PROLOGIS
Form 10-Q
August 07, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended June 30, 2007

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 01-12846

PROLOGIS

(Exact name of registrant as specified in its charter)

Maryland	**74-2604728**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
4545 Airport Way, Denver, Colorado	**80239**
(Address or principal executive offices)	**(Zip Code)**

(303) 567-5000

(Registrant s telephone number, including area code)

(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 for the past 90 days.

Yes þ No o

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).

Yes o No þ

The number of shares outstanding of the Registrant s common shares as of August 2, 2007 was 256,966,568.

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PART 1.
Item 1. Financial Statements

PROLOGIS
CONSOLIDATED STATEMENTS OF
EARNINGS AND COMPREHENSIVE INCOME
(Unaudited)
(In thousands, except per share data)

	Three months ended June 30,		Six months ended June 30,	
	2007	**2006**	**2007**	**2006**
Revenues:				
Rental income	$ 272,529	$ 215,876	$ 530,606	$ 440,644
CDFS disposition proceeds	686,715	433,854	1,356,653	738,864
Property management and other fees and incentives	23,937	20,329	45,584	58,897
Development management and other income	6,176	11,258	13,615	15,426
Total revenues	989,357	681,317	1,946,458	1,253,831
Expenses:				
Rental expenses	73,705	53,202	139,311	112,236
Cost of CDFS dispositions	476,684	348,552	915,675	586,838
General and administrative	50,503	39,138	100,645	75,298
Depreciation and amortization	74,522	67,943	152,733	138,269
Other expenses	15,068	3,421	17,934	5,947
Total expenses	690,482	512,256	1,326,298	918,588
Operating income	298,875	169,061	620,160	335,243
Other income (expense):				
Earnings from unconsolidated property funds	15,804	10,969	34,768	67,414
Earnings from CDFS joint ventures and other unconsolidated investees	1,773	33,904	2,317	37,421
Interest expense	(90,640)	(68,663)	(179,291)	(139,516)
Interest income on notes receivable	2,891	4,286	6,157	9,322
Interest and other income, net	6,844	709	14,752	5,283
Total other income (expense)	(63,328)	(18,795)	(121,297)	(20,076)
Earnings before minority interest	235,547	150,266	498,863	315,167
Minority interest	(723)	(851)	(896)	(1,976)
Earnings before certain net gains	234,824	149,415	497,967	313,191
Gains recognized on dispositions of certain non-CDFS business assets	124,085		124,085	13,709

Foreign currency exchange gains, net	22,706	8,569	9,154	7,247
Earnings before income taxes	381,615	157,984	631,206	334,147
Income taxes:				
Current income tax expense	26,645	27,892	44,745	41,089
Deferred income tax (benefit) expense	(9,503)	5,413	(6,182)	5,582
Total income taxes	17,142	33,305	38,563	46,671
Earnings from continuing operations	364,473	124,679	592,643	287,476

(Continued)

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PROLOGIS
CONSOLIDATED STATEMENTS OF
EARNINGS AND COMPREHENSIVE INCOME (CONTINUED)
(Unaudited)
(In thousands, except per share data)

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Discontinued operations:				
Income attributable to disposed properties and assets held for sale	631	5,878	1,601	11,147
Gains recognized on dispositions:				
Non-CDFS business assets	27,161	34,223	32,125	50,651
CDFS business assets	14,196	9,971	22,537	14,990
Total discontinued operations	41,988	50,072	56,263	76,788
Net earnings	406,461	174,751	648,906	364,264
Less preferred share dividends	6,357	6,354	12,711	12,708
Net earnings attributable to common shares	400,104	168,397	636,195	351,556
Other comprehensive income items:				
Foreign currency translation gains	5,041	38,128	4,666	33,655
Unrealized gains on derivative contracts, net	2,188	2,787	753	2,367
Comprehensive income	$ 407,333	$ 209,312	$ 641,614	$ 387,578
Weighted average common shares outstanding Basic	257,086	244,998	255,677	244,642
Weighted average common shares outstanding Diluted	267,880	255,196	266,723	255,093
Net earnings per share attributable to common shares Basic:				
Continuing operations	$ 1.40	$ 0.49	$ 2.27	$ 1.13
Discontinued operations	0.16	0.20	0.22	0.31
Net earnings per share attributable to common shares Basic	$ 1.56	$ 0.69	$ 2.49	$ 1.44
Net earnings per share attributable to common shares Diluted:				
Continuing operations	$ 1.34	$ 0.46	$ 2.18	$ 1.09
Discontinued operations	0.16	0.20	0.21	0.30

Net earnings per share attributable to common shares Diluted	$	1.50	$	0.66	$	2.39	$	1.39
Distributions per common share	$	0.46	$	0.40	$	0.92	$	0.80

The accompanying notes are an integral part of these Consolidated Financial Statements.

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PROLOGIS
CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

	June 30, 2007 (Unaudited)	December 31, 2006
ASSETS		
Real estate	$ 15,147,686	$ 13,953,999
Less accumulated depreciation	1,291,012	1,280,206
	13,856,674	12,673,793
Investments in and advances to unconsolidated investees	1,523,599	1,299,697
Cash and cash equivalents	942,204	475,791
Accounts and notes receivable	363,933	439,791
Other assets	1,373,903	957,295
Discontinued operations assets held for sale	44,114	57,158
Total assets	$ 18,104,427	$ 15,903,525
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Debt	$ 9,563,153	$ 8,386,886
Accounts payable and accrued expenses	620,900	518,651
Other liabilities	685,799	546,129
Discontinued operations assets held for sale	844	1,012
Total liabilities	10,870,696	9,452,678
Minority interest	70,359	52,268
Shareholders equity:		
Series C Preferred Shares at stated liquidation preference of $50.00 per share; $0.01 par value; 2,000 shares issued and outstanding at June 30, 2007 and December 31, 2006	100,000	100,000
Series F Preferred Shares at stated liquidation preference of $25.00 per share; $0.01 par value; 5,000 shares issued and outstanding at June 30, 2007 and December 31, 2006	125,000	125,000
Series G Preferred Shares at stated liquidation preference of $25.00 per share; $0.01 par value; 5,000 shares issued and outstanding at June 30, 2007 and December 31, 2006	125,000	125,000
Common Shares; $0.01 par value; 256,880 shares issued and outstanding at June 30, 2007 and 250,912 shares issued and outstanding at December 31, 2006	2,569	2,509
Additional paid-in capital	6,368,396	6,000,119
Accumulated other comprehensive income	222,341	216,922

Retained earnings (distributions in excess of net earnings)	220,066	(170,971)
Total shareholders equity	7,163,372	6,398,579
Total liabilities and shareholders equity	$ 18,104,427	$ 15,903,525

The accompanying notes are an integral part of these Consolidated Financial Statements.

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PROLOGIS
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Six months ended June 30, 2007	Six months ended June 30, 2006
Operating activities:		
Net earnings	$ 648,906	$ 364,264
Minority interest share in earnings	896	1,976
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Straight-lined rents	(23,484)	(16,088)
Cost of share-based compensation awards	14,142	12,076
Depreciation and amortization	154,941	145,303
Amortization of deferred loan costs and net premium on debt	(396)	(3,748)
Gains recognized on dispositions of non-CDFS business assets	(156,210)	(64,360)
Impairment charges	12,600	3,560
Equity in earnings from unconsolidated investees	(37,085)	(104,835)
Distributions from and changes in operating receivables of unconsolidated investees	32,437	53,130
Unrealized foreign currency exchange (gains) losses	(17,176)	904
Deferred income tax (benefit) expense	(6,182)	5,582
Increase in accounts receivable and other assets	(130,827)	(114,508)
Increase in accounts payable and accrued expenses and other liabilities	119,989	70,188
Net cash provided by operating activities	612,551	353,444
Investing activities:		
Real estate investments	(2,297,438)	(1,867,957)
Purchase of ownership interests in property funds		(259,248)
Cash paid in the Parkridge acquisition, net of cash acquired	(707,374)	
Tenant improvements and lease commissions on previously leased space	(30,827)	(35,947)
Recurring capital expenditures	(16,210)	(11,469)
Proceeds from dispositions of real estate assets	1,964,286	1,164,820
Proceeds from repayment of notes receivable, net	40,322	59,847
Investments in unconsolidated investees	(62,205)	(117,575)
Return of investment from unconsolidated investees	49,201	28,153
Net cash used in investing activities	(1,060,245)	(1,039,376)
Financing activities:		
Proceeds from sales and issuances of common shares under various common share plans	17,380	26,094
Distributions paid on common shares	(235,883)	(195,679)
Minority interest distributions	(4,748)	(8,357)
Dividends paid on preferred shares	(12,711)	(12,708)

Debt and equity issuance costs paid	(8,187)	(5,405)
Net (payments on) proceeds from lines of credit	(277,501)	218,233
Proceeds from issuance of senior notes, secured and unsecured debt	606,569	851,236
Proceeds from issuance of convertible senior notes	1,228,125	
Payments on senior notes, secured debt and assessment bonds	(395,636)	(81,729)
Net cash provided by financing activities	917,408	791,685
Effect of exchange rate changes on cash	(3,301)	4,488
Net increase in cash and cash equivalents	466,413	110,241
Cash and cash equivalents, beginning of period	475,791	203,800
Cash and cash equivalents, end of period	$ 942,204	$ 314,041

See Note 13 for information on non-cash investing and financing activities and other information.

The accompanying notes are an integral part of these Consolidated Financial Statements.

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PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. General:

Business. ProLogis, collectively with our consolidated subsidiaries (we , our , us , the Company or ProLogis), publicly held real estate investment trust (REIT) that owns, operates and develops (directly and through our unconsolidated investees) primarily industrial distribution properties in North America, Europe and Asia. Our business consists of three reportable business segments: (i) property operations; (ii) fund management; and (iii) CDFS business. Our property operations segment represents the direct long-term ownership of industrial distribution and retail properties. Our fund management segment represents the long-term investment management of property funds and the properties they own. Our CDFS business segment primarily encompasses our development or acquisition of real estate properties that are generally contributed to a property fund in which we have an ownership interest and act as manager, or sold to third parties. See Note 12 for further discussion of our business segments.

Basis of Presentation. The accompanying Consolidated Financial Statements, presented in the U.S. dollar, are prepared in accordance with U.S. generally accepted accounting principles (GAAP). GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities as of the date of the financial statements and revenue and expenses during the reporting period. Our actual results could differ from those estimates and assumptions. All material intercompany transactions with consolidated entities have been eliminated.

The accompanying unaudited interim financial information has been prepared according to the rules and regulations of the U.S. Securities and Exchange Commission (the SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted in accordance with such rules and regulations. Our management believes that the disclosures presented in these financial statements are adequate to make the information presented not misleading. In our opinion, all adjustments and eliminations, consisting only of normal recurring adjustments, necessary to present fairly our financial position as of June 30, 2007 and our results of operations for the three and six months ended June 30, 2007 and 2006 and cash flows for the six months ended June 30, 2007 and 2006 have been included. The results of operations for such interim periods are not necessarily indicative of the results for the full year. The accompanying unaudited interim financial information should be read in conjunction with our December 31, 2006 Consolidated Financial Statements, as filed with the SEC in our Annual Report on Form 10-K.

Certain amounts included in the accompanying Consolidated Financial Statements for 2006 have been reclassified to conform to the 2007 financial statement presentation.

Adoption of New Accounting Pronouncements. In July 2006, Financial Accounting Standards Board (FASB) Interpretation No. 48 *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109* (FIN 48) was issued. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes* . FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The new standard also provides guidance on various income tax accounting issues, including derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The provisions of FIN 48 were effective for our fiscal year beginning January 1, 2007 and were applied to all tax positions upon initial adoption. Only tax positions that meet the more-likely-than-not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption of FIN 48. The cumulative effect of applying the provisions of FIN 48 was reported as an adjustment to the opening balance of retained earnings for the year of adoption. We adopted the provisions of FIN 48 and, as a result, we recognized a $9.3 million increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007 balance of retained earnings. See Note 5 for further information.

Recent Accounting Pronouncements. In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with GAAP and expands disclosures about fair value measurements. SFAS 157 applies to other accounting pronouncements that require or permit fair value measurements but does not require any new fair value

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

measurements. SFAS 157 is effective for our fiscal year beginning January 1, 2008. We are currently assessing what impact, if any, the adoption of SFAS 157 will have on our financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities including an Amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The provisions of SFAS 159 are effective for our fiscal year beginning January 1, 2008. We are currently assessing the impact, if any, of the provisions of SFAS 159 on our financial position and results of operations.

Proposed Accounting Pronouncements. The FASB has authorized a FASB Staff Position (the proposed FSP) that would require, if issued, separate accounting for the debt and equity components of convertible instruments. The proposed FSP would require that the value assigned to the debt component would be the estimated fair value of a similar bond without the conversion feature, which would result in the debt being recorded at a discount. The debt would subsequently be accreted to its par value over its expected life with a rate of interest being reflected in earnings that reflects the market rate at issuance. The proposed FSP, if issued in the form expected, would be applied retrospectively to both new and existing convertible instruments, including the Convertible Notes that we issued in March 2007, and would result in approximately $28.0 million to $33.0 million of additional interest expense per annum.

2. Mergers and Acquisitions:

In February 2007, we purchased the industrial business and made a 25% investment in the retail business of Parkridge Holdings Limited (Parkridge), a European developer. The total purchase price was $1.3 billion, which was financed with $741.2 million in cash, the issuance of 4.8 million common shares (valued for accounting purposes at $71.01 per share for a total of $339.5 million) and the assumption of $194.9 million in debt and other liabilities. The assumption of debt includes $113.0 million of loans made to certain affiliates of Parkridge in November 2006, which were included in accounts and notes receivable in our Consolidated Balance Sheet at December 31, 2006. The cash portion of the acquisition was funded with borrowings under our global senior credit facility (Global Line) and a new $600.0 million senior unsecured facility (see Note 10 for more information on the new credit facility).

The acquisition included 6.3 million square feet of operating distribution properties, including 0.7 million square feet of developments under construction, and 1,139 acres of land, primarily in Central Europe and the United Kingdom. We allocated the purchase price based on estimated fair values and recorded approximately $739.3 million of real estate assets, $156.3 million of investments in CDFS joint ventures and other unconsolidated investees, $58.1 million of cash and other tangible assets and $321.9 million of goodwill and other intangible assets. The allocation of the purchase price was based upon preliminary estimates and assumptions and, accordingly, these allocations are subject to revision when final information is available. Revisions to the fair value allocations, which may be significant, will be recorded as adjustments to the purchase price allocation in subsequent periods and should not have a significant impact on our overall financial position or results of operations. The Parkridge acquisition would not have had a material impact on our consolidated results of operations for the six months ended June 30, 2007 and 2006, and as such, we have not presented any pro forma financial information.

We may be required to make additional payments to the selling shareholders over the next several years (primarily through the issuance of our common shares) of up to £52.3 million (the currency equivalent of $104.2 million at June 30, 2007) upon the successful completion of pending land entitlements or achievement of certain incremental development profit targets.

3. Unconsolidated Investees:

Summary of Investments

Our investments in and advances to unconsolidated investees, which are accounted for under the equity method, are summarized by type of investee as follows (in thousands):

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

	June 30, 2007	December 31, 2006
Property funds	$ 1,063,671	$ 981,840
CDFS joint ventures and other unconsolidated investees	459,928	317,857
Totals	$ 1,523,599	$ 1,299,697

Property Funds

We recognize earnings or losses from our investments in unconsolidated property funds consisting of our proportionate share of the net earnings or losses of the property funds, including interest income on advances made to these investees, if any. In addition, we earn fees for providing services to the property funds. The amounts we have recognized from our investments in property funds are summarized as follows (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Earnings from unconsolidated property funds:				
North America	$ 5,689	$ 5,375	$ 11,641	$ 47,857
Europe	6,398	2,450	14,468	13,649
Asia	3,717	3,144	8,659	5,908
Total earnings from unconsolidated property funds	$ 15,804	$ 10,969	$ 34,768	$ 67,414
Property management and other fees and incentives:				
North America	$ 9,879	$ 8,380	$ 19,771	$ 37,009
Europe	11,262	9,549	20,892	16,948
Asia	2,796	2,400	4,921	4,940
Total property management and other fees and incentives	$ 23,937	$ 20,329	$ 45,584	$ 58,897

Upon contribution of developed properties to a property fund, we realize a portion of the profits from our development activities while at the same time allowing us to maintain a long-term ownership interest in our developed properti