. GUARANTOR SUBSIDIARIES:

The 9% Senior Subordinated Notes issued by the Company s wholly-owned subsidiary, Quality Distribution LLC (QD LLC), and the Series B Floating Interest Rate Subordinated Term Notes due 2006 issued by the Company are unconditionally guaranteed on a senior subordinated basis pursuant to guarantees by all of the Company s direct and indirect domestic subsidiaries (the Guarantors). In addition, the Company unconditionally guarantees on a senior subordinated basis the 9% Senior Subordinated Notes. Each of the

Company s direct and indirect subsidiaries, including QD LLC, is 100% owned. All non-domestic subsidiaries including Levy Transport, Ltd. are non-guarantor subsidiaries.

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 to the Company s indebtedness depends on the earnings of subsidiaries and its ability to receive funds from its subsidiaries through dividend and other payments. The subsidiary guarantors are wholly owned subsidiaries of QD LLC and have fully and unconditionally guaranteed the 9% Senior Subordinated Notes and the Series B Floating Interest Rate Subordinated Term Notes on a joint and several basis.

The 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 above-mentioned notes.

The following condensed consolidating financial information for the Company, QD LLC and combined guarantor subsidiaries presents:

1. Balance Sheets as of June 30, 2004 and December 31, 2003.

2. Statements of Operations for the three months ended June 30, 2004 and June 30, 2003.

3. Statements of Operations for the six months ended June 30, 2004 and June 30, 2003.

4. Statements of Cash Flows for the six months ended June 30, 2004 and June 30, 2003.

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

FORM 10-Q

PART I FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CONDENSED CONSOLIDATING BALANCE SHEET

JUNE 30, 2004

(In 000 s)

	QDI	QD LLC	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS						
Current assets:						
Cash and cash equivalents	$	$	$ 1,097	$ 258	$	$ 1,355
Accounts receivable, net			86,238	337		86,575
Current maturities of notes receivable from affiliates			1,335			1,335
Prepaid expenses			3,772	149		3,921
Prepaid tires			7,805	155		7,960
Other			2,202	45		2,247
Total current assets			102,449	944		103,393
Property and equipment, net			124,716	5,676		130,392
Goodwill			131,363			131,363
Intangibles, net			1,497			1,497
Notes receivable from affiliates			741			741
Other assets		100,000	9,265	3	(100,000)	9,268
Investment in subsidiaries	(11,365)	147,625			(136,260)	
Total assets	$ (11,365)	$ 247,625	$ 370,031	$ 6,623	$ (236,260)	$ 376,654
LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS EQUITY (DEFICIT)						
Current liabilities:						
Current maturities of indebtedness	$	$ 1,630	$	$	$	$ 1,630
Accounts payable			20,664			20,664
Intercompany	16,170	(16,190)	10,044	(10,024)		
Affiliates and independent owner-operators payable			10,792	(2)		10,790
Accrued expenses			60,499	194		60,693
Income taxes payable			(655)	994		339
Total current liabilities	16,170	(14,560)	101,344	(8,838)		94,116
Long-term indebtedness, less current maturities		273,550				273,550

Environmental liabilities			20,771			20,771
Other non-current liabilities			112,457		(100,000)	12,457
Deferred tax liability			(1,479)	2,941		1,462
Total liabilities	16,170	258,990	233,093	(5,897)	(100,000)	402,356
Minority interest in subsidiary			1,833			1,833
Stockholders equity (deficit):						
Common stock	356,091	176,122	91,342	15,127	(282,591)	356,091
Treasury stock	(1,310)					(1,310)
Accumulated (deficit) retained earnings	(176,469)	16,772	56,694	(813)	(72,653)	(176,469)
Stock recapitalization	(189,589)	(189,589)		(55)	189,644	(189,589)
Accumulated other comprehensive loss	(14,670)	(14,670)	(12,931)	(1,739)	29,340	(14,670)
Stock purchase warrants	73					73
Stock subscriptions receivable	(1,661)					(1,661)
Total stockholders equity (deficit)	(27,535)	(11,365)	135,105	12,520	(136,260)	(27,535)
Total liabilities, minority interest and stockholders equity (deficit)	$ (11,365)	$ 247,625	$ 370,031	$ 6,623	$ (236,260)	$ 376,654

FORM 10-Q

PART I FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CONDENSED CONSOLIDATING BALANCE SHEET

DECEMBER 31, 2003

(In 000 s)

	QDI	QD LLC	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS						
Current assets:						
Cash and cash equivalents	$	$	$ 705	$ 250	$	$ 955
Accounts receivable, net			74,959	(15)		74,944
Current maturities of notes receivable from affiliates			676			676
Prepaid expenses			3,474	92		3,566
Prepaid tires			7,812	166		7,978
Other			1,994	61		2,055
Total current assets			89,620	554		90,174
Property and equipment, net			131,381	6,580		137,961
Goodwill			131,232			131,232
Intangibles, net						