

PACER INTERNATIONAL INC

Form 10-Q

November 02, 2005

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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 23, 2005

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

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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 ☒ No ☐

Indicate by checkmark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes ☒ No ☐

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.

<u>Class</u>	<u>Outstanding at October 12, 2005</u>
Common stock, \$.01 par value per share	37,405,548 shares

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PACER INTERNATIONAL, INC. AND SUBSIDIARIES

FORM 10-Q

FISCAL QUARTER ENDED SEPTEMBER 23, 2005

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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 23, 2005	December 31, 2004
	(In millions)	
ASSETS		
Current assets		
Cash and cash equivalents	\$ 9.0	\$
Accounts receivable, net of allowances of \$5.9 million and \$3.9 million, respectively	200.3	232.1
Prepaid expenses and other	6.7	10.2
Deferred income taxes	3.4	4.1
Total current assets	219.4	246.4
Property and equipment		
Property and equipment at cost	92.9	101.2
Accumulated depreciation	(57.0)	(52.1)
Property and equipment, net	35.9	49.1
Other assets		
Goodwill	288.3	288.3
Deferred income taxes	11.8	11.5
Other assets	15.5	10.2
Total other assets	315.6	310.0
Total assets	\$ 570.9	\$ 605.5
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Current maturities of long-term debt and capital leases	\$	\$ 0.1
Book overdraft		18.6
Accounts payable and other accrued liabilities	169.3	166.0
Total current liabilities	169.3	184.7
Long-term liabilities		

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Long-term debt and capital leases	108.0	154.0
Other	2.4	2.3
	<hr/>	<hr/>
Total long-term liabilities	110.4	156.3
	<hr/>	<hr/>
Total liabilities	279.7	341.0
	<hr/>	<hr/>
Commitments and contingencies (Note 6)		
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 37,405,548 and 37,286,638 issued and outstanding at September 23, 2005 and December 31, 2004, respectively		
	0.4	0.4
Additional paid-in-capital	277.2	275.4
Unearned compensation	(0.1)	(0.1)
Retained Earnings (accumulated deficit)	13.9	(11.0)
Accumulated other comprehensive loss	(0.2)	(0.2)
	<hr/>	<hr/>
Total stockholders' equity	291.2	264.5
	<hr/>	<hr/>
Total liabilities and stockholders' equity	\$ 570.9	\$ 605.5
	<hr/>	<hr/>

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. 23, 2005	Sept. 17, 2004	Sept. 23, 2005	Sept. 17, 2004
	(in millions, except share and per share amounts)			
Revenues	\$ 441.6	\$ 438.2	\$ 1,356.3	\$ 1,277.3
Operating expenses:				
Cost of purchased transportation and services	338.3	343.9	1,048.8	1,001.2
Direct operating expenses	26.5	25.6	84.4	79.8
Selling, general and administrative expenses	49.0	46.3	149.6	134.7
Write-off of computer software (Note 3)			11.3	
Depreciation and amortization	1.7	1.8	5.2	5.4
Total operating expenses	415.5	417.6	1,299.3	1,221.1
Income from operations	26.1	20.6	57.0	56.2
Interest expense	1.9	2.2	6.3	7.1
Income before income taxes	24.2	18.4	50.7	49.1
Income taxes	9.6	7.1	20.2	18.9
Net income	\$ 14.6	\$ 11.3	\$ 30.5	\$ 30.2
Earnings per share (Note 8):				
Basic:				
Earnings per share	\$ 0.39	\$ 0.30	\$ 0.82	\$ 0.81
Weighted average shares outstanding	37,397,514	37,263,222	37,361,481	37,247,585
Diluted:				
Earnings per share	\$ 0.38	\$ 0.30	\$ 0.80	\$ 0.79
Weighted average shares outstanding	38,061,243	37,995,418	38,021,710	38,140,098

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 23, 2005

(Unaudited)

	<u>Common Stock</u>		<u>Additional</u>		<u>Retained</u>	<u>Accumulated</u>	<u>Total</u>
	<u>No. of</u>	<u>Amount</u>	<u>Paid-in-</u>	<u>Unearned</u>	<u>Earnings</u>	<u>Other</u>	<u>Stockholders</u>
	<u>Shares</u>		<u>Capital</u>	<u>Compensation</u>	<u>(Accumulated</u>	<u>Comprehensive</u>	<u>Equity</u>
					<u>Deficit)</u>	<u>Loss</u>	
	(in millions, except share amounts)						
Balance December 31, 2004	37,286,638	\$ 0.4	\$ 275.4	\$ (0.1)	\$ (11.0)	\$ (0.2)	\$ 264.5
Net income					30.5		30.5
Other comprehensive loss							
Total comprehensive income					30.5		30.5
Common stock dividends; \$0.15 per share					(5.6)		(5.6)
Tax benefit from exercise of stock options			0.5				0.5
Issuance of common stock for exercise of options	118,910		1.3				1.3
Balance September 23, 2005	37,405,548	\$ 0.4	\$ 277.2	\$ (0.1)	\$ 13.9	\$ (0.2)	\$ 291.2

Total comprehensive income for the nine months ended September 17, 2004 was \$30.1 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)**

	Nine Months Ended	
	Sept. 23, 2005	Sept. 17, 2004
	(in millions)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 30.5	\$ 30.2
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5.2	5.4
Deferred taxes	0.4	8.8
Write-off of computer software	11.3	
Changes in operating assets and liabilities:		
Accounts receivable, net	31.8	(17.2)
Prepaid expenses and other	3.5	1.3
Accounts payable and other accrued liabilities	(2.3)	9.2
Other	(4.7)	(0.8)
Net cash provided by operating activities	75.7	36.9
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(3.3)	(3.3)
Proceeds from sales of property and equipment	0.1	0.3
Net cash used in investing activities	(3.2)	(3.0)
CASH FLOWS FROM FINANCING ACTIVITIES		
Book overdraft	(18.6)	9.4
Proceeds from exercise of stock options	1.3	0.6
Debt, revolving credit facility and capital lease obligation repayment	(46.0)	(45.0)
Net cash used in financing activities	(63.3)	(35.0)
Effect of exchange rate changes on cash	(0.2)	0.3
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	9.0	(0.8)
CASH AND CASH EQUIVALENTS BEGINNING OF PERIOD		0.8
CASH AND CASH EQUIVALENTS END OF PERIOD	\$ 9.0	\$

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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 23, 2005 and December 31, 2004 and for the three- and nine-month periods ended September 23, 2005 and September 17, 2004 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 31, 2004 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 23, 2005 and December 31, 2004 and for the three- and nine-month periods ended September 23, 2005 and September 17, 2004 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 from 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

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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 23, 2005 and December 31, 2004, accounts receivable included unbilled amounts for services rendered of \$19.3 million and \$23.7 million, respectively. Unbilled receivables represent revenue earned in the respective period but not billed to the customer until future dates, usually within one month.

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

(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 31, 2004	\$ (0.2)
Activity during 2005 (net of tax)	
Balance at September 23, 2005	\$ (0.2)

Stock-Based Compensation

The Company accounts for stock-based employee compensation arrangements in accordance with provisions of Accounting Principles Board Opinion No. 25 (APB No. 25), Accounting for Stock Issued to Employees, and related interpretations and complies with the disclosure provisions of Statement of Financial Accounting Standard (SFAS) No. 123, Accounting for Stock-Based Compensation, (SFAS No. 123) as amended by SFAS No. 148, Accounting for Stock Based Compensation Transition and Disclosure. Under APB No. 25, compensation cost is 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 equal to 100% of the market price on the date of grant. Accordingly, no compensation cost has been recognized for the stock option grants. If the compensation cost had been determined based on the fair value at the grant dates for awards consistent with the method of SFAS No. 123, the Company's pro forma net income (in millions), earnings per share and related assumptions for the three- and nine-month periods ended September 23, 2005 and September 17, 2004 would have been:

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

(Unaudited)

	Three Months Ended		Nine Months Ended	
	Sept. 23, 2005	Sept. 17, 2004	Sept. 23, 2005	Sept. 17, 2004
Net income, as reported	\$ 14.6	\$ 11.3	\$ 30.5	\$ 30.2
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	0.3	0.4	0.9	1.0
Net income, pro forma	\$ 14.3	\$ 10.9	\$ 29.6	\$ 29.2
Earnings per share:				
Basic, as reported	\$ 0.39	\$ 0.30	\$ 0.82	\$ 0.81
Basic, pro forma	\$ 0.38	\$ 0.29	\$ 0.79	\$ 0.78
Diluted, as reported	\$ 0.38	\$ 0.30	\$ 0.80	\$ 0.79
Diluted, pro forma	\$ 0.38	\$ 0.29	\$ 0.78	\$ 0.77
Black-Scholes option-pricing model assumptions:				
Risk-free interest rate	4.24%	4.25%	4.09%	3.80%
Volatility	32%	33%	33%	43%
Dividend yield	0.0%	0.0%	0.0%	0.0%
Estimated option life	6.1 years	7 years	6.1 years	7 years
Fair value of options granted	\$ 10.30	\$ 7.10	\$ 9.14	\$ 9.74

Recently Issued Accounting Pronouncements

In June 2005, the Emerging Issues Task Force (EITF) reached consensus on Issue No. 05-06, Determining the Amortization Period for Leasehold Improvements, which requires that leasehold improvements acquired in a business combination or purchased subsequent to the inception of a lease be amortized over the lesser of the useful life of the assets or a term that includes renewals that are reasonably assured at the date of the business combination or purchase. EITF No. 05-06 is effective for periods beginning after June 29, 2005. The Company adopted this EITF on July 2, 2005, the first day of its third fiscal quarter. The adoption did not have a material impact on the Company's results of operations or financial condition.

In May 2005, the Financial Accounting Standards Board (FASB) issued SFAS No. 154 (SFAS No. 154), Accounting Changes and Error Corrections - a replacement of APB Opinion No. 20 and SFAS Statement No. 3. APB No. 20, Accounting Changes and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements required the inclusion of the cumulative effect of changes in accounting principle in net

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income in the period of the change. SFAS No. 154 establishes, unless impracticable, retrospective application to prior periods financial statements as the required method for reporting a voluntary change in accounting principle in the absence of explicit transition requirements specific to the newly adopted accounting principle. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company will assess the impact of a retrospective application of a change in accounting principle in accordance with SFAS No. 154 if the need for such a change arises after the effective date.

In December 2004, the FASB issued SFAS No. 123 (Revised 2004) (SFAS No. 123R), Share-Based Payment . SFAS No. 123R is a revision of SFAS No. 123, Accounting for Stock-Based Compensation and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and its

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PACER INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

related implementation guidance. SFAS No. 123R requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). That cost will be recognized in the statement of operations over the period during which an employee is required to provide service in exchange for the award. This statement is effective as of the beginning of the Company's next fiscal year and the Company will adopt the standard effective December 31, 2005 (the first day of the Company's 2006 fiscal year). The Company has not determined the impact that this statement will have on its results of operations or financial condition.

In March 2005, the SEC issued Staff Accounting Bulletin No. 107, Share-Based Payment (SAB 107). SAB 107 summarizes the views of the SEC staff regarding the interaction between SFAS No. 123R (see above) and certain SEC rules and regulations, and is intended to assist in the initial implementation of SFAS No. 123R. The Company has not determined the impact that this statement will have on its results of operations or financial condition.

NOTE 2. SHELF REGISTRATION

On January 7, 2004, the Company filed with the SEC a shelf registration statement providing for the issuance by the Company of up to \$150.0 million in additional common stock, preferred stock and warrants to purchase any of such securities and for the sale by certain selling stockholders of 8,702,893 shares of common stock. The registration statement was declared effective on January 21, 2004. There are currently no arrangements in place for the Company to issue any additional securities.

On April 8, 2004 and November 10, 2004, the Company filed with the SEC supplements to the prospectus included in the shelf registration statement discussed in the paragraph above for the sale by selling stockholders of all 8,702,893 shares of the Company's common stock owned by such stockholders in underwritten public offerings. The April 8, 2004 offering was for 4,000,000 shares at \$20.07 per share net to the selling stockholders and the November 10, 2004 offering was for 4,702,893 shares at \$17.67 per share net to the selling stockholders. There were no new shares issued by the Company in either offering and the Company received no proceeds from the offerings. Including the January 7, 2004 registration statement, the Company paid \$0.5 million of fees and expenses related to these offerings and charged the costs to the Selling, General and Administrative Expense line item on the Statement of Operations.

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 included \$6.9 million paid to a third party developer under a fixed-price development contract discussed below.

During the third quarter of 2002, and in connection with this conversion, 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. Since the Company was unable to reach a mutually acceptable agreement with the developer, during the fourth quarter of 2002 the Company instituted arbitration under the contract seeking damages for the developer's failure to complete the contract and other claims. The developer answered by denying liability and asserting a counter-claim against the Company for failing to continue to make progress payments following the developer's breach of the contract. The Company denied liability on the developer's counter-claim and any obligation to continue to make payments to the developer. On April 7, 2003, the developer and its corporate affiliates completed a general assignment for the benefit of creditors under California law. Under this assignment, the developer and its corporate affiliates transferred ownership of all of their rights in tangible and intangible assets, including the developer's claims in the

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PACER INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

arbitration proceeding the Company commenced, to a third party assignee for purposes of liquidating such assets, winding down the developer and its corporate affiliates, and distributing the net liquidation proceeds to creditors.

As a result of this assignment and the related liquidation proceedings, the assignee retained control over the partially completed software code created by the developer under the original contract, thus preventing the Company from utilizing it in connection with the conversion project. While the separate arbitration and liquidation proceedings were pending, however, the Company utilized the system design work performed by the developer under the original contract. In July 2004, the Company entered into an agreement with the assignee settling all claims between the Company and the developer asserted in the arbitration and otherwise arising under the original contract. 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 and the assignee exchanged mutual releases of all claims asserted in the arbitration and otherwise arising under the original contract. In addition, pursuant to the settlement agreement the Company took delivery from the assignee and a third party escrow agent of all of the partially completed software code that had been developed by the developer 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 early June 2005, the Company completed this evaluation, and identified a number of significant factors bearing on the Company's decision whether to continue with the development of the software and place it into service, including: continuing growth and changes in the Company's wholesale business since 2001 when the original system transition plan was adopted; advances in systems technology, architecture and programming language since adoption of the original system transition plan in 2001; the significant incremental costs and additional time that would be required to complete the originally planned stand-alone system and the risks in the coming years associated with the commitment to that older system; and the ongoing evolution and development of the Company's wholesale business strategy. Based on these considerations and following the Company's completed evaluation in the second quarter of 2005 of the software development work that had been performed by the developer, the Company determined to abandon the software and to write-off the \$11.3 million of capitalized costs in that period, constituting all of development costs previously capitalized in connection with this project. The Company will continue to avail itself of the services and support under its existing long-term technology services agreement with APL Limited.

NOTE 4. LONG-TERM DEBT

At September 23, 2005, the Company had \$59.7 million available under the \$75.0 million revolving credit facility, net of \$15.3 million of outstanding letters of credit. At September 23, 2005, the term loan of \$108.0 million was outstanding with a current interest rate of 5.4%. The Company repaid \$46.0 million and \$45.0 million of long-term debt and capital lease obligations during the nine months ended September 23, 2005 and September 17, 2004, respectively. Operating cash flows funded the repayment of the debt.

On September 14, 2005, the Company entered into an amendment to its credit agreement to, among other things, increase the maximum aggregate cash dividends payable by the Company.

On April 28, 2005 the Company negotiated a repricing for the term loan. The repricing resulted in an immediate reduction of $\frac{1}{2}$ of 1 percent to the applicable margin. The applicable margin is subject to further reductions based upon the Company achieving certain financial ratios.

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

(Unaudited)

Long-term debt and capital leases are summarized as follows (in millions):

	Sept. 23, 2005
Term loan (5.4%; due June 10, 2010)	\$ 108.0
Revolving credit facility (due June 10, 2008)	
Total	108.0
Less current portion	
Long-term portion	\$ 108.0

Contractual maturities of long-term debt subsequent to September 23, 2005 are as follows (in millions):

Remaining in 2005	\$
2006	
2007	
2008	
2009	0.5
2010	107.5
Total	\$ 108.0

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

(Unaudited)

NOTE 5. STOCK OPTION PLANS

The Company has two stock option plans, the 1999 Stock Option Plan and the 2002 Stock Option Plan. The table below details the Company's stock option activity for the nine-month periods ended September 23, 2005 and September 17, 2004, respectively.

Common Stock Options	Nine Months Ended	
	Sept. 23, 2005	Sept. 17, 2004
Granted		
@ \$16.18 per share		47,000
@ \$19.54 per share	47,000	
@ \$19.66 per share		99,000
@ \$20.31 per share		37,000
@ \$25.75 per share	47,500	
Subtotal	94,500	183,000
Exercised		
@ \$4.31 per share		58,728
@ \$5.00 per share	23,310	29,859
@ \$10.00 per share	49,000	6,000
@ \$12.50 per share	19,700	13,300
@ \$13.74 per share	14,000	
@ \$15.78 per share	5,500	
@ \$16.18 per share	5,800	
@ \$19.66 per share	1,600	
Subtotal	118,910	107,887
Canceled or Expired		
@ \$5.00 per share	1,333	17,998
@ \$12.50 per share	23,200	47,700
@ \$13.74 per share	6,000	
@ \$15.00 per share		34,760
@ \$15.78 per share	25,000	4,800
@ \$19.76 per share		10,000
@ \$21.51 per share	200	
Subtotal	55,733	115,258

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

NOTE 6. 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, results of operations or liquidity. Most of the lawsuits to which the Company is a party are covered by insurance and are being defended by insurance carriers.

Two subsidiaries of the Company 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

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PACER INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

agreed to a minimum judgment of \$250,000 and a maximum judgment of \$1.75 million. In August 2000, the trial court ruled in the Company's favor on all issues except one, namely that in 1998 the Company's subsidiaries failed to issue to the owner-operators new certificates of insurance disclosing a change in the Company's 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 Company's 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 elected to obtain through the Company's subsidiaries, 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. The Company sought review at the California Supreme Court of this workers compensation issue, and the plaintiffs sought review only of whether the Company's subsidiaries' providing insurance for the owner-operators constituted engaging in the insurance 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, the Company successfully defended and prevailed over the plaintiffs' challenges to core operating practices of the Company, establishing that (i) the owner-operators were independent contractors and not employees of the Company and (ii) the Company may charge the owner-operators for liability insurance coverage purchased by the Company. Following the California Supreme Court's decision, the only remaining issue is 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.

In the fourth quarter of 2004, the trial court set the schedule for the remand trial and ordered each of the parties to present its case to the court by way of written submissions of the affidavits, records and other documentary evidence and the legal arguments upon which such party would rely in the remand trial. Following these submissions, the court would then determine whether to schedule and hear oral testimony and argument. During the second quarter of 2005, and following extensions of filing deadlines, the parties delivered their respective evidentiary submissions and initial briefs to the court. The court extended into the third quarter the deadlines for filing final response and reply briefs.

During the second quarter of 2005 the Company also 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 believes 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), taken together with the original \$488,978 restitution award for the Company's failure to disclose the change in its liability insurance retention amount, 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, 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 has retained an independent third party to administer the claims process. Upon completion of this process, the Company and plaintiffs' counsel will submit the final settlement of claims to the court for final approval. Upon final court approval, payment of allowed claims will be made and the settlement will be completed. The Company presently expects that the claims process and final settlement will be concluded in the first quarter of 2006.

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PACER INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The same law firm prosecuting the *Albillo* case has filed a separate class action lawsuit 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. The claims in the *Renteria* case, which is being stayed pending full and final disposition of the remaining issue in *Albillo*, mirror those in *Albillo*, specifically, that the Company's 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 the Company's subsidiaries violated California's Business and Professions Code. The Company believes that the final disposition of the insurance issue in *Albillo* in the Company's favor precludes the plaintiffs from re-litigating this issue in *Renteria*. Based on the final ruling in *Albillo* on the insurance issue and other information presently available, and in light of the Company's 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 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. Including pre- and post-judgment interest and court costs, the total amount of the judgment is approximately \$1,300,000 at present.

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. The Company contends that this finding was incorrect under well-settled law in Texas in circumstances where a plaintiff's own conduct contributes to or causes his own accident and injuries. The Company appealed to the Twelfth Texas Court of Appeals at Tyler, which earlier this year refused to reverse the trial court. The Company then appealed to the Texas Supreme Court. The Supreme Court ordered a full briefing of the appeal, which was completed during the first quarter of 2005. On October 14, the Supreme Court notified the Company's counsel that it would not accept the Company's appeal. On October 31, the Company filed a motion for rehearing with the Supreme Court based on several factors, including the Supreme Court's recent issuance of case law that indicates that the court of appeals decision with respect to the plaintiff's own negligence was improperly decided, and which the Company believes can warrant the Supreme Court's granting of the Company's appeal. If the Supreme Court grants the Company's motion for rehearing, it would likely schedule oral arguments and then take the Company's appeal under consideration and render a final decision. If the Supreme Court denies the Company's motion for rehearing, the original trial court verdict will become final and the full amount of the *Dicks* judgment, plus interest and costs, will become due and payable. Currently the maximum possible loss exposure approximates \$1.3 million, of which \$0.3 million has been accrued.

The Company instituted a related case, *Pacific Motor Transport Company v. Lockton Companies, Inc., Lockton Risk Services, Inc., and Cambridge Integrated Services Group, Inc.*, in which the Company seeks to hold an insurance broker, the insurer's managing general agent, and a claims administrator responsible for its losses in the *Dicks* case due to their mishandling of the Company's claim for insurance coverage. At the time of the incident, the Company 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. The Company 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.

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The Company 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

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

(Unaudited)

been removed from the case. The Company is still pursuing the case against the Lockton entities and Cambridge for violations of the Texas Insurance Code, negligent misrepresentation, and other claims, in which the Company seeks to recover all of the losses, costs and damages arising out of the Lockton entities' and Cambridge's conduct in mishandling the Company's insurance claim for the *Dicks* incident.

At September 23, 2005, the Company had a commitment to acquire 1,746 53-ft. containers and 860 53-ft. chassis through operating leases. Delivery will take place through February 2006.

NOTE 7. 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.

The following table presents revenues generated by country or geographical area for the three- and nine-month periods ended September 23, 2005 and September 17, 2004 (in millions).

	Three Months Ended		Nine Months Ended	
	Sept. 23, 2005	Sept. 17, 2004	Sept. 23, 2005	Sept. 17, 2004
United States	\$ 372.6	\$ 393.8	\$ 1,194.1	\$ 1,153.4
Mexico	28.5	9.3	48.3	28.4
Russia/China	13.9	8.2	29.8	24.7
Europe	7.4	6.0	22.5	16.5
Far East	5.3	4.5	16.2	12.7
Canada	4.8	4.5	13.7	11.4
Australia/New Zealand	2.9	1.8	7.6	5.0
Africa	1.2	0.2	1.8	0.6
South America	0.8	0.8	3.4	2.3
Mideast	0.8	3.3	2.6	4.7
All Other	3.4	5.8	16.3	17.6
Total	\$ 441.6	\$ 438.2	\$ 1,356.3	\$ 1,277.3

All of the foreign revenues are generated by the retail segment with the exception of Mexico, where the Company's wholesale Stacktrain operation generates revenues.

For the three- and nine-month periods ended September 23, 2005 and September 17, 2004, the Company had no customers that contributed more than 10% of the Company's total revenues.

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

(Unaudited)

The following table presents reportable segment information for the three- and nine-month periods ended September 23, 2005 and September 17, 2004 (in millions).

	<u>Wholesale</u>	<u>Retail</u>	<u>Corp./Other</u>	<u>Consolidated</u>
3 Months ended September 23, 2005				
Revenues	\$ 269.0	\$ 213.2	\$	\$ 482.2
Inter-segment elimination	(40.6)			(40.6)
Subtotal	228.4	213.2		441.6
Income from operations	28.6	2.1	(4.6)	26.1
Depreciation	0.8	0.8	0.1	1.7
Capital expenditures	0.6	0.6		1.2
Total assets	\$ 469.7	\$ 132.8	\$ (31.6)	\$ 570.9
3 Months ended September 17, 2004				
Revenues	\$ 233.4	\$ 235.7	\$	\$ 469.1
Inter-segment elimination	(30.9)			(30.9)
Subtotal	202.5	235.7		438.2
Income from operations	23.6	1.0	(4.0)	20.6
Depreciation	0.9	0.9		1.8
Capital expenditures	0.1	1.5		1.6
Total assets	\$ 390.3	\$ 232.0	\$ (23.7)	\$ 598.6
9 Months ended September 23, 2005				
Revenues	\$ 794.1	\$ 683.3	\$	\$ 1,477.4
Inter-segment elimination	(121.1)			(121.1)
Subtotal	673.0	683.3		1,356.3
Income from operations 1/	63.7	7.5	(14.2)	57.0
Depreciation	2.6	2.5	0.1	5.2
Capital expenditures	1.0	2.3		3.3
Total assets	\$ 469.7	\$ 132.8	\$ (31.6)	\$ 570.9
9 Months ended September 17, 2004				
Revenues	\$ 695.8	\$ 669.4	\$	\$ 1,365.2
Inter-segment elimination	(87.9)			(87.9)
Subtotal	607.9	669.4		1,277.3
Income from operations	61.8	5.2	(10.8)	56.2
Depreciation	2.8	2.6		5.4
Capital expenditures	0.2	3.1		3.3
Total assets	\$ 390.3	\$ 232.0	\$ (23.7)	\$ 598.6

Data in the Corp./Other column includes corporate amounts (primarily compensation and overhead costs unrelated to a specific segment) and elimination of intercompany balances and subsidiary investment. Intersegment revenues were \$40.6 million and \$121.1 million for the three-

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and nine-month periods ending September 23, 2005 and \$30.9 million and \$87.9 million for the three- and nine-month periods ending September 17, 2004, respectively. All intersegment services are provided and purchased at quoted market rates and have been included in the wholesale segment revenues above.

1/ Wholesale segment and consolidated income from operations for the nine-month period ended September 23, 2005 includes \$11.3 million for the write-off of previously capitalized computer software development costs (see Note 3).

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

(Unaudited)

NOTE 8. EARNINGS PER SHARE

The following table sets forth the computation of earnings per share-basic and diluted (in millions, except share and per share amounts):

	Three Months Ended		Nine Months Ended	
	Sept. 23, 2005	Sept. 17, 2004	Sept. 23, 2005	Sept. 17, 2004
Numerator:				
Net income	\$ 14.6	\$ 11.3	\$ 30.5	\$ 30.2
Denominator:				
Denominator for earnings per share-basic:				
Weighted average common shares outstanding	37,397,514	37,263,222	37,361,481	37,247,585
Effect of dilutive securities:				
Stock options	663,729	732,196	660,229	892,513
Denominator for earnings per share-diluted	38,061,243	37,995,418	38,021,710	38,140,098
Earnings per share-basic	\$ 0.39	\$ 0.30	\$ 0.82	\$ 0.81
Earnings per share-diluted	\$ 0.38	\$ 0.30	\$ 0.80	\$ 0.79

Options to purchase 47,500 shares of common stock at \$25.75 per share were outstanding during the three- and nine-months ended September 23, 2005 but were not included in the computation of diluted earnings per share for those periods because the options' exercise price was greater than the average market price of the common shares during these periods. Options to purchase 10,000 shares of common stock at \$19.65 per share, 99,000 shares of common stock at \$19.66 per share, 37,000 shares of common stock at \$20.31 per share, and 7,000 shares of common stock at \$21.51 per share were outstanding during the three- and nine-months ended September 17, 2004 but were not included in the computation of diluted earnings per share for those periods because the options' exercise prices were greater than the average market price of the common shares during these periods.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Management's Discussion and Analysis (MD&A) should be read in conjunction with the MD&A, including the discussion of our Critical Accounting Policies, and the Consolidated Financial Statements included in the Company's annual report on Form 10-K for the fiscal year ended December 31, 2004.

Forward-Looking Statements

This quarterly report on Form 10-Q contains forward-looking statements, in accordance with Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that reflect our current estimates, expectations and projections about our future results, performance, prospects and opportunities. Forward-looking statements include, among other things, the information concerning our possible future results of operations, business and growth strategies, financing plans, our competitive position and the effects of competition, the projected growth of the industries in which we operate, and the benefits and synergies to be obtained from our completed and any future acquisitions. Forward-looking statements include all statements that are not historical facts and can be identified by forward-looking words such as anticipate , believe , could , estimate , expect , intend , plan , may , should , will , would, project and similar expressions. Forward-looking statements are based on information currently available to us and are subject to a number of risks, uncertainties and other factors that could cause our actual results, performance, prospects or opportunities to differ materially from those expressed in, or implied by, these forward-looking statements. Important factors that could cause our actual results to differ materially from the results referred to in the forward-looking statements we make in this quarterly report include:

General economic and business conditions;

Congestion, work stoppages, capacity shortages or weather related issues and service disruptions affecting our rail and motor transportation providers;

Industry trends, including changes in the costs of services from rail and motor transportation providers;

The loss of one or more of our major customers;

The impact of competitive pressures in the marketplace;

The frequency and severity of accidents, particularly involving our trucking operations;

Changes in our business strategy, development plans or cost savings plans;

Availability of qualified personnel;

Changes in, or the failure to comply with, government regulation;

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Increases in interest rates;

Difficulties in maintaining or enhancing our information technology systems;

Our ability to integrate acquired businesses;

Terrorism and acts of war;

Increases in our leverage; and

The other risk factors detailed from time to time in the documents filed by the Company with the Securities and Exchange Commission (SEC), including those set forth under the caption Risks Related to Our Business in our annual report on Form 10-K for the fiscal year ended December 31, 2004 filed March 14, 2005.

You should not place undue reliance on any forward-looking statements. Except as otherwise required by federal securities laws, we undertake no obligation to publicly revise our forward-looking statements to reflect events or circumstances that arise after the date of this quarterly report.

Executive Summary

During the third quarter of 2005, our Board of Directors made the decision to institute a quarterly dividend policy of \$0.15 per common share (\$0.60 per common share per annum) to enhance shareholder value and return profits to stockholders. In September 2005, the first quarterly dividend of \$0.15 per common share was declared by our Board of Directors. The dividend was paid in October 2005. The declaration of future dividends by the Company and the amount thereof is in the discretion of our Board of

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Directors and will depend on our results of operations, financial condition, cash requirements, future prospects and other factors deemed relevant by the Board of Directors.

Our financial performance for the third quarter of 2005 was one of our strongest quarters since our IPO in 2002 with both our wholesale and retail segments showing improvements in the 2005 quarter versus the 2004 quarter. Income from operations for the 2005 quarter increased \$5.5 million to \$26.1 million, net income increased \$3.3 million to \$14.6 million and diluted earnings per share increased \$0.08 to \$0.38 for the quarter. The recent hurricane activity has had minimal impact on our results as we were able to reroute the majority of shipments through the St. Louis gateway and away from the New Orleans gateway. We completed the transition of a lower margin truck brokerage customer to another service provider during the quarter, and our retail segment usage of our wholesale segment increased to \$40.6 million for the 2005 quarter, representing a 31.4% increase over the 2004 quarter due to our initiative to increase cross selling between segments. We generated \$37.1 million in operating cash flows for the third quarter of 2005 and repaid \$16.0 million of debt, reducing our long-term debt to \$108.0 million. While our next required debt payment is not until December 30, 2009, we intend to continue to make voluntary debt payments with our operating cash flows.

We believe that our retail segment operations continued to show progress during the third quarter of 2005, contributing \$2.1 million to income from operations, up 110% from the comparable 2004 quarter. Our wholesale Stacktrain operations continue to be the strength of the Company with income from operations of \$27.6 million for the 2005 quarter. All three Stacktrain lines of business increased revenues for the third quarter of 2005 over the 2004 quarter with third-party domestic up 23.8%, automotive up 7.6% and international up 25.8%. Contributing to the revenue increases for the third quarter of 2005 was a 15.1% average fuel surcharge compared to a 7.0% surcharge in the comparable 2004 quarter. We believe that the higher fuel surcharges will continue in the near future. Income from operations for our cartage operations decreased \$0.4 million for the 2005 quarter compared to the 2004 quarter due primarily to costs related to the acquisition and retention of owner/operators, fuel costs and equipment charges.

We still have a number of areas that need management focus in the quarters ahead including: improving rail service by working with our core rail carriers; improving the success of our owner/operator acquisition and retention activities; continuing progress on safety; and, improving intermodal volumes in our rail brokerage unit which softened during the 2005 quarter.

As discussed in our annual report on Form 10-K for the year ended December 31, 2004 filed with the SEC on March 14, 2005, we use a key objective management process designed to improve execution of objectives deemed to be substantive to our financial results. Progress is continuing on 9 critical and 13 other key objectives underway throughout the Company. These initiatives are aimed at increasing business growth, improving margins and profitability and improving or maintaining safety in our transportation businesses. However, no assurance can be given that any of the identified objectives will be successful or achieve the business growth or operating improvements sought.

Critical Accounting Policies

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Future events and their effects cannot be predicted with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results inevitably will differ from those estimates, and such differences may be material to the financial statements. Management believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements. For additional information regarding each of these critical accounting policies, including the potential effect of specified deviations from management estimates, see Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies in our annual report on Form 10-K for the year ended December 31, 2004.

Recognition of Revenue. We recognize revenue when all of the following conditions are met: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is determinable and collectability is reasonably assured. We maintain signed contracts with our customers or have bills of lading specifying shipment details. Our Stacktrain operations recognize revenue

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for loads that are in transit at the end of an accounting period on a percentage-of-completion basis. Revenue is recorded for the portion of the transit that has been completed because reasonably dependable estimates of the transit status of loads are available. In addition, our Stacktrain operations offer volume discounts based on annual volume thresholds. We estimate our customers' annual shipments throughout the year and record a reduction to revenue accordingly. Should our customers' annual volume vary significantly from our estimates, a revision to revenue for volume discounts would be required. Our wholesale cartage operations and our retail segment recognize revenue after services have been completed.

Recognition of Cost of Purchased Transportation and Services. Both our wholesale and retail segments estimate the cost of purchased transportation and services and accrue an amount on a load by load basis in a manner that is consistent with revenue recognition. In addition, our retail segment earns discounts to the cost of purchased transportation and services that are primarily based on the annual volume of loads transported over major railroads. We estimate our annual volume throughout the year and record a reduction to cost of purchased transportation accordingly. Should our annual volume vary significantly from our estimates, a revision to the cost of purchased transportation would be required.

Allowance for Doubtful Accounts. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. Estimates are used in determining this allowance based on our historical collection experience, current trends, credit policy and a percentage of our accounts receivable by aging category. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances could be required. Historically, our actual losses have been within the estimated allowances. However, unexpected or significant future changes could result in a material impact to future results of operations.

Deferred Tax Assets. At September 23, 2005, we have recorded net deferred tax assets of \$16.1 million. We have not recorded a valuation reserve on the recorded amount of net deferred tax assets as we believe that future earnings will more likely than not be sufficient to fully utilize the assets. The minimum amount of future taxable income required to realize this asset is \$40.5 million. Should we not be able to generate this future income, we would be required to record valuation allowances against the deferred tax assets resulting in additional income tax expense.

Goodwill. We adopted the Financial Accounting Standards Board Statement of Financial Accounting Standard (SFAS) No. 142, Goodwill and Other Intangible Assets effective December 29, 2001. SFAS No. 142 requires periodic testing for impairment and recognition of impairment losses under certain circumstances. The Company evaluates the carrying value of goodwill and recoverability should events or circumstances occur that bring into question the realizable value or impairment of goodwill, or at least annually. Determination of impairment requires comparison of the reporting unit's fair value with the units carrying amount, including goodwill. If this comparison indicates that the fair value is less than the carrying value, then the implied fair value of the reporting unit's goodwill is compared with the carrying amount of the reporting unit's goodwill to determine the impairment loss to be charged to operations.

Table of Contents**Results of Operations****Three Months Ended September 23, 2005 Compared to Three Months Ended September 17, 2004**

The following table sets forth our historical financial data by reportable segment for the three months ended September 23, 2005 and September 17, 2004 (in millions).

	<u>2005</u>	<u>2004</u>	<u>Change</u>	<u>% Change</u>
Revenues				
Wholesale	\$ 269.0	\$ 233.4	\$ 35.6	15.3%
Retail	213.2	235.7	(22.5)	(9.5)
Inter-segment elimination	(40.6)	(30.9)	(9.7)	31.4
Total	441.6	438.2	3.4	0.8
Cost of purchased transportation and services				
Wholesale	196.2	168.0	28.2	16.8
Retail	182.7	206.8	(24.1)	(11.7)
Inter-segment elimination	(40.6)	(30.9)	(9.7)	31.4
Total	338.3	343.9	(5.6)	(1.6)
Direct operating expenses				
Wholesale	26.5	25.6	0.9	3.5
Retail				
Total	26.5	25.6	0.9	3.5
Selling, general & administrative expenses				
Wholesale	16.9	15.3	1.6	10.5
Retail	27.6	27.0	0.6	2.2
Corporate	4.5	4.0	0.5	12.5
Total	49.0	46.3	2.7	5.8
Depreciation and amortization				
Wholesale	0.8	0.9	(0.1)	(11.1)
Retail	0.8	0.9	(0.1)	(11.1)
Corporate	0.1		0.1	n.m.
Total	1.7	1.8	(0.1)	(5.6)
Income from operations				
Wholesale	28.6	23.6	5.0	21.2
Retail	2.1	1.0	1.1	110.0
Corporate	(4.6)	(4.0)	(0.6)	(15.0)
Total	26.1	20.6	5.5	26.7
Interest expense	1.9	2.2	(0.3)	(13.6)
Income taxes	9.6	7.1	2.5	35.2

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Net income	\$ 14.6	\$ 11.3	\$ 3.3	29.2%
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Revenues. Revenues increased \$3.4 million, or 0.8%, for the three months ended September 23, 2005 compared to the three months ended September 17, 2004. Revenues in our retail segment decreased \$22.5 million, or 9.5%, for the 2005 quarter compared to the 2004 quarter due primarily to the completion of the transitioning of a truck brokerage customer to another service provider, coupled with reduced intermodal traffic volumes. Revenues for our truck brokerage unit decreased 39.7% compared to the 2004 quarter due to the completion of this transitioning. While our rail brokerage unit reported higher income from operations for the 2005 quarter compared to the 2004 quarter due primarily to yield management and cost cutting efforts, revenues decreased by 11.7% due to decreased intermodal traffic volumes during the 2005 period partially offset by a higher fuel surcharge in the 2005 period. Warehousing and distribution revenues were up 30.5% due to additional business from existing customers and yield management efforts. Our international unit revenues were up 16.8% due to continuing strong import/export business compared to the 2004 quarter. Truck services revenues were up 14.4% due to additional agents in the 2005 quarter and an increase in the amount of freight brokered due to high transportation demand. Revenues for our supply chain services unit increased 1.4% due to increases from existing customers.

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Wholesale segment revenues increased \$35.6 million, reflecting an increase in our Stacktrain operations partially offset by a decrease in our cartage operations. Cartage revenues decreased \$0.2 million due to owner/operator acquisition and retention issues. In addition, revenue growth at the new cartage locations opened in the northeast and southeast sections of the United States in early 2005 continues to be slow. These issues are being addressed with key objective management focus. Stacktrain revenues increased \$35.8 million in the third quarter of 2005 compared to the 2004 quarter and reflected increases in wholesale third-party domestic, automotive, international and container per diem revenues. The 23.8% increase in wholesale third-party domestic freight revenues was due to increases during the 2005 quarter compared to the 2004 quarter from several intermodal marketing companies, including our own rail brokerage operations. In addition to selective rate increases implemented during the quarter, a 15.1% average fuel surcharge was in effect during the 2005 quarter compared to a 7.0% average surcharge during the 2004 quarter. We expect that the fuel surcharge percentage will remain at these increased levels at least for the near term due to high fuel costs. Domestic containers handled increased 8.7% over the 2004 quarter and the average freight revenue per container increased 13.8%. Results in both periods were negatively impacted by hurricane activity and service issues with our core rail carriers. The 7.6% increase in automotive freight revenues was due to a volume increase of 4.8% over the third quarter of 2004 coupled with a 2.6% increase in the average freight revenue per container. The 25.8% increase in wholesale international revenues was due to a 13.0% increase in the average freight revenue per container combined with an 11.3% increase in containers handled. The \$0.8 million 2005 quarter increase in container per diem revenue resulted from more containers in service during the 2005 quarter compared to the 2004 quarter. In addition, a new Stacktrain per diem billing system was completed during the first quarter of 2005 which has improved billing and collection efforts.

Our retail segment usage of our wholesale segment for rail transportation increased by \$9.7 million, or 31.4%, in the 2005 quarter compared to the 2004 quarter as a result of an initiative to increase cross-selling. Cross-selling activities within the retail segment decreased by \$1.3 million in the 2005 quarter compared to the 2004 quarter due primarily to reduced retail automotive business.

Cost of Purchased Transportation and Services. Cost of purchased transportation and services decreased \$5.6 million, or 1.6%, for the three months ended September 23, 2005 compared to the three months ended September 17, 2004. Cost of purchased transportation and services in our retail segment decreased \$24.1 million due primarily to the completion of transition of a truck brokerage customer during the 2005 quarter coupled with reduced rail brokerage shipments discussed above. The overall gross margin percentage on our retail business increased from 12.3% in the 2004 quarter to 14.3% in the 2005 quarter primarily reflecting changes in business mix and improved yield efforts. The reduction in business from the transitioning of a customer in our truck brokerage unit to another transportation provider contributed to the margin percentage increase as this customer was a low margin account. Our rail brokerage margin percentage increased over the 2004 quarter due in part to yield management initiatives. These increases were partially offset by a decline in margin percentage in our truck services unit due to the increase in the amount of brokerage business which is priced at a lower margin percentage than when using trucks of our independent owner/operators. Our international unit also experienced a margin percentage decline reflecting an increase in lower margin import business in the 2005 quarter compared to the 2004 quarter. Margin percentages in our remaining retail segment divisions for the 2005 quarter were comparable to the 2004 quarter.

The wholesale segment's cost of purchased transportation and services increased \$28.2 million for the 2005 quarter compared to the 2004 quarter reflecting increases in both Stacktrain and cartage costs. The Stacktrain increase was related to the increased shipments noted above combined with a 9.1% increase in the cost per container due primarily to increased fuel costs from our underlying service providers and changes in business mix. The cartage increase was due to higher owner/operator costs, fuel costs and equipment charges during the 2005 quarter. The overall gross margin percentage for the wholesale segment decreased from 28.0% in the 2004 quarter to 27.0% in the 2005 quarter.

Direct Operating Expenses. Direct operating expenses, which are only incurred by our wholesale Stacktrain operations, increased \$0.9 million, or 3.5%, in the 2005 quarter compared to the 2004 quarter due primarily to increased container and chassis lease and maintenance costs attributable to the larger fleet size during the 2005 quarter. At September 23, 2005, we had 12.6% or 3,083 more containers and 7.8% or 2,020 more chassis than at September 17, 2004.

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Selling, General and Administrative Expenses. Selling, general and administrative expenses increased \$2.7 million, or 5.8%, in the 2005 quarter compared to the 2004 quarter. The increase was primarily the result of increased compensation expense associated with a 4% wage increase effective January 1, 2005. Average employment decreased by 29 in the 2005 quarter compared to the 2004 quarter due primarily to reductions related to the completion of the transition of a truck brokerage customer to another service provider. In addition, during the 2005 quarter \$2.2 million was accrued for employee bonuses compared to no accrual in the comparable 2004 quarter. This increase in expense relative to the prior period was partially offset by reduced temporary warehouse rental expense in our retail segment during the 2005 quarter due to vacating temporary warehouses in 2004, as well as reduced Sarbanes-Oxley Act of 2002 compliance costs.

Depreciation and Amortization. Depreciation and amortization expenses decreased \$0.1 million, or 5.6%, in the 2005 quarter compared to the 2004 quarter due to property retirements.

Income From Operations. Income from operations increased \$5.5 million, or 26.7%, from \$20.6 million in the 2004 quarter to \$26.1 million in the 2005 quarter. Wholesale segment income from operations increased \$5.0 million reflecting a \$5.4 million increase in Stacktrain income from operations partially offset by a \$0.4 million decrease in cartage income from operations. The Stacktrain increase was due to strength in all three lines of the wholesale business as well as increased container per diem income related to more containers in service during the 2005 quarter. The cartage decrease was due primarily to higher owner/operator costs related to the acquisition and retention of owner/operators, and higher fuel costs and equipment charges during the 2005 quarter compared to the 2004 quarter. Retail segment income from operations increased \$1.1 million for the quarter reflecting increases primarily at the rail brokerage, warehouse and distribution and international units, partially offset by reduced income from operations at the truck services unit due to the increase in lower margin brokerage business and the truck brokerage unit due to the completion of the transition of a customer to another service provider. Income from operations for the 2005 quarter was adversely impacted by the corporate bonus accrual partially offset by reduced costs related to compliance with the Sarbanes-Oxley Act of 2002.

Interest Expense. Interest expense decreased by \$0.3 million, or 13.6%, for the 2005 quarter compared to the 2004 quarter due primarily to a lower level of outstanding debt during the period. At September 23, 2005, total long-term debt was \$108.0 million, \$61.1 million less than the balance of \$169.1 million at September 17, 2004. Interest rates have increased from an average of approximately 4.0% during the 2004 quarter to 5.4% during the 2005 quarter.

Income Tax Expense. Income tax expense increased \$2.5 million in the 2005 quarter compared to the 2004 quarter due to higher pre-tax income in the 2005 quarter, combined with a higher effective tax rate of 39.7% for the 2005 quarter compared to 38.6% for the 2004 quarter. The effective tax rate for the 2004 quarter was lower than the rate for the 2005 quarter due to a state tax rate study reducing the rate for the 2004 quarter.

Net Income. Net income increased by \$3.3 million from \$11.3 million in the 2004 quarter to \$14.6 million in the 2005 quarter reflecting the higher income from operations (up \$5.5 million) as discussed above, combined with reduced interest costs (down \$0.3 million) associated with the lower level of outstanding debt during the 2005 quarter, partially offset by higher income tax expense (up \$2.5 million) related to a higher pre-tax income and higher effective tax rate in the 2005 quarter.

Table of ContentsNine Months Ended September 23, 2005 Compared to Nine Months Ended September 17, 2004

The following table sets forth our historical financial data by reportable segment for the nine months ended September 23, 2005 and September 17, 2004 (in millions).

	<u>2005</u>	<u>2004</u>	<u>Change</u>	<u>% Change</u>
Revenues				
Wholesale	\$ 794.1	\$ 695.8	\$ 98.3	14.1%
Retail	683.3	669.4	13.9	2.1
Inter-segment elimination	(121.1)	(87.9)	(33.2)	37.8
Total	1,356.3	1,277.3	79.0	6.2
Cost of purchased transportation and services				
Wholesale	579.4	505.0	74.4	14.7
Retail	590.5	584.1	6.4	1.1
Inter-segment elimination	(121.1)	(87.9)	(33.2)	37.8
Total	1,048.8	1,001.2	47.6	4.8
Direct operating expenses				
Wholesale	84.4	79.8	4.6	5.8
Retail				
Total	84.4	79.8	4.6	5.8
Selling, general & administrative expenses				
Wholesale	52.7	46.3	6.4	13.8
Retail	82.8	77.6	5.2	6.7
Corporate	14.1	10.8	3.3	30.6
Total	149.6	134.7	14.9	11.1
Write-off of computer software				
Wholesale	11.3		11.3	n.m.
Retail				
Corporate				
Total	11.3		11.3	n.m.
Depreciation and amortization				
Wholesale	2.6	2.9	(0.3)	(10.3)
Retail	2.5	2.5		
Corporate	0.1		0.1	n.m.
Total	5.2	5.4	(0.2)	(3.7)
Income from operations				
Wholesale	63.7	61.8	1.9	3.1
Retail	7.5	5.2	2.3	44.2
Corporate	(14.2)	(10.8)	(3.4)	31.5
Total	57.0	56.2	0.8	1.4

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Interest expense	6.3	7.1	(0.8)	(11.3)
Income taxes	20.2	18.9	1.3	6.9
Net income	\$ 30.5	\$ 30.2	\$ 0.3	1.0%

Revenues. Revenues increased \$79.0 million, or 6.2%, for the nine months ended September 23, 2005 compared to the nine months ended September 17, 2004. Revenues in our retail segment increased \$13.9 million, or 2.1%, for the 2005 period compared to the 2004 period due to increased revenues from all but two of our retail divisions. Truck services revenues were up 18.8% due to additional agents in the 2005 period and an increase in the amount of freight brokered due to high transportation demand. Our international unit revenues were up 19.1% due to continuing strong import/export business compared to the 2004 period which more than offset reduced international relief shipments during the 2005 period. Warehousing and distribution revenues were up 13.3% due to additional business from existing customers and yield management efforts. Revenues for our supply chain services unit increased 5.4% due to expansion of services to and other increases from existing customers. While our rail brokerage unit reported higher income from operations for the 2005 period compared to the 2004 period due primarily to yield management and cost cutting efforts, revenues decreased by 0.6% due to decreased intermodal traffic

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volumes during the 2005 period partially offset by a higher fuel surcharge in the 2005 period. Our truck brokerage unit experienced a 14.1% decline in revenues during the 2005 period compared to the 2004 period due to the completion of transitioning of a customer to another service provider, partially offset by increases in brokered freight activities.

Wholesale segment revenues increased \$98.3 million, reflecting increases in both cartage and Stacktrain operations. Depressing both Stacktrain and cartage revenues during the 2005 period was the Union Pacific embargo of Southern California locations due to severe weather conditions in January 2005 and during the 2004 period was the West Coast independent owner/operator truckers' work stoppage. In addition, hurricane activity has impaired operations during both periods. Cartage revenues increased \$4.2 million due to increased revenue from the nine new cartage locations opened in early 2005, primarily in the northeast and southeast sections of the United States, although revenue growth has been slow at these locations. In addition, depressing cartage revenue growth has been owner/operator acquisition and retention issues. These issues are being addressed with key objective management focus. Stacktrain revenues increased \$94.1 million in the 2005 period compared to the 2004 period and reflected increases in wholesale third-party domestic, automotive, international and container per diem revenues. The 20.0% increase in wholesale third-party domestic freight revenues was due to increases during the 2005 period compared to the 2004 period from several intermodal marketing companies, including our own rail brokerage operations. In addition to selective rate increases implemented during the period, a 13.2% average fuel surcharge was in effect during the 2005 period compared to a 5.9% average surcharge during the 2004 period. We expect that the fuel surcharge percentage for the near term will remain at the increased levels experienced during the third quarter of 2005 due to high fuel costs. Domestic containers handled increased 7.3% over the 2004 period and the average freight revenue per container increased 11.8%. The 10.6% increase in automotive freight revenues was due to a volume increase of 7.8% over the 2004 period coupled with a 2.6% increase in the average freight revenue per container. The 11.0% increase in wholesale international revenues was due to a 7.8% increase in the average freight revenue per container coupled with a 2.9% increase in containers handled. The \$3.8 million 2005 period increase in container per diem revenue resulted from more containers in service during the 2005 period compared to the 2004 period. In addition, a new Stacktrain per diem billing system was completed during the first quarter of 2005 which has improved billing and collection efforts.

Our retail segment usage of our wholesale segment for rail transportation increased by \$33.2 million, or 37.8%, in the 2005 period compared to the 2004 period as a result of an initiative to increase cross-selling. Cross-selling activities within the retail segment decreased by \$5.5 million in the 2005 period compared to the 2004 period due primarily to reduced retail automotive business.

Cost of Purchased Transportation and Services. Cost of purchased transportation and services increased \$47.6 million, or 4.8%, for the nine months ended September 23, 2005 compared to the nine months ended September 17, 2004. Cost of purchased transportation and services in our retail segment increased \$6.4 million due primarily to the increased business discussed above. The overall gross margin percentage on our retail business increased from 12.8% in the 2004 period to 13.6% in the 2005 period primarily reflecting changes in business mix and improved yield efforts. The reduction in business from the transitioning of a customer in our truck brokerage unit to another transportation provider contributed to the margin percentage increase as this customer was a low margin account. Also contributing to the margin percentage increase in the 2005 period was an increase in the warehousing and distribution gross margin percentage due to improved handling and yield management and the inclusion, in the 2004 period, of costs to vacate temporary warehousing facilities. These increases were partially offset by a decline in margin percentage in our truck services unit due to the increase in the amount of brokerage business which is priced at a lower margin percentage than when using trucks of our independent owner/operators. Our international unit also experienced a margin percentage decline with the increase in lower margin import business in the 2005 period compared to the 2004 period. Margin percentages in our remaining retail segment divisions for the 2005 period were comparable to the 2004 period.

The wholesale segment's cost of purchased transportation and services increased \$74.4 million, or 14.7%, for the 2005 period compared to the 2004 period reflecting increases in both Stacktrain and cartage costs. The Stacktrain increase was related to the increased shipments noted above combined with a 7.6% increase in the cost per container due primarily to increased fuel costs from our underlying service providers and changes in business mix. The cartage increase was also due primarily to increased shipments noted above coupled with higher owner/operator costs, fuel costs and equipment charges during the 2005

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period. The overall gross margin percentage for the wholesale segment decreased slightly from 27.4% in the 2004 period to 27.0% in the 2005 period.

Direct Operating Expenses. Direct operating expenses, which are only incurred by our wholesale Stacktrain operations, increased \$4.6 million, or 5.8%, in the 2005 period compared to the 2004 period due primarily to increased container and chassis lease and maintenance costs attributable to the larger fleet size during the 2005 period. At September 23, 2005, we had 12.6% or 3,083 more containers and 7.8% or 2,020 more chassis than at September 17, 2004.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased \$14.9 million, or 11.1%, in the 2005 period compared to the 2004 period. During the 2005 period, we expensed \$1.9 million relating to the settlement of three legal cases. These cases related to our cartage, truck services and corporate units. The overall increase was also the result of increased compensation expense associated with a 4% wage increase effective January 1, 2005, an overall average increase of 22 people employed during the 2005 period compared to the 2004 period and an increase in other professional fees and costs related to various continuing legal matters. In addition, during the 2005 period, \$4.7 million was accrued for employee bonuses compared to no accrual in the comparable 2004 period. Also contributing to the increased 2005 expense was the receipt during the 2004 period of an insurance settlement related to the September 11, 2001 terrorist attack which reduced costs in the 2004 period. The overall increase in expense relative to the prior period was partially offset by reduced temporary warehouse rental expense in our retail segment during the 2005 period due to vacating temporary warehouses in 2004, as well as reduced Sarbanes-Oxley Act of 2002 compliance costs. The headcount increase was in our retail segment and related primarily to increased employment in our truck services division partially offset by reduced truck brokerage employment related to the completion of transitioning of a customer to another service provider.

Write-off of Computer Software. During the second quarter of 2005, based on an internal analysis of the cost to continue the computer software development project and an assessment of a review by an independent third-party, we decided to abandon the conversion from APL Limited's computer systems to a stand-alone capability for our Stacktrain operations. A total of \$11.3 million, which had been capitalized in property and equipment for the development of the software, was written-off. We will continue to avail ourselves of the services and support for up to the next 14 years under the existing long-term agreement with APL Limited.

Depreciation and Amortization. Depreciation and amortization expenses decreased by \$0.2 million, or 3.7%, for the 2005 period compared to the 2004 period due to property retirements.

Income From Operations. Income from operations increased \$0.8 million, or 1.4%, from \$56.2 million in the 2004 period to \$57.0 million in the 2005 period. Wholesale segment income from operations increased \$1.9 million reflecting a \$4.2 million increase in Stacktrain income from operations partially offset by a \$2.3 million decrease in cartage income from operations. The Stacktrain increase was due to strength in all three lines of wholesale business as well as increased container per diem related to more containers in service during the 2005 period, partially offset by the write-off of the \$11.3 million of software development costs. The cartage decrease was due primarily to a legal settlement mentioned above combined with higher owner/operator costs related to the acquisition and retention of owner/operators, and higher fuel costs and equipment charges during the 2005 period compared to the 2004 period. Retail segment income from operations increased \$2.3 million for the period reflecting increases at the warehouse and distribution, rail brokerage, truck brokerage and international units. This was partially offset by reduced income from operations at the truck services and supply chain services units. Income from operations for the 2005 period was adversely impacted by corporate costs related to the settlement of the litigation mentioned above coupled with increased bonus accruals in the 2005 quarter, partially offset by reduced costs related to compliance with the Sarbanes-Oxley Act of 2002. Excluding the \$11.3 million charge for the write-off of Stacktrain computer software, overall income from operations for the 2005 period would have been \$68.3 million. See the table below for a reconciliation of as reported results to as adjusted results.

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Interest Expense. Interest expense decreased by \$0.8 million, or 11.3%, for the 2005 period compared to the 2004 period due primarily to a lower level of outstanding debt during the period. At September 23, 2005, total long-term debt was \$108.0 million, \$61.1 million less than the balance of \$169.1

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million at September 17, 2004. Interest rates have increased from an average of approximately 4.0% during the 2004 period to 5.4% during the 2005 period.

Income Tax Expense. Income tax expense increased \$1.3 million in the 2005 period compared to the 2004 period due to higher pre-tax income in the 2005 period, combined with a higher effective tax rate of 39.8% for the 2005 period compared to 38.5% for the 2004 period. The effective tax rate for the 2004 period was lower than the rate for the 2005 period due to a state tax rate study reducing the rate for the 2004 period.

Net Income. Net income increased \$0.3 million from \$30.2 million in the 2004 period to \$30.5 million in the 2005 period reflecting the higher income from operations (up \$0.8 million) as discussed above, combined with reduced interest costs (down \$0.8 million) associated with the lower level of outstanding debt during the 2005 period, partially offset by higher income tax expense (up \$1.3 million) related to a higher pre-tax income and a higher effective tax rate in the 2005 period. Excluding the \$11.3 million pre-tax charge (\$6.8 million after-tax) for the write-off of Stacktrain computer software, net income for the 2005 period would have been \$37.3 million. See the table below for a reconciliation of as reported results to as adjusted results.

Reconciliation of As Reported Financial Results to As Adjusted Financial Results

For the Nine Months Ended September 23, 2005 (in millions, except share and per share amounts)

(Unaudited)

Item	As Reported Results	Adjustments	As Adjusted Results
Income from operations	\$ 57.0	\$ 11.3 1/	\$ 68.3
Interest expense	6.3		6.3
Income before income taxes	50.7	11.3	62.0
Income taxes	20.2	4.5 2/	24.7
Net income	\$ 30.5	\$ 6.8	\$ 37.3
Diluted earnings per share	\$ 0.80	\$ 0.18	\$ 0.98
Weighted average shares outstanding	38,021,710	38,021,710	38,021,710

1/ Write-off of costs related to the development of Stacktrain computer software.

2/ Income tax effect of the write-off at the effective rate.

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Cash generated by operating activities was \$75.7 million and \$36.9 million for the nine months ended September 23, 2005 and September 17, 2004, respectively. The increase in cash provided by operating activities in the 2005 period was due primarily to a higher income from operations combined with the \$11.3 million non-cash write-off of computer software during the second quarter of 2005 and the timing of receivables and payables. Both receivables and payables were slightly elevated at year-end and are now at more normal levels. In addition, the completion of the transitioning of a truck brokerage customer to another service provider also contributed to the increase, as well as reduced interest charges during the 2005 period as compared to the 2004 period due to the lower level of outstanding debt during the 2005 period. Partially offsetting the increase in cash from operating activities were tax payments of \$18.7 million made during the 2005 period compared to \$8.1 million for the 2004 period. Since our federal tax loss carryforwards have all been used, annual income tax cash payments are expected to be approximately \$23 million in 2005 compared to \$12.7 million for 2004. Cash generated from operating activities is typically used for working capital purposes, to fund capital expenditures and dividends, to repay debt, and in the future would be available to fund any acquisitions we decide to make. We utilize a revolving credit facility in lieu of maintaining large cash reserves. We prefer to reduce debt and minimize our interest expense rather than to maintain cash balances and incur increased interest costs. We had working capital of \$50.1 million and \$54.1 million at September 23, 2005 and September 17, 2004, respectively.

Our operating cash flows are also the primary source for funding our contractual obligations. The table below summarizes our major commitments as of September 23, 2005 (in millions).

Contractual Obligations

	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-term debt	\$ 108.0	\$	\$	\$ 108.0	\$
Interest on long-term debt	30.5	6.4	12.8	11.3	
Operating leases	401.7	61.8	105.0	91.4	143.5
Equipment obligation	26.8	2.5	6.7	6.8	10.8
Volume incentives	10.6	10.6			
IT agreements	7.1	5.3	1.8		
Purchased transportation	26.6	26.6			
Total	\$ 611.3	\$ 113.2	\$ 126.3	\$ 217.5	\$ 154.3

Our total long-term debt, as refinanced, was originally incurred to finance our recapitalization and acquisition of Pacer Logistics in 1999 and four acquisitions in our retail segment in 2000. Cash interest expense on long-term debt was estimated using current rates for all periods based upon required repayments. The majority of the operating lease obligations relate to our wholesale segment's lease of railcars, containers and chassis. In addition, each year a portion of the operating leases must be renewed or can be terminated based upon equipment requirements. The equipment obligation is our estimate of operating lease payments on 1,746 containers and 860 chassis ordered and remaining to be financed. We anticipate financing the equipment through an operating lease and will receive the equipment through February 2006. Volume incentives relate to amounts payable to companies that ship on our Stacktrain division and will most likely meet certain volume shipping commitments for the year 2005. IT agreements reflect our Stacktrain operation's use of APL Limited's computer systems under a long-term contract that may be terminated by us on 120 days notice, a three year telecommunications commitment for voice, data and frame relay services and the costs of outsourcing our computer help desk function. The purchased transportation amount reflects our estimate of the cost of transportation purchased by our segments that is in process at quarter-end but not yet completed and minimum container commitments to ocean carriers made by our non-vessel operating common carrier operation.

Based upon the current level of operations and the anticipated future growth in both operating segments, management believes that operating cash flow and availability under the revolving credit facility will be adequate to meet our working capital, capital expenditure and other cash needs for at least the next two years, although no assurance can be given in this regard. Our revolving credit facility matures in June

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2008 and our term loan matures in June 2010. Due to our voluntary debt repayments during the 2005 quarter, our next required debt payment under the credit facility is December 30, 2009, but we intend to continue to make voluntary debt payments with our operating cash flows.

Cash flows used in investing activities were \$3.2 million and \$3.0 million for the nine months ended September 23, 2005 and September 17, 2004, respectively. During the 2005 period, \$0.2 million was expended for the new cartage operating system with the remainder of expenditures in the 2005 period and all of the expenditures in the 2004 period for normal computer system replacement items. The 2005 and 2004 amounts were partially offset by net proceeds of \$0.1 million and \$0.3 million from the sale of property, respectively.

In March 2001, we commenced plans for the conversion from APL Limited's computer systems to a stand-alone capability for our 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.

During the third quarter of 2002, and in connection with this conversion, we 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 us. Since we were unable to reach a mutually acceptable agreement with the developer, during the fourth quarter of 2002 we instituted arbitration under the contract seeking damages for the developer's failure to complete the contract and other claims. The developer answered by denying liability and asserting a counter-claim against us for failing to continue to make progress payments following the developer's breach of the contract. We denied liability on the developer's counter-claim and any obligation to continue to make payments to the developer. On April 7, 2003, the developer and its corporate affiliates completed a general assignment for the benefit of creditors under California law. Under this assignment, the developer and its corporate affiliates transferred ownership of all of their rights in tangible and intangible assets, including the developer's claims in the arbitration proceeding we commenced, to a third party assignee for purposes of liquidating such assets, winding down the developer and its corporate affiliates, and distributing the net liquidation proceeds to creditors.

As a result of this assignment and the related liquidation proceedings, the assignee retained control over the partially completed software code created by the developer under the original contract, thus preventing us from utilizing it in connection with the conversion project. While the separate arbitration and liquidation proceedings were pending, however, we utilized the system design work performed by the developer under the original contract. In July 2004, we entered into an agreement with the assignee settling all claims between us and the developer asserted in the arbitration and otherwise arising under the original contract. Under the settlement agreement, we received a cash payment of approximately \$102,000 out of the assets of the developer that remained available for distribution to unsecured creditors, and we and the assignee exchanged mutual releases of all claims asserted in the arbitration and otherwise arising under the original contract. In addition, pursuant to the settlement agreement we took delivery from the assignee and a third party escrow agent of all of the partially completed software code that had been developed by the developer under the original contract. With the assistance of independent consultants, we 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 early June 2005, we completed this evaluation, and identified a number of significant factors bearing on our decision whether to continue with the development of the software and place it into service, including: continuing growth and changes in our wholesale business since 2001 when the original system transition plan was adopted; advances in systems technology, architecture and programming language since adoption of the original system transition plan in 2001; the significant incremental costs and additional time that would be required to complete the originally planned stand-alone system and the risks in the coming years associated with the commitment to that older system; and the ongoing evolution and development of our wholesale business strategy. Based on these considerations and following our completed evaluation in the second quarter of 2005 of the software development work that had been performed by the developer, we determined to abandon the software and to write-off the \$11.3

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million of capitalized costs in that quarter, constituting all of development costs previously capitalized in connection with this project. We will continue to avail ourselves of the services and support under our existing long-term technology services agreement with APL Limited.

Cash flows used in financing activities were \$63.3 million and \$35.0 million for the nine months ended September 23, 2005 and September 17, 2004, respectively. During the 2005 period, we repaid \$46.0 million principal amount of our long-term debt. Options to purchase 118,910 shares of our common stock were exercised during the 2005 period for total proceeds to the Company of \$1.3 million. During the 2004 period, we repaid \$45.0 million on our long-term debt. Options to purchase 107,887 shares of our common stock were exercised during the 2004 period for total proceeds to the Company of \$0.6 million. At September 23, 2005, the Company had \$59.7 million available under the \$75.0 million revolving credit facility, net of \$15.3 million of outstanding letters of credit. At September 23, 2005, the term loan of \$108.0 million was outstanding with a current interest rate of 5.4%.

On September 14, 2005, we entered into an amendment to our credit agreement to, among other things, increase the maximum aggregate cash dividends payable by us.

On April 28, 2005, we negotiated a repricing for the term loan. The repricing resulted in an immediate reduction of $\frac{1}{2}$ of 1 percent to the applicable margin. The applicable margin is subject to further reductions based upon the Company achieving certain financial ratios.

On January 7, 2004, we filed a shelf registration statement with the SEC, providing for the issuance by us of up to \$150.0 million in additional common stock, preferred stock and warrants to purchase any of such securities and for the sale by certain selling stockholders of 8,702,893 shares of common stock. The registration statement was declared effective on January 21, 2004. There are currently no arrangements in place for the Company to issue any additional securities.

On April 8, 2004 and November 10, 2004, we filed with the SEC supplements to the prospectus included in the shelf registration statement discussed in the paragraph above for the sale by selling stockholders of all 8,702,893 shares of our common stock owned by such stockholders in underwritten public offerings. The April 8, 2004 offering was for 4,000,000 shares at \$20.07 per share net to the selling stockholders and the November 10, 2004 offering was for 4,702,893 shares at \$17.67 per share net to the selling stockholders. There were no new shares issued by the Company in either offering and we received no proceeds from the offerings. Including the January 7, 2004 registration statement, we paid \$0.5 million of fees and expenses related to these offerings and charged the costs to the Selling, General and Administrative Expenses line item of our consolidated statement of operations.

During the 2005 period, the wholesale segment received 3,251 new 53-ft. leased containers and 2,851 leased chassis and returned 1,616, 48-ft. and 53-ft. leased containers and 862 primarily leased chassis.

During the 2004 period, the wholesale segment received 2,655 new 53-ft. leased containers and 3,311 leased chassis and returned 1,699, 48-ft. and 53-ft., leased containers and 1,737 primarily leased chassis.

Recently Issued Accounting Pronouncements

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In June 2005, the Emerging Issues Task Force (EITF) reached consensus on Issue No. 05-06, Determining the Amortization Period for Leasehold Improvements, which requires that leasehold improvements acquired in a business combination or purchased subsequent to the inception of a lease be amortized over the lesser of the useful life of the assets or a term that includes renewals that are reasonably assured at the date of the business combination or purchase. EITF No. 05-06 is effective for periods beginning after June 29, 2005. We adopted this EITF on July 2, 2005, the first day of our third fiscal quarter. The adoption did not have a material impact on our results of operations or financial condition.

In May 2005, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 154 (SFAS No. 154), Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and SFAS Statement No. 3 . APB No. 20, Accounting Changes and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements required the inclusion

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of the cumulative effect of changes in accounting principle in net income in the period of the change. SFAS No. 154 establishes, unless impracticable, retrospective application to prior periods financial statements as the required method for reporting a voluntary change in accounting principle in the absence of explicit transition requirements specific to the newly adopted accounting principle. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. We will assess the impact of a retrospective application of a change in accounting principle in accordance with SFAS No. 154 if the need for such a change arises after the effective date.

In December 2004, the FASB issued SFAS No. 123 (Revised 2004) (SFAS No. 123R), Share-Based Payment . SFAS No. 123R is a revision of SFAS No. 123, Accounting for Stock-Based Compensation and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance. SFAS No. 123R requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). That cost will be recognized over the period during which an employee is required to provide service in exchange for the award. This statement is effective as of the beginning of our next fiscal year and we will adopt the standard effective December 31, 2005 (the first day of our 2006 fiscal year). We have not determined the impact that this statement will have on our results of operations or financial condition.

In March 2005, the SEC issued Staff Accounting Bulletin No. 107, Share-Based Payment (SAB 107). SAB 107 summarizes the views of the SEC staff regarding the interaction between SFAS No. 123R (see above) and certain SEC rules and regulations, and is intended to assist in the initial implementation of SFAS No. 123R. We have not determined the impact that this statement will have on our results of operations or financial condition.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our market risk is affected primarily by changes in interest rates. Under our policies, we may use hedging techniques and derivative financial instruments to reduce the impact of adverse changes in interest rates.

We have market risk in interest rate exposure, primarily in the United States. We manage interest exposure through our floating rate debt. Interest rate swaps may be used from time to time to adjust interest rate exposure when appropriate based on market conditions. There were no swaps outstanding as of September 23, 2005.

Based upon the average variable interest rate debt outstanding during the first nine months of 2005, a 1% change in our variable interest rates would affect our pre-tax earnings by approximately \$1.3 million on an annual basis.

As our foreign business expands, we will be subjected to greater foreign currency risk.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures. We evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act) as of the end of the period covered by this report. This evaluation (the controls evaluation) was done under the supervision and with the participation of management, including our chief executive officer (CEO) and chief financial officer (CFO).

Objectives of Controls. Disclosure controls and procedures are designed so that information required to be disclosed in our reports filed under the Exchange Act, such as this quarterly report on Form 10-Q, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures are also intended to ensure that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. In designing and evaluating disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and

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management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Conclusions. Based upon the controls evaluation, our CEO and CFO have concluded that as of September 23, 2005, our disclosure controls and procedures are effective to provide reasonable assurance that the foregoing objectives are achieved.

Changes in Internal Control over Financial Reporting. There were no changes in our internal control over financial reporting, as defined in Rule 13a-15(f) under the Exchange Act, during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

Information on legal proceedings is set forth in Note 6 to the Notes to Condensed Consolidated Financial Statements included in Part I of this report, which information (exclusive of the last paragraph of Note 6) is incorporated by reference herein.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

<u>Exhibit No.</u>	<u>Description</u>
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
32.1	Certification of Chief Executive Officer and Chief Financial Officer, Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**

* filed herewith

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** furnished herewith, but not deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under that section. Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that we explicitly incorporate it by reference.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PACER INTERNATIONAL, INC.

Date: November 2, 2005

By: /s/ D.C. Orris
Chairman, President and Chief Executive Officer
(Principal Executive Officer)

Date: November 2, 2005

By: /s/ L.C. Yarberry
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

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PACER INTERNATIONAL, INC. AND SUBSIDIARIES

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