

TAL International Group, Inc.
Form 10-Q
April 29, 2014
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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 March 31, 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 April 18, 2014, there were 33,994,771 shares of the Registrant's common stock, \$0.001 par value outstanding.

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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 March 31, 2014 and December 31, 2013 and for the three months ended March 31, 2014 and March 31, 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.

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TAL INTERNATIONAL GROUP, INC.

Consolidated Balance Sheets

(Dollars in thousands, except share data)

(Unaudited)

	March 31, 2014	December 31, 2013
ASSETS:		
Leasing equipment, net of accumulated depreciation and allowances of \$946,558 and \$910,713	\$3,459,396	\$3,414,904
Net investment in finance leases, net of allowances of \$1,057 and \$1,057	250,262	257,176
Equipment held for sale	55,371	58,042
Revenue earning assets	3,765,029	3,730,122
Unrestricted cash and cash equivalents	70,323	68,875
Restricted cash	31,235	29,126
Accounts receivable, net of allowances of \$886 and \$948	78,968	74,174
Goodwill	74,523	74,523
Deferred financing costs	29,271	29,087
Other assets	15,699	11,898
Fair value of derivative instruments	21,105	27,491
Total assets	\$4,086,153	\$4,045,296
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Equipment purchases payable	\$95,068	\$112,268
Fair value of derivative instruments	2,380	1,900
Accounts payable and other accrued expenses	50,813	63,022
Net deferred income tax liability	371,644	358,255
Debt	2,871,738	2,817,933
Total liabilities	3,391,643	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, 37,006,614 and 36,858,778 shares issued respectively	37	37
Treasury stock, at cost, 3,011,843 shares	(37,535)	(37,535)
Additional paid-in capital	500,715	498,854
Accumulated earnings	225,922	220,492
Accumulated other comprehensive income	5,371	10,070
Total stockholders' equity	694,510	691,918
Total liabilities and stockholders' equity	\$4,086,153	\$4,045,296

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

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TAL INTERNATIONAL GROUP, INC.

Consolidated Statements of Income

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

(Unaudited)

	Three Months Ended March 31,	
	2014	2013
Revenues:		
Leasing revenues:		
Operating leases	\$ 139,330	\$ 134,054
Finance leases	4,953	3,098
Total leasing revenues	144,283	137,152
Equipment trading revenues	12,487	18,286
Management fee income	450	619
Other revenues	34	18
Total revenues	157,254	156,075
Operating expenses (income):		
Equipment trading expenses	10,839	15,611
Direct operating expenses	8,682	5,962
Administrative expenses	11,832	11,904
Depreciation and amortization	53,803	49,317
Provision (reversal) for doubtful accounts	31	(82)
Net (gain) on sale of leasing equipment	(3,096)	(10,261)
Total operating expenses	82,091	72,451
Operating income	75,163	83,624
Other expenses:		
Interest and debt expense	27,619	28,883
Write-off of deferred financing costs	1,170	—
Net loss (gain) on interest rate swaps	373	(3,152)
Total other expenses	29,162	25,731
Income before income taxes	46,001	57,893
Income tax expense	15,990	20,373
Net income	\$ 30,011	\$ 37,520
Net income per common share—Basic	\$ 0.89	\$ 1.12
Net income per common share—Diluted	\$ 0.89	\$ 1.12
Cash dividends paid per common share	\$ 0.72	\$ 0.64
Weighted average number of common shares outstanding—Basic	33,608	33,469
Dilutive stock options and restricted stock	168	172
Weighted average number of common shares outstanding—Diluted	33,776	33,641

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

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TAL INTERNATIONAL GROUP, INC.

Consolidated Statements of Comprehensive Income

(Dollars in thousands)

(Unaudited)

	Three Months Ended March 31,	
	2014	2013
Net income	\$30,011	\$37,520
Other comprehensive (loss) income:		
Change in fair value of derivative instruments designated as cash flow hedges (net of income tax effect of \$(2,858) and \$(875))	(5,195)	(1,601)
Amortization of loss on terminated derivative instruments designated as cash flow hedges (net of income tax effect of \$254 and \$277)	461	506
Foreign currency translation adjustment	35	(346)
Other comprehensive (loss) income, net of tax	(4,699)	(1,441)
Comprehensive income	\$25,312	\$36,079

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

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

	Three Months Ended March 31,	
	2014	2013
Cash flows from operating activities:		
Net income	\$30,011	\$37,520
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	53,803	49,317
Amortization of deferred financing costs	1,922	1,683
Amortization of net loss on terminated derivative instruments designated as cash flow hedges	715	783
Net (gain) on sale of leasing equipment	(3,096	) (10,261
Net loss (gain) on interest rate swaps	373	(3,152
Write-off of deferred financing costs	1,170	—
Deferred income taxes	15,990	20,310
Stock compensation charge	1,808	1,857
Changes in operating assets and liabilities:		
Net equipment purchased for resale activity	(8,677	) (18,835
Net realized loss on interest rate swaps terminated prior to their contractual maturities	(1,670) —
Other changes in operating assets and liabilities	(17,918	) (12,763
Net cash provided by operating activities	74,431	66,459
Cash flows from investing activities:		
Purchases of leasing equipment and investments in finance leases	(148,622	) (195,221
Proceeds from sale of equipment, net of selling costs	39,461	37,352
Cash collections on finance lease receivables, net of income earned	12,004	8,951
Other	25	(316
Net cash (used in) investing activities	(97,132	) (149,234
Cash flows from financing activities:		
Stock options exercised and stock related activity	(51	) (304
Financing fees paid under debt facilities	(3,276	) (7,527
Borrowings under debt facilities	356,017	549,207
Payments under debt facilities and capital lease obligations	(302,231	) (441,475
(Increase) in restricted cash	(2,109	) (2,686
Common stock dividends paid	(24,201	) (21,429
Net cash provided by financing activities	24,149	75,786
Net increase (decrease) in unrestricted cash and cash equivalents	\$1,448	\$(6,989
Unrestricted cash and cash equivalents, beginning of period	68,875	65,843
Unrestricted cash and cash equivalents, end of period	\$70,323	\$58,854
Supplemental non-cash investing activities:		
Equipment purchases payable	\$95,068	\$74,163

The accompanying notes to the unaudited consolidated financial statements are

an integral part of these statements.

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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.

C. Recently Adopted Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2013-2 ("ASU 2013-2"), Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. ASU 2013-2 requires the presentation, in one place, of information about reclassifications out of accumulated other comprehensive income. Additionally, ASU 2013-2 requires the presentation of reclassifications out of accumulated other comprehensive income by component for periods in which changes in accumulated other comprehensive income balances are presented. The Company has adopted ASU 2013-2 effective January 1, 2013. The Company's adoption of ASU 2013-2 had no impact on the Company's consolidated financial statements as it is disclosure-only in nature.

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 compliments our current leasing business by expanding the product types available for our existing customer base.

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 March 31, 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).

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TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2—Fair Value of Financial Instruments (Continued)

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).

	March 31, 2014	December 31, 2013
Assets		
Net Investment in Finance Leases - carrying value	\$251,319	\$258,233
Net Investment in Finance Leases - fair value	\$258,033	\$265,745
Liabilities		
Debt—carrying value	\$2,871,738	\$2,817,933
Debt—estimated fair value	\$2,859,387	\$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

The Company paid the following quarterly dividends during the three months ended March 31, 2014 and 2013 on its issued and outstanding common stock:

Record Date	Payment Date	Aggregate Payment	Per Share Payment
March 3, 2014	March 24, 2014	\$24.2 Million	\$0.72
March 7, 2013	March 28, 2013	\$21.4 Million	\$0.64

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. During the three months ended March 31, 2014 and 2013, the Company recognized compensation costs of \$1.8 million and \$1.9 million, respectively, in administrative expenses related to the Company's stock based compensation plans as a result of restricted shares granted in 2012, 2013 and 2014.

Total unrecognized compensation costs of approximately \$9.8 million as of March 31, 2014 related to restricted shares granted during 2012, 2013 and 2014 will be recognized over the remaining weighted average vesting period of approximately 2.2 years.

During the three months ended March 31, 2014, plan participants exercised 2,950 options which had been granted under the 2005 Management Omnibus Incentive Plan. Plan participants tendered 2,364 shares, all of which were subsequently retired by the Company, to satisfy payment of withholding taxes related to activity under the Company's stock compensation plans.

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TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 4—Capital Stock and Stock Options (Continued)

Accumulated Other Comprehensive Income

Accumulated other comprehensive income 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	(7,088)	—	(7,088)
Reclassification of realized loss on interest rate swap agreements designated as cash flow hedges	1,893	—	1,893
Amortization of net loss on derivative instruments previously designated as cash flow hedges	461	—	461
Foreign currency translation adjustment	—	35	35
Other comprehensive income (loss)	(4,734)	35	(4,699)
Balance as of March 31, 2014	\$6,225	\$(854)	\$ 5,371
	Cash Flow Hedges	Foreign Currency Translation	Accumulated Other Comprehensive Income / (Loss)
Balance as of December 31, 2012	\$(7,481)	\$(949)	\$(8,430)
Change in fair value of derivative instruments designated as cash flow hedges	(1,601)	—	(1,601)
Amortization of net loss on derivative instruments previously designated as cash flow hedges	506	—	506
Foreign currency translation adjustment	—	(346)	(346)
Other comprehensive income (loss)	(1,095)	(346)	(1,441)
Balance as of March 31, 2013	\$(8,576)	\$(1,295)	\$(9,871)

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 March 31, 2014	Three Months Ended March 31, 2013	
Realized loss on interest rate swap agreements, designated as cash flow hedges	\$2,903	\$—	Interest and debt expense
Amortization of net loss on derivative instruments previously designated as cash flow hedges	715	783	Interest and debt expense
Amounts reclassified from Accumulated other comprehensive income	3,618	783	Income before income taxes
Income tax (benefit)	(1,264)	(277)	Income tax expense
Amounts reclassified from Accumulated other comprehensive income	\$2,354	\$506	Net income

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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):

	March 31, 2014	December 31, 2013
Gross finance lease receivables	\$309,679	\$320,149
Allowance on gross finance lease receivables	(1,057)	(1,057)
Gross finance lease receivables, net of allowance	308,622	319,092
Unearned income	(58,360)	(61,916)
Net investment in finance leases	\$250,262	\$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 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 established 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):

	March 31, 2014	December 31, 2013
Tier 1	\$282,624	\$283,172
Tier 2	27,055	36,977
Tier 3	—	—
Gross finance lease receivables	\$309,679	\$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 March 31, 2014, approximately \$0.1 million of the Company's Tier 1 gross finance lease receivables and \$0.4 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 March 31, 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.

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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 three months ended				
March 31, 2014	\$1,057	\$—	\$—	\$1,057
March 31, 2013	\$897	\$(73	) \$(1	) \$823

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

Note 6—Debt

Debt consisted of the following (amounts in thousands):

	March 31, 2014	December 31, 2013
Asset backed securitization (ABS) term notes	\$1,406,792	\$1,303,128
Term loan facilities	841,014	865,089
Asset backed warehouse facility	—	83,000
Revolving credit facilities	515,000	450,000
Capital lease obligations	108,932	116,716
Total Debt	\$2,871,738	\$2,817,933

As of March 31, 2014, the Company had \$1,442.7 million of debt outstanding on facilities with fixed interest rates and \$1,429.0 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 March 31, 2014, the Company had interest rate swaps in place with a net notional amount of \$986.5 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 March 31, 2014, was in compliance with all such covenants.

Asset Backed Securitization Term Notes

In February 2014, the Company issued \$270.9 million of Class A fixed rate secured notes and \$20.1 million of Class B fixed rate secured notes under the Asset Backed Securitization ("ABS") facilities.

In March 2014, the Company prepaid all of the outstanding principal balance on a certain fixed rate secured note issued under the ABS facilities in the amount of \$120.4 million.

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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 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 March 31, 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)
\$986.5 Million	1.47%	5.5 years

(1) As of March 31, 2014, the net notional amount outstanding on the Company's interest rate swap agreements is comprised of \$1,283.4 million of pay-fixed rate/receive-floating rate agreements and \$296.9 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 three months ended March 31, 2014, the Company terminated a pay-fixed rate/receive-floating rate interest rate swap agreement with an aggregate notional amount of \$150.0 million. The Company designated this interest rate swap agreement as a cash flow hedge at its inception. There was no material ineffectiveness associated with this cash flow hedge in the period from designation through March 31, 2014. The Company made a net payment of \$1.7 million to its interest rate swap counterparty related to the termination of the agreement.

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 \$0.7 million and \$0.8 million for the three months ended March 31, 2014 and 2013, respectively.

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TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 7—Derivative Instruments (Continued)

The following table represents amounts in accumulated other comprehensive income / (loss) related to interest rate swap agreements (in millions):

	Three Months Ended March 31, 2014
Unrecognized income (loss)	\$9.6
Income (loss) expected to be recognized over the next 12 months in interest and debt expense	(\$8.5)

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 agreements.

Foreign Currency Exchange Rate Swaps

In April 2008, the Company entered into foreign currency rate swap agreements to manage foreign currency rate risk exposure by exchanging Euros for U.S. dollars based on expected payments under its Euro denominated finance lease receivables. The Company will pay a total of approximately 0.3 million Euros and receive approximately \$0.5 million over the remaining term of the foreign currency rate swap agreements, which expire in April 2015. The Company does not account for the foreign currency rate swap agreements as hedging instruments under ASC 815, and therefore changes in the fair value of the foreign currency rate swap agreements are reflected in the consolidated statements of income in administrative expenses.

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	Fair Value of Derivative Instruments (In Millions)							
	Asset Derivatives				Liability Derivatives			
	March 31, 2014		December 31, 2013		March 31, 2014		December 31, 2013	
	Balance Sheet	Fair Value	Balance Sheet	Fair Value	Balance Sheet	Fair Value	Balance Sheet	Fair Value
Interest rate swap contracts, designated as cash flow hedges	Fair value of derivative instruments	\$20.7	Fair value of derivative instruments	\$27.0	Fair value of derivative instruments	\$1.6	Fair value of derivative instruments	\$1.4
Interest rate swap contracts, not designated	Fair value of derivative	0.4	Fair value of derivative	0.3	Fair value of derivative	0.8	Fair value of derivative	0.5

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Foreign exchange contracts, not designated	instruments Fair value of derivative instruments	—	instruments Fair value of derivative instruments	0.2	instruments Fair value of derivative instruments	—	instruments Fair value of derivative instruments	—
Total derivatives		\$21.1		\$27.5		\$2.4		\$1.9

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TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 7—Derivative Instruments (Continued)

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 March 31,	
		2014	2013
Realized loss on interest rate swap agreements	Interest and debt expense	\$3.2	\$3.1
Unrealized loss (gain) on interest rate swap agreements, designated as cash flow hedges	Other comprehensive income	8.1	2.5
Net (gain) loss on interest rate swaps, not designated	Net loss (gain) on interest rate swaps	0.4	(3.2)
Foreign exchange agreements, not designated	Administrative expenses	0.1	—

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

	Three Months Ended March 31,			2013		
	2014		Totals	2013		Totals
	Equipment Leasing	Equipment Trading	Totals	Equipment Leasing	Equipment Trading	Totals
Total revenues	\$141,267	\$15,987	\$157,254	\$134,895	\$21,180	\$156,075
Equipment trading expenses	—	10,839	10,839	—	15,611	15,611
Depreciation and amortization expense	53,424	379	53,803	48,581	736	49,317
Net (gain) on sale of leasing equipment	(3,096)	—	(3,096)	(10,261)	—	(10,261)
Interest and debt expense	26,966	653	27,619	28,160	723	28,883
Income before income taxes(1)	43,682	3,862	47,544	51,002	3,739	54,741
Equipment held for sale at March 31	32,626	22,745	55,371	19,634	31,018	50,652
Goodwill at March 31	73,523	1,000	74,523	70,898	1,000	71,898
Total assets at March 31	4,010,968	75,185	4,086,153	3,724,228	77,879	3,802,107
Purchases of leasing equipment and investments in finance leases(2)	145,247	3,375	148,622	194,673	548	195,221

Segment income before income taxes excludes net losses on interest rate swaps of \$0.4 million and net gains on (1) interest rate swaps of \$3.2 million for the three months ended March 31, 2014 and 2013, respectively, and the write-off of deferred financing costs of \$1.2 million for the three months ended March 31, 2014.

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.

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TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 8—Segment and Geographic Information (Continued)

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 and will be 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 its 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 revenues for the periods indicated based on customers' primary domicile and allocates equipment trading revenue based on the location of sale (in thousands):

	Three Months Ended March 31,	
	2014	2013
Total revenues:		
United States of America	\$8,861	\$10,854
Asia	69,855	68,384
Europe	69,872	67,945
Other International	8,666	8,892
Total	\$157,254	\$156,075

As all 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.

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TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 March 31, 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 March 31, 2014.

Purchase Commitments

At March 31, 2014, commitments for capital expenditures totaled approximately \$81.3 million.

Note 10—Income Taxes

The consolidated income tax expense for the three months ended March 31, 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 April 22, 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 June 24, 2014 to shareholders of record at the close of business on June 3, 2014.

Debt Facilities

On April 2, 2014, the Company closed a \$350.0 million senior secured term loan facility and used the proceeds to prepay its 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.

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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 consolidated operations include the acquisition, leasing, re-leasing and subsequent sale of multiple types of intermodal containers and chassis. As of March 31, 2014, our total fleet consisted of 1,294,542 containers and chassis, including 18,910 containers under management for third parties, representing 2,124,228 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 March 31, 2014. Our customers are among the largest shipping lines in the world. For the three months ended March 31, 2014, our twenty largest customers accounted for 81% of our leasing revenues, our five largest customers accounted for 52% of our leasing revenues, and our largest customer, CMA CGM, accounted for 17% of our leasing revenues.

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

	Equipment Fleet in Units								
	March 31, 2014			December 31, 2013			March 31, 2013		
	Owned	Managed	Total	Owned	Managed	Total	Owned	Managed	Total
Dry	1,094,422	17,500	1,111,922	1,087,462	17,971	1,105,433	1,024,044	20,132	1,044,176
Refrigerated	66,462	57	66,519	63,967	63	64,030	59,956	97	60,053
Special	55,273	1,353							