QUALITY DISTRIBUTION INC
Form 10-Q
August 08, 2011
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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 June 30, 2011

or

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

For the transition period from to

Commission File Number: 000-24180

Quality Distribution, Inc.

(Exact name of registrant as specified in its charter)

Florida	**59-3239073**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
4041 Park Oaks Boulevard, Suite 200, Tampa, FL	**33610**
(Address of Principal Executive Offices)	**(Zip Code)**

813-630-5826

(Registrant s telephone number, including area code)

N/A

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	x

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

As of August 3, 2011, the registrant had 23,825,146 shares of Common Stock, no par value, outstanding.

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QUALITY DISTRIBUTION, INC.

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

PART I FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

Consolidated Statements of Operations

(Unaudited - in 000 s, Except Per Share Amounts)

	Three months ended June 30, 2011	Three months ended June 30, 2010	Six months ended June 30, 2011	Six months ended June 30, 2010
OPERATING REVENUES:				
Transportation	$ 129,397	$ 129,473	$ 254,078	$ 248,390
Service revenue	27,642	26,473	54,380	51,379
Fuel surcharge	32,954	21,606	59,445	39,116
Total operating revenues	189,993	177,552	367,903	338,885
OPERATING EXPENSES:				
Purchased transportation	133,692	121,670	258,414	231,495
Compensation	15,515	14,980	30,398	28,872
Fuel, supplies and maintenance	11,665	13,455	23,442	26,822
Depreciation and amortization	3,378	4,067	6,870	8,310
Selling and administrative	4,886	4,449	10,035	9,227
Insurance costs	3,540	4,540	8,225	7,877
Taxes and licenses	652	674	1,099	1,270
Communication and utilities	657	1,192	1,459	2,238
(Gain) loss on disposal of property and equipment	(410)	234	(650)	652
Restructuring (credit) costs	(521)	1,068	(521)	2,215
Total operating expenses	173,054	166,329	338,771	318,978
Operating income	16,939	11,223	29,132	19,907
Interest expense	7,311	8,640	15,122	17,307
Interest income	(178)	(156)	(317)	(317)
Write-off of debt issuance costs			1,786	
Other expense (income)	29	220	(7)	226
Income before income taxes	9,777	2,519	12,548	2,691
Provision for (benefit from) income taxes	731	463	780	(163)
Net income	$ 9,046	$ 2,056	$ 11,768	$ 2,854
PER SHARE DATA:				
Net income per common share				
Basic	$ 0.39	$ 0.10	$ 0.52	$ 0.14
Diluted	$ 0.37	$ 0.09	$ 0.49	$ 0.13

Weighted-average number of shares				
Basic	23,253	20,256	22,723	19,880
Diluted	24,581	21,748	24,024	21,585

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

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QUALITY DISTRIBUTION, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(In 000 s)

	Unaudited June 30, 2011	Audited December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,643	$ 1,753
Accounts receivable, net	95,202	80,895
Prepaid expenses	5,503	6,911
Deferred tax asset	4,503	3,848
Other	4,684	4,891
Total current assets	111,535	98,298
Property and equipment, net	111,229	113,419
Goodwill	27,023	27,023
Intangibles, net	16,231	16,924
Other assets	13,348	15,671
Total assets	$ 279,366	$ 271,335
LIABILITIES, REDEEMABLE NONCONTROLLING INTEREST AND SHAREHOLDERS DEFICIT		
Current liabilities:		
Current maturities of indebtedness	$ 2,631	$ 3,991
Current maturities of capital lease obligations	5,246	4,572
Accounts payable	7,754	7,200
Independent affiliates and independent owner-operators payable	14,449	11,059
Accrued expenses	21,063	24,363
Environmental liabilities	3,208	3,687
Accrued loss and damage claims	10,011	8,471
Total current liabilities	64,362	63,343
Long-term indebtedness, less current maturities	280,337	300,491
Capital lease obligations, less current maturities	5,075	8,278
Environmental liabilities	6,336	7,255
Accrued loss and damage claims	11,109	10,454
Other non-current liabilities	25,503	26,060
Total liabilities	392,722	415,881
Commitments and contingencies - Note 14		
Redeemable noncontrolling interest		1,833
SHAREHOLDERS DEFICIT		
Common stock, no par value; 49,000 shares authorized; 24,068 issued and 23,825 outstanding at June 30, 2011 and 21,678 issued and 21,458 outstanding at December 31, 2010, respectively	391,963	371,288
Treasury stock, 243 shares at June 30, 2011 and 220 shares at December 31, 2010	(1,606)	(1,593)
Accumulated deficit	(290,206)	(301,974)
Stock recapitalization	(189,589)	(189,589)
Accumulated other comprehensive loss	(25,601)	(26,194)

Stock purchase warrants	1,683	1,683
Total shareholders deficit	(113,356)	(146,379)
Total liabilities, redeemable noncontrolling interest and shareholders deficit	$ 279,366	$ 271,335

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 Deficit

For the Six Months Ended June 30, 2011 and 2010

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	Stock Subscription Receivables	Total Shareholders Deficit
Balance, December 31, 2009	20,297	(220)	$ 364,046	$ (1,580)	$ (294,568)	$ (189,589)	$ (25,587)	$ 6,696	$ (154)	$ (140,736)
Net income					2,854					2,854
Issuance of restricted stock	69									
Amortization of restricted stock			463							463
Amortization of stock options			614							614
Stock warrant exercise	1,307		5,000					(5,000)		
Stock option exercise	1		3							3
Forgiveness of stock option receivable									21	21
Amortization of prior service costs and losses (pension plans), net of tax							647			647
Foreign currency translation adjustment, net of tax							(4)			(4)
Balance, June 30, 2010	21,674	(220)	$ 370,126	$ (1,580)	$ (291,714)	$ (189,589)	$ (24,944)	$ 1,696	$ (133)	$ (136,138)
Balance, December 31, 2010	21,678	(220)	$ 371,288	$ (1,593)	$ (301,974)	$ (189,589)	$ (26,194)	$ 1,683	$	$ (146,379)
Net income					11,768					11,768
Issuance of restricted stock	83									
Forfeiture of restricted stock		(18)								
Amortization of restricted stock			562							562

Amortization of stock options			896							896
Stock option exercises	307	(1)	1,618	(13)						1,605
Proceeds from equity offering, net of transaction costs	2,000		17,599							17,599
Satisfaction of stock subscription receivable		(4)								
Amortization of prior service costs and losses (pension plans), net of tax							636			636
Foreign currency translation adjustment, net of tax							(43)			(43)
Balance, June 30, 2011	24,068	(243)	$ 391,963	$ (1,606)	$ (290,206)	$ (189,589)	$ (25,601)	$ 1,683	$	$ (113,356)

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)

	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 11,768	$ 2,854
Adjustments to reconcile to net cash and cash equivalents provided by (used in) operating activities:		
Depreciation and amortization	6,870	8,310
Bad debt recoveries	(118)	(314)
(Gain) loss on disposal of property and equipment	(650)	652
PIK interest on Senior Subordinated Notes	187	1,120
Write-off of deferred financing costs	328	
Write-off of original bond issuance costs	1,458	
Financing costs		94
Stock-based compensation	1,458	1,077
Amortization of deferred financing costs	1,095	1,353
Amortization of bond discount	220	1,169
Noncontrolling interest dividends	38	72
Changes in assets and liabilities:		
Accounts and other receivables	(14,540)	(18,446)
Prepaid expenses	1,408	2,216
Other assets	1,527	(4,152)
Accounts payable	406	2,318
Accrued expenses	(3,301)	(4,568)
Environmental liabilities	(1,398)	(305)
Accrued loss and damage claims	2,195	(2,544)
Independent affiliates and independent owner-operators payable	3,390	3,081
Other liabilities	(126)	28
Current income taxes	187	(149)
Net cash provided by (used in) operating activities	12,402	(6,134)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(9,336)	(5,675)
Proceeds from sales of property and equipment	6,279	3,309
Net cash used in investing activities	(3,057)	(2,366)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments on long-term debt	(30,379)	(2,595)
Principal payments on capital lease obligations	(2,545)	(3,059)
Proceeds from revolver	60,000	36,500
Payments on revolver	(53,000)	(25,000)
Payments on acquisition notes	(405)	(521)
Deferred financing costs	(607)	(94)
Change in book overdraft	149	597
Noncontrolling interest dividends	(38)	(72)
Redemption of noncontrolling interest	(1,833)	
Proceeds from equity offering, net of transaction costs	17,599	

Proceeds from exercise of stock options	1,605	3
Net cash (used in) provided by financing activities	(9,454)	5,759
Effect of exchange rate changes on cash	(1)	
Net decrease in cash and cash equivalents	(110)	(2,741)
Cash and cash equivalents, beginning of period	1,753	5,633
Cash and cash equivalents, end of period	$ 1,643	$ 2,892
Supplemental Disclosure of Cash Flow Information		
Cash paid during the period for:		
Interest	$ 13,657	$ 15,563
Income Taxes	631	346

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

Notes to 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, (iii) the term QD Capital refers to our wholly owned subsidiary, QD Capital Corporation, a Delaware corporation, (iv) the term QCI refers to our wholly owned subsidiary, Quality Carriers, Inc., an Illinois Corporation (v) the term Boasso refers to our wholly owned subsidiary, Boasso America Corporation, a Louisiana corporation and (vi) the term CLC refers to our wholly owned subsidiary, Chemical Leaman Corporation, a Pennsylvania corporation.

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

Our accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and do not include all of the information and notes required by accounting principles generally accepted in the United States (GAAP) for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments and accruals) considered necessary for a fair statement of consolidated financial position, results of operations and cash flows have been included. The year ended December 31, 2010 consolidated balance sheet data was derived from our audited financial statements, but does not include all the disclosures required by GAAP. For further information, refer to our Annual Report on Form 10-K for the year ended December 31, 2010, including the consolidated financial statements and accompanying notes.

Operating results for the three and six months ended June 30, 2011 are not necessarily indicative of the results that may be expected for any future period.

Reclassification

Certain prior period amounts have been reclassified amongst operating expense line items to conform to the current year presentation.

New Accounting Pronouncements

In December 2010, the Financial Accounting Standards Board (FASB) issued amended guidance to clarify the acquisition date that should be used for reporting pro forma financial information for business combinations. If comparative financial statements are presented, the pro forma revenue and earnings of the combined entity for the comparable prior reporting period should be reported as though the acquisition date had been completed as of the beginning of the comparable prior annual reporting period. The amendments in this guidance are effective prospectively for business combinations for which the acquisition date is on or after January 1, 2011. Adoption of this amended guidance did not have an impact on the Company s consolidated financial results.

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In December 2010, the FASB also issued amendments to the guidance on goodwill impairment testing. The amendments modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In making that determination, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. These amendments are effective for fiscal years and interim periods beginning January 1, 2011 and the adoption of these amendments did not have an impact on the Company s financial position, results of operations or cash flows.

In June 2011, the FASB updated its guidance on comprehensive income. This accounting update eliminates the option to present the components of other comprehensive income as part of the statement of shareholders equity. Instead, the Company must report comprehensive income in either a single continuous statement of comprehensive income which contains two sections, net income and other comprehensive income, or in two separate but consecutive statements. This amendment will be effective for public companies during the interim and annual periods beginning after December 15, 2011 with early adoption permitted. Adoption of this amended guidance is not expected to have a material impact on the Company s consolidated financial statements.

Acquisition and Dispositions

During 2010 and the first six months of 2011, we did not complete any acquisitions or dispositions of businesses or independent affiliates.

2. Variable Interest Entities

At June 30, 2011, we hold a variable interest in one variable interest entity (VIE), for which we are not the primary beneficiary. We have concluded, based on our qualitative consideration of our contract with this VIE, the operating structure of the VIE and our role with the VIE, that we do not have the power to direct the activities that most significantly impact their economic performance. Therefore, we are not required to consolidate the operations of this VIE.

The VIE is an independent affiliate that is directly engaged in the dry bulk business through the management of three trucking terminals in the North East region of the U.S. As such, this business is highly seasonal. We are involved with the VIE as a non-controlling interest. Our maximum exposure to loss as a result of our involvement with this unconsolidated VIE, is limited to our recorded loans receivable which aggregated approximately $2.7 million at June 30, 2011. These loans are secured by a second priority lien on the VIE s assets and a limited personal guarantee from the owner of the VIE.

Severe winter weather created cash flow constraints for this VIE in the first quarter of 2011. While the VIE s business and cash flow improved in the second quarter, as expected, we remain reliant on collateral for payment of our loans and there are uncertainties involved with ultimate collection. During the first quarter, we recorded a $0.5 million reserve against our $2.7 million of loans receivable.

3. Fair Value of Financial Instruments

The three-level valuation hierarchy for fair value measurements is based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our market assumptions. These two types of inputs create the following fair value hierarchy:

Level 1 Quoted prices for identical instruments in active markets;

Level 2 Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose significant inputs are observable: and

Level 3 Instruments whose significant inputs are unobservable.

Following is a description of the valuation methodologies we used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Fair Value Measurements on a Nonrecurring Basis

The fair values of our long-term indebtedness were based on level 2 quoted market prices. As of June 30, 2011, the carrying values and fair values are as follows (in thousands):

	Carrying Value	Fair Value
11.75% Senior Subordinated PIK Notes due 2013	$ 5,792	$ 5,792
9.875% Second-Priority Senior Secured Notes due 2018	225,000	229,500
	$ 230,792	$ 235,292

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Our asset-based loan facility (the ABL Facility) is variable rate debt and approximates fair value.

The carrying amounts reported in the accompanying balance sheets for cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of the immediate or short-term maturities of these financial instruments.

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4. Goodwill and Intangible Assets

Goodwill

Under the FASB guidance, goodwill and intangible assets are subject to an annual impairment test as well as impairment assessments of certain triggering events. We evaluate goodwill for impairment by determining the fair value based on criteria in the FASB guidance for each reporting unit, our logistics segment and our intermodal segment. These reporting units contain goodwill and other identifiable intangible assets as a result of previous business acquisitions. Our annual impairment test is performed during the second quarter with a measurement date of June 30th. The methodology applied in the analysis performed at June 30, 2011 was consistent with the methodology applied in prior years, but was based on updated assumptions, as appropriate. As a result of our analysis, we concluded no impairment had occurred as of June 30, 2011. We continued to evaluate indicators of impairment quarterly following our annual goodwill impairment test at June 30, 2010. There were no indications that a triggering event had occurred leading up to our analysis at June 30, 2011. As of June 30, 2011, we had total goodwill of $27.0 million, all of which related to our intermodal segment.

Under the FASB guidance, the process of evaluating the potential impairment of goodwill involves a two-step process and requires significant judgment at many points during the analysis. In the first step, we determine whether there is an indication of impairment by comparing the fair value of a reporting unit to its carrying amount, including goodwill. If, based on the first step, we determine that there is an indication of goodwill impairment, we assess the impairment in step two in accordance with the FASB guidance.

In the first step, we determine the fair value for each reporting unit using a combination of two valuation approaches: the market approach and the income approach. The market approach uses a guideline company methodology which is based upon a comparison of us to similar publicly-traded companies within our industry. We derive a market value of invested capital or business enterprise value for each comparable company by multiplying the price per share of common stock of the publicly traded companies by their total common shares outstanding and adding each company s current level of debt. We calculate a business enterprise multiple based on revenue and earnings from each company, then apply those multiples to each reporting unit s revenue and earnings to conclude a reporting unit business enterprise value. Assumptions regarding the selection of comparable companies are made based on, among other factors, capital structure, operating environment and industry. As the comparable companies were typically larger and more diversified than our reporting units, multiples were adjusted prior to application to our reporting units revenues and earnings to reflect differences in margins, long-term growth prospects and market capitalization.

The income approach uses a discounted debt-free cash flow analysis to measure fair value by estimating the present value of future economic benefits. To perform the discounted debt-free cash flow analysis, we develop a pro forma analysis of each reporting unit to estimate future available debt-free cash flow and discount estimated debt-free cash flow by an estimated industry weighted average cost of capital based on the same comparable companies used in the market approach. Per the FASB guidance, the weighted average cost of capital is based on inputs (e.g., capital structure, risk, etc.) from a market participant s perspective and not necessarily from the reporting unit s or QDI s perspective. Future cash flow is projected based on assumptions for our economic growth, industry expansion, future operations and the discount rate, all of which require significant judgments by management.

Intangible Assets

Intangible assets at June 30, 2011 are as follows (in thousands):

	Gross value	Accumulated amortization	Net book value	Average lives (in years)
Tradename	$ 7,400	$	$ 7,400	Indefinite
Customer relationships	11,900	(3,471)	8,429	12
Non-compete agreements	2,593	(2,191)	402	3 5
	$ 21,893	$ (5,662)	$ 16,231	

Of our total intangibles of $16.2 million at June 30, 2011, $15.9 million was allocated to our intermodal segment and $0.3 million was allocated to our logistics segment.

Amortization expense for the six months ended June 30, 2011 and 2010 was $0.7 million and $0.8 million, respectively. Estimated future amortization expense for intangible assets is as follows (in thousands):

2011 remaining	$ 676
2012	1,205
2013	996
2014	991
2015 and after	4,963

5. Comprehensive Income

Comprehensive income is as follows (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2011	**2010**	**2011**	**2010**
Net income	$ 9,046	$ 2,056	$ 11,768	$ 2,854
Other comprehensive income:				
Amortization of prior service costs, net of tax	318	324	636	647
Foreign currency translation adjustments, net of tax	7	48	(43)	(4)
Comprehensive income	$ 9,371	$ 2,428	$ 12,361	$ 3,497

6. Income Per Share

A reconciliation of the numerators and denominators of the basic and diluted income per share computations is as follows (in thousands, except per share amounts):

	Three months ended					
	June 30, 2011			June 30, 2010		
	Net income (numerator)	**Shares (denominator)**	**Per-share amount**	**Net income (numerator)**	**Shares (denominator)**	**Per-share amount**
Basic income available to common shareholders:						
Net income	$ 9,046	23,253	$ 0.39	$ 2,056	20,256	$ 0.10
Effect of dilutive securities:						
Stock options		666			280	
Unvested restricted stock		220			205	
Stock warrants		442			1,007	
Diluted income available to common shareholders:						
Net income	$ 9,046	24,581	$ 0.37	$ 2,056	21,748	$ 0.09

	Six months ended					
	June 30, 2011			June 30, 2010		
	Net income (numerator)	**Shares (denominator)**	**Per-share amount**	**Net income (numerator)**	**Shares (denominator)**	**Per-share amount**
Basic income available to common shareholders:						

Net income	$ 11,768	22,723	$ 0.52	$ 2,854	19,880	$ 0.14
Effect of dilutive securities:						
Stock options		636			168	
Unvested restricted stock		223			161	
Stock warrants		442			1,376	

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	Three months ended					
	June 30, 2011			June 30, 2010		
	Net income (numerator)	Shares (denominator)	Per-share amount	Net income (numerator)	Shares (denominator)	Per-share amount
Diluted income available to common shareholders:						
Net income	$ 11,768	24,024	$ 0.49	$ 2,854	21,585	$ 0.13

The following securities were not included in the calculation of diluted earnings per share because such inclusion would be anti-dilutive (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Stock options	1,580	1,921	1,610	2,033
Unvested restricted stock	248	419	246	463

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7. Stock-Based Compensation

We maintain performance incentive plans under which stock options, restricted shares, and stock units may be granted to employees, non-employee directors, consultants and advisors. As of June 30, 2011, we had two active stock-based compensation plans.

We recognize expense for stock-based compensation based upon estimated grant date fair value. 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 awards vesting term. Compensation expense is recognized only for those awards expected to vest, with forfeitures estimated based on our historical experience and future expectations. All stock-based compensation expense is classified within Compensation in the Consolidated Statements of Operations. None of the stock-based compensation was capitalized during the first six months of 2011.

The fair value of options granted during the first six months of 2011 and 2010 were 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 2011, expected stock price volatility is based on the historical volatility of our common stock. 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 weighted average assumptions:

	2011	2010
Risk free rate	2.0%	2.5%
Expected life	5 years	5 years
Volatility	78.0%	77.5%
Expected dividend	nil	nil

The following options and restricted shares were issued during the three months ended:

	2011		2010	
	Options Issued	Restricted Shares Issued	Options Issued	Restricted Shares Issued
March 31st	222,500	83,189		68,621
June 30th			85,000	

The following table summarizes stock-based compensation expense (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Stock options	$ 458	$ 339	$ 896	$ 614
Restricted stock	276	249	562	463