

TAL International Group, Inc.  
Form 10-Q  
October 29, 2014  
Table of Contents

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

FORM 10-Q

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

For The Quarterly Period Ended September 30, 2014

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- 001-32638

TAL International Group, Inc.

(Exact name of registrant as specified in the charter)

Delaware

(State or other jurisdiction of  
incorporation or organization)

20-1796526

(I.R.S. Employer  
Identification Number)

100 Manhattanville Road, Purchase, New York

(Address of principal executive office)

10577-2135

(Zip Code)

(914) 251-9000

(Registrant's telephone number including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer  Accelerated Filer  Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in rule 12b-2 of the Exchange Act). YES  NO

As of October 17, 2014, there were 33,647,028 shares of the Registrant's common stock, \$0.001 par value outstanding.



Table of Contents

TAL International Group, Inc.

Index

	Page No.
<b><u>PART I—FINANCIAL INFORMATION</u></b>	
<b><u>Item 1.</u></b> <b><u>Financial Statements</u></b>	<b><u>3</u></b>
<u>Consolidated Balance Sheets (unaudited) as of September 30, 2014 and December 31, 2013</u>	<u>4</u>
<u>Consolidated Statements of Income (unaudited) for the three and nine months ended September 30, 2014 and September 30, 2013</u>	<u>5</u>
<u>Consolidated Statements of Comprehensive Income (unaudited) for the three and nine months ended September 30, 2014 and September 30, 2013</u>	<u>6</u>
<u>Consolidated Statements of Cash Flows (unaudited) for the nine months ended September 30, 2014 and September 30, 2013</u>	<u>7</u>
<u>Notes to Consolidated Financial Statements</u>	<u>8</u>
<b><u>Item 2.</u></b> <b><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	<b><u>19</u></b>
<b><u>Item 3.</u></b> <b><u>Quantitative and Qualitative Disclosures About Market Risk</u></b>	<b><u>35</u></b>
<b><u>Item 4.</u></b> <b><u>Controls and Procedures</u></b>	<b><u>35</u></b>
<b><u>PART II—OTHER INFORMATION</u></b>	
<b><u>Item 1.</u></b> <b><u>Legal Proceedings</u></b>	<b><u>36</u></b>
<b><u>Item 1A.</u></b> <b><u>Risk Factors</u></b>	<b><u>36</u></b>
<b><u>Item 2.</u></b> <b><u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	<b><u>36</u></b>
<b><u>Item 6.</u></b> <b><u>Exhibits</u></b>	<b><u>37</u></b>
<b><u>Signature</u></b>	<b><u>38</u></b>

Table of Contents

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, that involve substantial risks and uncertainties. In addition, we, or our executive officers on our behalf, may from time to time make forward-looking statements in reports and other documents we file with the Securities and Exchange Commission, or SEC, or in connection with oral statements made to the press, potential investors or others. All statements, other than statements of historical facts, including statements regarding our strategy, future operations, future financial position, future revenues, projected costs, prospects, plans and objectives of management are forward-looking statements. The words "expect," "estimate," "anticipate," "predict," "believe," "think," "plan," "will," "should," "intend," "seek," "potential" and similar expressions and variations are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words.

Forward-looking statements in this report are subject to a number of known and unknown risks and uncertainties that could cause our actual results, performance or achievements to differ materially from those described in the forward-looking statements, including, but not limited to, the risks and uncertainties described in the section entitled "Risk Factors" in our Annual Report on Form 10-K filed with the SEC on February 20, 2014, in this report as well as in the other documents we file with the SEC from time to time, and such risks and uncertainties are specifically incorporated herein by reference.

Forward-looking statements speak only as of the date the statements are made. Except as required under the federal securities laws and rules and regulations of the SEC, we undertake no obligation to update or revise forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information. We caution you not to unduly rely on the forward-looking statements when evaluating the information presented in this report.

PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

The consolidated financial statements of TAL International Group, Inc. ("TAL" or the "Company") as of September 30, 2014 and December 31, 2013 and for the three and nine months ended September 30, 2014 and September 30, 2013 included herein have been prepared by the Company, without audit, pursuant to U.S. generally accepted accounting principles and the rules and regulations of the SEC. In addition, certain information and note disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading. These financial statements reflect, in the opinion of management, all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the results for the interim periods. The results of operations for such interim periods are not necessarily indicative of the results for the full year. These financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K filed with the SEC, on February 20, 2014 from which the accompanying December 31, 2013 Balance Sheet information was derived, and all of our other filings filed with the SEC from October 11, 2005 through the current date pursuant to the Exchange Act.

Table of Contents

## TAL INTERNATIONAL GROUP, INC.

## Consolidated Balance Sheets

(Dollars in thousands, except share data)

(Unaudited)

	September 30, 2014	December 31, 2013
<b>ASSETS:</b>		
Leasing equipment, net of accumulated depreciation and allowances of \$1,020,199 and \$910,713	\$3,651,393	\$3,414,904
Net investment in finance leases, net of allowances of \$1,056 and \$1,057	228,013	257,176
Equipment held for sale	48,929	58,042
Revenue earning assets	3,928,335	3,730,122
Unrestricted cash and cash equivalents	73,433	68,875
Restricted cash	29,478	29,126
Accounts receivable, net of allowances of \$821 and \$948	81,425	74,174
Goodwill	74,523	74,523
Deferred financing costs	27,358	29,087
Other assets	9,906	11,898
Fair value of derivative instruments	6,379	27,491
Total assets	\$4,230,837	\$4,045,296
<b>LIABILITIES AND STOCKHOLDERS' EQUITY:</b>		
Equipment purchases payable	\$68,228	\$112,268
Fair value of derivative instruments	4,044	1,900
Accounts payable and other accrued expenses	53,382	63,022
Net deferred income tax liability	401,895	358,255
Debt	3,004,872	2,817,933
Total liabilities	3,532,421	3,353,378
Stockholders' equity:		
Preferred stock, \$0.001 par value, 500,000 shares authorized, none issued	—	—
Common stock, \$0.001 par value, 100,000,000 shares authorized, 37,006,283 and 36,858,778 shares issued respectively	37	37
Treasury stock, at cost, 3,187,843 and 3,011,843 shares	(45,225)	(37,535)
Additional paid-in capital	503,607	498,854
Accumulated earnings	238,766	220,492
Accumulated other comprehensive income	1,231	10,070
Total stockholders' equity	698,416	691,918
Total liabilities and stockholders' equity	\$4,230,837	\$4,045,296

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

Table of Contents

## TAL INTERNATIONAL GROUP, INC.

## Consolidated Statements of Income

(Dollars and shares in thousands, except earnings per share)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Leasing revenues:				
Operating leases	\$ 145,613	\$ 139,994	\$ 424,432	\$ 410,352
Finance leases	4,441	3,868	14,118	10,118
Other revenues	470	582	1,464	1,944
Total leasing revenues	150,524	144,444	440,014	422,414
Equipment trading revenues	13,745	13,984	45,026	64,051
Equipment trading expenses	(12,032	) (11,977	) (39,450	) (55,082
Trading margin	1,713	2,007	5,576	8,969
Net gain on sale of leasing equipment	870	4,293	6,427	22,580
Operating expenses:				
Depreciation and amortization	57,198	52,321	165,238	151,470
Direct operating expenses	8,287	6,854	25,236	19,034
Administrative expenses	11,317	10,432	34,277	32,950
Provision for doubtful accounts	22	256	58	1,759
Total operating expenses	76,824	69,863	224,809	205,213
Operating income	76,283	80,881	227,208	248,750
Other expenses:				
Interest and debt expense	26,695	27,105	81,202	84,291
Write-off of deferred financing costs	173	—	5,072	2,578
Net (gain) loss on interest rate swaps	(545	) 295	410	(8,125
Total other expenses	26,323	27,400	86,684	78,744
Income before income taxes	49,960	53,481	140,524	170,006
Income tax expense	17,343	18,820	48,534	59,949
Net income	\$32,617	\$34,661	\$91,990	\$110,057
Net income per common share—Basic	\$0.97	\$1.04	\$2.74	\$3.29
Net income per common share—Diluted	\$0.97	\$1.03	\$2.72	\$3.27
Cash dividends paid per common share	\$0.72	\$0.68	\$2.16	\$1.98
Weighted average number of common shares outstanding—Basic	33,594	33,486	33,607	33,480
Dilutive stock options and restricted stock	201	222	168	194
Weighted average number of common shares outstanding—Diluted	33,795	33,708	33,775	33,674

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

Table of Contents

## TAL INTERNATIONAL GROUP, INC.

## Consolidated Statements of Comprehensive Income

(Dollars in thousands)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Net income	\$32,617	\$34,661	\$91,990	\$110,057
Other comprehensive income (loss):				
Change in fair value of derivative instruments designated as cash flow hedges (net of income tax effect of \$(516), \$(2,688), \$(8,766) and \$3,740, respectively)	(1,051	) (4,920	) (16,303	) 6,847
Reclassification of realized loss on interest rate swap agreements designated as cash flow hedges (net of income tax effect of \$1,326, \$953, \$3,339 and \$1,600, respectively)	2,546	1,748	6,386	2,933
Amortization of loss on terminated derivative instruments designated as cash flow hedges (net of income tax effect of \$102, \$266, \$619 and \$812, respectively)	186	482	1,132	1,484
Foreign currency translation adjustment	(234	) 288	(54	) (57
Other comprehensive income (loss), net of tax	1,447	(2,402	) (8,839	) 11,207
Comprehensive income	\$34,064	\$32,259	\$83,151	\$121,264

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

Table of Contents

TAL INTERNATIONAL GROUP, INC.  
Consolidated Statements of Cash Flows  
(Dollars in thousands)  
(Unaudited)

	Nine Months Ended September 30,	
	2014	2013
Cash flows from operating activities:		
Net income	\$91,990	\$110,057
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	165,238	151,470
Amortization of deferred financing costs	5,799	5,400
Amortization of net loss on terminated derivative instruments designated as cash flow hedges	1,751	2,296
Net (gain) on sale of leasing equipment	(6,427	) (22,580
Net loss (gain) on interest rate swaps	410	(8,125
Write-off of deferred financing costs	5,072	2,578
Deferred income taxes	48,533	59,836
Stock compensation charge	4,700	4,099
Changes in operating assets and liabilities:		
Net equipment purchased for resale activity	(6,335	) (5,214
Net realized gain (loss) on interest rate swaps terminated prior to their contractual maturities	7,408	(24,235
Other changes in operating assets and liabilities	(16,485	) (17,123
Net cash provided by operating activities	301,654	258,459
Cash flows from investing activities:		
Purchases of leasing equipment and investments in finance leases	(547,555	) (534,884
Proceeds from sale of equipment, net of selling costs	117,351	106,141
Cash collections on finance lease receivables, net of income earned	36,269	29,083
Other	(108	) —
Net cash (used in) investing activities	(394,043	) (399,660
Cash flows from financing activities:		
Purchases of treasury stock	(7,690	) —
Stock options exercised and stock related activity	(234	) (222
Financing fees paid under debt facilities	(9,074	) (10,062
Borrowings under debt facilities	1,225,935	803,207
Payments under debt facilities and capital lease obligations	(1,039,021	) (605,590
(Increase) decrease in restricted cash	(352	) 7,361
Common stock dividends paid	(72,617	) (66,300
Net cash provided by financing activities	96,947	128,394
Net increase (decrease) in unrestricted cash and cash equivalents	\$4,558	\$(12,807
Unrestricted cash and cash equivalents, beginning of period	68,875	65,843
Unrestricted cash and cash equivalents, end of period	\$73,433	\$53,036
Supplemental non-cash investing activities:		
Equipment purchases payable	\$68,228	\$38,797

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



Table of Contents

TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 1—Description of the Business, Basis of Presentation and Recently Adopted Accounting Pronouncements

A. Description of the Business

TAL International Group, Inc. ("TAL" or the "Company") leases intermodal transportation equipment, primarily maritime containers, and provides maritime container management services, through a worldwide network of offices, third party depots and other facilities. The Company operates in both international and domestic markets. The majority of the Company's business is derived from leasing its containers to shipping line customers through a variety of long-term and short-term contractual lease arrangements. The Company also sells its own containers and containers purchased from third parties for resale. TAL also enters into management agreements with third party container owners under which the Company manages the leasing and selling of containers on behalf of the third party owners.

B. Basis of Presentation

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the reported amounts of revenues and expenses during the reporting period and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

The consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany transactions and balances have been eliminated in consolidation. Certain reclassifications have been made to the accompanying prior period financial statements and notes to conform to the current year's presentation.

In the second quarter of 2014, the Company revised the Income Statement presentation by removing the line item "Total revenues" and moving "Equipment trading revenues" and "Equipment trading expenses" line items together and adding a line for "Trading margin". The Company believes that this new presentation better highlights the trends in leasing revenues and the relative size and contribution of the Equipment trading segment.

C. New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU No. 2014-09"). This new standard will replace all current U.S. GAAP guidance on this topic and eliminate all industry-specific guidance. Leasing revenue recognition is specifically excluded from this ASU, and therefore, the new standard will only apply to Equipment Trading revenues and sales of leasing equipment. ASU No. 2014-09 is effective for interim and annual periods beginning after December 15, 2016, with early application prohibited. ASU 2014-09 allows for either full retrospective or modified retrospective adoption. The Company is evaluating the transition method that will be elected and the potential effects of adopting the provisions of ASU No. 2014-09.

D. Business Combination

Effective July 1, 2013, the Company acquired the assets and business of Martec Leasing for \$11.9 million. Martec Leasing is a worldwide supplier of rolltrailers. Of the total purchase price, the Company allocated \$8.5 million to Leasing equipment, \$0.8 million to other assets representing the acquisition date fair value of above-market leases, and \$2.6 million to Goodwill, in its consolidated balance sheet. The Company believes that the acquisition of Martec Leasing complements our current leasing business by expanding our product types available for our existing customer base.

Table of Contents

TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 2—Fair Value of Financial Instruments

The Company believes that the carrying amounts of its cash and cash equivalents, accounts receivable, equipment purchases payable, and accounts payable approximated their fair value as of September 30, 2014 and December 31, 2013.

Fair value represents the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company utilizes the following fair value hierarchy when selecting inputs for its valuation techniques, with the highest priority given to Level 1:

Level 1—Financial assets and liabilities whose values are based on observable inputs such as quoted prices for identical instruments in active markets (unadjusted).

Level 2—Financial assets and liabilities whose values are based on observable inputs such as (i) quoted prices for similar instruments in active markets; (ii) quoted prices for identical or similar instruments in markets that are not active; or (iii) model-derived valuations in which all significant inputs are observable in active markets.

Level 3—Financial assets and liabilities whose values are derived from valuation techniques based on one or more significant unobservable inputs.

The Company does not measure net investment in finance leases or debt at fair value in its consolidated balance sheets. The fair value, which was measured using Level 2 inputs, and the carrying value of the Company's net investment in finance leases and debt are listed in the table below as of the dates indicated (in thousands).

	September 30, 2014	December 31, 2013
Assets		
Net investment in finance leases - carrying value	\$229,069	\$258,233
Net investment in finance leases - estimated fair value	\$232,268	\$265,745
Liabilities		
Debt—carrying value	\$3,004,872	\$2,817,933
Debt—estimated fair value	\$3,021,367	\$2,787,582

The Company estimated the fair value of its net investment in finance leases and debt instruments based on the net present value of its future receipts or payments, using a discount rate which reflects the Company's estimate of current market interest rates and spreads as of the balance sheet date.

## Note 3—Dividends and Treasury Stock

## Dividends

The Company paid the following quarterly dividends during the nine months ended September 30, 2014 and 2013 on its issued and outstanding common stock:

Record Date	Payment Date	Aggregate Payment	Per Share Payment
September 3, 2014	September 24, 2014	\$24.2 Million	\$0.72
June 3, 2014	June 24, 2014	\$24.2 Million	\$0.72
March 3, 2014	March 24, 2014	\$24.2 Million	\$0.72
September 3, 2013	September 24, 2013	\$22.8 Million	\$0.68
June 4, 2013	June 25, 2013	\$22.1 Million	\$0.66
March 7, 2013	March 28, 2013	\$21.4 Million	\$0.64

## Treasury Stock

On March 13, 2006, our Board of Directors authorized a stock buyback program for the repurchase of our common stock. The stock repurchase program, as now amended, authorizes us to repurchase up to 4.0 million shares. During the third quarter of 2014, TAL repurchased 176,000 shares at an average price of \$43.67. As of September 30, 2014, 812,157 shares may yet be purchased under the stock buyback program.



Table of Contents

TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 4—Capital Stock and Stock Options

## Stock Based Compensation Plans

The Company records compensation cost relating to stock based payment transactions in accordance with ASC 718. The cost is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense over the employee's requisite service period (generally the vesting period of the equity award) on a straight-line basis. The Company recognized compensation costs in administrative expenses related to restricted shares granted in 2012, 2013 and 2014 under the Company's stock based compensation plans of \$1.3 million and \$1.1 million during the three months ended September 30, 2014 and 2013, respectively, and \$4.7 million and \$4.1 million during the nine months ended September 30, 2014 and 2013, respectively.

Total unrecognized compensation cost of approximately \$7.1 million as of September 30, 2014 related to restricted shares granted during 2012, 2013 and 2014 will be recognized over the remaining weighted average vesting period of approximately 1.8 years.

During the nine months ended September 30, 2014, plan participants exercised 2,950 options which had been granted under the 2005 Management Omnibus Incentive Plan. Plan participants tendered 6,695 shares, all of which were subsequently retired by the Company, to satisfy payment of the exercise price, and in certain instances withholding taxes related to activity under the Company's stock compensation plans.

No further grants will be made under the 2005 Management Omnibus Incentive Plan but the terms of the 2005 Management Omnibus Incentive Plan will continue to apply to awards previously granted under the plan.

On March 14, 2014, the Company's Board of Directors adopted and on April 22, 2014, the Company's shareholders approved the 2014 Equity Incentive Plan. No grants have been made and no shares have been issued under the 2014 Equity Incentive Plan.

## Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) consisted of the following as of the dates indicated (in thousands and net of tax effects):

	Cash Flow Hedges	Foreign Currency Translation	Accumulated Other Comprehensive Income (Loss)
Balance as of December 31, 2013	\$10,959	\$(889)	) \$ 10,070
Change in fair value of derivative instruments designated as cash flow hedges	(16,303)	) —	(16,303)
Reclassification of realized loss on interest rate swap agreements designated as cash flow hedges	6,386	—	6,386
Amortization of net loss on derivative instruments previously designated as cash flow hedges	1,132	—	1,132
Foreign currency translation adjustment	—	(54)	) (54)
Other comprehensive income (loss)	(8,785)	) (54)	) (8,839)
Balance as of September 30, 2014	\$2,174	\$(943)	) \$ 1,231

Table of Contents

TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 4—Capital Stock and Stock Options (Continued)

	Cash Flow Hedges	Foreign Currency Translation	Accumulated Other Comprehensive (Loss) Income
Balance as of December 31, 2012	\$(7,481	) \$(949	) \$ (8,430
Change in fair value of derivative instruments designated as cash flow hedges	6,847	—	6,847
Reclassification of realized loss on interest rate swap agreements designated as cash flow hedges	2,933	—	2,933
Amortization of net loss on derivative instruments previously designated as cash flow hedges	1,484	—	1,484
Foreign currency translation adjustment	—	(57	) (57
Other comprehensive income (loss)	11,264	(57	) 11,207
Balance as of September 30, 2013	\$3,783	\$(1,006	) \$ 2,777

The following table presents reclassifications out of Accumulated other comprehensive income for the period indicated (in thousands):

	Amounts Reclassified From Accumulated Other Comprehensive Income				Affected Line Item in the Consolidated Statements of Income
	Three Months Ended September 30,		Nine Months Ended September 30,		
	2014	2013	2014	2013	
Realized loss on interest rate swap agreements, designated as cash flow hedges	\$3,872	\$2,701	\$9,725	\$4,533	Interest and debt expense
Amortization of net loss on derivative instruments previously designated as cash flow hedges	288	748	1,751	2,296	Interest and debt expense
Amounts reclassified from Accumulated other comprehensive income	4,160	3,449	11,476	6,829	Income before income taxes
Income tax (benefit)	(1,428	) (1,219	) (3,958	) (2,412	) Income tax expense
Amounts reclassified from Accumulated other comprehensive income	\$2,732	\$2,230	\$7,518	\$4,417	Net income

Table of Contents

TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 5—Net Investment in Finance Leases

The following table represents the components of the net investment in finance leases (in thousands):

	September 30, 2014	December 31, 2013
Gross finance lease receivables	\$278,913	\$320,149
Allowance on gross finance lease receivables	(1,056 )	(1,057 )
Gross finance lease receivables, net of allowance	277,857	319,092
Unearned income	(49,844 )	(61,916 )
Net investment in finance leases	\$228,013	\$257,176

The Company evaluates potential losses in its finance lease portfolio by regularly reviewing the specific receivables in the portfolio and analyzing historical loss experience. The Company's historical loss experience on its gross finance lease receivables, after considering equipment recoveries, was less than 1%. Net investment in finance lease receivables is generally charged off after an analysis is completed which indicates that collection of the full balance is remote.

In order to estimate its allowance for losses contained in the gross finance lease receivables, the Company categorizes the credit worthiness of the receivables in the portfolio based on internal customer credit ratings, which are reviewed and updated, as appropriate, on an ongoing basis. The internal customer credit ratings are developed based on a review of the financial performance and condition, operating environment, geographical location and trade routes of our customers.

The categories of gross finance lease receivables based on the Company's internal customer credit ratings can be described as follows:

Tier 1—These customers are typically large international shipping lines who have been in business for many years and have world class operating capabilities and significant financial resources. In most cases, the Company has had a long commercial relationship with these customers and currently maintains regular communication with them at several levels of management, which provides TAL with insight into the customer's current operating and financial performance. In the Company's view, these customers have the greatest ability to withstand cyclical down turns and would likely have greater access to needed capital than lower rated customers. The Company views the risk of default for Tier 1 customers to range from minimal to modest.

Tier 2—These customers are typically either smaller shipping lines with less operating scale or shipping lines with a high degree of financial leverage, and accordingly the Company views these customers as subject to higher volatility in financial performance over the business cycle. The Company generally expects these customers to have less access to capital markets or other sources of financing during cyclical down turns. The Company views the risk of default for Tier 2 customers as moderate.

Tier 3—Customers in this category exhibit volatility in payments on a regular basis, thus they are considered non-performing. The Company has initiated or implemented plans to recover equipment on lease to these customers and believes that default is likely, or has already occurred.

Based on the above categories, the Company's gross finance lease receivables are as follows (in thousands):

	September 30, 2014	December 31, 2013
Tier 1	\$256,583	\$283,172
Tier 2	22,330	36,977
Tier 3	—	—
Gross finance lease receivables	\$278,913	\$320,149

The Company considers an account past due when a payment has not been received in accordance with the terms of the related lease agreement. As of September 30, 2014, approximately \$0.1 million of the Company's Tier 1 gross finance lease receivables and \$0.3 million of the Company's Tier 2 gross finance lease receivables were past due, substantially all of which were aged approximately 31 days. As of September 30, 2014, none of the Company's gross

finance lease receivables were in non-accrual status. The Company categorizes customers as non-accrual based on the credit ratings described above and recognizes income on gross finance lease receivables in non-accrual status as collections are made.

Table of Contents

TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 5—Net Investment in Finance Leases (Continued)

The following table represents the activity of the Company's allowance on gross finance lease receivables for the periods presented (in thousands):

	Beginning Balance	Additions/ (Reversals)	Other(a)	Ending Balance
Finance Lease—Allowance for doubtful accounts: For the nine months ended September 30, 2014	\$1,057	\$—	\$(1	) \$1,056

(a) Primarily relates to the effect of foreign currency translation.

## Note 6—Debt

Debt consisted of the following (amounts in thousands):

	September 30, 2014	December 31, 2013
Asset backed securitization (ABS) term notes	\$1,299,485	\$1,303,128
Term loan facilities	880,715	865,089
Asset backed warehouse facility	280,000	83,000
Revolving credit facilities	445,000	450,000
Capital lease obligations	99,672	116,716
Total Debt	\$3,004,872	\$2,817,933

As of September 30, 2014, the Company had \$1,375.9 million of debt outstanding on facilities with fixed interest rates and \$1,629.0 million of debt outstanding on facilities with interest rates based on floating rate indices (primarily LIBOR). The Company economically hedges the risks associated with fluctuations in interest rates on a portion of its floating rate borrowings by entering into interest rate swap agreements that convert a portion of its floating rate debt to a fixed rate basis, thus reducing the impact of interest rate changes on future interest expense. As of September 30, 2014, the Company had interest rate swaps in place with a net notional amount of \$1,135.5 million to fix the floating interest rates on a portion of its floating rate debt obligations.

The Company is subject to certain financial covenants under its debt facilities, and as of September 30, 2014, was in compliance with all such covenants.

## Asset Backed Securitization Term Notes

On May 20, 2014, TAL Advantage IV LLC, an indirect wholly owned subsidiary of the Company, prepaid all of the outstanding principal balance of the TAL Advantage IV LLC Series 2012-1 Notes.

On May 19, 2014, TAL Advantage V LLC (“TAL Advantage V”), an indirect wholly owned subsidiary of the Company, completed the offering of \$70 million Series 2014-2 Fixed Rate Asset-Backed Notes, Class A-1, \$150 million Series 2014-2 Fixed Rate Asset-Backed Notes, Class A-2, and \$18 million Series 2014-2 Fixed Rate Asset-Backed Notes, Class B.

## Term Loan Facilities

On April 2, 2014, TAL International Container Corporation, a direct wholly owned subsidiary of the Company entered into a \$350 million term loan agreement. The proceeds were used to prepay the outstanding principal balance on certain term loan facilities in the amount of \$194.6 million, to prepay all of the outstanding principal balance of the TAL Advantage II LLC Series 2008-1 Notes in the amount of \$119.6 million, and for general corporate purposes.



Table of Contents

TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 7—Derivative Instruments

## Interest Rate Swaps

The Company has entered into interest rate swap agreements to manage interest rate risk exposure. The majority of interest rate swap agreements utilized by TAL effectively modify the Company's exposure to interest rate risk by converting a portion of its floating rate debt to a fixed rate basis, thus reducing the impact of interest rate changes on future interest expense. Such agreements involve the receipt of floating rate amounts in exchange for fixed rate interest payments over the lives of the agreements without an exchange of the underlying principal amounts. In limited instances, the Company has also entered into interest rate swap agreements that involve the receipt of fixed rate amounts in exchange for floating rate interest payments. The counterparties to the Company's interest rate swap agreements are highly rated financial institutions. In the unlikely event that the counterparties fail to meet the terms of the interest rate swap agreements, the Company's exposure is limited to the interest rate differential on the notional amount at each monthly settlement period over the life of the agreements. The Company does not anticipate any non-performance by the counterparties. Substantially all of the assets of certain indirect, wholly owned subsidiaries of the Company have been pledged as collateral for the underlying indebtedness and the amounts payable under the interest rate swap agreements for each of these entities. In addition, certain assets of TAL International Container Corporation, a direct wholly owned subsidiary of the Company, are pledged as collateral for the \$450 million senior secured revolving credit facility and the amounts payable under certain interest rate swap agreements.

As of September 30, 2014, the Company had net interest rate swap agreements in place to fix the floating interest rates on a portion of the borrowings under its debt facilities as summarized below:

Net Notional Amount(1)	Weighted Average Fixed Leg (Pay) Interest Rate(2)	Weighted Average Remaining Term(2)
\$1,135.5 Million	1.92%	6.3 years

(1) As of September 30, 2014, the net notional amount outstanding on the Company's interest rate swap agreements is comprised of \$1,288.6 million of pay-fixed rate/receive-floating rate agreements and \$153.1 million of pay-floating rate/receive-fixed rate agreements. The Company entered into the pay-floating rate/receive-fixed rate agreements at the parent company level to offset the cash flows on certain pay-fixed rate/receive-floating rate agreements of certain wholly owned subsidiaries. The pay-floating rate/receive-fixed rate and pay-fixed rate/receive-floating rate agreements have terms that offset each other.

(2) The calculations of weighted average fixed (pay) leg interest rate and weighted average remaining term on the Company's interest rate swap agreements reflect the impact of the pay-floating rate/receive-fixed rate agreements and the pay-fixed rate/receive-floating rate agreements they offset.

During the nine months ended September 30, 2014, the Company had net receipts of \$7.4 million to terminate certain designated interest rate swap agreements with an aggregate notional amount of \$550.0 million.

The Company recognized amortization of accumulated other comprehensive income attributable to losses on terminated interest rate swap agreements that had been designated as cash flow hedges in interest and debt expense of \$0.3 million and \$0.7 million for the three months ended September 30, 2014 and 2013, respectively, and \$1.8 million and \$2.3 million for the nine months ended September 30, 2014 and 2013, respectively.

The following table represents pre-tax amounts in accumulated other comprehensive income related to interest rate swap agreements (in millions) expected to be recognized in income over the next 12 months:

	Nine Months Ended September 30, 2014	)
Change in fair value of derivative instruments designated as cash flow hedges	(\$17.5	)
Amortization of loss on terminated derivative instruments designated as cash flow hedges	(\$0.9	)



Table of Contents

TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 7—Derivative Instruments (Continued)

Amounts recorded in accumulated other comprehensive income attributable to these terminated interest rate swap agreements may be recognized in earnings immediately in conjunction with a termination of the related debt balances.

## Fair Value of Derivative Instruments

Under the criteria established by ASC 820, the Company has elected to use the income approach to value its interest rate swap and foreign currency rate swap agreements, using observable Level 2 market expectations at the measurement date and standard valuation techniques to convert future amounts to a single present amount (discounted) assuming that participants are motivated, but not compelled to transact. The Level 2 inputs for the interest rate swap and forward valuations are limited to quoted prices for similar assets or liabilities in active markets (specifically futures contracts and spot currency rates) and inputs other than quoted prices that are observable for the asset or liability (specifically forward currency points, LIBOR cash and swap rates, basis swap adjustments and credit risk at commonly quoted intervals).

## Location of Derivative Instruments in Financial Statements

Derivative Instrument	Balance Sheet Location	Fair Value of Derivative Instruments (In Millions)			
		Asset Derivatives		Liability Derivatives	
		September 30, 2014	December 31, 2013	September 30, 2014	December 31, 2013
		Fair Value	Fair Value	Fair Value	Fair Value
Interest rate swap contracts, designated as cash flow hedges	Fair value of derivative instruments	\$6.2	\$27.0	\$3.5	\$1.4
Interest rate swap contracts, not designated	Fair value of derivative instruments	0.1	0.3	0.5	0.5
Foreign exchange contracts, not designated	Fair value of derivative instruments	0.1	0.2	—	—
Total derivatives		\$6.4	\$27.5	\$4.0	\$1.9

Effect of Derivative Instruments on Consolidated Statements of Income and Consolidated Statements of Comprehensive Income  
(In Millions)

Location of (Gain) Loss on Derivative Instruments	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Realized loss on interest rate swap agreements	\$4.2	\$3.0	\$10.6	\$9.0
Unrealized loss (gain) on interest rate swap agreements, designated as cash flow hedges	(2.3)	4.9	15.3	(15.1)
Net loss (gain) on interest rate swaps, not designated	(0.5)	0.3	0.4	(8.1)
Foreign exchange agreements, not designated	—	0.1	0.1	0.3

Table of Contents

TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 8—Segment and Geographic Information

## Industry Segment Information

The Company conducts its business activities in one industry, intermodal transportation equipment, and has two reporting segments:

**Equipment leasing**—the Company owns, leases and ultimately disposes of containers and chassis from its lease fleet, as well as manages leasing activities for containers owned by third parties.

**Equipment trading**—the Company purchases containers from shipping line customers, and other sellers of containers, and resells these containers to container retailers and users of containers for storage or one-way shipment. Included in the Equipment trading segment revenues are leasing revenues from equipment purchased for resale that is currently on lease until the containers are dropped off.

The following tables show segment information for the periods indicated and the consolidated totals reported (dollars in thousands):

	Three Months Ended September 30,			2013		
	2014		Totals	Equipment	Equipment	Totals
	Leasing	Trading		Leasing	Trading	
Total leasing revenues	\$147,502	\$3,022	\$150,524	\$140,735	\$3,709	\$144,444
Trading margin	—	1,713	1,713	—	2,007	2,007
Net gain on sale of leasing equipment	870	—	870	4,293	—	4,293
Depreciation and amortization expense	56,914	284	57,198	51,958	363	52,321
Interest and debt expense	26,190	505	26,695	26,510	595	27,105
Income before income taxes(1)	45,928	3,660	49,588	49,320	4,456	53,776

(1) Segment income before income taxes excludes net gains on interest rate swaps of \$0.5 million and net losses on interest rate swaps of \$0.3 million for the three months ended September 30, 2014 and 2013, respectively, and the write-off of deferred financing costs of \$0.2 million for the three months ended September 30, 2014. There was no write-off of deferred financing costs for the three months ended September 30, 2013.

Table of Contents

TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 8—Segment and Geographic Information (Continued)

	Nine Months Ended September 30, 2014			2013		
	Equipment Leasing	Equipment Trading	Totals	Equipment Leasing	Equipment Trading	Totals
Total leasing revenues	\$430,192	\$9,822	\$440,014	\$412,894	\$9,520	\$422,414
Trading margin	—	5,576	5,576	—	8,969	8,969
Net gain on sale of leasing equipment	6,427	—	6,427	22,580	—	22,580
Depreciation and amortization expense	164,227	1,011	165,238	149,912	1,558	151,470
Interest and debt expense	79,464	1,738	81,202	82,313	1,978	84,291
Income before income taxes(1)	134,253	11,753	146,006	150,538	13,921	164,459
Equipment held for sale at September 30	29,529	19,400	48,929	30,065	14,458	44,523
Goodwill at September 30	73,523	1,000	74,523	73,523	1,000	74,523
Total assets at September 30	4,169,668	61,169	4,230,837	3,840,716	69,335	3,910,051
Purchases of leasing equipment and investments in finance leases(2)	544,709	2,846	547,555	520,487	14,397	534,884

Segment income before income taxes excludes net losses on interest rate swaps of \$0.4 million and net gains on interest rate swaps of \$8.1 million for the nine months ended September 30, 2014 and 2013, respectively, and the (1) write-off of deferred financing costs of \$5.1 million and \$2.6 million for the nine months ended September 30, 2014 and 2013, respectively.

Represents cash disbursements for purchases of leasing equipment and investments in finance lease as reflected in (2) the consolidated statements of cash flows for the periods indicated, but excludes cash flows associated with the purchase of equipment held for resale.

There are no intercompany revenues or expenses between segments. Additionally, certain administrative expenses have been allocated between segments based on an estimate of services provided to each segment. A portion of the Company's equipment purchased for resale was purchased through certain sale-leaseback transactions with our shipping line customers. Due to the expected longer term nature of these transactions, these purchases are reflected as leasing equipment as opposed to equipment held for sale and the cash flows associated with these transactions are reflected as purchases of leasing equipment and proceeds from the sale of equipment in investing activities in the Company's consolidated statements of cash flows.

## Geographic Segment Information

The Company earns most of its leasing revenues from international containers which are deployed by its customers in a wide variety of global trade routes. Substantially all of the Company's leasing related revenue is denominated in U.S. dollars. The following table represents the geographic allocation of leasing revenues for the periods indicated based on customers' primary domicile (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Total leasing revenues:				
United States of America	\$8,410	\$8,120	\$24,585	\$24,128
Asia	72,232	63,499	201,491	183,107
Europe	65,593	66,594	196,445	197,225
Other International	4,289	6,231	17,493	17,954
Total	\$150,524	\$144,444	\$440,014	\$422,414

As most of the Company's containers are used internationally, where no one container is domiciled in one particular place for a prolonged period of time, substantially all of the Company's long-lived assets are considered to be international.

Table of Contents

TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 8—Segment and Geographic Information (Continued)

The following table represents the geographic allocation of equipment trading revenues for the periods indicated based on the location of sale (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2014	2013	September 30, 2014	2013
Total equipment trading revenues:				
United States of America	\$2,574	\$1,743	\$5,646	\$6,937
Asia	6,732	5,853	22,984	36,425
Europe	3,650	5,267	14,348	15,334
Other International	789	1,121	2,048	5,355
Total	\$13,745	\$13,984	\$45,026	\$64,051

## Note 9—Commitments and Contingencies

## Residual Value Guarantees

During 2008, the Company entered into commitments for equipment residual value guarantees in connection with certain finance leases that were sold or brokered to financial institutions. The guarantees represent the Company's commitment that these assets will be worth a specified amount at the end of certain lease terms (if the lessee does not default on the lease) which expire in 2016. At September 30, 2014, the maximum potential amount of the guarantees under which the Company could be required to perform was approximately \$27.1 million. The carrying values of the guarantees of \$1.1 million have been deferred and are included in accounts payable and accrued expenses. Under the criteria established by ASC 820, the Company performed fair value measurements of the guarantees at origination using Level 2 inputs, which were based on significant other observable inputs other than quoted prices, either on a direct or indirect basis. The Company accounts for the residual value guarantees under Accounting Standards Codification 460, Guarantees. The Company expects that the market value of the equipment covered by the guarantees will equal or exceed the value of the guarantees and therefore, no contingent loss has been provided as of September 30, 2014.

## Purchase Commitments

At September 30, 2014, commitments for capital expenditures totaled approximately \$45.9 million.

## Note 10—Income Taxes

The consolidated income tax expense for the three and nine months ended September 30, 2014 and 2013 was determined based upon estimates of the Company's consolidated effective income tax rates for the year ending December 31, 2014 and the year ended December 31, 2013. The difference between the consolidated effective income tax rate and the U.S. federal statutory rate is primarily attributable to state income taxes, foreign income taxes and the effect of certain permanent differences.

## Note 11—Subsequent Events

## Quarterly Dividend

On October 21, 2014, the Company's Board of Directors approved and declared a \$0.72 per share quarterly cash dividend on its issued and outstanding common stock, payable on December 23, 2014 to shareholders of record at the close of business on December 2, 2014.

## Debt Facilities

On October 10, 2014, TAL Advantage III LLC, an indirect wholly owned subsidiary of TAL International Group, Inc., renewed its warehouse credit facility. The renewed facility extends the revolving period to three years, increases the credit limit to \$650 million, and lowers the interest rate during the revolving period to LIBOR plus 1.65%. The advance rate remains at 81%. If the facility is not refinanced or renewed following the three year revolving period ending October 10, 2017 the notes will convert to term notes with a maturity date of October 10, 2021, the interest rate will increase to LIBOR plus 2.65%, and the notes will amortize by 10% per year.



Table of Contents

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

The following discussion and analysis of the consolidated financial condition and results of operations of TAL International Group, Inc. and its subsidiaries should be read in conjunction with related consolidated financial data and our annual audited consolidated financial statements and related notes thereto included in our Annual Report on Form 10-K filed with the SEC on February 20, 2014. The statements in this discussion regarding industry outlook, our expectations regarding our future performance, liquidity and capital resources and other non-historical statements are subject to numerous risks and uncertainties, including, but not limited to, the risks and uncertainties described under "Risk Factors" and "Forward-Looking Statements" in our Form 10-K. Our actual results may differ materially from those contained in or implied by any forward-looking statements.

**Our Company**

We are one of the world's largest and oldest lessors of intermodal containers and chassis. Intermodal containers are large, standardized steel boxes used to transport freight by ship, rail or truck. Because of the handling efficiencies they provide, intermodal containers are the primary means by which many goods and materials are shipped internationally. Chassis are used for the transportation of containers domestically.

We operate our business in one industry, intermodal transportation equipment, and have two business segments:

• **Equipment leasing**—we own, lease and ultimately dispose of containers and chassis from our lease fleet, as well as manage containers owned by third parties.

• **Equipment trading**—we purchase containers from shipping line customers, and other sellers of containers, and resell these containers to container retailers and users of containers for storage or one-way shipment.

**Operations**

Our operations include the acquisition, leasing, re-leasing and subsequent sale of multiple types of intermodal containers and chassis. As of September 30, 2014, our total fleet consisted of 1,367,754 containers and chassis, including 17,408 containers under management for third parties, representing 2,244,837 twenty-foot equivalent units (TEU). We have an extensive global presence, offering leasing services through 17 offices in 11 countries and approximately 230 third party container depot facilities in approximately 40 countries as of September 30, 2014. Our customers are among the largest shipping lines in the world. For the nine months ended September 30, 2014, our twenty largest customers accounted for 80.9% of our leasing revenues, our five largest customers accounted for 51.7% of our leasing revenues, and our largest customer, CMA CGM, accounted for 16.3% of our leasing revenues.

Table of Contents

The following tables provide the composition of our equipment fleet as of the dates indicated (in units, TEU and cost-equivalent units, or "CEU"):

Equipment Fleet in Units										
	September 30, 2014			December 31, 2013			September 30, 2013			
	Owned	Managed	Total	Owned	Managed	Total	Owned	Managed	Total	
Dry	1,175,240	16,185	1,191,425	1,087,462	17,971	1,105,433	1,064,175	18,611	1,082,786	
Refrigerated	65,760	38	65,798	63,967	63	64,030	59,441	78	59,519	
Special	55,747	1,185	56,932	55,295	1,466	56,761	55,694	1,537	57,231	
Tank	9,542	—	9,542	8,100	—	8,100	7,717	—	7,717	
Chassis	13,412	—	13,412	13,724	—	13,724	13,745	—	13,745	
Equipment leasing fleet	1,319,701	17,408	1,337,109	1,228,548	19,500	1,248,048	1,200,772	20,226	1,220,998	
Equipment trading fleet	30,645	—	30,645	40,374	—	40,374	36,722	—	36,722	
Total	1,350,346	17,408	1,367,754	1,268,922	19,500	1,288,422	1,237,494	20,226	1,257,720	
Percentage	98.7	% 1.3	% 100.0	% 98.5	% 1.5	% 100.0	% 98.4	% 1.6	% 100.0	%
Equipment Fleet in TEU										
	September 30, 2014			December 31, 2013			September 30, 2013			
	Owned	Managed	Total	Owned	Managed	Total	Owned	Managed	Total	
Dry	1,902,960	28,384	1,931,344	1,759,100	31,875	1,790,975	1,719,825	33,124	1,752,949	
Refrigerated	125,667	64	125,731	122,466	113	122,579	113,984	138	114,122	
Special	101,376	2,019	103,395	99,473	2,481	101,954	100,146	2,600	102,746	
Tank	9,542	—	9,542	8,100	—	8,100	7,717	—	7,717	
Chassis	23,910	—	23,910	24,505	—	24,505	24,526	—	24,526	
Equipment leasing fleet	2,163,455	30,467	2,193,922	2,013,644	34,469	2,048,113	1,966,198	35,862	2,002,060	
Equipment trading fleet	50,915	—	50,915	65,102	—	65,102	61,525	—	61,525	
Total	2,214,370	30,467	2,244,837	2,078,746	34,469	2,113,215	2,027,723	35,862	2,063,585	
Percentage	98.6	% 1.4	% 100.0	% 98.4	% 1.6	% 100.0	% 98.3	% 1.7	% 100.0	%
Equipment Fleet in CEU										
	September 30, 2014			December 31, 2013			September 30, 2013			
	Owned	Managed	Total	Owned	Managed	Total	Owned	Managed	Total	
Operating leases	2,429,825	26,462	2,456,287	2,260,404	30,232	2,290,636	2,214,891	31,571	2,246,462	
Finance leases	210,250	831	211,081	210,535	830	211,365	172,549	825	173,374	
Equipment trading fleet	109,757	—	109,757	138,742	—	138,742	136,520	—	136,520	
Total	2,749,832	27,293	2,777,125	2,609,681	31,062	2,640,743	2,523,960	32,396	2,556,356	
Percentage	99.0	% 1.0	% 100.0	% 98.8	% 1.2	% 100.0	% 98.7	% 1.3	% 100.0	%

In the equipment fleet tables above, we have included total fleet count information based on CEU. CEU is a ratio used to convert the actual number of containers in our fleet to a figure based on the relative purchase prices of our various equipment types to that of a 20 foot dry container. For example, the CEU ratio for a 40 foot standard height dry container is 1.6, and a 40 foot high cube refrigerated container is 10.0. The CEU ratios used in this calculation are from our debt agreements and may differ slightly from current actual cost ratios and CEU ratios used by others in the industry.

We lease five types of equipment: (1) dry freight containers, which are used for general cargo such as manufactured component parts, consumer staples, electronics and apparel, (2) refrigerated containers, which are used for perishable items such as fresh and frozen foods, (3) special containers, which are used for heavy and over-sized cargo such as marble slabs,

20

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Table of Contents

building products and machinery, (4) tank containers, which are used to transport bulk liquid products such as chemicals, and (5) chassis, which are used for the transportation of containers domestically. Our in-house equipment sales group manages the sale process for our used containers and chassis from our equipment leasing fleet and buys and sells used and new containers and chassis acquired from third parties.

The percentage of our equipment fleet by equipment type as of September 30, 2014 and the percentage of our leasing revenues by equipment type for the nine months ended September 30, 2014 are as follows:

Equipment Type	Percent of total fleet in units		Percent of total fleet in CEU		Percent of leasing revenues	
Dry	87.1	%	60.6	%	64.4	%
Refrigerated	4.8		23.0		20.6	
Special	4.2		5.0		7.3	
Tank	0.7		5.5		3.5	
Chassis	1.0		1.9		2.0	
Equipment leasing fleet	97.8		96.0		97.8	
Equipment trading fleet	2.2		4.0		2.2	
Total	100.0	%	100.0	%	100.0	%

We generally lease our equipment on a per diem basis to our customers under three types of leases: long-term leases, finance leases and service leases. Long-term leases, typically with initial contractual terms ranging from three to eight years, provide us with stable cash flow and low transaction costs by requiring customers to maintain specific units on-hire for the duration of the lease. Finance leases, which are typically structured as full payout leases, provide for a predictable recurring revenue stream with the lowest cost to the customer because customers are generally required to retain the equipment for the duration of its useful life. Service leases command a premium per diem rate in exchange for providing customers with a greater level of operational flexibility by allowing the pick-up and drop-off of units during the lease term. We also have expired long-term leases whose fixed terms have ended but for which the related units remain on-hire and for which we continue to receive rental payments pursuant to the terms of the initial contract. Some leases have contractual terms that have features reflective of both long-term and service leases and we classify such leases as either long-term or service leases, depending upon which features we believe are predominant.

The following table provides a summary of our equipment leasing fleet portfolio by lease type, based on CEU as of the dates indicated below:

Lease Portfolio	September 30, 2014		December 31, 2013		September 30, 2013	
Long-term leases	66.9	%	68.0	%	69.3	%
Finance leases	8.5		9.2		7.6	
Service leases	18.3		18.0		17.4	
Expired long-term leases (units on-hire)	6.3		4.8		5.7	
Total	100.0	%	100.0	%	100.0	%

As of September 30, 2014, December 31, 2013 and September 30, 2013, our long-term and finance leases combined had average remaining contract terms of approximately 42 months, 44 months, and 42 months, respectively, assuming no leases are renewed.

Table of Contents

## Operating Performance

Our profitability is primarily determined by the extent to which our leasing and other revenues exceed our ownership, operating and administrative expenses. Our profitability is also impacted by the gains or losses that we realize on the sale of our used equipment and the net sales margins on our equipment trading activities.

Our leasing revenues are primarily driven by the size of our owned fleet, our equipment utilization and the average lease rates in our lease portfolio. Our leasing revenues also include ancillary fees driven by container pick-up and drop-off volumes. Leasing revenues for the third quarter of 2014 increased 4.2% from the third quarter of 2013.

**Owned fleet size.** As of September 30, 2014, our owned fleet included 2,749,832 CEU, an increase of 5.4% from December 31, 2013 and 8.9% from September 30, 2013. The increase in our fleet size over the third quarter of 2013 was primarily due to our purchases of new containers and the completion of several large sale-leaseback transactions during 2013 and 2014. These investments were supported by solid leasing demand. In 2014, leasing demand has been driven by improved trade growth and the continued market share shift from owned to leased containers. Market forecasters are generally projecting global trade growth will be between 5% and 6% this year and our customers have continued to lease a larger than normal share of their new container requirements due to strains on their financial performance created by excess vessel capacity and weak freight rates.

As of October 22, 2014, we have purchased over \$585 million of containers for delivery in 2014 through new orders and sale-leaseback transactions.

**Utilization.** Our average utilization was 97.9% during the third quarter of 2014, an increase from 97.3% in both the second quarter of 2014 and the third quarter of 2013. Our utilization remains historically high due to the relatively tight supply/demand balance for containers and the high percentage of our units that are on-hire to customers on long-term or finance leases. In general, we expect that our utilization will remain at a high level in 2014, though over time we expect our utilization will moderate gradually as the global supply and demand for containers normalizes.

The following tables set forth our equipment fleet utilization(1) for the periods indicated below:

	Quarter Ended				
	September 30, 2014	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013
Average Utilization	97.9	% 97.3	% 97.1	% 97.0	% 97.3
	September 30, 2014	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013
Ending Utilization	98.1	% 97.7	% 96.9	% 97.2	% 97.0

(1) Utilization is computed by dividing our total units on lease (in CEU) by the total units in our fleet (in CEU) excluding new units not yet leased and off-hire units designated for sale.

**Average lease rates.** Average lease rates in the third quarter of 2014 for our dry container product line decreased by 2.1% from the second quarter of 2014 and 6.6% from the third quarter of 2013, excluding the impact of sale-leaseback transactions. Lower new container prices, widespread availability of attractively priced financing, and extremely aggressive competition for new leasing transactions continue to pressure market lease rates, and market lease rates for dry containers are currently well below our portfolio average. Low market lease rates negatively impact our overall average lease rates as we add new containers to our fleet and as existing containers either have leases renegotiated and re-priced at expiration or as the containers are dropped-off from older leases with higher lease rates and picked-up onto new leases with lower lease rates. We expect our dry container lease rates will continue to decrease for the remainder of 2014, and if market lease rates remain near their current low level for an extended period of time, we expect the decrease in our average dry container lease rates will accelerate in 2015 and 2016 due to the large number of leases with high lease rates that are scheduled to expire in those years.

Average lease rates in the third quarter of 2014 for our refrigerated container product line decreased by 4.0% from the third quarter of 2013. For several years, our average lease rates for refrigerated containers have been negatively impacted by historically low market leasing rates. The cost of refrigeration machines included in refrigerated

containers has trended down over the last few years, which has led to lower refrigerated container prices and lease rates. Lease rates for new refrigerated containers are also being negatively impacted by the widespread availability of attractively priced financing and aggressive competition.

Table of Contents

The average lease rates for special containers were approximately 3.2% higher in the third quarter of 2014, compared to the third quarter of 2013, excluding the impact of sale-leaseback transactions. This increase is mainly the result of the drop-off and sale of older special containers that were on leases with rates well below our portfolio average.

**Equipment disposals.** During the third quarter of 2014, we recognized a \$0.9 million gain on the sale of our used containers, compared to a gain of \$4.3 million in the third quarter of 2013.

In the third quarter of 2014, our gain on sale was negatively impacted by lower average sale prices for used containers. Our average used container selling prices decreased approximately 18% from the third quarter of 2013 as leasing companies and shipping lines have increased disposal volumes in response to the gradual normalization of the global container supply/demand balance. We expect used container selling prices will continue to trend down toward historical levels as the global supply and demand balance for containers continues to normalize.

Our gain on equipment disposals has also been negatively impacted by a decrease in the disposal volume of original TAL dry containers and by high purchase prices paid for sale-leaseback containers. In general, used dry container sale prices remain above our long-term estimated residual values, and the per unit gains on the disposal of original TAL dry containers remain relatively high. However, TAL purchased few new containers in the late 1990's and early 2000's, and as a result, we have a limited amount of original TAL dry containers currently available for sale.

TAL has been supplementing its reduced sale volume of original TAL containers with older containers purchased from our customers through sale-leaseback transactions. These containers have generally been purchased for prices higher than the net book value of original TAL containers of similar ages. The higher purchase prices are supported by per diem revenue and drop-off fees received by TAL under the terms of the leaseback agreements, and these sale-leaseback transactions remain profitable on an overall basis. However, TAL has started to recognize losses on the disposal of a large portion of our sale-leaseback containers due to the reduction in sale prices for used containers and the fact that lease revenue and fees are excluded from the gain or loss calculations upon disposal.

**Equipment ownership expenses.** Our ownership expenses, which consist of depreciation and interest expense, increased by \$4.5 million or 5.7% in the third quarter of 2014 as compared to the third quarter of 2013. This increase in our ownership expenses was less than the increase in the average net book value of our revenue earning assets, which increased by approximately 7.8% from the third quarter of 2013 to the third quarter of 2014.

Depreciation expense increased \$4.9 million or 9.4% in the third quarter 2014 as compared to the third quarter of 2013 mainly due to the net increase in the size of our depreciable fleet. Depreciation expense increased faster than our revenue earning assets mainly reflecting a decrease in the portion of our fleet that is fully depreciated. TAL purchased few new containers in the late 1990's and early 2000's, and as a result, we have relatively few original TAL containers reaching the end of their depreciable lives. We expect the portion of fully depreciated containers in our fleet will continue to trend down for the next several years.

Interest expense decreased \$0.4 million or 1.5% in the third quarter of 2014 as compared to the third quarter of 2013. This decrease was due to a decrease in our average effective interest rate, partially offset by an increase in our average outstanding debt. Our average effective interest rate decreased to 3.62% in the third quarter of 2014 as compared to 3.80% in the third quarter of 2013 reflecting the refinancing of selected debt facilities with lower cost debt and the issuance of new debt at interest rates lower than those on our existing debt facilities. Our average outstanding debt increased by 3.35% mainly due to the 7.8% increase in average revenue earning assets.

**Credit performance.** We recorded a small provision for doubtful accounts during the third quarter of 2014, compared to a \$0.3 million provision during the third quarter of 2013. While our credit performance was strong during the third quarter of 2014, our overall concern about credit risk remains heightened due to the difficult market conditions facing our shipping line customers. Most of the major shipping lines have reported modest or negative profitability over the last few years due to persistent excess vessel capacity and weak freight rates. Several shipping lines are also currently undertaking significant financial restructurings due to high current financial leverage and ongoing sizable losses. In addition, it is anticipated that the volume of new vessels entering service over the next several years will cause the global container vessel fleet to grow at a higher rate than global containerized trade. As a result, we expect freight rates and our customers' financial performance to remain under pressure.

**Operating expenses.** Direct operating expenses were \$8.3 million in the three months ended September 30, 2014, compared to \$6.9 million in the same period in 2013, an increase of \$1.4 million. This increase was due to an increase

of \$1.0 million, mostly in repair, handling, and repositioning expenses due to a larger volume of pick-up and drop-off activity. In addition, there was an increase in survey costs of \$0.6 million related to increased procurement activity. Our storage costs remained relatively flat, despite an increase in utilization due to an increase in the average number of containers held for sale of 4,802 TEU or 14.2% from the third quarter of 2013 to the third quarter of 2014.

Table of Contents

Our administrative expenses increased \$0.9 million to \$11.3 million in the third quarter of 2014, compared to \$10.4 million in the third quarter of 2013. This increase was mainly due to an increase in incentive compensation and foreign exchange losses on our Euro and GBP denominated assets and liabilities.

**Dividends**

We paid the following quarterly dividends during the nine months ended September 30, 2014 and 2013 on our issued and outstanding common stock:

Record Date	Payment Date	Aggregate Payment	Per Share Payment
September 3, 2014	September 24, 2014	\$24.2 Million	\$0.72
June 3, 2014	June 24, 2014	\$24.2 Million	\$0.72
March 3, 2014	March 24, 2014	\$24.2 Million	\$0.72
September 3, 2013	September 24, 2013	\$22.8 Million	\$0.68
June 4, 2013	June 25, 2013	\$22.1 Million	\$0.66
March 7, 2013	March 28, 2013	\$21.4 Million	\$0.64

Historically, most of our dividends have been treated as a non-taxable return of capital, and based on our current estimates we believe that our dividends paid in 2014 will also be treated as a non-taxable return of capital to TAL shareholders. The taxability of the dividends to TAL shareholders does not impact TAL's corporate tax position. Investors should consult with a tax adviser to determine the proper tax treatment of these distributions.

**Stock Buyback Program**

On March 13, 2006, our Board of Directors authorized a stock buyback program for the repurchase of our common stock. The stock repurchase program, as now amended, authorizes us to repurchase up to 4.0 million shares. During the third quarter of 2014, TAL repurchased 176,000 shares at an average price of \$43.67. As of September 30, 2014, 812,157 shares may yet be purchased under the stock buyback program.

Table of Contents

Results of Operations

The following table summarizes our results of operations for the three and nine months ended September 30, 2014 and 2013 (in thousands of dollars):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Leasing revenues:				
Operating leases	\$145,613	\$139,994	\$	