

CAI International, Inc.
Form 10-Q
November 02, 2018

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, 2018

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)

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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 every Interactive Data File required to be submitted 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 such files). Yes No

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
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

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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, 2018
Common Stock, \$.0001 par value per share	19,306,202 shares

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CAI INTERNATIONAL, INC.

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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, 2017 filed with the Securities and Exchange Commission (SEC) on February 27, 2018 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, 2018	December 31, 2017
Assets		
Current assets		
Cash	\$ 14,550	\$ 14,735
Cash held by variable interest entities	23,779	20,685
Accounts receivable, net of allowance for doubtful accounts of \$1,455 and \$1,440 at September 30, 2018 and December 31, 2017, respectively	83,698	68,324
Current portion of net investment in direct finance leases	74,637	30,063
Prepaid expenses and other current assets	2,600	4,258
Total current assets	199,264	138,065
Restricted cash	31,634	11,789
Rental equipment, net of accumulated depreciation of \$575,866 and \$505,546 at September 30, 2018 and December 31, 2017, respectively	2,299,955	2,004,961
Net investment in direct finance leases	444,741	246,450
Goodwill	15,794	15,794
Intangible assets, net of accumulated amortization of \$4,946 and \$3,407 at September 30, 2018 and December 31, 2017, respectively	6,184	7,723
Furniture, fixtures and equipment, net of accumulated depreciation of \$3,303 and \$3,201 at September 30, 2018 and December 31, 2017, respectively	619	338
Other non-current assets	974	3,008
Total assets (1)	\$ 2,999,165	\$ 2,428,128
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	\$ 6,269	\$ 7,831
Accrued expenses and other current liabilities	18,882	15,706
Due to container investors	993	1,845
Unearned revenue	8,345	7,811
Current portion of debt	194,563	132,049

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Rental equipment payable	257,947	92,415
Total current liabilities	486,999	257,657
Debt	1,777,420	1,570,773
Deferred income tax liability	38,277	35,853
Total liabilities (2)	2,302,696	1,864,283
Stockholders' equity		
Preferred stock, par value \$.0001 per share; authorized 10,000,000 and 5,000,000 shares at September 30, 2018 and December 31, 2017, respectively:		
8.50% Series A fixed-to-floating rate cumulative redeemable perpetual preferred stock, issued and outstanding 2,199,610 and 0 shares at September 30, 2018 and December 31, 2017, respectively, at liquidation preference	54,990	-
8.50% Series B fixed-to-floating rate cumulative redeemable perpetual preferred stock, issued and outstanding 1,955,000 and 0 shares at September 30, 2018 and December 31, 2017, respectively, at liquidation preference	48,875	-
Common stock, par value \$.0001 per share; authorized 84,000,000 shares; issued and outstanding 19,306,202 and 20,390,622 shares at September 30, 2018 and December 31, 2017, respectively	2	2
Additional paid-in capital	145,069	172,325
Accumulated other comprehensive loss	(6,379)	(6,122)
Retained earnings	453,912	397,640
Total stockholders' equity	696,469	563,845
Total liabilities and stockholders' equity	\$ 2,999,165	\$ 2,428,128

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- (1) Total assets at September 30, 2018 and December 31, 2017 include the following assets of certain variable interest entities (VIEs) that can only be used to settle the liabilities of those VIEs: Cash, \$23,779 and \$20,685; Net investment in direct finance leases, \$9,375 and \$4,423; and Rental equipment, net of accumulated depreciation, \$73,110, and \$61,842, respectively.
- (2) Total liabilities at September 30, 2018 and December 31, 2017 include the following VIE liabilities for which the VIE creditors do not have recourse to CAI International, Inc.: Current portion of debt, \$39,302 and \$22,549; Debt, \$65,717 and \$72,727, 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,	
	2018	2017	2018	2017
Revenue				
Container lease revenue	\$ 75,331	\$ 61,870	\$ 208,298	\$ 169,784
Rail lease revenue	8,759	7,279	26,982	23,459
Logistics revenue	31,362	21,012	81,251	61,116
Total revenue	115,452	90,161	316,531	254,359
Operating expenses				
Depreciation of rental equipment	31,272	27,788	89,521	82,814
Storage, handling and other expenses	3,514	3,506	10,227	16,651
Logistics transportation costs	27,541	17,855	70,536	51,608
Gain on sale of used rental equipment	(2,625)	(1,663)	(7,539)	(2,539)
Administrative expenses	12,869	10,781	36,270	31,212
Total operating expenses	72,571	58,267	199,015	179,746
Operating income	42,881	31,894	117,516	74,613
Other expenses				
Net interest expense	19,783	13,959	55,122	37,916
Other expense	116	449	510	651
Total other expenses	19,899	14,408	55,632	38,567
Income before income taxes	22,982	17,486	61,884	36,046
Income tax expense (benefit)	1,228	(101)	2,695	549
Net income	21,754	17,587	59,189	35,497
Preferred stock dividends	1,748	-	2,917	-
Net income attributable to CAI common stockholders	\$ 20,006	\$ 17,587	\$ 56,272	\$ 35,497
Net income per share attributable to CAI common stockholders				
Basic	\$ 1.04	\$ 0.92	\$ 2.85	\$ 1.86
Diluted	\$ 1.03	\$ 0.90	\$ 2.81	\$ 1.83
Weighted average shares outstanding				
Basic	19,214	19,180	19,741	19,108

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Diluted	19,492	19,633	19,997	19,422
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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,	
	2018	2017	2018	2017
Net income	\$ 21,754	\$ 17,587	\$ 59,189	\$ 35,497
Other comprehensive income, net of tax:				
Foreign currency translation adjustments	(19)	698	(257)	1,742
Comprehensive income before preferred stock dividends	21,735	18,285	58,932	37,239
Dividends on preferred stock	(1,748)	-	(2,917)	-
Comprehensive income available to CAI common stockholders	\$ 19,987	\$ 18,285	\$ 56,015	\$ 37,239

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,	
	2018	2017
Cash flows from operating activities		
Net income	\$ 59,189	\$ 35,497
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	89,635	83,088
Amortization of debt issuance costs	3,173	2,400
Amortization of intangible assets	1,538	1,536
Stock-based compensation expense	2,101	1,539
Reduction in contingent consideration	-	(2,211)
Unrealized loss on foreign exchange	317	42
Gain on sale of used rental equipment	(7,539)	(2,539)
Deferred income taxes	2,424	393
Bad debt (recovery) expense	(14)	750
Changes in other operating assets and liabilities:		
Accounts receivable	(7,305)	(10,715)
Prepaid expenses and other assets	(2,130)	(72)
Accounts payable, accrued expenses and other current liabilities	(901)	(5,887)
Due to container investors	(852)	(697)
Unearned revenue	(49)	(540)
Net cash provided by operating activities	139,587	102,584
Cash flows from investing activities		
Purchase of rental equipment	(529,230)	(277,769)
Proceeds from sale of used rental equipment	44,373	48,863
Purchase of furniture, fixtures and equipment	(394)	(91)
Receipt of principal payments from direct finance leases	26,982	14,536
Net cash used in investing activities	(458,269)	(214,461)
Cash flows from financing activities		
Proceeds from debt	1,302,912	556,544
Principal payments on debt	(1,025,954)	(448,436)
Debt issuance costs	(9,882)	(3,129)
Proceeds from issuance of common and preferred stock	103,681	-
Repurchase of common stock	(27,946)	-
Dividends paid to preferred stockholders	(1,376)	-
Exercise of stock options	24	1,362
Net cash provided by financing activities	341,459	106,341

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Effect on cash of foreign currency translation	(23)	380
Net increase (decrease) in cash and restricted cash	22,754	(5,156)
Cash and restricted cash at beginning of the period (1)	47,209	52,326
Cash and restricted cash at end of the period (2)	\$ 69,963	\$ 47,170
Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Income taxes	\$ 378	\$ 174
Interest	51,168	35,014
Supplemental disclosure of non-cash investing and financing activity		
Transfer of rental equipment to direct finance lease	\$ 271,938	\$ 144,907
Transfer of direct finance lease to rental equipment	-	291
Rental equipment payable	257,947	190,180

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- (1) Includes cash of \$14,735 and \$15,685, cash held by variable interest entities of \$20,685 and \$30,449, and restricted cash of \$11,789 and \$6,192 at December 31, 2017 and 2016, respectively.
- (2) Includes cash of \$14,550 and \$12,508, cash held by variable interest entities of \$23,779 and \$22,445, and restricted cash of \$31,634 and \$12,217 at September 30, 2018 and 2017, respectively.

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., 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.

The Company's common stock, 8.50% Series A Fixed-to-Floating Rate Cumulative Redeemable Perpetual Stock and 8.50% Series B Fixed-to-Floating Rate Cumulative Redeemable Perpetual Stock are traded on the New York Stock Exchange under the symbols "CAI," "CAI-PA" and "CAI-PB," respectively. 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. and its wholly-owned subsidiaries. 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, 2018 and December 31, 2017, the Company's results of operations for the three and nine months ended September 30, 2018 and 2017, and the Company's cash flows for the nine months ended September 30, 2018 and 2017. 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 2018 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, 2017, included in the Company's Annual Report on

Form 10-K filed with the Securities and Exchange Commission (SEC) on February 27, 2018.

(2) Accounting Policies and Recent Accounting Pronouncements

(a) Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606) (ASU 2014-09), which supersedes previous revenue recognition guidance. Leasing revenue recognition is specifically excluded, and therefore, the new standard is only applicable to the Company's logistics services agreements, management services agreements, and the sale of used rental equipment. The new standard defines a five-step process to achieve the core principle of ASU 2014-09, which is to recognize revenue when promised goods or services are transferred to customers in amounts that reflect the consideration the Company expects to receive in exchange for those goods or services. The Company adopted ASU 2014-09 effective January 1, 2018, which did not have a material impact on the Company's consolidated financial statements and related disclosures. See Note 2(b) for further details.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (ASU 2016-15), which clarifies the classification of certain cash receipts and cash payments in the statement of cash flows, including debt prepayment or extinguishment costs, settlement of contingent consideration arising from a business combination and insurance settlement proceeds. The Company adopted ASU 2016-15 effective January 1, 2018, which did not result in any changes to the presentation of amounts shown on the Company's consolidated statements of cash flows for all periods presented.

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash (ASU 2016-18), that requires the inclusion of restricted cash and restricted cash equivalents with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The Company adopted ASU 2016-18 effective January 1, 2018, which resulted in the inclusion of the Company's restricted cash balances along with cash in the Company's consolidated statements of cash flows and separate line items showing changes in restricted cash balances were eliminated from the Company's consolidated statements of cash flows. ASU 2016-18 was applied retrospectively to all periods presented.

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CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Except as described above, there were no changes to the Company's accounting policies during the nine months ended September 30, 2018. See Note 2 to the audited consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, filed with the SEC on February 27, 2018, for a description of the Company's significant accounting policies.

(b) Revenue Recognition

The Company provides a range of services to its customers incorporating the rental, sale and management of equipment and the provision of logistics services. Revenue for all forms of service is recognized when earned following the guidelines under FASB Accounting Standards Codification (ASC) Topic 606, Revenue Recognition and FASB ASC Topic 840, Leases. Revenue is reported net of any related sales tax.

Container and Rail Lease Revenue

The Company recognizes revenue from operating leases of its owned equipment as earned over the term of the lease. Where minimum lease payments vary over the lease term, revenue is recognized on a straight-line basis over the term of the lease. The Company recognizes revenue on a cash basis for certain railcar leases that are billed on an hourly or mileage basis through a third-party railcar manager. Early termination of the rental contracts subjects the lessee to a penalty, which is included in lease revenue upon such termination. Finance lease income is recognized using the effective interest method, which generates a constant rate of interest over the period of the lease.

Included in lease revenue is revenue consisting primarily of fees charged to the lessee for handling, delivery, and repairs, which are recognized as earned.

Also included in lease revenue is revenue from management fees earned under equipment management agreements. Management fees are generally calculated as a percentage of the monthly net operating income for an investor's portfolio and recognized as revenue in the month of service.

Logistics Revenue

The Company's logistics business derives its revenue from three principal sources: (1) truck brokerage services, (2) intermodal transportation services, and (3) international ocean freight and freight forwarding services. For truck brokerage services, which typically involve a short transit time, revenue is recognized when delivery has been completed due to the lack of reliable information to reasonably measure progress toward complete satisfaction of the performance obligation. For intermodal transportation services, which can take a longer time to complete, revenue is recognized over time by measuring progress toward complete satisfaction of the performance obligation, utilizing input methods. For any such services not completed as of the end of a reporting period, a percentage of completion method based on costs incurred to date is used to allocate the appropriate revenue to each separate reporting period. The Company provides international freight forwarding services as an indirect carrier, sometimes referred to as a Non-Vessel Operating Common Carrier. Due to the lack of reliable information to reasonably measure progress toward complete satisfaction of the performance obligation, revenue for these shipments is recognized at the time the freight departs the terminal of origin, which is when the customer is billed and the Company has no further obligation to the customer.

The Company reports logistics revenue on a gross basis as it is primarily responsible for fulfilling the promise to provide the specified service desired by the customer and has discretion in establishing the price for the specified service.

Unearned Revenue

The Company records unearned revenue when cash payments are received in advance of the Company satisfying its performance obligations.

Payment terms vary by customer and type of service. The term between invoicing and when payment is due is not significant. For certain customers or services, the Company may require payment before the services are delivered or performed for the customer.

Practical Expedients

The Company expenses sales commissions when incurred because the period of amortization would have been one year or less. These costs are recorded within administrative expenses.

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CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The Company does not disclose the value of unsatisfied performance obligations for (i) contracts with an original expected length of one year or less and (ii) contracts with variable consideration for a distinct good or service that forms part of a single performance obligation.

(3) 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, Consolidation:

- 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. All of the funds under financing arrangements are Japanese container funds that were established under separate investment agreements allowed under Japanese commercial laws. 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. No container portfolios were

sold to the funds during the three and nine months ended September 30, 2018 and 2017.

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 840-40, 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, 2018, and December 31, 2017, and the results of the VIEs' operations and cash flows for the three and nine months ended September 30, 2018 and 2017, 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 \$82.5 million as of September 30, 2018. The container equipment, together with \$23.8 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 \$103.1 million and term loans held by VIE of \$1.9 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, 2018 and 2017, had a net book value of \$14.6 million and \$6.0 million, respectively. Containers sold to the Japanese investor funds during the nine months ended September 30, 2018 and 2017, had a net book value of \$29.8 million and \$13.2 million, respectively.

(4) Rental Equipment

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

	September 30, 2018	December 31, 2017
Dry containers	\$ 1,820,977	\$ 1,533,063
Refrigerated containers	342,915	345,744
Other specialized equipment	207,563	160,529
Railcars	504,366	471,171
	2,875,821	2,510,507
Accumulated depreciation	(575,866)	(505,546)
Rental equipment, net of accumulated depreciation	\$ 2,299,955	\$ 2,004,961

(5) 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, 2018	December 31, 2017
Gross finance lease receivables (1)	\$ 757,087	\$ 412,489
Unearned income (2)	(237,709)	(135,976)
Net investment in direct finance leases	\$ 519,378	\$ 276,513

- (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 \$64.8 million and \$34.4 million unguaranteed residual value at September 30, 2018 and December 31, 2017, respectively, included in gross finance lease receivables. There were no executory costs included in gross finance lease receivables as of September 30, 2018 and December 31, 2017.
- (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, 2018 and December 31, 2017.

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.

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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.

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

	September 30, 2018	December 31, 2017
Tier 1	\$ 645,856	\$ 366,629
Tier 2	111,231	45,860
Tier 3	-	-
	\$ 757,087	\$ 412,489

Contractual maturities of the Company's gross finance lease receivables subsequent to September 30, 2018 for the years ending September 30 are as follows (in thousands):

2019	\$ 114,346
2020	97,319
2021	77,996
2022	70,787
2023	68,946
2024 and thereafter	327,693
	\$ 757,087

(6) 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	5-8 years

The Company's intangible assets as of September 30, 2018 and December 31, 2017 were as follows (in thousands):

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
September 30, 2018			
Trademarks and tradenames	\$ 1,786	\$ (1,739)	\$ 47
Customer relationships	9,344	(3,207)	6,137
	\$ 11,130	\$ (4,946)	\$ 6,184
December 31, 2017			
Trademarks and tradenames	\$ 1,786	\$ (1,411)	\$ 375
Customer relationships	9,344	(1,996)	7,348
	\$ 11,130	\$ (3,407)	\$ 7,723

Amortization expense was \$0.5 million and \$0.4 million for the three months ended September 30, 2018 and 2017, respectively, and \$1.5 million for both the nine months ended September 30, 2018 and 2017, and was included in administrative expenses in the consolidated statements of income.

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CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

As of September 30, 2018, estimated future amortization expenses are as follows (in thousands):

2019	\$ 1,654
2020	1,609
2021	1,609
2022	666
2023	475
2024 and thereafter	171
	\$ 6,184

(7) Debt

Details of the Company's debt as of September 30, 2018 and December 31, 2017 were as follows (dollars in thousands):

	September 30, 2018			December 31, 2017			Maturity
	Outstanding Current	Outstanding Long-term	Average Interest	Outstanding Current	Outstanding Long-term	Average Interest	
Revolving credit facility - Rail	\$ -	\$ 146,000	3.9%	\$ -	\$ 528,000	3.2%	June 2023
Revolving credit facility - Euro	-	306,000	3.7%	-	272,000	3.2%	October 2020
Term loan	1,800	27,750	4.3%	21,900	-	3.4%	September 2020
Term loan	6,750	107,250	3.8%	9,000	111,750	3.1%	April 2023
Term loan	7,000	77,250	4.0%	7,000	82,500	3.3%	October 2019
Term loan	1,230	15,598	3.4%	1,198	16,524	3.4%	June 2021
							December 2020

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Term loan	2,882	41,388	3.6%	2,805	43,560	3.6%	August 2021 September 2022
Senior secured notes	6,110	52,775	4.9%	6,110	58,885	4.9%	October 2027
Asset-backed notes 2012-1	17,100	52,725	3.5%	17,100	65,550	3.5%	March 2028
Asset-backed notes 2013-1	22,900	80,150	3.4%	22,900	97,325	3.4%	June 2042
Asset-backed notes 2017-1	25,307	196,129	3.7%	25,307	215,109	3.7%	February 2043
Asset-backed notes 2018-1	34,890	293,658	4.0%	-	-	-	September 2043
Asset-backed notes 2018-2	34,350	309,150	4.4%	-	-	-	September 2021
Collateralized financing obligations	37,388	65,717	1.1%	22,549	69,441	1.2%	June 2019
Term loans held by VIE	1,914	-	3.0%	-	3,286	2.7%	
	199,621	1,791,273		135,869	1,578,666		
Debt issuance costs	(5,058)	(13,853)		(3,820)	(7,893)		
Total Debt	\$ 194,563	\$ 1,777,420		\$ 132,049	\$ 1,570,773		

The Company maintains its revolving credit facilities to finance the acquisition of rental equipment and for general working capital purposes. As of September 30, 2018, the Company had \$1,157.2 million in total availability under its revolving credit facilities (net of \$0.1 million in letters of credit) subject to the Company's ability to meet the collateral requirements under the agreements governing the facilities. Based on the borrowing base and collateral requirements at September 30, 2018, the borrowing availability under the Company's revolving credit facilities was \$151.9 million, assuming no additional contributions of assets.

On February 28, 2018, CAL Funding III Limited (CAL Funding III), a wholly-owned indirect subsidiary of CAI, issued \$332.0 million of 4.0% Class A fixed rate asset-backed notes and \$16.9 million of 4.8% Class B fixed rate asset-backed notes (collectively, the Series 2018-1 Asset-Backed Notes). Principal and interest on the Series 2018-1 Asset-Backed Notes is payable monthly commencing on March 26, 2018, with the Series 2018-1 Asset-Backed Notes maturing in February 2043. The proceeds were used for general corporate purposes, including repayment of debt by the Company.

On April 19, 2018, the Company entered into a \$30.0 million five-year term loan agreement with a bank. The loan is payable in 19 quarterly installments of \$0.5 million starting July 31, 2018 and a final payment of \$21.5 million on April 30, 2023. The loan bears interest at a variable rate based on LIBOR.

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CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

On June 27, 2018, the Company entered into an amendment to its Third Amended and Restated Revolving Credit Agreement, pursuant to which the Company's senior revolving credit facility was amended to, among other things, increase the commitment level from \$960 million to \$1.1 billion with the ability to increase the revolving credit facility by an additional \$250 million without lender approval, subject to certain conditions. The amendment also extended the maturity date of the revolving credit facility to June 26, 2023 and revised certain covenants, restrictions and events of default to provide the Company with additional flexibility, including an increase in the maximum total leverage ratio from 3.75:1.00 to 4.00:1.00, subject to certain conditions.

On September 19, 2018, CAL Funding III issued \$331.5 million of 4.3% Class A fixed rate asset-backed notes and \$12.0 million of 5.2% Class B fixed rate asset-backed notes (collectively, the Series 2018-2 Asset-Backed Notes). Principal and interest on the Series 2018-2 Asset-Backed Notes is payable monthly commencing on October 25, 2018, with the Series 2018-2 Asset-Backed Notes maturing on September 25, 2043. The proceeds were used for general corporate purposes, including repayment of debt.

On October 18, 2018, the Company entered into a \$100.0 million five-year term loan agreement with a bank. The loan is payable in 20 quarterly installments of \$1.5 million starting December 20, 2018 and a final payment of \$70.0 million on October 18, 2023. The outstanding principal amounts under the loan bear interest at a fixed rate per annum of 4.6%.

On October 22, 2018, CAI Rail, Inc. (CAI Rail), a wholly owned subsidiary of the Company, entered into a Third Amended and Restated Revolving Credit Agreement, pursuant to which CAI Rail's revolving credit facility was amended to, among other things, (i) increase the commitment level from \$500 million to \$550 million, with the ability to increase the facility by an additional \$150 million, subject to certain conditions, (ii) extend the maturity date from October 22, 2020 to October 23, 2023, and (iii) revise certain covenants, restrictions and events of default to provide the Company with additional flexibility, including an increase in the maximum total leverage ratio from 3.75:1.00 to 4.00:1.00, subject to certain conditions.

The agreements relating to all of the Company's debt contain various financial and other covenants. As of September 30, 2018, the Company was in compliance with all of its financial and other 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, 2017, filed with the SEC on February 27, 2018.

(8) Stock-Based Compensation Plan

Stock Options

The Company may grant 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 the 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.

The following table summarizes the Company's stock option activities for the nine months ended September 30, 2018 and 2017:

	Nine Months Ended September 30,			
	2018		2017	
	Number of	Weighted	Number of	Weighted
	Shares	Average	Shares	Average
		Exercise		Exercise
		Price		Price
Options outstanding at January 1	859,560	\$ 16.44	1,428,255	\$ 16.31
Options granted	-	\$ -	230,500	\$ 16.80
Options exercised	(9,393)	\$ 14.76	(240,173)	\$ 11.40
Options outstanding at September 30	850,167	\$ 16.46	1,418,582	\$ 17.22
Options exercisable	625,263	\$ 17.54	975,087	\$ 18.24
Weighted average remaining term	6.0 years		5.0 years	

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CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The aggregate intrinsic value of stock options exercised during the nine months ended September 30, 2018 and 2017 was \$0.1 million and \$2.2 million, respectively. The aggregate intrinsic value of all options outstanding as of September 30, 2018 was \$5.7 million based on the closing price of the Company's common stock of \$22.87 per share on September 28, 2018, the last trading day of the quarter.

The Company recognized stock-based compensation expense relating to stock options of \$0.2 million and \$0.4 million for the three months ended September 30, 2018 and 2017, respectively, and \$1.0 million and \$1.2 million for the nine months ended September 30, 2018 and 2017, respectively. As of September 30, 2018, the remaining unamortized stock-based compensation cost relating to stock options granted to the Company's employees and independent directors was approximately \$1.5 million, which is to be recognized over the remaining weighted average vesting period of approximately 2.0 years.

The Company did not grant any stock options in the nine months ended September 30, 2018. 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,	
	2018	2017
Stock price	\$ -	\$ 16.80
Exercise price	\$ -	\$ 16.80
Expected term (years)	-	5.50 - 6.25
Expected volatility (%)	-	56.40 - 57.50
Risk-free interest rate (%)	-	1.77 - 2.14
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 common 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.

Restricted Stock and Performance Stock

The Company grants restricted stock, comprising restricted stock units and restricted stock awards, from time to time to certain employees and non-employee directors pursuant to the Plan. The Company recognizes the compensation cost associated with restricted stock over a specified award vesting period based on the closing price of the Company's common stock on the date of grant.

The Company grants performance stock to selected executives and other key employees. The performance stock vests at the end of a 3-year performance cycle if certain financial performance targets are met. The Company recognizes compensation cost associated with the performance stock ratably over the 3-year term based on the likelihood of performance targets being met. Compensation cost is based on the closing price of the Company's common stock on the date of grant.

The following table summarizes the activity of restricted stock and performance stock under the Plan:

	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2017	78,542	\$ 14.92
Granted	154,165	\$ 22.48
Vested	(29,982)	\$ 16.52
Outstanding at September 30, 2018	202,725	\$ 20.43

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CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The Company recognized \$0.5 million and \$0.1 million of stock-based compensation expense relating to restricted stock and performance stock awards for the three months ended September 30, 2018 and 2017, respectively, and \$1.1 million and \$0.4 million for the nine months ended September 30, 2018 and 2017, respectively. As of September 30, 2018, unamortized stock-based compensation expense relating to restricted stock and performance stock was \$3.2 million, which will be recognized over the remaining average vesting period of 2.4 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.

(9) Income Taxes

The consolidated income tax expense for the three and nine months ended September 30, 2018 and 2017, was determined based upon estimates of the Company's consolidated annual effective income tax rate for the years ending December 31, 2018 and 2017, 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 4.4% at September 30, 2018, compared to 1.5% at September 30, 2017.

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, 2018, the Company had unrecognized tax benefits of \$0.3 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, 2018. The Company does not believe the total amount of unrecognized tax benefits as of September 30, 2018 will change for the remainder of 2018.

The Company was notified on May 1, 2017 that its 2015 federal income tax return was selected for examination. The examination was concluded on June 20, 2018 with no impact to tax expense.

(10) 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 \$1,066.4 million, collateralized financing obligations of \$103.1 million and fixed-rate term loans of \$61.1 million as of September 30, 2018 were estimated to have a fair value of approximately \$1,049.6 million, \$104.7 million and \$59.8 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 \$471.7 million, variable-rate term loans of \$227.8 million, senior secured notes of \$58.9 million and term loans held by VIE of \$1.9 million approximate their fair values as of September 30, 2018. The fair value of these financial instruments would be categorized as Level 2 in the fair value hierarchy.

(11) Commitments and Contingencies

In addition to its debt obligations described in Note 7 above, the Company had commitments to purchase approximately \$61.4 million of containers and \$62.2 million of railcars as of September 30, 2018, all 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 \$5.1 million as of September 30, 2018.

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CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(12) Stockholders' Equity

Common Stock At-the-Market (ATM) Offering Program

In October 2017, the Company commenced an ATM offering program with respect to its common stock, which allows the Company to issue and sell up to 2.0 million shares of its common stock. During the nine months ended September 30, 2018, the Company issued 100,000 shares of common stock under the ATM offering program for net proceeds of \$2.8 million. The Company paid commissions to the sales agent of \$0.1 million in connection with the sales of common stock under this ATM offering program during the nine months ended September 30, 2018. The net proceeds were used for general corporate purposes. The Company has remaining capacity to issue up to approximately 1.0 million of additional shares of common stock under this ATM offering program. The Company did not issue any shares under this ATM offering program during the three months ended September 30, 2018.

Series A Preferred Stock Underwritten Offering

In March 2018, the Company completed an underwritten public offering of 1,600,000 shares of its 8.5% Series A Fixed-to-Floating Rate Cumulative Redeemable Perpetual Preferred Stock, par value \$0.0001 per share and liquidation preference \$25.00 per share (Series A Preferred Stock), resulting in net proceeds to the Company of approximately \$38.3 million, after deducting the underwriting discount and other offering expenses. Dividends on the Series A Preferred Stock accrue daily and are cumulative from and including the date of original issuance and are payable quarterly in arrears on the 15th day of each April, July, October and January. Dividends accrue at the Fixed Dividend Rate (as defined in the certificate of designations for the Series A Preferred Stock (Series A Certificate of Designations)) at an annual rate of 8.5% of the \$25.00 liquidation preference per annum from, and including, the date of original issuance to, but not including, April 15, 2023. On and after April 15, 2023, dividends on the Series A Preferred Stock shall accrue at an annual rate equal to the sum of (a) Three-Month LIBOR (as defined in the Series A Certificate of Designations) as calculated on each applicable date and (b) 5.82% of the \$25.00 liquidation preference per share of Series A Preferred Stock. The Series A Preferred Stock ranks senior to the Company's common stock with respect to dividend rights and rights upon the Company's liquidation, dissolution or winding up.

The Series A Preferred Stock becomes redeemable by the Company beginning April 25, 2023 for cash at a redemption price of \$25.00 per share of Series A Preferred Stock, plus accrued but unpaid dividends thereon to, but not including, the date fixed for redemption. In addition, upon the occurrence of a Change of Control (as defined in the Series A Certificate of Designations), subject to certain restrictions, the Company may, at its option, upon not less than thirty

(30) days' nor more than sixty (60) days' written notice, redeem the Series A Preferred Stock, in whole or in part, within one hundred twenty (120) days after the first date on which such Change of Control occurred, for cash at a redemption price of \$25.00 per share, plus any accumulated and unpaid dividends thereon to, but not including, the date fixed for redemption. There is no mandatory redemption of the Series A Preferred Stock or redemption at the option of the holders. Holders of the Series A Preferred Stock generally have no voting rights except for limited voting rights if the Company fails to pay dividends on the Series A Preferred Stock for six or more quarterly periods (whether or not consecutive) or the Company fails to maintain the listing of the Series A Preferred Stock on a National Exchange (as defined in the Series A Certificate of Designations) for a period of 180 consecutive days.

In April 2018, the Company sold an additional 170,900 shares of Series A Preferred Stock upon the partial exercise by the underwriters of their option to purchase additional Series A Preferred Stock, resulting in net proceeds to the Company of approximately \$4.1 million, after deducting the underwriting discount of \$0.1 million.

Series A Preferred Stock ATM Offering Program

In May 2018, the Company commenced an ATM offering program with respect to its Series A Preferred Stock, which allows the Company to issue and sell up to 2.2 million shares of its Series A Preferred Stock. During the nine months ended September 30, 2018, the Company issued 428,710 shares of Series A Preferred Stock under the ATM offering program for net proceeds of \$10.5 million. The Company paid commissions to the sales agent of \$0.2 million in connection with the sales of Series A Preferred Stock under this ATM offering program during the nine months ended September 30, 2018. The net proceeds were used for repayment of debt and general corporate purposes. The Company has remaining capacity to issue up to approximately 1.8 million of additional shares of Series A Preferred Stock under this ATM offering program. The Company did not issue any shares under this ATM offering program during the three months ended September 30, 2018.

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CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Series B Preferred Stock Underwritten Offering

In August 2018, the Company completed an underwritten public offering of 1,700,000 shares of its 8.5% Series B Fixed-to-Floating Rate Cumulative Redeemable Perpetual Preferred Stock, par value \$0.0001 per share and liquidation preference \$25.00 per share (Series B Preferred Stock), resulting in net proceeds to the Company of approximately \$41.2 million, after deducting the underwriting discount. The Company sold an additional 255,000 shares of Series B Preferred Stock upon the exercise by the underwriters of their option to purchase additional Series B Preferred Stock, resulting in net proceeds to the Company of approximately \$6.2 million, after deducting the underwriting discount of \$0.2 million.

Dividends on the Series B Preferred Stock accrue daily and are cumulative from and including the date of original issuance and are payable quarterly in arrears on the 15th day of each January, April, July and October. Dividends accrue at the Fixed Dividend Rate (as defined in the Series B certificate of designations for the Series B Preferred Stock (Series B Certificate of Designations)) at an annual rate of 8.5% of the \$25.00 liquidation preference per annum from, and including, the date of original issuance to, but not including, August 15, 2023. On and after August 15, 2023, dividends on the Series B Preferred Stock shall accrue at an annual rate equal to the sum of (a) Three-Month LIBOR (as defined in the Certificate of Designations) as calculated on each applicable date and (b) 5.69% of the \$25.00 liquidation preference per share of Series B Preferred Stock. The Series B Preferred Stock ranks senior to the Company's common stock with respect to dividend rights and rights upon the Company's liquidation, dissolution or winding up.

The Series B Preferred Stock becomes redeemable by the Company beginning August 15, 2023 for cash at a redemption price of \$25.00 per share of Series B Preferred Stock, plus accrued but unpaid dividends thereon to, but not including, the date fixed for redemption. In addition, upon the occurrence of a Change of Control (as defined in the Series B Certificate of Designations), subject to certain restrictions, the Company may, at its option, upon not less than thirty (30) days' nor more than sixty (60) days' written notice, redeem the Series B Preferred Stock, in whole or in part, within one hundred twenty (120) days after the first date on which such Change of Control occurred, for cash at a redemption price of \$25.00 per share, plus any accumulated and unpaid dividends thereon to, but not including, the date fixed for redemption. There is no mandatory redemption of the Series B Preferred Stock or redemption at the option of the holders. Holders of the Series B Preferred Stock generally have no voting rights except for limited voting rights if the Company fails to pay dividends on the Series B Preferred Stock for six or more quarterly periods (whether or not consecutive) or the Company fails to maintain the listing of the Series B Preferred Stock on a National Exchange (as defined in the Series B Certificate of Designations) for a period of 180 consecutive days.

(13) Related Party Transactions

In May 2018, the Company purchased, and subsequently cancelled, 1,225,214 shares of its common stock, from an affiliate of Andrew S. Ogawa in a privately-negotiated transaction. Mr. Ogawa is a member of the Company's Board of Directors. The stock was purchased at a price of \$22.81 per share, which represented a 2% discount to the closing price on the date of purchase.

(14) 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 the segments based upon relative asset values or revenue.

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CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following tables show condensed segment information for the three and nine months ended September 30, 2018 and 2017, reconciled to the Company's income before income taxes as shown in its consolidated statements of income for such periods (in thousands):

	Three Months Ended September 30, 2018			
	Container	Rail	Logistics	Total
	Leasing	Leasing		
Total revenue	\$ 75,331	\$ 8,759	\$ 31,362	\$ 115,452
Total operating expenses	32,723	5,789	34,059	72,571
Operating income (loss)	42,608	2,970	(2,697)	42,881
Net interest and other expenses (income)	15,931	3,973	(5)	19,899
Income (loss) before income taxes	\$ 26,677	\$ (1,003)	\$ (2,692)	\$ 22,982
Goodwill	\$ -	\$ -	\$ 15,794	\$ 15,794
Total assets	\$ 2,481,010	\$ 474,718	\$ 43,437	\$ 2,999,165
Purchase of rental equipment (1)	\$ 251,670	\$ 5,599	\$ -	\$ 257,269

	Three Months Ended September 30, 2017			
	Container	Rail	Logistics	Total
	Leasing	Leasing		
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
Net interest and other expenses	11,537	2,871	-	14,408
Income (loss) before income taxes	\$ 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

Nine Months Ended September 30, 2018
Logistics Total

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	Container Leasing	Rail Leasing		
Total revenue	\$ 208,298	\$ 26,982	\$ 81,251	\$ 316,531
Total operating expenses	95,153	18,721	85,141	199,015
Operating income (loss)	113,145	8,261	(3,890)	117,516
Net interest and other expenses (income)	44,284	11,364	(16)	55,632
Income (loss) before income taxes	\$ 68,861	\$ (3,103)	\$ (3,874)	\$ 61,884
Purchase of rental equipment (1)	\$ 477,563	\$ 51,667	\$ -	\$ 529,230

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
Net interest and other expenses	30,346	8,220	1	38,567
Income (loss) before income taxes	\$ 39,650	\$ (799)	\$ (2,805)	\$ 36,046
Purchase of rental equipment (1)	\$ 246,378	\$ 31,391	\$ -	\$ 277,769

(1) Represents cash disbursements for purchasing of rental equipment as reflected in the consolidated statements of cash flows for the periods indicated.

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CAI INTERNATIONAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Geographic Data

The Company earns its revenue primarily from intermodal containers, which are deployed by its customers in a wide variety of global trade routes. Virtually all of the Company's containers are used internationally and typically no container is domiciled in one particular place for a prolonged period of time. As such, substantially all of the Company's long-lived assets are considered to be international, with no single country of use.

The Company's railcars, with a net book value of \$464.8 million as of September 30, 2018, are used primarily to transport cargo within North America.

The following table represents the geographic allocation of revenue for the periods indicated based on customers' primary domicile (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
United States	\$ 41,921	\$ 30,131	\$ 113,688	\$ 90,208
Switzerland	13,929	9,182	36,246	21,087
France	9,295	8,938	27,435	25,600
Korea	8,707	5,831	21,927	14,096
Singapore	5,987	5,345	16,725	14,669
Other Asia	4,326	16,283	38,106	47,813
Other Europe	14,636	11,815	40,794	32,904
Other International	16,651	2,636	21,610	7,982
Total revenue	\$ 115,452	\$ 90,161	\$ 316,531	\$ 254,359

(15) Earnings Per Share

Basic earnings per share is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that

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would occur if securities or other contracts to issue common stock were exercised or converted into common stock; however, potential common equivalent shares are excluded if their effect is anti-dilutive.

The following table sets forth the reconciliation of basic and diluted net income per share for the three and nine months ended September 30, 2018 and 2017 (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Numerator				
Net income attributable to CAI common stockholders	\$ 20,006	\$ 17,587	\$ 56,272	\$ 35,497
Denominator				
Weighted-average shares used in per share computation - basic	19,214	19,180	19,741	19,108
Effect of dilutive securities:				
Stock options and restricted stock	278	453	256	314
Weighted-average shares used in per share computation - diluted	19,492	19,633	19,997	19,422
Net income per share attributable to CAI common stockholders:				
Basic	\$ 1.04	\$ 0.92	\$ 2.85	\$ 1.86
Diluted	\$ 1.03	\$ 0.90	\$ 2.81	\$ 1.83

The calculation of diluted earnings per share for the three months ended September 30, 2018 and 2017, excluded from the denominator 86,055 and 41,989 shares, respectively, of common stock options because their effect would have been anti-dilutive. The calculation of diluted earnings per share for the nine months ended September 30, 2018 and 2017, excluded from the denominator 158,495 and 822,226 shares, respectively, of common stock options because their effect would have been anti-dilutive.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our audited consolidated financial statements and related notes thereto, included in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC on February 27, 2018. In addition to historical consolidated financial information, the following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results may differ materially from those contained in or implied by any forward-looking statements. The financial information included in this discussion and in our consolidated financial statements may not be indicative of our consolidated financial position, operating results, changes in equity and cash flows in the future. See "Special Note Regarding Forward-Looking Statements" included earlier in this report.

Unless the context requires otherwise, references to "CAI," the "Company," "we," "us" or "our" in this Quarterly Report on Form 10-Q refer to CAI International, Inc. and its subsidiaries.

Overview

We are one of the world's leading transportation finance and logistics companies. We purchase equipment, primarily intermodal shipping containers and railcars, which we lease to our customers. We also manage equipment for third-party investors. In operating our fleet, we lease, re-lease and dispose of equipment and contract for the repair, repositioning and storage of equipment. We also provide domestic and international logistics services.

The following tables show the composition of our fleet as of September 30, 2018 and 2017, and our average utilization for the three and nine months ended September 30, 2018 and 2017:

	As of September 30,	
	2018	2017
Owned container fleet in TEUs	1,435,516	1,121,355
Managed container fleet in TEUs	75,872	83,086
Total container fleet in TEUs	1,511,388	1,204,441
Owned container fleet in CEUs	1,475,142	1,188,078
Managed container fleet in CEUs	69,134	75,596
Total container fleet in CEUs	1,544,276	1,263,674

Owned railcar fleet in units	7,489	6,795
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	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Average container fleet utilization in CEUs	99.2%	98.0%	99.2%	96.9%
Average owned container fleet utilization in CEUs	99.2%	98.2%	99.2%	97.1%
Average railcar fleet utilization	89.0%	89.3%	88.1%	91.0%

The intermodal marine container industry-standard measurement unit is the 20-foot equivalent unit (TEU), which compares the size of a container to a standard 20-foot container. For example, a 20-foot container is equivalent to one TEU and a 40-foot container is equivalent to two TEUs. Containers can also be measured in cost equivalent units (CEUs), whereby the cost of each type of container is expressed as a ratio relative to the cost of a standard 20-foot dry van container. For example, the CEU ratio for a standard 40-foot dry van container is 1.6, and a 40-foot high cube container is 1.7.

Utilization of containers is computed by dividing the average total units on lease during the period in CEUs, by the average total CEUs in our container fleet during the period. Utilization of railcars is computed by dividing the average number of railcars on lease during the period by the average total number of railcars in our fleet during the period. In both cases, the total fleet excludes new units not yet leased and off-hire units designated for sale. If new units not yet leased are included in the total fleet, utilization would be 96.6% and 97.1% for the total container fleet, 96.5% and 97.0% for the owned container fleet, and 84.0% and 79.1% for the railcar fleet, for the three and nine months ended September 30, 2018, respectively.

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Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017

The following table summarizes our operating results for the three months ended September 30, 2018 and 2017 (dollars in thousands):

	Three Months Ended		Increase	
	September 30, 2018	September 30, 2017	Amount	Percent
Total revenue	\$ 115,452	\$ 90,161	\$ 25,291	28 %
Operating expenses	72,571	58,267	14,304	25 %
Total other expenses	19,899	14,408	5,491	38 %
Net income attributable to CAI common stockholders	20,006	17,587	2,419	14 %

Total revenue for the three months ended September 30, 2018 increased \$25.3 million, or 28%, compared to the three months ended September 30, 2017, due to a \$13.5 million, or 22%, increase in container lease revenue, a \$1.5 million, or 20%, increase in rail lease revenue and a \$10.4 million, or 49%, increase in logistics revenue. Operating expenses for the three months ended September 30, 2018 increased \$14.3 million, or 25%, compared to the three months ended September 30, 2017, as a result of a \$9.7 million, or 54%, increase in logistics transportation costs, a \$3.5 million, or 13%, increase in depreciation expense, and a \$2.1 million, or 19%, increase in administrative expenses, partially offset by a \$1.0 million, or 58%, increase in gain on sale of used rental equipment. Total other expenses for the three months ended September 30, 2018 increased \$5.5 million, or 38%, compared with the three months ended September 30, 2017, primarily due to a \$5.8 million, or 42%, increase in net interest expense. A dividend of \$1.7 million on our preferred stock was recorded in the three months ended September 30, 2018, while we did not have any preferred stock outstanding in the three months ended September 30, 2017. The increase in revenue, partially offset by the increase in operating expenses, the increase in total other expenses, and the preferred stock dividend resulted in a \$2.4 million, or 14%, increase in net income attributable to CAI common stockholders for the three months ended September 30, 2018 compared to the three months ended September 30, 2017.

Container lease revenue

Three Months Ended	Increase
September 30,	

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(\$ in thousand)	2018	2017	Amount	Percent
Container lease revenue	\$ 75,331	\$ 61,870	\$ 13,461	22 %

The increase in container lease revenue for the three months ended September 30, 2018 compared to the three months ended September 30, 2017 was mainly attributable to a \$14.3 million increase in rental revenue, primarily due to a 25% increase in the average number of CEUs of on-lease owned containers, partially offset by a \$0.6 million decrease resulting from a 1% reduction in average owned container per diem rental rates.

Rail lease revenue

	Three Months Ended September 30,		Increase	
(\$ in thousand)	2018	2017	Amount	Percent
Rail lease revenue	\$ 8,759	\$ 7,279	\$ 1,480	20 %

Rail lease revenue increased for the three months ended September 30, 2018 compared to the three months ended September 30, 2017, primarily as a result of a 20% increase in the average size of our on-lease railcar fleet during the last twelve months.

Logistics revenue and gross margin

	Three Months Ended September 30,		Increase	
(\$ in thousand)	2018	2017	Amount	Percent
Logistics revenue	\$ 31,362	\$ 21,012	\$ 10,350	49 %
Logistics transportation costs	27,541	17,855	9,686	54 %
Logistics gross margin	\$ 3,821	\$ 3,157	\$ 664	21 %

The increase in logistics revenue for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, was primarily due to an increase in freight rates in our intermodal and truck brokerage operations. Transportation costs increased at a slightly higher rate than revenue due primarily to increased volume in our lower margin intermodal business and resulted in a decrease in the gross margin percentage from 15.0% for the three months ended September 30, 2017 to 12.2% for the three months ended September 30, 2018.

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Depreciation of rental equipment

(\$ in thousand)	Three Months Ended		Increase	
	September 30, 2018	September 30, 2017	Amount	Percent
Container leasing	\$ 27,735	\$ 24,958	\$ 2,777	11 %
Rail leasing	3,537	2,830	707	25 %
	\$ 31,272	\$ 27,788	\$ 3,484	13 %

Container leasing

The increase in depreciation expense for the three months ended September 30, 2018 compared to the three months ended September 30, 2017 was primarily attributable to an increase in the average size of our owned container fleet during the last twelve months.

Rail leasing

The increase in depreciation expense for the three months ended September 30, 2018 compared to the three months ended September 30, 2017 was primarily attributable to an 11% increase in the average size of the railcar fleet during the last twelve months, as well as an increase in the proportion of new railcars in the fleet.

Storage, handling and other expenses

(\$ in thousand)	Three Months Ended September 30,		Increase/(Decrease)	
	2018	2017	Amount	Percent
Container leasing	\$ 2,506	\$ 1,952	\$ 554	28 %

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Rail leasing	1,008	1,529	(521)	(34)	%
Logistics	-	25	(25)	(100)	%
	\$ 3,514	\$ 3,506	\$ 8	0	%

Container leasing

The increase in storage, handling and other expenses for the three months ended September 30, 2018 compared to the three months ended September 30, 2017 was primarily attributable to \$1.5 million of insurance proceeds recorded in 2017 related to repair costs associated with the previously reported Hanjin bankruptcy, partially offset by a \$0.4 million decrease in storage charges resulting from a decrease in the average size of the off-lease fleet and a 1% increase in average utilization between the two periods, as well as a \$0.5 million decrease in unit recovery costs as a result of insurance proceeds received in 2018 relating to the Hanjin bankruptcy.

Rail leasing

The decrease in storage, handling and other expenses for the three months ended September 30, 2018 compared to the three months ended September 30, 2017 was primarily attributable to a decrease of \$0.4 million in repair and maintenance expense due to the timing of repairs performed on our rail cars.

Gain (loss) on sale of used rental equipment

(\$ in thousand)	Three Months Ended September 30,		Increase/(Decrease)	
	2018	2017	Amount	Percent
Container leasing	\$ 2,633	\$ 1,663	\$ 970	58 %
Rail leasing	(8)	-	(8)	(100) %
	\$ 2,625	\$ 1,663	\$ 962	58 %

Container leasing

While we sold approximately 6% fewer used containers during the three months ended September 30, 2018 compared to the three months ended September 30, 2017, there was an increase of 52% in the average sales price per unit, which reflected the recovery in new equipment prices in the last twelve months as well as a limited supply of used

equipment, and resulted in an increase in gain on sale of used rental equipment.

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Administrative expenses

(\$ in thousand)	Three Months Ended		Increase	
	September 30, 2018	September 30, 2017	Amount	Percent
Container leasing	\$ 6,980	\$ 5,425	\$ 1,555	29 %
Rail leasing	1,235	1,174	61	5 %
Logistics	4,654	4,182	472	11 %
	\$ 12,869	\$ 10,781	\$ 2,088	19 %

Container leasing

The increase in administrative expenses for the three months ended September 30, 2018 compared to the three months ended September 30, 2017 was primarily attributable to a \$1.6 million reduction in contingent consideration liability related to acquisitions that was recorded during the three months ended September 30, 2017.

Rail leasing

Administrative expenses for the three months ended September 30, 2018 remained consistent with the three months ended September 30, 2017.

Logistics

The increase in administrative expenses for the three months ended September 30, 2018 compared to the three months ended September 30, 2017 was primarily attributable to a \$0.7 million increase in payroll-related costs between the two periods due to additional headcount, partially offset by a \$0.2 million decrease in bad debt expense.

Other expenses

(\$ in thousand)	Three Months Ended		Increase/(Decrease)	
	September 30, 2018	September 30, 2017	Amount	Percent
Net interest expense	\$ 19,783	\$ 13,959	\$ 5,824	42 %
Other expense	116	449	(333)	(74) %
	\$ 19,899	\$ 14,408	\$ 5,491	38 %

Net interest expense

The increase in net interest expense for the three months ended September 30, 2018 compared to the three months ended September 30, 2017 was due primarily to an increase in the average loan principal balance between the two periods, as we continue to increase borrowings to finance the acquisition of additional rental equipment, as well as an increase in the average interest rate on our outstanding debt, caused by an increase in LIBOR, from approximately 3.1% to 3.8%.

Other expense

Other expense, representing a loss on foreign exchange of \$0.1 million for the three months ended September 30, 2018, decreased \$0.3 million from a loss of \$0.4 million for the three months ended September 30, 2017, primarily as a result of movements in the U.S. Dollar exchange rate against the Euro.

Income tax expense

(\$ in thousand)	Three Months Ended September		Increase	
	30, 2018	30, 2017	Amount	Percent
Income tax expense (benefit)	\$ 1,228	\$ (101)	\$ 1,329	1,316 %

The estimated effective tax rate at September 30, 2018 was 4.4% compared to 1.5% at September 30, 2017. The increase in estimated effective tax rate at September 30, 2018 was primarily caused by an increase in the amount of interest income generated by foreign direct finance leases subject to both foreign and U.S. income tax.

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Preferred stock dividends

(\$ in thousand)	Three Months Ended		Increase	
	September 30, 2018	September 30, 2017	Amount	Percent
Preferred stock dividends	\$ 1,748	\$ -	\$ 1,748	100 %

An accrual for preferred stock dividends of \$1.7 million was recorded in the three months ended September 30, 2018 as a result of 2.2 million shares of Series A Preferred Stock and 2.0 million shares of Series B Preferred Stock being issued and sold in 2018. We did not have any shares of preferred stock outstanding during the three months ended September 30, 2017. See Note 12 to our consolidated financial statements in this Quarterly Report on Form 10-Q for additional information related to our preferred stock.

Nine Months Ended September 30, 2018 Compared to Nine Months Ended September 30, 2017

The following table summarizes our operating results for the nine months ended September 30, 2018 and 2017 (dollars in thousands):