CAI International, Inc.
Form 10-Q
August 02, 2011

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

FORM 10-Q

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

For the quarterly period ended June 30, 2011

OR

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

For the transition period from to

Commission file number: 001-33388

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 (Address of principal executive offices)	94105 (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 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

(§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 x No ¨

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	x
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 Exchange Act). Yes ¨ No x

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

Common	July 29, 2011
Common Stock, $.0001 par value per share	19,295,359 shares

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CAUTIONARY STATEMENT FOR PURPOSES OF THE "SAFE HARBOR" PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

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 and 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," "p "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 identified under "Risk Factors" below, as well as those identified in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 filed on March 16, 2011, pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. 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 filings with the Securities and Exchange Commission.

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PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CAI INTERNATIONAL, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share information)
(UNAUDITED)

ASSETS	June 30, 2011	December 31, 2010
Cash	$ 11,064	$ 14,393
Accounts receivable (owned fleet), net of allowance for doubtful accounts of $1,143 and $2,182 at June 30, 2011 and December 31, 2010, respectively	19,975	20,874
Accounts receivable (managed fleet)	19,863	19,496
Current portion of direct finance leases	3,276	3,948
Prepaid expenses	6,472	6,645
Deferred tax assets	1,875	1,931
Other current assets	2,910	1,364
Total current assets	65,435	68,651
Container rental equipment, net of accumulated depreciation of $94,706 and $85,596 at June 30, 2011 and December 31, 2010, respectively	738,659	530,939
Net investment in direct finance leases	11,236	7,886
Furniture, fixtures and equipment, net of accumulated depreciation of $780 and $548 at June 30, 2011 and December 31, 2010, respectively	2,229	2,383
Intangible assets, net of accumulated amortization of $6,053 and $5,982 at June 30, 2011 and December 31, 2010 respectively	3,000	3,593
Total assets	$ 820,559	$ 613,452
LIABILITIES AND STOCKHOLDERS' EQUITY		
Accounts payable	$ 2,327	$ 2,411
Accrued expenses and other current liabilities	5,231	5,408
Due to container investors	24,132	23,283
Unearned revenue	5,799	5,724
Current portion of term loans	15,600	24,800
Current portion of capital lease obligations	3,479	4,438
Rental equipment payable	72,094	88,097
Total current liabilities	128,662	154,161
Revolving credit facility	256,600	51,600
Term loans	170,600	169,200
Deferred income tax liability	30,882	30,226
Capital lease obligations	9,803	10,509
Income taxes payable	82	82
Total liabilities	596,629	415,778
Stockholders' equity:		
	2	2

Common stock: par value $.0001 per share; authorized 84,000,000 shares; issued and outstanding, 19,295,359 shares at June 30, 2011 and December 31, 2010				
Additional paid-in capital		127,504		127,064
Accumulated other comprehensive loss		(780)		(2,510)
Retained earnings		78,719		55,043
Total CAI stockholders' equity		205,445		179,599
Non-controlling interest		18,485		18,075
Total stockholders' equity		223,930		197,674
Total liabilities and stockholders' equity	$	820,559	$	613,452

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 June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Revenue:				
Container rental revenue	$24,711	$13,974	$47,096	$26,318
Management fee revenue	3,275	2,536	6,790	4,717
Gain on sale of container portfolios	253	348	1,663	614
Finance lease income	520	505	952	907
Total revenue	28,759	17,363	56,501	32,556
Operating expenses:				
Depreciation of container rental equipment	7,436	4,471	14,172	8,678
Amortization of intangible assets	343	341	686	695
Impairment of container rental equipment	5	11	10	28
Gain on disposition of used container equipment	(2,785)	(2,498)	(6,400)	(3,918)
Storage, handling and other expenses	1,360	1,763	2,455	3,954
Marketing, general and administrative expenses	5,517	5,527	10,119	10,476
(Gain) loss on foreign exchange	(37)	230	23	411
Total operating expenses	11,839	9,845	21,065	20,324
Operating income	16,920	7,518	35,436	12,232
Interest expense	3,529	963	6,503	1,820
Interest income	(1)	(88)	(4)	(120)
Net interest expense	3,528	875	6,499	1,700
Net income before income taxes and non-controlling interest	13,392	6,643	28,937	10,532
Income tax expense	2,301	967	4,851	1,807
Net income	11,091	5,676	24,086	8,725
Net income attributable to non-controlling interest	(211)	-	(410)	-
Net income attributable to CAI common stockholders	$10,880	$5,676	$23,676	$8,725
Net income per share attributable to CAI common stockholders:				
Basic	$0.56	$0.32	$1.23	$0.49
Diluted	$0.55	$0.31	$1.20	$0.48
Weighted average shares outstanding:				
Basic	19,295	17,910	19,295	17,908
Diluted	19,798	18,141	19,779	18,098

See accompanying notes to unaudited consolidated financial statements.

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CAI INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOW
(In thousands)
(UNAUDITED)

	Six Months Ended June 30, 2011	2010
Cash flows from operating activities:		
Net income	$24,086	$8,725
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	14,397	8,773
Amortization of debt issuance costs	621	256
Amortization of intangible assets	686	695
Impairment of container rental equipment	10	28
Stock-based compensation expense	572	536
(Gain) loss on foreign exchange	(95)	755
Gain on sale of container portfolios	(1,663)	(614)
Gain on disposition of used container equipment	(6,400)	(3,918)
Deferred income taxes	480	-
Restructuring charges	-	107
Bad debt (recovery) expense	(1,044)	427
Changes in other operating assets and liabilities:		
Accounts receivable	2,031	(4,986)
Prepaid expenses and other assets	(1,306)	4,428
Accounts payable, accrued expenses and other current liabilities	(890)	(5,340)
Due to container investors	849	2,850
Unearned revenue	(7)	60
Net cash provided by operating activities	32,327	12,782
Cash flows from investing activities:		
Purchase of containers	(261,258)	(40,260)
Net proceeds from sale of container portfolios	12,642	12,367
Net proceeds from disposition of used container equipment	15,627	17,112
Purchase of furniture, fixtures and equipment	(65)	(85)
Receipt of principal payments from direct financing leases	3,010	2,847
Net cash used in investing activities	(230,044)	(8,019)
Cash flows from financing activities:		
Proceeds from bank debt	221,800	29,200
Principal payments on capital leases	(2,661)	(1,864)
Principal payments made on bank debt	(24,200)	(40,200)
Principal payments on related party term loan	(400)	(400)
Debt issuance costs	(456)	-
Stock issuance costs	(132)	-
Net cash provided by (used in) financing activities	193,951	(13,264)
Effect on cash of foreign currency translation	437	(593)
Net decrease in cash	(3,329)	(9,094)
Cash at beginning of the period	14,393	14,492
Cash at end of the period	$11,064	$5,398

Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes	$3,353	$788
Interest	5,112	1,318
Supplemental disclosure of non-cash investing and financing activity:		
Transfer of container rental equipment to direct finance lease	5,510	5,111
Transfer of container rental equipment off direct finance lease	-	1,237
Container equipment purchase funded by offset to accounts receivable	-	1,764

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. (CAI or the Company) operates in the international intermodal marine cargo container leasing business. Within this single industry sector, the Company generates revenue from two reportable segments: container leasing and container management. The container leasing segment specializes primarily in the ownership and leasing of intermodal dry freight standard containers, while the container management segment manages containers for container investors. The Company leases its containers principally to international container shipping lines located throughout the world. The Company sells containers primarily to 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 and its subsidiaries. All intercompany 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 June 30, 2011 and December 31, 2010, the Company's results of operations for the three and six months ended June 30, 2011 and 2010 and the Company’s cash flows for the six months ended June 30, 2011 and 2010. 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 2011 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 financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2010, included in the Company’s Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC) on March 16, 2011.

(2) Accounting Policies and Recent Accounting Pronouncements

(a) Accounting Policies

During the three months ended March 31, 2011, the Company completed a review of historical disposal experience relating to its fleet of container equipment and concluded that the estimated residual values and depreciable lives used in its equipment depreciation calculations should be amended effective January 1, 2011. The following table shows the current and prior residual values and depreciable lives adopted by the Company for each type of equipment:

	Residual Value		Depreciable Life in Years	
	Current	Prior	Current	Prior
20-ft. standard dry van	$ 950	$ 850	12.5	12.5
40-ft. standard dry van	$ 1,150	$ 950	12.5	12.5

40-ft. high cube dry van	$ 1,300	$ 1,000	12.5	12.5
40-ft. high cube refrigerated container	$ 3,000	15% of OEC*	12.0	15.0

* Original equipment cost

The above changes reduced the Company's depreciation expense and increased pre-tax income by approximately $0.7 million and $1.5 million, increased net income by approximately $0.6 million and $1.2 million, and increased diluted earnings per share by $0.03 and $0.06 for the three and six months ended June 30, 2011, respectively.

There were no other changes to the Company’s accounting policies during the six months ended June 30, 2011. See Note 2 to the consolidated financial statements in the Company’s Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on March 16, 2011.

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CAI INTERNATIONAL, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(b) Recent Accounting Pronouncements

In October 2009, the Financial Accounting Standards Board (FASB) issued an update to the Accounting Standards Codification (ASC) relating to revenue recognition. The update eliminates the requirement that all undelivered elements in an arrangement with multiple deliverables have objective and reliable evidence of fair value before revenue can be recognized for items that have been delivered. The update also no longer allows use of the residual method when allocating consideration to deliverables. Instead, arrangement consideration is to be allocated to deliverables using the relative selling price method, applying a selling price hierarchy. Vendor specific objective evidence (VSOE) of selling price should be used if it exists. Otherwise, third party evidence (TPE) of selling price should be used. If neither VSOE nor TPE is available, the company's best estimate of selling price should be used. The update requires expanded qualitative and quantitative disclosures. The Company adopted the provisions of the update on January 1, 2011. Adoption of the update did not have a material effect on the Company's consolidated financial statements.

In January 2010, the FASB issued guidance to amend the disclosure requirements related to recurring and nonrecurring fair value measurements. The guidance requires new disclosures on the transfers of assets and liabilities between Level 1 (quoted prices in active markets for identical assets or liabilities) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy, including the reasons and the timing of the transfers. Additionally, the guidance requires a roll-forward of activities on purchases, sales, issuance, and settlements of the assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements). The guidance related to new disclosures was effective for the Company's first quarter of 2010. The guidance related to the roll-forward of Level 3 assets and liabilities was effective for the Company's first quarter of 2011. Adoption of the guidance did not have a material effect on the Company's consolidated financial statements. In May 2011, the FASB issued further guidance associated with fair value measurement and disclosure. Most of the changes are clarifications of existing guidance and wording changes to align with International Financial Reporting Standards. The guidance is effective for interim and annual periods beginning after December 15, 2011 and its adoption is not expected to have an impact on the Company's consolidated financial statements.

In June 2011, the FASB issued a pronouncement to increase the prominence of other comprehensive income in financial statements. Under this pronouncement, an entity will have the option to present the components of net income and comprehensive income in either one or two consecutive financial statements. The option to present other comprehensive income in the statement of changes in equity has been eliminated. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company will adopt the guidance in the first quarter of 2012.

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

The Company regularly performs a review of the container funds that it manages for 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 has a variable interest in, and 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 our 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 operations.

Included among the funds that the Company manages are several 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. The container funds under management 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 such as leasing and managing the containers owned by the funds. With the exception of two specific Japanese funds established in September 2010, 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. With the exception of the sale of containers to the two Japanese funds established in September 2010, the Company recognized gains on sale of containers to the unconsolidated VIEs as sales in the ordinary course of the business. For the three and six months ended June 30, 2011, the Company sold $4.3 million and $12.6 million, respectively, of container portfolios to the Japanese VIEs and recognized gains of $0.3 million and $1.7 million, respectively. For the three and six months ended June 30, 2010, the Company sold $7.1 million and $12.4 million of containers, respectively, and recognized gains of $0.3 million and $0.6 million, respectively.

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CAI INTERNATIONAL, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

In September 2010, the Company transferred approximately $16.0 million of containers to two specific Japanese funds that are considered VIEs. The terms of the transaction included 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 so 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 two specific VIEs and included the VIEs' assets and liabilities as of June 30, 2011 and December 31, 2010 and the results of the VIEs' operations and cash flows for the three and six months ended June 30, 2011 in the Company's consolidated financial statements.

The containers transferred to the two consolidated Japanese VIEs had a net book value of $14.8 million as of June 30, 2011. The container equipment along with $1.1 million of cash held by these container funds and $1.7 million of net investment in direct finance leases, have been included on the Company's consolidated balance sheet with the offsetting equity related to the funds presented separately as non-controlling interest of $18.5 million in the equity section of the Company's consolidated balance sheet as of June 30, 2011. No gain or loss was recognized upon the initial consolidation of the VIEs in September 2010. The net income of $0.2 million and $0.4 million for the three and six months ended June 30, 2011, respectively, attributable to the two Japanese funds is presented as net income attributable to non-controlling interest and was deducted from the Company's consolidated statements of income for the three and six months ended June 30, 2011.

(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):

	June 30, 2011	December 31, 2010
Gross finance lease receivables (1)	$ 19,851	$ 15,290
Allowance on gross finance lease receivables (2)	—	—
Gross finance lease receivables, net of allowance	19,851	15,290
Unearned income (3)	(5,339)	(3,456)
Net investment in finance leases	$ 14,512	$ 11,834

(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 receivable is reduced as customer payments are received. Approximately $6.0 million and $4.0 million of unguaranteed residual value at June 30, 2011 and December 31, 2010, respectively, were included in gross finance lease receivables. There were no executory costs included in gross finance lease receivables as of June 30, 2011 and December 31, 2010.

(2) The Company evaluates potential losses in its finance lease portfolio by regularly reviewing the specific receivables in the portfolio and analyzing historical loss experience. For the period 2004 through June 30, 2011, the Company's loss experience on its gross finance lease receivables, after considering equipment recoveries, was less than 2.0%.

(3) The difference between the gross finance lease receivable 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 June 30, 2011 and December 31, 2010.

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 which 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.

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CAI INTERNATIONAL, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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. The Company has initiated or implemented plans to recover equipment on lease to these customers and believes that default is likely, or has already occurred.

Based on the above categories, the Company's gross finance lease receivables as of June 30, 2011, are as follows (in thousands):

Tier 1	$	6,938