

PACER INTERNATIONAL INC
Form 10-Q
October 26, 2006
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 22, 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 000-49828

PACER INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Tennessee
(State or other jurisdiction)

of organization)

62-0935669
(I.R.S. employer

identification no.)

2300 Clayton Road, Suite 1200

Concord, CA 94520

Telephone Number (877) 917-2237

Indicate by checkmark 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 Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer **x** Accelerated filer **..** Non-accelerated filer **..**

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Indicate by checkmark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at October 20, 2006
Common stock, \$.01 par value per share	36,855,197 shares

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PACER INTERNATIONAL, INC. AND SUBSIDIARIES

FORM 10-Q

FISCAL QUARTER ENDED SEPTEMBER 22, 2006

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Table of Contents**PART 1 FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****PACER INTERNATIONAL, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)**

	September 22, 2006	December 30, 2005
	(In millions)	
ASSETS		
Current assets		
Cash and cash equivalents	\$ 3.0	\$ 9.1
Accounts receivable, net of allowances of \$6.1 million and \$6.4 million, respectively	225.8	219.3
Prepaid expenses and other	7.7	10.8
Deferred income taxes	4.0	4.0
Total current assets	240.5	243.2
Property and equipment		
Property and equipment at cost	96.6	94.8
Accumulated depreciation	(63.0)	(58.7)
Property and equipment, net	33.6	36.1
Other assets		
Goodwill	288.3	288.3
Deferred income taxes	4.5	9.1
Other assets	17.1	13.5
Total other assets	309.9	310.9
Total assets	\$ 584.0	\$ 590.2
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Current maturities of long-term debt and capital leases	\$	\$
Accounts payable and other accrued liabilities	182.3	188.2
Total current liabilities	182.3	188.2
Long-term liabilities		
Long-term debt	80.0	90.0
Other	5.4	5.3
Total long-term liabilities	85.4	95.3
Total liabilities	267.7	283.5

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Commitments and contingencies (Note 5)

Stockholders' equity

Preferred stock: \$0.01 par value, 50,000,000 shares authorized, none issued and outstanding

Common stock: \$0.01 par value, 150,000,000 shares authorized, 36,855,197 and 37,463,748

issued and outstanding at September 22, 2006 and December 30, 2005, respectively

	0.4	0.4
Additional paid-in-capital	284.3	277.8
Retained Earnings	31.8	28.7
Accumulated other comprehensive loss	(0.2)	(0.2)

Total stockholders' equity	316.3	306.7
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Total liabilities and stockholders' equity	\$ 584.0	\$ 590.2
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The accompanying notes are an integral part of the condensed consolidated financial statements.

Table of Contents**PACER INTERNATIONAL, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)**

	Three Months Ended		Nine Months Ended	
	Sept. 22, 2006	Sept. 23, 2005	Sept. 22, 2006	Sept. 23, 2005
	(in millions, except share and per share amounts)			
Revenues	\$ 458.2	\$ 441.6	\$ 1,385.8	\$ 1,356.3
Operating expenses:				
Cost of purchased transportation and services	343.5	338.3	1,060.9	1,048.8
Direct operating expenses	29.4	26.5	90.2	84.4
Selling, general and administrative expenses	52.0	49.0	148.2	149.6
Write-off of computer software (Note 3)				11.3
Depreciation and amortization	1.7	1.7	5.2	5.2
Total operating expenses	426.6	415.5	1,304.5	1,299.3
Income from operations	31.6	26.1	81.3	57.0
Interest expense	(1.7)	(2.0)	(5.3)	(6.6)
Interest income	0.1	0.1	0.4	0.3
Income before income taxes	30.0	24.2	76.4	50.7
Income taxes	11.7	9.6	29.6	20.2
Net income	\$ 18.3	\$ 14.6	\$ 46.8	\$ 30.5
Earnings per share (Note 7):				
Basic:				
Earnings per share	\$ 0.49	\$ 0.39	\$ 1.25	\$ 0.82
Weighted average shares outstanding	37,330,706	37,397,514	37,484,958	37,361,481
Diluted:				
Earnings per share	\$ 0.48	\$ 0.38	\$ 1.22	\$ 0.80
Weighted average shares outstanding	37,943,668	38,061,243	38,201,709	38,021,710

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

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PACER INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

Nine Months Ended September 22, 2006

(Unaudited)

	Common Shares	Common Stock and Paid-in- Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders Equity
Balance at December 30, 2005	37,463,748	\$ 278.2	\$ 28.7	\$ (0.2)	\$ 306.7
Net income			46.8		46.8
Other comprehensive loss					
Total comprehensive income			46.8		46.8
Common stock dividends, \$0.45 per share			(16.9)		(16.9)
Stock based compensation		1.2			1.2
Tax benefit from exercise of options		3.0			3.0
Issuance of common stock for exercise of options	357,267	2.3			2.3
Repurchase and retirement of Pacer common stock	(965,818)		(26.8)		(26.8)
Balance at September 22, 2006	36,855,197	\$ 284.7	\$ 31.8	\$ (0.2)	\$ 316.3

Total comprehensive income for the nine months ended September 23, 2005 was \$30.5 million.

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

Table of Contents**PACER INTERNATIONAL, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

	<div> <div>Nine Months Ended</div> <div> <div>Sept. 22, 2006</div> <div>Sept. 23, 2005</div> </div> </div> <div>(in millions)</div>	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	\$ 46.8	\$ 30.5
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5.2	5.2
Gain on sale of property and equipment	(0.1)	
Deferred taxes	4.6	0.4
Stock based compensation expense	1.2	
Excess tax benefit from exercise of stock options	(2.2)	
Loss on write-off of computer software		11.3
Changes in operating assets and liabilities:		
Accounts receivable, net	(6.5)	31.8
Prepaid expenses and other	3.1	3.5
Accounts payable and other accrued liabilities	(3.7)	(2.3)
Other	(2.8)	(4.7)
Net cash provided by operating activities	45.6	75.7
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(2.7)	(3.3)
Proceeds from sales of property and equipment	0.2	0.1
Net cash used in investing activities	(2.5)	(3.2)
CASH FLOWS FROM FINANCING ACTIVITIES		
Book overdraft		(18.6)
Proceeds from exercise of stock options	2.3	1.3
Excess tax benefit from exercise of stock options	2.2	
Dividends paid to shareholders	(16.9)	
Repurchase and retirement of Pacer common stock	(26.8)	
Debt, revolving credit facility and capital lease obligation repayment	(10.0)	(46.0)
Net cash used in financing activities	(49.2)	(63.3)
Effect of exchange rate changes on cash		(0.2)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(6.1)	9.0
CASH AND CASH EQUIVALENTS BEGINNING OF PERIOD	9.1	
CASH AND CASH EQUIVALENTS END OF PERIOD	\$ 3.0	\$ 9.0

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

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PACER INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements as of September 22, 2006 and December 30, 2005 and for the three- and nine-month periods ended September 22, 2006 and September 23, 2005 for Pacer International, Inc. (the Company or Pacer) do not contain all information required by generally accepted accounting principles to be included in a full set of financial statements. In the opinion of management, all adjustments, consisting of only normal recurring adjustments that are necessary for a fair presentation have been included. The results of operations for any interim period are not necessarily indicative of the results of operations to be expected for any full fiscal year. These unaudited condensed consolidated financial statements and footnotes should be read in conjunction with the audited financial statements for the fiscal year ended December 30, 2005 included in the Company's Form 10-K as filed with the Securities and Exchange Commission (SEC).

Principles of Consolidation

The condensed consolidated financial statements as of September 22, 2006 and December 30, 2005 and for the three- and nine-month periods ended September 22, 2006 and September 23, 2005 include the accounts of the Company and all entities in which the Company has a majority voting or economic interest. All significant intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates are included in recognition of revenue, costs of purchased transportation and services, allowance for doubtful accounts, valuation of deferred income taxes and goodwill. Actual results could differ from those estimates.

Business and Industry Segments

Pacer is a non-asset based logistics provider that facilitates the movement of freight by trailer or container using various modes of transportation. The Company provides these services through two operating segments; the wholesale segment and the retail segment. The wholesale segment provides intermodal rail transportation and local trucking services primarily to intermodal marketing companies, large automotive intermediaries and international shipping companies. The retail segment provides truck brokerage and truck services, intermodal marketing services, warehousing and distribution, international freight forwarding and supply chain management services primarily to shippers.

Accounts Receivable

Accounts receivable are carried at original invoice amount less allowance made for doubtful accounts. Estimates are used when determining this allowance based on the Company's historical collection experience, current trends, credit policy and a percentage of the accounts receivable by aging category. At September 22, 2006 and December 30, 2005, accounts receivable included unbilled amounts for services rendered of \$23.1 million and \$18.7 million, respectively. Unbilled receivables represent revenue earned in the respective period but not billed to the customer until future dates, usually within one month.

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(Unaudited)

Financial Instruments

The carrying amounts for cash, accounts receivable and accounts payable approximate fair value due to the short-term nature of these instruments. The carrying value of long-term debt approximates fair value due to the floating nature of the interest rates.

Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss includes foreign currency translation adjustments, net of related tax. Accumulated other comprehensive loss consists of the following (in millions):

	Foreign Currency
	Translation Adjustment
Balance at December 30, 2005	\$ (0.2)
Activity during 2006 (net of tax)	
Balance at September 22, 2006	\$ (0.2)

Common Stock

On June 12, 2006, the Company announced that its Board of Directors had authorized the purchase of up to \$60 million of its common stock. The authorization expires on June 15, 2008. The Company repurchased a total of 965,818 shares at an average price of \$27.72 per share through September 22, 2006. The Company intends to make further share repurchases from time to time as market conditions warrant.

Stock-Based Compensation

See the discussion under NOTE 4. STOCK OPTION PLANS.

Recently Issued Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. (FIN) 48, Accounting for Uncertainty in Income Taxes, which clarifies the accounting for uncertainty in income taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 requires that the Company recognize in the financial statements, the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure. FIN 48 will be effective for the Company on December 30, 2006 (the first day of the Company's 2007 fiscal year). The Company has not yet determined the impact that this guidance will have on its results of operations or financial condition.

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 will be effective for the Company on December 29, 2007 (the first day of the Company's 2008 fiscal year). The Company does not believe that this statement will have a material impact on its results of operations or financial condition.

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In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements

Table of Contents**PACER INTERNATIONAL, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(Unaudited)

in Current Year Financial Statements, that requires public companies to utilize a dual-approach to assessing the quantitative effects of financial misstatements. This dual approach includes both an income statement focused assessment and a balance sheet focused assessment. SAB No. 108 is effective for annual financial statements covering the first fiscal year ending after November 15, 2006. The Company is currently assessing the impact of SAB No. 108 but does not expect that it will have a material effect on its results of operations or financial condition.

NOTE 2. LONG-TERM DEBT

At September 22, 2006, the Company had \$57.5 million available under the \$75.0 million revolving credit facility, net of \$17.5 million of outstanding letters of credit. At September 22, 2006, the term loan of \$80.0 million was outstanding with a current interest rate of 7.0%. The Company repaid \$10.0 million and \$46.0 million of long-term debt and capital lease obligations during the nine months ended September 22, 2006 and September 23, 2005, respectively. Operating cash flows funded the repayment of the debt.

Long-term debt is summarized as follows (in millions):

	Sept. 22, 2006
Term loan (7.0%; due June 10, 2010)	\$ 80.0
Revolving credit facility (expires June 10, 2008)	
Total	
Less current portion	
Long-term portion	\$ 80.0

Contractual maturities of long-term debt subsequent to September 22, 2006 are as follows (in millions):

Remaining in 2006	\$
2007	
2008	
2009	
2010	80.0
Total	\$ 80.0

NOTE 3. CAPITALIZED SOFTWARE

In March 2001, the Company commenced plans for the conversion from APL Limited's computer systems to a stand-alone capability for the Company's wholesale Stacktrain operation based on information technology systems then available in the marketplace from unrelated third parties. At July 1, 2005, an aggregate of \$11.3 million had been paid to such third parties for the acquisition and development of software in connection with the conversion project, which had been capitalized in property and equipment under Statement of Position No. 98-1, Accounting for Costs of Computer Software Developed or Obtained for Internal Use (SOP 98-1). This amount includes \$6.9 million paid to a third party developer under a fixed-price development contract discussed below.

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During the third quarter of 2002, the Company engaged in the negotiation of proposed contract modifications requested by the third party developer that, if accepted and agreed to, would have extended the completion of the development work through the end of 2004 at an increased cost to the Company. The Company was unable to reach agreement with the developer, and in the fourth quarter of 2002 the Company instituted arbitration seeking damages for the developer's failure to complete the contract and other claims. The developer subsequently ceased doing business and executed a general assignment for

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PACER INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

creditors under California law. In the third quarter of 2004, the Company entered into an agreement with the assignee settling all claims. Under the settlement agreement, the Company received a cash payment of approximately \$102,000 out of the assets of the developer that remained available for distribution to unsecured creditors, and the Company took delivery of all of the partially completed software code that had been developed under the original contract.

With the assistance of independent consultants, the Company evaluated the extent of the software development work that had been performed by the developer and the feasibility of completing the development of the software and placing it into service. In the second quarter of 2005, following completion of our evaluation, the Company determined to abandon the software and to write-off the \$11.3 million of capitalized costs in that quarter, constituting all of the development costs previously capitalized in connection with this project. The Company will continue to avail itself of the services and support under the existing long-term technology services agreement with APL Limited.

NOTE 4. STOCK OPTION PLANS

The Company has two stock option plans, the 1999 Stock Option Plan (the "1999 Plan") and the 2002 Stock Option Plan (the "2002 Plan"). No further awards may be made under the 1999 Plan. Any shares issued under the 1999 Plan that are forfeited to or repurchased by the Company or that are issuable upon exercise of options that expire or become unexercisable for any reason without having been exercised in full are also available for grant and issuance under the 2002 Plan. Awards under the 2002 Plan may be granted to employees, directors and contractors. The life of each grant is ten years from date of grant and, for current grants, employee options vest on a straight-line basis over 5 years and director options vest on a straight-line basis over 4 years. No more than 2,500,000 shares of common stock may be issued in the aggregate under the 2002 Plan. As of September 22, 2006, the Company has available 1,874,000 shares of common stock for future grant under the 2002 Plan. During the third quarter of 2006, the 1999 Plan, outstanding awards under the 1999 and 2002 Plans and future awards under the 2002 Plan were amended to provide for the acceleration of vesting upon a change in control (as defined). The table below details the Company's stock option activity for the nine-month periods ended September 22, 2006 and September 23, 2005, respectively.

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(Unaudited)

	Nine Months Ended	
	Sept. 22, 2006	Sept. 23, 2005
Common Stock Options		
Granted		
@ \$19.54 per share		54,500
@ \$25.75 per share		47,500
@ \$25.77 per share	12,000	
@ \$28.05 per share	60,000	
@ \$29.44 per share	6,000	
@ \$30.89 per share	50,000	
@ \$35.17 per share	22,000	
Subtotal	150,000	102,000
Exercised		
@ \$5.00 per share	302,767	23,310
@ \$10.00 per share	5,500	49,000
@ \$12.50 per share	16,300	19,700
@ \$13.74 per share	9,000	14,000
@ \$15.78 per share	4,000	5,500
@ \$16.18 per share	3,900	5,800
@ \$17.92 per share	4,500	
@ \$18.64 per share	3,000	
@ \$19.66 per share	2,900	1,600
@ \$20.31 per share	5,400	
Subtotal	357,267	118,910
Canceled or Expired		
@ \$5.00 per share		1,333
@ \$10.00 per share	10,000	
@ \$12.50 per share	4,200	23,200
@ \$13.74 per share		12,000
@ \$15.78 per share		25,000
@ \$16.18 per share		3,000
@ \$21.51 per share		200
Subtotal	14,200	64,733

All proceeds were used for general corporate purposes and all canceled or expired options were due to employee terminations.

Stock-Based Compensation

Effective December 31, 2005, the Company adopted Financial Accounting Standards Board Statement of Financial Accounting Standard (SFAS) No. 123(R), Share-Based Payments, which establishes the accounting for employee stock-based awards. Under the provisions of SFAS No. 123(R), stock-based compensation is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense over the requisite employee service period (generally the vesting period of the grant). The Company adopted SFAS No. 123(R) using the modified prospective method and, as a result, periods prior to December 31, 2005 have not been restated. The Company recognized stock-based compensation for awards issued under the Company's stock option plans in the Selling, General and Administrative line item of the Condensed Consolidated Statement of Operations. Additionally, no modifications were made to outstanding stock options prior to the adoption of SFAS No. 123(R), and no cumulative adjustments were recorded in the Company's financial statements.

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Prior to December 31, 2005, the Company accounted for stock-based compensation in accordance with provisions of Accounting Principles Board Opinion No. 25 (APB No. 25), Accounting for Stock Issued to Employees, and related interpretations. Under APB No. 25, compensation cost was recognized based on the difference, if any, on the date of grant between the fair value of the Company's stock and the amount an employee must pay to acquire the stock. The Company grants stock options at an exercise price

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(Unaudited)

equal to 100% of the market price on the date of grant. Accordingly, no compensation expense was recognized for the stock option grants in periods prior to the adoption of SFAS No. 123(R).

SFAS No. 123(R) requires disclosure of pro-forma information for periods prior to the adoption. The pro-forma disclosures are based on the fair value of awards at the grant date, amortized to expense over the service period. The following table illustrates the effect on net income and earnings per share as if the Company had applied the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation, for the period prior to the adoption of SFAS No. 123(R), and the actual effect on net income and earnings per share for the period after the adoption of SFAS No. 123(R) (in millions).

	Three Months Ended		Nine Months Ended	
	Sept. 22, 2006	Sept. 23, 2005	Sept. 22, 2006	Sept. 23, 2005
Net income, as reported	\$ 18.3	\$ 14.6	\$ 46.8	\$ 30.5
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	0.3		0.7	
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(0.3)	(0.3)	(0.7)	(0.9)
Net income, pro forma	\$ 18.3	\$ 14.3	\$ 46.8	\$ 29.6
Earnings per share:				
Basic, as reported	\$ 0.49	\$ 0.39	\$ 1.25	\$ 0.82
Basic, pro forma	\$ 0.49	\$ 0.38	\$ 1.25	\$ 0.79
Diluted, as reported	\$ 0.48	\$ 0.38	\$ 1.22	\$ 0.80
Diluted, pro forma	\$ 0.48	\$ 0.38	\$ 1.22	\$ 0.78

The fair value of each option grant is estimated using the Black-Scholes valuation model and the assumptions noted in the following table. The expected term of stock options is based on an analysis of historical exercise behavior. The expected volatility is based on the change in weekly prices of the Company's stock over a 104-week period preceding each grant date. The risk free interest rate is based on the implied yield on U.S. Treasury issues with a term equal to the expected term of the option. The dividend yield reflects an estimated annual dividend of \$0.60 per share divided by the market price at date of grant.

	Three Months Ended		Nine Months Ended	
	Sept. 22, 2006	Sept. 23, 2005	Sept. 22, 2006	Sept. 23, 2005
Weighted avg. expected option term	6.0 years	6.1 years	5.9 years	6.1 years
Weighted avg. volatility	32%	32%	32%	33%
Weighted avg. risk-free interest rate	4.91%	4.24%	4.76%	4.09%
Weighted avg. dividend yield	2.0%	0.0%	2.0%	0.0%
Weighted avg. fair value of options granted	\$ 9.56	\$ 10.30	\$ 9.54	\$ 9.14

Table of Contents**PACER INTERNATIONAL, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(Unaudited)

A summary of stock option activity under the plans for the nine months ended September 22, 2006 is presented as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (\$ millions)
Outstanding, December 30, 2005	1,805,730	\$ 11.18		
Granted	150,000	29.91		
Exercised	357,267	6.51		
Canceled or Expired	14,200	10.74		
Outstanding, September 22, 2006	1,584,263	14.01	5.3	\$ 20.3
Exercisable, September 22, 2006	642,663	\$ 9.33	4.0	\$ 11.2

The excess tax benefit realized for the tax deductions from option exercises totaled \$3.0 million and \$0.5 million for the nine months ended September 22, 2006 and September 23, 2005, respectively. The tax benefit for stock option expense included in the provision for income taxes totaled \$0.1 million and \$0.5 million for the three and nine months ended September 22, 2006, respectively. The total intrinsic value of options exercised was \$7.8 million and \$1.5 million for the nine months ended September 22, 2006 and September 23, 2005, respectively. As of September 22, 2006, there was \$2.2 million of total unrecognized compensation costs related to stock options assuming no new grants or forfeitures. These costs are expected to be recognized over a weighted-average period of approximately 1.92 years.

NOTE 5. COMMITMENTS AND CONTINGENCIES

The Company is subject to routine litigation arising in the ordinary course of business, none of which is expected to have a material adverse effect on the Company's business, financial condition, consolidated results of operations or liquidity. Most of the lawsuits to which the Company is a party are covered by insurance and are being defended in cooperation with insurance carriers.

Two of our subsidiaries engaged in local cartage and harbor drayage operations, Interstate Consolidation, Inc., which was subsequently merged into Pacer Cartage, Inc., and Intermodal Container Service, Inc., were named defendants in a class action filed in July 1997 in the State of California, Los Angeles Superior Court, Central District (the *Albillo* case), alleging, among other things, breach of fiduciary duty, unfair business practices, conversion and money had and received in connection with monies (including insurance premium costs) allegedly wrongfully deducted from truck drivers' earnings. The plaintiffs and defendants entered into a Judge Pro Tempore Submission Agreement in October 1998, pursuant to which they waived their rights to a jury trial, stipulated to a certified class, and agreed to a minimum judgment of \$250,000 and a maximum judgment of \$1.75 million. In August 2000, the trial court ruled in our subsidiaries' favor on all issues except one, namely that in 1998 our subsidiaries failed to issue to the owner-operators new certificates of insurance disclosing a change in the subsidiaries' liability insurance retention amount, and ordered that restitution of \$488,978 be paid for this omission. Plaintiffs' counsel then appealed all issues except one (the independent contractor status of the drivers), and the subsidiaries appealed the insurance retention disclosure issue.

In December 2003, the appellate court affirmed the trial court's decision as to all but one issue, reversed the trial court's decision that the owner-operators could be charged for the workers compensation insurance coverage that they voluntarily elected to obtain through our subsidiaries (a case of first impression in California), and remanded back to the trial court the question of whether the collection of workers compensation insurance charges from the owner-operators violated California's Business and Professions Code and, if so, to determine an appropriate remedy. Our subsidiaries sought review at the California Supreme Court of this workers compensation issue, and the plaintiffs

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sought review only of whether our subsidiaries providing insurance for the owner-operators constituted engaging in the insurance

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

business without a license under California law. In March 2004, the Supreme Court of California denied both parties' petitions for appeal, thus ending all further appellate review.

As a result, we had successfully defended and prevailed over the plaintiffs' challenges to our subsidiaries' core operating practices, establishing that (i) the owner-operators were independent contractors and not employees of our subsidiaries and (ii) our subsidiaries may charge the owner-operators for liability insurance coverage purchased by our subsidiaries. Following the California Supreme Court's decision, the only remaining issue was whether our subsidiaries' collection of workers compensation insurance charges from the owner-operators violated California's Business and Professions Code and, if so, what restitution, if any, should be paid to the owner-operator class. This issue was remanded back to the same trial court that heard the original case in 1998.

During the second quarter of 2005, the Company engaged in earnest discussions with the plaintiffs in an attempt to structure a potential settlement of the case within the original \$1.75 million cap but on a claims-made basis that would return to the Company any settlement funds not claimed by members of the plaintiff class. The Company believed that the ongoing cost of litigating the final issue in the case (including defending appeals that the plaintiffs' counsel has assured would occur if the Company were to prevail in the remand trial) would exceed the net liability to the Company of a final settlement on a claims-made basis within the cap of \$1.75 million. During the second quarter, the Company reached an agreement in principle with the plaintiffs to settle the litigation on a claims-made basis within the cap of \$1.75 million. Based on the settlement agreement, the Company increased its reserve to the full amount of the \$1.75 million cap at the end of the second quarter.

During the third quarter of 2005, the parties signed the definitive documents reflecting the settlement agreement, and the settlement agreement and related documents received the preliminary approval of the court. Pursuant to the settlement agreement, the Company retained an independent third party to administer the claims process. In the first quarter of 2006, the court granted final approval to the settlement. The claims process, payment calculations and final settlement payments were concluded in the second quarter of 2006.

The same law firm that brought the *Albillo* case filed a separate class action lawsuit against our same subsidiaries in March 2003 in the same jurisdiction on behalf of a putative class of owner-operators (the *Renteria* class action) who are purportedly not included in the *Albillo* class. Each of the claims in the *Renteria* case, which had been stayed pending full and final disposition of the remaining issue in *Albillo*, mirror claims in *Albillo*, specifically that our subsidiaries' providing insurance for their owner-operators constitutes engaging in the insurance business without a license in violation of California law and that charging the putative class of owner-operators in *Renteria* for workers compensation insurance that they elected to obtain through our subsidiaries violated California's Business and Professions Code. We believe that the final disposition in our favor of the insurance issue in *Albillo* precludes the plaintiffs from re-litigating this issue in *Renteria*. The *Renteria* case is currently in the discovery phase. Based on the final ruling in *Albillo* on the insurance issue and other information presently available, and in light of our legal and other defenses on the insurance issue and the workers compensation related claim, management does not expect the *Renteria* case to have a material adverse impact on the Company's consolidated financial position, results of operations or liquidity.

The Company's wholly owned subsidiary, Pacific Motor Transport Company d/b/a Pacer Transport, was a defendant in a personal injury action filed in May 1997 in Upshur County, East Texas, *Dicks v. Pacific Motor Transport Company*, which arose out of a 1996 motor vehicle incident. The jury found Pacer Transport liable and awarded damages to the plaintiff in the amount of \$607,000. At trial, the jury did not find any negligence on the part of the plaintiff, who was riding in an elevated position in the back of a speeding pickup truck and was thrown from the bed when the pick-up truck allegedly swerved to avoid Pacer Transport's truck as it pulled out into the roadway. The trial judge refused to set aside the jury's finding that the plaintiff himself was not negligent in any way. We contended that this finding was incorrect under Texas law in circumstances where a plaintiff's own conduct contributes to or causes his own accident and injuries. We appealed to the Twelfth Texas Court of Appeals at Tyler; in early 2005,

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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however, the appellate court refused to reverse the trial court. We then appealed to the Texas Supreme Court, which ordered a full briefing that was completed in the first quarter of 2005. As of December 30, 2005, the original judgment plus pre- and post-judgment interest amounted to approximately \$1.3 million, which had been accrued in accounts payable and other accrued liabilities in the consolidated balance sheet as of that date. The Supreme Court ultimately denied our appeal and subsequent motion for rehearing, which resulted in the original trial court verdict becoming final and the full amount of the *Dicks* judgment plus interest and costs was paid in the first quarter of this year.

In November 2001, our subsidiary instituted a related case, *Pacific Motor Transport Company v. Lockton Companies, Inc., Lockton Risk Services, Inc., and Cambridge Integrated Services Group, Inc.*, in which we seek to hold an insurance broker, the insurer's managing general agent, and a claims administrator responsible for our losses in the *Dicks* case due to their mishandling of our subsidiary's claim for insurance coverage. At the time of the incident, we maintained a comprehensive insurance program consisting of primary insurance and excess insurance. The primary insurance policy applicable to the *Dicks* claim was subject to a \$250,000 deductible. Our subsidiary provided all required notices of the *Dicks* claim and litigation to the insurer through its authorized representatives. Nevertheless, at the conclusion of the *Dicks* trial, the insurer's agent reserved rights and refused to acknowledge any responsibility for losses above \$250,000. Our subsidiary then sued the insurer, the various Lockton entities and Cambridge. The insurer was subsequently placed into receivership in Pennsylvania and has since gone out of business, and therefore has been removed from the case. We are still pursuing the case against the Lockton entities and Cambridge for violations of the Texas Insurance Code, negligent misrepresentation, and other claims, in which we seek to recover all of the losses, costs and damages arising out of the Lockton entities' and Cambridge's conduct in mishandling the insurance claim for the *Dicks* incident.

At September 22, 2006, the Company had a commitment to acquire 1,614 53-ft. containers, 427 53-ft. chassis and 65 truck tractors through operating leases. Delivery will take place through the first quarter of 2007.

NOTE 6. SEGMENT INFORMATION

The Company has two reportable segments, the wholesale segment and the retail segment, which have separate management teams and offer different but related products and services. The wholesale segment provides intermodal rail transportation and local trucking services primarily to intermodal marketing companies, large automotive intermediaries and international shipping companies. The retail segment provides truck brokerage and truck services, intermodal marketing, warehousing and distribution, international freight forwarding and supply chain management services primarily to shippers. Approximately 85% to 90% of total revenues are generated in the United States and all significant assets are located in the United States.

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(Unaudited)

The following table presents revenues generated by country or geographical area for the three- and nine-month periods ended September 22, 2006 and September 23, 2005 (in millions).

	Three Months Ended		Nine Months Ended	
	Sept. 22, 2006	Sept. 23, 2005 1/	Sept. 22, 2006	Sept. 23, 2005 1/
United States	\$ 410.0	\$ 391.9	\$ 1,243.3	\$ 1,213.4
Mexico	9.8	9.2	29.2	29.0
Russia/China	9.3	13.9	25.2	29.8
Europe	8.1	7.4	22.3	22.5
Canada	4.5	4.8	14.9	13.7
Far East	4.1	5.3	14.0	16.2
Australia/New Zealand	2.1	2.9	5.9	7.6
Mideast	1.5	0.8	5.7	2.6
South America	1.0	0.8	3.3	3.4
Africa	0.4	1.2	1.2	1.8
All Other	7.4	3.4		