CAI International, Inc.
Form 10-Q
October 20, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2017

or

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

For the transition period from to

Commission file number: 001-33388

CAI International, Inc.

(Exact name of registrant as specified in its charter)

Delaware	94-3109229
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
Steuart Tower, 1 Market Plaza, Suite 900 San Francisco, California	94105
(Address of principal executive offices)	(Zip Code)

415-788-0100

(Registrant's telephone number, including area code)

None

(Former name, former address and former fiscal year, if changed since last report)

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 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

1

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

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

If an emerging growth company, indicate by check mark of the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

Common	September 30, 2017
Common Stock, $.0001 par value per share	19,268,083 shares

Table of Contents

CAI INTERNATIONAL, INC.

INDEX

3

Table of Contents

SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains certain forward-looking statements, including, without limitation, statements concerning the conditions in our industry, our operations, our economic performance and financial condition, including, in particular, statements relating to our business, operations, growth strategy and service development efforts. The Private Securities Litigation Reform Act of 1995 provides a “safe harbor” for certain forward-looking statements so long as such information is identified as forward-looking and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those projected in the information. When used in this Quarterly Report on Form 10-Q, the words “may,” “might,” “should,” “estimate,” “project,” “plan,” “anticipate,” “expect,” “intend,” “outlook,” “believe” and other similar expressions are intended t identify forward-looking statements and information. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of their dates. These forward-looking statements are based on estimates and assumptions by our management that, although we believe to be reasonable, are inherently uncertain and subject to a number of risks and uncertainties. These risks and uncertainties include, without limitation, those in our Annual Report on Form 10-K for the year ended December 31, 2016 filed with the Securities and Exchange Commission (SEC) on March 13, 2017 and our other reports filed with the SEC. We undertake no obligation to publicly update or revise any forward-looking statement as a result of new information, future events or otherwise, except as otherwise required by law. Reference is also made to such risks and uncertainties detailed from time to time in our other filings with the SEC.

Table of Contents

PART I — FINANCIAL INFORMATION

ITEM 1.FINANCIAL STATEMENTS

CAI INTERNATIONAL, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share information)

(UNAUDITED)

	September 30, 2017	December 31, 2016
Assets		
Current assets		
Cash	$ 12,508	$ 15,685
Cash held by variable interest entities	22,445	30,449
Accounts receivable, net of allowance for doubtful accounts of $1,636 and $1,340 at September 30, 2017 and December 31, 2016, respectively	69,478	63,745
Current portion of net investment in direct finance leases	27,947	19,959
Prepaid expenses and other current assets	5,016	5,315
Total current assets	137,394	135,153
Restricted cash	12,217	6,192
Rental equipment, net of accumulated depreciation of $484,428 and $421,153 at September 30, 2017 and December 31, 2016, respectively	1,979,012	1,807,010
Net investment in direct finance leases	199,994	80,582
Goodwill	15,794	15,794
Intangible assets, net of accumulated amortization of $2,974 and $2,681 at September 30, 2017 and December 31, 2016, respectively	8,156	9,691
Furniture, fixtures and equipment, net of accumulated depreciation of $3,131 and $2,833 at September 30, 2017 and December 31, 2016, respectively	370	550
Other non-current assets	3,220	962
Total assets (1)	$ 2,356,157	$ 2,055,934
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$ 6,320	$ 13,804
Accrued expenses and other current liabilities	13,540	11,778
Due to container investors	4,119	7,077

Unearned revenue	8,361	10,613
Current portion of debt	133,322	95,527
Rental equipment payable	190,180	25,207
Total current liabilities	355,842	164,006
Debt	1,450,588	1,380,499
Deferred income tax liability	51,193	51,804
Other long term liabilities	-	2,121
Total liabilities (2)	1,857,623	1,598,430
Stockholders' equity		
Common stock: par value $.0001 per share; authorized 84,000,000 shares; issued and outstanding 19,268,083 and 19,057,217 shares at September 30, 2017 and December 31, 2016, respectively	2	2
Additional paid-in capital	143,845	141,058
Accumulated other comprehensive loss	(6,390)	(8,132)
Retained earnings	361,077	324,576
Total stockholders' equity	498,534	457,504
Total liabilities and stockholders' equity	$ 2,356,157	$ 2,055,934

5

Table of Contents

(1) Total assets at September 30, 2017 and December 31, 2016 include the following assets of certain variable interest entities (VIEs) that can only be used to settle the liabilities of those VIEs: Cash, $22,445 and $30,449; Net investment in direct finance leases, $4,423 and $7,331; and Rental equipment, net of accumulated depreciation, $58,075 and $62,477, respectively.

(2) Total liabilities at September 30, 2017 and December 31, 2016 include the following VIE liabilities for which the VIE creditors do not have recourse to CAI International, Inc.: Current portion of debt, $23,365 and $30,980; Debt, $71,086 and $74,887, respectively.

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

CAI INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Revenue				
Container lease income	$ 61,870	$ 49,661	$ 169,784	$ 152,875
Rail lease income	7,279	7,614	23,459	22,462
Logistics revenue	21,012	21,197	61,116	41,743
Total revenue	90,161	78,472	254,359	217,080
Operating expenses				
Depreciation of rental equipment	27,788	29,873	82,814	77,401
Storage, handling and other expenses	3,506	8,802	16,651	27,176
Logistics transportation costs	17,855	18,045	51,608	35,127
(Gain) loss on sale of used rental equipment	(1,663)	3,323	(2,539)	7,950
Administrative expenses	10,781	11,067	31,212	28,750
Total operating expenses	58,267	71,110	179,746	176,404
Operating income	31,894	7,362	74,613	40,676
Other expenses				
Net interest expense	13,959	10,902	37,916	31,535
Other expense	449	85	651	407
Total other expenses	14,408	10,987	38,567	31,942
Income (loss) before income taxes and non-controlling interest	17,486	(3,625)	36,046	8,734
Income tax (benefit) expense	(101)	1,826	549	3,320
Net income (loss)	17,587	(5,451)	35,497	5,414
Net income attributable to non-controlling interest	-	-	-	37
Net income (loss) attributable to CAI common stockholders	$ 17,587	$ (5,451)	$ 35,497	$ 5,377
Net income (loss) per share attributable to CAI common stockholders				
Basic	$ 0.92	$ (0.28)	$ 1.86	$ 0.28
Diluted	$ 0.90	$ (0.28)	$ 1.83	$ 0.28
Weighted average shares outstanding				

Basic	19,180	19,130	19,108	19,427
Diluted	19,633	19,130	19,422	19,498

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

CAI INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net income (loss)	$ 17,587	$ (5,451)	$ 35,497	$ 5,414
Other comprehensive income, net of tax:				
Foreign currency translation adjustments	698	137	1,742	1,047
Comprehensive income (loss)	18,285	(5,314)	37,239	6,461
Comprehensive income attributable to non-controlling interest	-	-	-	37
Comprehensive income (loss) attributable to CAI common stockholders	$ 18,285	$ (5,314)	$ 37,239	$ 6,424

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

CAI INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(UNAUDITED)

	Nine Months Ended September 30,			
	2017		2016	
Cash flows from operating activities				
Net income	$	35,497	$	5,414
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation		83,088		77,636
Amortization of debt issuance costs		2,400		2,217
Amortization of intangible assets		1,536		682
Stock-based compensation expense		1,539		1,320
Reduction in contingent consideration		(2,211)		(1,000)
Unrealized loss on foreign exchange		42		82
(Gain) loss on sale of used rental equipment		(2,539)		7,950
Loss on disposal of subsidiary		-		146
Deferred income taxes		393		2,193
Bad debt expense		750		2,458
Changes in other operating assets and liabilities:				
Accounts receivable		(6,280)		(7,560)
Prepaid expenses and other assets		(72)		(191)
Accounts payable, accrued expenses and other current liabilities		(5,887)		1,540
Due to container investors		(2,958)		(32)

Unearned revenue		(540)		1,013
Net cash provided by operating activities		104,758		93,868
Cash flows from investing activities				
Purchase of rental equipment		(277,769)		(170,582)
Acquisitions, net of cash acquired		-		(15,620)
Proceeds from sale of used rental equipment		48,863		46,137
Disposal of subsidiary, net of cash disposed of		-		(460)
Purchase of furniture, fixtures and equipment		(91)		(92)
Receipt of principal payments from direct financing leases		12,362		17,368
Net cash used in investing activities		(216,635)		(123,249)
Cash flows from financing activities				
Proceeds from debt		556,544		432,540
Principal payments on debt		(448,436)		(408,375)
Debt issuance costs		(3,129)		(1,461)
(Increase) decrease in restricted cash		(6,025)		765
Repurchase of stock		-		(9,176)
Exercise of stock options		1,362		-
Net cash provided by financing activities		100,316		14,293
Effect on cash of foreign currency translation		380		1
Net decrease in cash		(11,181)		(15,087)
Cash at beginning of the period		46,134		52,553
Cash at end of the period	$	34,953	$	37,466
Supplemental disclosure of cash flow information				
Cash paid during the period for:				
Income taxes	$	174	$	752
Interest		35,014		29,617
Supplemental disclosure of non-cash investing				

and financing activity				
Transfer of rental equipment to direct finance lease	$	144,907	$	14,816
Transfer of direct finance lease to rental equipment		291		-

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(1) The Company and Nature of Operations

Organization

CAI International, Inc., together with its subsidiaries (collectively, CAI or the Company), is a transportation finance and logistics company. The Company purchases equipment, primarily intermodal shipping containers and railcars, which it leases to its customers. The Company also manages equipment for third-party investors. In operating its fleet, the Company leases, re-leases and disposes of equipment and contracts for the repair, repositioning and storage of equipment. The Company also provides domestic and international logistics services.

In February 2016, the Company purchased Challenger Overseas LLC (Challenger), a Non-Vessel Operating Common Carrier, for approximately $10.8 million. Challenger is headquartered in Eatontown, New Jersey.

In June 2016, the Company purchased Hybrid Logistics, Inc. and its affiliate, General Transportation Services, Inc. (collectively, Hybrid), asset light truck brokers, for approximately $12.0 million. Hybrid is headquartered in Portland, Oregon.

The Company's common stock is traded on the New York Stock Exchange under the symbol "CAI." The Company's corporate headquarters are located in San Francisco, California.

Basis of Presentation

The accompanying unaudited consolidated financial statements include the financial statements of CAI International, Inc., its wholly-owned subsidiaries, and its previously 80%-owned subsidiary, CAIJ, Inc. (CAIJ), up to its date of disposal in April 2016. All significant intercompany balances and transactions have been eliminated in consolidation.

In the opinion of management, the accompanying unaudited consolidated financial statements contain all normal, recurring adjustments necessary to present fairly the Company's financial position as of September 30, 2017 and December 31, 2016, the Company's results of operations for the three and nine months ended September 30, 2017 and 2016, and the Company's cash flows for the nine months ended September 30, 2017 and 2016. The results of operations and cash flows for the periods presented are not necessarily indicative of the results of operations or cash flows which may be reported for the remainder of 2017 or in any future period. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) have been condensed or omitted. The accompanying unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2016, included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC) on March 13, 2017.

(2) Accounting Policies and Recent Accounting Pronouncements

Accounting Policies

Container rental equipment is recorded at original cost and depreciated to an estimated residual value on a straight-line basis over its estimated useful life. The estimated useful lives and residual values of the Company's container equipment are based on historical disposal experience and the Company's expectations for future used container sale prices. Depreciation estimates are reviewed on a regular basis to determine whether sustained changes have taken place in the useful lives of equipment or assigned residual values, which would suggest that a change in depreciation estimates is warranted.

After the Company conducted its regular depreciation policy review for 2016, it concluded that a change in the estimated residual value for 40-foot high cube dry van containers from $1,650 to $1,400 per container, effective July 1, 2016, was appropriate. The change increased the Company's depreciation expense by $4.4 million, decreased net income by $4.3 million, and decreased diluted earnings per share by $0.22, for the nine months ended September 30, 2017.

The Company continuously monitors disposal prices across its entire portfolio for indications of a sustained market downturn. The Company will adjust its residual value estimates as and when conditions warrant.

Except as described below in "Recent Accounting Pronouncements," there were no changes to the Company's accounting policies during the nine months ended September 30, 2017. See Note 2 to the consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2016, filed with the SEC on March 13, 2017, for a description of the Company's significant accounting policies.

Table of Contents

CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-09, Improvements to Employee Share-Based Payment Accounting (ASU 2016-09). The new standard simplifies certain aspects of the accounting for share-based payment transactions, including income taxes, classification of awards and classification on the statement of cash flows. The new guidance also allows an entity to make a policy election to account for forfeitures as they occur. The Company adopted ASU 2016-09 effective January 1, 2017. Accordingly, excess tax benefits or deficiencies from stock-based compensation are now reflected in the consolidated statements of income as a component of the provision for income taxes, whereas they were previously recognized in equity. As a result of the adoption of ASU 2016-09, the Company recognized $1.0 million in deferred tax assets associated with excess tax benefits not previously recognized in deferred taxes as a cumulative-effect adjustment to retained earnings as of January 1, 2017. Adoption of the new standard did not have a material impact on our provision for income taxes for the three and nine months ended September 30, 2017. The Company elected to apply the change in presentation to the statements of cash flows prospectively and elected to account for forfeitures as they occur, rather than estimate expected forfeitures, which did not have a material impact on the Company's consolidated financial statements.

(3) Insurance Receivable and Impairment

In August 2016, Hanjin Shipping Co., Ltd. (Hanjin) filed for bankruptcy protection from its creditors. Based on the recovery of Hanjin containers to date and prior experience, the Company believes that most of its containers will be recovered. As of September 30, 2017, the Company has recovered approximately 92% of the containers that were on lease to Hanjin. The Company maintains insurance to cover the value of containers that are unlikely to be recovered from its customers, the cost to recover and repair containers, and up to 180 days of lost lease rental income, subject to deductibles of $0.5 million and $2.0 million.

During the year ended December 31, 2016, the Company recorded an impairment of $3.2 million representing the book value of containers the Company estimated would not be recovered from Hanjin. As of December 31, 2016, an insurance receivable of $3.8 million was recorded for $1.2 million of estimated unrecoverable containers in excess of the insurance deductible, which was recorded in depreciation expense, and $2.6 million of recovery costs, which was recorded as a reduction to storage, handling and other expenses for the year ended December 31, 2016. During the nine months ended September 30, 2017, the Company recorded an additional insurance receivable of $7.4 million for $2.2 million of lost lease rental income, recognized as container lease income, and $1.5 million of repair costs and $3.7 million of recovery costs, recorded as a reduction to storage, handling and other expenses. The Company also received insurance proceeds of $8.0 million, which was recorded as a reduction to the insurance receivable. As of September 30, 2017, the insurance receivable related to this customer was $3.2 million, of which payment of $1.5 million was received in October 2017.

(4) Consolidation of Variable Interest Entities

The Company regularly performs a review of its container fund arrangements with investors to determine whether or not it has a variable interest in the fund and if the fund is a variable interest entity (VIE). If it is determined that the Company does not have a variable interest in the fund, further analysis is not required and the Company does not consolidate the fund. If it is determined that the Company does have a variable interest in the fund and the fund is a VIE, a further analysis is performed to determine if the Company is a primary beneficiary of the VIE and meets both of the following criteria under FASB ASC Topic 810:

- it has power to direct the activities of a VIE that most significantly impact the VIE’s economic performance; and
- it has the obligation to absorb losses of the VIE that could be potentially significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE.

If in the Company’s judgment both of the above criteria are met, the VIE’s financial statements are included in the Company’s consolidated financial statements as required under FASB ASC Topic 810, Consolidation.

The Company currently enters into two types of container fund arrangements with investors which are reviewed under FASB ASC Topic 810, Consolidation. These arrangements include container funds that the Company manages for investors and container funds that have entered into financing arrangements with investors. Several of the funds that the Company manages and funds under financing arrangements are Japanese container funds that were established under separate investment agreements allowed under Japanese commercial laws (see Note 14). Each of the funds is financed by unrelated Japanese third-party investors.

Managed Container Funds

The fees earned by the Company for arranging, managing and establishing container funds are commensurate with the level of effort required to provide those services, and are at or above the same level of seniority as other operating liabilities of the funds that are incurred in the normal course of business. As such, the Company does not have a variable interest in the managed containers funds, and does not consolidate those funds. The Company recognizes gain on sale of containers to the unconsolidated funds as sales in the ordinary course of business. No container portfolios were sold to the Japanese funds in the three and nine months ended September 30, 2017 and 2016.

Table of Contents

CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Collateralized Financing Obligations

The Company has transferred containers to Japanese investor funds while concurrently entering into lease agreements for the same containers, under which the Company leases the containers back from the Japanese investors. In accordance with FASB ASC Topic 840, Sale-Leaseback Transactions, the Company concluded these were financing transactions under which sale-leaseback accounting was not applicable.

The terms of the transactions with container funds under financing arrangements include options for the Company to purchase the containers from the funds at a fixed price. As a result of the residual interest resulting from the fixed price call option, the Company concluded that it may absorb a significant amount of the variability associated with the funds' anticipated economic performance and, as a result, the Company has a variable interest in the funds. The funds are considered VIEs under FASB ASC Topic 810, Consolidation, because, as lessee of the funds, the Company has the power to direct the activities that most significantly impact each entity's economic performance, including the leasing and managing of containers owned by the funds. As the Company has the power to direct the activities that most significantly impact the economic performance of the VIEs and the variable interest provides the Company with the right to receive benefits from the entity that could potentially be significant to the funds, the Company determined that it is the primary beneficiary of these VIEs and included the VIEs' assets and liabilities as of September 30, 2017, and December 31, 2016, and the results of the VIEs' operations and cash flows for the three and nine months ended September 30, 2017 and 2016, in the Company's consolidated financial statements.

The containers that were transferred to the Japanese investor funds had a net book value of $66.1 million as of September 30, 2017. The container equipment, together with $22.4 million of cash held by the investor funds that can only be used to settle the liabilities of the VIEs, has been included on the Company's consolidated balance sheets with the related liability presented in the debt section of the Company's consolidated balance sheets as collateralized financing obligations of $90.7 million and term loans held by VIE of $3.7 million. No gain or loss was recognized by the Company on the initial consolidation of the VIEs. Containers sold to the Japanese investor funds during the three months ended September 30, 2017 and 2016, had a net book value of $6.0 million and $9.2 million, respectively. Containers sold to the Japanese investor funds during the nine months ended September 30, 2017 and 2016, had a book value of $13.2 million and $26.1 million, respectively.

(5) Acquisitions

In 2016, the Company completed the acquisitions of Challenger and Hybrid, for total consideration of $22.8 million, $6.0 million of which was contingent and based on their future performance. The aggregate allocation of the combined purchase price included $1.2 million of cash, $9.9 million of identifiable intangible assets, $12.9 million of residual goodwill, and $1.2 million of net liabilities assumed.

The contingent consideration liability was $2.2 million as of December 31, 2016. Expected future payments of $2.1 million and $0.1 million were recorded in Other long-term liabilities and Accrued expenses and Other current liabilities, respectively, in the Company's consolidated balance sheets at December 31, 2016. Based on the forecasted future performance of Challenger and Hybrid, it has been estimated that there will be no future payments made and, as a result, the fair value of the contingent consideration liability has been estimated to be zero at September 30, 2017. The following table provides a reconciliation of the contingent consideration liability measured at estimated fair value based on the balance as of December 31, 2016 and updated quarterly for the nine months ended September 30, 2017 (in thousands):

	2017
January 1	$ 2,211
Net decrease in estimated fair value of contingent consideration included in Administrative expenses	
Three months ended March 31, 2017	-
Three months ended June 30, 2017	(631)
Three months ended September 30, 2017	(1,580)
September 30	$ -

12

Table of Contents

CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(6) Rental Equipment

The following table provides a summary of the Company’s rental equipment (in thousands):

	September 30, 2017	December 31, 2016
Dry containers	$ 1,529,405	$ 1,322,508
Refrigerated containers	346,996	350,776
Other specialized equipment	162,357	164,934
Railcars	424,682	389,945
	2,463,440	2,228,163
Accumulated depreciation	(484,428)	(421,153)
Rental equipment, net of accumulated depreciation	$ 1,979,012	$ 1,807,010

(7) Net Investment in Direct Finance Leases

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

	September 30, 2017	December 31, 2016
Gross finance lease receivables (1)	$ 329,223	$ 123,563
Unearned income (2)	(101,282)	(23,022)
Net investment in direct finance leases	$ 227,941	$ 100,541

(1) At the inception of the lease, the Company records the total minimum lease payments, executory costs, if any, and unguaranteed residual value as gross finance lease receivables. The gross finance lease receivables are reduced as customer payments are received. There was $21.9 million and $2.1 million unguaranteed residual value at

September 30, 2017 and December 31, 2016, respectively, included in gross finance lease receivables. There were no executory costs included in gross finance lease receivables as of September 30, 2017 and December 31, 2016.

(2) The difference between the gross finance lease receivables and the cost of the equipment or carrying amount at the lease inception is recorded as unearned income. Unearned income, together with initial direct costs, are amortized to income over the lease term so as to produce a constant periodic rate of return. There were no unamortized initial direct costs as of September 30, 2017 and December 31, 2016.

In order to estimate the allowance for losses contained in gross finance lease receivables, the Company reviews the credit worthiness of its customers on an ongoing basis. The review includes monitoring credit quality indicators, the aging of customer receivables and general economic conditions.

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

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

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

Tier 3— Customers in this category exhibit volatility in payments on a regular basis.

Table of Contents

CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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

	September 30, 2017	December 31, 2016
Tier 1	$ 273,742	$ 74,777
Tier 2	55,481	48,786
Tier 3	-	-
	$ 329,223	$ 123,563

Contractual maturities of the Company's gross finance lease receivables subsequent to and as of September 30, 2017 for the years ending September 30 were as follows (in thousands):

2018	$ 46,735
2019	62,606
2020	32,929
2021	30,873
2022	27,974
2023 and thereafter	128,106
	$ 329,223

(8) Intangible Assets

The Company amortizes intangible assets on a straight line-basis over their estimated useful lives as follows:

Trademarks and tradenames	2-3 years
Customer relationships	8 years

The Company's intangible assets as of September 30, 2017 and December 31, 2016 were as follows (in thousands):

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
September 30, 2017			
Trademarks and tradenames	$ 1,786	$ (1,269)	$ 517
Customer relationships	9,344	(1,705)	7,639
	$ 11,130	$ (2,974)	$ 8,156
December 31, 2016			
Trademarks and tradenames	$ 3,028	$ (1,850)	$ 1,178
Customer relationships	9,344	(831)	8,513
	$ 12,372	$ (2,681)	$ 9,691

Total amortization expense was $0.4 million for both the three months ended September 30, 2017 and 2016, respectively, and $1.5 million and $0.7 million for the nine months ended September 30, 2017 and 2016, respectively, and was included in administrative expenses in the consolidated statements of income.

As of September 30, 2017, estimated future amortization expenses are as follows (in thousands):

2018	$ 1,637
2019	1,213
2020	1,167
2021	1,167
2022	1,167
2023 and thereafter	1,805
	$ 8,156

Table of Contents

CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(9) Debt

Details of the Company's debt as of September 30, 2017 and December 31, 2016 were as follows (dollars in thousands):

	September 30, 2017 Outstanding			December 31, 2016 Outstanding			
	Current	Long-term	Average Interest	Current	Long-term	Average Interest	Maturity
Revolving credit facility	$ -	$ 407,000	3.0%	$ -	$ 526,000	2.5%	March 2020
Revolving credit facility - Rail	-	254,000	2.7%	-	223,500	2.4%	October 2020
Revolving credit facility - Euro	-	14,534	2.0%	-	-	-	September 2020
Term loan	22,350	-	3.2%	1,800	21,900	2.9%	April 2018
Term loan	9,000	114,000	2.8%	9,000	120,750	2.3%	October 2019
Term loan	7,000	84,250	3.0%	7,000	89,500	2.5%	June 2021
Term loan	1,188	16,827	3.4%	1,158	17,723	3.4%	December 2020
Term loan	2,780	44,270	3.6%	2,705	46,365	3.6%	August 2021
Senior secured notes	6,110	58,885	4.9%	6,110	64,995	4.9%	September 2022
Asset-backed notes	65,307	394,311	3.5%	40,000	202,875	3.4%	June 2042
Collateralized financing obligations	23,365	67,343	1.3%	28,693	71,346	1.1%	September 2020
Term loans held by VIE	-	3,743	2.7%	2,287	3,541	2.5%	June 2019
	137,100	1,459,163		98,753	1,388,495		
Debt issuance costs	(3,778)	(8,575)		(3,226)	(7,996)		
Total Debt	$ 133,322	$ 1,450,588		$ 95,527	$ 1,380,499		

On June 16, 2017, the Company entered into an amendment to the Third Amended and Restated Revolving Credit Agreement, pursuant to which the revolving credit facility was amended to increase the commitment level from $775.0 million to $960.0 million.

The Company maintains its revolving credit facilities to finance the acquisition of rental equipment and for general working capital purposes. As of September 30, 2017, the Company had $813.9 million in total availability under its revolving credit facilities (net of $0.1 million in letters of credit).

On July 6, 2017, CAL Funding III Limited (CAL Funding III), a wholly-owned indirect subsidiary of CAI, issued $240.9 million of 3.6% Class A fixed rate asset-backed notes and $12.2 million of 4.6% Class B fixed rate asset-backed notes (collectively, the Notes). Principal and interest on the Notes is payable monthly commencing on July 25, 2017, with the Notes maturing in June 2042. The proceeds from the Notes were used for general corporate purposes, including repayment of debt by the Company. The Notes are secured by all of the assets of CAL Funding III.

The agreements relating to all of the Company's debt contain various financial and other covenants. As of September 30, 2017, the Company was in compliance with all of its debt covenants.

For further information on the Company's debt instruments, see Note 10 to the consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2016, filed with the SEC on March 13, 2017.

(10) Stock–Based Compensation Plan

Stock Options

The Company grants stock options from time to time to certain employees and independent directors pursuant to its 2007 Equity Incentive Plan, as amended (Plan). Under the Plan, a maximum of 3,421,980 share awards may be granted.

Stock options granted to employees have a vesting period of four years from grant date, with 25% vesting after one year, and 1/48th vesting each month thereafter until fully vested. Stock options granted to independent directors vest in one year. All of the stock options have a contractual term of ten years.

Table of Contents

CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following table summarizes the Company’s stock option activities for the nine months ended September 30, 2017 and 2016:

	Nine Months Ended September 30,			
	2017		2016	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Options outstanding at January 1	1,428,255	$ 16.31	1,189,255	$ 18.08
Options granted	230,500	$ 16.80	245,000	$ 7.87
Options exercised	(240,173)	$ 11.40	-	$ -
Options forfeited/cancelled	-	$ 16.94	(6,000)	$ 21.99
Options outstanding at September 30	1,418,582	$ 17.22	1,428,255	$ 16.31
Options exercisable	975,087	$ 18.24	1,033,518	$ 17.47
Weighted average remaining term	5.0 years		4.7 years	

The aggregate intrinsic value of stock options exercised during the nine months ended September 30, 2017 was $2.2 million. The aggregate intrinsic value of all options outstanding as of September 30, 2017 was $18.6 million based on the closing price of the Company’s common stock of $30.32 per share on September 29, 2017, the last trading day of the quarter.

The Company recognized stock-based compensation expense relating to stock options of $0.4 million and $0.3 million for the three months ended September 30, 2017 and 2016, respectively, and $1.2 million and $1.0 million for the nine months ended September 30, 2017 and 2016, respectively. As of September 30, 2017, the remaining unamortized stock-based compensation cost relating to stock options granted to the Company’s employees and independent directors was approximately $2.9 million, which is to be recognized over the remaining weighted average vesting period of approximately 2.5 years.

The fair value of stock options granted to the Company’s employees and independent directors was estimated using the Black-Scholes-Merton pricing model using the following weighted average assumptions:

	Nine Months Ended September 30,	
	2017	2016
Stock price	$ 16.80	$ 7.87
Exercise price	$ 16.80	$ 7.87
Expected term (years)	5.50 - 6.25	5.50 - 6.25
Expected volatility (%)	56.40 - 57.50	45.40 - 46.70
Risk-free interest rate (%)	1.77 - 2.14	1.30 - 1.40
Dividend yield (%)	-	-

The expected option term is calculated using the simplified method in accordance with SEC guidance. The expected volatility was derived from the average volatility of the Company's stock over a period approximating the expected term of the options. The risk-free rate is based on the daily U.S. Treasury yield curve with a term approximating the expected term of the options. No forfeiture rate was estimated on all options granted during the nine months ended September 30, 2017, as the Company accounts for forfeitures as they occur (see Note 2).

Table of Contents

CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Restricted Stock

The Company grants restricted stock from time to time to certain employees pursuant to the Plan. The restricted stock is valued based on the closing price of the Company's stock on the date of grant and has a vesting period of four years. The following table summarizes the activity of restricted stock under the Plan:

	Number of Shares of Restricted Stock	Weighted Average Grant Date Fair Value
Restricted stock outstanding, December 31, 2016	65,802	$ 14.75
Restricted stock granted	37,414	$ 17.14
Restricted stock vested	(24,674)	$ 17.83
Restricted stock outstanding, September 30, 2017	78,542	$ 14.92

The Company recognized $0.1 million of stock-based compensation expense relating to restricted stock for both the three months ended September 30, 2017 and 2016, and $0.4 million and $0.3 million for the nine months ended September 30, 2017 and 2016, respectively. As of September 30, 2017, unamortized stock-based compensation expense relating to restricted stock was $1.0 million, which will be recognized over the remaining average vesting period of 2.6 years.

Stock-based compensation expense is recorded as a component of administrative expenses in the Company's consolidated statements of income with a corresponding credit to additional paid-in capital in the Company's consolidated balance sheets.

(11) Income Taxes

The consolidated income tax expense for the three and nine months ended September 30, 2017 and 2016, was determined based upon estimates of the Company's consolidated annual effective income tax rate for the years ending December 31, 2017 and 2016, respectively. The difference between the consolidated annual effective income tax rate and the U.S. federal statutory rate is primarily attributable to foreign income taxes, state income taxes and the effect of certain permanent differences.

The Company's estimated effective tax rate was 1.5% at September 30, 2017, compared to 38.0% at September 30, 2016. The lower estimated effective tax rate at September 30, 2017 was due to a significant increase in the proportion of pretax income generated in lower tax jurisdictions.

The Company accounts for uncertain tax positions based on an evaluation as to whether it is more likely than not that a position will be sustained on audit, including resolution of any related appeals or litigation processes. This evaluation is based on all available evidence and assumes that the appropriate tax authorities have full knowledge of all relevant information concerning the tax position. Once it has been determined that a tax position is more likely than not to be sustained on its technical merits, the tax benefit recognized is based on the largest amount that is greater than 50% likely of being realized upon ultimate settlement. As of September 30, 2017, the Company had unrecognized tax benefits of $0.2 million, which if recognized, would reduce the Company's effective tax rate. Total accrued interest relating to unrecognized tax benefits was less than $0.1 million as of September 30, 2017. The Company does not believe the total amount of unrecognized tax benefits as of September 30, 2017 will change for the remainder of 2017.

The Company was notified on May 1, 2017 that their 2015 federal income tax return was selected for examination. An initial meeting with the examining agent was held in August 2017. The examination is in its preliminary data gathering stage.

(12) Fair Value of Financial Instruments

The carrying amounts reported in the consolidated balance sheets for cash, accounts receivable and accounts payable approximate fair value because of the immediate or short-term maturity of these financial instruments. The Company's asset-backed notes of $459.6 million and collateralized financing obligations of $90.7 million as of September 30, 2017 were estimated to have a fair value of approximately $458.0 million and $92.2 million, respectively, based on the fair value of estimated future payments calculated using prevailing interest rates. The fair value of these financial instruments would be categorized as Level 2 in the fair value hierarchy. Management believes that the balances of the Company's revolving credit facilities of $675.5 million, term loans totaling $301.7 million, senior secured notes of $65.0 million, term loans held by VIE of $3.7 million and net investment in direct finance leases of $227.9 approximate their fair values as of September 30, 2017. The fair value of these financial instruments would be categorized as Level 2 in the fair value hierarchy.

CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(13) Commitments and Contingencies

In addition to its debt obligations described in Note 9 above, the Company had commitments to purchase approximately $63.9 million of containers and $150.2 million of railcars as of September 30, 2017; $63.9 million of containers and $113.5 million of railcars in the twelve months ending September 30, 2018 and $36.7 million of railcars in the twelve months ending September 30, 2019. The Company also utilizes certain office facilities and equipment under long-term non-cancellable operating lease agreements with total future minimum lease payments of approximately $4.3 million as of September 30, 2017.

(14) Related Party Transactions

The Company has transferred legal ownership of certain containers to Japanese container funds that were established by Japan Investment Adviser Co., Ltd. (JIA) and CAIJ, Inc. (CAIJ). Prior to April 2016, CAIJ was an 80%-owned subsidiary of CAI with the remaining 20% owned by JIA. Prior to the transfer of containers from the Company, the container funds received contributions from unrelated Japanese investors, under separate Japanese investment agreements allowed under Japanese commercial laws. The contributions were used to purchase container equipment from the Company. Under the terms of the agreements, the CAI-related Japanese entities manage the activities of certain Japanese entities but may outsource the whole or part of each operation to a third party. Pursuant to its services agreements with investors, the Japanese container funds outsourced the general management of their operations to CAIJ. The Japanese container funds also entered into equipment management service agreements and financing arrangements whereby the Company managed the leasing activity of containers owned by the Japanese container funds.

As described in Note 4, the Japanese managed container funds and financing arrangements are considered VIEs. However, with the exception of the financing arrangements described in Note 4, the Company does not consider its interest in the managed Japanese container funds to be a variable interest. As such, the Company did not consolidate the assets and liabilities, results of operations or cash flows of these funds in its consolidated financial statements.

As described in Note 4, the Company has included in its consolidated financial statements, the assets and liabilities, results of operations, and cash flows of the financing arrangements, in accordance with FASB ASC Topic 810, Consolidation.

(15) Segment and Geographic Information

The Company organizes itself by the nature of the services it provides which includes equipment leasing (consisting of container leasing and rail leasing) and logistics.

The container leasing segment is aggregated with equipment management and derives its revenue from the ownership and leasing of containers and fees earned for managing container portfolios on behalf of third party investors. The rail leasing segment derives its revenue from the ownership and leasing of railcars. The logistics segment derives its revenue from the provision of logistics services. There are no inter-segment revenues.

With the exception of administrative expenses, operating expenses are directly attributable to each segment. Administrative expenses that are not directly attributable to a segment are allocated to container or rail leasing based on the net book value of equipment in each segment.

The following tables show condensed segment information for the three and nine months ended September 30, 2017 and 2016, reconciled to the Company's income before income taxes and non-controlling interest as shown in its consolidated statements of income for such periods (in thousands):

	Three Months Ended September 30, 2017			
	Container Leasing	Rail Leasing	Logistics	Total
Total revenue	$ 61,870	$ 7,279	$ 21,012	$ 90,161
Total operating expenses	30,270	5,534	22,463	58,267
Operating income (loss)	31,600	1,745	(1,451)	31,894
Total other expenses	11,537	2,871	-	14,408
Income (loss) before income taxes and non-controlling interest	$ 20,063	$ (1,126)	$ (1,451)	$ 17,486
Goodwill	$ -	$ -	$ 15,794	$ 15,794
Total assets	$ 1,910,899	$ 405,118	$ 40,140	$ 2,356,157
Purchase of rental equipment (1)	$ 132,405	$ 16,771	$ -	$ 149,176

Table of Contents

CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

	Three Months Ended September 30, 2016			
	Container Leasing	Rail Leasing	Logistics	Total
Total revenue	$ 49,661	$ 7,614	$ 21,197	$ 78,472
Total operating expenses	45,184	4,367	21,559	71,110
Operating income (loss)	4,477	3,247	(362)	7,362
Total other expenses	9,159	1,827	1	10,987
(Loss) income before income taxes and non-controlling interest	$ (4,682)	$ 1,420	$ (363)	$ (3,625)
Goodwill	$ -	$ -	$ 15,579	$ 15,579
Total assets	$ 1,643,929	$ 343,214	$ 40,059	$ 2,027,202
Purchase of rental equipment (1)	$ 19,730	$ 20,613	$ -	$ 40,343

	Nine Months Ended September 30, 2017			
	Container Leasing	Rail Leasing	Logistics	Total
Total revenue	$ 169,784	$ 23,459	$ 61,116	$ 254,359
Total operating expenses	99,788	16,038	63,920	179,746
Operating income (loss)	69,996	7,421	(2,804)	74,613
Total other expenses	30,346	8,220	1	38,567
Income (loss) before income taxes and non-controlling interest	$ 39,650	$ (799)	$ (2,805)	$ 36,046
Purchase of rental equipment (1)	$ 246,378	$ 31,391	$ -	$ 277,769

	Nine Months Ended September 30, 2016			
	Container Leasing	Rail Leasing	Logistics	Total
Total revenue	$ 152,875	$ 22,462	$ 41,743	$ 217,080

Total operating expenses	121,519	12,363	42,522	176,404
Operating income (loss)	31,356	10,099	(779)	40,676
Total other expenses	27,203	4,738	1	31,942
Income (loss) before income taxes and non-controlling interest				