POWER INTEGRATIONS INC
Form 10-K
February 25, 2011
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-K

(Mark One)

x **Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2010**

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 0-23441

POWER INTEGRATIONS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**94-3065014**

(State or other jurisdiction of	**(I.R.S. Employer**
Incorporation or organization)	**Identification No.)**
5245 Hellyer Avenue, San Jose, California	**95138-1002**
(Address of principal executive offices)	**(Zip code)**

(408) 414-9200

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $.001 Par Value	The NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES x NO ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES ¨ NO x

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

Large accelerated filer x	Accelerated filer ¨	Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

The aggregate market value of registrant s voting and non-voting common stock held by non affiliates of registrant on June 30, 2010, the last business day of the registrant s most recently completed second fiscal quarter, was approximately $653,415,784, based upon the closing sale price of the common stock as reported on The NASDAQ Global Select Market. Shares of common stock held by each officer, director and holder of 10% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not a conclusive determination for other purposes.

Outstanding shares of registrant s common stock, $0.001 par value, as of February 16, 2011: 28,735,053.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III of this report, to the extent not set forth herein, is incorporated by reference from the Registrant s definitive proxy statement relating to the 2011 annual meeting of stockholders, which definitive proxy statement will be filed with the Securities and Exchange Commission within 120 days after the fiscal year to which this Report relates.

Table of Contents

TABLE OF CONTENTS

Table of Contents

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K, including information incorporated by reference herein, includes a number of forward-looking statements that involve many risks and uncertainties. In some cases, forward-looking statements are indicated by the use of words such as would , could , will , may , expect , believe , should , anticipate , outlook , if , future , intend , plan , estimate , predict , potential , targets words and phrases, including the negatives of these terms, or other variations of these terms. These statements reflect our current views with respect to future events and our potential financial performance and are subject to risks and uncertainties that could cause our actual results and financial position to differ materially and adversely from what is projected or implied in any forward-looking statements included in this Form 10-K. These factors include, but are not limited to: our ability to maintain and establish strategic relationships; the risks inherent in the development and delivery of complex technologies; our ability to attract, retain and motivate qualified personnel; the emergence of new markets for our products and services; our ability to compete in those markets based on timeliness, cost and market demand; and our ability to procure on reasonable terms an adequate and timely supply of our products from third party manufacturers. We make these forward looking statements based upon information available on the date of this Form 10-K, and we have no obligation (and expressly disclaim any obligation) to update or alter any forward-looking statements, whether as a result of new information or otherwise. In evaluating these statements, you should specifically consider the risks described under Item 1A of Part I Risk Factors, Item 7 of Part II Management s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Annual Report on Form 10-K.

PART I

TOPSwitch, TinySwitch, LinkSwitch, DPA-Switch, EcoSmart, Hiper, Qspeed and PI Expert are trademarks of Power Integrations, Inc.

Item 1. Business.

Overview

We design, develop, manufacture and market proprietary, high-voltage, analog and mixed-signal integrated circuits products, commonly referred to as ICs. We offer both monolithic (i.e., a single chip in an IC package) and hybrid (multiple chips in a single package) IC products. Following our acquisition of Qspeed Semiconductor Inc. in December 2010, we also now offer a range of high-performance, high-voltage silicon diodes. Our ICs and diodes are used in electronic power supplies, also known as switched-mode power supplies or switchers. Power supplies convert electricity from a high-voltage source, such as a wall outlet, to the type of power needed by a given electronic device, such as a mobile phone or a computer. In most cases, this conversion entails, among other functions, converting alternating current to direct current (referred to as AC-DC conversion), reducing the voltage and regulating the output voltage and/or current. Switched-mode power supplies perform these functions using an array of electronic components, often including ICs and diodes such as ours.

We believe our patented TOPSwitch ICs, introduced in 1994, were the first highly integrated power-conversion ICs to achieve widespread market acceptance. We have since introduced a number of additional IC product families in order to broaden our addressable market and increase the functionality of our products. Our ICs bring a number of important benefits to the power-supply market compared with less advanced alternatives, including reduced component count and design complexity, smaller board size, higher reliability and reduced time-to-market. Our products also reduce the amount of electricity wasted by power supplies and help our customers meet the increasingly stringent efficiency standards that have been adopted or proposed around the world.

We currently offer IC products that can be used in AC-DC power supplies with output wattages ranging from less than one watt up to approximately 500 watts. Our ICs can be used in virtually any power-supply application within our addressable power range; the vast majority are used in power supplies intended for the communications, consumer, computer and industrial end markets. We have shipped approximately five billion ICs since 1994.

Industry Background

Virtually every electronic device that plugs into a wall socket requires a power supply to convert the high-voltage alternating current provided by electric utilities into the low-voltage direct current required by most electronic devices. A power supply may be located inside a device, such as a DVD player or desktop computer, or it may be outside the device as in the case of a mobile-phone charger or an adapter for a cordless phone.

Until approximately 1970, AC-DC power supplies were generally in the form of line-frequency, or linear, transformers. These devices, consisting primarily of copper wire wound around an iron core, tend to be bulky and heavy, and typically waste a substantial amount of electricity. In the 1970s, the invention of high-voltage discrete semiconductors enabled the development of a new generation of power supplies known as switched-mode power supplies, or switchers. These switchers generally came to be a cost-effective alternative to linear transformers in applications requiring more than about three watts of power; in recent years the use of linear transformers has declined even further as a result of energy-efficiency standards and higher raw-material prices.

Switchers are generally smaller, lighter-weight and more energy-efficient than linear transformers. However, switchers designed with discrete components are highly complex, containing numerous components

Table of Contents

and requiring a high level of analog design expertise. Further, discrete switchers can be relatively costly and difficult to manufacture due to their complexity and high component count. These drawbacks tend to result in time-to-market and development risks for new products. Also, some discrete switchers lack inherent safety and energy-efficiency features; adding these features may further increase the component count, cost and complexity of the power supply.

In 1994 we introduced TOPSwitch, the industry s first cost-effective high-voltage IC for switched-mode AC-DC power supplies.

Our Highly Integrated Solution

Our patented ICs integrate onto a single chip many of the functions otherwise performed by numerous discrete electronic components. Because of this integration, our ICs enable power supplies to have superior features and functionality at a total cost equal to or lower than that of discrete switchers and linear transformers. Our products offer the following key benefits to power supplies:

Fewer Components, Reduced Size and Higher Reliability

Our highly integrated ICs, used in combination with our patented power-supply design techniques, enable the design and production of switchers that use up to 70% fewer components than discrete switchers. For example, our ICs provide safety and reliability features and features designed to mitigate electromagnetic interference, while discrete switchers must often include additional components in order to provide these functions. As a result of their lower component count, power supplies utilizing our ICs are typically smaller and more reliable than discrete switchers. Switchers that incorporate our ICs are also lighter and more portable than comparable power supplies built with copper-and-iron linear transformers, which are still used in some low-power applications.

Reduced Time-to-Market, Enhanced Manufacturability

Because our ICs eliminate much of the complexity associated with the design of switched-mode power supplies, designs can typically be completed in much less time, resulting in more efficient use of our customers design resources and accelerating time-to-market for new designs. The lower component count and reduced complexity enabled by our ICs also makes power supply designs more suitable for high-volume manufacturing compared with discrete switchers. We also provide online design tools, such as our PI Expert design software, that further reduce time-to-market and product development risks.

Energy Efficiency

Our patented EcoSmart technology, introduced in 1998, improves the energy efficiency of electronic devices during normal operation as well as standby and no-load conditions. This technology enables manufacturers to cost-effectively meet the growing demand for energy-efficient products, and to comply with increasingly stringent energy-efficiency requirements.

Wide Power Range and Scalability

Products in our current IC families can address AC-DC power supplies with output wattages ranging from less than one watt up to approximately 500 watts as well as certain high-voltage DC-DC applications. Within each of our product families, the designer can scale up or down in power to address a wide range of designs with minimal design effort.

Energy Efficiency

Linear transformers and many discrete switchers draw significantly more electricity than the amount needed by the devices they power. As a result, billions of dollars worth of electricity is wasted each year, and millions of tons of greenhouse gases are unnecessarily produced by power plants. Energy waste occurs during both normal

4

operations of a device and in standby mode, when the device is performing little or no useful function. For example, computers and printers waste energy while in sleep mode. TVs and DVD players that are turned off by remote control consume energy while awaiting a remote control signal to turn them back on. A mobile-phone charger left plugged into a wall outlet continues to draw electricity even when not connected to the phone (a condition known as no-load). Many common household appliances, such as microwave ovens, dishwashers and washing machines, also consume power when not in use. One study has estimated that standby power alone amounts to as much as ten percent of residential energy consumption in developed countries.

Lighting is another major source of energy waste. Less than five percent of the energy consumed by traditional incandescent light bulbs is converted to light, while the remainder is wasted as heat. The Alliance to Save Energy has estimated that a conversion to efficient lighting technologies such as compact fluorescent bulbs and light-emitting diodes, or LEDs, could save as much as $18 billion worth of electricity and 158 million tons of carbon dioxide emissions per year in the U.S. alone.

In response to concerns about the environmental impact of carbon emissions, policymakers are taking action to promote energy efficiency. For example, the ENERGY STAR® program and the European Union Code of Conduct encourage manufacturers of electronic devices such as home appliances, DVD players, computers, TVs and external power supplies to comply with voluntary energy-efficiency specifications. In 2007, the California Energy Commission, or CEC, implemented mandatory efficiency standards for external power supplies; in 2009 the CEC announced mandatory efficiency standards for televisions, scheduled to take effect in 2011. The CEC standards for external power supplies were implemented nationwide in the U.S. in July 2008 as a result of the Energy Independence and Security Act of 2007 (EISA). Similar standards took effect in the European Union in 2010 as part of the EU s EcoDesign Directive for Energy-Related Products. Also in 2010, the EcoDesign Directive implemented standards limiting standby power consumption on a wide range of electronic products; the limit currently stands at one watt for most end products and will be reduced to 0.5 watts in 2013. The EISA also requires substantial improvements in the efficiency of lighting technologies beginning in 2012; these new rules are being implemented in California beginning in 2011. Plans to phase out incandescent lamps have also been announced in Canada, Australia and Europe.

We offer products that we believe enable manufacturers to meet or exceed these and all other current and proposed energy-efficiency regulations for electronic products. Our EcoSmart technology, introduced in 1998, dramatically reduces waste in both operating and standby modes. In 2010 we introduced CapZero and SenZero, which eliminate additional sources of standby waste in certain power supplies, as well as LinkSwitch-PH and LinkSwitch-PL, which enable highly efficient power-conversion for LED lighting. We estimate that our EcoSmart technology has saved approximately $4.6 billion worth of standby power worldwide since 1998.

Products

Below is a brief description of our products:

* *AC-DC power conversion products for the low-power market*

TOPSwitch, our first commercially successful product family, was introduced in 1994. Since that time we have introduced a wide range of products (including five subsequent generations of TOPSwitch) to both improve upon the functionality of the original TOPSwitch and broaden the range of power levels we can address. In 1998 we introduced TinySwitch, the first family of products to incorporate our EcoSmart technology; in 2006, we introduced the third generation of the TinySwitch line, TinySwitch-III. In 2002 we introduced LinkSwitch, the industry s first highly integrated IC designed specifically to replace linear transformers. LinkSwitch-II, our second-generation LinkSwitch, was introduced in 2008.

In 2010 we introduced two extensions of the LinkSwitch product line, LinkZero-AX and LinkZero-LP, which enable designers to achieve low standby power consumption, down to zero watts in certain applications. Also in 2010 we introduced LinkSwitch-PH and LinkSwitch-PL, our first products designed specifically for LED lighting applications.

Table of Contents

This portfolio of power-conversion products generally addresses power supplies ranging from less than one watt of output up to approximately 50 watts of output, a market we refer to as the low-power market. This market is comprised of an extremely broad range of applications including mobile-device chargers, consumer appliances, utility meters, LCD monitors, standby power supplies for desktop computers and TVs and numerous other consumer and industrial applications.

* *Products for the high-power market*

In an effort to further expand our addressable market, we have recently introduced a range of products designed for use in applications up to approximately 500 watts of output. We believe these products enable us to bring many of the same benefits to the high-power market that we have historically brought to the low-power market, including reduced component count, improved reliability and better energy-efficiency compared with competing alternatives. Our Hiper family of products, first introduced in 2008, includes both power-conversion and power-factor-correction products for high-power applications, which include main power supplies for desktop computers, TVs and game consoles, as well as LED street lights and a variety of other applications.

In 2010 we introduced CapZero and SenZero, our first products to perform functions other than power conversion. These products are designed to further improve the energy-efficiency of power supplies and reduce standby consumption by eliminating particular sources of power waste within a power supply, specifically the so-called bleed resistors (CapZero) and sense resistors (SenZero).

Following our acquisition of Qspeed Semiconductor in December 2010, we now offer a range of high-performance, high-voltage diodes known as Qspeed diodes. Qspeed diodes utilize a proprietary silicon technology to provide a unique combination of high efficiency and low noise, as well as high-frequency operation, which reduces the cost and size of magnetic components in a power supply. We believe these products, as well as our CapZero and SenZero products, will most commonly be used in applications with above 50 watts of output; we therefore refer to them as products for the high-power market.

* *High-voltage DC-DC products*

The DPA-Switch family of products, introduced in June 2002, was the first monolithic high-voltage power conversion IC designed specifically for use in DC-DC converters and distributed power architectures. Applications include power-over-Ethernet powered devices such as voice-over-IP phones and security cameras, as well as network hubs, line cards, servers, digital PBX phones, DC-DC converter modules and industrial controls.

Revenue mix by product family for the years ended December 31, 2010, 2009 and 2008 was approximately as follows:

	Year Ended December 31,		
Product Family	**2010**	**2009**	**2008**
TinySwitch	38%	43%	44%
LinkSwitch	37%	33%	29%
TOPSwitch	24%	23%	25%
Other	1%	1%	2%

Table of Contents

Markets and Customers

Our strategy is to target markets that can benefit the most from our highly integrated power conversion ICs. The following chart shows the primary applications of our products in power supplies in several major market categories.

Market Category	Primary Applications
Communications	Cellphone chargers, routers, cordless phones, broadband modems, voice-over-IP phones, other network and telecom gear
Consumer	Major appliances, air conditioners, set-top boxes for cable and satellite services, small appliances, DVD players, digital cameras, LCD TVs, videogame consoles
Computer	Desktop PCs, LCD monitors, servers, LCD projectors, adapters for notebook computers
Industrial Electronics	LED lighting, industrial controls, utility meters, motor controls, uninterruptible power supplies, tools

Revenue by our end market categories for 2010 was approximately 38 percent consumer, 31 percent communications, 19 percent industrial electronics and 12 percent computer.

Sales, Distribution and Marketing

We sell our products to original equipment manufacturers, or OEMs, and merchant power supply manufacturers through a direct sales staff and through a worldwide network of independent sales representatives and distributors. We have sales offices in California, Georgia and Illinois, as well as offices in the United Kingdom, Germany, Italy, India, China, Japan, Korea, the Philippines, Singapore and Taiwan. Direct sales to OEMs and merchant power supply manufacturers represented approximately 33%, 36% and 37% of our net product revenues for 2010, 2009 and 2008, respectively, while sales through distributors accounted for approximately 67%, 64% and 63% for 2010, 2009 and 2008, respectively. All distributors are entitled to certain return privileges based on sales revenue and are protected from price reductions affecting their inventories. Our distributors are not subject to minimum purchase requirements and sales representatives and distributors can discontinue marketing any of our products at any time.

Our top ten customers, including distributors that resell to OEMs and merchant power supply manufacturers, accounted for 62%, 62% and 60% of our net revenues for 2010, 2009 and 2008, respectively. In 2010, two distributors, Avnet and ATM Electronic Corporation, accounted for approximately 17% and 11% of our net revenues, respectively. In 2009 these same distributors accounted for 15% and 10% of our net revenues, respectively. In 2008, Avnet accounted for approximately 16% of our net revenues. No other customers accounted for more than 10% of net revenues in 2008. In 2010, 2009 and 2008 sales to customers in the United States accounted for approximately 4%, 5% and 4% of our net revenues, respectively. See Note 2, Summary of Significant Accounting Policies, in our notes to consolidated financial statements regarding sales to customers located in foreign countries. See our consolidated financial statements regarding total revenues and profit for the last three fiscal years.

We are subject to certain risks stemming from the fact that most of our manufacturing and most of our customers are located in foreign jurisdictions. Risks related to our foreign operations are set forth in Item 1A of this Annual Report on Form 10-K, and include: potential weaker intellectual property rights under foreign laws, the burden of complying with foreign laws and foreign-currency exchange risk.

Table of Contents

Backlog

Our sales are primarily made pursuant to standard purchase orders. The quantity of products purchased by our customers as well as shipment schedules are subject to revisions that reflect changes in both the customers requirements and in manufacturing availability. Historically, our business has been characterized by short lead-time orders and quick delivery schedules, and our order backlog at the beginning of a given period has not been a meaningful indicator of our ability to achieve any particular level of revenue or financial performance. In recent quarters our lead times to deliver products to customers extended due to strong demand, causing many customers to place orders further in advance than has historically been the case. This caused our backlog to expand and become a somewhat more meaningful indicator of the level of revenues we may expect to attain in a particular quarter. Nevertheless, because orders in backlog are subject to cancellation or postponement, backlog is not necessarily a reliable indicator of future revenues. Furthermore, because we do not recognize revenue on distribution sales until our products are sold through by distributors to our end-customers, our revenues in a given period can differ significantly from the value of the products we ship in the same period. We believe this further reduces the reliability of order backlog as an indicator of future revenues.

Technology

High-Voltage Transistor Structure and Process Technology Our company was founded on a patented silicon technology that uses a proprietary high-voltage MOS transistor structure and fabrication process that enables us to integrate high-voltage n-channel transistors and industry-standard CMOS and bipolar control circuitry on the same monolithic IC. Both the IC device structure and the wafer fabrication process contribute to the cost-effectiveness of our high-voltage technology. Subsequent generations of our high-voltage technology, introduced in 2000 and 2004 have enabled us to further reduce the silicon area of our ICs. Our high-voltage ICs are implemented on low-cost silicon wafers using standard 5 V CMOS silicon processing techniques with a relatively large feature size of between 1 and 3 microns. We have also developed a very cost-effective silicon-based high-voltage MOSFET technology for use in combination with one or more integrated circuits in a hybrid IC product.

IC Design and System Technology Our IC designs combine complex control circuits and high-voltage transistors on the same monolithic chip or in the same IC package. Our design technology takes advantage of our high-voltage process to minimize the die size of both the high-voltage device and control circuits and improve the performance of our highly integrated products versus competing integrated solutions. We have also developed extensive expertise in the design of switching power supplies, resulting in innovative circuit topologies and design techniques that reduce component count and system cost, increase system performance, and improve energy efficiency compared to alternative approaches.

Research and Development

Our research and development efforts are focused on improving our high-voltage device structures, wafer fabrication processes, analog circuit designs, system-level architectures and packaging. We seek to introduce new products to expand our addressable markets, further reduce the costs of our products, and improve the cost-effectiveness and functionality of our customers power supplies. We have assembled a team of highly skilled engineers to meet our research and development goals. These engineers have expertise in high-voltage device structure and process technology, analog design, power supply system architecture and packaging.

In 2010, 2009 and 2008, we incurred costs of $35.9 million, $30.5 million and $36.9 million, respectively, for research and development, including expenses related to stock-based compensation. Research and development expenses increased in 2010 compared to the prior year due primarily to higher salary and salary related expenses due to an increase in headcount. We increased headcount in 2010 due to the expansion of our research and development organization including the acquisition of an early-stage research and development company in August of 2010. The decrease in our research and development expenses in 2009 compared to 2008

Table of Contents

was due primarily to decreased stock based compensation expense, reflecting the fact that our 2008 research and development expenses included accelerated stock-based compensation expenses associated with the repurchase of employee stock options via a tender offer conducted in December 2008. We expect to continue to invest significant funds in research and development activities.

Intellectual Property and Other Proprietary Rights

We use a combination of patents, trademarks, copyrights, trade secrets and confidentiality procedures to protect our intellectual property rights. As of December 31, 2010, we held 395 U.S. patents and had received foreign patent protection on these patents resulting in 211 foreign patents. The U.S. patents have expiration dates ranging from 2011 to 2028. We also hold trademarks in the U.S. and various other geographies including Taiwan, Korea, Hong Kong, China, Europe and Japan.

We regard as proprietary certain equipment, processes, information and knowledge that we have developed and used in the design and manufacture of our products. Our trade secrets include a high-volume production process that produces our patented high-voltage ICs. We attempt to protect our trade secrets and other proprietary information through non-disclosure agreements, proprietary information agreements with employees and consultants and other security measures.

We granted a perpetual, non-transferable license to Matsushita Electric Industrial Co, Ltd., or Panasonic, to use our semiconductor patents and other intellectual property for our current high-voltage technology under a Technology License Agreement. This license allows Panasonic to manufacture and design products for internal use and for sale or distribution to other Japanese companies and their subsidiaries in Asia. In exchange for its license rights, Panasonic paid royalties on products using the licensed technology through June 2009.

The Technology License Agreement with Panasonic expired in June 2005 and has not been renewed. As a result, Panasonic s right to use our technology does not include technology developed after June 2005. Panasonic may sell products based on technology covered by the Technology License Agreement without payment of royalties after June 2009.

Our long-lived assets consist of property and equipment and intangible assets. Our intangible assets are comprised of developed and in-process technology, licenses, patents and goodwill. Our long-lived assets, including property and equipment and intangible assets, are located primarily in the United States; U.S. long-lived assets represented 57%, 66% and 70% of total long-lived assets in 2010, 2009 and 2008, respectively. No individual foreign country held more than 10% of total long-lived assets. See Note 2, Summary of Significant Accounting Policies, in our notes to consolidated financial statements regarding total property and equipment located in foreign countries.

Manufacturing

To manufacture our wafers using our proprietary processes, we contract with three foundries: (1) OKI Electric Industry, or OKI, (2) Seiko Epson Corporation, or Epson and (3) XFAB Dresden GmbH & Co KG, or XFAB (a wholly owned subsidiary of XFAB Semiconductor Foundries AG). These contractors manufacture our wafers at foundries located in Japan and Germany. For a small number of our products, we also buy wafers manufactured in Singapore by Global Foundries using a standard, non-proprietary process to implement certain integrated control circuits for use in combination with our proprietary high-voltage MOSFETs.

Our products are assembled and packaged by independent subcontractors in China, Malaysia, Thailand and the Philippines. We perform testing predominantly at the facilities of our packaging subcontractors in Asia and to a small extent, at our facility in San Jose, California. Our fabless manufacturing model enables us to focus on our engineering and design strengths, minimize fixed costs on capital expenditures and still have access to high-volume manufacturing capacity. We utilize both proprietary and standard IC packages for assembly. Some of the

Table of Contents

materials used in our packages and aspects of assembly are specific to our products. We require our assembly manufacturers to use high-voltage molding compounds which are more difficult to process than industry standard molding compounds. We will remain heavily involved with our contractors on an active engineering basis to maintain and improve our manufacturing processes.

Our proprietary high-voltage processes do not require leading-edge geometries for them to be cost-effective, and thus we can use our foundries older, low-cost facilities for wafer manufacturing. However, because of our highly sensitive high-voltage process, we must interact closely with our foundries to achieve satisfactory yields. Our wafer supply agreements with OKI, Epson and XFAB expire in April 2018, December 2020 and December 2012, respectively. Under the terms of the OKI agreement, OKI has agreed to reserve a specified amount of production capacity and to sell wafers to us at fixed prices, which are subject to periodic review jointly by OKI and us. In addition, OKI requires us to supply them with a rolling six-month forecast on a monthly basis. Our agreement with OKI provides for the purchase of wafers in Japanese yen, and allows for mutual sharing of the impact of the exchange rate fluctuation between the Japanese yen and the U.S. dollar. Under the terms of the Epson agreement, Epson has agreed to reserve a specified amount of production capacity and to sell wafers to us at fixed prices, which are subject to periodic review jointly by Epson and us. The agreement with Epson also requires us to supply Epson with rolling six-month forecasts on a monthly basis. Our agreement with Epson provides for the purchase of wafers in U.S. dollars, however, we do share the impact of the exchange rate fluctuation between the Japanese yen and the U.S. dollar. Under the terms of the XFAB agreement, XFAB has agreed to reserve a specified amount of production capacity and to sell wafers to us at fixed prices, which are subject to periodic review jointly by XFAB and us. The agreement with XFAB also requires us to supply XFAB with rolling six-month forecasts on a monthly basis. Our purchases of wafers from XFAB are denominated in U.S. dollars.

Although certain aspects of our relationships with OKI, Epson and XFAB are contractual, some important aspects of these relationships are not written in binding contracts and depend on the suppliers continued cooperation. We cannot assure that we will continue to work successfully with OKI, Epson or XFAB in the future, that they will continue to provide us with sufficient capacity at their foundries to meet our needs, or that any of them will not seek an early termination of their wafer supply agreement with us. Our operating results could suffer in the event of a supply disruption with OKI, Epson or XFAB if we were unable to quickly qualify alternative manufacturing sources for existing or new products or if these sources were unable to produce wafers with acceptable manufacturing yields.

We typically receive shipments from our foundries approximately four to six weeks after placing orders, and lead times for new products can be substantially longer. To provide sufficient time for assembly, testing and finishing, we typically need to receive wafers four weeks before the desired ship date to our customers. As a result of these factors and the fact that customers orders can be placed with little advance notice, we have only a limited ability to react to fluctuations in demand for our products. We try to carry a substantial amount of wafer and finished goods inventory to help offset these risks and to better serve our markets and meet customer demand.

Competition

Competing alternatives to our high-voltage ICs include monolithic, hybrid ICs and similar products from companies such as Fairchild Semiconductor, STMicroelectronics, Infineon, ON Semiconductor and Sanken Electric Company, as well as PWM controller chips paired with discrete high-voltage bipolar transistors and MOSFETs, which are produced by a large number of vendors. Self-oscillating switchers, built with discrete components supplied by numerous vendors, are also commonly used. For some applications, line-frequency transformers are also a competing alternative to designs utilizing our products.

Generally, our products enable customers to design power supplies with total bill-of-materials (BOM) costs similar to those of competing alternatives. As such, the value of our products is influenced by the prices of discrete components, which fluctuate in relation to market demand, raw-material prices and other factors, but have generally decreased over time.

While we vary the pricing of our ICs in response to fluctuations in prices of alternative solutions, we also compete based on a variety of other factors. Most importantly, the highly integrated nature of our ICs enables power supply designs that utilize fewer total components than comparable discrete designs or designs using other integrated or hybrid products. This enables power supplies to be designed more quickly and manufactured more efficiently and reliably than competing designs. To the extent that successive generations of our products enable further reductions in component count or other BOM cost savings, we are able to offset a portion of any price pressure caused by declines in prices for alternative solutions.

In addition to enabling a lower component count, we also compete on the basis of product functionality such as safety features and energy-efficiency features, ease of design and on the basis of the technical support we provide to our customers. This support includes hands-on design assistance as well as a range of design tools and documentation such as software and reference designs. We also believe that our record of product quality and history of delivering products to our customers on a timely basis serve as additional competitive advantages.

Warranty

We generally warrant that our products will substantially conform to the published specifications for 12 months from the date of shipment. Under the terms of our purchase orders, our liability is limited generally to either a credit equal to the purchase price or replacement of the defective part.

Employees

As of December 31, 2010, we employed 444 full time personnel, consisting of 71 in manufacturing, 136 in research and development, 202 in sales, marketing and applications support, and 35 in finance and administration.

Investor Information

We make available, free of charge, copies of our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after filing this material electronically or otherwise furnishing it to the SEC. You may obtain a free copy of these reports in the investor info section of our website, www.powerint.com. Our website address is provided solely for informational purposes. We do not intend, by this reference, that our website should be deemed to be part of this Annual Report. The reports filed with the SEC are also available at www.sec.gov.

Our corporate governance guidelines, the charters of our board committees, and our code of business conduct and ethics, including code of ethics provisions that apply to our principal executive officer, principal financial officer, controller and senior financial officers, are available in the corporate governance section of our website at www.powerint.com. These items are also available in print to any stockholder who requests them by calling (408) 414-9200.

Table of Contents

Executive Officers of the Registrant

As of February 16, 2011, our executive officers, who are appointed by and serve at the discretion of the board of directors, were as follows:

Name	Position With Power Integrations	Age
Balu Balakrishnan	President, Chief Executive Officer and Director	56
Douglas Bailey	Vice President, Marketing	44
Derek Bell	Vice President, Engineering	67
Bruce Renouard	Vice President, Worldwide Sales	50
Sandeep Nayyar	Vice President, Finance and Chief Financial Officer	51
John Tomlin	Vice President, Operations	63
Clifford J. Walker	Vice President, Corporate Development	59

Balu Balakrishnan has served as president and chief executive officer and as a director of Power Integrations since January 2002. He served as president and chief operating officer from April 2001 to January 2002. From January 2000 to April 2001, he was vice president of engineering and strategic marketing. From September 1997 to January 2000, he was vice president of engineering and new business development. From September 1994 to September 1997, Mr. Balakrishnan served as vice president of engineering and marketing. Prior to joining Power Integrations in 1989, Mr. Balakrishnan was employed by National Semiconductor Corporation.

Douglas Bailey has served as our vice president of marketing since November 2004. From March 2001 to April 2004, he served as vice president of marketing at ChipX, a structured ASIC company. His earlier experience includes serving as business management and marketing consultant for Sapiential Prime, Inc., director of sales and business unit manager for 8x8, Inc., and serving in application engineering management for IIT, Inc. and design engineering roles with LSI Logic, Inmos, Ltd. and Marconi.

Derek Bell has served as our vice president of engineering and technology since April 2001. Previously Mr. Bell was the chief operations officer at Palmchip Corporation, an integration and software service company from August 2000 to January 2001. Mr. Bell was vice president of engineering for the professional services group at Synopsys, Inc. an electronic design automation company, during 1999 and 2000, vice president of strategic alliances at Cirrus Logic, Inc., a semiconductor company, from 1996 to 1999, vice president and general manager of the application specific product group at National Semiconductor Corporation, Inc. a semiconductor company, from 1995 to 1996 and served as president and chief executive officer of NovaSensor, a manufacturer of silicon sensors from 1990 to 1994. He also held various senior management positions at Signetics, a semiconductor company, from 1972 to 1990, most recently as group vice president.

Bruce Renouard has served as our vice president, worldwide sales since February 2002. Mr. Renouard joined our company in January 2002 as a member of the sales organization. From August 1999 to August 2001, he served as vice president, worldwide sales of Zoran Corporation, a provider of digital solutions in the multimedia and consumer electronics markets. Mr. Renouard held the position of director, worldwide market development from June 1997 to August 1999 for IDT/Centaur, an X 86 processor company. From January 1995 to June 1997, he served as national distribution sales manager for Cyrix Corp, a company specializing in Intel compatible processors.

Sandeep Nayyar has served as our vice president and chief financial officer since June 2010. Previously Mr. Nayyar served as vice president of finance at Applied Biosystems, Inc., a developer and manufacturer of life-sciences products, from 2002 to 2009. Mr. Nayyar was a member of the executive team with world-wide responsibilities for finance. From 1990 to 2001, Mr. Nayyar served in a succession of financial roles including vice president of finance at Quantum Corporation, a computer storage company. Mr. Nayyar also worked for five years in the public-accounting field at Ernst & Young LLP. Mr. Nayyar is a Certified Public Accountant, Chartered Accountant and has a B.S. in Accounting from the University of Delhi, India.

Table of Contents

John Tomlin has served as our vice president, operations since October 2001. From 1981 to 2001, Mr. Tomlin served in a variety of senior management positions in operations, service, logistics and marketing, most recently as vice president of worldwide operations at Quantum Corporation, a computer storage company.

Clifford J. Walker has served as our vice president, corporate development since June 1995. From September 1994 to June 1995, Mr. Walker served as vice president of Reach Software Corporation, a software company. From December 1993 to September 1994, Mr. Walker served as president of Morgan Walker International, a consulting company.

Item 1A. Risk Factors.

In addition to the other information in this report, the following factors should be considered carefully in evaluating our business before purchasing shares of our stock.

Our quarterly operating results are volatile and difficult to predict. If we fail to meet the expectations of public market analysts or investors, the market price of our common stock may decrease significantly. Our net revenues and operating results have varied significantly in the past, are difficult to forecast, are subject to numerous factors both within and outside of our control, and may fluctuate significantly in the future. As a result, our quarterly operating results could fall below the expectations of public market analysts or investors. If that occurs, the price of our stock may decline.

Some of the factors that could affect our operating results include the following:

- the volume and timing of orders received from customers;
- competitive pressures on selling prices;
- the demand for our products declining in the major end markets we serve, which may occur due to competitive factors, supply-chain fluctuations or changes in macroeconomic conditions;
- the volume and timing of delivery of orders placed by us with our wafer foundries and assembly subcontractors;
- the inability to adequately protect or enforce our intellectual property rights;
- fluctuations in exchange rates, particularly the exchange rate between the U.S. dollar and the Japanese yen;
- an audit by the Internal Revenue Service, which is asserting that we owe additional taxes relating to a number of tax related positions;
- continued impact of recently enacted changes in securities laws and regulations, including potential risks resulting from our evaluation of internal controls under the Sarbanes-Oxley Act of 2002;
- expenses we are required to incur (or choose to incur) in connection with our intellectual property litigations;

the lengthy timing of our sales cycle;

undetected defects and failures in meeting the exact specifications required by our products;

reliance on international sales activities for a substantial portion of our net revenues;

our ability to develop and bring to market new products and technologies on a timely basis;

the ability of our products to penetrate additional markets;

our ability to attract and retain qualified personnel;

risks associated with acquisitions and strategic investments;

Table of Contents

our ability to successfully integrate, or realize the expected benefits from, our acquisitions;

changes in environmental laws and regulations, including with respect to energy consumption and climate change; and

earthquakes, terrorists acts or other disasters.

We do not have long-term contracts with any of our customers and if they fail to place, or if they cancel or reschedule orders for our products, our operating results and our business may suffer. Our business is characterized by short-term customer orders and shipment schedules. Our customer base is highly concentrated, and a relatively small number of distributors, OEMs and merchant power supply manufacturers account for a significant portion of our revenues. Our top ten customers, including distributors, accounted for 62% and 62% of our net revenues for the years ended December 31, 2010 and 2009, respectively. The ordering patterns of some of our existing large customers have been unpredictable in the past and we expect that customer-ordering patterns will continue to be unpredictable in the future. Not only does the volume of units ordered by particular customers vary substantially from period to period, but also purchase orders received from particular customers often vary substantially from early oral estimates provided by those customers for planning purposes. In addition, customer orders can be canceled or rescheduled without significant penalty to the customer. In the past, we have experienced customer cancellations of substantial orders for reasons beyond our control, and significant cancellations could occur again at any time.

Intense competition in the high-voltage power supply industry may lead to a decrease in our average selling price and reduced sales volume of our products. The high-voltage power supply industry is intensely competitive and characterized by significant price sensitivity. Our products face competition from alternative technologies, such as linear transformers, discrete switcher power supplies, and other integrated and hybrid solutions. If the price of competing solutions decreases significantly, the cost effectiveness of our products will be adversely affected. If power requirements for applications in which our products are currently utilized go outside the cost-effective range of our products, some of these alternative technologies can be used more cost effectively. In addition, as our patents expire, our competitors could legally begin using the technology covered by the expired patents in their products, potentially increasing the performance of their products and/or decreasing the cost of their products, which may enable our competitors to compete more effectively. Our current patents may or may not inhibit our competitors from getting any benefit from an expired patent. Our U.S. patents have expiration dates ranging from 2011 to 2028. We cannot assure that our products will continue to compete favorably or that we will be successful in the face of increasing competition from new products and enhancements introduced by existing competitors or new companies entering this market. We believe our failure to compete successfully in the high-voltage power supply business, including our ability to introduce new products with higher average selling prices, would materially harm our operating results.

If demand for our products declines in our major end markets, our net revenues will decrease. A limited number of applications of our products, such as cellphone chargers, standby power supplies for PCs, and power supplies for home appliances comprise a significant percentage of our net revenues. We expect that a significant level of our net revenues and operating results will continue to be dependent upon these applications in the near term. The demand for these products has been highly cyclical and has been impacted by economic downturns in the past. Any economic slowdown in the end markets that we serve could cause a slowdown in demand for our ICs. When our customers are not successful in maintaining high levels of demand for their products, their demand for our ICs decreases, which adversely affects our operating results. Any significant downturn in demand in these markets would cause our net revenues to decline and could cause the price of our stock to fall.

We depend on third-party suppliers to provide us with wafers for our products and if they fail to provide us sufficient quantities of wafers, our business may suffer. We have supply arrangements for the production of wafers with OKI, XFAB and Epson. Our contracts with these suppliers expire in April 2018, December 2012 and December 2020, respectively. Although certain aspects of our relationships with OKI (purchased by Rohm Co. of Japan as of October 1, 2008), XFAB and Epson are contractual, many important aspects of these relationships depend on their continued cooperation. We cannot assure that we will continue to work successfully with OKI, XFAB and Epson in the future, and that the wafer foundries capacity will meet our needs. Additionally, one or more of these wafer foundries could seek an early termination of our wafer supply agreements. Any serious disruption in the supply of wafers from OKI, XFAB or Epson could harm our business. We estimate that it would take 12 to 24 months from the time we identified an alternate manufacturing source to produce wafers with acceptable manufacturing yields in sufficient quantities to meet our needs.

Although we provide our foundries with rolling forecasts of our production requirements, their ability to provide wafers to us is ultimately limited by the available capacity of the wafer foundry. Any reduction in wafer foundry capacity available to us could require us to pay amounts in excess of contracted or anticipated amounts for wafer deliveries or require us to make other concessions to meet our customers requirements, or may limit our ability to meet demand for our products. Further, to the extent demand for our products exceeds wafer foundry capacity, this could inhibit us from expanding our business and harm relationships with our customers. Any of these concessions or limitations could harm our business.

If our third-party suppliers and independent subcontractors do not produce our wafers and assemble our finished products at acceptable yields, our net revenues may decline. We depend on independent foundries to produce wafers, and independent subcontractors to assemble and test finished products, at acceptable yields and to deliver them to us in a timely manner. The failure of the foundries to supply us wafers at acceptable yields could prevent us from selling our products to our customers and would likely cause a decline in our net revenues and gross margin. In addition, our IC assembly process requires our manufacturers to use a high-voltage molding compounds that have been available from only a few suppliers. These compounds and their specified processing conditions require a more exacting level of process control than normally required for standard IC packages. Unavailability of assembly materials or problems with the assembly process can materially and adversely affect yields, timely delivery and cost to manufacture. We may not be able to maintain acceptable yields in the future.

In addition, if prices for commodities used in our products increase significantly, raw material costs would increase for our suppliers which could result in an increase in the prices our suppliers charge us. (Recent increases in the price of gold, which is used in our IC packages, have in fact increased our product costs to some degree.) To the extent we are not able to pass these costs on to our customers; this would have an adverse effect on our gross margins.

If we are unable to adequately protect or enforce our intellectual property rights, we could lose market share, incur costly litigation expenses, suffer incremental price erosion or lose valuable assets, any of which could harm our operations and negatively impact our profitability. Our success depends upon our ability to continue our technological innovation and protect our intellectual property, including patents, trade secrets, copyrights and know-how. We are currently engaged in litigation to enforce our intellectual property rights, and associated expenses have been, and are expected to remain, material and have adversely affected our operating results. We cannot assure that the steps we have taken to protect our intellectual property will be adequate to prevent misappropriation, or that others will not develop competitive technologies or products. From time to time, we have received, and we may receive in the future, communications alleging possible infringement of patents or other intellectual property rights of others. Costly litigation may be necessary to enforce our intellectual property rights or to defend us against claimed infringement. The failure to obtain necessary licenses and other rights, and/or litigation arising out of infringement claims could cause us to lose market share and harm our business.

As our patents expire, we will lose intellectual property protection previously afforded by those patents. Additionally, the laws of some foreign countries in which our technology is or may in the future be licensed may not protect our intellectual property rights to the same extent as the laws of the United States, thus limiting the protections applicable to our technology.

Fluctuations in exchange rates, particularly the exchange rate between the U.S. dollar and the Japanese yen, may impact our gross margin. The contract prices to purchase wafers from OKI are denominated in

Table of Contents

Japanese yen, and the contract prices to purchase wafers from Epson is denominated in U.S. dollars. The agreements with these vendors allow for mutual sharing of the impact of the exchange rate fluctuation between Japanese yen and the U.S. dollar. Nevertheless, changes in the exchange rate between the U.S. dollar and the Japanese yen could subject our gross profit and operating results to the potential for material fluctuations.

We are being audited by the Internal Revenue Service which is asserting that we owe additional taxes relating to a number of tax related positions, and if we are not successful in defending our positions we may be obligated to pay additional taxes, as well as penalties and interest, and may also have a higher effective income tax rate in the future. Our operations are subject to income and transaction taxes in the United States and in multiple foreign jurisdictions and to review or audit by the IRS and state, local and foreign tax authorities. In connection with an IRS audit of our United States federal income tax returns for fiscal years 2002 and 2003, the IRS proposed a material adjustment related to our research and development cost-sharing arrangement. We are disputing the proposed adjustment, but at the request of the IRS, we agreed to rollover the disputed proposed adjustment into the audit of our United States Federal income tax returns for fiscal years 2004 through 2006, which are currently under audit. While the IRS has not completed its audit for these years, we anticipate that it will again propose an adjustment related to our research and development cost-sharing arrangement. Resolution of this matter could take considerable time, possibly years.

We believe the IRS s position with respect to the proposed adjustment related to our research and development cost-sharing arrangement is inconsistent with applicable tax law, and that we have a meritorious defense to our position. Accordingly, we intend to continue to challenge the IRS s position on this matter vigorously. While we believe the IRS s asserted position on this matter is not supported by applicable law, we may be required to make additional payments in order to resolve this matter. If this matter is litigated and the IRS is able to successfully sustain its position, our results of operations and financial condition could be materially and adversely affected.

Securities laws and regulations, including potential risk resulting from our evaluation of internal controls under the Sarbanes-Oxley Act of 2002, will continue to impact our results. Complying with the requirements of the Sarbanes-Oxley Act of 2002 and NASDAQ s conditions for continued listing have imposed significant legal and financial compliance costs, and are expected to continue to impose significant costs and management burden on us. These rules and regulations also may make it more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. These rules and regulations could also make it more difficult for us to attract and retain qualified executive officers and members of our board of directors, particularly qualified members to serve on our audit committee. Further, the rules and regulations under the Dodd-Frank Wall Street Reform and Consumer Protection Act, which are to become effective throughout 2011, are also expected to continue to impose significant costs and management burden on us.

Additionally, because these laws, regulations and standards promulgated by the Sarbanes-Oxley Act are, and those promulgated under the Dodd-Frank Act when they become effective are expected to be, subject to varying interpretations, their application in practice may evolve over time as new guidance becomes available. This evolution may result in continuing uncertainty regarding compliance matters and additional costs necessitated by ongoing revisions to our disclosure and governance practices.

If we do not prevail in our litigation, we will have expended significant financial resources, potentially without any benefit, and may also suffer the loss of rights to use certain technologies. We are currently involved in a number of patent litigation matters and the outcome of the litigation is uncertain. See Note 9, Legal Proceedings, in Notes to Consolidated Financial Statements in Item 15 of Part IV. For example, in one of our patent suits the infringing company has been found to infringe four of our patents. Despite the favorable court finding, the infringing party filed an appeal to the damages awarded. In another matter, we are being sued for patent infringement in China, where the outcome of litigation can be more uncertain than in the United States. Should we ultimately be determined to be infringing on another party s patents, or if an injunction is issued against us while litigation is pending on those claims, such result could have an adverse impact on our ability to sell products found to be infringing, either directly or indirectly. In the event of an adverse outcome, we may be required to pay substantial damages, stop our manufacture, use, sale, or importation of infringing products, or obtain licenses to the intellectual property we are found to have infringed. We have also incurred, and expect to continue to incur, significant legal costs in conducting these lawsuits, including the appeal of the case we won, and our involvement in this litigation and any future intellectual property litigation could adversely affect sales and divert the efforts and attention of our technical and management personnel, whether or not such litigation is resolved in our favor. Thus, even if we are successful in these lawsuits, the benefits of this success may fail to outweigh the significant legal costs we will have incurred.

Because the sales cycle for our products can be lengthy, we may incur substantial expenses before we generate significant revenues, if any. Our products are generally incorporated into a customer s products at the design stage. However, customer decisions to use our products, commonly referred to as design wins, can often require us to expend significant research and development and sales and marketing resources without any assurance of success. These significant research and development and sales and marketing resources often precede volume sales, if any, by a year or more. The value of any design win will largely depend upon the commercial success of the customer s product. We cannot assure that we will continue to achieve design wins or that any design win will result in future revenues. If a customer decides at the design stage not to incorporate our products into its product, we may not have another opportunity for a design win with respect to that product for many months or years.

Our products must meet exacting specifications, and undetected defects and failures may occur which may cause customers to return or stop buying our products. Our customers generally establish demanding specifications for quality, performance and reliability, and our products must meet these specifications. ICs as complex as those we sell often encounter development delays and may contain undetected defects or failures when first introduced or after commencement of commercial shipments. We have from time to time in the past experienced product quality, performance or reliability problems. If defects and failures occur in our products, we could experience lost revenue, increased costs, including warranty expense and costs associated with customer support and customer expenses, delays in or cancellations or rescheduling of orders or shipments and product returns or discounts, any of which would harm our operating results.

Our international sales activities account for a substantial portion of our net revenues, which subjects us to substantial risks. Sales to customers outside of the Americas account for, and have accounted for a large portion of our net revenues, including approximately 95% of our net revenues for the years ended December 31, 2010 and 2009. If our international sales declined and we were unable to increase domestic sales, our revenues would decline and our operating results would be harmed. International sales involve a number of risks to us, including:

- potential insolvency of international distributors and representatives;
- reduced protection for intellectual property rights in some countries;
- the impact of recessionary environments in economies outside the United States;
- tariffs and other trade barriers and restrictions;
- the burdens of complying with a variety of foreign and applicable U.S. Federal and state laws; and
- foreign-currency exchange risk.

Our failure to adequately address these risks could reduce our international sales and materially and adversely affect our operating results. Furthermore, because substantially all of our foreign sales are denominated in U.S. dollars, increases in the value of the dollar cause the price of our products in foreign markets to rise, making our products more expensive relative to competing products priced in local currencies.

If our efforts to enhance existing products and introduce new products are not successful, we may not be able to generate demand for our products. Our success depends in significant part upon our ability to develop

new ICs for high-voltage power conversion for existing and new markets, to introduce these products in a timely manner and to have these products selected for design into products of leading manufacturers. New product introduction schedules are subject to the risks and uncertainties that typically accompany development and delivery of complex technologies to the market place, including product development delays and defects. If we fail to develop and sell new products in a timely manner then our net revenues could decline.

In addition, we cannot be sure that we will be able to adjust to changing market demands as quickly and cost-effectively as necessary to compete successfully. Furthermore, we cannot assure that we will be able to introduce new products in a timely and cost-effective manner or in sufficient quantities to meet customer demand or that these products will achieve market acceptance. Our failure, or our customers failure, to develop and introduce new products successfully and in a timely manner would harm our business. In addition, customers may defer or return orders for existing products in response to the introduction of new products. When a potential liability exists we will maintain reserves for customer returns, however we cannot assure that these reserves will be adequate.

If our products do not penetrate additional markets, our business will not grow as we expect. We believe that our future success depends in part upon our ability to penetrate additional markets for our products. We cannot assure that we will be able to overcome the marketing or technological challenges necessary to penetrate additional markets. To the extent that a competitor penetrates additional markets before we do, or takes market share from us in our existing markets, our net revenues and financial condition could be materially adversely affected.

We must attract and retain qualified personnel to be successful and competition for qualified personnel is intense in our market. Our success depends to a significant extent upon the continued service of our executive officers and other key management and technical personnel, and on our ability to continue to attract, retain and motivate qualified personnel, such as experienced analog design engineers and systems applications engineers. The competition for these employees is intense, particularly in Silicon Valley. The loss of the services of one or more of our engineers, executive officers or other key personnel could harm our business. In addition, if one or more of these individuals leaves our employ, and we are unable to quickly and efficiently replace those individuals with qualified personnel who can smoothly transition into their new roles, our business may suffer. We do not have long-term employment contracts with, and we do not have in place key person life insurance policies on, any of our employees.

We are exposed to risks associated with acquisitions and strategic investments. We have made, and in the future intend to make, acquisitions of, and investments in, companies, technologies or products in existing, related or new markets. Acquisitions involve numerous risks, including but not limited to:

- inability to realize anticipated benefits, which may occur due to any of the reasons described below, or for other unanticipated reasons;
- the risk of litigation or disputes with customers, suppliers, partners or stockholders of an acquisition target arising from a proposed or completed transaction;
- impairment of acquired intangible assets and goodwill as a result of changing business conditions, technological advancements or worse-than-expected performance, which would adversely affect our financial results; and
- unknown, underestimated and/or undisclosed commitments, liabilities or issues not discovered in our due diligence of such transactions.

We also make strategic investments in other companies, which may decline in value and/or not meet desired objectives. The success of these strategic investments depends on various factors over which we may have limited or no control and requires ongoing and effective cooperation with strategic partners. Moreover, these investments are often illiquid, such that it may be difficult or impossible for us to monetize such investments.

Table of Contents

Our inability to successfully integrate, or realize the expected benefits from, our acquisitions could adversely affect our results. We have made acquisitions of other businesses, including Qspeed Semiconductor Inc., and there is a risk that integration difficulties may cause us not to realize expected benefits. The success of the acquisitions could depend, in part, on our ability to realize the anticipated benefits and cost savings (if any) from combining the businesses of the acquired companies and our business, which may take longer to realize than expected.

Changes in environmental laws and regulations may increase our costs related to obsolete products in our existing inventory. Changing environmental regulations and the timetable to implement them continue to impact our customers demand for our products. As a result there could be an increase in our inventory obsolescence costs for products manufactured prior to our customers adoption of new regulations. Currently we have limited visibility into our customers strategies to implement these changing environmental regulations into their business. The inability to accurately determine our customers strategies could increase our inventory costs related to obsolescence.

In the event of an earthquake, terrorist act or other disaster, our operations may be interrupted and our business would be harmed. Our principal executive offices and operating facilities are situated near San Francisco, California, and most of our major suppliers, which are wafer foundries and assembly houses, are located in areas that have been subject to severe earthquakes. Many of our suppliers are also susceptible to other disasters such as tropical storms, typhoons or tsunamis. In the event of a disaster, we or one or more of our major suppliers may be temporarily unable to continue operations and may suffer significant property damage. Any interruption in our ability or that of our major suppliers to continue operations at our facilities could delay the development and shipment of our products.

Like other U.S. companies, our business and operating results are subject to uncertainties arising out of economic consequences of current and potential military actions or terrorist activities and associated political instability, and the impact of heightened security concerns on domestic and international travel and commerce. These uncertainties could also lead to delays or cancellations of customer orders, a general decrease in corporate spending or our inability to effectively market and sell our products. Any of these results could substantially harm our business and results of operations, causing a decrease in our revenues.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

We own our principal executive, administrative, manufacturing and technical offices which are located in San Jose, California. In addition to our facility in San Jose, we also own a research and development facility in New Jersey, which was purchased in 2010 in connection with our acquisition of an early-stage research and development company. We lease an administrative office in Singapore, a research and development facility in Canada, and sales offices in various countries around the world to accommodate our sales force. We believe that our current facilities are sufficient for our company, if headcount increases above capacity we may need to lease additional space.

Item 3. Legal Proceedings.

Information with respect to this item may be found in Note 9, Legal Proceedings, in Notes to Consolidated Financial Statements included later in this Annual Report on Form 10-K, which information is incorporated herein by reference.

Table of Contents

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our common stock trades on the NASDAQ Global Select Market under the symbol POWI . The following table shows the high and low closing sales prices per share of our common stock as reported on the NASDAQ Global Select Market for the periods indicated during which our common stock traded on the NASDAQ Global Select Market.

	Price Range	
Year Ended December 31, 2010	**High**	**Low**
Fourth quarter	$ 42.00	$ 31.08
Third quarter	$ 38.54	$ 26.81
Second quarter	$ 45.90	$ 30.91
First quarter	$ 42.23	$ 31.21
Year Ended December 31, 2009	**High**	**Low**
Fourth quarter	$ 36.95	$ 30.90
Third quarter	$ 34.53	$ 22.44
Second quarter	$ 24.78	$ 16.91
First quarter	$ 21.48	$ 17.20

As of February 16, 2011, there were approximately 57 stockholders of record. Because brokers and other institutions hold many of our shares on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

During the fourth quarter of 2008, our board of directors declared five quarterly cash dividends in the amount of $0.025 per share to be paid consecutively each quarter beginning in the fourth quarter of 2008. In January 2010, our board of directors declared four quarterly cash dividends, each in the amount of $0.05 per share to be paid at the end of each quarter in 2010; as a result we have paid dividends on a quarterly basis through the end of 2010. In addition, in October 2010, our board of directors declared four quarterly cash dividends in the amount of $0.05 per share to be paid at the end of each quarter in 2011. The declaration of any future cash dividend beyond 2011 is at the discretion of the board of directors and will depend on our financial condition, results of operations, capital requirements, business conditions and other factors, as well as a determination that cash dividends are in the best interest of our stockholders.

ISSUER PURCHASES OF EQUITY SECURITIES

On May 14, 2009, we announced that our board of directors had authorized the use of up to $25 million for the repurchase of shares of our common stock. From May 14, 2009 to December 31, 2009, we purchased 496,468 shares of our common stock for approximately $11.0 million. In the first two quarters of 2010 we purchased 395,915 shares of our common stock for approximately $14.0 million (including fees), concluding this repurchase program.

Table of Contents

Performance Graph(1)

The following graph shows the cumulative total stockholder return of an investment of $100 in cash on December 31, 2005 through December 31, 2010, for (a) our common stock, (b) The NASDAQ Composite Index and (c) The NASDAQ Electronic Components Index. Pursuant to applicable SEC rules, all values assume reinvestment of the full amount of all dividends. The stockholder return shown on the graph below is not necessarily indicative of future performance, and we do not make or endorse any predictions as to future stockholder returns.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

Among Power Integrations, Inc., the NASDAQ Composite Index

and the NASDAQ Electronic Components Index

* $100 invested on 12/31/05 in stock or index, including reinvestment of dividends.

Fiscal year ended December 31, 2010.

	12/05	12/06	12/07	12/08	12/09	12/10
Power Integrations, Inc.	**100.00**	**98.49**	**144.60**	**83.61**	**153.53**	**170.58**
NASDAQ Composite	**100.00**	**111.74**	**124.67**	**73.77**	**107.12**	**125.93**
NASDAQ Electronic Components	**100.00**	**94.09**	**110.35**	**56.37**	**90.71**	**103.28**

(1) This Section is not soliciting material, is not deemed filed with the SEC and is not to be incorporated by reference in any filing of Power Integrations under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language in any such filing.

Table of Contents

Item 6. Selected Financial Data.

The following selected consolidated financial data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and the notes thereto included elsewhere in this Form 10-K to fully understand factors that may affect the comparability of the information presented below. We derived the selected consolidated balance sheet data as of December 31, 2010 and 2009 and the consolidated statements of income data for the years ended December 31, 2010, 2009 and 2008 from our audited consolidated financial statements, and accompanying notes, in this Annual Report on Form 10-K. The consolidated statements of income data for each of the years ended December 31, 2007 and 2006 and the consolidated balance sheet data as of December 31, 2008, 2007 and 2006 are derived from consolidated financial statements which are not included in this report. Our historical results are not necessarily indicative of results for any future period.

	Year Ended December 31, (in thousands, except per share data)				
	2010	2009	2008	2007	2006
Consolidated Statements of Income:					
Net revenues	$ 299,803	$ 215,701	$ 201,708	$ 191,043	$ 162,403
Cost of revenues	147,262	107,633	96,678	87,558	73,794
Gross profit	152,541	108,068	105,030	103,485	88,609
Operating expenses:					
Research and development	35,886	30,473	36,867	25,176	24,415
Sales and marketing	31,167	25,018	35,898	26,940	25,712
General and administrative	25,562	23,967	27,296	24,249	34,648
Intangible asset impairment			1,958		
In-process research and development				1,370	
Total operating expenses	92,615	79,458	102,019	77,735	84,775
Income from operations	59,926	28,610	3,011	25,750	3,834
Other income:					
Other income, net	1,879	1,913	6,835	7,960	5,924
Insurance reimbursement			878	841	
Total other income	1,879	1,913	7,713	8,801	5,924
Income before provision for income taxes	61,805	30,523	10,724	34,551	9,758
Provision for income taxes	12,341	7,254	8,921	7,927	333
Net income	$ 49,464	$ 23,269	$ 1,803	$ 26,624	$ 9,425
Earnings per share:					
Basic	$ 1.78	$ 0.86	$ 0.06	$ 0.92	$ 0.32
Diluted	$ 1.67	$ 0.82	$ 0.06	$ 0.85	$ 0.31
Shares used in per share calculation:					
Basic	27,837	26,920	30,099	28,969	29,059
Diluted	29,556	28,297	31,755	31,254	30,819
Dividend per share	$ 0.20	$ 0.10	$ 0.025		

	2010	2009	December 31, 2008 (in thousands)	2007	2006
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$ 155,667	$ 134,974	$ 167,472	$ 118,353	$ 124,937
Short-term investments	27,355	20,567	6,363	85,821	2,506
Cash, cash equivalents and short-term investments	183,022	155,541	173,835	204,174	127,443
Working capital	212,055)	$3,151	$(11,474)		

The components of accumulated other comprehensive loss, net of taxes, are as follows:

	September 30, 2002	December 31, 2001
Marketable securities	$ (40)	$ (28)
Other investment securities	618	618
Cumulative foreign currency translation adjustment	(52)	
Swap agreements	(29,664)	(15,393)
	$ (29,138)	$ (14,803)

G. Reclassifications:

Certain reclassifications have been made to the 2001 amounts in order to conform to the 2002 presentation.

Note 2 Relationship with CAI:

The Company holds a 50% common equity interest in CAI, which it acquired in April 1998. CAI owns and leases its own fleet of containers and manages, for a fee, containers owned by the Company and third parties. The Company entered into its operating relationship with CAI primarily to facilitate the rental in the short-term market of containers coming off long-term lease, to gain access to new companies looking to lease containers on a long term basis and to realize cost efficiencies from the operation of a coordinated container lease marketing group. The marketing group, which is organized as a wholly-owned subsidiary of the Company, is responsible for soliciting container lease business for both the Company and CAI, including long-term and direct finance lease business and short-term lease business on master lease agreements. All long-term and direct finance lease business is purchased by the Company, except that the Company offers to CAI, at cost, 10% of this long-term and direct finance lease business.

The 50% equity interest in CAI not held by the Company is owned by CAI s chief executive officer. Under the terms of a Shareholder Agreement entered into in 1998 between the Company and CAI s chief executive officer, if an initial public offering for the registration and sale of CAI s common stock has not been initiated before April 2003, CAI s chief executive officer has the right to have an independent valuation of CAI completed on an annual basis to determine the fair value of CAI. Following the completion of this appraisal, the Company has the right to make a written offer to acquire the chief executive officer s equity for an amount equal to 50% of the fair value of CAI as indicated in the appraisal. If the offer is not extended by the Company within 30 days, CAI s chief executive officer has an additional 90 days to require CAI to take the necessary steps to effect an initial public offering to sell his equity. All costs associated with an initial public offering of CAI will be borne by CAI.

In connection with the acquisition of its equity interest in CAI, the Company loaned CAI $33,650 under a Subordinated Note Agreement (Note), which is collateralized by all containers owned by CAI as of April 30, 1998 or thereafter acquired, subject to the priority security interest lien of CAI s senior credit facility, except for certain excluded collateral. Interest on the Note is calculated at an annual fixed rate of 10.5% payable quarterly. The original repayment terms required mandatory quarterly principal payments of $1,683 beginning July 30, 2003 through July 30, 2008. The Note was subject to certain financial covenants and was cross-defaulted with CAI s senior credit facility, subject to the terms of a subordination agreement.

On June 27, 2002, CAI entered into an amended $110,000 senior revolving credit agreement with a group of financial institutions. To facilitate the closing of this new credit facility, the Company agreed to extend the repayment terms of its Note so as to require mandatory quarterly principal payments of $1,683 beginning July 30, 2006 through July 30, 2011 and modified certain financial covenants in the Note. Interest on the Note continues to accrue at an annual fixed rate of 10.5% and is payable quarterly. The Note continues to be cross-defaulted with CAI s senior credit agreement, subject to the terms of an amended and restated subordination agreement. At the same time, the Company was provided a majority position on CAI s board of directors. The Company has determined that as a result of these transactions and gaining a majority position on CAI s board, the Company s financial statements for the quarter ended June 30, 2002 must include CAI as a consolidated subsidiary commencing June 27, 2002. Previously, CAI was accounted for under the equity method of accounting. The Company s share of the equity earnings (losses) of CAI for the periods from January 1, 2002 through June 27, 2002 have been recorded in Loss for Investments Accounted for Under the Equity Method in the accompanying Condensed Consolidated Statements of Income. For the period from June 27 through September 30, 2002, CAI s results of operations have been included in the appropriate captions on the accompanying Condensed Consolidated Statements of Income. The assets and liabilities of CAI at September 30, 2002 have been included on the accompanying Condensed Consolidated Balance Sheets.

12

(dollars in thousands, except per share amounts)

A total of $86,300 was outstanding under CAI s senior revolving credit facility at September 30, 2002. Borrowings under CAI s senior credit facility are secured by substantially all CAI s assets and are payable on June 27, 2005. The senior credit facility contains various financial and other covenants. At June 30, 2002, CAI would not have been in compliance with one of the financial covenants then contained in its senior credit facility as well as similar covenants under two master lease agreements relating to equipment in CAI s fleet. CAI received amendments to these covenants in September 2002 which were made retroactive to June 30, 2002. As a result, CAI was in compliance as of June 30, 2002 with all revolving credit facility and lease covenants as amended and continues to be in compliance as of September 30, 2002.

The assets and liabilities of CAI reflected in the consolidated financial statements at September 30, 2002, after recording the effect of elimination entries with the Company, are as follows:

Cash and short term investments	$ 2,591
Accounts and notes receivable	21,558
Net investment in direct financing leases	2,352
Leasing equipment, net of accumulated depreciation and amortization	139,881
Other assets	2,744
Accounts payable and accrued expenses	$ 26,581
Income taxes	7,588
Deferred income	569
Debt and capital lease obligations	86,300
Minority interest	7,770

The revenues and expenses recorded by the Company resulting from transactions with CAI prior to June 27, 2002 are as follows:

	Three Months Ended September 30, 2001	Nine Months Ended September 30, 2002	Nine Months Ended September 30, 2001
Revenues	$3,032	$5,608	$9,440
Lease operating and administrative expenses	$ 760	$1,026	$1,384
Interest income	$ 903	$1,776	$2,689
Interest expense		$ 77	

Subsequent to June 27, 2002, revenues and expenses for transactions between the Company and CAI are eliminated in consolidation. Minority interest income recorded by the Company for the three and nine month periods ended September 30, 2002 was $779 and $837, respectively for periods subsequent to June 27, 2002.

Note 3 Discontinued Operations:

During the three months ended September 30, 2001, the Company adopted a formal plan to dispose of PCR, a 51%-owned subsidiary, and to discontinue the operations of Microtech, a 75.5%-owned subsidiary, and liquidate its lease portfolio. Within the historical financial statements of the Company, PCR and Microtech comprised the computer-leasing segment and specialized in the leasing of microcomputers and related equipment.

As a result of the decision made by the Company, PCR and Microtech were classified as discontinued operations. Pursuant to Accounting Principles Board Opinion No. 30, Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, the accompanying unaudited Condensed Consolidated Financial Statements and notes thereto have been restated for all comparative periods presented to reflect the decision to discontinue the computer leasing segment. Accordingly, the assets and liabilities, results of operations and cash flows of PCR and Microtech were accounted for as Discontinued Operations in the accompanying unaudited Condensed Consolidated Financial Statements.

On December 31, 2001, the Company completed the sale of its 51% ownership stake of PCR to an investment group comprised of the management of PCR. Under the agreement, the Company sold its share of PCR for $3,200 ($2,297 after considering the effect of the Company s discounting of the note received from PCR in partial satisfaction of the purchase price).

13

(dollars in thousands, except per share amounts)

The purchase price of $3,200 was settled through the issuance of a non-recourse note issued by the investment group comprised of the management of PCR to the Company in the amount of $2,560 and a payment of $640 received by the Company on January 2, 2002. The original terms of the note are interest only at 5% through December 31, 2004 and an annual rate of 7.5% for the period from December 31, 2004 through December 31, 2010 (the maturity date). Monthly principal payments in equal installments of $35 commence on January 31, 2005 and continue through the maturity date. The Company recorded the note in the amount of $1,657, after discounting the note at 15%, which was its estimate of the market value of the note at that date. In addition, on April 6, 1999, the Company entered into a $3,500 long-term revolving credit facility with PCR. This revolving credit facility is due on demand and remains outstanding as of September 30, 2002. The line of credit bears interest at 12% per annum and is payable monthly. This line of credit is secured by substantially all of PCR s assets, subordinated to the interest of a financial institution which provided PCR an additional line of credit. Since 2000, the Company has guaranteed PCR debts due to parties other than the Company totaling $5,000, which remain in effect. The amounts due from PCR as of September 30, 2002 and December 31, 2001, respectively, were $4,782 and $5,797.

In a separate transaction, the management of PCR sold its 24.5% ownership in Microtech valued at $792 to the Company, thereby increasing the Company s ownership in Microtech to 100%. During the nine months ended September 30, 2002, Microtech recorded $710 of losses primarily the result of additional bad debt reserves due to a weaker economic environment resulting in specific customer defaults that were identified subsequent to September 30, 2001, the date that the Company discontinued the operations of Microtech. These losses were accrued at March 31, 2002. For the three months ended September 30, 2002 and 2001, the revenues applicable to the discontinued operations were $385 and $8,104, respectively. For the nine months ended September 30, 2002 and 2001, the revenues applicable to the discontinued operations were $1,410 and $27,598, respectively.

The assets and liabilities of discontinued operations, presented in the accompanying unaudited Condensed Consolidated Balance Sheets are primarily comprised of Cash, Accounts Receivable, Net Investment in Direct Financing Leases, Leasing Equipment, Other Assets, Accounts Payable and Accrued Expenses and Debt Obligations.

Note 4 Chassis Holdings I LLC:

The Ivy Group, a New Jersey general partnership composed directly or indirectly of Martin Tuchman, Radcliff Group, Inc., Raoul J. Witteveen, Thomas P. Birnie and Graham K. Owen, has previously leased chassis to Trac Lease, Inc. (Trac Lease). As of December 31, 2000, pursuant to various equipment lease agreements, Trac Lease leased 6,047 chassis from The Ivy Group and its principals for an aggregate annual lease payment of approximately $2,900. On January 1, 2001, the various leases for the 6,047 units were combined into a single lease pursuant to which The Ivy Group and its principals were paid an aggregate lease payment of $2,691 through June 30, 2001. On July 1, 2001, the Company restructured its relationship with The Ivy Group and its principals to provide the Company with managerial control over 6,047 chassis previously leased by Trac Lease, a wholly owned subsidiary of the Company, from The Ivy Group. As a result of the restructuring, the partners of The Ivy Group contributed these 6,047 chassis and certain other assets and liabilities to a newly formed subsidiary, Chassis Holdings I LLC

(Chassis Holdings), in exchange for $26,000 face value of preferred membership units and 10% of the common membership units, and Trac Lease contributed 902 chassis and $2,407 in cash to Chassis Holdings in exchange for $3,000 face value of preferred membership units and 90% of the common membership units. The preferred membership units are entitled to receive a preferred return prior to the receipt of any distributions by the holders of the common membership units. The value of the contributed chassis was determined by taking the arithmetic average of the results of independent appraisals performed by three nationally recognized appraisal firms in connection with the Company s establishment of a chassis securitization facility in July 2000. As the managing member of Chassis Holdings, Trac Lease exercises sole managerial control over the entity s operations. Chassis Holdings leases all of its chassis to Trac Lease at a rental rate equal to the then current Trac Lease fleet average per diem. Chassis Holdings and the holders of the preferred membership units are party to a Put/Call Agreement which provides that the holders of preferred units may put such units to Chassis Holdings under certain circumstances and Chassis Holdings may redeem such units under certain circumstances. Chassis Holdings will be required to make certain option payments to the holders of the preferred membership units in order to preserve its right to redeem such units.

The terms of all arrangements between Chassis Holdings and Trac Lease, including rental rates, are, in the opinion of our management, comparable to terms that we would have obtained in arms length transactions with unrelated third parties. The Ivy Group has entered into an agreement with us pursuant to which it has agreed not to engage in any business activities that are competitive with the business activities of Interpool or its subsidiaries without our prior written consent.

Based on 90% common unit ownership held by Trac Lease, the Company s condensed consolidated financial statements include the accounts of Chassis Holding I LLC. The Ivy Group s interest in the common and preferred units of Chassis Holdings I LLC of approximately $26,326 is classified as minority interest in equity of subsidiaries in the accompanying condensed consolidated balance sheets. For the nine months ended September 30, 2002, dividends paid on the common units and distributions on the preferred units owned by The Ivy Group, totaling $2,340, are included in minority interest (income)/expense, net in the accompanying condensed consolidated statements of income.

14

(dollars in thousands, except per share amounts)

Note 5 Cash flow information:

For the nine months ended September 30, 2002 and 2001 cash paid for interest was approximately $86,143 and $83,857, respectively. Cash paid for income taxes was approximately $1,888 and $1,880, respectively.

Note 6 Leasing Activities:

As lessee:

The net book value of leasing equipment acquired through capital leases was $690,248 at September 30, 2002. The aggregate capital lease obligations, secured by equipment, with installments payable in varying amounts through 2022, were $740,754 at September 30, 2002.

As of September 30, 2002, the annual maturities of capital leases and related interest were as follows:

Twelve Months Ended September 30,	Payment	Interest	Principal
2003	$ 80,102	$ 32,397	$ 47,705
2004	102,592	29,869	72,723
2005	78,337	27,018	51,319
2006	91,793	24,114	67,679
2007	79,228	21,598	57,630
Thereafter	574,901	131,203	443,698
	$1,006,953	$ 266,199	$ 740,754

The Company leases office space and certain leasing equipment under operating leases expiring at various dates through 2010. Rental expense under operating leases aggregated $14,127 and $13,317 for the periods ended September 30, 2002 and

2001, respectively.

As of September 30, 2002, the aggregate minimum rental commitment under operating leases having initial or remaining noncancellable lease terms in excess of one year was as follows:

Twelve Months Ended September 30,	
2003	$19,800
2004	21,006
2005	20,543
2006	18,105
2007	16,057
Thereafter	41,650

As lessor:

The Company has entered into various leases of equipment that qualify as direct financing leases. At the inception of a direct finance lease, the Company records a net investment based on the gross investment (representing the total future minimum lease payments plus unguaranteed residual value), net of unearned lease income. The unguaranteed residual value is generally equal to the purchase option of the lessee, which in the case of the Company s lease contracts is insignificant and is included in total lease receivables (approximately $16,420 and $16,186 at September 30, 2002 and December 31, 2001, respectively). Unearned income represents the excess of gross investment over equipment cost. Receivables under these direct financing leases, net of unearned income, are collectible through 2011 as follows:

(dollars in thousands, except per share amounts)

		September 30, 2002	
Twelve Months Ended September 30,	**Total Lease Receivable**	**Unearned Lease Income**	**Net Lease Receivable**
2003	$75,909	$24,501	$ 51,408
2004	69,497	18,230	51,267
2005	52,731	12,910	39,821
2006	42,761	8,795	33,966
2007	32,435	4,854	27,581
Thereafter	37,061	5,334	31,727
	310,394	$74,624	$235,770

As of September 30, 2002 the Company also had noncancelable operating leases, under which it will receive future minimum rental payments as follows:

Twelve Months Ended September 30,	
2003	69,687
2004	47,082
2005	29,969
2006	17,473
2007	10,595
Thereafter	6,888

During the three months ended June 30, 2001, the Company initiated a bankruptcy claim against a customer and sought to collect receivables and to recover equipment values through its insurance policies. The Company demanded the return of approximately $48,588 of equipment, including $8,482 of direct finance leases, which were reclassified to leasing equipment. At September 30, 2002, the outstanding receivables from this customer, including amounts for equipment the Company anticipates will not be recovered, totaled approximately $33,453, all of which is covered by insurance (which is net of $950 in reserves for amounts not covered by insurance). The receivables are included in other receivables, net in the accompanying condensed consolidated balance sheets. At this time, the Company has estimated no impairment upon the liquidation and/or re-lease of these assets after considering anticipated insurance proceeds. The maximum insurance coverage related to this claim is $35,000. The overall recovery of the asset values has been evaluated taking into consideration the equipment book value, the cost to recover and re-lease the equipment, and the total outstanding receivables, as well as the likelihood to collect through the recovery and sale of the equipment or the stipulated equipment values within the lease contracts that are covered by the insurance policies. The Company continued to record revenue from these leases through August 20, 2001 at which time, revenue recognition was discontinued, as contractual lease payments through August 20, 2001 were covered by the insurance policies. Over the past several months, the Company has provided the supporting documentation for its claim to an adjuster appointed by the insurance underwriters. Based upon discussions with the adjuster, the analysis of the supporting documentation is nearly complete and it is anticipated that a report of the adjuster s findings will be submitted to the underwriters in November 2002. The Company will continue to assess the overall recovery of the claim and will pursue its timely resolution. As additional information becomes available, reserves for the impairment of the asset values may be necessary.

During the three months ended March 31, 2002, the Company recognized a recovery of $2,434 for the excess of amounts billable to the lease customer for unrecovered equipment over the Company s net book value of the equipment, which is expected to be recovered through insurance proceeds.

Allowance for doubtful accounts -

The following summarizes the activity in the allowance for doubtful accounts:

	2002	2001
Balance beginning of year	$ 5,862	$ 14,271
Provision charged to expense	2,935	1,852
Increase for allowance from the consolidation of CAI at June 27, 2002	1,898	
Write-offs, net of recoveries	(169)	(10,364)
Balance, September 30	$ 10,526	$ 5,759

(dollars in thousands, except per share amounts)

As of September 30, 2002 and December 31, 2001, included in accounts and notes receivable are non-performing receivables of $7,113 and $4,887, respectively.

Note 7 Segment and geographic data:

The Company has two reportable segments: container leasing and domestic intermodal equipment. The container leasing segment specializes in the leasing of intermodal dry freight standard containers, while the domestic intermodal equipment segment specializes in the leasing of intermodal container chassis and freight rail cars. Beginning June 27, 2002, the container leasing segment includes revenues and expenses and the related balance sheet accounts for CAI, previously accounted for under the equity method of accounting.

The accounting policies of the segments are the same as those described in Note 1. The Company evaluates performance based on profit or loss from continuing operations before income taxes and extraordinary items. The Company s reportable segments are strategic business units that offer different products and services.

Segment Information:

Nine Months ended 2002:	Container Leasing	Domestic Intermodal Equipment	Totals

Nine Months ended 2002:	Container Leasing	Domestic Intermodal Equipment	Totals
Revenues from external customers	$ 94,458	$ 138,955	$ 233,413
Lease operating, administrative and other expenses	17,663	56,487	74,150
Depreciation and amortization	34,633	26,325	60,958
Other income/(expense), net	(25)	(485)	(510)
Interest income	1,646	2,481	4,127
Interest expense	19,662	61,548	81,210
Income from continuing operations before taxes, results from discontinued operations, extraordinary item and change in accounting principle	24,121	(3,409)	20,712
Net investment in DFL s	173,585	62,185	235,770
Leasing equipment, net	753,867	869,494	1,623,361
Total segment assets	1,053,244	1,166,257	2,219,501
Equipment purchases	$ 140,861	$ 87,807	$ 228,668

Nine Months ended 2001:	Container Leasing	Domestic Intermodal Equipment	Totals
Revenues from external customers	$ 82,692	$ 146,374	$ 229,066
Lease operating, administrative and other expenses	10,529	59,052	69,581
Depreciation and amortization	26,835	28,690	55,525
Other income/(expense), net	(167)	645	478
Interest income	3,057	3,503	6,560
Interest expense	21,588	49,880	71,468
Income from continuing operations before taxes, results from discontinued operations, extraordinary item and change in accounting principle	26,630	12,900	39,530
Net investment in DFL s	147,025	43,904	190,929
Leasing equipment, net	522,105	812,016	1,344,121
Total segment assets	751,420	1,035,651	1,787,071
Equipment purchases	$ 118,558	$ 50,973	$ 169,531

(dollars in thousands, except per share amounts)

The Company s shipping line customers utilize international containers in world trade over many varied and changing trade routes. In addition, most large shipping lines have many offices in various countries involved in container operations. The Company s revenue from international containers is earned while the containers are used in service carrying cargo around the world, while certain other equipment is utilized in the United States. Accordingly, the information about the business of the Company by geographic area is derived from either international sources or from United States sources. Such presentation is consistent with industry practice.

Geographic Information:

	2002	2001
REVENUES:		
United States	$ 149,839	$ 146,419
International	83,574	82,647
	$ 233,413	$ 229,066
ASSETS:		
United States	$ 1,346,291	$ 1,035,651
International	873,210	751,420
	$ 2,219,501	$ 1,787,071

Note 8 Other contingencies and commitments:

At September 30, 2002, commitments for capital expenditures totaled approximately $9,800.

Under certain of the Company s leasing agreements, the Company, as lessee, may be obligated to indemnify the lessor for loss, recapture or disallowance of certain tax benefits arising from the lessor s ownership of the equipment.

The Company is engaged in various legal proceedings from time to time incidental to the conduct of its business. In the opinion of management, the Company is adequately insured against the claims relating to such proceedings, and any ultimate liability arising out of such proceedings will not have a material adverse effect on the financial condition or results of operations of the Company.

Note 9 Lease securitization program:

On March 30, 1999, the Company entered into an asset backed note program (the ABN Program). The ABN Program involved the sale by the Company of direct finance leases (collateralized by intermodal containers) with a historical net book value of $228,832 (the Assets). The Assets were sold to a special purpose entity (which is not consolidated by the Company) whose sole business activity is issuing asset backed notes (ABNs), supported by the future cash flows of the Assets and the underlying residuals. Proceeds received by the Company upon selling the Assets were $189,087 of cash and the lowest priority ABN issued in the ABN Program (the retained interest) with an allocated historical book value of $47,687.

The Company classified the retained interest as an available for sale security, which is included in Other Investment Securities in the accompanying condensed consolidated balance sheets. Accordingly, the retained interest is accounted for at fair value, with any changes in fair value over its allocated historical book value recorded as a component of other comprehensive income, net of tax, in the statement of changes in shareholders equity. As of September 30, 2002 and December 31, 2001, the Company estimated the fair market value of the retained interest was $11,589 and $15,970, respectively. During the nine months ended September 30, 2002 and 2001, the Company recorded interest income on the retained interest totaling $1,366 and $2,819 which is included in revenues in the accompanying condensed consolidated statements of income. During the three months ended September 30, 2002 and 2001, the Company recorded interest income on the retained interest totaling $403 and $877 which is included in revenues in the accompanying condensed consolidated statements of income. As of September 30, 2002, Assets with a historical book value of $48,085 remain in the special purpose entity with $39,627 of asset backed notes outstanding. During the three months ended September 30, 2001, defaulted finance leases of bankrupt customers were removed from the securitization program resulting in a reduction of the retained interest totaling $331.

Interpool Limited, a subsidiary of the Company (the Servicer), acts as servicer for the Assets. Pursuant to the terms of the servicing agreement, the Servicer is paid a fee of 0.40% of the assets under management. The Company s management has determined that the servicing fee paid approximates the fair value for services provided, as such, no servicing asset or liability has been recorded. For the nine months ended September 30, 2002 and 2001, the Company received servicing fees totaling $406 and $350 which are included in revenues in the accompanying condensed consolidated statements of income. For the three months ended September 30, 2002 and 2001, the Company received servicing fees totaling $147 and $131 which are included in revenues in the accompanying condensed consolidated statements of income. For the nine months ended September 30, 2002 and 2001, cash flows received on the retained interest were $5,747 and $8,675, respectively.

18

(dollars in thousands, except per share amounts)

At September 30, 2002 and December 31, 2001, key economic assumptions and the sensitivity of the current fair value of residual cash flows to immediate 10 percent and 20 percent adverse changes in those assumptions are as follows:

	September 30, 2002	December 31, 2001
Carrying amount/fair value of retained interests	$11,589	$15,970
Weighted-average life (in years)	1.8	2.0
Expected credit losses (annual rate)	**1.5%**	**1.5%**
Impact on fair value of 10% adverse change	$ 236	$ 129
Impact on fair value of 20% adverse change	$ 336	$ 275
Residual cash flows discount rate (annual)	**12.6%**	**12.6%**
Impact on fair value of 10% adverse change	$ 343	$ 310
Impact on fair value of 20% adverse change	$ 540	$ 619

Note 10 Gain on Sale of Land:

In April 2002, the Company sold an industrial property and recorded a gain of $4,766, which is included in other (income)/expense, net for the nine months ended September 30, 2002 in the accompanying condensed consolidated statements of income.

Note 11 Derivative instruments:

The Company s assets are primarily fixed rate in nature while its debt instruments are primarily floating rate. The Company employs derivative financial instruments (interest rate swap agreements) to effectively convert certain floating rate debt instruments into fixed rate instruments and thereby manage its exposure to fluctuations in interest rates.

As of September 30, 2002 and December 31, 2001, included in accounts payable and accrued expenses in the accompanying condensed consolidated balance sheets is a liability of $50,327 and $21,611, respectively, representing the market value of the Company s derivative instruments.

The unrealized pre-tax losses on cash flow hedges for the nine months ended September 30, 2002 of $22,953 have been reported in the Company s condensed consolidated balance sheet as a component of accumulated other comprehensive income (loss), along with related deferred income tax benefit of $8,682.

Amounts recorded in accumulated other comprehensive income would be reclassified into earnings upon termination of these interest rate swap agreements prior to their contractual maturity. The Company may at its discretion terminate or redesignate any such interest rate swap agreements prior to maturity. Any gains or losses on termination would be reclassified into income at that time.

Pre-tax income for the three and nine month periods ended September 30, 2002 resulting from the change in fair value of interest rate swap agreements held which do not qualify as cash flow hedges under Statement 133 of $3,792 and $5,827, respectively have been recorded on the condensed consolidated statements of income as market value adjustment for derivative instruments. Interest rate swap agreements, which qualify as perfect cash flow hedges, have no ineffectiveness and therefore are not reflected in the condensed consolidated statements of income. Pre-tax income for the three and nine month periods ended September 30, 2002 resulting from interest rate swap agreements which qualify as cash flow hedges but are not perfectly correlated have associated ineffectiveness of $(35) and $(18), respectively which has been recorded in the condensed consolidated statements of income as market value adjustment for derivative instruments. Future ineffectiveness related to these interest rate swap agreements will continue to be recorded in the condensed consolidated statements of income during the next twelve months.

As of September 30, 2002, the Company holds 15 interest rate swap agreements with various financial institutions. The aggregate notional balance of the swaps was $703,704 as of September 30, 2002.

(dollars in thousands, except per share amounts)

Note 12 Income taxes:

Significant components of deferred tax assets and liabilities as of September 30, 2002 were as follows:

	2002
Deferred tax assets:	
Loss carry forwards	$ 104,818
Finance leases receivable	4,337
Other, primarily operating reserves	25,421
Total deferred tax assets	134,576
Deferred tax liabilities:	
Operating property, net	146,399
Other	15,709
Total deferred tax liabilities	162,108
Net deferred tax liability	$ 27,532

A reconciliation of the U. S. statutory tax rate to the actual tax rate for the nine months ended September 30 follows:

	2002	2001
U.S. statutory rate	35.0%	35.0%
Difference due to operation of subsidiary in Barbados	(33.2)	(22.4)
Federal taxes on foreign income	2.6	1.0
State taxes	1.3	1.7
Tax benefit on U.S. losses	(8.4)	
Other	1.0	.5
Actual tax rate	(1.7)%	15.8%

The provision for income taxes reflected in the accompanying consolidated statements of income is as follows:

	2002
U.S.	$ (1,091)
Other	741
	$ (350)
Current	$ 2,347

	2002
Deferred	(2,697)
	$ (350)

Note 13 Debt:

Debt consists of notes and loans with installments payable in varying amounts through 2009, with effective interest rates of approximately 2.6% to 7.9% and a weighted average rate of 6.22% in 2002. The principal amount of debt payable under fixed rate contracts is $291,626. Remaining debt is payable under floating rate arrangements. Approximately $703,704 of floating rate debt outstanding has been converted to fixed rate debt through the use of interest rate swaps as described below. The agreements contain certain covenants (as defined), which, among other things, provide for the maintenance of specified levels of tangible net worth and a maximum debt to net worth ratio. At September 30, 2002, under covenants in the Company s loan agreement approximately $188,200 of retained earnings were available for dividends. The Company was in compliance with its debt covenants at September 30, 2002.

As of September 30, 2002, the annual maturities of notes and loans, net of interest thereon were as follows:

Twelve Months Ended September 30,	
2003	$131,335
2004	89,372
2005	319,338
2006	39,005
2007	227,791
Thereafter	8,175
	$815,016

(dollars in thousands, except per share amounts)

The Company has a $215,000 revolving credit facility with a group of commercial banks; on September 30, 2002, $170,000 was outstanding, with an interest rate of 7.08%, including the effect of interest rate swap contracts in place as of September 30, 2002. In July 2000, this facility was renewed and amended with the term extended to July 31, 2005. The credit limit remains at $215,000 through July 31, 2003; thereafter the credit limit declines to $193,500 through July 31, 2004 and $172,000 through July 31, 2005. Subsequent to September 30, 2002 the Company has continued to incur and repay debt obligations in connection with financing its equipment leasing activities. Under its revolving credit facility and most of its other debt instruments, the Company is required to maintain covenants (as defined) for a tangible net worth of $125,000, a fixed charge coverage ratio of 1.5 to 1 and a funded debt to net worth ratio of 4.0 to 1. At September 30, 2002, the Company was in compliance with these requirements.

In March 2002, the Company established a $500,000 chassis asset-backed securitization facility. This facility is guaranteed by MBIA and was therefore rated AAA by Standard & Poor s and Aaa by Moody s. The proceeds from this financing were used to repay debt related to a secured financing facility used to fund the acquisition of assets from Transamerica, to repay a previously established chassis securitization facility, to fund growth of our intermodal equipment fleet and for working capital purposes. On September 30, 2002, the Company completed the second phase of this transaction by entering into a sale/leaseback transaction and expanding the total debt and capital lease obligations to a total of $540,968 outstanding, of which $129,328 is a debt obligation and $411,640 is a capital lease obligation under the sale/leaseback. The interest rate on this facility is 5.05%, including the effect of interest rate swap contracts in place as of September 30, 2002. This facility continues to be accounted for as on-balance sheet secured financing. The assets used to secure this facility are segregated in a Delaware statutory titling trust (the Trust) and in a special purpose entity (which is consolidated by the Company) and amount to $18,370 of accounts receivable and fixed assets with a net book value of $502,920 at September 30, 2002. In addition, $23,302 of cash and marketable securities at September 30, 2002 are restricted for use by the Trust and the special purpose entity and included on the Company s consolidated balance sheet. The assets, which are segregated in the special purpose entity and included on the Company s consolidated balance sheet, are not available to pay the claims of the Company s creditors.

In October 2000, the Company established a secured financing facility in the amount of $300,000 to fund the TA transaction. At December 31, 2001, $97,656 of this facility was outstanding with an interest rate of 3.94%. The Company repaid this facility in full in March 2002 with proceeds from our new chassis asset-backed securitization facility completed in March 2002.

In July 2000, the Company established a chassis securitization facility of $280,000. In October 2000, this chassis securitization facility was increased to $300,000. At December 31, 2001, $277,410 of this facility was outstanding with an interest rate of 4.75%, including the effect of interest rate swap contracts in place as of December 31, 2001. The Company repaid this facility in full in March 2002 with proceeds from our new chassis asset-backed securitization facility completed in March 2002.

In July 2001, the Company s container securitization facility, which was originally established as an off-balance sheet source of financing in March 1999, was amended allowing additional financings to be accounted for as on-balance sheet secured debt financing. In August 2002, the container securitization facility was extended with the maximum outstanding limited to $150,000. In October 2002 the facility was renewed and the facility amount was set at $200,000. At September 30, 2002, $120,020 of the container securitization facility was utilized, of which $39,627 relates to off-balance sheet financing, while $80,393 relates to on-balance sheet financing and is included in debt and capital lease obligations in the condensed consolidated balance sheets. At September 30, 2002, the rate on this facility is 5.06%, including the effect of interest rate swap contracts in place as of September 30, 2002.

In February 1998, the Company issued $100,000 principal amount of 6-5/8% Notes due 2003 (the 6-5/8% Notes). The net proceeds were used to repay $83,000 in borrowings under the revolving credit agreement and for other general corporate purposes. During the fourth quarter of 1999, the Company retired $17,000 of the 6-5/8% Notes and recognized an extraordinary gain of $740 net of tax expense of $494. During the first quarter of 2000, the Company retired $8,200 of the 6-5/8% Notes and recognized an extraordinary gain of $471 net of tax expense of $314. During the second and third quarters of 2001, the Company retired $27,174 of the 6-5/8% Notes and recognized an extraordinary gain of $435 net of tax expense of $290. During the second and third quarters of 2002, the Company retired $6,365 of the 6 5/8% Notes and recognized an extraordinary gain of $19 net of tax expense of $13. As of September 30, 2002, $41,261 principal amount of the 6-5/8% Notes remains outstanding.

In July and August, 1997, the Company issued $225,000 of ten year notes, comprised of $150,000 of 7.35% Notes due 2007 and $75,000 of 7.20% Notes due 2007. The net proceeds from these offerings were used to repay secured indebtedness, to purchase equipment and for other investments. During the first quarter of 2000, the Company retired $3,000 of the 7.35% Notes and recognized an extraordinary gain of $369 net of tax expense of $246. During 2001, the Company retired $2,075 of the 7.20% Notes and recognized an extraordinary gain of $123 net of tax expense of $82. As of September 30, 2002, $72,925 and $147,000 principal amount of the 7.20% and 7.35% Notes, respectively, remains outstanding.

(dollars in thousands, except per share amounts)

In addition to the debt specifically identified above, the Company has additional notes and loans outstanding with various financial institutions totaling $174,107, as of September 30, 2002, with installments payable in varying amounts through 2009 with interest rates of approximately 2.6% to 7.9%.

In 2002, the Company entered into interest rate swap contracts with notional amounts totaling $609,676. The terms of the interest rate swap contract are for six and ten years. The interest rate swap contracts convert variable rate debt into fixed rate debt. The maturity of the contracts coincide with the maturity of the underlying debt instruments hedged. At September 30, 2002, the notional amounts are approximately $467,574.

In 2001, the Company entered into an interest rate swap contract with notional amounts totaling $51,467. These amounts relate to the container securitization completed in March 1999, as amended in July 2001, which included both on and off balance sheet financing, of which the notional amounts are $43,330 and $8,137, respectively. The terms of the interest rate swap contract are for six years. The interest rate swap contracts convert variable rate debt into fixed rate debt. The maturity of the contract coincides with the maturity of the underlying debt instruments hedged. At September 30, 2002, the on and off balance sheet notional amounts are approximately $30,782 and $5,758, respectively.

In 2000, the Company entered into interest rate swap contracts with notional amounts totaling $334,882. The terms of the interest rate swap contracts are for two and seven years. The interest rate swap contracts convert variable rate debt into fixed rate debt. The maturity of these contracts coincides with the maturity of the underlying debt instruments hedged. At September 30, 2002, the notional amount was approximately $176,908.

In 1998, the Company entered into interest rate swap contracts with notional amounts totaling $79,709. The terms of the interest rate swap contracts are for three, five and seven years. The interest rate swap contracts convert variable rate debt into fixed rate debt. The maturity of these contracts coincides with the maturity of the underlying debt instruments hedged. In 2000, a portion of the debt instrument hedged was retired and the related portion of the swap contract was closed. At September 30, 2002, the notional amount was approximately $28,440.

See Note 2 for further information regarding CAI s debt (which is included in the debt maturity schedule on the preceding page).

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

The information in this quarterly report on Form 10-Q contains certain forward-looking statements within the meaning of the securities laws. These forward-looking statements reflect the current view of the Company with respect to future events and financial performance and are subject to a number of risks and uncertainties, many of which are beyond our control. Some of these risks and uncertainties are described in our Annual Report on Form 10-K and/or our other filings with the Securities and Exchange Commission. All statements other than statements of historical facts included or this report, including the statements under Management s Discussion and Analysis of Financial Condition and Results of Operations, regarding our strategy, future operations, financial position, estimated revenues, projected costs, prospects, plans and objectives of management are forward-looking statements. When used in this report, the words will, believe, anticipate, intend, estimate, expect, project and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words.

All forward-looking statements speak only as of the date of this report. We do not undertake any obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise. Although we believe that our plans, intentions and expectations reflected in or suggested by the forward-looking statements we make in this report are reasonable, we can give no assurance that these plans, intentions or expectations will be achieved. Future economic and industry trends that could potentially impact revenues and profitability are difficult to predict.

We suggest that this quarterly report be read in conjunction with the Management s Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2001.

General

The Company generates revenues through leasing transportation equipment, primarily intermodal chassis and dry freight standard containers. Most of the Company s revenues are derived from payments received under operating leases. The utilization of the Company s operating lease fleet of chassis for the nine months ended September 30, 2002 has declined from the same period in 2001 as economic activity in North America has declined. This has brought about reduced operating lease revenue accompanied by increased costs, in particular for storage of the idle equipment. In recent weeks, the Company s chassis utilization has increased primarily because shippers have attempted to alleviate the congestion in West Coast ports brought about by the longshoreman strike in September 2002. This trend is continuing in the fourth quarter of 2002. Short-term utilization of CAI s container fleet has increased since April 2002 and this trend is expected to continue through the fourth quarter of 2002. Our long-term international container utilization has remained steady. The Company also enters into finance leases, under which the lessee has the right to purchase the equipment at the end of the lease term. The Company s finance lease portfolio has remained relatively unchanged since December 31, 2001. For the nine months ended September 30, 2002 revenues from direct finance leases accounted for 8% of the leasing revenues.

On June 27, 2002, the Company s 50% owned subsidiary, Container Applications International, Inc. (CAI), which concentrates on short term container leasing, entered into a new senior credit agreement with a group of financial institutions. To facilitate the closing of this new credit facility, the Company agreed to extend the repayment terms of an outstanding subordinated note (Note) of CAI held by the Company and modified certain financial covenants of the Note. At the same time, the Company was provided a majority position on CAI s board of directors. The Company has determined that as a result of these transactions and gaining a majority position on CAI s board, the Company s financial statements for the quarter ended June 30, 2002 must include CAI as a consolidated subsidiary commencing June 27, 2002. Previously, CAI was accounted for under the equity method of accounting. The Company s share of the equity earnings (losses) of CAI for the periods from January 1, 2002 through June 27, 2002 have been recorded in (Income)/Loss for Investments Accounted for Under the Equity Method in the accompanying Condensed Consolidated Statements of Income. For the period from June 27 through September 30, 2002, CAI s results of operations have been included in the appropriate captions on the accompanying Condensed Consolidated Statements of Income. The assets and liabilities of CAI at September 30, 2002 have been included on the accompanying Condensed Consolidated Balance Sheets.

During the three months ended September 30, 2001, the Company initiated a plan to dispose of PCR, a 51%-owned subsidiary engaged in leasing computers and related equipment, and to discontinue the operations of Microtech, a 75.5%-owned subsidiary, also engaged in computer leasing. As a result, PCR and Microtech have been classified as discontinued operations in the condensed consolidated financial statements.

Three Months Ended September 30, 2002 compared to Three Months Ended September 30, 2001

Revenues

The Company s revenues increased to $86.1 million for the three months ended September 30, 2002, from $74.9 million in the three months ended September 30, 2001, an increase of $11.2 million or 15%. The increase was attributable to increased finance lease revenues of $.9 million, as well as $10.4 million of incremental leasing revenues as a result of consolidating CAI, partially offset by $.1 million in reduced operating lease revenues. Although the Company s container and chassis fleets increased in size by 14% and 11%, respectively as compared to the three months ended September 30, 2001, the operating lease revenue for the three months ended September 30, 2002 declined when compared to the three months ended September 30, 2001 as a result of reductions in the daily rental rates of 12% for containers and 10% for chassis for the three months ended September 30, 2002 as compared to the three months ended September 30, 2001. The decrease in container rates resulted from the termination of leases with higher rates that were written when the cost of equipment was higher than it is currently. These leases are being replaced by leases with lower rates reflecting the current cost of equipment. The Company s chassis rates declined as a result of the acquisition, in December 2001, of 20,700 used chassis on hire at per diem rates lower than the Company s existing fleet. In addition, a change to California law, which made the lessee of the equipment responsible for the payment of licensing costs, lowered the rates since these costs were previously recovered through per diem rates. Utilization rates of the Company s container fleet and its domestic intermodal chassis operating fleets at September 30, 2002 were 98% and 92%, respectively, as compared to 95% and 93%, respectively, at September 30, 2001. The Company s containers managed by CAI are considered to be on hire for utilization purposes. The yield (per diem revenue net of operating costs) on the CAI managed assets was $.44 and $.52 per unit per day for the three months ended September 30, 2002 and 2001, respectively. The reduction in yield was the result of lower utilization of the equipment in the short term leasing market.

23

Lease Operating and Administrative Expenses

The Company s lease operating and administrative expenses increased to $26.6 million for the three months ended September 30, 2002 from $20.6 million in the three months ended September 30, 2001, an increase of $6.0 million or 29%.

The increase was primarily due to:

An increase of $6.3 million resulting from the consolidation of the activities of CAI.

An increase in accounting and legal fees of $.7 million primarily resulting from the investigation of consolidation matters in the June 30, 2002 Form 10Q and other legal matters.

An increase in storage costs of $.6 million primarily due to the reduction in utilization and the increase in the container and chassis fleets.

An increase to equipment rental costs of $.4 million related to the short term rental of equipment to meet customer lease requirements.

A reduction in licensing cost of $1.8 resulting from a change in California law which made the user of the equipment, not the lessor, responsible for the payment of licensing fees. This reduction in expense has brought about a comparable reduction in operating lease revenues since these licensing costs were previously recovered through increased rental rates.

An increase in salary related cost of $.9 million primarily related to anticipated benefits under the Company s bonus and commission programs.

A reduction of $.5 million in California use taxes related to the Transamerica assets acquired in October 2000.

A reduction of $.5 million in insurance expense primarily due to the termination of insurance to cover against losses from lessee defaults, the continuation of which has been deemed to be uneconomical.

Provision for Doubtful Accounts

The Company s provision for doubtful accounts increased to $1.3 million for the three months ended September 30, 2002 from $.5 million in the three months ended September 30, 2001. The increase was primarily attributable to additional reserves provided for a specific customer in default under its lease obligations within the domestic intermodal division. The Company s provision for doubtful accounts is provided based upon a review of the outstanding receivables and an evaluation of the adequacy of the allowance for doubtful accounts which the Company considers to be adequate based upon the risk profile of the receivables.

Market Value Adjustment for Derivative Instruments

The increase in the non-cash market value adjustment for derivative instruments of $2.5 million for the three months ended September 30, 2002 as compared to the prior year period primarily resulted from the change in the fair value of an interest rate swap entered into in March 2002 with a notional amount of $250.0 million which did not qualify for hedge accounting treatment under SFAS 133. This swap converts the variable rate payments of certain of the Company s debt to fixed payments.

Depreciation and Amortization of Leasing Equipment

The Company s depreciation and amortization expenses increased to $23.2 million for the three months ended September 30, 2002 from $18.8 million for the three months ended September 30, 2001, an increase of $4.4 million or 23%. The increase was primarily the result of $4.3 million of incremental depreciation expense as a result of consolidating CAI, partially offset by changes to the Company s depreciation policy for chassis amounting to a depreciation savings of $2.3 million and a change to the depreciation policy of its containers amounting to a depreciation savings of $.1 million. These reductions to depreciation expense were partially offset by an increase in depreciation resulting from an expanded fleet size. See Note 1 to the condensed consolidated financial statements for further information regarding the depreciation policy changes for chassis and containers, which were effective April 1, 2002.

Minority Interest (Income)/Expense, Net

The change in minority interest (income)/expense, net of $.6 million for the three months ended September 30, 2002 as compared to the prior year period resulted primarily from minority interest income of $.8 million as a result of the consolidation of CAI effective June 27, 2002, partially offset by an increase in dividends and distributions paid by Chassis Holdings of $.2 million.

Income/Loss for Investments Accounted for Under the Equity Method

The change in (income)/loss for investments accounted for under the equity method during the three months ended September 30, 2002 is nominal as compared to the three months ended September 30, 2001. The Company recorded its equity in the earnings/(losses) of CAI through June 26, 2002, at which time CAI became a consolidated subsidiary of the Company. For the three months ended September 30, 2001, the Company s share of its equity earnings of CAI was $.1 million. For the three months ended September 30, 2002, the Company recorded $.1 million as a result of certain other investments accounted for under the equity method of accounting.

Other (Income)/Expense, Net

The Company had other expense of $.6 million during the three months ended September 30, 2002. The change in other (income)/expense, net of $.3 million from the three months ended September 30, 2001 was due to:

fee income of $.4 million as a result of the Company acting as an agent and arranging a lease transaction between two parties.

a reduction in goodwill amortization of $.2 million resulting from the adoption of FASB 142.

additional losses of $.9 million primarily resulting from the sale of leasing equipment recovered from a customer in default.

Interest Expense

The Company s interest expense increased to $29.5 million in the three months ended September 30, 2002 from $23.2 million in the three months ended September 30, 2001, an increase of $6.3 million or 27%. The increase in interest expense was primarily attributable to $2.1 million of incremental interest expense as a result of consolidating CAI, deferred financing fees of $2.5 million which were written off when the Company refinanced certain of its debt instruments, and increased borrowings to fund capital expenditures, resulting in incremental interest expense of $5.4 million, partially offset by reduced borrowing costs resulting in reduced interest expense of $3.7 million.

Interest Income

The Company s interest income decreased to $.6 million in the three months ended September 30, 2002 from $1.3 million in the three months ended September 30, 2001, a decrease of $.7 million or 54%. The decrease in interest income was primarily due to reduced earnings on invested cash balances.

(Benefit)/Provision for Income Taxes

The Company recorded an income tax benefit of $1.5 million for the three months ended September 30, 2002 as compared to a tax provision of $1.2 million for the three months ended September 30, 2001. A portion of this change resulted from an overall decrease in income from continuing operations. In addition, pre-tax income from continuing operations of $8.7 million was generated by the Company s international container operations which is subject to a lower tax rate (approximately 3.4%) than the domestic intermodal and container divisions (approximately 38.7%), which generated a pre-tax loss of $6.7 million from continuing operations. Partially offsetting the decrease was a tax law change in New Jersey which prevented current utilization of the Company s NOL s in that jurisdiction resulting in an increased tax provision of $0.8 million, net of U.S. Federal tax benefit.

Income from Continuing Operations Before Discontinued Operations and Extraordinary Gain

As a result of the factors described above, the Company s income from continuing operations before discontinued operations, the cumulative effect of change in accounting principle and extraordinary gain was $3.5 million in the three months ended September 30, 2002 versus $10.0 million in the three months ended September 30, 2001.

(Loss) Gain from Discontinued Operations

The Company recorded break-even results relating to the discontinued operations of Microtech for the three months ended September 30, 2002, as compared to a loss from discontinued operations of $.9 million for the three months ended September 30, 2001. The Company, along with the management of Microtech, believes all future losses expected to be incurred by Microtech during the liquidation of its lease portfolio have been properly accrued as of September 30, 2002. The Company, along with the management of Microtech, will continue to assess whether additional accruals for losses are necessary, as additional information becomes available during the liquidation of Microtech s lease portfolio.

Extraordinary Gain

The Company recorded an extraordinary gain on the retirement of debt of $.3 million in the three months ended September 30, 2001.

Net Income

As a result of the factors described above, the Company s net income decreased to $3.5 million in the three months ended September 30, 2002 from $9.5 million in the three months ended September 30, 2001.

Nine Months Ended September 30, 2002 compared to Nine Months Ended September 30, 2001

Revenues

The Company s revenues increased to $233.4 million for the nine months ended September 30, 2002, from $229.1 million in the nine months ended September 30, 2001, an increase of $4.3 million or 2%. The increase was attributable to $10.8 million of incremental leasing revenues as a result of consolidating CAI, increased finance lease revenues of $4.4 million, partially offset by reduced operating lease revenues of $10.9 million. Although the Company s container and chassis fleets increased in size by 13% and 8%, respectively as compared to the nine months ended September 30, 2001, the operating lease revenue for the nine months ended September 30, 2002 declined when compared to the nine months ended September 30, 2001 as a result of reductions in the daily rental rates of 11% for containers and 8% for chassis for the nine months ended September 30, 2002 as compared to the nine months ended September 30, 2001. The decrease in container rates resulted from the termination of leases with higher rates that were written when the cost of equipment was higher than it is currently. These leases are being replaced by leases with lower rates reflecting the current cost of equipment. The Company s chassis rates declined as a result of the acquisition, in December 2001, of 20,700 used chassis on hire at per diem rates lower than the Company s existing fleet. In addition, a change to California law, which made the lessee of the equipment responsible for the payment of licensing costs, lowered the rates since these costs were previously recovered through per diem rates. Utilization rates of the Company s container fleet and its domestic intermodal chassis operating fleets at September 30, 2002 were 98% and 92%, respectively, as compared to 95% and 93%, respectively, at September 30, 2001. The Company s containers managed by CAI are considered to be on hire for utilization purposes. The yield (per diem revenue net of operating costs) on the CAI managed assets was $.41 and $.55 per unit per day for the nine months ended September 30, 2002 and 2001, respectively. The reduction in yield was the result of lower utilization of the equipment in the short term leasing market.

Lease Operating and Administrative Expenses

The Company s lease operating and administrative expenses increased to $65.4 million for the nine months ended September 30, 2002 from $65.6 million in the nine months ended September 30, 2001, a decrease of $.2 million.

The increase was primarily due to:

A reduction in California licensing costs of $4.5 million due to a change in California law which made the user of the equipment, not the lessor, responsible for the payment of the licensing fees. This reduction in expense has brought about a reduction in operating lease revenues since these licensing costs were previously recovered through increased rental rates.

A decline in maintenance and repair costs of $2.6 million primarily due to billable repairs in accordance with the lease terms to a customer in default which were accrued for in previous periods and are recoverable under insurance policies.

A decline in consulting costs of $.9 million due to expenditures in 2001 related to the IT integration of the assets acquired from Transamerica in October 2000.

A reduction in equipment rental of $1.8 million for equipment leased from the Ivy Group for the period prior to July 1, 2001.

A reduction of $.7 million in California use taxes related to the Transamerica assets acquired in October 2000.

A reduction of $1.3 million in insurance expense primarily due to the termination of insurance to cover against losses from lessee defaults, the continuation of which has been deemed to be uneconomical.

An increase of $6.6 million resulting from the consolidation of the activities of CAI.

An increase in storage costs of $4.6 million primarily due to a reduction in utilization and the increased size of the Company s fleet.

Provision for Doubtful Accounts

The Company s provision for doubtful accounts increased to $2.9 million for the nine months ended September 30, 2002 from $1.9 million in the nine months ended September 30, 2001. The increase was primarily attributable to additional reserves provided for a specific customer in default under its lease obligations within the domestic intermodal division. The Company s provision for doubtful accounts is provided based upon a review of the outstanding receivables and an evaluation of the adequacy of the allowance for doubtful accounts which the Company considers to be adequate based upon the risk profile of the receivables.

Market Value Adjustment for Derivative Instruments

The Company s non-cash market value adjustment for derivative instruments expense increased to $5.8 million for the nine months ended September 30, 2002 from $2.1 million in the nine months ended September 30, 2001, an increase of $3.7 million. This increase primarily resulted from the change in the fair value of an interest rate swap entered into in March 2002 with a notional amount of $250.0 million which did not qualify for hedge accounting treatment under SFAS 133. This swap converts the variable rate payments of certain of the Company s debt to fixed payments.

Depreciation and Amortization of Leasing Equipment

The Company s depreciation and amortization expenses increased to $61.0 million for the nine months ended September 30, 2002 from $55.5 million for the nine months ended September 30, 2001, an increase of $5.5 million or 10%. The increase was primarily the result of $4.5 million of incremental depreciation expense as a result of consolidating CAI, as well as an expanded fleet size, partially offset by a decrease in depreciation expense as a result of the changes to the Company s depreciation policy for chassis amounting to a depreciation savings of $4.6 million and a change to the depreciation policy of its containers amounting to a depreciation savings of $.2 million, as well as reduced depreciation expense of $1.3 million as a result of the Company s sale of its rail trailers and domestic containers to GE Capital in March 2001. See Note 1 to the condensed consolidated financial statements for further information regarding the depreciation policy changes for chassis and containers, which were effective April 1, 2002.

Minority Interest (Income)/Expense, Net

The change in minority interest (income)/expense, net of $1.0 million for the nine months ended September 30, 2002 as compared to the prior year period resulted primarily from an increase in dividends and distributions paid by Chassis Holdings of $1.8 million, partially offset by minority interest income of $.8 million as a result of the consolidation of CAI effective June 27, 2002.

Income/Loss for Investments Accounted for Under the Equity Method

Losses for investments accounted for under the equity method of accounting increased from $.1 million for the nine months ended September 30, 2001 to $3.6 million for the nine months ended September 30, 2002. The Company recorded its equity in the losses of CAI through June 26, 2002, at which time CAI became a consolidated subsidiary of the Company. The increase was primarily the result of CAI recording an impairment loss of $5.4 million related to damaged and held for sale equipment, as well as a change in the container depreciation policy effective April 1, 2002 which resulted in an increase in CAI s depreciation for the three months ended June 30, 2002 of $.6 million. These two items increased losses recorded by the Company by $2.0 million, net of CAI s tax benefit, during the three months ended June 30, 2002. The remaining increase in losses resulted from reduced operating performance of the CAI fleet.

Other (Income)/Expense, Net

The Company had other income of $4.7 million during the nine months ended September 30, 2002. The change in other (income)/expense, net of $3.5 million from the nine months ended September 30, 2001 was due to:

the sale of the Company s Chicago property, which had been acquired as part of the acquisition of the North American Intermodal division of Transamerica Leasing, Inc. (TA) and resulted in a gain of $4.8 million recorded in the second quarter of 2002.

fee income of $.4 million as a result of the Company acting as an agent and arranging a lease transaction between two parties.

a reduction in goodwill amortization of $.6 million resulting from the adoption of FASB 142.

a gain of $2.4 million related to insurance settlements on equipment not recovered from a customer in default recorded in the first quarter of 2002.

additional losses of $2.7 million primarily resulting from the sale of leasing equipment recovered from a customer in default.

gain of $1.8 million on the sale of rail trailers and domestic containers previously owned by the Company to GE Capital Corporation during the three months ended March 31, 2001.

Interest Expense

The Company s interest expense increased to $81.2 million in the nine months ended September 30, 2002 from $71.5 million in the nine months ended September 30, 2001, an increase of $9.7 million or 14%. The increase in interest expense was primarily attributable to $2.2 million of incremental interest expense as a result of consolidating CAI, deferred financing fees of $3.7 million which were written off when the Company refinanced certain of its debt instruments, and increased borrowings to fund capital expenditures, resulting in incremental interest expense of $4.5 million, partially offset by reduced borrowing costs resulting in reduced interest expense of $.7 million.

Interest Income

The Company s interest income decreased to $4.1 million in the nine months ended September 30, 2002 from $6.6 million in the nine months ended September 30, 2001, a decrease of $2.5 million or 38%. The decrease in interest income was primarily due to reduced earnings on invested cash balances, as well as reduced cash balances on hand during 2002.

(Benefit)/Provision for Income Taxes

The Company recorded an income tax benefit of $.4 million for the nine months ended September 30, 2002 as compared to a tax provision of $6.3 million for the nine months ended September 30, 2001. A portion of this change resulted from an overall decrease in income from continuing operations. In addition, pre-tax income from continuing operations of $25.8 million was generated by the Company s international container operations which is subject to a lower tax rate (approximately 3.4%) than the domestic intermodal and container divisions (approximately 39.6%), which generated a pre-tax loss of $5.1 million from continuing operations. Partially offsetting the decrease was a tax law change in New Jersey which prevented current utilization of the Company s NOL s in that jurisdiction resulting in an increased tax provision of $0.8 million, net of U.S. Federal tax benefit.

Income from Continuing Operations Before Discontinued Operations, Cumulative Effect of Change in Accounting Principle and Extraordinary Gain

As a result of the factors described above, the Company s income from continuing operations before discontinued operations, the cumulative effect of change in accounting principle and extraordinary gain was $21.1 million in the nine months ended September 30, 2002 versus $33.3 million in the nine months ended September 30, 2001.

(Loss) Gain from Discontinued Operations

The Company s loss from the discontinued operations of Microtech was $.7 million for the nine months ended September 30, 2002, as compared to a loss from discontinued operations of $1.7 million for the nine months ended September 30, 2001. The Company, along with the management of Microtech, believes all future losses expected to be incurred by Microtech during the liquidation of its lease portfolio have been properly accrued as of September 30, 2002. The Company, along with the management of Microtech, will continue to assess whether additional accruals for losses are necessary, as additional information becomes available during the liquidation of Microtech s lease portfolio.

Cumulative Effect of Change in Accounting Principle

The Company recorded the cumulative effect of a change in accounting principle of $.8 million in the three months ended March 31, 2001. This represents the cumulative effect through December 31, 2000 regarding the Company s accounting for swap transactions not accounted for as hedges in accordance with the Financial Accounting Standards Board issued statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities.* The adoption of Statement 133 on January 1, 2001 increased liabilities by approximately $9.0 million, with offsetting amounts recorded as decreases to deferred tax liabilities of $2.4 million and accumulated other comprehensive income of $7.4 million.

Extraordinary Gain

The Company recorded an extraordinary gain on the retirement of debt of $.6 million in the nine months ended September 30, 2001.

Net Income

As a result of the factors described above, the Company s net income decreased to $20.4 million in the nine months ended September 30, 2002 from $33.0 million in the nine months ended September 30, 2001.

Liquidity and Capital Resources

The Company uses funds from various sources to finance the acquisition of equipment for lease to customers. The primary funding sources are cash provided by operations, borrowings (generally from banks), securitization of lease receivables, the issuance of capital lease obligations and the sale of the Company s securities. In addition, the Company generates cash from the sale of equipment being retired from the Company s fleet. In general, the Company seeks to meet debt service requirements from the leasing revenue generated by its equipment.

The Company generated cash flow from operations of $83.6 million and $83.7 million in the first nine months of 2002 and 2001, respectively, and net cash provided by (used for) financing activities was $111.8 million and ($324.5) million for the first nine months of 2002 and 2001, respectively. The Company has purchased equipment amounting to: $228.7 million for the nine months ended September 30, 2002 and $169.5 million for the six months ended September 30, 2001.

In July 2001, the Company s container securitization facility, which was originally established as an off-balance sheet source of financing in March 1999, was amended allowing additional financings to be accounted for as on-balance sheet secured debt financing. In August 2002, the container securitization facility was extended with the maximum outstanding limited to $150.0 million. In October 2002 the facility was renewed and the facility amount was set at $200.0 million. At September 30, 2002, $120.0 million of the container securitization facility was utilized, of which $39.6 million relates to off-balance sheet financing, while $80.4 million relates to on-balance sheet financing and is included in debt and capital lease obligations in the condensed consolidated balance sheets. At September 30, 2002, the rate on this facility is 5.06%, including the effect of interest rate swap contracts in place as of September 30, 2002.

In March 2002, the Company established a $500.0 million chassis asset-backed securitization facility. This facility is guaranteed by MBIA and was therefore rated AAA by Standard & Poor s and Aaa by Moody s. The proceeds from this financing were used to repay debt related to a secured financing facility used to fund the acquisition of assets from Transamerica, to repay a previously established chassis securitization facility, to fund growth of our intermodal equipment fleet and for working capital purposes. On September 30, 2002, the Company completed the second phase of this transaction by entering into a sale/leaseback transaction and expanding the total debt and capital lease obligations to a total of $540.9 million outstanding, of which $129.3 million is a debt obligation and $411.6 million is a capital lease obligation under the sale/leaseback. The interest rate on this facility is 5.05%, including the effect of interest rate swap contracts in place as of September 30, 2002. This facility continues to be accounted for as on-balance sheet secured financing. The assets used to secure this facility are segregated in a Delaware statutory titling trust (the Trust) and in a special purpose entity (which is consolidated by the Company) and amount to $18.4 million of accounts receivable and fixed assets with a net book value of $502.9 million at September 30, 2002. In addition, $23.3 million of cash and marketable securities at September 30, 2002 are restricted for use by the Trust and the special purpose entity and included on the Company s consolidated balance sheet. The assets, which are segregated in the special purpose entity and included on the Company s consolidated balance sheet, are not available to pay the claims of the Company s creditors.

In October 2000, the Company established a secured financing facility in the amount of $300.0 million to fund the TA transaction. At December 31, 2001, $97.7 million of this facility was outstanding with an interest rate of 3.94%. The Company repaid this facility in full in March 2002 with proceeds from our new chassis asset-backed securitization facility completed in March 2002.

In July 2000, the Company established a chassis securitization facility of $280.0 million. In October 2000, this chassis securitization facility was increased to $300.0 million. At December 31, 2001, $277.4 million of this facility was outstanding, with an interest rate of 4.75%, including the effect of interest rate swap contracts in place as of December 31, 2001. The Company repaid this facility in full in March 2002 with proceeds from our new chassis asset-backed securitization facility completed in March 2002.

The Company has a $215.0 million revolving credit facility with a group of commercial banks; on September 30, 2002, $170.0 million was outstanding, with an interest rate of 7.08%, including the effect of interest rate swap contracts in place as of September 30, 2002. In July 2000, this facility was renewed and amended with the term extended to July 31, 2005. The credit limit remains at $215.0 million through July 31, 2003; thereafter the credit limit declines to $193.5 million through July 31, 2004 and $172.0 million through July 21, 2005. Subsequent to September 30, 2002 the Company has continued to incur and repay debt obligations in connection with financing its equipment leasing activities. Under our revolving credit facility and most of our other debt instruments, the Company is required to maintain covenants (as defined) for a tangible net worth of $125 million, a fixed charge coverage ratio of 1.5 to 1 and a funded debt to net worth ratio of 4.0 to 1. At September 30, 2002, the Company was in compliance with these requirements.

In February 1998, the Company issued $100.0 million principal amount of 6-5/8% Note due 2003. During the second and third quarters of 2001, the Company retired a total of $27.2 million of the 6-5/8% Notes and recognized an extraordinary gain, net of tax, of $0.4 million. During the second and third quarters of 2002, the Company retired a total of $6.4 million of the 6-5/8% Notes. As of September 30, 2002, $41.3 million principal amount of 6-5/8% Notes remain outstanding. On October 16, 2002, the Company commenced a tender offer for any and all of its outstanding 6-5/8% Notes due 2003 (the 6-5/8% Notes). Approximately 41.3 million principal amount of 6-5/8% Notes were outstanding upon commencement of the tender offer. The purchase price in the tender offer is $1,000 per $1,000 principal amount of the 6-5/8% Notes, plus accrued and unpaid interest. The source of the consideration for the tender offer is cash on hand. The expiration date of the tender offer is November 15, 2002, unless extended by the Company.

In April 1998, the Company acquired a 50% common equity interest in Container Applications International, Inc. (CAI). CAI owns and leases its own fleet of containers and manages, for a fee, containers owned by third parties. The Company entered into its operating relationship with CAI primarily to facilitate the rental in the short-term market of containers coming off long-term lease, to gain access to new companies looking to lease containers on a long term basis and to realize cost efficiencies from the operation of a coordinated container lease marketing group. The marketing group which is organized as a wholly-owned subsidiary of the Company, is responsible for soliciting container lease business for both the Company and CAI, including long-term and direct finance lease business and short-term lease business on master lease agreements. All long-term and direct finance lease business is purchased by the Company, except that the Company offers to CAI, at cost, 10% of this long-term and direct finance lease business.

In connection with the acquisition of its equity interest in CAI, the Company loaned CAI $33.7 million under a Subordinated Note Agreement (Note) which is collateralized by all containers owned by CAI as of April 30, 1998 or thereafter acquired, subject to the priority security interest lien of CAI s senior credit facility, except for certain excluded collateral. Interest on the Note was calculated at an annual fixed rate of 10.5% payable quarterly. The original repayment terms required mandatory quarterly principle payments of $1.7 million beginning July 30, 2003 through July 30, 2008. The Note was subject to certain financial covenants and was cross-defaulted with CAI s senior credit facility, subject to the terms of a subordination agreement.

On June 27, 2002, CAI entered into an amended $110.0 million senior revolving credit agreement with a group of financial institutions. To facilitate the closing of this new credit facility, the Company agreed to extend the repayment terms of its Note so as to require mandatory quarterly principal payments of $1.7 million beginning July 30, 2006 through July 30, 2011 and modified certain financial covenants in the Note. Interest on the Note continues to accrue at an annual fixed rate of 10.5% and is payable quarterly. The Note continues to be cross-defaulted with CAI s credit agreement, subject to the terms of an amended and restated subordination agreement.

A total of $86.3 million was outstanding under CAI s senior revolving credit facility at September 30, 2002. Borrowings under CAI s senior credit facility are secured by substantially all CAI s assets and are payable on June 27, 2005. The senior credit facility contains various financial and other covenants. At June 30, 2002, CAI would not have been in compliance with one of the financial covenants then contained in the senior credit facility as well as similar covenants under two master lease agreements relating to equipment in CAI s fleet. CAI received amendments to these covenants in September 2002 which were made retroactive to June 30, 2002. As a result, CAI was in compliance as of June 30, 2002 with all senior credit facility and lease covenants as amended and continued to be in compliance as of September 30, 2002.

In March 2001, the Company completed the sale of 50,000 rail trailers and domestic containers to GE Capital Corporation, including all 40,000 rail trailers and domestic containers the Company acquired from TA in October 2000, for approximately $345.0 million.

In May 1999, our Microtech subsidiary acquired a 51% interest in Personal Computer Rentals, Inc. (PCR), a nationwide lessor of computers and related equipment. We also provided financing to PCR. During the three months ended September 30, 2001, we initiated a plan to dispose of PCR, a 51%-owned subsidiary, and to discontinue the operations of Microtech, a 75.5%-owned subsidiary and liquidate its lease portfolio. As a result of this decision, PCR and Microtech have been classified as discontinued operations in the consolidated financial statements. On December 31, 2001, we completed the sale of our 51% ownership stake of PCR to an investment group comprised of the management of PCR.

During the three months ended June 30, 2001, the Company initiated a bankruptcy claim against a customer and sought to collect receivables and to recover equipment values through its insurance policies. The Company demanded the return of approximately $48.6 million of equipment, including $8.5 million of direct finance leases, which were reclassified to leasing equipment. At September 30, 2002, the outstanding receivables from this customer, including amounts for equipment the Company anticipates will not be recovered, totaled approximately $33.5 million, all of which is covered by insurance (which is net of $1.0 million in reserves for amounts not covered by insurance). The receivables are included in other receivables, net in the accompanying condensed consolidated balance sheets. At this time, the Company has estimated no impairment upon the liquidation and/or re-lease of these assets after considering anticipated insurance proceeds. The maximum insurance coverage related to this claim is $35.0 million. The overall recovery of the asset values has been evaluated taking into consideration the equipment book value, the cost to recover and re-lease the equipment, and the total outstanding receivables, as well as the likelihood to collect through the recovery and sale of the equipment or the stipulated equipment values within the lease contracts that are covered by the insurance policies. The Company continued to record revenue from these leases through August 20, 2001 at which time, revenue recognition was discontinued, as contractual lease payments through August 20, 2001 were covered by the insurance policies. Over the past several months, the Company has provided the supporting documentation for its claim to an adjuster appointed by the insurance underwriters. Based upon discussions with the adjuster, the analysis of the supporting documentation is nearly complete and it is anticipated that a report of the adjuster s findings will be submitted to the underwriters in November 2002. The Company will continue to assess the overall recovery of the claim and will pursue its timely resolution. As additional information becomes available, reserves for the impairment of the asset values may be necessary.

As of September 30, 2002, commitments for capital expenditures totaled approximately $9.8 million. The Company believes that cash on hand, cash flow from operations, borrowings under credit facilities and the net proceeds of the issuance of debt and equity securities in appropriate markets will be sufficient to meet the working capital needs, capital expenditures and required debt repayments for the next twelve months. The Company s available liquidity at September 30, 2002 was $189.9 million consisting of $144.9 million of cash and marketable securities (excluding $23.3 million of cash within the chassis securitization facility) and $45.0 million of availability under our $215.0 million revolving credit facility. Required debt repayments are $179.0 million for the next twelve months. In addition, the Company expects to rely in substantial part on long-term financing for any purchase of equipment or strategic acquisitions to expand its business in the future. The Company cannot assure that additional long-term financing will be available for these purposes on acceptable terms or at all. In addition, from time to time, the Company explores new sources of capital both at the parent and subsidiary levels. For example, the Company has given consideration to the possibility of securitizing new categories of assets and has been seeking to develop a new source of financing by offering its convertible debentures to stockholders in a subscription rights offering.

On July 1, 2001, the Company restructured its relationship with The Ivy Group and its principals to provide the Company with managerial control over 6,047 chassis previously leased by Trac Lease, Inc. (Trac Lease), a wholly owned subsidiary of the Company, from The Ivy Group. As a result of the restructuring, the partners of The Ivy Group contributed these 6,047 chassis and certain other assets and liabilities to a newly formed subsidiary, Chassis Holdings I LLC (Chassis Holdings), in exchange for $26.0 million face value of preferred membership units and 10% of the common membership units, and Trac Lease contributed 902 chassis and $2.4 million in cash to Chassis Holdings in exchange for $3.0 million face value of preferred membership units and 90% of the common membership units. The preferred membership units are entitled to receive a preferred return prior to the receipt of any distributions by the holders of the common membership units. The value of the contributed chassis was determined by taking the arithmetic average of the results of independent appraisals performed by three nationally recognized appraisal firms in connection with the Company s establishment of a chassis securitization facility in July 2000. As the managing member of Chassis Holdings, Trac Lease exercises sole managerial control over the entity s operations. Chassis Holdings leases all of its chassis to Trac Lease at a rental rate equal to the then current Trac Lease fleet average per diem. Chassis Holdings and the holders of the preferred membership units are party to a Put/Call Agreement which provides that the holders of preferred units may put such units to Chassis Holdings under certain circumstances and Chassis Holdings may redeem such units under certain circumstances. Chassis Holdings will be required to make certain option payments to the holders of the preferred membership units in order to preserve its right to redeem such units. For the nine months ended September 30, 2002, dividends paid on the common units and distributions on the preferred units owned by The Ivy Group, totaling $2.3 million, are included in minority interest (income)/expense, net in the accompanying condensed consolidated statements of income.

As previously announced, the Company has authorized the repurchase up to 1,000,000 shares of its common stock. The shares will be purchased from time to time through open market purchases or privately negotiated transactions. During the first quarter of 2002, the Company purchased 2,100 shares for an aggregate purchase price of $.04 million. During the fourth quarter of 2001, the Company purchased 58,100 shares for an aggregate purchase price of $.9 million. Subsequent to September 30, 2002, the Company purchased 7,200 shares for an aggregate purchase price of $.09 million.

From time to time, we enter into discussions with third parties regarding potential acquisitions or business combinations. If additional capital were to be required for any such acquisition, there can be no assurance that such additional capital would be available on terms acceptable to us.

In July 2002, the Company commenced a registered subscription rights offering of up to $31.5 million of its 9.25% Convertible Redeemable Subordinated Debentures. The debentures were offered to holders of the Company s common stock pursuant to the exercise of non-transferable subscription rights and were to be convertible into shares of the Company s common stock. The Company had the right in its discretion to accept offers from other parties to purchase debentures not subscribed for by stockholders. On August 14, 2002, the Company terminated the subscription rights offering due to a delay in filing its Form 10-Q for the quarter ended June 30, 2002. The Company intends to re-commence the offering during November 2002.

Item 3: Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk. The nature of the Company s business exposes the Company to market risk arising from changes in interest rates. The Company manages interest rate risk to protect its margins on existing transactions. Interest rate risk is the risk of earnings volatility attributable to changes in interest rates. Additionally, the Company considers interest rate swap contracts as an integral part of borrowing transactions. The Company seeks to minimize its exposure by entering into amortizing interest rate swap contracts, which coincide with the principal and maturity of the underlying debt instruments hedged. The Company does not use leveraged swaps and does not use leverage in any of its investment activities that would put principal capital at risk.

For 2001, a 10 basis point change in interest rates would result in a $1.6 million change in the Company s pretax earnings.

Credit Risk. The Company maintains detailed credit records about customers. The Company s credit policy sets different maximum exposure limits for its customers. Credit criteria may include, but are not limited to, customer trade route, country, social and political climate, assessments of net worth, asset ownership, bank and trade credit references, credit bureau reports, and operational history.

In the past the Company has sought to reduce its credit risk by maintaining insurance coverage against lessee defaults. The Company s insurance policy covering such credit risks expired on January 31, 2002. We do not currently anticipate replacement coverage can be obtained upon terms acceptable to the Company. Even if replacement coverage is obtainable, we expect that premium rates and deductibles will increase as a result of general rate increases for this type of insurance as well as our historical claim experience and that of our competitors in the industry.

Item 4: Controls and Procedures

During the 90-day period prior to the filing of this report, management, including the Company s Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company s disclosure controls and procedures. Based upon that evaluation, and as of the date of that evaluation, the Company s Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures were effective, in all material respects, to ensure that information required to be disclosed in the reports the Company files under the Exchange Act is recorded, processed, summarized and reported as and when required. There have been no significant changes in the Company s internal controls or in other factors that could significantly affect internal controls subsequent to the date the Company carried out its evaluation.

32

PART II OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 2. Changes in Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

Exhibit 10.44	(1) Employment Agreement dated September 20, 2002 between Mitchell I. Gordon and the Company	
Exhibit 99:	Press Releases dated:	
	(1) 11/12/02	Interpool, Inc. Announced Increase in Cash Dividend on Common Stock
		Strong Cash Flow Delivers Third Increase in Dividend in Past 18 Months
	(2) 10/16/02	

	Interpool, Inc. Named as One of Forbes 200 Best Small Companies in America for 2002
(3) 10/16/02	Interpool, Inc. Commences Tender Offer For Its Outstanding 6 5/8% Notes Due 2003
(4) 10/04/02	Chassis Critical to Easing Shipping Woes Caused by Work Stoppage at West Coast Ports
(5) 10/01/02	Interpool, Inc. Completes $540 Million AAA-Rated Asset-Backed Financing Company Capitalizes on Lower Interest Rate Environment by Locking in Long Term Facility
(6) 09/24/02	Interpool, Inc. To Pay Cash Dividend On Common Stock
(7) 09/23/02	Interpool, Inc. Reports Second Quarter 2002 Results Container Fleet Size and Utilization Rates up from First Quarter 2002
(8) 09/20/02	Interpool, Inc. to Webcast Second Quarter 2002 Earnings Results

(b) Reports on Form 8-K:

On August 5, 2002, the Registrant filed a current report on Form 8-K reporting a change in the Company s independent public accountants. Arthur Andersen LLP has been dismissed and KMPG LLP has been engaged as the Company s independent public accountants of record.

On August 15, 2002, the Registrant filed a current report on Form 8-K reporting that its financial statements for the period ended June 30, 2002 would include consolidated information for Container Applications International, Inc., the Registrant s 50% owned subsidiary which engages in the short term container leasing business. As a result of this new consolidation, the filing of the Registrant s second quarter financial results on Form 10-Q was delayed and the pending subscription rights offering of convertible debentures was terminated. The Registrant reported its intention to re-commence the rights offering.

33

SIGNATURES

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

INTERPOOL, INC.

Dated: November 14, 2002	\s\ Martin Tuchman Martin Tuchman Chief Executive Officer
Dated: November 14, 2002	\s\ William Geoghan William Geoghan Senior Vice President

34

CERTIFICATIONS

I, Martin Tuchman, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Interpool, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

(a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

(b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and

(c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of the registrant s board of directors:

(a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ Martin Tuchman

Martin Tuchman
Chairman and Chief Executive Officer

CERTIFICATIONS

I, Mitchell I. Gordon, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Interpool, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

(a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

(b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and

(c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of the registrant s board of directors:

(a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ Mitchell I. Gordon

Mitchell I. Gordon
Executive Vice President and
Chief Financial Officer

36

CERTIFICATIONS

I, Martin Tuchman, Chairman and Chief Executive Officer of Interpool, Inc. (the Company), pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, do hereby certify as follows:

1. The quarterly report of the Company on Form 10-Q for the period ended September 30, 2002 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in such quarterly report fairly presents, in all material respects, the financial condition and results of operations of the Company.

IN WITNESS WHEREOF, I have executed this Certification this 14th day of November, 2002.

/s/ Martin Tuchman

Martin Tuchman
Chief Executive Officer

I, Mitchell I. Gordon, Executive Vice President and Chief Financial Officer of Interpool, Inc. (the Company), pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, do hereby certify as follows:

1. The quarterly report of the Company on Form 10-Q for the period ended September 30, 2002 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in such quarterly report fairly presents, in all material respects, the financial condition and results of operations of the Company.

IN WITNESS WHEREOF, I have executed this Certification this 14th day of November, 2002.

/s/ Mitchell I. Gordon

Mitchell I. Gordon
Executive Vice President and
Chief Financial Officer

37

INDEX TO EXHIBITS

Filed with Interpool, Inc.
Report on Form 10-Q for the Quarter Ended September 30, 2002

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