QUALITY DISTRIBUTION INC
Form 10-Q
November 09, 2006
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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 September 30, 2006

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 **(State or other jurisdiction of** **incorporation or organization)**	**59-3239073** **(I.R.S. Employer** **Identification No.)**
3802 Corporex Park Drive, Tampa, FL **(Address of Principal Executive Offices)**	**33619** **(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 a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Exchange Act Rule 12b-2.

Large accelerated filer ¨	Accelerated filer x	Non-accelerated filer ¨

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

As of November 1, 2006, the registrant had 19,000,488 outstanding shares of Common Stock, no par value, outstanding.

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Audit Committee Draft   November 2, 2006

QUALITY DISTRIBUTION, INC.

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

PART I FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

Quality Distribution, Inc. and Subsidiaries

Consolidated Statements of Operations

(Unaudited in 000 s, Except Per Share Amounts)

CONSOLIDATED STATEMENTS OF OPERATIONS

For the Years Ended

	Three months ended September 30, 2006	Three months ended September 30, 2005	Nine months ended September 30, 2006	Nine months ended September 30, 2005
OPERATING REVENUES:				
Transportation	$ 149,150	$ 136,184	$ 440,779	$ 409,026
Other service revenue	15,524	16,990	50,728	50,747
Fuel surcharge	25,354	17,452	67,549	43,022
Total operating revenues	190,028	170,626	559,056	502,795
OPERATING EXPENSES:				
Purchased transportation	128,973	119,465	380,363	348,960
Compensation	19,052	15,485	55,326	46,502
Fuel, supplies and maintenance	15,064	9,608	38,803	26,049
Depreciation and amortization	3,873	4,107	11,661	12,864
Selling and administrative	4,875	5,451	15,626	16,014
Insurance claims	2,232	6,746	10,160	15,936
Taxes and licenses	1,018	605	2,663	2,233
Communication and utilities	2,012	1,588	6,867	5,652
Loss (gain) on disposal of property and equipment	(697)	280	(920)	333
PPI class action settlement and related expenses		126		1,039
Total operating expenses	176,402	163,461	520,549	475,582
Operating income	13,626	7,165	38,507	27,213
Interest expense	(7,903)	(6,933)	(23,168)	(19,797)
Interest income	260	56	1,370	158
Write-off of debt issuance costs				(1,110)
Other income (expense)	(95)	132	262	122
Income before income taxes	5,888	420	16,971	6,586
Benefit (provision) for income taxes	32,139	(370)	31,070	(902)
Net income	$ 38,027	$ 50	$ 48,041	$ 5,684
PER SHARE DATA:				
Net income per common share				

Basic	$	2.01	$	0.00	$	2.54	$	0.30
Diluted	$	1.94	$	0.00	$	2.46	$	0.29
Weighted average number of shares								
Basic		18,874		18,929		18,910		18,929
Diluted		19,569		19,217		19,548		19,302

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

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

Quality Distribution, Inc. And Subsidiaries

Consolidated Balance Sheets

(In 000 s)

Unaudited

CONSOLIDATED BALANCE SHEETS

For the Years Ended

	September 30, 2006	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,952	$ 1,636
Accounts receivable, net	97,274	101,353
Prepaid expenses	4,828	5,336
Prepaid tires	7,445	7,360
Deferred tax asset, net	16,475	
Other	12,521	5,017
Total current assets	141,495	120,702
Property and equipment, net	115,691	115,199
Assets held-for-sale	829	158
Goodwill	134,386	133,138
Intangibles, net	1,046	1,165
Non-current deferred tax asset, net	14,785	
Other assets	10,953	12,043
Total assets	$ 419,185	$ 382,405
LIABILITIES, MINORITY INTEREST AND SHAREHOLDERS EQUITY (DEFICIT)		
Current liabilities:		
Current maturities of indebtedness	$ 1,400	$ 1,400
Current maturities of capital lease obligations	779	115
Accounts payable	10,881	16,609
Affiliates and independent owner-operators payable	14,962	11,979
Accrued expenses	25,260	22,046
Environmental liabilities	6,425	8,516
Accrued loss and damage claims	7,027	9,598
Total current liabilities	66,734	70,263
Long-term indebtedness, less current maturities	279,915	286,983
Capital lease obligations, less current maturities	1,825	618
Environmental liabilities	5,535	8,643
Accrued loss and damage claims	26,025	25,032
Other non-current liabilities	9,672	10,213
Deferred tax liability		930

Total liabilities	389,706	402,682
Commitments and contingencies - Note 8		
Minority interest in subsidiary	1,833	1,833
SHAREHOLDERS EQUITY (DEFICIT)		
Common stock, no par value; 29,000 shares authorized; 19,150 issued at September 30, 2006 and 19,123 issued at December 31, 2005	360,062	359,772
Treasury stock, 180 and 93 shares at September 30, 2006 and December 31, 2005	(2,409)	(1,042)
Accumulated deficit	(121,006)	(168,710)
Stock recapitalization	(189,589)	(189,589)
Accumulated other comprehensive loss	(19,115)	(19,079)
Stock purchase warrants	43	54
Unearned compensation, restricted stock and stock units		(1,975)
Stock subscriptions receivable	(340)	(1,541)
Total shareholders equity (deficit)	27,646	(22,110)
Total liabilities, minority interest and shareholders equity (deficit)	$ 419,185	$ 382,405

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

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

Consolidated Statements of Shareholders Equity (Deficit)

For the Nine Months Ended September 30, 2006 and 2005

Unaudited (In 000 s)

	Shares of Common Stock	Shares of Treasury Stock	Common Stock	Treasury Stock	Accumulated Deficit	Stock Recapitalization	Accumulated Other Comprehensive Loss	Stock Purchase Warrants	Unearned Compensation Restricted Stock	Stock Subscription Receivables	Total Shareholders Equity (Deficit)
Balance, December 31, 2004	19,113	73	$ 357,777	$ (743)	$ (180,854)	$ (189,589)	$ (18,042)	$ 73	$ (1,077)	$ (1,645)	$ (34,100)
Net income					5,684						5,684
Issuance of restricted stock		(15)	163	226	(226)				(163)		
Issuance of stock units			2,345						(2,345)		
Amortization of restricted stock and stock units									491		491
Amortization of non-employee options			93								93
Forfeiture of restricted stock		47	(704)	(685)	685				704		
Stock warrant exercise											
Payment of stock subscriptions receivable										76	76
Acquisition of treasury stock		1		(28)						28	
Translation adjustment, net of a deferred tax provision of nil							(68)				(68)
Balance, September 30, 2005	19,113	106	$ 359,674	$ (1,230)	$ (174,711)	$ (189,589)	$ (18,110)	$ 73	$ (2,390)	$ (1,541)	$ (27,824)
Balance, December 31, 2005	19,123	93	$ 359,772	$ (1,042)	$ (168,710)	$ (189,589)	$ (19,079)	$ 54	$ (1,975)	$ (1,541)	$ (22,110)
Net income					48,041						48,041
			(1,975)						1,975		

Reclass of unearned compensation restricted stock											
Issuance of restricted stock		(21)		319	(319)						
Forfeiture of restricted stock		1		(18)	18						
Amortization of restricted stock			286								286
Amortization of stock units			1,102								1,102
Amortization of non-employee options			93								93
Amortization of stock options			773								773
Stock warrant exercise	27		11					(11)			
Stock option exercise		(22)		223	(36)						187
Acquisition of treasury stock		129		(1,891)						1,201	(690)
Translation adjustment, net of a deferred tax provision of nil							(36)				(36)
Balance, September 30, 2006	19,150	180	$ 360,062	$ (2,409)	$ (121,006)	$ (189,589)	$ (19,115)	$ 43	$	$ (340)	$ 27,646

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

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(Unaudited In 000 s)

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30,	
	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 48,041	$ 5,684
Adjustments to reconcile to net cash and cash equivalents used in operating activities:		
Depreciation and amortization	11,661	12,864
Bad debt expense (recoveries)	(487)	2,203
Foreign currency transaction (gain) loss		(80)
(Gain) loss on disposal of property and equipment	(920)	333
Interest income on repayment of stock subscription	(690)	
Write-off of deferred financing costs		1,110
Stock based compensation	2,255	584
Amortization of deferred financing costs	1,361	1,386
Amortization of bond discount	182	172
Minority dividends	109	109
Deferred tax asset	(32,190)	
Changes in assets and liabilities:		
Accounts and other receivables	4,566	(2,132)
Notes receivable from affiliates	140	416
Prepaid expenses	508	979
Prepaid tires	(448)	(617)
Other assets	(7,845)	(2,421)
Accounts payable and accrued expenses	(5,892)	(9,645)
Environmental liabilities	(5,199)	(4,733)
Accrued loss and damage claims	(1,578)	399
Affiliates and independent owner-operators payable	2,983	(2,281)
Other liabilities	(540)	829
Current income taxes		(2,484)
Net cash provided by operating activities	16,017	2,675
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(10,692)	(10,441)
Acquisition of businesses and assets	(5,506)	(2,673)
Proceeds from sales of property and equipment	5,466	3,813
Net cash used in investing activities	(10,732)	(9,301)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of long-term debt and capital lease obligations		83,300
Principal payments on long-term debt	(1,050)	(78,550)
Principal payments on capital lease obligations	(111)	
Proceeds from revolver	159,000	103,200

Payments on revolver	(165,200)	(103,000)
Deferred financing costs		(3,162)
Change in book overdraft	3,378	3,594
Minority dividends	(109)	(109)
Other stock transactions	186	76
Net cash provided by (used in) financing activities	(3,906)	5,349
Effect of exchange rate changes on cash	(63)	
Net increase / (decrease) in cash and cash equivalents	1,316	(1,277)
Cash and cash equivalents, beginning of year	1,636	2,700
Cash and cash equivalents, end of period	$ 2,952	$ 1,423
Supplemental disclosures of non-cash flow information:		
Capital lease obligations	$ 1,982	

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

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

Quality Distribution, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Summary of Significant Accounting Policies

Basis of Presentation

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

We are engaged primarily in truckload transportation of bulk chemicals in North America with a significant portion of our business conducted through a network of company terminals, affiliates and independent owner-operators. Affiliates are independent companies, which enter into one-year renewable contracts with us. Affiliates are responsible for paying for their own power equipment (including debt service), fuel and other operating costs. Certain affiliates lease trailers from us. Owner-operators are independent contractors, who, through a contract with us, supply one or more tractors and drivers for our use. Contracts with owner-operators may be terminated by either party on short notice. We charge affiliates and third parties for the use of tractors and trailers as necessary and occasionally sell or lease tractors to them. In exchange for the services rendered, affiliates and owner-operators are normally paid a percentage of the revenues generated for each load hauled.

Our accompanying unaudited condensed, consolidated financial statements 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 our Annual Report on Form 10-K for the year ended December 31, 2005, including the consolidated financial statements and accompanying notes. Certain prior-period amounts have been reclassified to conform to the current year s presentation.

Operating results for the three and nine months ended September 30, 2006, are not necessarily indicative of the results that may be expected for the entire fiscal year.

New Accounting Pronouncements

In May 2005, the Financial Accounting Standards Board (FASB) issued SFAS No. 154, Accounting Changes and Corrections (SFAS No. 154). SFAS No. 154 replaces APB Opinion No. 20, Accounting Changes and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements and changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS No. 154 also provides guidance on the accounting for and reporting of error corrections. The January 2006 adoption of SFAS No. 154 had no material affect on our financial position, results of operations or cashflows.

Prior to the January 1, 2006 adoption of FASB Statement No. 123(R), Share-Based Payment (SFAS 123R), we accounted for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, because the stock option grant price generally equaled the market price on the date of grant, no compensation expense was normally recognized for Company-issued stock options. As permitted by SFAS 123, Accounting for Stock-Based Compensation (SFAS 123), stock-based compensation was included as a pro forma disclosure in the Notes to the Consolidated Financial Statements.

Effective January 1, 2006, we adopted SFAS 123R using the modified prospective transition method and, as a result, did not retroactively adjust results from prior periods. Under this transition method, stock-based compensation was recognized for: 1) expense related to the remaining unvested portion of all stock option awards granted prior to January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123; and 2) expense related to all stock option awards granted on or subsequent to January 1, 2006, based on the grant date

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

fair value estimated in accordance with the provisions of SFAS 123R. We apply the Black-Scholes valuation model in determining the fair value of share-based payments to employees, which is then amortized on a straight-line basis over the requisite service period. See Note 4 of the Notes to Consolidated Financial Statements in this Form 10-Q for further discussion of stock-based compensation.

In May 2006, the FASB issued FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes (FIN 48) which clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. We are in the process of analyzing the January 2007 adoption of FIN 48 in order to determine its effects, if any, on our financial position, results of operations or cashflows.

In September 2006, the FASB issued Statement of Financial Accounting Standard (SFAS) No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of SFAS 157 are effective for the fiscal year beginning January 1, 2008. We are currently evaluating the impact of the provisions of SFAS 157 on our financial position, results of operations or cash flows.

In October 2006, the FASB issued SFAS 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132 (R) (SFAS 158). SFAS 158 changed the accounting rules for reporting and disclosures related to pensions and other postretirement benefit plans. We are currently evaluating the impact of the provisions of SFAS 158 on our financial position, results of operations or cashflows.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108 (SAB 108), Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements, to address diversity in practice in quantifying financial statement misstatements, SAB 108, provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materially assessment. SAB 108 is effective for our year ended December 31, 2006, and allows a one-time transitional cumulative effect adjustment to retained earnings as of January 1, 2006 for errors that were not previously deemed material, but are material under the guidance in SAB 108. We are in the process of determining the effects, if any, that SAB 108 will have on our financial position, results of operations or cashflows.

Acquisition of Business Assets

We acquired the businesses of two transportation companies in the nine months ended September 30, 2006, for approximately $4.1 million. We also purchased the businesses of two affiliates for $1.7 million. Of the $5.8 million aggregate purchase price, we allocated $4.2 million to fixed assets, $1.3 million to goodwill, less than $0.1 million to non-compete arrangements, and expensed $0.2 million for consulting services.

Goodwill and Intangible Assets

Goodwill

Under SFAS 142, Goodwill and Other Intangible Assets, goodwill is subject to an annual impairment test as well as impairment assessments of certain triggering events. SFAS 142 requires us to compare the fair value of the reporting unit to its carrying amount to determine if there is a potential impairment. If the fair value of the reporting unit is less than its carrying amount, an impairment loss is recorded to the extent the carrying amount of the goodwill within the reporting unit is greater than the implied fair value of goodwill.

We selected the second quarter to perform our annual impairment test. Projections for future cash flows were based on our recent operating trends which projected an average growth rate for revenue of approximately 6% over 5 years. EBITDA multiples were derived from other comparable publicly traded companies. The discount rate used to discount cash flows was based on our weighted average cost of capital of approximately 11.5%. No impairment was determined to have occurred as of June 30, 2006, since the calculated fair value exceeded the carrying amount. The factors used in deriving the estimate of the fair value included improving economic conditions, increasing revenues and operating income.

Our goodwill assets as of September 30, 2006 and December 31, 2005 were $134.4 million and $133.1 million, respectively. Goodwill increased $1.3 million due to the purchase of three businesses during the 2006 fiscal year.

QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

Intangible Assets

Net intangible assets consist of a $0.9 million intangible pension plan asset and $0.1 million in total of non-compete agreements with remaining lives of 3 to 5 years, and customer lists and customer contracts acquired from a competitor with lives of 5 years. Accumulated amortization of the remaining non-pension intangible assets was $0.3 million and $0.2 million at September 30, 2006 and December 31, 2005, respectively. The gross amount of intangible assets at September 30, 2006 and December 31, 2005 was $1.3 million and $1.4 million, respectively.

Amortization expense for the non-pension intangible assets for the nine months ended September 30, 2006 and 2005 was approximately $0.1 million in all periods. Amortization expense for the next five years is expected to be less than $0.1 million per year.

2. Comprehensive Income (Loss)

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

	Three months ended September 30, 2006	Three months ended September 30, 2005	Nine months ended September 30, 2006	Nine months ended September 30, 2005
Net income	$ 38,027	$ 50	$ 48,041	$ 5,684
Other comprehensive income (loss):				
Foreign currency translation adjustments	48	(102)	(36)	(68)
Comprehensive income (loss)	$ 38,075	$ (52)	$ 48,005	$ 5,616

3. Earnings Per Share

A reconciliation of the numerators and denominators of the basic and diluted income per share computations follows:

	Three months ended					
	September 30, 2006			September 30, 2005		
(In 000 s except per share amounts)	Net income (numerator)	Shares (denominator)	Per-share amount	Net income (numerator)	Shares (denominator)	Per-share amount
Basic income available to common shareholders:						
Net income	$ 38,027	18,874	$ 2.01	$ 50	18,929	$ .00
Effect of dilutive securities:						
Stock options		243			150	
Unvested restricted stock		65			11	
Stock units		237			49	
Stock warrants		150			78	
Diluted income available to common shareholders:						
Net income	$ 38,027	19,569	$ 1.94	$ 50	19,217	$ .00

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

	Nine months ended					
	September 30, 2006			September 30, 2005		
(In 000 s except per share amounts)	Net income (numerator)	Shares (denominator)	Per-share amount	Net income (numerator)	Shares (denominator)	Per-share amount
Basic income available to common shareholders:						
Net income	$ 48,041	18,910	$ 2.54	$ 5,684	18,929	$ .30
Effect of dilutive securities:						
Stock options		196			167	
Unvested restricted stock		63			13	
Stock units		232			27	
Stock warrants		147			166	
Diluted income available to common shareholders:						
Net income	$ 48,041	19,548	$ 2.46	$ 5,684	19,302	$ .29

The effect of our stock options, restricted stock, stock units and stock warrants, which represent the shares shown in the table above are included in the computation of diluted earnings per share for the three and nine month periods ended September 30, 2006 and 2005.

The following securities were not included in the calculation of diluted EPS because such inclusion would be anti-dilutive:

	Three months ended September 30,		Nine months ended September 30,	
(In thousands)	2006	2005	2006	2005
Stock options	1,186	1,403	1,158	1,358
Unvested restricted stock		24		24

4. Stock-Based Compensation

We maintain performance incentive plans under which stock options, restricted shares, and stock units may be granted to employees and non-employee directors.

Effective January 1, 2006, we adopted SFAS 123R, using the modified prospective transition method, and, as a result, did not retroactively adjust results from prior periods. Under this transition method, stock-based compensation was recognized for: 1) expense related to the remaining unvested portion of all stock option awards granted prior to January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123; and 2) expense related to all stock option awards granted on or subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. We apply the Black-Scholes valuation model in determining the fair value of share-based payments to employees. The resulting compensation expense is recognized over the requisite service period, which is generally the option vesting term of four years. Prior to fiscal 2006, stock-based compensation was included as a pro forma disclosure in the Notes to the Consolidated Financial Statements as permitted by SFAS 123.

Compensation expense is recognized only for those options expected to vest, with forfeitures estimated based on our historical experience and future expectations. Prior to the adoption of SFAS 123R, the effect of forfeitures on the pro forma expense amounts was recognized as the forfeitures occurred.

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

As a result of adopting SFAS 123R, the impact to the Consolidated Statement of Operations for the three and nine months ended September 30, 2006 is as follows:

(In thousands except per share data)	Three months ended September 30, 2006	Nine months ended September 30, 2006
Income before income taxes	$ 276	$ 773
Net income	$ 276	$ 773
Earnings per share		
Basic	$ 0.01	$ 0.04
Diluted	$ 0.01	$ 0.04

In addition, prior to the adoption of SFAS 123R, we presented the tax benefit resulting from the exercise of stock options as operating cash inflows in the Consolidated Statements of Cash Flows. Under SFAS 123R, any excess tax benefits for those options will be classified as financing cash inflows and operating cash outflows.

The table below reflects net income and basic and diluted net income per share for the three and nine months ended September 30, 2005, had we applied the fair value recognition provisions of SFAS 123R (in thousands, except per share data):

	Three months ended September 30, 2005	Nine months ended September 30, 2005
Net income	$ 50	$ 5,684
Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects of nil for all periods	(500)	(1,401)
Restricted stock compensation expense and stock option expense included in net income attributable to common shareholders as reported	477	584
Pro forma net income	$ 27	$ 4,867
Income per common share:		
As reported basic	$ .00	$ .30
Pro forma basic	.00	.26
As reported diluted	.00	.29
Pro forma diluted	.00	.25

Pro forma disclosure for the three and nine months ended September 30, 2006 is not presented because the amounts are recognized in the consolidated financial statements.

The pro forma fair value of options granted during the first nine months of 2006 and 2005 was based upon the Black-Scholes option-pricing model. The expected term of the options represents the estimated period of time until exercise giving consideration to the contractual terms, vesting schedules and expectations of future employee behavior. For fiscal 2006, expected stock price volatility is based on the historical volatility of our common stock, which began trading on November 13, 2003. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant with an equivalent remaining term. The Company has not paid dividends in the past and does not currently plan to pay any dividends in the foreseeable future. The Black-Scholes model was used with the following assumptions:

	2006	**2005**
Risk free rate	4.5%	3.8%
Expected life	4 years	5 years
Volatility	71.2%	60.0%
Expected dividend	nil	nil

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As of September 30, 2006, we have three stock-based compensation plans. There is also an agreement to issue stock units which applies solely to Mr. Gerald L. Detter, our Chief Executive Officer. During the nine months ended September 30, 2006, we recognized compensation expense of approximately $866,000 for all options, approximately $286,000 for all restricted stock and approximately $1,102,000 for all stock units. During the nine months ended September 30, 2005, we recognized compensation expense of approximately $93,000 for all options, approximately $48,000 for all restricted stock due and approximately $491,000 for all stock units. All stock-based compensation expense is classified within Compensation on the Consolidated Statement of Operations. None of the stock-based compensation was capitalized during 2006.

There were no modifications to stock option awards during 2006. The remaining unrecognized compensation cost related to unvested option awards at September 30, 2006 is $2.7 million and the weighted-average period of time over which this cost will be recognized is 3.1 years. This amount does not include the cost of any additional options that may be granted in future periods nor any changes in the Company s forfeiture rate. We had options exercised in the first nine months of 2006 representing 22,000 shares.

Due to the issuance of stock options representing 200,000 shares to an executive who joined us in November 2004, we recognized approximately $93,000 of compensation expense for the nine months ended September 30, 2006 and will recognize approximately $156,000 of compensation expense over the next 15 months.

We issued options for 417,500 shares to various employees with an exercise price of $7.94 on January 3, 2006. The total compensation expense that will be recognized over four years for these options is approximately $1.9 million. We issued options for 60,000 shares to four directors with an exercise price of $15.36 on May 17, 2006. The total compensation expense that will be recognized over four years for these options is approximately $0.5 million. We also issued 18,890 shares of restricted stock in January 2006 to certain directors as part of their annual compensation package. We will recognize approximately $150,000 as compensation expense over four years for these restricted shares.

2003 Stock Option Plan

The 2003 Stock Option Plan was adopted on November 5, 2003 in connection with our IPO and expires 10 years after adoption. It was amended on May 13, 2005. It provides for the grant of nonqualified stock options that become exercisable, with limited exceptions, in 25% increments on each of the first four anniversaries of the date upon which the options are granted. The number of shares available for issuance under this plan automatically increases on January 1 of each year commencing with January 1, 2004 unless otherwise determined by the Board of Directors. The current year increase is 2.5% of the outstanding shares as of December 31 of the prior year. No more than 6,500,000 shares of common stock may be issued under the 2003 Stock Option Plan.

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Stock option activity for the 2003 Stock Option Plan for the nine months ended September 30, 2006 is as follows (shares in thousands):

	Shares Available for Grant	Outstanding Options Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value(in thousands) (a)
December 31, 2005	733	2,143	$ 12.23		
2006 option activity:					
Additional shares reserved	475				
Granted	(477)	477	8.87		
Exercised		(22)	8.49		
Canceled	34	(34)	11.65		
September 30, 2006	765	2,564	11.65	7.87	$ 10,333
September 30, 2006 - exercisable		1,545	14.18	7.27	3,239

(a) The intrinsic value of a stock option is the amount by which the market value of the underlying stock as of September 30, 2006, exceeds the exercise price of the option.

As of September 30, 2006, total unrecognized stock-based compensation expense for the 2003 Stock Option Plan related to nonvested stock options was approximately $2.7 million, which is expected to be recognized over a weighted average period of approximately 3.1 years.

1998 Stock Option Plan

Until adoption of the 2003 Stock Option Plan, we administered the 1998 Stock Option Plan pursuant to which a total of 377,400 shares of our common stock were available for grant. The maximum term of granted options is ten years. Fifty percent of each new option granted vested in equal increments over four years. The remaining fifty percent of each new option will vest in nine years from grant date, subject to acceleration if certain per-share equity value targets are achieved or in the event of a sale of the Company. Vesting of the new options occurs only during an employee s term of employment. The new options will become fully vested in the event of a termination of employment without cause or for good reason within nine months following a sale of the Company.

Stock option activity for the 1998 Stock Option Plan for the nine months ended September 30, 2006 is as follows (in thousands, except per share data):

	Shares Available for Grant	Outstanding Options Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands) (a)

December 31, 2005	306	71	$ 23.53	
2006 option activity:				
Granted				
Canceled	2	(2)		
September 30, 2006	308	69	23.53	2.1
September 30, 2006 - exercisable		35	23.53	2.1

(a) The intrinsic value of a stock option is the amount by which the market value of the underlying stock, as of September 30, 2006, exceeds the exercise price of the option.

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As of September 30, 2006, there was no unrecognized stock-based compensation expense for the 1998 Stock Option Plan related to nonvested stock options.

2003 Restricted Stock Incentive Plan

On November 5, 2003, our Board of Directors approved the 2003 Restricted Stock Incentive Plan, which terminates ten years from the approval date. The 2003 Restricted Stock Incentive Plan was amended on May 13, 2005. The restricted stock issuances to persons initially receiving a grant generally vest by December 31, 2008. The vesting periods for other grant recipients are at the discretion of the Compensation Committee of the Board of Directors. In subsequent years, participants in the plan may be granted an annual, aggregate amount of up to $1 million of shares, valued at our common stock closing price at the date of grant, at the direction of the Board of Directors. No more than 700,000 shares of common stock may be issued under this plan nor more than $7.5 million of stock may be issued under this plan.

In the first nine months of fiscal year 2006, we vested 3,872 shares of restricted stock with a fair value of $54,000, canceled 3,301 shares due to employee terminations and granted 18,890 shares of restricted stock for which we expect to recognize $150,000 of total compensation expense over four years. Compensation expense for the first nine months related to the issuance of restricted shares was $286,000 in 2006 and $48,000 in 2005.

As of September 30, 2006, total unrecognized stock-based compensation expense for the 2003 Restricted Incentive Stock Plan was approximately $210,000, which is expected to be recognized over a weighted average period of approximately 2.9 years. We recognize compensation for restricted stock based on Financial Interpretation Number 28.

Stock Unit Grant Agreement

In 2005 in connection with his employment agreement, our Chief Executive Officer, Mr. Detter, was granted 300,000 stock units. Mr. Detter is also entitled to $50,000 in value of stock units annually with the first annual grant made upon execution of his employment agreement and subsequent grants on each anniversary. Under the Stock Unit Grant Agreement, the 300,000 unit grant (Initial Grant) vests on December 31, 2006 if Mr. Detter is still an employee on that date. Mr. Detter was awarded 3,858 stock units worth $50,000 in June 2006 as part of his annual grant.

Annual grants are determined by dividing $50,000 by the fair market value of the common stock on the date of grant. Stock units subject to each annual award vest (i) 14.2% on December 31 of the year in which such Annual Award is granted; and (ii) 28.6% on December 31 of each successive year.

The stock units are credited to an unfunded account and dividends, if any, paid on Company stock are paid on stock units in additional stock units rather than in cash. Stock units credited will be paid out in a single lump sum in an equivalent whole number of shares of common stock. We have discretion to pay stock units attributable to dividend equivalents in cash. Fractional share interests shall be disregarded, but may be cumulated, or, in our discretion, paid in cash. The Initial Grant will be distributed upon the first to occur of: (1) December 31, 2008, (2) termination of employment, (3) disability or (4) a change in control event. Annual awards shall be distributed upon the first to occur of: (1) termination of employment, (2) disability or (3) a change in control event.

As of September 30, 2006, total unrecognized stock-based compensation expense for the Stock Unit Grant Agreement was approximately $0.4 million, which is expected to be recognized over a weighted average period of approximately 0.7 years. We recognize compensation for the Stock Unit Grant Agreement on a straight-line basis.

5. Employee Benefit Plans

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

We use a December 31st measurement date for both of our plans.

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

We have contributed $2.0 million to our pension plans during the nine months ended September 30, 2006, and expect to contribute $1.5 million during the remainder of 2006.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
Service cost	$ 64	$ 67	$ 192	$ 203
Interest cost	675	669	2,025	2,008
Amortization of prior service cost	24	23	70	70
Amortization of loss	148	257	445	769
Expected return on plan assets	(769)	(704)	(2,306)	(2,113)
Net periodic pension cost	142	312	426	937

6. Geographic Segments

Our operations are located primarily in the United States, Canada and Mexico. Inter-area sales are not significant to the total revenue of any geographic area. Information about our operations in different geographic areas for the three and nine months ended September 30, 2006 and 2005 is as follows (in thousands):

	Three Months Ended September 30, 2006		
	U. S.	**International**	**Consolidated**
Total operating revenues	$ 180,545	$ 9,483	$ 190,028
Operating income	11,833	1,793	13,626

	Three Months Ended September 30, 2005		
	U. S.	**International**	**Consolidated**
Total operating revenues	$ 158,242	$ 12,384	$ 170,626
Operating income	5,310	1,855	7,165

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

	Nine Months Ended September 30, 2006		
	U. S.	International	Consolidated
Total operating revenues	$ 524,914	$ 34,142	$ 559,056
Operating income	32,977	5,530	38,507
	As of September 30, 2006		
Identifiable assets	408,811	10,374	419,185

	Nine Months Ended September 30, 2005		
	U. S.	International	Consolidated
Total operating revenues	$ 465,920	$ 36,875	$ 502,795
Operating income	21,838	5,375	27,213
	As of December 31, 2005		
Identifiable assets	371,670	10,735	382,405

7. Deferred Income Taxes

During the third quarter of fiscal 2006, we released approximately $39.1 million of our $46.7 million deferred tax valuation allowance, due to improved operating results and the determination that it is more likely than not that expected future taxable income will be sufficient to utilize certain of our deferred tax assets. We will evaluate the remaining $7.6 million of the deferred tax valuation allowance during our fourth quarter and if it is determined that it is more likely than not that the remaining deferred tax assets will be realized, we will release the remaining deferred tax valuation allowance. To the extent that estimates of future taxable income decrease or do not materialize, potentially significant additional valuation allowances may be required.

8. Commitments and Contingencies

Environmental Matters

It is our policy and the policy of each of our subsidiaries to be in compliance with all applicable environmental, safety, and health laws. We also are committed to the principles of Responsible Care®, an international chemical industry initiative to enhance the industry s responsible management of chemicals.

Our activities involve the handling, transportation and storage of bulk chemicals, both liquid and dry, many of which are classified as hazardous materials or hazardous substances. Our tank wash and terminal operations engage in the creation, storage or discharge and proper disposal of wastewater that may contain hazardous substances, and the control and discharge of storm-water from industrial sites. In addition, we may store diesel fuel and other petroleum products at our terminals. As such, we and others who operate in our industry or own and operate real property, are subject to environmental, health and safety laws and regulation by U.S. federal, state and local agencies as well as foreign governmental authorities. Environmental laws and regulations are complex, and address emissions to the air, discharge onto land or water, and the generation, handling, storage, transportation, treatment and disposal of waste materials. These laws change frequently and generally require us to obtain and maintain various licenses and permits. Environmental laws have tended to become more stringent over time, and most provide for substantial fines and potential criminal sanctions for violations. Some of these laws and regulations are subject to varying and conflicting interpretations.

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

Facility managers are responsible for environmental compliance at each operating location. Audits conducted by our staff assess operations, safety training and procedures, equipment and grounds maintenance, emergency response capabilities and waste management. We may also, if circumstances warrant, contract with independent environmental consulting firms to conduct periodic, unscheduled, compliance assessments that focus on unsafe conditions with the potential to result in releases of hazardous substances or petroleum, and that also include screening for evidence of past spills or releases. Our staff includes environmental professionals who develop guidelines and procedures, including periodic audits of our terminals, tank cleaning facilities, and certain historical operations.

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), the Resource Conservation and Recovery Act of 1976 (RCRA), the Superfund Amendments and Reauthorization Act of 1986, and comparable state and foreign laws. Under certain of these laws, we could also be subject to allegations of liability for the activities of our affiliates or owner-operators. From time to time, we have incurred remedial costs and regulatory penalties with respect to chemical or wastewater spills and releases at our facilities and on the road, and, notwithstanding the existence of our environmental management program, we cannot assure that such obligations will not be incurred in the future, nor predict with certainty the extent of future liabilities and costs under environmental, health, and safety laws, nor that such liabilities will not result in a material adverse effect on our financial condition, results of operations or business reputation.

In addition, we may face liability for alleged personal injury or property damage due to exposure to chemicals and other hazardous substances at our facilities or as the result of accidents and spills. Although these types of claims have not historically had a material impact on our operations, a significant increase in these claims could have a material adverse effect on our business, financial condition, operating results or cash flow.

As the result of environmental studies conducted at our facilities or third party sites in conjunction with our environmental management program, we have identified environmental contamination at certain sites that will require remediation.

Reserves

Our policy is to accrue remediation expenses when it is probable that such efforts will be required and the related expenses can be reasonably estimated. Estimates of costs for future environmental compliance and remediation are necessarily imprecise due to such factors as the continuing evolution of environmental laws and regulatory requirements, the availability and application of technology, the identification of currently unknown remediation sites and the allocation of costs among the potentially responsible parties under applicable statutes. We have estimated future expenditures to be in the range of $11.4 million to $21.6 million. As of September 30, 2006 and December 31, 2005, we had reserves in the amount of $12.0 million and $17.2 million, respectively, for all environmental matters discussed below.

The activity in the environmental liability reserves is as follows at September 30, 2006 (in thousands):

	2006
Reserve at beginning of year	$ 17,159
Payments	(5,846)
Additions	647
Reserve at end of period	$ 11,960

We increased our environmental reserves by $0.6 million mainly due to developments at our Bridgeport, New Jersey and William Dick, Pennsylvania site partially offset by decreases at certain other minor sites. The balances presented include both long term and current environmental reserves. We expect these environmental obligations to be paid over the next five years. Additions to the environmental liability reserves are classified on the Consolidated Statements of Operations within the Selling and administrative category.

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

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 Chemical Leaman Corporation (CLC) prior to our acquisition of and merger with CLC in 1998. The two most significant Superfund sites are:

Bridgeport, New Jersey

QDI is required under the terms of two federal consent decrees to perform remediation at this operating truck terminal and tank wash site. CLC entered into consent orders with USEPA in May 1991 for the treatment of groundwater (operable unit one or OU1) and October 1998 for the removal of contamination in the wetlands (OU3). In addition, we were required to assess the removal of contaminated soils (OU2).

In connection with OU1, USEPA originally required us to construct a large treatment plant with discharge via a two mile pipeline to the Delaware River watershed with construction to be completed by the end of 2001. We have negotiated an alternative remedy with USEPA which would call for a significantly smaller treatment facility, in place treatment of groundwater contamination via in-situ treatment and a local discharge. The treatment facility has been approved and construction is anticipated to be completed by January, 2007. USEPA has also approved an OU3 remedy for approximately 2.5 acres of affected wetland. This reflects a reduction from an approximate seven acre area that had been under negotiation. Site mobilization for the OU3 work took place in late May 2004 but was delayed due to weather-related issues. Field work was re-started in May 2005 and remediation work is on-going. Additional contamination has been identified since December 31, 2005. In regard to OU2, USEPA is now in the process of finalizing a Feasibility Study for the limited areas that show contamination and warrant additional investigation or work. USEPA also wants to include in OU2 the in-situ treatment previously described as part of OU1. The environmental projections for OU1 and OU2 have been changed to reflect the reallocation of the in-situ costs to OU2 and the proposed contract amount for the OU1 work. We have estimated expenditures to be in the range of $5.2 million to $9.6 million.

William Dick, Pennsylvania

CLC entered into a consent order with the Pennsylvania DEP (PADEP) and USEPA in October 1995 obligating it to provide a replacement water supply to area residents (OU1), treat contaminated groundwater (OU2), and perform remediation of contaminated soils (OU3) at this former wastewater disposal site. OU1 is complete. PADEP and USEPA had previously been unable to agree on the final interim remedy design for OU2; specifically, the discharge location for the treated groundwater. We have projected an interim remedy, which involves the construction of a treatment facility and discharge locally. A preliminary engineering design, which includes a discharge to a local tributary, was submitted in August 2004 to USEPA and PADEP for their review and comment. Agency comments have been received and a final design has been submitted to the agency and is pending final approval. Based on recent data showing reduction in site groundwater contamination due to natural attenuation and the more extensive handling and removal of contaminated soils, we believe that the groundwater project can be completed over the five-year term of this interim remedy. The agencies have approved an OU3 remedy, which requires both thermal treatment of contaminated soils and treatment of residuals via soil vapor extraction (SVE). The OU3 remedy expanded in April 2004 to off-site shipment of contaminated soils because these soils were found to be incompatible with the thermal treatment unit, which started full-scale operation in May 2004. We determined in June 2004 that we would incur increased expense due to the off-site additional contaminated soil that was found to be incompatible with the thermal treatment unit, the increased volume of soil subject to thermal treatment based on an increase in the lateral extent of contamination, and the discovery of buried drums and associated contaminated material and soils, which required off-site disposal. In the third quarter of 2004, we determined that a latex liner waste material was present in the third pond, which needed to be excavated and removed for disposal offsite. This work was completed in early 2005. We also determined that the soils in pond three needed to be excavated to determine if they will be suitable for the originally planned SVE treatment. We excavated the pond s soils into three discrete piles and determined the best approach to treat these soil piles. It was determined that most of the soil piles could be treated on site using SVE as originally planned. However, some modifications to the design had to be made in order to treat a limited number of soil piles. The SVE work began in 2006 and is on-going. We have estimated expenditures to be in the range of $2.1 million to $3.4 million.

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Other Owned Property

Scary Creek, West Virginia: CLC received a clean up notice from the State authority in August 1994 requiring remediation of contaminated soils and groundwater at this former wastewater disposal facility. However, the State and we have agreed that remediation can be conducted under the State s voluntary clean-up program (instead of the state superfund enforcement program). We are currently completing the originally planned remedial investigation, but it appears that additional site investigation work will be required to completely delineate the extent of site contamination. Upon completion of the site investigation phase, a remedial feasibility study and design will be prepared to address contaminated soils, and, if applicable, groundwater. The expectation is that a remedy utilizing primarily in-situ treatment with limited soil removal will be conducted.

Tonawanda, New York: CLC entered into a consent order with the New York Department of Environmental Conservation on June 22, 1999 obligating it to perform soil and groundwater remediation at this former truck terminal and tank wash site. We have completed a remedial investigation and a feasibility study with the expectation that we will conduct a remedy that may include in-situ treatment, limited soil removal and monitored natural attenuation of the groundwater.

Charleston, West Virginia: CLC completed a remediation of a former drum disposal area in 1995 at its active truck terminal and tank wash site under the terms of a State hazardous waste permit. The State has required supplemental groundwater monitoring in connection with the same permit. We have completed this work and believe that no additional remediation will be required.

East Rutherford, New Jersey: CLC entered into a Memorandum of Agreement with the State of New Jersey on June 11, 1996 obligating it to perform a Remedial Investigation and Remedial Action with respect to a subsurface loss of an estimated 7,000 gallons of fuel oil at this active truck terminal and tank wash site. We have completed the recovery of free product and conducted groundwater monitoring and are awaiting final approval of a plan to terminate further remedial action with some limited contamination left in place.

ISRA New Jersey Facilities: We are obliged to conduct investigations and remediation at three current or former New Jersey tank wash and terminal sites pursuant to the state s Industrial Sites Remediation Act, which requires such remediation following the sale of facilities after 1983. The former owner has agreed to take responsibility for one of the sites and the other two are in the process of remedial investigation with projections set in contemplation of limited soil remediation expense for contaminated areas.

We have estimated expenditures for these other owned properties to be in the range of $2.8 million to $4.8 million.

Other Environmental Matters

We have been named as a potentially responsible party (PRP) under CERCLA and similar state laws at 18 other multi-party sites.

We and our predecessors have been named in three civil actions seeking contribution for remediation at offsite treatment, storage and disposal facilities (TSDs) or privately owned properties. We have also received notices of potential liability at fifteen other TSDs and are negotiating with Federal, State and private parties on the scope of our obligations (if any) in connection with remedies at these sites. In addition, there are eight sites with respect to which we received information requests but have denied liability and there has been no demand for payment (considered inactive). Our financial projection is established with respect to those sites where a financial demand is made or an allocation of financial liability is reasonably ascertainable.

We were notified in August, 2004 of potential liabilities involving the Lower Passaic River Study Area in New Jersey and the Malone Superfund Site in Texas. We will be participating in the initial studies of these two sites to determine site remediation objectives, goals and technologies. Since the overall liability cannot be estimated at this time, we have set reserves for only the initial remedial investigation phase at the two sites.

We were also notified in August, 2004 of our potential liability for remedial measures to be undertaken by the EPA at the Mobile Tank Wash Facility Superfund Site in Mobile, Alabama. Liability cannot be estimated at this time. We have asserted claims against the site owner (currently in bankruptcy) and the owner s insurers.

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

We have estimated expenditures for these other environmental matters to be in the range of $1.3 million to $3.8 million.

Legal Matters

Other than reported in this Note and in the Item 3 - Legal Proceedings of our Annual Report on Form 10-K for the year ended December 31, 2005 and in Note 19. Commitments and Contingencies to our audited consolidated financial statements contained in such Form 10-K, we are from time to time involved in litigation incidental to the conduct of our business. We believe that no such routine litigation currently pending against us, if adversely determined, would have a material adverse effect on our consolidated financial position, results of operations or cash flows.

9. Guarantor Subsidiaries

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

QD LLC conducts substantially all of its business through and derives virtually all of its income from its subsidiaries. Therefore, its ability to make required principal and interest payments with respect to its indebtedness depends on the earnings of subsidiaries and its ability to receive funds from its subsidiaries through dividend and other payments. The subsidiary guarantors are wholly owned subsidiaries of QD LLC and have fully and unconditionally guaranteed the 9% Senior Subordinated Notes and the Senior Floating Interest Rate Subordinated Term Notes on a joint and several basis.

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

Condensed consolidating balance sheets at September 30, 2006 and December 31, 2005 and condensed consolidating statements of operations for each of the three and nine month periods ended September 30, 2006 and September 30, 2005 and the consolidating statements and cash flows for each of the nine month periods ended September 30, 2006 and September 30, 2005.

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

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

Consolidating Statements of Operations

Three Months Ended September 30, 2006

Unaudited - (In 000 s)

	QDI	QD LLC and QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Operating revenues:						
Transportation	$	$	$ 149,150	$	$	$ 149,150
Other service revenue			15,267	257		15,524
Fuel surcharge			25,354			25,354
Total operating revenues			189,771	257		190,028
Operating expenses:						
Purchased transportation			128,973			128,973
Compensation			19,052			19,052
Fuel, supplies and maintenance			15,064			15,064
Depreciation and amortization			3,708	165		3,873
Selling and administrative			4,847	28		4,875
Insurance claims			2,232			2,232
Taxes and Licenses			1,016	2		1,018
Communication and utilities			2,012			2,012
(Gain)/loss on disposal of property and equipment			(697)			(697)
PPI class action settlement and related expenses						
Operating income			13,564	62		13,626
Interest expense		(7,760)	(477)		334	(7,903)
Interest income	5		464	125	(334)	260
Write-off of debt issuance costs						
Other income (expense)			(56)	(39)		(95)
Income (loss) before taxes	5	(7,760)	13,495	148		5,888
Income tax (provision) benefit	(16)	(1,400)	33,564	(9)		32,139
Equity in earnings (loss) of subsidiaries	38,038	47,198			(85,236)	
Net income (loss)	$ 38,027	$ 38,038	$ 47,059	$ 139	$ (85,236)	$ 38,027

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

Consolidating Statements of Operations

Three Months Ended September 30, 2005

Unaudited - (In 000 s)

	QDI	QD LLC and QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Operating revenues:						
Transportation	$	$	$ 136,123	$ 61	$	$ 136,184
Other service revenue			16,748	242		16,990
Fuel surcharge			17,442	10		17,452
Total operating revenues			170,313	313		170,626
Operating expenses:						
Purchased transportation			119,459	6		119,465
Compensation			15,456	29		15,485
Fuel, supplies and maintenance			9,577	31		9,608
Depreciation and amortization			3,988	119		4,107
Selling and administrative			5,407	44		5,451
Insurance claims			6,746			6,746
Taxes and Licenses			585	20		605
Communication and utilities			1,588			1,588
(Gain)/loss on disposal of property and equipment			236	44		280
PPI class action settlement and related expenses			126			126
Operating income (loss)			7,145	20		7,165
Interest expense		(6,623)	(394)	(1)	85	(6,933)
Interest income			55	86	(85)	56
Write-off of debt issuance costs						
Other income (expense)	(2)		(76)	210		132
Income (loss) before taxes	(2)	(6,623)	6,730	315		420
Income tax (provision) benefit		1,299	(1,630)	(39)		(370)
Equity in earnings (loss) of subsidiaries	52	5,376			(5,428)	
Net income (loss)	$ 50	$ 52	$ 5,100	$ 276	$ (5,428)	$ 50

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

Consolidating Statements of Operations

Nine Months Ended September 30, 2006

Unaudited - (In 000 s)

	QDI	QD LLC and QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Operating revenues:						
Transportation	$	$	$ 440,779	$	$	$ 440,779
Other service revenue			49,933	795		50,728
Fuel surcharge			67,549			67,549
Total operating revenues			558,261	795		559,056
Operating expenses:						
Purchased transportation			380,363			380,363
Compensation			55,326			55,326
Fuel, supplies and maintenance			38,786	17		38,803
Depreciation and amortization			11,168	493		11,661
Selling and administrative			15,424	202		15,626
Insurance claims			10,160			10,160
Taxes and Licenses			2,660	3		2,663
Communication and utilities			6,867			6,867
(Gain)/loss on disposal of property and equipment			(920)			(920)
PPI class action settlement and related expenses						
Operating income			38,427	80		38,507
Interest expense		(22,841)	(661)		334	(23,168)
Interest income	744		588	372	(334)	1,370
Write-off of debt issuance costs						
Other income (expense)			214	48		262
Income (loss) before taxes	744	(22,841)	38,568	500		16,971
Income tax (provision) benefit	(16)		31,157	(71)		31,070
Equity in earnings (loss) of subsidiaries	47,313	70,154			(117,467)	
Net income (loss)	$ 48,041	$ 47,313	$ 69,725	$ 429	$ (117,467)	$ 48,041

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

Consolidating Statements of Operations

Nine Months Ended September 30, 2005

Unaudited - (In 000 s)

	QDI	QD LLC and QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Operating revenues:						
Transportation	$	$	$ 408,168	$ 858	$	$ 409,026
Other service revenue			50,068	679		50,747
Fuel surcharge			42,904	118		43,022
Total operating revenues			501,140	1,655		502,795
Operating expenses:						
Purchased transportation			348,889	71		348,960
Compensation			46,143	359		46,502
Fuel, supplies and maintenance			25,537	512		26,049
Depreciation and amortization			12,407	457		12,864
Selling and administrative			15,900	114		16,014
Insurance claims			15,936			15,936
Taxes and Licenses			2,189	44		2,233
Communication and utilities			5,641	11		5,652
(Gain)/loss on disposal of property and equipment			289	44		333
PPI class action settlement and related expenses			1,039			1,039
Operating income			27,170	43		27,213
Interest expense		(19,699)	(438)	(8)	348	(19,797)
Interest income	7		150	349	(348)	158
Write-off of debt issuance costs		(1,110)				(1,110)
Other income (expense)	(2)		(73)	197		122
Income (loss) before taxes	5	(20,809)	26,809	581		6,586
Income tax (provision) benefit		2,422	(3,049)	(275)		(902)
Equity in earnings (loss) of subsidiaries	5,679	24,066			(29,745)	
Net income (loss)	$ 5,684	$ 5,679	$ 23,760	$ 306	$ (29,745)	$ 5,684

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

Consolidating Balance Sheet

As of Ended September 30, 2006

Unaudited (In 000 s)

	QDI	QD LLC & QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS						
Current assets:						
Cash and cash equivalents	$	$	$ 1,410	$ 1,542	$	$ 2,952
Accounts receivable, net	53		97,045	176		97,274
Prepaid expenses		9	4,819			4,828
Prepaid tires			7,403	42		7,445
Deferred tax asset, net			16,475			16,475
Other	(15)		12,846	(310)		12,521
Total current assets	38	9	139,998	1,450		141,495
Property and equipment, net			114,460	1,231		115,691
Assets held-for-sale			829			829
Goodwill			134,386			134,386
Intangibles, net			1,046			1,046
Investment in subsidiaries	25,168	580,068			(605,236)	
Non-current deferred tax asset, net			15,532	(747)		14,785
Other assets		7,112	3,841			10,953
Total assets	$ 25,206	$ 587,189	$ 410,092	$ 1,934	$ (605,236)	$ 419,185
LIABILITIES, MINORITY INTEREST, SHAREHOLDERS' EQUITY (DEFICIT)						
Current liabilities:						
Current maturities of indebtedness	$	$ 1,400	$	$	$	$ 1,400
Current maturities of capital leases			779			779
Accounts payable			10,877	4		10,881
Intercompany	(2,449)	274,188	(268,102)	(3,637)		
Affiliates and independent owner-operators payable			14,962			14,962
Accrued expenses	9	6,518	18,706	27		25,260
Environmental liabilities			6,425			6,425
Accrued loss and damage claims			7,027			7,027
Income taxes payable						
Total current liabilities	(2,440)	282,106	(209,326)	(3,606)		66,734
Long-term indebtedness, less current maturities		279,915				279,915
Long-term capital leases, less current maturities			1,825			1,825
Environmental liabilities			5,535			5,535
Accrued loss and damage claims			26,025			26,025
Other non-current liabilities			9,672			9,672
Deferred tax liability						

Total liabilities	(2,440)	562,021	(166,269)	(3,606)		389,706
Minority interest in subsidiary			1,833			1,833
Shareholders' equity (deficit):						
Common stock	360,062	354,963	437,796	7,629	(800,388)	360,062
Treasury stock	(2,409)					(2,409)
(Accumulated deficit)/retained earnings	(121,006)	(121,091)	155,594	(1,780)	(32,723)	(121,006)
Stock recapitalization	(189,589)	(189,589)		(55)	189,644	(189,589)
Accumulated other comprehensive loss	(19,115)	(19,115)	(18,862)	(254)	38,231	(19,115)
Stock purchase warrants	43					43
Unearned compensation, restricted stock and stock units						
Stock subscription receivable	(340)					(340)
Total shareholders' equity (deficit)	27,646	25,168	574,528	5,540	(605,236)	27,646
Total liabilities, minority interest and shareholders' equity (deficit)	$ 25,206	$ 587,189	$ 410,092	$ 1,934	$ (605,236)	$ 419,185

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

Consolidating Balance Sheet

December 31, 2005

Unaudited - (In 000 s)

	QDI	QD LLC & QD Capital	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS						
Current assets:						
Cash and cash equivalents	$	$	$ 607	$ 1,029	$	