

HAPC, Inc.  
Form 10-Q  
August 09, 2007  
Table of Contents

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

\_\_\_\_\_  
**FORM 10-Q**  
\_\_\_\_\_

**x** **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
**for the quarterly period ended June 30, 2007**

**or**

**..** **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
**for the transition period from \_\_\_\_\_ to \_\_\_\_\_**

Commission File Number: 000-51902

\_\_\_\_\_  
**HAPC, INC.**

(Exact name of registrant as specified in its charter)

\_\_\_\_\_

**Delaware**  
(State or Other Jurisdiction of

Incorporation or Organization)

**350 Madison Avenue, New York, New York 10017**

(Address of Principal Executive Offices including zip code)

**(212) 418-5070**

**20-3341405**  
(I.R.S. Employer

Identification No.)

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(Registrant's Telephone Number, Include Area Code)

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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 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (check one).

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Indicated by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of August 8, 2007, 18,625,252 shares of the registrant's common stock, par value \$0.0001 per share, were outstanding.

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**Table of Contents**

**HAPC, INC. AND SUBSIDIARY**

**Index to Form 10-Q**

	<b>PAGE</b>
<b>PART I - FINANCIAL INFORMATION</b>	
Item 1 <b><u>Financial Statements (Unaudited):</u></b>	
<u>Condensed Consolidated Balance Sheets as of June 30, 2007 and December 31, 2006</u>	1
<u>Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2007 and 2006, and for the period from August 15, 2005 (inception) to June 30, 2007</u>	2
<u>Condensed Consolidated Statements of Stockholders Equity (Deficit) for the period August 15, 2005 (inception) to December 31, 2005, the year ended December 31, 2006 and for the six months ended June 30, 2007</u>	3
<u>Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2007 and 2006 and for the period from August 15, 2005 (inception) to June 30, 2007</u>	4
<u>Notes to Condensed Consolidated Financial Statements</u>	5
Item 2 <b><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	19
Item 3 <b><u>Quantitative and Qualitative Disclosures About Market Risk</u></b>	26
Item 4 <b><u>Controls and Procedures</u></b>	27
<b>PART II - <u>OTHER INFORMATION</u></b>	
Item 6 <b><u>Exhibits</u></b>	28
<b><u>Signatures</u></b>	29

**Table of Contents****Item 1. Financial Statements****HAPC, INC. AND SUBSIDIARY**

(formerly HEALTHCARE ACQUISITION PARTNERS CORP.)

(a corporation in the development stage)

**CONDENSED CONSOLIDATED BALANCE SHEETS**

(UNAUDITED)

	June 30, 2007	December 31, 2006
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 99,813	\$ 427,372
Investments held in trust	100,261,456	98,151,128
Prepaid expenses and other current assets	81,472	445,369
Deferred acquisition costs	2,371,449	1,273,961
<b>Total assets</b>	<b>\$ 102,814,190</b>	<b>\$ 100,297,830</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>Current Liabilities:</b>		
Accounts payable other	\$ 409,308	\$ 289,738
Ticking fee payable to I-Flow	415,625	63,542
Accrued professional fees	1,393,675	405,079
Accrued franchise tax	82,500	165,000
Accrued expenses other	43,801	27,964
Stockholder advance	100	100
Federal Income tax payable	6,584	
Deferred underwriting fees	5,467,581	5,467,581
Warrant liabilities	9,112,636	9,112,636
<b>Total Current Liabilities</b>	<b>16,931,810</b>	<b>15,531,640</b>
<b>Commitments</b>		
Common stock subject to possible conversion 3,373,363 shares at conversion value	20,042,265	19,620,410
<b>Stockholders Equity</b>		
Preferred stock, \$.0001 par value; authorized 1,000,000 shares; none issued and outstanding		
Common stock, \$.0001 par value; authorized 200,000,000 shares; issued 21,041,918 and outstanding 18,625,252	2,104	2,104
Additional paid-in capital	74,145,248	73,027,803
Deficit accumulated during the development stage	(8,307,237)	(7,884,127)
<b>Total stockholders equity</b>	<b>65,840,115</b>	<b>65,145,780</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 102,814,190</b>	<b>\$ 100,297,830</b>

See accompanying notes to condensed consolidated financial statements.



Table of Contents**HAPC, INC. AND SUBSIDIARY****(formerly HEALTHCARE ACQUISITION PARTNERS CORP.)**

(a corporation in the development stage)

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(Unaudited)

	Three Months Ended		Six Months Ended		For the period from
	June 30		June 30		August 15, 2005
	2007	2006	2007	2006	(inception) to
					June 30, 2007
	\$	\$	\$	\$	\$
Revenues					
Operating Expenses:					
Compensation expense	611,147	2,184,901	1,226,200	4,381,517	20,960,742
Guaranty Fee					100,000
General and Administrative Expenses Other	325,313	177,880	724,179	178,453	1,643,473
Total Operating Expenses	936,460	2,362,781	1,950,379	4,559,970	22,704,215
<b>Loss from Operations</b>	<b>936,460</b>	<b>2,362,781</b>	<b>1,950,379</b>	<b>4,559,970</b>	<b>22,704,215</b>
Other Income (Expenses):					
Interest income	1,173,223	857,032	2,324,050	857,032	5,527,870
Interest expense	(11,302)	(223)	(15,461)	(1,011)	(17,065)
Ticking fee	(189,583)		(352,083)		(446,875)
Gain (Loss) on warrant liabilities	(2,025,030)	9,787,645		9,787,645	10,800,160
	(1,052,692)	10,644,454	1,956,506	10,643,666	15,864,090
<b>Income (Loss) before provision for income taxes</b>	<b>(1,989,153)</b>	<b>8,281,673</b>	<b>6,127</b>	<b>6,083,696</b>	<b>(6,840,125)</b>
Provision for income tax	208,766	191,149	429,237	191,893	1,467,112
<b>Net Income (Loss)</b>	<b>\$ (2,197,918)</b>	<b>\$ 8,090,524</b>	<b>\$ (423,110)</b>	<b>\$ 5,891,803</b>	<b>\$ (8,307,237)</b>
Net Income (Loss) per share:					
basic	\$ (0.12)	\$ 0.53	\$ (0.02)	\$ 0.68	\$ (0.65)
diluted	\$ (0.12)	\$ 0.46	\$ (0.02)	\$ 0.54	\$ (0.65)
Weighted average shares outstanding:					
basic	18,625,252	15,403,969	18,625,252	8,614,703	12,860,187
diluted	18,625,252	17,670,794	18,625,252	10,881,528	12,860,187

See accompanying notes to condensed consolidated financial statements.

Table of Contents**HAPC, INC. AND SUBSIDIARY****(formerly HEALTHCARE ACQUISITION PARTNERS CORP.)**

(a corporation in the development stage)

**CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY (DEFICIT)**

For the period August 15, 2005 (inception) to December 31, 2005,

the year ended December 31, 2006 and for the six months ended June 30, 2007

(Unaudited)

	Common Stock		Paid in Capital in Excess of Par	Deficit Accumulated During the Development Stage	Treasury Stock		Total Stockholders Equity
	Shares	Par Value \$0.0001 Amount			Shares	Amount	
Balances at August 15, 2005		\$	\$	\$		\$	\$
Common stock issues September 13, 2005	4,166,667	417	24,583				25,000
Treasury stock purchased					(4,166,667)	(25,000)	(25,000)
Issuance of treasury shares for services			(25,000)		1,750,001	25,000	
Amortization of stock based compensation expense			24,407				24,407
Net loss				(24,783)			(24,783)
<b>Balances at December 31, 2005</b>	<b>4,166,667</b>	<b>\$ 417</b>	<b>\$ 23,990</b>	<b>\$ (24,783)</b>	<b>(2,416,666)</b>	<b>\$</b>	<b>\$ (376)</b>
Issuance of common stock and warrants	16,875,251	1,687	101,249,819				101,251,506
Reclassifications of proceeds allocated to warrants-derivative liabilities			(19,912,796)				(19,912,796)
Non-cash compensation			13,049,996				13,049,996
Expenses of offering			(10,826,601)				(10,826,601)
Non-cash charge related to sale of option			1,966,666				1,966,666
Amortization of stock based compensation expense			6,660,139				6,660,139
Proceeds subject to possible conversion of 3,373,363 shares			(19,620,410)				(19,620,410)
Issuance of warrants			437,000				437,000
Net loss				(7,859,344)			(7,859,344)
<b>Balances at December 31, 2006</b>	<b>21,041,918</b>	<b>\$ 2,104</b>	<b>\$ 73,027,803</b>	<b>\$ (7,884,127)</b>	<b>(2,416,666)</b>	<b>\$</b>	<b>\$ 65,145,780</b>
Net Loss				(423,110)			(423,110)
Current period adjustment to proceeds subject to possible conversion of 3,373,363 shares			(421,855)				(421,855)
Issuance of option to purchase 833,333 units to FTN Midwest			100				100
Issuance of warrants			313,000				313,000
Amortization of stock based compensation expense			1,226,200				1,226,200
<b>Balances at June 30, 2007</b>	<b>21,041,918</b>	<b>\$ 2,104</b>	<b>\$ 74,145,248</b>	<b>\$ (8,307,237)</b>	<b>(2,416,666)</b>	<b>\$</b>	<b>\$ 65,840,115</b>

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See accompanying notes to condensed consolidated financial statements.



**Table of Contents****HAPC, INC. AND SUBSIDIARY**

(formerly HEALTHCARE ACQUISITION PARTNERS CORP.)

(a corporation in the development stage)

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006	For the period from August 15, 2005 (inception) to June 30, 2007
<b>Cash flows from operating activities:</b>			
Net income (loss)	\$ (423,110)	\$ 5,891,803	\$ (8,307,237)
<b>Adjustments to reconcile net income (loss) to net cash used in operating activities:</b>			
Gain on warrant liabilities		(9,787,645)	(10,800,160)
Interest income on investments held in trust	(2,318,328)	(854,039)	(5,501,820)
Withdrawal of interest earned on investments held in trust	208,000	191,149	1,455,157
Amortization of stock based compensation	1,226,200	4,381,517	7,886,339
Non-cash compensation satisfied by grant of stock			13,049,996
Stock issued for services			24,407
<b>Changes in current assets and liabilities:</b>			
Decrease (Increase) in prepaid expenses and other current assets	363,895	(673,249)	(81,474)
Decrease in other deferred offering costs		165,088	
Increase in accounts payable other	119,570		222,455
Increase in ticking fee payable to I-Flow	352,083		415,625
Increase (Decrease) in accrued franchise tax	(82,500)		82,500
(Decrease) Increase in accrued expenses other	(14,481)	(81,454)	13,483
Increase in accrued professional fees	81,036		140,665
Increase in Federal and Corporate taxes payable	6,584	191,149	6,584
<b>Net cash used in operating activities</b>	<b>(481,051)</b>	<b>(575,681)</b>	<b>(1,393,480)</b>
<b>Cash flows from investing activities:</b>			
Purchase of investments held in trust		(96,214,793)	(96,214,793)
Payment of deferred acquisition costs	(159,608)		(901,266)
<b>Net cash used in investing activities</b>	<b>(159,608)</b>	<b>(96,214,793)</b>	<b>(97,116,059)</b>
<b>Cash flows from financing activities:</b>			
Advance from initial stockholder			100
Proceeds from issuance of option to purchase units to FTN Midwest	100		100
Proceeds from notes payable			85,000
Proceeds from issuance of warrants	313,000		750,000
Payment of notes payable		(85,000)	(85,000)
Payment of offering costs		(3,392,354)	(3,392,354)
Proceeds from public offering		81,885,657	81,631,096
Proceeds from issuance of shares of stock subject to possible conversion		19,365,849	19,620,410
<b>Net cash provided by financing activities</b>	<b>313,100</b>	<b>97,774,152</b>	<b>98,609,352</b>

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<b>Net change in cash</b>		<b>(327,559)</b>	<b>983,678</b>	<b>99,813</b>
<b>Cash, beginning of period</b>		<b>427,372</b>	<b>13,590</b>	
<b>Cash, end of period</b>	<b>\$</b>	<b>99,813</b>	<b>\$ 997,268</b>	<b>\$ 99,813</b>
<b>Supplemental Disclosures of Cash Flow Information:</b>				
Cash paid for interest	\$		\$	\$ 1,304
Cash paid for taxes		377,156		1,630,700
<b>Schedule of Non-Cash Financing Transactions:</b>				
Options issued to underwriter	\$	100	\$ 1,966,666	\$ 1,966,766
Deferred underwriting fees			5,468,000	5,467,581
Issuance of notes payable to treasury stock				25,000
Warrant obligations in connection with sale of units in offering			19,912,796	19,912,796
			See accompanying notes to condensed consolidated financial statements.	

**Table of Contents**

**HAPC, INC. AND SUBSIDIARY**

**(formerly HEALTHCARE ACQUISITION PARTNERS CORP.)**

(a corporation in the development stage)

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**1. Basis of Presentation**

The information in this Report on Form 10-Q includes the financial position of HAPC, INC. (formerly Healthcare Acquisition Partners Corp.) and its consolidated subsidiary, Iceland Acquisition Subsidiary, Inc. (collectively, the Company) as of June 30, 2007 and the results of operations and cash flows for the three months and six months ended June 30, 2007 and 2006. The financial statements of all entities are consolidated and all intercompany accounts are eliminated upon consolidation. This Form 10-Q should be read in conjunction with the Company's Form 10-K for the fiscal year ended December 31, 2006.

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

In the opinion of management, all adjustments (consisting only of normal recurring accruals) have been made that are necessary to present fairly the financial position of the Company as of June 30, 2007 and the results of its operations and its cash flows for the three months and six months ended June 30, 2007 and 2006 in conformity with generally accepted accounting principles. Operating results for the interim period are not necessarily indicative of the results to be expected for the full year.

**2. Nature of Operations and Summary of Significant Accounting Policies**

The Company was incorporated in Delaware on August 15, 2005 as a blank check company whose objective is to acquire through a merger, capital stock exchange, asset acquisition or other similar business combination, one or more operating businesses primarily in the healthcare sector. As disclosed in Note 11, the Company has identified an acquisition candidate, InfuSystem, Inc. (InfuSystem) and has entered into an agreement to acquire all of the issued and outstanding stock of InfuSystem through Iceland Acquisition Subsidiary, Inc.

The Company's Amended and Restated Certificate of Incorporation provides for mandatory liquidation of the Company in the event that the Company does not consummate a business combination within 18 months from the date of the consummation of the Company's initial public offering (the IPO), or 24 months from the consummation of the IPO in the event that a definitive agreement to complete a business combination was executed but was not consummated within such 18 month period.

Substantially all activity through June 30, 2007 relates to the Company's formation, the IPO and efforts related to the pending acquisition of InfuSystem described below. The Company has selected December 31 as its fiscal year end. The registration statement for the Company's IPO was declared effective on April 11, 2006. The Company consummated the IPO on April 18, 2006 and received gross proceeds of \$100,000,000. Legal fees totaling \$497,000 and underwriting costs totaling \$2,600,000 have been paid from these proceeds. Substantially all of the net proceeds of the IPO are intended to be applied toward acquiring InfuSystem.

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**Table of Contents**

**HAPC, INC. AND SUBSIDIARY**

**(formerly HEALTHCARE ACQUISITION PARTNERS CORP.)**

(a corporation in the development stage)

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**2. Nature of Operations and Summary of Significant Accounting Policies (Continued)**

Of the proceeds of the IPO, \$96,214,793 was deposited and is being held in a trust account ( Trust Account ) and invested in a money market fund, fully collateralized by U.S. government securities until the earlier of (i) the consummation of the acquisition of InfuSystem or (ii) the distribution of the Trust Account as described below. The amount in the Trust Account includes \$5,467,581 of contingent underwriting compensation (the Discount ) which will be paid to the underwriters if the acquisition of InfuSystem is consummated, but which will be forfeited if public stockholders vote against the proposed acquisition and elect to have their shares redeemed for cash if the acquisition of InfuSystem is not consummated. Pro rata decreases in the Discount will occur if the acquisition of InfuSystem is consummated but there are up to 19.99% dissenting stockholders who vote against the acquisition proposal and elect to have their shares redeemed for cash. The remaining amount of the proceeds were used to pay business, legal, accounting, due diligence on prospective acquisitions and continuing general and administrative expenses. The Company continues to recapitalize its working capital requirements by issuing additional securities such as the sale of warrants on December 28, 2006 for \$437,000 and on April 12, 2007 for \$313,000 as discussed in Note 9.

**Use of estimates**

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

**Cash and cash equivalents**

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

**Investments Held in Trust**

The Company invests amounts held in trust in a United States Treasury money market account. Under the terms of the trust agreement, these amounts are restricted to the funding of an acquisition and to the payment of income taxes on the trust's taxable income.

**Share Based Payment**

FASB Statement No. 123 (R), Share Based Payment requires all entities to recognize compensation expense in an amount equal to the fair value of share based payments made to employees, among other requirements. Under the fair value based method, compensation cost is measured at the grant date based on the fair value of the award and is recognized on a straight-line basis over the award vesting period.

Accordingly, share based payments issued to officers, directors and vendors are measured at fair value and recognized as expense over the related vesting periods.

The compensation expense recognized for the three months ended June 30, 2007 and 2006 was \$611,147 and \$2,184,901, respectively. The compensation expense recognized for the six months ended June 30, 2007 and 2006 was \$1,226,200 and \$4,381,517 respectively. The compensation expense recognized for the period from August 15, 2005 (inception) to June 30, 2007 was \$20,960,742.

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**Table of Contents**

**HAPC, INC. AND SUBSIDIARY**

**(formerly HEALTHCARE ACQUISITION PARTNERS CORP.)**

(a corporation in the development stage)

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**2. Nature of Operations and Summary of Significant Accounting Policies (Continued)**

**Accounting for Warrants and Derivative Instruments**

On April 18, 2006, the Company consummated its IPO of 16,666,667 units. Each unit consists of one share of common stock and two redeemable common stock purchase warrants. Each warrant entitles the holder to purchase from the Company one share of its common stock at an exercise price of \$5.00. On May 18, 2006, the Company sold an additional 208,584 units to FTN Midwest Securities Corp., the underwriter of its IPO, pursuant to a partial exercise by FTN Midwest Securities Corp. of its over-allotment option. The Warrant Agreement provides for the Company to register the shares underlying the warrants in the absence of the Company's ability to deliver registered shares to the warrant holders upon warrant exercise.

In September 2000, the Emerging Issues Task Force issued EITF 00-19, Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in, a Company's Own Stock, (EITF 00-19) which requires freestanding derivative contracts that are settled in a company's own stock, including common stock warrants, to be designated as equity instruments, assets or liabilities. Under the provisions of EITF 00-19, a contract designated as an asset or a liability must be carried at its fair value on a company's balance sheet, with any changes in fair value recorded in the company's results of operations. A contract designated as an equity instrument must be included within equity, and no fair value adjustments are required from period to period. In accordance with EITF 00-19, the 33,750,502 warrants issued in connection with the IPO and over-allotment to purchase stock are separately accounted for as liabilities. The fair value of these warrants is shown on the Company's balance sheet and the unrealized changes in the value of these warrants are shown in the Company's statement of operations as Gain (loss) on warrant liabilities. These warrants are freely traded on the Over The Counter Bulletin Board. Consequently, the fair value of these warrants is estimated as the market price of the warrant at each period end. To the extent the market price increases or decreases, the Company's warrant liabilities will also increase or decrease, including the effect on the Company's statement of operations.

Sales of warrants that can be settled in unregistered shares of common stock are treated as equity and included in additional paid in capital.

**Table of Contents****HAPC, INC. AND SUBSIDIARY****(formerly HEALTHCARE ACQUISITION PARTNERS CORP.)**

(a corporation in the development stage)

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****2. Nature of Operations and Summary of Significant Accounting Policies (Continued)****Income taxes**

The Company uses the liability method for reporting income taxes, under which current and deferred tax liabilities and assets are recorded in accordance with enacted tax laws and rates. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Under the liability method, the amounts of deferred tax liabilities and assets at the end of each period are determined using the tax rate expected to be in effect when taxes are actually paid or recovered. Future tax benefits are recognized when it is more likely than not that such benefits will be realized.

The Company has a total deferred tax asset of \$4,436,999 related to the compensation expense associated with the reserve of certain shares of its common stock currently held as treasury stock for two directors and other expenses. The Company has established a reserve for the full amount of the benefit based on the uncertainty that the benefit will be fully utilized.

**Earnings Per Share**

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted earnings per share assumes the issuance of potentially dilutive shares of common stock during the periods related to the stock options and warrants. The following table reconciles the numerators and denominators of the basic and diluted net income (loss) per share computations for net income (loss) for the following periods:

	Three Months Ended		Six Months Ended		For the period from
	June 30		June 30		August 15, 2005
	2007	2006	2007	2006	(inception) to June 30, 2007
<b>Numerator:</b>					
Net Income (loss)	\$ (2,197,918)	\$ 8,090,524	\$ (423,110)	\$ 5,891,803	\$ (8,307,237)
<b>Denominator:</b>					
Weighted Average common shares outstanding					
Basic	18,625,252	15,403,969	18,625,252	8,614,703	12,860,187
Diluted	18,625,252	17,670,794	18,625,252	10,881,528	12,860,187
<b>Net Income (loss) per share:</b>					
Basic	\$ (0.12)	\$ 0.53	\$ (0.02)	\$ 0.68	\$ (0.65)
Diluted	\$ (0.12)	\$ 0.46	\$ (0.02)	\$ 0.54	\$ (0.65)

**Table of Contents**

**HAPC, INC. AND SUBSIDIARY**

**(formerly HEALTHCARE ACQUISITION PARTNERS CORP.)**

(a corporation in the development stage)

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**2. Nature of Operations and Summary of Significant Accounting Policies (Continued)**

**Recently issued accounting pronouncements**

In June 2006, the Financial Accounting Standards Board ( FASB ) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 ( FIN 48 ), which provides criteria for the recognition, measurement, presentation and disclosure of uncertain tax positions. A tax benefit from an uncertain position may be recognized only if it is more likely than not that the position is sustainable on its technical merits. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. The Company adopted FIN 48 on January 1, 2007, which had no impact on its consolidated financial condition, results of operations or cash flows.

We classify interest on tax deficiencies as interest expense and income tax penalties as penalties expense. At January 1, 2007 (date of adoption) and at June 30, 2007, no liabilities have been recorded for uncertain tax positions pursuant to FIN 48, as the Company determined that all previously determined tax positions are highly certain. In addition, the Company did not record a cumulative effect adjustment related to the adoption on FIN 48.

As of January 1, 2007 (date of adoption) and June 30, 2007, the tax years 2005 and 2006 remain subject to examination by major tax jurisdictions.

In September 2006, the FASB issued FASB Statement No. 157 Fair Value Measurements ( FASB No. 157 ) which relates to the definition of fair value, the methods used to measure fair value and the expanded disclosures about fair value measurements. The provisions of FASB No. 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company does not expect this statement to have a material effect on its consolidated financial condition, results of operations or cash flows upon adoption.

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**Table of Contents**

**HAPC, INC. AND SUBSIDIARY**

**(formerly HEALTHCARE ACQUISITION PARTNERS CORP.)**

(a corporation in the development stage)

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**2. Nature of Operations and Summary of Significant Accounting Policies (Continued)**

**Recently issued accounting pronouncements**

In February 2007, the FASB issued FASB Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115, ( FASB No. 159 ) which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. FASB No. 159 is expected to expand the use of fair value measurement, which is consistent with the Board's long-term measurement objectives for accounting for financial instruments. FASB No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. FASB No. 159 does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value. FASB No. 159 does not establish requirements for recognizing and measuring dividend income, interest income, or interest expense. FASB No. 159 does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements, included in FASB Statements No. 157, Fair Value Measurements, and No. 107, Disclosures about Fair Value of Financial Instruments. FASB No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company has not yet completed its assessment of the impact upon adoption of FASB No. 159 on its consolidated financial condition, results of operations or cash flows.

**Cash concentration of credit risk**

The Company maintains cash balances with financial institutions, which, at times, may exceed the Federal Deposit Insurance Corporation limit. The Company has not experienced any losses to date as a result of this policy, and management believes there is little risk of loss.

**3. Initial Public Offering**

On April 18, 2006, the Company sold 16,666,667 units ( Units ) to the public at a price of \$6.00 per unit. Each Unit consists of one share of the Company's common stock, \$.0001 par value, and two redeemable common stock purchase warrants. Each warrant will entitle the holder to purchase from the Company one share of common stock at an exercise price of \$5.00 commencing on the later of the completion of a business combination or one year from the effective date of the IPO and expiring five years from the effective date of the IPO. The Company may call the warrants for redemption in whole and not in part at a price of \$.01 per warrant at any time after the warrants become exercisable. They cannot be redeemed unless the warrant holders receive written notice not less than 30 days prior to the redemption; and, if, and only if, the reported last sale price of the common stock equals or exceeds \$8.50 per share for any 20 trading days within a 30 trading day period ending on the third business day prior to the notice of redemption to warrant holders. In connection with the IPO, the Company paid to FTN Midwest Securities Corp. an underwriting discount of 7% of the IPO price and a non-accountable expense allowance of 1% of the IPO price.



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**Table of Contents**

**HAPC, INC. AND SUBSIDIARY**

**(formerly HEALTHCARE ACQUISITION PARTNERS CORP.)**

(a corporation in the development stage)

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**3. Initial Public Offering (Continued)**

In addition, on April 18, 2006, the Company issued to FTN Midwest Securities Corp., for \$100, an option to purchase up to a total of 833,333 units. The units issuable upon exercise of this option are identical to those offered in the IPO, except that each of the warrants underlying this option entitles the holder to purchase one share of the Company's common stock at a price of \$6.25. This option is exercisable at \$7.50 per unit commencing on the later of the consummation of a business combination or one year from the date of the prospectus and expiring five years from the date of the prospectus. The option may only be exercised or converted by the option holder. The Company received payment of \$100 for this option in the first quarter of 2007.

The sale of the option was accounted for as an equity transaction. Accordingly, there was no net impact on the Company's financial position or results of operations, except for the recording of the \$100 proceeds from the sale. The Company determined that the fair value of the option on the date of sale was \$2.36 per unit, or \$1,966,666 total, using an expected life of five years, volatility of 47% and a risk-free interest rate of 3.98%. Accordingly, this amount was recorded as an expense of the offering resulting in a charge directly to stockholders' equity during 2006.

The volatility calculation of 47% is based on the 180 day average volatility of a representative sample of 41 healthcare industry companies (the Sample Companies) with market capitalization under \$200 million. Because it does not have a long trading history, the Company needed to estimate the potential volatility of its common stock price. The Company referred to the 180 day average volatility of the Sample Companies because Management believes that the average volatility of such companies is a reasonable benchmark to use in estimating the expected volatility of the Company's common stock post-business combination. Although an expected life of five years was taken into account for purposes of assigning a fair value to the options, if the Company does not consummate a business combination within the prescribed time period and liquidates, the options would become worthless.

On May 18, 2006, the Company sold 208,584 Units (the Overallotment Units) to FTN Midwest Securities Corp. pursuant to a partial exercise by FTN Midwest Securities Corp. of its overallotment option. The Overallotment Units were sold at the offering price of \$6.00 per Unit, less FTN Midwest Securities Corp.'s 7% underwriting discount.

**4. Investments Held in Trust**

Investments held in trust at June 30, 2007 and December 31, 2006, consist of a United States Treasury money market account with a carrying value of \$100,261,456 and \$98,151,128, respectively. The fair value of the investments approximate the carrying value.

**5. Notes Payable**

On September 28, 2005, the Company issued a \$60,000 unsecured promissory note to Healthcare Acquisition Holdings, LLC, a company owned by certain directors of the Company. The note bears interest at a rate of 3% per annum and is payable on the earlier of September 28, 2006 or the date the Company consummates an initial public offering.

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**Table of Contents**

**HAPC, INC. AND SUBSIDIARY**

**(formerly HEALTHCARE ACQUISITION PARTNERS CORP.)**

(a corporation in the development stage)

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**5. Notes Payable (Continued)**

On December 30, 2005, the Company issued an \$25,000 unsecured promissory note, at an interest rate of 3% per annum to Healthcare Acquisition Holdings, LLC, to repurchase the 4,166,667 common shares that Healthcare Acquisition Holdings, LLC received upon formation of the Company. At September 30, 2006, 2,416,666 shares were included in the Treasury shares of the Company.

Due to the short-term nature of the notes, the fair values of the notes approximate the carrying values. Both notes were re-paid in full in May 2006 and are no longer outstanding.

Interest expense for the three months and six months ended June 30, 2007 was \$11,302 and \$15,461, respectively. Interest expense for the three months and six months ended June 30, 2006 was \$223 and \$1,011, respectively. The interest expense for the six months ended June 30, 2007 consists mainly of accrued interest the Company agreed to pay I-Flow Corporation on acquisition-related obligations incurred by I-Flow that will be reimbursed to them by HAPC, Inc. The interest rate on these obligations is 4.50% over the prime rate. The rate at June 30, 2007 was 12.75%. The interest expense for the six months ended June 30, 2006 consists of interest on notes payable paid off during the six months ended June 30, 2006.

**6. Warrant Liabilities**

The warrants will be exercisable only if at the time of exercise (i) a registration statement under the Securities Act of 1933, as amended (the Securities Act ), with respect to the common stock underlying the warrants issuable upon exercise of the option is effective, or (ii) in the opinion of counsel to the Company or counsel to the option holder reasonably satisfactory to the Company, the exercise of the warrants is exempt from the registration requirements of the Securities Act and such securities are qualified for sale or exempt from qualification under applicable securities laws of the states or other jurisdictions in which the registered holders reside. The warrants may not be exercised by, or securities issued to, any registered holder in any state in which such exercise or issuance would be unlawful. The option holder is not entitled to receive a net cash settlement or other settlement in lieu of physical settlement if the common stock underlying the warrants, or securities underlying the option, as applicable, are not covered by an effective registration statement.

The Company has determined that the warrants issued in connection with the IPO including the overallotment shares issued on May 18, 2006 are classified as liabilities in accordance with EITF 00-19. Therefore, the fair value of each instrument must be recorded as a liability on the Company's balance sheet. Changes in the fair values of these instruments will result in adjustments to the amount of the recorded liabilities, and the corresponding gain or loss will be recorded in the Company's statement of operations. At the date of the conversion of each warrant or portion thereof (or exercise of the warrants or portion thereof, as the case may be), the corresponding liability will be reclassified as equity.

The fair values of the Company's 33,750,502 warrants issued in connection with the IPO outstanding at June 30, 2007 and December 31, 2006 were \$9,112,636 or \$0.27 per warrant.

**7. Related Party Transactions**

The Company was initially funded by Healthcare Acquisition Holdings, LLC. Cash was received from the issuance of two unsecured promissory notes as discussed in Note 5. The proceeds were used as working capital until the Company was able to consummate its IPO. Both notes were repaid in full in May 2006.

**Table of Contents****HAPC, INC. AND SUBSIDIARY****(formerly HEALTHCARE ACQUISITION PARTNERS CORP.)**

(a corporation in the development stage)

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****7. Related Party Transactions (Continued)**

Two of the Company's directors were former Managing Directors of FTN Midwest Securities Corp. Mr. McDevitt resigned from his position as Managing Director of FTN Midwest Securities Corp. effective January 19, 2007 and Mr. LaVecchia resigned from his position as Managing Director of FTN Midwest Securities Corp. effective February 2, 2007. FTN Midwest Securities Corp., who was the underwriter in the Company's IPO, received an underwriting discount of 7%, a non-accountable expense allowance of 1% and an option to purchase 833,333 shares for a fee of \$100. The Company reserved in its treasury 2,000,000 shares of common stock for issuance to Sean McDevitt and 416,666 shares of common stock for issuance to Pat LaVecchia on the date that is the later of six months after the completion of the acquisition of InfuSystem, or another business combination or April 11, 2007.

The Company currently utilizes and will continue to utilize certain administrative, technological and secretarial services, as well as certain limited office space provided by FTN Midwest Securities Corp. until the consummation of a business combination by the Company. The Company has agreed to pay \$1 per year for such services commencing on the effective date of the IPO and continuing monthly thereafter.

Refer to Note 11 for discussion of the Termination and Break Up Fee and the related guaranty.

As disclosed in Note 11, the Company is paying a ticking fee to I-Flow in consideration of its acquisition of InfuSystem. The Company incurred \$189,583 and \$352,083 related to the ticking fee during the three months and six months ended June 30, 2007, respectively, which was recorded in other income (expenses).

**8. Income Taxes**

The major components of deferred tax assets at June 30, 2007 and December 31, 2006 are as follows:

	<b>June 30, 2007</b>	<b>December 31, 2006</b>
Stock based compensation	\$ 4,436,999	\$ 4,503,228
Valuation allowance	(4,436,999)	(4,503,228)
	\$ 2,450	
Unrestricted cash and cash equivalents, beginning of period	68,875	65,843
Unrestricted cash and cash equivalents, end of period	\$ 57,802	\$ 68,293
Supplemental non-cash investing activities:		
Equipment purchases payable	\$ 61,579	\$ 39,193

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



Table of Contents

TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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

A. Description of the Business

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

B. Basis of Presentation

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

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

In the second quarter of 2014, the Company has revised the Income Statement presentation for the three months and six months ended June 30, 2014 and June 30, 2013 by removing the line item "Total revenues" and moving "Equipment trading revenues" and "Equipment trading expenses" line items together and adding a line for "Trading margin". The Company believes that this new presentation better highlights the trends in leasing revenues and the relative size and contribution of the Equipment trading segment.

C. New Accounting Pronouncements

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

D. Business Combination

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

Table of Contents

TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 2—Fair Value of Financial Instruments

The Company believes that the carrying amounts of its cash and cash equivalents, accounts receivable, equipment purchases payable, and accounts payable approximated their fair value as of June 30, 2014 and December 31, 2013. Fair value represents the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company utilizes the following fair value hierarchy when selecting inputs for its valuation techniques, with the highest priority given to Level 1:

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

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

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

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

	June 30, 2014	December 31, 2013
Assets		
Net investment in finance leases - carrying value	\$240,972	\$258,233
Net investment in finance leases - estimated fair value	\$243,021	\$265,745
Liabilities		
Debt—carrying value	\$2,868,075	\$2,817,933
Debt—estimated fair value	\$2,897,777	\$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 six months ended June 30, 2014 and 2013 on its issued and outstanding common stock:

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

Table of Contents

TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 4—Capital Stock and Stock Options

## Stock Based Compensation Plans

The Company records compensation cost relating to stock based payment transactions in accordance with ASC 718. The cost is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense over the employee's requisite service period (generally the vesting period of the equity award) on a straight-line basis. The Company recognized compensation costs in administrative expenses related to restricted shares granted in 2012, 2013 and 2014 under the Company's stock based compensation plans of \$1.6 million and \$1.1 million during the three months ended June 30, 2014 and 2013, respectively, and \$3.4 million and \$3.0 million during the six months ended June 30, 2014 and 2013, respectively.

Total unrecognized compensation cost of approximately \$8.4 million as of June 30, 2014 related to restricted shares granted during 2012, 2013 and 2014 will be recognized over the remaining weighted average vesting period of approximately 2.0 years.

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

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

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

## Accumulated Other Comprehensive (Loss) Income

Accumulated other comprehensive (loss) 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 (Loss) Income
Balance as of December 31, 2013	\$10,959	\$(889 )	\$ 10,070
Change in fair value of derivative instruments designated as cash flow hedges	(15,252 )	—	(15,252 )
Reclassification of realized loss on interest rate swap agreements designated as cash flow hedges	3,840	—	3,840
Amortization of net loss on derivative instruments previously designated as cash flow hedges	946	—	946
Foreign currency translation adjustment	—	179	179
Other comprehensive income (loss)	(10,466 )	179	(10,287 )
Balance as of June 30, 2014	\$493	\$(710 )	\$ (217 )

Table of Contents

TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

	Cash Flow Hedges	Foreign Currency Translation	Accumulated Other Comprehensive 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	11,767	—	11,767
Reclassification of realized loss on interest rate swap agreements designated as cash flow hedges	1,185	—	1,185
Amortization of net loss on derivative instruments previously designated as cash flow hedges	1,002	—	1,002
Foreign currency translation adjustment	—	(345 )	(345 )
Other comprehensive income (loss)	13,954	(345 )	13,609
Balance as of June 30, 2013	\$ 6,473	\$ (1,294 )	\$ 5,179

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

	Amounts Reclassified From Accumulated Other Comprehensive (Loss) Income				Affected Line Item in the Consolidated Statements of Income
	Three Months Ended June 30,		Six Months Ended June 30,		
	2014	2013	2014	2013	
Realized loss on interest rate swap agreements, designated as cash flow hedges	\$ 2,950	\$ 1,832	\$ 5,853	\$ 1,832	Interest and debt expense
Amortization of net loss on derivative instruments previously designated as cash flow hedges	748	765	1,463	1,548	Interest and debt expense
Amounts reclassified from Accumulated other comprehensive income	3,698	2,597	7,316	3,380	Income before income taxes
Income tax (benefit)	(1,266 )	(919 )	(2,530 )	(1,193 )	Income tax expense
Amounts reclassified from Accumulated other comprehensive income	\$ 2,432	\$ 1,678	\$ 4,786	\$ 2,187	Net income



Table of Contents

TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 5—Net Investment in Finance Leases

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

	June 30, 2014	December 31, 2013
Gross finance lease receivables	\$295,006	\$320,149
Allowance on gross finance lease receivables	(1,057 )	(1,057 )
Gross finance lease receivables, net of allowance	293,949	319,092
Unearned income	(54,034 )	(61,916 )
Net investment in finance leases	\$239,915	\$257,176

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

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

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

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

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

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

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

	June 30, 2014	December 31, 2013
Tier 1	\$269,727	\$283,172
Tier 2	25,279	36,977
Tier 3	—	—
Gross finance lease receivables	\$295,006	\$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 June 30, 2014, approximately \$1.6 million of the Company's Tier 1 gross finance lease receivables and \$0.1 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 June 30, 2014, none of the Company's gross finance lease

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

12

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Table of Contents

TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

	Beginning Balance	Additions/ (Reversals)	Ending Balance
Finance Lease—Allowance for doubtful accounts:			
For the six months ended			
June 30, 2014	\$1,057	\$—	\$1,057
Note 6—Debt			
Debt consisted of the following (amounts in thousands):			
		June 30, 2014	December 31, 2013
Asset backed securitization (ABS) term notes		\$1,368,737	\$1,303,128
Term loan facilities		848,186	865,089
Asset backed warehouse facility		65,000	83,000
Revolving credit facilities		484,000	450,000
Capital lease obligations		102,152	116,716
Total Debt		\$2,868,075	\$2,817,933

As of June 30, 2014, the Company had \$1,422.7 million of debt outstanding on facilities with fixed interest rates and \$1,445.4 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 June 30, 2014, the Company had interest rate swaps in place with a net notional amount of \$986.0 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 June 30, 2014, was in compliance with all such covenants.

## Asset Backed Securitization Term Notes

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

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

## Term Loan Facilities

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

Table of Contents

TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 7—Derivative Instruments

## Interest Rate Swaps

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

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

Net Notional Amount(1)	Weighted Average Fixed Leg (Pay) Interest Rate(2)	Weighted Average Remaining Term(2)
\$986 Million	1.47%	5.2 years

(1) As of June 30, 2014, the net notional amount outstanding on the Company's interest rate swap agreements is comprised of \$1,148.5 million of pay-fixed rate/receive-floating rate agreements and \$162.5 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 six months ended June 30, 2014, the Company paid \$1.7 million to terminate certain designated interest rate swap agreements with an aggregate notional amount of \$150.0 million.

The Company recognized amortization of accumulated other comprehensive (loss) 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 June 30, 2014 and 2013, respectively, and \$1.5 million for both the six months ended June 30, 2014 and 2013.

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

	Six Months Ended June 30, 2014
Change in fair value of derivative instruments designated as cash flow hedges	(\$11.3 )
Amortization of loss on terminated derivative instruments designated as cash flow hedges	(\$2.7 )



Table of Contents

TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 7—Derivative Instruments (Continued)

Amounts recorded in accumulated other comprehensive (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

Derivative Instrument	Fair Value of Derivative Instruments (In Millions)							
	Asset Derivatives				Liability Derivatives			
	June 30, 2014		December 31, 2013		June 30, 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	\$ 11.9	Fair value of derivative instruments	\$ 27.0	Fair value of derivative instruments	\$ 2.3	Fair value of derivative instruments	\$ 1.4
Interest rate swap contracts, not designated	Fair value of derivative instruments	0.3	Fair value of derivative instruments	0.3	Fair value of derivative instruments	1.3	Fair value of derivative instruments	0.5
Foreign exchange contracts, not designated	Fair value of derivative instruments	—	Fair value of derivative instruments	0.2	Fair value of derivative instruments	—	Fair value of derivative instruments	—
Total derivatives		\$ 12.2		\$ 27.5		\$ 3.6		\$ 1.9

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

Location of (Gain)	Three Months Ended June 30,		Six Months Ended June 30,		
	2014	2013	2014	2013	
Loss on Derivative Instruments					
Realized loss on interest rate swap agreements	Interest expense	\$ 3.3	\$ 2.9	\$ 6.5	\$ 6.0
Unrealized loss (gain) on interest rate swap agreements, designated as cash flow hedges	Other comprehensive income	9.6	(22.5)	17.6	(20.0)
Net loss (gain) on interest rate swaps, not designated	Net loss (gain) on interest rate swaps	0.6	(5.3)	1.0	(8.4)
Foreign exchange agreements, not designated		—	0.2	0.1	0.2

Administrative  
expenses

15

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Table of Contents

TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 8—Segment and Geographic Information

## Industry Segment Information

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

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

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

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

	Three Months Ended June 30,			2013		
	2014		Totals	Equipment	Equipment	Totals
	Leasing	Trading		Leasing	Trading	
Total leasing revenues	\$141,423	\$3,300	\$144,723	\$137,264	\$2,917	\$140,181
Trading margin	—	2,215	2,215	—	4,287	4,287
Net gain on sale of leasing equipment	2,461	—	2,461	8,026	—	8,026
Depreciation and amortization expense	53,889	348	54,237	49,373	459	49,832
Interest and debt expense	26,308	580	26,888	27,643	660	28,303
Income before income taxes(1)	44,643	4,231	48,874	50,216	5,726	55,942

Segment income before income taxes excludes net losses on interest rate swaps of \$0.6 million and net gains on interest rate swaps of \$5.3 million for the three months ended June 30, 2014 and 2013, respectively, and the (1) write-off of deferred financing costs of \$3.7 million and \$2.6 million for the three months ended June 30, 2014 and 2013, respectively.



Table of Contents

TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

	Six Months Ended June 30,			2013		
	2014		Totals	Equipment	Equipment	Totals
	Equipment	Equipment		Leasing	Trading	
	Leasing	Trading		Leasing	Trading	
Total leasing revenues	\$282,690	\$6,800	\$289,490	\$272,159	\$5,811	\$277,970
Trading margin	—	3,863	3,863	—	6,962	6,962
Net gain on sale of leasing equipment	5,557	—	5,557	18,287	—	18,287
Depreciation and amortization expense	107,313	727	108,040	97,954	1,195	99,149
Interest and debt expense	53,274	1,233	54,507	55,803	1,383	57,186
Income before income taxes(1)	88,325	8,093	96,418	101,218	9,465	110,683
Equipment held for sale at June 30	30,914	19,400	50,314	24,308	14,754	39,062
Goodwill at June 30	73,523	1,000	74,523	70,898	1,000	71,898
Total assets at June 30	3,997,999	64,566	4,062,565	3,796,077	69,441	3,865,518
Purchases of leasing equipment and investments in finance leases(2)	286,652	3,114	289,766	361,110	11,466	372,576

Segment income before income taxes excludes net losses on interest rate swaps of \$1.0 million and net gains on interest rate swaps of \$8.4 million for the six months ended June 30, 2014 and 2013, respectively, and the write-off (1) of deferred financing costs of \$4.9 million and \$2.6 million for the six months ended June 30, 2014 and 2013, respectively.

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

There are no intercompany revenues or expenses between segments. Additionally, certain administrative expenses have been allocated between segments based on an estimate of services provided to each segment. A portion of the Company's equipment purchased for resale was purchased through certain sale-leaseback transactions with our shipping line customers. Due to the expected longer term nature of these transactions, these purchases are reflected as leasing equipment as opposed to equipment held for sale and the cash flows associated with these transactions are 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 most of its leasing revenues from international containers which are deployed by its customers in a wide variety of global trade routes. Substantially all of the Company's leasing related revenue is denominated in U.S. dollars. The following table represents the geographic allocation of leasing revenues for the periods indicated based on customers' primary domicile (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,	2013	June 30,	2013
	2014		2014	
Total leasing revenues:				
United States of America	\$8,136	\$7,965	\$16,175	\$16,008
Asia	65,187	61,390	129,259	119,608
Europe	64,858	64,864	130,852	130,631
Other International	6,542	5,962	13,204	11,723
Total	\$144,723	\$140,181	\$289,490	\$277,970

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

Table of Contents

TAL INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
Total equipment trading revenues:				
United States of America	\$2,251	\$2,383	\$3,073	\$5,194
Asia	10,468	20,405	16,251	30,572
Europe	5,270	6,228	10,698	5,962
Other International	805	2,765	1,259	8,339
Total	\$18,794	\$31,781	\$31,281	\$50,067

## 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 June 30, 2014, the maximum potential amount of the guarantees under which the Company could be required to perform was approximately \$27.1 million. The carrying values of the guarantees of \$1.1 million have been deferred and are included in accounts payable and accrued expenses. Under the criteria established by ASC 820, the Company performed fair value measurements of the guarantees at origination using Level 2 inputs, which were based on significant other observable inputs other than quoted prices, either on a direct or indirect basis. The Company accounts for the residual value guarantees under Accounting Standards Codification 460, Guarantees. The Company expects that the market value of the equipment covered by the guarantees will equal or exceed the value of the guarantees and therefore, no contingent loss has been provided as of June 30, 2014.

## Purchase Commitments

At June 30, 2014, commitments for capital expenditures totaled approximately \$228.9 million.

## Note 10—Income Taxes

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

## Note 11—Subsequent Events

## Quarterly Dividend

On July 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 September 24, 2014 to shareholders of record at the close of business on September 3, 2014.

Table of Contents

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

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

**Our Company**

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

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

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

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

**Operations**

Our operations include the acquisition, leasing, re-leasing and subsequent sale of multiple types of intermodal containers and chassis. As of June 30, 2014, our total fleet consisted of 1,298,201 containers and chassis, including 18,133 containers under management for third parties, representing 2,130,650 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 June 30, 2014. Our customers are among the largest shipping lines in the world. For the six months ended June 30, 2014, our twenty largest customers accounted for 80.4% of our leasing revenues, our five largest customers accounted for 51.5% of our leasing revenues, and our largest customer, CMA CGM, accounted for 16.5% of our leasing revenues.

Table of Contents

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

Equipment Fleet in Units										
	June 30, 2014			December 31, 2013			June 30, 2013			
	Owned	Managed	Total	Owned	Managed	Total	Owned	Managed	Total	
Dry	1,104,005	16,818	1,120,823	1,087,462	17,971	1,105,433	1,044,302	19,343	1,063,645	
Refrigerated	66,293	51	66,344	63,967	63	64,030	60,125	84	60,209	
Special	54,396	1,264	55,660	55,295	1,466	56,761	54,718	1,596	56,314	
Tank	8,940	—	8,940	8,100	—	8,100	7,004	—	7,004	
Chassis	13,495	—	13,495	13,724	—	13,724	13,377	—	13,377	
Equipment leasing fleet	1,247,129	18,133	1,265,262	1,228,548	19,500	1,248,048	1,179,526	21,023	1,200,549	
Equipment trading fleet	32,939	—	32,939	40,374	—	40,374	37,854	—	37,854	
Total	1,280,068	18,133	1,298,201	1,268,922	19,500	1,288,422	1,217,380	21,023	1,238,403	
Percentage	98.6	% 1.4	% 100.0	% 98.5	% 1.5	% 100.0	% 98.3	% 1.7	% 100.0	%
Equipment Fleet in TEUs										
	June 30, 2014			December 31, 2013			June 30, 2013			
	Owned	Managed	Total	Owned	Managed	Total	Owned	Managed	Total	
Dry	1,785,811	29,629	1,815,440	1,759,100	31,875	1,790,975	1,685,545	34,543	1,720,088	
Refrigerated	126,725	89	126,814	122,466	113	122,579	115,354	149	115,503	
Special	98,440	2,153	100,593	99,473	2,481	101,954	98,285	2,702	100,987	
Tank	8,940	—	8,940	8,100	—	8,100	7,004	—	7,004	
Chassis	24,056	—	24,056	24,505	—	24,505	23,826	—	23,826	
Equipment leasing fleet	2,043,972	31,871	2,075,843	2,013,644	34,469	2,048,113	1,930,014	37,394	1,967,408	
Equipment trading fleet	54,807	—	54,807	65,102	—	65,102	63,113	—	63,113	
Total	2,098,779	31,871	2,130,650	2,078,746	34,469	2,113,215	1,993,127	37,394	2,030,521	
Percentage	98.5	% 1.5	% 100.0	% 98.4	% 1.6	% 100.0	% 98.2	% 1.8	% 100.0	%
Equipment Fleet in CEUs										
	June 30, 2014			December 31, 2013			June 30, 2013			
	Owned	Managed	Total	Owned	Managed	Total	Owned	Managed	Total	
Operating Leases	2,318,769	27,808	2,346,577	2,260,404	30,232	2,290,636	2,196,305	32,940	2,229,245	
Finance Leases	210,017	831	210,848	210,535	830	211,365	149,366	825	150,191	
Equipment trading fleet	121,308	—	121,308	138,742	—	138,742	135,137	—	135,137	
Total	2,650,094	28,639	2,678,733	2,609,681	31,062	2,640,743	2,480,808	33,765	2,514,573	
Percentage	98.9	% 1.1	% 100.0	% 98.8	% 1.2	% 100.0	% 98.7	% 1.3	% 100.0	%

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

We lease five types of equipment: (1) dry freight containers, which are used for general cargo such as manufactured component parts, consumer staples, electronics and apparel, (2) refrigerated containers, which are used for perishable items such as fresh and frozen foods, (3) special containers, which are used for heavy and over-sized cargo such as marble slabs, building products and machinery, (4) tank containers, which are used to transport bulk liquid products such as chemicals, and

20

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Table of Contents

(5) chassis, which are used for the transportation of containers domestically. Our in-house equipment sales group manages the sale process for our used containers and chassis from our equipment leasing fleet and buys and sells used and new containers and chassis acquired from third parties.

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

Equipment Type	Percent of total fleet in units	Percent of total fleet in CEUs	Percent of leasing revenues		
Dry	86.4	% 59.1	% 64.0	%	
Refrigerated	5.1	24.1	20.7		
Special	4.3	5.0	7.4		
Tank	0.7	5.3	3.5		
Chassis	1.0	2.0	2.0		
Equipment leasing fleet	97.5	95.5	97.6		
Equipment trading fleet	2.5	4.5	2.4		
Total	100.0	% 100.0	% 100.0	%	

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

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

Lease Portfolio	June 30, 2014	December 31, 2013	June 30, 2013		
Long-term leases	67.2	% 68.0	% 65.3	%	
Finance leases	8.9	9.2	6.9		
Service leases	17.7	18.0	20.5		
Expired long-term leases (units on-hire)	6.2	4.8	7.3		
Total	100.0	% 100.0	% 100.0	%	

As of June 30, 2014, December 31, 2013 and June 30, 2013, our long-term and finance leases combined had average remaining contract terms of approximately 44 months, 44 months, and 43 months, respectively, assuming no leases are renewed.

Table of Contents

## Operating Performance

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

Our leasing revenues are primarily driven by the size of our owned fleet, our equipment utilization and the average lease rates in our lease portfolio. Our leasing revenues also include ancillary fees driven by container pick-up and drop-off volumes. Leasing revenues for the second quarter of 2014 increased 3.2% from the second quarter of 2013. Owned fleet size. As of June 30, 2014, our owned fleet included 2,650,094 CEUs, an increase of 1.5% from December 31, 2013 and 6.8% from June 30, 2013. The increase in our fleet size over the second quarter of 2013 was primarily due to our purchases of new containers and the completion of several large sale-leaseback transactions during the second half of 2013 and the first half of 2014. These investments were supported by a moderate level of global trade growth and the continued market share shift from owned to leased containers. Most forecasters are projecting global trade growth will be between 5% and 6% this year. Our customers have continued to lease a larger than normal share of their new container requirements due to strains on their financial performance created by excess vessel capacity and weak freight rates.

As of July 23, 2014, we have purchased over \$460 million of containers for delivery in 2014 through new orders and sale-leaseback transactions.

Utilization. Our average utilization was 97.3% during the second quarter of 2014, an increase from 97.1% in the first quarter and down slightly from 97.5% in the second quarter of 2013. Our utilization remains historically high due to the relatively tight supply/demand balance for containers and the high percentage of our units that are on-hire to customers on long-term or finance leases. In general, we expect that our utilization will remain at a high level in 2014, though over time we expect our utilization will moderate gradually as the global supply and demand for containers normalizes.

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

	Quarter Ended					
	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013	
Average Utilization	97.3	% 97.1	% 97.0	% 97.3	% 97.5	%
	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013	
Ending Utilization	97.7	% 96.9	% 97.2	% 97.0	% 97.5	%

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

Average lease rates. Average lease rates in the second quarter of 2014 for our dry container product line decreased by 2.3% from the first quarter of 2014 and 5.5% from the second quarter of 2013, excluding the impact of sale-leaseback transactions. Lower new container prices, widespread availability of attractively priced financing, and extremely aggressive competition for new leasing transactions continue to pressure market lease rates, and market lease rates for dry containers are currently well below our portfolio average. Low market lease rates negatively impact our overall average lease rates as we add new containers to our fleet and as existing containers either have leases renegotiated and re-priced at expiration or as the containers are dropped-off from older leases with higher lease rates and picked-up onto new leases with lower lease rates. We expect our dry container lease rates will continue to decrease in 2014 and if market lease rates remain near their current low level for an extended period of time, we expect the decrease in our average dry container lease rates will accelerate in 2015 and 2016 due to the large number of leases with high lease rates that are scheduled to expire in those years.

Average lease rates in the second quarter of 2014 for our refrigerated container product line decreased by 0.4% from the first quarter of 2014 and 4.8% from the second quarter of 2013. For several years, our average lease rates for



refrigerated containers have been negatively impacted by historically low market leasing rates. The cost of refrigeration machines included in refrigerated containers has trended down over the last few years, which has led to lower refrigerated container prices and lease rates. Lease rates for new refrigerated containers are also being negatively impacted by the widespread availability of attractively priced financing and aggressive competition.

Table of Contents

The average lease rates for special containers were approximately 4.4% higher in the second quarter of 2014 compared to the second quarter of 2013, excluding the impact of sale-leaseback transactions. This increase is mainly the result of the drop-off and sale of older special containers that were on leases with rates well below our portfolio average.

**Equipment disposals.** During the second quarter of 2014, we recognized a \$2.5 million gain on the sale of our used containers compared to a gain of \$8.0 million in the second quarter of 2013.

In the second quarter of 2014, our gain on sale was negatively impacted by lower average sale prices and the higher cost of equipment sold. Our average used container selling prices decreased approximately 20% from the second quarter of 2013 as leasing companies and shipping lines have increased disposal volumes in response to the gradual normalization of the container supply/demand balance. We expect used container selling prices will continue to trend down toward historical levels as the global supply and demand balance for containers continues to normalize.

Our gain on equipment disposals has also been negatively impacted by a decrease in the disposal volume of original TAL dry containers. Current used dry container sale prices remain well above our long-term estimated residual values, and the per unit gains on the disposal of original TAL dry containers remain relatively high. However, TAL purchased few new containers in the late 1990's and early 2000's, and as a result, we have a limited amount of original TAL dry containers currently available for sale. We have supplemented our original TAL container fleet with the purchase of older containers through more recent sale-leaseback transactions, but we have typically purchased these containers at prices higher than the net book values of our older original TAL containers, resulting in lower per unit disposal gains from our sale-leaseback containers.

**Equipment ownership expenses.** Our ownership expenses, which consist of depreciation and interest expense, increased by \$3.0 million or 3.8% in the second quarter of 2014 as compared to the second quarter of 2013. This increase in our ownership expenses was less than the increase in the average net book value of our revenue earning assets, which increased by approximately 5.7% from the second quarter of 2013 to the second quarter of 2014 reflecting the addition of new and sale-leaseback containers.

Depreciation expense increased \$4.4 million or 8.8% in the second quarter 2014 as compared to the second quarter of 2013 mainly due to the net increase in the size of our depreciable fleet. Depreciation expense increased faster than our revenue earning assets mainly reflecting a decrease in the portion of our fleet that is fully depreciated. TAL purchased few new containers in the late 1990's and early 2000's, and as a result, we have relatively few original TAL containers reaching the end of their depreciable lives. We expect the portion of fully depreciated containers in our fleet will continue to trend down for the next several years.

Interest expense decreased \$1.4 million or 4.9% in the second quarter of 2014 as compared to the second quarter of 2013. The decrease was due to a decrease in our average effective interest rate, partially offset by an increase in our average outstanding debt. Our average effective interest rate decreased to 3.70% in the second quarter of 2014 as compared to 4.06% in the second quarter of 2013 reflecting the refinancing of selected debt facilities with lower cost debt and the issuance of new debt at interest rates lower than those on our existing debt facilities. Our average outstanding debt increased by 4.33% mainly due to the 5.7% increase in average revenue earning assets.

**Credit performance.** We recorded a small provision for doubtful accounts during the second quarter of 2014 compared to a \$1.6 million provision for doubtful accounts during the second quarter of 2013. During the second quarter of last year, we recorded a provision related to payment defaults and estimated recovery costs for several small regional shipping lines. We had no such defaults this year. While our credit performance was strong during the second quarter of 2014, our overall concern about credit risk remains heightened due to the difficult market conditions facing our shipping line customers. Most of the major shipping lines reported modest or negative profitability over the last few years due to persistent excess vessel capacity and weak freight rates. Several large shipping lines are also currently undertaking significant financial restructurings due to high current financial leverage and ongoing sizable losses. In addition, it is anticipated that the volume of new vessels entering service over the next several years will cause the global container vessel fleet to grow at a higher rate than global containerized trade. As a result, we expect freight rates and our customers' financial performance to remain under pressure.

**Operating expenses.** Direct operating expenses were \$8.3 million in the second quarter of 2014, compared to \$6.2 million in the second quarter of 2013. This increase was mainly due to higher storage and handling costs resulting

from higher volume of re-deliveries, slightly lower utilization, and an increase in the number of containers held for sale. The number of containers held for sale increased by 8,557 TEU from June 30, 2013 to June 30, 2014. In addition, we also incurred higher repair and repositioning costs as a result of the higher volume of re-deliveries.

Our administrative expenses increased \$0.5 million to \$11.1 million in the second quarter of 2014 compared to \$10.6 million in the second quarter of 2013. This increase was due to increased incentive compensation partially offset by a reduction in foreign exchange losses on our Euro and GBP denominated assets and liabilities.

Table of Contents

## Dividends

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

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

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

Table of Contents

## Results of Operations

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Leasing revenues:				
Operating leases	\$139,489	\$136,304	\$278,819	\$270,358
Finance leases	4,724	3,152	9,677	6,250
Other revenues	510	725	994	1,362
Total leasing revenues	144,723	140,181	289,490	277,970
Equipment trading revenues	18,794	31,781	31,281	50,067
Equipment trading expenses	(16,579)	(27,494)	(27,418)	(43,105)
Trading margin	2,215	4,287	3,863	6,962
Net gain on sale of leasing equipment	2,461	8,026	5,557	18,287
Operating expenses:				
Depreciation and amortization	54,237	49,832	108,040	99,149
Direct operating expenses	8,267	6,218	16,949	12,180
Administrative expenses	11,128	10,614	22,960	22,518
Provision for doubtful accounts	5	1,585	36	1,503
Total operating expenses	73,637	68,249	147,985	135,350
Operating income	75,762	84,245	150,925	167,869
Other expenses:				
Interest and debt expense	26,888	28,303	54,507	57,186
Write-off of deferred financing costs	3,729	2,578	4,899	2,578
Net loss (gain) on interest rate swaps	582	(5,268)	955	(8,420)
Total other expenses	31,199	25,613	60,361	51,344
Income before income taxes	44,563	58,632	90,564	116,525
Income tax expense	15,201	20,756	31,191	41,129
Net income	\$29,362	\$37,876	\$59,373	\$75,396

Table of Contents

## Comparison of Three Months Ended June 30, 2014 to Three Months Ended June 30, 2013

Leasing revenues. The principal components of our leasing revenues are presented in the following table. Per diem revenue represents daily usage revenue earned under operating lease contracts; fee and ancillary lease revenue represent fees billed for the pick-up and drop-off of containers in certain geographic locations and billings of certain reimbursable operating costs such as repair and handling expenses; and finance lease revenue represents interest income earned under finance lease contracts.

	Three Months Ended June 30,	
	2014	2013
	(in thousands)	
Leasing revenues:		
Operating lease revenues:		
Per diem revenue	\$ 132,727	\$ 130,949
Fee and ancillary lease revenue	6,762	5,355
Other revenues	510	725
Total operating lease revenue	139,999	137,029
Finance lease revenue	4,724	3,152
Total leasing revenues	\$ 144,723	\$ 140,181

Total leasing revenues were \$144.7 million in the three months ended June 30, 2014, compared to \$140.2 million in the same period in 2013, an increase of \$4.5 million, or 3.2%.

Per diem revenue increased by \$1.8 million, or 1.4%, compared to the three months ended June 30, 2013. The primary reasons for this increase are as follows:

- \$6.3 million increase due to an increase of approximately 100,000 CEUs in the average number of containers on-hire under operating leases; partially offset by a

- \$4.5 million decrease due to lower average per diem rates.

Fee and ancillary lease revenue increased by \$1.4 million in the three months ended June 30, 2014 compared to the same period in 2013. This increase was primarily due to a higher number of refrigerated and special container re-deliveries in the second quarter of 2014. Per unit reimbursable repair costs are typically relatively high for refrigerated and special containers.

Finance lease revenue increased by \$1.6 million in the three months ended June 30, 2014, compared to the same period in 2013, primarily due to an increase in the average size of our finance lease portfolio partially offset by a decrease in the portfolio average interest rate.

Equipment Trading Activities. Equipment trading revenues represent the proceeds on the sale of equipment purchased for resale. Equipment trading expenses represent the cost of equipment sold, including costs associated with the acquisition, maintenance and selling of trading inventory, such as positioning, repairs, handling and storage costs, and estimated direct selling and administrative costs.

	Three Months Ended June 30,	
	2014	2013
	(in thousands)	
Equipment trading revenues	\$ 18,794	\$ 31,781
Equipment trading expenses	(16,579 )	(27,494 )
Equipment trading margin	\$ 2,215	\$ 4,287

The equipment trading margin decreased by \$2.1 million in the three months ended June 30, 2014 compared to the same period in 2013. Equipment trading margin decreased by \$0.9 million due to lower sales volumes and decreased by \$1.2 million due to lower per unit margins on equipment sold resulting from declining selling prices.

Table of Contents

Net gain on sale of leasing equipment. Gain on sale of equipment was \$2.5 million for the three months ended June 30, 2014 compared to \$8.0 million in the same period in 2013, a decrease of \$5.5 million. The primary reasons for this decrease are as follows:

\$6.2 million decrease due to a 20% decline in used dry container selling prices; partially offset by a \$0.7 million increase due to an increase in sales volume.

Depreciation and amortization. Depreciation and amortization was \$54.2 million in the second quarter of 2014, compared to \$49.8 million in the second quarter of 2013, an increase of \$4.4 million or 8.8%. Depreciation expense increased \$5.3 million primarily due to the net increase in the size of our depreciable fleet, partially offset by a decrease of \$0.9 million due to equipment becoming fully depreciated.

Direct operating expenses. Direct operating expenses primarily consist of our costs to repair equipment returned off lease, to store the equipment when it is not on lease and to reposition equipment that has been returned to locations with weak leasing demand.

Direct operating expenses were \$8.3 million in the three months ended June 30, 2014, compared to \$6.2 million in the same period in 2013, an increase of \$2.1 million. This increase was mainly due to higher storage and handling costs of \$1.2 million due to slightly lower utilization and an increase in the number of containers held for sale, a \$0.4 million increase due to higher repair expense, and a \$0.3 million increase due to higher equipment re-positioning expense.

Administrative expenses. Administrative expenses were \$11.1 million in the second quarter of 2014 compared to \$10.6 million in the same period in 2013, an increase of \$0.5 million or 4.7%. This increase was due to increased incentive compensation partially offset by a reduction in foreign exchange losses on our Euro and GBP denominated assets and liabilities.

Provision for doubtful accounts. Our provision for doubtful accounts was minimal in the second quarter of 2014, compared to a provision for doubtful accounts of \$1.6 million in the second quarter of 2013. During the second quarter of last year, we recorded a provision related to payment defaults and estimated recovery costs for several small regional shipping lines. We had no such defaults this year.

Interest and debt expense. Interest and debt expense was \$26.9 million in the second quarter of 2014, compared to \$28.3 million in the second quarter of 2013, a decrease of \$1.4 million. Interest and debt expense decreased by \$2.6 million due to a lower effective interest rate of 3.70% in the second quarter of 2014 compared to 4.06% in the prior year quarter. This was partially offset by a \$1.2 million increase due to a higher average debt balance of \$2,875.2 million in the second quarter of 2014, compared to \$2,755.9 million in the prior year quarter.

Net loss (gain) on interest rate swaps. Net loss on interest rate swaps was \$0.6 million in the three months ended June 30, 2014, compared to a gain of \$5.3 million in the same period in 2013. The fair value of our interest rate swap agreements decreased during the second quarter of 2014 due to a decrease in long term interest rates. Under the majority of our interest rate swap agreements, we make interest payments based on fixed interest rates and receive payments based on the applicable prevailing variable interest rate. As long term interest rates decreased during the second quarter of 2014, the current market rate on interest rate swap agreements with similar terms decreased relative to our existing interest rate swap agreements, which caused the fair value of our existing interest rate swap agreements to decrease during the quarter.

Income tax expense. Income tax expense was \$15.2 million in the three months ended June 30, 2014, compared to \$20.8 million in the same period in 2013. The effective tax rates for the three months ended June 30, 2014 and 2013 were 34.1% and 35.4%, respectively. Our effective tax rate decreased due to changes in state apportionment factors for several states which lowered our state effective tax rate.

While we record income tax expense, we do not currently pay any significant federal, state or foreign income taxes due to the availability of net operating loss carryovers and accelerated tax depreciation for our equipment. The majority of the expense recorded for income taxes is recorded as a deferred tax liability on the balance sheet. We anticipate that the deferred income tax liability will continue to grow for the foreseeable future.

Table of Contents

## Comparison of Six Months Ended June 30, 2014 to Six Months Ended June 30, 2013

Leasing revenues. The principal components of our leasing revenues are presented in the following table. Per diem revenue represents daily usage revenue earned under operating lease contracts; fee and ancillary lease revenue represent fees billed for the pick-up and drop-off of containers in certain geographic locations and billings of certain reimbursable operating costs such as repair and handling expenses; and finance lease revenue represents interest income earned under finance lease contracts.

	Six Months Ended June 30,	
	2014	2013
	(in thousands)	
Leasing revenues:		
Operating lease revenues:		
Per diem revenue	\$264,730	\$259,666
Fee and ancillary lease revenue	14,089	10,692
Other revenues	994	1,362
Total operating lease revenue	279,813	271,720
Finance lease revenue	9,677	6,250
Total leasing revenues	\$289,490	\$277,970

Total leasing revenues were \$289.5 million in the six months ended June 30, 2014, compared to \$278.0 million in the same period in 2013, an increase of \$11.5 million, or 4.1%.

Per diem revenue increased by \$5.1 million, or 2.0%, compared to the six months ended June 30, 2013. The primary reasons for this increase are as follows:

- \$12.6 million increase due to an increase of approximately 100,000 CEUs in the number of containers on-hire under operating leases; partially offset by a

- \$7.5 million decrease due to lower average per diem rates.

Fee and ancillary lease revenue increased by \$3.4 million in the six months ended June 30, 2014 compared to the same period in 2013 mostly due to higher repair revenue resulting from higher drop off volume. This increase was primarily due to a higher number of refrigerated and special container drop-offs in 2014. Per unit reimbursable repair costs are typically relatively high for refrigerated and special containers.

Finance lease revenue increased by \$3.4 million in the six months ended June 30, 2014, compared to the same period in 2013. This is mainly due to an increase in the average size of our finance lease portfolio partially offset by a decrease in the portfolio average interest rate.

Equipment Trading Activities. Equipment trading revenues represent the proceeds on the sale of equipment purchased for resale. Equipment trading expenses represent the cost of equipment sold, including costs associated with the acquisition, maintenance and selling of trading inventory, such as positioning, repairs, handling and storage costs, and estimated direct selling and administrative costs.

	Six Months Ended June 30,	
	2014	2013
	(in thousands)	
Equipment trading revenues	\$31,281	\$50,067
Equipment trading expenses	(27,418)	(43,105)
Equipment trading margin	\$3,863	\$6,962

The equipment trading margin decreased \$3.1 million in the six months ended June 30, 2014 compared to the same period in 2013. The trading margin decreased \$1.5 million due to lower sales volumes and decreased \$1.6 million due to lower per unit margins on equipment sold.



Table of Contents

Net gain on sale of leasing equipment. Gain on sale of equipment was \$5.6 million in the six months ended June 30, 2014 compared to \$18.3 million in the same period in 2013, a decrease of \$12.7 million. The primary reasons for this decrease are as follows:

\$12.2 million decrease due to a decline of approximately 20% in used dry container selling prices;

\$2.5 million decrease due to larger gains in the first half of 2013 related to units declared lost by one of our customers, which were not repeated in the first half of 2014; partially offset by a

\$2.0 million increase due to an increase in sales volume.

Depreciation and amortization. Depreciation and amortization was \$108.0 million in the six months ended June 30, 2014, compared to \$99.1 million in the same period in 2013, an increase of \$8.9 million or 9.0%. Depreciation expense increased by \$10.6 million due to the net increase in the size of our depreciable fleet, partially offset by a decrease of \$1.7 million due to equipment becoming fully depreciated.

Direct operating expenses. Direct operating expenses primarily consist of our costs to repair equipment returned off lease, to store the equipment when it is not on lease and to reposition equipment that has been returned to locations with weak leasing demand.

Direct operating expenses were \$16.9 million in the six months ended June 30, 2014, compared to \$12.2 million in the same period in 2013, an increase of \$4.7 million primarily driven by a \$2.8 million increase in storage and handling costs due to an increase in the number of containers off-hire, a \$1.2 million increase due to higher repair expense, and a \$0.4 million increase due to higher equipment re-positioning expense.

Administrative expenses. Administrative expenses were \$23.0 million in the six months ended June 30, 2014 compared to \$22.5 million in the same period in 2013, an increase of \$0.5 million or 2.2%. This increase was due to increased incentive compensation partially offset by a reduction in foreign exchange losses on our Euro and GBP denominated assets and liabilities.

Provision for doubtful accounts. Our provision for doubtful accounts was minimal for the six months ended June 30, 2014, compared to a provision for doubtful accounts of \$1.5 million in the six months ended June 30, 2013. During the second quarter of last year, we recorded a provision related to payment defaults and estimated recovery costs for several small regional shipping lines. We had no such defaults this year.

Interest and debt expense. Interest and debt expense was \$54.5 million in the six months ended June 30, 2014, compared to \$57.2 million in the six months ended June 30, 2013, a decrease of \$2.7 million. Interest and debt expense decreased by \$5.8 million due to a lower effective interest rate of 3.78% in the six months ended June 30, 2014 compared to 4.20% for the same period in 2013. This was partially offset by an increase of \$3.1 million due to a higher average debt balance of \$2,871.8 million in the six months ended June 30, 2014, compared to \$2,708.8 million in the six months ended June 30, 2013.

Net loss (gain) on interest rate swaps. Net loss on interest rate swaps was \$1.0 million in the six months ended June 30, 2014, compared to a gain of \$8.4 million in the same period in 2013. The fair value of our interest rate swap agreements decreased during the six months ended June 30, 2014 due to a decrease in long term interest rates. Under the majority of our interest rate swap agreements, we make interest payments based on fixed interest rates and receive payments based on the applicable prevailing variable interest rate. As long term interest rates decreased during 2014, the current market rate on interest rate swap agreements with similar terms decreased relative to our existing interest rate swap agreements, which caused the fair value of our existing interest rate swap agreements to decrease.

Income tax expense. Income tax expense was \$31.2 million in the six months ended June 30, 2014, compared to \$41.1 million in the same period in 2013. The effective tax rates for the six months ended June 30, 2014 and 2013 were 34.4% and 35.3%, respectively. Our effective tax rate decreased due to changes in state apportionment factors for several states which lowered our state effective tax rate.

While we record income tax expense, we do not currently pay any significant federal, state or foreign income taxes due to the availability of net operating loss carryovers and accelerated tax depreciation for our equipment. The majority of the expense recorded for income taxes is recorded as a deferred tax liability on the balance sheet. We anticipate that the deferred income tax liability will continue to grow for the foreseeable future.



Table of Contents

## Business Segments

We operate our business in one industry, intermodal transportation equipment, and in two business segments, Equipment leasing and Equipment trading.

## Equipment leasing

We own, lease and ultimately dispose of containers and chassis from our leasing fleet, as well as manage containers owned by third parties. Equipment leasing segment revenues represent leasing revenues from operating and finance leases, fees earned on managed container leasing activities, as well as other revenues. Expenses related to equipment leasing include direct operating expenses, administrative expenses, depreciation expense and interest expense. The Equipment leasing segment also includes gains and losses on the sale of owned leasing equipment.

## 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. Equipment trading segment revenues represent the proceeds on the sale of containers purchased for resale. Expenses related to equipment trading include the cost of containers purchased for resale that were sold and related selling costs, as well as direct operating expenses, administrative expenses and interest expense.

## Segment income before income taxes

The following table lists the income before income taxes for the Equipment leasing and Equipment trading segments for the periods indicated:

	Three Months Ended			Six Months Ended		
	June 30, 2014	2013	% Change	June 30, 2014	2013	% Change
Income before income taxes(1)						
Equipment leasing segment	\$44,643	\$50,216	(11.1)%	\$88,325	\$101,218	(12.7)%
Equipment trading segment	\$4,231	\$5,726	(26.1)%	\$8,093	\$9,465	(14.5)%

In the three months ended June 30, 2014 and 2013, income before income taxes excludes net losses and gains on interest rate swaps of \$0.6 million and \$5.3 million, respectively, and the write-off of deferred financing costs of (1)\$3.7 million and \$2.6 million, respectively. For the six months ended June 30, 2014 and 2013, income before income taxes excludes net losses and gains on interest rate swaps of \$1.0 million and \$8.4 million, respectively, and the write-off of deferred financing costs of \$4.9 million and \$2.6 million, respectively.

Equipment leasing income before income taxes. Income before income taxes for the Equipment leasing segment was \$44.6 million in the three months ended June 30, 2014, compared to \$50.2 million in the same period in 2013, a decrease of \$5.6 million, which was entirely due to a decrease in used container disposal gains.

Income before income taxes for the Equipment leasing segment was \$88.3 million in the six months ended June 30, 2014 compared to \$101.2 million in the same period in 2013, a decrease of \$12.9 million, which was primarily due to a \$12.7 million decrease in used container disposal gains.

Equipment trading income before income taxes. Income before income taxes for the Equipment trading segment was \$4.2 million in the three months ended June 30, 2014, compared to \$5.7 million in the same period in 2013, a decrease of \$1.5 million. This decrease was primarily due to a \$2.1 million decrease in trading margin resulting from lower volume and lower per unit margins on equipment sold. This was partially offset by \$0.6 million increase in leasing margin (leasing revenue less depreciation and interest) resulting from an increase in units on lease that were purchased for resale that will remain on lease until they are dropped off.

Income before income taxes for the Equipment trading segment was \$8.1 million in the six months ended June 30, 2014, compared to \$9.5 million in the same period in 2013, a decrease of \$1.4 million. This decrease was due to a \$3.1 million decrease in the equipment trading margin resulting from lower sales volumes and lower per unit margins on equipment sold. This was partially offset by a \$1.6 million increase in leasing margin (leasing revenue less depreciation and interest) resulting from an increase in units on lease that were purchased for resale that will remain on lease until they are dropped off.



Table of Contents

## Liquidity and Capital Resources

Our principal sources of liquidity are cash flows provided by operating activities, proceeds from the sale of our leasing equipment, principal payments on finance lease receivables and borrowings under our credit facilities. Our cash in-flows and borrowings are used to finance capital expenditures, meet debt service requirements and pay dividends. We continue to have sizable cash in-flows. For the twelve months ended June 30, 2014, cash provided by operating activities, together with the proceeds from the sale of our leasing equipment and principal payments on our finance leases, was \$599.0 million. In addition, as of June 30, 2014 we had \$57.8 million of unrestricted cash and \$551.0 million of additional borrowing capacity under our current credit facilities.

As of June 30, 2014, major committed cash outflows in the next 12 months include \$417.5 million of scheduled principal payments on our existing debt facilities and \$290.5 million of committed but unpaid capital expenditures. We believe that cash provided by operating activities and existing cash, proceeds from the sale of our leasing equipment, principal payments on our finance lease receivables and availability under our borrowing facilities will be sufficient to meet our obligations over the next 12 months.

At June 30, 2014, our outstanding indebtedness was comprised of the following (amounts in millions):

	Current Amount Outstanding	Maximum Borrowing Commitment
Asset backed securitization (ABS) term notes	\$1,368.7	\$1,368.7
Term loan facilities	848.2	848.2
Asset backed warehouse facility	65.0	550.0
Revolving credit facilities	484.0	550.0
Capital lease obligations	102.2	102.2
Total Debt	\$2,868.1	\$3,419.1

The maximum commitment levels depicted in the chart above may not reflect the actual availability under all of the credit facilities. Certain of these facilities are governed by borrowing bases that limit borrowing capacity to an established percentage of relevant assets.

As of June 30, 2014, we had \$1,422.7 million of debt outstanding on facilities with fixed interest rates and \$1,445.4 million of debt outstanding on facilities with interest rates based on floating rate indices (primarily LIBOR). We economically hedge the risks associated with fluctuations in interest rates on our floating rate borrowings by entering into interest rate swap agreements that convert a portion of our floating rate debt to a fixed rate basis, thus reducing the impact of interest rate changes on future interest expense. As of June 30, 2014, we had interest rate swaps in place with a net notional amount of \$986.0 million to fix the floating interest rates on a portion of our floating rate debt obligations.

## Debt Covenants

We are subject to certain financial covenants under our debt agreements. As of June 30, 2014, we were in compliance with all such covenants. Below are the primary financial covenants to which we are subject:

- ♣Minimum Earnings Before Interest and Taxes ("Covenant EBIT") to Cash Interest Expense;
- ♣Minimum Tangible Net Worth ("TNW"); and
- ♣Maximum Indebtedness to TNW.

Table of Contents

## Non-GAAP Measures

We primarily rely on our results measured in accordance with generally accepted accounting principles ("GAAP") in evaluating our business. Covenant EBIT, Cash Interest Expense, TNW, and Indebtedness are non-GAAP financial measures defined in our debt agreements that are used to determine our compliance with certain covenants contained in our debt agreements and should not be used as a substitute for analysis of our results as reported under GAAP.

However, we believe that the inclusion of this non-GAAP information provides additional information to investors regarding our debt covenant compliance.

## Minimum Covenant EBIT to Cash Interest Expense

For the purpose of this covenant, Covenant EBIT is calculated based on the cumulative sum of our earnings for the last four quarters (excluding income taxes, interest expense, amortization, net gain or loss on interest rate swaps and certain non-cash charges). Cash Interest Expense is calculated based on interest expense adjusted to exclude interest income, amortization of deferred financing costs, and the difference between current and prior period interest expense accruals.

Minimum Covenant EBIT to Cash Interest Expense is calculated on a consolidated basis and for certain of our wholly-owned special purpose entities ("SPEs"), whose primary activity is to issue asset backed notes. Covenant EBIT for each of our SPEs is calculated based on the net earnings generated by the assets pledged as collateral for the underlying debt issued. The actual Covenant EBIT to Cash Interest Expense ratio for each SPE may differ depending on the specific net earnings associated with those pledged assets. As of June 30, 2014, the minimum and actual consolidated Covenant EBIT to Cash Interest Expense ratio and Covenant EBIT to Cash Interest Expense ratio for each of the issuers of our debt facilities whose initial borrowing capacity was approximately \$200 million or greater were as follows:

Entity/Issuer	Minimum Covenant EBIT to Cash Interest Expense Ratio	Actual Covenant EBIT to Cash Interest Expense Ratio
Consolidated	1.10	3.10
TAL Advantage I, LLC	1.10	8.00
TAL Advantage III, LLC	1.30	2.51
TAL Advantage IV, LLC	1.10	2.26
TAL Advantage V, LLC	1.10	2.71

## Minimum TNW and Maximum Indebtedness to TNW Covenants

We are required to meet consolidated Minimum TNW and Maximum Indebtedness to TNW covenants. For the purpose of calculating these covenants, all amounts are based on the consolidated balance sheet of TAL International Group, Inc. TNW is calculated as total tangible assets less total indebtedness, which includes equipment purchases payable and, in certain cases, the fair value of derivative instruments liability.

Table of Contents

For the majority of our debt facilities, the Minimum TNW is calculated as \$321.4 million plus 50% of cumulative net income or loss since January 1, 2006, which as of June 30, 2014 was \$665.6 million. As of June 30, 2014, the actual TNW for each of our SPEs and for the \$450 million revolving credit facility was \$1,012.2 million. As of June 30, 2014, the maximum and actual Indebtedness to TNW ratios for each of our debt facilities whose initial borrowing capacity was approximately \$200 million or greater was as follows:

Entity/Issuer	Maximum Indebtedness to TNW Ratio	Actual Indebtedness to TNW Ratio
Consolidated	4.75	2.91
TAL Advantage I, LLC	4.75	2.90
TAL Advantage III, LLC	4.75	2.90
TAL Advantage IV, LLC	4.75	2.90
TAL Advantage V, LLC	4.75	2.90

As of June 30, 2014, our outstanding debt on facilities whose initial borrowing capacity was approximately \$200 million or greater was approximately \$2.2 billion. Outstanding debt on the remaining facilities of \$0.7 billion have various other debt covenants, all of which the Company is in compliance with as of June 30, 2014.

Failure to comply with these covenants could result in a default under the related credit agreements and/or could result in the acceleration of our outstanding debt if we were unable to obtain a waiver from the creditors.

**Cash Flow**

The following table sets forth certain cash flow information for the six months ended June 30, 2014 and 2013 (in thousands):

	Six Months Ended June 30,	
	2014	2013
Net cash provided by operating activities	\$ 178,208	\$ 142,224
Cash flows from investing activities:		
Purchases of leasing equipment and investments in finance leases	\$(289,766 )	\$(372,576 )
Proceeds from sale of equipment, net of selling costs	83,503	71,983
Cash collections on finance lease receivables, net of income earned	24,100	19,446
Other	97	(268 )
Net cash (used in) investing activities	\$(182,066 )	\$(281,415 )
Net cash (used in) provided by financing activities	\$(7,215 )	\$ 141,641

**Operating Activities**

Net cash provided by operating activities increased by \$36.0 million to \$178.2 million in the six months ended June 30, 2014, compared to \$142.2 million in the same period in 2013. The majority of this increase is comprised of the following:

Earnings excluding non-cash expenses increased by \$8.2 million,

In 2014, we terminated a forward starting interest rate swap contract in conjunction with the issuance of the series 2014-1 ABS notes and paid \$1.7 million. In 2013, we paid \$24.2 million to terminate certain interest rate swap contracts and replaced them with new interest rate swap contracts at lower fixed rates. This resulted in an increase in operating cash flows of \$22.5 million, and

- Net purchases of equipment for resale were lower this year increasing operating cash flows by \$2.1 million.

**Investing Activities**

Net cash used in investing activities decreased by \$99.3 million to \$182.1 million in the six months ended June 30, 2014 compared to \$281.4 million in the same period in 2013. This decrease was primarily due to a decrease in

purchases of leasing

33

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Table of Contents

equipment, higher proceeds from the sale of equipment due to higher disposal volumes, and an increase in cash collections on finance lease receivables, net of income earned.

**Financing Activities**

In the six months ended June 30, 2014, cash flows from financing activities decreased by \$148.8 million to net cash used in financing activities of \$7.2 million, compared to net cash provided by financing activities of \$141.6 million in the same period in 2013. This decrease was primarily due to a decrease of \$136.4 million in net borrowings under our various debt facilities related to the decrease in purchases of leasing equipment. In addition, restricted cash requirements increased by \$7.7 million and dividends paid on common stock increased by \$4.9 million year over year.

**Contractual Obligations**

We are party to various operating and capital leases and are obligated to make payments related to our long term borrowings. We are also obligated under various commercial commitments, including obligations to our equipment manufacturers. Our equipment manufacturer obligations are in the form of conventional accounts payable, and are satisfied by cash flows from operations and long term financing activities.

The following table summarizes our contractual obligations and commercial commitments as of June 30, 2014:

Contractual Obligations:	Contractual Obligations by Period					
	Total	Remaining 2014	2015	2016	2017	2018 and thereafter
	(dollars in millions)					
Total debt obligations(1)	\$3,153.1	\$269.3	\$470.6	\$416.6	\$265.4	\$1,731.2
Capital lease obligations(2)	112.1	5.9	39.7	29.9	18.8	17.8
Operating leases (mainly facilities)	8.1	0.9	1.6	1.4	1.2	3.0
Purchase obligations:						
Equipment purchases payable	61.6	61.6	—	—	—	—
Equipment purchase commitments	228.9	201.3	27.6	—	—	—
Total contractual obligations	\$3,563.8	\$539.0	\$539.5	\$447.9	\$285.4	\$1,752.0

(1) Amounts include actual and estimated interest for floating rate debt based on June 30, 2014 rates and the net effect of our interest rate swaps.

(2) Amounts include interest.

**Off-Balance Sheet Arrangements**

As of June 30, 2014, we did not have any relationships with unconsolidated entities or financial partnerships, such entities which are often referred to as structured finance or special purpose entities, which were established for the purpose of facilitating off-balance sheet arrangements. We are, therefore, not exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

**Critical Accounting Policies**

Our consolidated financial statements have been prepared in conformity with United States generally accepted accounting principles, which require us to make estimates and assumptions that affect the amounts and disclosures reported in the consolidated financial statements and accompanying notes. Our estimates are based on historical experience and currently available information. Actual results could differ from such estimates. Our critical accounting policies are discussed in our 2013 Form 10-K filed with the SEC on February 20, 2014.

Table of Contents**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk represents the risk of changes in value of a financial instrument, derivative or non-derivative, caused by fluctuations in interest rates, foreign exchange rates and equity prices. Changes in these factors could cause fluctuations in the results of our operations and cash flows. In the ordinary course of business, we are exposed to interest rate and foreign currency exchange rate risks.

**Interest Rate Risk**

We enter into interest rate swap agreements to fix the interest rates on a portion of our floating rate debt. We assess and manage the external and internal risk associated with these derivative instruments in accordance with our overall operating goals. External risk is defined as those risks outside of our direct control, including counterparty credit risk, liquidity risk, systemic risk and legal risk. Internal risk relates to those operational risks within the management oversight structure and includes actions taken in contravention of our policy.

The primary external risk of our interest rate swap agreements is counterparty credit exposure, which is defined as the ability of a counterparty to perform its financial obligations under a derivative agreement. All of our derivative agreements are with highly rated financial institutions. Credit exposures are measured based on the market value of outstanding derivative instruments. Both current and potential exposures are calculated for each derivative agreement to monitor counterparty credit exposure.

As of June 30, 2014, we had net interest rate swap agreements in place to fix interest rates on a portion of our borrowings under debt facilities with floating interest rates as summarized below:

Net Notional Amount	Weighted Average Fixed (Pay) Leg Interest Rate	Weighted Average Remaining Term
\$986 Million	1.47%	5.2 years

During the six months ended June 30, 2014, we designated certain interest rate swap agreements as cash flow hedges at their inception. For the three and six months ended June 30, 2014, we recognized unrealized losses of \$9.6 million and \$17.6 million, respectively, in accumulated other comprehensive loss related to changes in the fair value of the designated agreements. Changes in the fair value of non-designated interest rate swap agreements are recognized in the consolidated statements of income as net gains or losses on interest rate swaps. We recognized net activity on interest rate swaps in the three and six months ended June 30, 2014 and 2013 as follows (amounts in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net loss (gain) on interest rate swaps	\$0.6	\$(5.3)	\$1.0	\$(8.4)

Since 68% of our floating rate debt is hedged using interest rate swaps, our interest expense is not significantly affected by changes in interest rates. However, a 100 basis point increase in the interest rates on our floating rate debt (primarily LIBOR) would result in an increase of approximately \$3.4 million in interest expense over the next 12 months.

**Foreign Currency Exchange Rate Risk**

Although we have significant foreign based operations, the U.S. dollar is the operating currency for the large majority of our leases and obligations, and most of our revenues and expenses for the six months ended June 30, 2014 and 2013 were denominated in U.S. dollars, therefore foreign currency exchange gains and losses were de minimis in the three and six months ended June 30, 2014 and 2013, respectively.

**ITEM 4. CONTROLS AND PROCEDURES.**

Based upon the required evaluation of our disclosure controls and procedures, our President and Chief Executive Officer and our Senior Vice President and Chief Financial Officer concluded that as of June 30, 2014 our disclosure controls and procedures were adequate and effective to ensure that information was gathered, analyzed and disclosed on a timely basis.

There has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during our fiscal quarter ended June 30, 2014, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



Table of Contents

PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

From time to time, we are a party to litigation matters arising in connection with the normal course of our business. While we cannot predict the outcome of these matters, in the opinion of our management, based on information presently available to us, we believe that we have adequate legal defenses, reserves or insurance coverage and any liability arising from these matters will not have a material adverse effect on our business. Nevertheless, unexpected adverse future events, such as an unforeseen development in our existing proceedings, a significant increase in the number of new cases or changes in our current insurance arrangements could result in liabilities that have a material adverse impact on our business.

ITEM 1A. RISK FACTORS.

For a detailed discussion of our risk factors, refer to our 2013 Form 10-K filed with the Securities and Exchange Commission on February 20, 2014.

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

On March 13, 2006, our Board of Directors authorized a stock repurchase program for the repurchase of our common stock. The stock repurchase program, as amended, authorizes us to repurchase up to 4.0 million shares of our common stock. There were no repurchases of stock during the three and six months ended June 30, 2014.

Table of Contents

## ITEM 6. EXHIBITS.

Exhibit Number	Exhibit Description
4.69*	Series 2014-2 Supplement dated as of May 19, 2014 by and between TAL Advantage V LLC, as Issuer and Wells Fargo Bank, National Association, as the Indenture Trustee
4.70*	Series 2014-2 Note Purchase Agreement dated as of May 8, 2014 by and between TAL Advantage V LLC, as Issuer, TAL International Container Corporation, as Manager, BNP Paribas Securities Corp., Wells Fargo Securities, LLC, and RBC Capital Markets, LLC as Initial Purchasers
31.1*	Certification of the Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended
31.2*	Certification of the Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended
32.1**	Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350
32.2**	Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350
101.INS***	XBRL Instance Document
101.SCH***	XBRL Instance Extension Schema
101.CAL***	XBRL Taxonomy Extension Calculation Linkbase
101.DEF***	XBRL Taxonomy Extension Definition Linkbase
101.LAB***	XBRL Taxonomy Extension Label Linkbase
101.PRE***	XBRL Taxonomy Extension Presentation Linkbase

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\* Filed herewith.

\*\* Furnished herewith.

\*\*\* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability.

Table of Contents

SIGNATURE

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

TAL International Group, Inc.

July 30, 2014

By: /s/ JOHN BURNS  
John Burns  
Senior Vice President and Chief Financial Officer (Principal  
Financial Officer)

38