TAL International Group, Inc.
Form 10-Q
November 03, 2015


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

FORM 10-Q

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

For The Quarterly Period Ended September 30, 2015

Or

o 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 | 20-1796526 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |
| 100 Manhattanville Road, Purchase, New York | 10577-2135 |
| (Address of principal executive office) | (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 ý No o

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 ý No o

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 ý | Accelerated Filer o | Non-accelerated filer o | Smaller reporting company o |
| | | (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 o NO ý

As of October 23, 2015, there were 33,255,291 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 19, 2015, 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, 2015 and December 31, 2014 and for the three and nine months ended September 30, 2015 and September 30, 2014 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 19, 2015 from which the accompanying December 31, 2014 Balance Sheet information was derived, and our other reports filed with the SEC 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)

| | September 30, 2015 | December 31, 2014 |
|---|---|---|
| ASSETS: | | |
| Leasing equipment, net of accumulated depreciation and allowances of $1,178,845 and $1,055,864 | $3,856,833 | $3,674,031 |
| Net investment in finance leases, net of allowances of $844 and $1,056 | 202,078 | 219,872 |
| Equipment held for sale | 67,480 | 59,861 |
| Revenue earning assets | 4,126,391 | 3,953,764 |
| Unrestricted cash and cash equivalents | 66,817 | 79,132 |
| Restricted cash | 31,185 | 35,649 |
| Accounts receivable, net of allowances of $1,250 and $978 | 84,883 | 85,681 |
| Goodwill | 74,523 | 74,523 |
| Deferred financing costs | 27,015 | 32,937 |
| Other assets | 12,967 | 11,400 |
| Fair value of derivative instruments | 86 | 1,898 |
| Total assets | $4,423,867 | $4,274,984 |
| LIABILITIES AND STOCKHOLDERS' EQUITY: | | |
| Equipment purchases payable | $12,572 | $88,336 |
| Fair value of derivative instruments | 34,019 | 10,394 |
| Accounts payable and other accrued expenses | 54,428 | 57,877 |
| Net deferred income tax liability | 443,962 | 411,007 |
| Debt | 3,222,149 | 3,040,842 |
| Total liabilities | 3,767,130 | 3,608,456 |
| 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, 37,167,134 and 37,006,283 shares issued respectively | 37 | 37 |
| Treasury stock, at cost, 3,911,843 and 3,829,928 shares | (75,310) | (71,917) |
| Additional paid-in capital | 509,960 | 504,891 |
| Accumulated earnings | 249,874 | 246,766 |
| Accumulated other comprehensive (loss) | (27,824) | (13,249) |
| Total stockholders' equity | 656,737 | 666,528 |
| Total liabilities and stockholders' equity | $4,423,867 | $4,274,984 |

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 September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Leasing revenues: | | | | |
| Operating leases | $150,471 | $145,613 | $441,608 | $424,432 |
| Finance leases | 3,807 | 4,441 | 11,718 | 14,118 |
| Other revenues | 148 | 470 | 913 | 1,464 |
| Total leasing revenues | 154,426 | 150,524 | 454,239 | 440,014 |
| Equipment trading revenues | 15,360 | 13,745 | 48,683 | 45,026 |
| Equipment trading expenses | (14,169) | (12,032) | (44,557) | (39,450) |
| Trading margin | 1,191 | 1,713 | 4,126 | 5,576 |
| Net (loss) gain on sale of leasing equipment | (2,854) | 870 | (4,963) | 6,427 |
| Operating expenses: | | | | |
| Depreciation and amortization | 61,711 | 57,198 | 180,116 | 165,238 |
| Direct operating expenses | 13,002 | 8,287 | 31,835 | 25,236 |
| Administrative expenses | 10,962 | 11,317 | 34,311 | 34,277 |
| Provision for doubtful accounts | 256 | 22 | 68 | 58 |
| Total operating expenses | 85,931 | 76,824 | 246,330 | 224,809 |
| Operating income | 66,832 | 76,283 | 207,072 | 227,208 |
| Other expenses: | | | | |
| Interest and debt expense | 30,477 | 26,695 | 89,322 | 81,202 |
| Write-off of deferred financing costs | 895 | 173 | 895 | 5,072 |
| Net loss (gain) on interest rate swaps | 662 | (545) | 1,014 | 410 |
| Total other expenses | 32,034 | 26,323 | 91,231 | 86,684 |
| Income before income taxes | 34,798 | 49,960 | 115,841 | 140,524 |
| Income tax expense | 12,287 | 17,343 | 40,903 | 48,534 |
| Net income | $22,511 | $32,617 | $74,938 | $91,990 |
| Net income per common share—Basic | $0.69 | $0.97 | $2.28 | $2.74 |
| Net income per common share—Diluted | $0.68 | $0.97 | $2.27 | $2.72 |
| Cash dividends paid per common share | $0.72 | $0.72 | $2.16 | $2.16 |
| Weighted average number of common shares outstanding—Basic | 32,860 | 33,594 | 32,860 | 33,607 |
| Dilutive stock options and restricted stock | 94 | 201 | 129 | 168 |
| Weighted average number of common shares outstanding—Diluted | 32,954 | 33,795 | 32,989 | 33,775 |

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 September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Net income | $22,511 | $32,617 | $74,938 | $91,990 |
| Other comprehensive income (loss): | | | | |
| Change in fair value of derivative instruments designated as cash flow hedges (net of income tax effect of $(12,185), $(516), $(13,755) and $(8,766), respectively) | (22,421) | (1,051) | (25,276) | (16,303) |
| Reclassification of realized loss on interest rate swap agreements designated as cash flow hedges (net of income tax effect of $1,733, $1,326, $5,181 and $3,339, respectively) | 3,174 | 2,546 | 9,490 | 6,386 |
| Amortization of loss on terminated derivative instruments designated as cash flow hedges (net of income tax effect of $228, $102, $705 and $619, respectively) | 418 | 186 | 1,296 | 1,132 |
| Foreign currency translation adjustment | (170) | (234) | (85) | (54) |
| Other comprehensive (loss) income, net of tax | (18,999) | 1,447 | (14,575) | (8,839) |
| Comprehensive income | $3,512 | $34,064 | $60,363 | $83,151 |

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)

| | Nine Months Ended September 30, 2015 | 2014 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | $74,938 | $91,990 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 180,116 | 165,238 |
| Amortization of deferred financing costs | 5,788 | 5,799 |
| Amortization of net loss on terminated derivative instruments designated as cash flow hedges | 2,001 | 1,751 |
| Amortization of lease premiums | 2,250 | — |
| Net loss (gain) on sale of leasing equipment | 4,963 | (6,427) |
| Net loss on interest rate swaps | 1,014 | 410 |
| Write-off of deferred financing costs | 895 | 5,072 |
| Deferred income taxes | 40,903 | 48,533 |
| Stock compensation charge | 5,031 | 4,700 |
| Changes in operating assets and liabilities: | | |
| Net equipment purchased for resale activity | (7,000) | (6,335) |
| Net realized gain on interest rate swaps terminated prior to their contractual maturities | — | 7,408 |
| Other changes in operating assets and liabilities | 1,327 | (16,485) |
| Net cash provided by operating activities | 312,226 | 301,654 |
| Cash flows from investing activities: | | |
| Purchases of leasing equipment and investments in finance leases | (561,687) | (547,555) |
| Proceeds from sale of equipment, net of selling costs | 95,556 | 117,351 |
| Cash collections on finance lease receivables, net of income earned | 32,051 | 36,269 |
| Other | (35) | (108) |
| Net cash (used in) investing activities | (434,115) | (394,043) |
| Cash flows from financing activities: | | |
| Purchases of treasury stock | (4,446) | (7,690) |
| Stock options exercised and stock related activity | 38 | (234) |
| Financing fees paid under debt facilities | (761) | (9,074) |
| Borrowings under debt facilities | 555,000 | 1,225,935 |
| Payments under debt facilities and capital lease obligations | (373,750) | (1,039,021) |
| Decrease (increase) in restricted cash | 4,464 | (352) |
| Common stock dividends paid | (70,971) | (72,617) |
| Net cash provided by financing activities | 109,574 | 96,947 |
| Net (decrease) increase in unrestricted cash and cash equivalents | $(12,315) | $4,558 |
| Unrestricted cash and cash equivalents, beginning of period | 79,132 | 68,875 |
| Unrestricted cash and cash equivalents, end of period | $66,817 | $73,433 |
| Supplemental non-cash investing activities: | | |
| Equipment purchases payable | $12,572 | $68,228 |

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. New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-09 ("ASU No. 2014-09"), Revenue from Contracts with Customers (Topic 606). 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. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers, which defers by one year the effective date of ASU 2014-09 until reporting periods beginning after December 15, 2017, including interim periods within that annual period. Earlier application is permitted as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. ASU No. 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.

In August 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-15 ("ASU No. 2014-15"), Presentation of Financial Statements (Topic 205): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. This standard requires management to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity’s ability to continue as a going concern within one year after the date that financial statements are issued and to disclose those conditions if management has concluded that substantial doubt exists. Subsequent to adoption, this guidance will need to be applied by management at the end of each annual period and interim period therein to determine what, if any, impact there will be on the Consolidated Financial Statements in a given reporting period. These changes become effective for the Company for the 2016 annual period. Management has determined that the adoption of these changes will not have an impact on the Consolidated Financial Statements as this standard is disclosure only.

In April 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2015-03 ("ASU No. 2015-03"), Imputation of Interest (Topic 835): Simplifying the Presentation of Debt Issuance Costs. This standard changes the presentation of debt issuance costs in the financial statements but does not affect the recognition and measurement of debt issuance costs. The ASU specifies that debt issuance costs related to a note shall be reported in the balance sheet as a direct deduction from the face amount of that note and that amortization of debt issuance costs also shall be reported as interest expense. The ASU’s basis for conclusions observes that in practice, debt issuance costs incurred before the associated funding is received (i.e., before the issuance of the debt liability) are deferred on the balance sheet until that debt liability amount is recorded. These changes will become effective for the Company beginning after December 15, 2015. The Company believes that the adoption of ASU No. 2015-03 will have no impact on its income or cash flows and no material impact on its financial position.

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TAL INTERNATIONAL GROUP, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

In August 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2015-15 ("ASU No. 2015-15"), Imputation of Interest (Topic 835): Presentation and Subsequent Measurement of Debt Issuance Costs
Associated with Line-of-Credit Agreements. This standard updates ASU No. 2015-03 which was issued in April, 2015, as ASU No. 2015-03 does not address the presentation or subsequent measurement of debt issuance costs related to line-of-credit arrangements. Given the absence of authoritative guidance with ASU No. 2015-03 for debt issuance costs related to line-of-credit arrangements, the SEC would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. These changes will become effective for the Company beginning after December 15, 2015. The Company is planning on presenting all debt issuance costs in conjunction with ASU No. 2015-03, which is effective beginning after December 15, 2015.

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, 2015 and December 31, 2014.

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, 2015 | December 31, 2014 |
|---|---|---|
| Assets | | |
| Net investment in finance leases - carrying value | $202,922 | $220,928 |
| Net investment in finance leases - estimated fair value | $209,112 | $223,455 |
| Liabilities | | |
| Debt—carrying value | $3,222,149 | $3,040,842 |
| Debt—estimated fair value | $3,257,848 | $3,060,790 |

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.

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TAL INTERNATIONAL GROUP, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3—Dividends and Treasury Stock

Dividends

The Company paid the following quarterly dividends during the nine months ended September 30, 2015 and 2014 on its issued and outstanding common stock:

| Record Date | Payment Date | Aggregate Payment | Per Share Payment |
|---|---|---|---|
| September 2, 2015 | September 23, 2015 | $23.7 Million | $0.72 |
| June 3, 2015 | June 24, 2015 | $23.7 Million | $0.72 |
| March 3, 2015 | March 24, 2015 | $23.7 Million | $0.72 |
| 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 |

Treasury Stock

In the first quarter of 2015, TAL repurchased 81,915 shares at an average price of $41.40 under TAL's 2006 stock repurchase program. On February 11, 2015, TAL's Board of Directors authorized a new share repurchase program of up to 3,000,000 of its outstanding shares. These shares augmented the remaining 88,157 shares authorized for purchase under TAL's 2006 stock repurchase program. TAL had no repurchases of shares under these programs during the second and third quarters of 2015. No time limit was set for the completion of the repurchase program. As of September 30, 2015, 3,088,157 shares may yet be purchased under the 2006 and the 2015 stock buyback programs. See Note 11, "Subsequent Events" for further information on the Company's stock repurchase program.

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 2013, 2014 and 2015 under the Company's stock-based compensation plans of $1.6 million and $1.3 million during the three months ended September 30, 2015 and 2014, respectively and $5.0 million and $4.7 million during the nine months ended September 30, 2015 and 2014, respectively.

Total unrecognized compensation costs of approximately $7.3 million as of September 30, 2015 related to restricted shares granted during 2013, 2014 and 2015 will be recognized over the remaining weighted average vesting period of approximately 1.8 years.

The Company's stock-based compensation plans consist of the 2014 Equity Incentive Plan and the 2005 Management Omnibus Incentive Plan. Following the approval by the Company's shareholders of the 2014 Equity Incentive Plan in April 2014, no further grants will be made under the 2005 Management Omnibus Incentive Plan but the terms of the 2005 Management Omnibus Incentive Plan continue to apply to awards previously granted under the plan.

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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 (Loss)
Accumulated other comprehensive (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 (Loss) Income |
|---|---|---|---|
| Balance as of December 31, 2014 | $(12,145) | $(1,104) | $ (13,249) |
| Change in fair value of derivative instruments designated as cash flow hedges | (25,276) | — | (25,276) |
| Reclassification of realized loss on interest rate swap agreements designated as cash flow hedges | 9,490 | — | 9,490 |
| Amortization of net loss on derivative instruments previously designated as cash flow hedges | 1,296 | — | 1,296 |
| Foreign currency translation adjustment | — | (85) | (85) |
| Other comprehensive (loss) | (14,490) | (85) | (14,575) |
| Balance as of September 30, 2015 | $(26,635) | $(1,189) | $ (27,824) |

| | 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 (loss) | (8,785) | (54) | (8,839) |
| Balance as of September 30, 2014 | $2,174 | $(943) | $ 1,231 |

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

| | Amounts Reclassified From Accumulated Other Comprehensive (Loss) | | | | Affected Line Item in the Consolidated Statements of Income |
|---|---|---|---|---|---|
| | Three Months Ended September 30, | | Nine Months Ended September 30, | | |
| | 2015 | 2014 | 2015 | 2014 | |
| Realized loss on interest rate swap agreements, designated as cash flow hedges | $4,907 | $3,872 | $14,671 | $9,725 | Interest and debt expense |
| Amortization of net loss on derivative instruments previously designated as cash flow hedges | 646 | 288 | 2,001 | 1,751 | Interest and debt expense |
| Amounts reclassified from Accumulated other comprehensive (loss) | 5,553 | 4,160 | 16,672 | 11,476 | Income before income taxes |

| | | | | | |
|---|---|---|---|---|---|
| Income tax (benefit) | (1,961 ) | (1,428 ) | (5,886 ) | (3,958 ) | Income tax expense |
| Amounts reclassified from Accumulated other comprehensive (loss) | $3,592 | $2,732 | $10,786 | $7,518 | 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):

| | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Gross finance lease receivables | $241,668 | $267,720 |
| Allowance on gross finance lease receivables | (844) | (1,056) |
| Gross finance lease receivables, net of allowance | 240,824 | 266,664 |
| Unearned income | (38,746) | (46,792) |
| Net investment in finance leases | $202,078 | $219,872 |

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, 2015 | December 31, 2014 |
|---|---|---|
| Tier 1 | $190,093 | $244,136 |
| Tier 2 | 51,575 | 23,584 |
| Tier 3 | — | — |
| Gross finance lease receivables | $241,668 | $267,720 |

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, 2015, approximately $1.6 million of the Company's Tier 1 and $0.2 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, 2015, 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) | Ending Balance |
|---|---|---|---|
| Finance Lease—Allowance for doubtful accounts: | | | |
| For the nine months ended | | | |
| September 30, 2015 | $1,056 | $(212 ) | $844 |

Note 6—Debt
Debt consisted of the following (amounts in thousands):

| | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Asset backed securitization (ABS) term notes | $1,212,171 | $1,504,183 |
| Term loan facilities | 961,633 | 858,973 |
| Asset backed warehouse facility | 610,000 | 420,000 |
| Revolving credit facilities | 365,000 | 160,000 |
| Capital lease obligations | 73,345 | 97,686 |
| Total Debt | $3,222,149 | $3,040,842 |

As of September 30, 2015, the Company had $1,361.6 million of debt outstanding on facilities with fixed interest rates and $1,860.5 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, 2015, the Company had interest rate swaps in place with a net notional amount of $1,135.0 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, 2015, was in compliance with all such covenants.

Asset Backed Securitization Term Notes

On July 20, 2015, TAL Advantage IV LLC, an indirect wholly owned subsidiary of TAL International Group, Inc., prepaid all of the $100.1 million outstanding principal balance of the TAL Advantage IV LLC Series 2010-1 Notes.

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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 direct wholly owned subsidiary of the Company, are pledged as collateral for various credit facilities and the amounts payable under certain interest rate swap agreements.
As of September 30, 2015, 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 Million | 2.00% | 6.8 years |

(1) As of September 30, 2015, the net notional amount outstanding on the Company's interest rate swap agreements is comprised of $1,235.0 million of pay-fixed rate/receive-floating rate agreements and $100.0 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.

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

| | Nine Months Ended September 30, 2015 |
|---|---|
| Loss on derivative instruments designated as cash flow hedges | ($17.0 ) |
| Amortization of loss on terminated derivative instruments designated as cash flow hedges | ($2.3 ) |

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TAL INTERNATIONAL GROUP, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 7—Derivative Instruments (Continued)

Amounts recorded in accumulated other comprehensive (loss) 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

| | | Fair Value of Derivative Instruments (In Millions) | | | |
|---|---|---|---|---|---|
| | | Asset Derivatives | | Liability Derivatives | |
| Derivative Instrument | Balance Sheet Location | September 30, 2015 Fair Value | December 31, 2014 Fair Value | September 30, 2015 Fair Value | December 31, 2014 Fair Value |
| Interest rate swap contracts, designated as cash flow hedges | Fair value of derivative instruments | $— | $ 1.7 | $32.0 | $ 9.4 |
| Interest rate swap contracts, not designated | Fair value of derivative instruments | 0.1 | 0.1 | 2.0 | 1.0 |
| Foreign exchange contracts, not designated | Fair value of derivative instruments | — | 0.1 | — | — |
| Total derivatives | | $0.1 | $ 1.9 | $34.0 | $ 10.4 |

| | | Effect of Derivative Instruments on Consolidated Statements of Income and Consolidated Statements of Comprehensive Income (In Millions) | | | |
|---|---|---|---|---|---|
| | | Three Months Ended September 30, | | Nine Months Ended September 30, | |
| | Location of Loss (Gain) on Derivative Instruments | 2015 | 2014 | 2015 | 2014 |
| Realized loss on interest rate swap agreements | Interest and debt expense | $5.2 | $4.2 | $15.5 | $10.6 |
| Amortization of realized net loss on terminated derivative instruments, designated as cash flow hedges | Interest and debt expense | 0.6 | 0.3 | 2.0 | 1.8 |
| Change in fair value of derivatives, designated as cash flow hedges | Other comprehensive income | 34.6 | 1.6 | 39.0 | 25.1 |
| Net loss (gain) on interest rate swaps, not designated | Net loss (gain) on interest rate swaps | 0.7 | (0.5) | 1.0 | 0.4 |
| Foreign exchange agreements, not designated | Administrative expenses | — | — | — | 0.1 |

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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, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | | 2014 | | |
| | Equipment Leasing | Equipment Trading | Totals | Equipment Leasing | Equipment Trading | Totals |
| Total leasing revenues | $151,698 | $2,728 | $154,426 | $147,502 | $3,022 | $150,524 |
| Trading margin | — | 1,191 | 1,191 | — | 1,713 | 1,713 |
| Net (loss) gain on sale of leasing equipment | (2,854) | — | (2,854) | 870 | — | 870 |
| Depreciation and amortization expense | 61,226 | 485 | 61,711 | 56,914 | 284 | 57,198 |
| Interest and debt expense | 29,972 | 505 | 30,477 | 26,190 | 505 | 26,695 |
| Income before income taxes(1) | 33,768 | 2,587 | 36,355 | 45,928 | | |