QUALITY DISTRIBUTION INC
Form 10-Q
May 17, 2004
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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 March 31, 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	**I.R.S. Employer**
incorporation or organization)	**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 May 12, 2004
Common Stock (no par value per share)	**19,115,646**

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ITEM 1 FINANCIAL STATEMENTS

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In 000 s)

	March 31, 2004 (Unaudited)	December 31, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	$ 763	$ 955
Accounts receivable, net of allowance of $8,091 and $6,893	81,252	74,944
Current maturities of notes receivable from affiliates	1,241	676
Inventories	843	819
Prepaid expenses	6,413	3,566
Prepaid tires	8,085	7,978
Other	1,169	1,236
Total current assets	99,766	90,174
Property and equipment, net of accumulated depreciation of $198,106 and $203,816	134,016	137,961
Goodwill	131,232	131,232
Intangibles, net	1,368	1,402
Notes receivable from affiliates	781	1,051
Other assets	9,368	9,871
Total assets	$ 376,531	$ 371,691
LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS DEFICIT		
Current liabilities:		
Current maturities of indebtedness	$ 1,694	$ 1,759
Accounts payable	21,007	18,988
Affiliates and independent owner-operators payable	10,577	7,319
Accrued expenses	56,214	54,242
Income taxes payable	272	518
Total current liabilities	89,764	82,826
Long-term indebtedness, less current maturities	271,400	272,750
Environmental liabilities	18,643	19,689
Other non-current liabilities	13,057	13,712
Deferred tax liability	1,495	1,552
Total liabilities	394,359	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, 19,114 issued at March 31, 2004 and 19,080 issued at December 31, 2003	356,091	356,078
Treasury stock, 112 and 111 shares at March 31, 2004 and December 31, 2003, respectively	(1,285)	(1,258)
Accumulated deficit	(168,607)	(169,569)
Stock recapitalization	(189,589)	(189,589)
Accumulated other comprehensive loss	(14,655)	(14,689)
Stock purchase warrants	73	86
Stock subscriptions receivable	(1,689)	(1,730)
Total stockholders deficit	(19,661)	(20,671)
Total liabilities, minority interest and stockholders deficit	$ 376,531	$ 371,691

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

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited In 000 s, Except Per Share Amounts)

	Three months ended March 31, 2004	Three months ended March 31, 2003
Operating revenues:		
Transportation	$ 127,857	$ 114,809
Other service revenues	18,413	17,591
Fuel surcharge	4,915	4,615
Total operating revenues	151,185	137,015
Operating expenses:		
Purchased transportation	100,774	83,932
Compensation	14,549	16,452
Depreciation and amortization	6,020	7,494
Insurance claims	4,328	4,122
PPI professional fees	3,242	
Other operating expenses	16,026	16,422
Operating income	6,246	8,593
Interest expense	5,217	6,644
Other expense (income)	28	(24)
Income before taxes	1,001	1,973
Provision for income taxes	39	138
Net income	962	1,835
Distributions to minority interest/preferred stock dividends and accretions		(2,191)
Net income (loss) attributable to common stockholders	$ 962	$ (356)
Per share data:		
Net income (loss) per common stockholder basic	$ 0.05	$ (0.11)
Net income (loss) per common stockholder diluted	$ 0.05	$ (0.11)
Weighted average number of shares basic	18,892	3,337
Weighted average number of shares diluted	19,114	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)

	Three months ended March 31, 2004	2003
Cash flows from operating activities:		
Net income	$ 962	$ 1,835
Adjustments for non-cash charges	6,660	9,013
Changes in assets and liabilities	(5,441)	(7,701)
Net cash provided by operating activities	2,181	3,147
Cash flows from investing activities:		
Proceeds from life insurance	137	
Capital expenditures	(2,308)	(2,170)
Proceeds from asset dispositions	213	328
Net cash used in investing activities	(1,958)	(1,842)
Cash flows from financing activities:		
Net payments on the revolver	(1,000)	(400)
Payments of debt obligations	(414)	(746)
Increase in bank overdraft	932	733
Other	17	(36)
Net cash used in financing activities	(465)	(449)
Net increase (decrease) in cash	(242)	856
Effect of exchange rate changes on cash	50	(171)
Cash, beginning of period	955	661
Cash, end of period	$ 763	$ 1,346
Supplemental disclosures of non-cash activities:		
Preferred stock accretions	$	$ 2,155

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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.

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 three months ended March 31, 2003 reflect adjustments relating to matters at Power Purchasing, Inc., a non-core insurance subsidiary.

For further information, refer to the audited consolidated financial statements and notes thereto for the year ended December 31, 2003 included in the Company s annual report on Form 10-K.

Operating results for the three months ended March 31, 2004 are not necessarily indicative of the results that may be expected for the entire fiscal year.

New Accounting Pronouncements

In January 2003, the 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 did not have a material impact on the Company s financial reporting.

2. COMPREHENSIVE INCOME:

Comprehensive income is as follows (in thousands):

	Three months ended March 31,	
	2004	2003
Net income	$ 962	$ 1,835
Other comprehensive income:		
Foreign currency translation adjustments	34	622
Comprehensive income	$ 996	$ 2,457

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3. EARNINGS PER SHARE:

The March 31, 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.

The reconciliation of basic to diluted shares of common stock is as follows (in thousands):

	Three months ended March 31,	
	2004	2003
Weighted average common shares outstanding basic	18,892	3,337
Additional shares assuming:		
Exercise of stock options and warrants (1)	217	
Vesting of restricted stock	5	
Weighted average common shares outstanding diluted	19,114	3,337

(1) Represents the number of shares of common stock issuable on the exercise of dilutive employee stock options and warrants less the number of shares, which could have been purchased with the proceeds from the exercise of such options and warrants. These purchases were assumed to have been made at the average market price of the common stock during the period or that part of the period for which the option was outstanding. At March 31, 2004 and 2003, 2,050,000 and 108,000 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.

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 March 31,

	2004	2003
Net income (loss) attributable to common stockholders as reported	$ 962	$ (356)
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	(455)	(38)
Pro forma net income (loss) attributable to common stockholders	$ 507	$ (394)
Income (loss) per common share:		
As reported basic	$ 0.05	$ (0.11)
Pro forma basic	$ 0.03	$ (0.12)
As reported diluted	$ 0.05	$ (0.11)
Pro forma diluted	$ 0.03	$ (0.12)

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.

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The components of net periodic pension cost are as follows for the three months ended March 31 (in thousands):

	2004	2003
Service cost	$ 69	$ 69
Interest cost	686	706
Expected return on plan assets	(440)	(335)
Net periodic pension cost	$ 315	$ 440

During April 2004, new legislation 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 $4.1 million for fiscal 2004. No amounts had been paid as of March 31, 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 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 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.

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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.

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.).

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.

OTHER ENVIRONMENTAL MATTERS. CLC has been named as 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.

RESERVES. As of March 31, 2004 and December 31, 2003, we had reserves in the amount of $27.9 million and $29.2 million for all environmental matters discussed above.

Litigation

On February 24, 2004, the first of three putative class action lawsuits, *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 6, 2003, initial public offering. The complaint alleges that, in connection with the IPO, the Company filed a registration statement with the Securities and Exchange Commission 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 causes of action (and seeks unspecified damages) against all defendants based on the alleged violation of Section 11 of the Securities Act of 1933, and against Mr. Finkbiner and Mr. Hensley as control persons, under the Act s Section 15, by virtue of their positions at the Company.

The second suit, *Steamfitters Local 449 Pension & Retirement Security Funds v. Quality Distribution, Inc., et al.*, was filed in the Circuit Court of 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 causes of action, plus an additional claim for rescission or damages based on an alleged violation of Section 12 of the Securities Act of 1933. On April 28, the defendants removed the action to the United States District Court for the Middle District of Florida, where *Meigs* was already pending. Plaintiff in *Steamfitters* has until May 28, 2004, to seek to remand the case to state court.

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Cochran v. Quality Distribution, Inc., et al., was filed in the United States District Court for the Middle District of Florida on April 15, 2004. The complaint is substantially identical to that in *Meigs*, naming the same defendants and asserting the same claims based on the same allegations. On April 23, 2004, plaintiff sought to consolidate her action with *Meigs* and to be named lead plaintiff in the consolidated case. Another plaintiff, Jemmco Investments Management LLC, has also sought to be named lead plaintiff in *Meigs*.

All three complaints 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. While three class actions lawsuits have thus far been served on QDI regarding the above matters, plaintiffs may file additional complaints and/or an Amended and Consolidated Complaint. 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 against the Company.

On May 13, 2004, a complaint, *Quality Food Grade Carriers, Inc., et ano. v. Quality Carriers, Inc. and Thomas Finkbiner, et al.,* was filed in the Circuit Court for the Thirteenth Judicial Circuit in and for Hillsborough County, against Quality Carriers, Inc., a wholly-owned subsidiary of the Company (QCI) and Thomas L. Finkbiner, QCI s President and Chief Executive Officer. The complaint in that action alleges 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. The Company believes that the complaint s allegations are meritless, and it intends to contest the action vigorously.

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

PPI Investigation

In connection with the irregularities discovered at PPI, the Company anticipates paying costs relating to state insurance regulatory proceedings. The Company recorded an accrual of $3.0 million in the fourth quarter of 2003 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 months ended March 31, 2004, the Company recorded $3.2 million 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 months ended March 31, 2004 and 2003, is as follows (in thousands):

Three months ended March 31, 2004

	U.S.	INTERNATIONAL	ELIMINATIONS	CONSOLIDATED
Operating revenues	$ 141,017	$ 10,168	$	$ 151,185
Operating income	5,162	1,084		6,246
Identifiable assets	362,832	26,230	(12,531)	376,531
Depreciation and amortization	5,313	707		6,020
Capital expenditures	2,296	12		2,308

	Three months ended March 31, 2003			
·	U.S.	INTERNATIONAL	ELIMINATIONS	CONSOLIDATED
Operating revenues	$ 134,856	$ 2,159	$	$ 137,015
Operating income	8,600	(7)		8,593
Depreciation and amortization	7,080	414		7,494
Capital expenditures	2,170			2,170

	As of December 31, 2003			
	U.S.	INTERNATIONAL	ELIMINATIONS	CONSOLIDATED
Identifiable assets	364,180	20,224	(12,713)	371,691

8. 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.

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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 March 31, 2004 and December 31, 2003.

2. Statements of Operations for the three months ended March 31, 2004 and March 31, 2003.

3. Statements of Cash Flows for the three months ended March 31, 2004 and March 31, 2003.

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

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PART I FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CONDENSED CONSOLIDATING BALANCE SHEET

MARCH 31, 2004

(Unaudited In 000 s)

	QDI	QD LLC	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS						
Current assets:						
Cash and cash equivalents	$	$	$ 515	$ 248	$	$ 763
Accounts receivable, net			81,105	147		81,252
Current maturities of notes receivable from affiliates			1,241			1,241
Inventories			780	63		843
Prepaid expenses			6,240	173		6,413
Prepaid tires			7,923	162		8,085
Other			1,169			1,169
Total current assets			98,973	793		99,766
Property and equipment, net			127,855	6,161		134,016
Goodwill			130,804	428		131,232
Intangibles, net			1,368			1,368
Notes receivable from affiliates			781			781
Other assets		100,000	9,364	4	(100,000)	9,368
Investment in subsidiaries	(3,491)	153,412			(149,921)	
Total assets	$ (3,491)	$ 253,412	$ 369,145	$ 7,386	$ (249,921)	$ 376,531
LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS EQUITY (DEFICIT)						
Current liabilities:						
Current maturities of indebtedness	$	$ 1,694	$	$	$	$ 1,694
Accounts payable			21,007			21,007
Intercompany	16,170	(16,191)	9,379	(9,358)		
Affiliates and independent owner-operators payable			10,579	(2)		10,577
Accrued expenses			55,959	255		56,214
Income taxes payable			(714)	986		272
Total current liabilities	16,170	(14,497)	96,210	(8,119)		89,764

Long-term indebtedness, less current maturities		271,400				271,400
Environmental liabilities			18,643			18,643
Other non-current liabilities			113,057		(100,000)	13,057
Deferred tax liability			(1,479)	2,974		1,495
Total liabilities	16,170	256,903	226,431			