

QUALITY DISTRIBUTION INC

Form 10-Q

May 14, 2002

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended MARCH 31, 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: 0-24180

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)

(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

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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 MARCH 31, 2002
(Common Stock, \$.01 par value)	1,991,726

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PART 1 FINANCIAL INFORMATION
 ITEM 1 FINANCIAL STATEMENTS
 QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (In thousands)

	March 31, 2002 (Unaudited)	December 31, 2001 *
ASSETS		
Current Assets:		
Cash	\$ 1,887	\$ 2,212
Accounts receivable	100,356	98,173
Allowance for doubtful accounts	(9,486)	(9,272)
Inventories	1,075	1,143
Prepaid expenses	6,425	5,767
Prepaid tires	8,806	8,968
Income tax receivable	6	306
Other	2,393	2,666
Total current assets	111,462	109,963
Property, plant and equipment	348,359	348,687
Less accumulated depreciation and amortization	(177,295)	(171,328)
	171,064	177,359
Goodwill, net	150,510	150,510
Intangibles	2,089	2,265
Other Assets	8,335	8,881
	\$ 443,460	\$ 448,978

* Condensed from audited financial statements

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

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PART 1 FINANCIAL INFORMATION
ITEM 1 FINANCIAL STATEMENTS
QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)
(continued)

	March 31, 2002 (Unaudited)	December 31, 2001 *
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Current maturities of indebtedness	\$ 2,679	\$ 2,677
Accounts payable and accrued expenses	61,945	62,848
Affiliates and owner operators payable	7,125	4,930
Income taxes payable	1,077	1,092
Total current liabilities	72,826	71,547
Long term bank debt, less current maturities	299,011	301,179
Subordinated debt	140,000	140,000
Environmental liabilities	34,874	36,163
Other long term obligations	12,930	13,744
Deferred tax	1,198	1,270
Total liabilities	560,839	563,903
Minority interest in subsidiary	1,833	1,833
Manditorily redeemable preferred stock	17,065	16,499
Manditorily redeemable common stock (30 shares)	1,210	1,210
Stockholders (deficit):		
Common stock, \$.01 par value; 15,000 shares authorized	20	20
Additional paid-in-capital	105,544	105,544
Treasury stock	(628)	(402)
Accumulated (deficit)	(41,082)	(37,435)
Stock recapitalization	(189,589)	(189,589)
Accumulated other comprehensive (loss)	(9,976)	(10,829)
Notes receivable	(1,776)	(1,776)
Total stockholders (deficit)	(137,487)	(134,467)
	\$ 443,460	\$ 448,978

* Condensed from audited financial statements.

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

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ITEM 1 FINANCIAL STATEMENTS
QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except per share data)

	Three months ended March 31,	
	2002	2001
Operating Revenues:		
Transportation	\$ 104,734	\$ 115,076
Other	20,192	15,727
	124,926	130,803
Total operating revenues		
Operating Expenses:		
Purchased transportation	71,116	74,217
Depreciation and amortization	8,113	8,648
Other operating expenses	38,610	39,180
	7,087	8,758
Operating income		
Interest expense, net	9,907	9,441
Other income (expense)	(36)	13
	(2,856)	(670)
Loss before taxes		
Benefit (provision) for income taxes	(189)	(360)
	(3,045)	(1,030)
Net loss		
Preferred stock dividends and accretions	(602)	(397)
	\$ (3,647)	\$ (1,427)
Net loss attributable to common stockholders		
Per Share Data:		
Basic and diluted loss per common share	\$ (1.83)	\$ (.71)
	1,996	2,021
Weighted average number of common shares outstanding-basic and diluted		

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

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FORM 10-Q
ITEM 1 FINANCIAL STATEMENTS
QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited) - (In thousands)

	Three months ended March 31,	
	2002	2001
Cash flows provided by (used in)		
Operating activities:		
Net loss	\$(3,045)	\$(1,030)
Adjustments for non cash charges	8,985	9,420
Changes in assets and liabilities	(2,028)	946
	3,912	9,336
Investing activities:		
Capital expenditures	(2,939)	(6,619)
Proceeds from asset dispositions	1,008	1,122
	(1,931)	(5,497)
Financing activities:		
Payment of debt obligation	(2,169)	(1,251)
Preferred stock redemption		(2,600)
Other	(263)	275
	(2,432)	(3,576)
Net increase (decrease) in cash	(451)	263
Effect of exchange rate changes on cash	126	(583)
Cash, beginning of period	2,212	2,636
	\$ 1,887	\$ 2,316
Supplemental disclosures of cash flow information:		
Cash payments for:		
Interest	\$ 6,550	\$ 6,315
Income taxes	\$ 73	\$ 208
Supplemental disclosures of Non-cash activities:		
Preferred Stock Accretion	\$ 566	\$ 361
Unrealized gain or (loss) on derivative instruments	\$ (142)	(903)

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

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FORM 10-Q
Item 1. FINANCIAL STATEMENTS
QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Basis of Presentation

The accompanying unaudited condensed, consolidated financial statements of Quality Distribution, Inc. (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 Company's annual report on Form 10-K which was filed March 29, 2002.

Operating results for the first quarter ended March 31, 2002 are not necessarily indicative of the results that may be expected for the entire fiscal year.

2. LIQUIDITY:

Our credit agreements include financial covenants which were modified December 14, 2001 as part of an amendment (the Fourth Amendment) thereto. The new financial covenants are less restrictive than the original covenants and remain in effect for four consecutive calendar quarters ending December 31, 2002. Our credit agreement includes financial covenants which require minimum or maximum ratios to be maintained. The financial covenants in the Fourth Amendment are less restrictive than the previously existing covenants and cover the calendar quarters through December 31, 2002. The Company currently believes that it will be in compliance with the covenants through December 31, 2002. In addition, the Fourth Amendment restricts the future availability of the revolving credit facility to an incremental \$15 million above the balance at the date of the agreement, plus places restrictions on the amount of capital expenditures allowed.

On April 5, 2002, we entered into a fifth amendment (the Fifth Amendment) to our credit agreement. The Fifth Amendment will further amend the financial covenants through the date of the final maturity of our credit agreement. Such revised covenants will be less restrictive than the previously existing covenants for the period beginning March 31, 2003 through final maturity of our credit agreement. The revised covenants in the Fifth Amendment will only become effective if we are able to satisfy certain conditions. If the Debt/Equity Exchange is consummated as a result of the Exchange Offer, then the conditions to effectiveness will be satisfied. There can be no assurance that the amendments to the financial covenants in the Fifth Amendment will become effective, or that if they do, that we will be able to comply with such revised financial covenants. (See note 7 Subsequent Events for a discussion of the Exchange Offer).

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3. COMPREHENSIVE INCOME:

Comprehensive Income is as follows: (dollars in thousands)

	Three Months Ended March 31,	
	2002	2001
Net loss	\$ (3,045)	\$ (1,030)
Other comprehensive income (loss):		
Foreign currency translation adjustments	(79)	(421)
Unrealized gain or (loss) on derivative instruments	933	(903)
Comprehensive loss	\$ (2,191)	\$ (2,354)

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, 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 \$341.7 million of variable interest debt at December 31, 2001 and March 31, 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 March 31, 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 March 31, 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 \$1.3 million impact, net of interest rate swap agreements, on future earnings on an annual basis.

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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 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 loss as it relates to derivatives is as follows:

	Three Months Ended	
	March 31, 2002	March 31, 2001
(In thousands)		
Balance beginning of period	\$(3,346)	\$ 337
Current period declines in fair value	(142)	(1,444)
Reclassifications to earnings	1,075	204
Balance at end of period	<u>\$(2,413)</u>	<u>\$ (903)</u>

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 March 31, 2002, and as such, there are no earnings reclassifications at March 31, 2002 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 March 31, 2002 and 2001, \$1.1 million and \$.2 million, respectively, was reclassified to earnings as interest expense. The \$(2.4) million recorded in accumulated other comprehensive loss at March 31, 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

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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 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. See Certain Considerations Environmental Risk Factors for a discussion of certain risks of our being associated with transporting hazardous substances.

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

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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
- (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

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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 Corporation 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 an increase in net income for the quarter ended March 31, 2002 of \$0.9 million. Goodwill is subject to an annual impairment test. The Company expects to have its initial impairment test complete by the end of the second quarter. Intangible assets consist mainly of non-compete agreements with lives ranging from 2-5 years, and an intangible pension plan asset. Accumulated amortization of intangible assets are \$1.6 million and \$1.4 million, at March 31, 2002 and December 31, 2001, respectively.

The following table presents net loss on a comparable basis, after adjustment for goodwill amortization (in thousands, except per share amounts):

	March 31, 2002	March 31, 2001
	_____	_____
Net loss:		
As reported	\$(3,045)	\$(1,030)
Goodwill amortization (net of tax)		952
	_____	_____
Adjusted net loss	\$(3,045)	\$ (78)
	_____	_____
Basic and diluted loss per common share:		
As reported	\$ (1.83)	\$ (.71)
	_____	_____
As adjusted	\$ (1.83)	\$ (.03)
	_____	_____

7. SUBSEQUENT EVENTS:

Pursuant to the terms of an Offering Memorandum and Consent Solicitation Statement, dated April 10, 2002 (the Offering Memorandum), Quality Distribution, Inc. (the Company) commenced an offer (the Exchange Offer) to exchange (the Debt/Equity Exchange), for each \$1,000 in principal amount of its currently outstanding 10% Series B Senior Subordinated Notes due 2006 (the Fixed Rate Notes) and Series B Floating Interest Rate Subordinated Term Securities due 2006 (FIRSTSSM) (the FIRSTS and, together with the Fixed Rate Notes, for debt and equity securities (the Debt/Equity Securities) consisting of (i) \$650 principal amount of new 12 1/2% Senior Subordinated Secured Notes due 2008 (the New Notes) to be issued by a wholly owned subsidiary of the Company and which will acquire substantially all of the Company's assets, (B) \$150 principal amount of new 12% Junior Subordinated PIK Notes due 2009 (the Junior PIK Notes) to be issued by the Company and (C) 1.59 Warrants, each to purchase one share of the Company's common stock, par value \$0.01 per share (the Common Stock, at an exercise price of \$10 per share (the Warrants).

The completion of the Debt/Equity Exchange is conditioned upon, among other things, at least \$61.3 million aggregate principal amount of Notes (excluding the \$53.0 million aggregate principal amount of Notes covered by the Lock-Up Agreements described below) being validly tendered (and not properly withdrawn)

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in the Exchange Offer (the \$61.3 Million Threshold). If the \$61.3 million Threshold is not satisfied, the Debt/Equity Exchange will not occur and eligible holders of Notes who have validly tendered (and not properly withdrawn) their Notes in the Exchange Offer prior to the expiration date will receive in exchange (the Senior Note Exchange) for their Notes a like principal amount of new 10% Senior Secured Notes due 2008 (the 10% Senior Secured Notes) to be issued by the Company. The Exchange Offer will expire on May 24, 2002, unless extended.

In conjunction with the Exchange Offer, the Company is soliciting consents from holders of Notes to amend the existing indenture governing the Notes. The proposed amendments would eliminate many of the restrictive covenants contained in the existing indenture and allow, among other things, the Company to complete the Debt/Equity Exchange. The proposed amendments require for adoption the Company's receipt of consents from holders representing at least a majority of the outstanding principal amount of Notes held by persons other than the Company or its affiliates. The adoption of the proposed amendments to the existing indenture is not conditioned on the consummation of the Debt/Equity Exchange.

In connection with the Exchange Offer, on April 10, 2002, the Company entered into lock-up agreements (collectively, the Lock-Up Agreements) with (i) certain affiliates of Apollo Management, L.P., the Company's controlling stockholder (Apollo), (ii) certain affiliates of Ares Management, L.P. (Ares) and (iii) certain members of the Company's management (the Management Group). Apollo, Ares and the Management Group collectively hold \$53.0 million aggregate principal amount, or approximately 37.9%, of Notes.

The Lock-Up Agreements provide that (i) if the \$61.3 Million Threshold is satisfied (but the \$78.3 Million Threshold (as defined below) and certain other conditions are not satisfied or waived) and the Debt/Equity Exchange is consummated pursuant to the terms of the Offering Memorandum, then Apollo, Ares and the Management Group will exchange their Notes for the Debt/Equity Securities, (ii) if at least \$78.3 million aggregate principal amount of Notes (excluding the \$53.0 million aggregate principal amount of Notes covered by the Lock-Up Agreements) are validly tendered (and not properly withdrawn) in the Exchange Offer (the \$78.3 Million Threshold) and certain other conditions are satisfied or waived, then, in lieu of receiving Debt/Equity Securities, Apollo will exchange its \$29.5 million of Notes for shares of the Company's 13.75% preferred stock, \$0.01 par value per share (the 13.75% Preferred Stock) and purchase an additional \$10.0 million of 13.75% Preferred Stock, (iii) if Apollo exchanges its Notes for 13.75% Preferred Stock as described in clause (ii) above, then the Management Group, in lieu of receiving Debt/Equity Securities, will exchange its \$1.0 million of Notes for shares of 13.75% Preferred Stock and (iv) if the Senior Note Exchange is consummated, then Apollo, Ares and the Management Group will exchange their \$53.0 million aggregate principal amount of Notes for a like principal amount of 10% Senior Secured Notes. On May 10, 2002, Apollo agreed to waive the \$78.3 million threshold condition upon satisfaction of the \$61.3 million threshold.

The Debt/Equity Securities or the 10% Senior Secured Notes, as applicable, and the 13.75% Preferred Stock will not be registered under the Securities Act of 1933, as amended, and may not be offered or sold in the United States absent registration or an applicable exemption from such registration requirements. This report is neither an offer to exchange, nor the solicitation of an offer to exchange, any Notes for Debt/Equity securities or 10% Senior Secured Notes, as applicable, nor the solicitation of any consents to the proposed amendments to the existing indenture for the Notes.

On April 5, 2002, we entered into a fifth amendment (the Fifth Amendment) to our credit agreement. The Fifth Amendment will further amend the financial covenants through the date of the final maturity of our credit agreement. Such

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revised covenants will be less restrictive than the previously existing covenants for the period beginning March 31, 2003 through final maturity of our credit agreement. The revised covenants in the Fifth Amendment will only become effective if we are able to satisfy certain conditions. If the Debt/Equity Exchange is consummated as a result of the Exchange Offer, then the conditions to effectiveness will be satisfied. There can be no assurance that the amendments to the financial covenants in the Fifth Amendment will become effective, or that if they do, that we will be able to comply with such revised financial covenants.

8. 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 quarters ended March 31, 2002 and March 31, 2001, is as follows:

	March 31, 2001		
	U.S.	INTERNATIONAL	ELIMINATIONS CONSOLIDATED
Operating revenues	\$ 124,293	\$ 6,510	\$ 130,803
Net operating income	8,641	117	8,758
Identifiable assets	432,585	26,630	(14,196) 445,019
Depreciation and amortization	7,785	863	8,648
Capital expenditures	6,194	425	6,619

	March 31, 2002		
	U.S.	INTERNATIONAL	ELIMINATIONS CONSOLIDATED
Operating revenues	\$ 120,057	\$ 4,869	\$ 124,926
Net operating income	6,952	135	7,087
Identifiable assets	432,604	12,413	(1,557) 443,460
Depreciation and amortization	7,414	699	8,113
Capital expenditures	2,926	13	2,939

9. GUARANTOR SUBSIDIARIES:

The 10% Series B Senior Subordinated Notes and Series B Floating Interest Rate Subordinated Term Notes issued in June 1998 and due 2006 are unconditionally guaranteed on a senior unsecured basis pursuant to guarantees by all 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 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 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 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.

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The following condensed consolidating financial information presents:

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

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FORM 10-Q
QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
CONSOLIDATING BALANCE SHEET
MARCH 31, 2002
(Unaudited)
(In thousands)

	<u>Parent</u>	<u>Guarantor Subs</u>	<u>Non Guarantor Subs</u>	<u>Eliminations</u>	<u>Consolidated</u>
ASSETS					
Current Assets:					
Cash	\$	\$ 602	\$ 1,285	\$	\$ 1,887
Accounts receivable, net		88,510	2,360		90,870
Inventories		850	225		1,075
Prepaid expense and other Current assets		16,901	729		17,630
		<u>106,863</u>	<u>4,599</u>		<u>111,462</u>
Property and equipment, net		155,920	15,144		171,064
Intangibles & goodwill, net		151,793	806		152,599
Other assets	100,000	8,331	4	(100,000)	8,335
Investment in subsidiaries	217,478			(217,478)	
	<u>\$ 317,478</u>	<u>\$ 422,907</u>	<u>\$ 20,553</u>	<u>\$ (317,478)</u>	<u>\$ 443,460</u>

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FORM 10-Q
QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
CONSOLIDATING BALANCE SHEET
MARCH 31, 2002
(Unaudited) (In thousands, continued)

	Parent	Guarantor Subs	Non-Guarantor Subs	Elim's	Consolidated
Current Liabilities:					
Current maturities of indebtedness	\$ 2,679	\$	\$	\$	\$ 2,679
Accounts payable and accrued expense		54,725	1,965		56,690
Inter-company		3,988	(3,988)		
Independent contractors payable		7,142	(17)		7,125
Other current liabilities		5,255			5,255
Income taxes payable		659	418		1,077
Total current liabilities	2,679	71,769	(1,622)		72,826
Bank debt, less current maturities	294,011		5,000		299,011
Subordinated debt, less current maturities	140,000	100,000		(100,000)	140,000
Other long term liabilities		11,023			11,023
Environmental liabilities		34,874			34,874
Deferred income taxes		(1,064)	2,262		1,198
Accrued loss and damage claims		1,907			1,907
Total liabilities	\$ 436,690	\$218,509	\$ 5,640	\$ (100,000)	\$ 560,839
Minority interest in subsidiaries		1,833			1,833
Mandatorily redeemable preferred stock	17,065				17,065
Mandatorily redeemable common stock	1,210				1,210
Stockholders' Equity (Deficit):					
Common stock and Additional paid-in-capital	105,564	140,254	15,082	(155,336)	105,564
Retained earnings	(41,082)	62,311	1,053	(63,364)	(41,082)
Stock recapitalization	(189,589)		(55)	55	(189,589)
Treasury stock	(628)				(628)
Other stockholders' equity	(9,976)		(1,167)	1,167	(9,976)
Note receivable	(1,776)				(1,776)
Total stockholders' equity (deficit)	(137,487)	202,565	14,913	(217,478)	(137,487)
	\$ 317,478	\$422,907	\$20,553	\$ (317,478)	\$ 443,460

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FORM 10-Q
QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES
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>
ASSETS					
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
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
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)	
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
	\$327,098	\$427,810	\$21,168	\$(327,098)	\$448,978
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>

* Condensed from audited financial statements.

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

	<u>PARENT</u>	<u>GUARANTOR SUBSIDIARIES</u>	<u>NON-GUARANTOR SUBSIDIARIES</u>	<u>ELIMINATIONS</u>	<u>CONSOLIDATED</u>
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
	<u>2,677</u>	<u>65,295</u>	<u>3,575</u>		<u>71,547</u>
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
		<u>(1,189)</u>	<u>2,459</u>		<u>1,270</u>