

CAI International, Inc.
Form 10-Q
November 05, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2014

or

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

For the transition period from to

Commission file number: 001-33388

CAI International, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization) 94-3109229
(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

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

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

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

Common	October 31, 2014
Common Stock, \$.0001 par value per share	20,782,776 shares

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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 to 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, 2013 filed with the Securities and Exchange Commission (SEC) on February 28, 2014 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.

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PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CAI INTERNATIONAL, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share information)

(UNAUDITED)

	September 30, 2014	December 31, 2013
Assets		
Current assets		
Cash	\$ 19,048	\$ 31,141
Cash held by variable interest entities	31,402	14,600
Accounts receivable (owned fleet), net of allowance for doubtful accounts of \$504 and \$503 at September 30, 2014 and December 31, 2013, respectively	46,220	41,226
Accounts receivable (managed fleet)	8,619	10,646
Current portion of direct finance leases	17,466	12,998
Prepaid expenses	14,712	14,803
Other current assets	555	5,553
Total current assets	138,022	130,967
Restricted cash	8,488	9,253
Rental equipment, net of accumulated depreciation of \$260,290 and \$210,165 at September 30, 2014 and December 31, 2013, respectively	1,565,149	1,465,092
Net investment in direct finance leases	79,890	68,210
Furniture, fixtures and equipment, net of accumulated depreciation of \$1,987 and \$1,697 at September 30, 2014 and December 31, 2013, respectively	1,058	1,390
Intangible assets, net of accumulated amortization of \$4,797 and \$4,638 at September 30, 2014 and December 31, 2013, respectively	368	677
Total assets (1)	\$ 1,792,975	\$ 1,675,589
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	\$ 6,785	\$ 8,002

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Accrued expenses and other current liabilities	8,641	6,230
Due to container investors	13,815	14,815
Unearned revenue	8,199	6,862
Current portion of debt	183,216	74,080
Current portion of capital lease obligations	1,215	1,921
Rental equipment payable	44,792	45,181
Total current liabilities	266,663	157,091
Debt	1,055,335	1,058,628
Deferred income tax liability	41,751	41,378
Capital lease obligations	1,817	3,366
Total liabilities (2)	1,365,566	1,260,463
Stockholders' equity		
Common stock: par value \$.0001 per share; authorized 84,000,000 shares; issued and outstanding 20,782,776 and 22,240,673 shares at September 30, 2014 and December 31, 2013, respectively	2	2
Additional paid-in capital	154,265	184,263
Accumulated other comprehensive loss	(4,317)	(2,356)
Retained earnings	276,735	232,623
Total CAI stockholders' equity	426,685	414,532
Non-controlling interest	724	594
Total stockholders' equity	427,409	415,126
Total liabilities and stockholders' equity	\$ 1,792,975	\$ 1,675,589

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- (1) Total assets at September 30, 2014 and December 31, 2013 include the following assets of certain variable interest entities (VIEs) that can only be used to settle the liabilities of those VIEs: Cash, \$31,402 and \$14,600; Net investment in direct finance leases, \$154 and \$137; and Rental equipment net of accumulated depreciation, \$101,893 and \$84,107, respectively.

- (2) Total liabilities at September 30, 2014 and December 31, 2013 include the following VIE liabilities for which the VIE creditors do not have recourse to CAI International, Inc.: Debt, \$132,082 and \$101,269, respectively.

See accompanying notes to unaudited consolidated financial statements.

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CAI INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenue				
Rental revenue	\$ 55,380	\$ 50,711	\$ 157,557	\$ 145,721
Management fee revenue	1,561	1,503	4,681	6,027
Finance lease income	2,262	1,684	6,541	6,096
Total revenue	59,203	53,898	168,779	157,844
Operating expenses				
Depreciation of rental equipment	19,888	17,389	57,607	49,007
Amortization of intangible assets	95	227	293	681
Gain on disposition of used rental equipment	(1,237)	(1,329)	(4,561)	(5,822)
Storage, handling and other expenses	6,532	4,979	19,322	13,611
Marketing, general and administrative expenses	6,676	6,055	19,779	18,274
Loss on foreign exchange	70	374	387	199
Total operating expenses	32,024	27,695	92,827	75,950
Operating income	27,179	26,203	75,952	81,894
Interest expense	9,265	9,546	26,943	26,905
Write-off of deferred financing costs	-	-	-	1,108
Interest income	(1)	-	(6)	(4)
Net interest expense	9,264	9,546	26,937	28,009
Net income before income taxes and non-controlling interest	17,915	16,657	49,015	53,885
Income tax expense	1,482	1,320	4,857	5,550
Net income	16,433	15,337	44,158	48,335
Net income attributable to non-controlling interest	(38)	-	(46)	-
Net income attributable to CAI common stockholders	\$ 16,395	\$ 15,337	\$ 44,112	\$ 48,335
Net income per share attributable to CAI common stockholders				
Basic	\$ 0.78	\$ 0.69	\$ 2.08	\$ 2.18
Diluted	\$ 0.77	\$ 0.68	\$ 2.04	\$ 2.13

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Weighted average shares outstanding				
Basic	20,936	22,186	21,193	22,139
Diluted	21,329	22,645	21,622	22,674

See accompanying notes to unaudited consolidated financial statements.

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CAI INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net income	\$ 16,433	\$ 15,337	\$ 44,158	\$ 48,335
Other comprehensive income, net of tax:				
Foreign currency translation adjustments	(1,950)	1,208	(1,961)	218
Comprehensive income	14,483	16,545	42,197	48,553
Comprehensive loss attributable to non-controlling interest	(38)	-	(46)	-
Comprehensive income attributable to CAI common stockholders	\$ 14,445	\$ 16,545	\$ 42,151	\$ 48,553

See accompanying notes to unaudited consolidated financial statements.

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CAI INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(UNAUDITED)

	Nine Months Ended September 30, 2014	2013
Cash flows from operating activities		
Net income	\$ 44,158	\$ 48,335
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	57,972	49,400
Amortization of debt issuance costs	2,236	3,090
Amortization of intangible assets	293	681
Stock-based compensation expense	1,364	1,111
Loss (gain) on foreign exchange	114	(20)
Gain on disposition of used rental equipment	(4,561)	(5,822)
Deferred income taxes	373	42
Bad debt expense	47	120
Changes in other operating assets and liabilities:		
Accounts receivable	(3,723)	788
Prepaid expenses and other assets	4,399	(24)
Accounts payable, accrued expenses and other current liabilities	1,779	(1,284)
Due to container investors	(1,000)	(5,374)
Unearned revenue	1,383	(1,252)
	104,834	89,791

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Net cash provided by operating activities		
Cash flows from investing activities		
Purchase of rental equipment	(226,118)	(287,959)
Net proceeds from disposition of used rental equipment	43,014	22,512
Purchase of furniture, fixtures and equipment	(31)	(59)
Receipt of principal payments from direct financing leases	11,602	9,142
Net cash used in investing activities	(171,533)	(256,364)
Cash flows from financing activities		
Proceeds from debt	316,853	536,170
Principal payments on debt	(212,783)	(340,154)
Debt issuance costs	(1,546)	(6,529)
Decrease (increase) in restricted cash	510	(5,132)
Repurchase of stock	(31,390)	-
Stock issuance costs	-	(155)
Exercise of stock options	28	1,500
Net cash provided by financing activities	71,672	185,700
Effect on cash of foreign currency translation	(264)	(1,180)
Net increase in cash	4,709	17,947
Cash at beginning of the period	45,741	17,671
Cash at end of the period	\$ 50,450	\$ 35,618
Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Income taxes	\$ 959	\$ 4,791
Interest	25,767	25,173
Supplemental disclosure of non-cash investing and financing activity		
Transfer of rental equipment to direct	\$ 27,826	\$ 29,091

finance lease Transfer of direct finance lease to rental equipment	-	30,118
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See accompanying notes to unaudited consolidated financial statements.

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CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(1)The Company and Nature of Operations

Organization

CAI International, Inc. and its subsidiaries (collectively, CAI or the Company) operate primarily in the international intermodal marine cargo container leasing business. The Company purchases and leases containers principally to international container shipping lines located throughout the world. The Company also owns a fleet of railcars, which it leases in North America. The Company generates revenue from two reportable segments: equipment leasing and equipment management. The equipment leasing segment specializes in the ownership and leasing of intermodal containers and rail cars. The equipment management segment purchases and sells equipment to third-party investor groups, and provides management services to those investors in return for a management fee.

The Company's common stock is traded on the New York Stock Exchange under the symbol "CAP". 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 the Company, its wholly-owned subsidiaries, and its 80% owned subsidiary, CAIJ, Inc. (CAIJ). The equity attributable to the minority interest in CAIJ is shown as a non-controlling interest on the Company's consolidated balance sheets as of September 30, 2014 and December 31, 2013, and the related net income is presented as net income attributable to non-controlling interest on the Company's consolidated statement of income for the three and nine months ended September 30, 2014. The non-controlling interest in CAIJ was immaterial and not included in the consolidated statements of income for the three and nine months ended September 30, 2013. All significant intercompany balances and transactions have been eliminated in consolidation.

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments necessary to present fairly the Company's financial position as of September 30, 2014 and December 31, 2013, the Company's results of operations for the three and nine months ended September 30, 2014 and 2013, and the Company's cash flows for the nine months ended September 30, 2014 and 2013. 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 2014 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 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, 2013, included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC) on February 28, 2014.

(2) Accounting Policies and Recent Accounting Pronouncements

(a) Accounting Policies

There were no changes to the Company's accounting policies during the nine months ended September 30, 2014. See Note 2 to the consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2013, filed with the SEC on February 28, 2014, for a description of the Company's significant accounting policies.

(b) Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606) (ASU No. 2014-09). This new standard will replace all current U.S. GAAP guidance on this topic and eliminate industry-specific guidance. Leasing revenue recognition is specifically excluded from this ASU, and therefore, the new standard will only apply to sales of equipment portfolios and dispositions of used equipment. The guidance is effective for interim and annual periods beginning after December 15, 2016, with early application prohibited. Adoption of the guidance is not expected to have a material impact on the Company's consolidated financial statements.

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CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(3)Consolidation of Variable Interest Entities as a Non-Controlling Interest

The Company regularly performs a review of its container fund arrangements with investors to determine whether a fund is a variable interest entity (VIE) and whether the Company has a variable interest that provides it with a controlling financial interest and is the primary beneficiary of the VIE in accordance with ASC 810, Consolidation. If the fund is determined to be 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 Paragraph 14A of ASC 810:

- It has power to direct the activities of a VIE that most significantly impact the entity's economic performance; and
- It has the obligation to absorb losses of the entity that could be potentially significant to the VIE or the right to receive benefits from the entity 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 ASC 810. The equity attributable to the VIE is shown as a non-controlling interest on the Company's consolidated balance sheet and the after tax result attributable to its operations is shown as a net income or loss attributable to non-controlling interest on the Company's consolidated statement of income.

The Company currently enters into two types of container fund arrangements with investors which are reviewed under ASC 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 all of the funds under financing arrangements, are Japanese container funds that were established by a related party under separate investment agreements allowed under Japanese commercial laws (see Note 11). Each of the funds is financed by unrelated Japanese third party investors.

Managed Container Funds

All container funds under management by the Company are considered VIEs because as manager of the funds, the Company has the power to direct the activities that most significantly impact the entity's economic performance including the leasing and managing of containers owned by the funds. The fees earned for arranging, managing and establishing the funds are not significant to the expected returns of the funds so the Company does not have a variable interest in the funds. The rights to receive benefits and obligations to absorb losses that could potentially be significant to the funds belong to the third party investors, so the Company concluded that it is not the primary beneficiary of the funds. The Company recognizes gain on sale of containers to the unconsolidated VIEs as sales in the ordinary course of business. For the three and nine months ended September 30, 2014 and 2013, the Company sold no container portfolios to the Japanese VIEs.

Collateralized Financing Obligations

As of September 30, 2014, the Company has transferred containers with a total net book value of \$130.8 million at the time of transfer 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 ASC 840, Sale-Leaseback Transactions, the Company concluded these were financing transactions under which sale-leaseback accounting was not applicable.

The container funds under financing arrangements are considered VIEs under ASC 810 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. The terms of the transactions 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. 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, 2014 and December 31, 2013, the results of the VIEs' operations for the three and nine months ended September 30, 2014 and 2013 and cash flows for the nine months ended September 30, 2014 and 2013, in the Company's consolidated financial statements.

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CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The containers that were transferred to the Japanese investor funds had a net book value of \$102.0 million as of September 30, 2014. The container equipment, together with \$31.4 million of cash held by the investor funds, has been included on the Company's consolidated balance sheet with the offsetting liability related to the funds presented in the debt section of the Company's consolidated balance sheet as collateralized financing obligations of \$121.8 million and term loan held by VIE of \$10.3 million. See Note 6(e) and 6(f) for additional information. No gain or loss was recognized by the Company on the initial consolidation of the VIEs.

(4) 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, 2014	December 31, 2013
Gross finance lease receivables (1)	\$ 121,141	\$ 103,887
Unearned income (2)	(23,785)	(22,679)
Net investment in direct finance leases	\$ 97,356	\$ 81,208

(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 no unguaranteed residual value at September 30, 2014 and approximately \$0.1 million at December 31, 2013 included in gross finance lease receivables. There were no executory costs included in gross finance lease receivables as of September 30, 2014 and December 31, 2013.

(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, 2014 and December 31, 2013.

In order to estimate the allowance for losses contained in the 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 modest.

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.

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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, 2014	December 31, 2013
Tier 1	\$ 92,968	\$ 85,990
Tier 2	28,173	17,897
Tier 3	-	-
	\$ 121,141	\$ 103,887

Contractual maturities of the Company's gross finance lease receivables subsequent to and as of September 30, 2014 for the years ending September 30 were as follows (in thousands):

2015	\$ 25,802
2016	24,336
2017	31,408
2018	