PROLOGIS
Form 10-Q
November 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 September 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 November 1, 2007 was 257,528,190.

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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 September 30, 2007	Three months ended September 30, 2006	Nine months ended September 30, 2007	Nine months ended September 30, 2006
Revenues:				
Rental income	$ 282,579	$ 232,495	$ 813,114	$ 673,040
CDFS disposition proceeds:				
Developed and repositioned properties	735,428	311,840	2,092,081	1,050,704
Acquired property portfolios	2,406,795		2,406,795	
Property management and other fees and incentives	27,095	20,421	72,679	79,318
Development management and other income	10,321	11,099	23,936	26,525
Total revenues	3,462,218	575,855	5,408,605	1,829,587
Expenses:				
Rental expenses	73,473	58,547	212,664	170,723
Cost of CDFS dispositions:				
Developed and repositioned properties	572,668	234,216	1,488,343	821,054
Acquired property portfolios	2,338,186		2,338,186	
General and administrative	52,326	37,787	152,971	113,085
Depreciation and amortization	72,497	69,634	225,206	207,876
Other expenses	3,550	2,977	21,484	8,924
Total expenses	3,112,700	403,161	4,438,854	1,321,662
Operating income	349,518	172,694	969,751	507,925
Other income (expense):				
Earnings from unconsolidated property funds	46,688	11,215	81,456	78,629
Earnings from CDFS joint ventures and other unconsolidated investees	4,679	9,590	6,996	47,011
Interest expense	(107,964)	(77,417)	(287,255)	(216,933)
Interest income on notes receivable	2,950	3,914	9,107	13,236
Interest and other income, net	8,663	5,313	23,415	10,596
Total other income (expense)	(44,984)	(47,385)	(166,281)	(67,461)
Earnings before minority interest	304,534	125,309	803,470	440,464
Minority interest	(1,855)	(565)	(2,751)	(2,541)

Earnings before certain net gains	302,679	124,744	800,719	437,923
Gains recognized on dispositions of certain non-CDFS business assets	21,289		145,374	13,709
Foreign currency exchange gains, net	991	9,202	10,145	16,449
Earnings before income taxes	324,959	133,946	956,238	468,081
Income taxes:				
Current income tax expense	14,204	34,824	58,949	75,913
Deferred income tax expense (benefit)	11,892	(22,362)	5,710	(16,780)
Total income taxes	26,096	12,462	64,659	59,133
Earnings from continuing operations	298,863	121,484	891,579	408,948

(Continued)

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

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
Discontinued operations:				
Income attributable to disposed properties and assets held for sale	328	6,601	1,856	17,760
Gains recognized on dispositions:				
Non-CDFS business assets	6,607	29,386	38,732	80,037
CDFS business assets		15,188	22,537	30,178
Total discontinued operations	6,935	51,175	63,125	127,975
Net earnings	305,798	172,659	954,704	536,923
Less preferred share dividends	6,354	6,354	19,065	19,062
Net earnings attributable to common shares	299,444	166,305	935,639	517,861
Other comprehensive income items:				
Foreign currency translation gains	88,700	17,106	93,366	50,761
Unrealized losses on derivative contracts, net	(9,987)	(17,447)	(9,234)	(15,080)
Comprehensive income	$ 378,157	$ 165,964	$ 1,019,771	$ 553,542
Weighted average common shares outstanding Basic	257,435	245,460	256,270	244,918
Weighted average common shares outstanding Diluted	267,871	256,233	267,177	255,559
Net earnings per share attributable to common shares Basic:				
Continuing operations	$ 1.13	$ 0.47	$ 3.40	$ 1.59
Discontinued operations	0.03	0.21	0.25	0.52
Net earnings per share attributable to common shares Basic	$ 1.16	$ 0.68	$ 3.65	$ 2.11
Net earnings per share attributable to common shares Diluted:				
Continuing operations	$ 1.09	$ 0.45	$ 3.27	$ 1.54
Discontinued operations	0.03	0.20	0.24	0.50

Net earnings per share attributable to common shares Diluted	$ 1.12	$ 0.65	$ 3.51	$ 2.04
Distributions per common share	$ 0.46	$ 0.40	$ 1.38	$ 1.20

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)

	September 30, 2007 (Unaudited)	Decembe 31, 2006
ASSETS		
l estate	$ 15,502,984	$ 13,953,9
s accumulated depreciation	1,340,046	1,280,2
	14,162,938	12,673,7
estments in and advances to unconsolidated investees	2,209,254	1,299,6
h and cash equivalents	550,272	475,7
counts and notes receivable	400,993	439,7
er assets	1,309,096	957,2
continued operations assets held for sale	18,519	57,1
al assets	$ 18,651,072	$ 15,903,5
LIABILITIES AND SHAREHOLDERS EQUITY		
bilities:		
ot	$ 9,574,635	$ 8,386,8
counts payable and accrued expenses	790,791	518,6
er liabilities	774,314	546,1
continued operations assets held for sale	385	1,0
al liabilities	11,140,125	9,452,6
nority interest	69,102	52,2
areholders equity:		
ies C Preferred Shares at stated liquidation preference of $50.00 per share; $0.01 par value; 2,000 shares ued and outstanding at September 30, 2007 and December 31, 2006	100,000	100,0
ies F Preferred Shares at stated liquidation preference of $25.00 per share; $0.01 par value; 5,000 shares ued and outstanding at September 30, 2007 and December 31, 2006	125,000	125,0
ies G Preferred Shares at stated liquidation preference of $25.00 per share; $0.01 par value; 5,000 shares ued and outstanding at September 30, 2007 and December 31, 2006	125,000	125,0
mmon Shares; $0.01 par value; 257,282 shares issued and outstanding at September 30, 2007 and 250,912 res issued and outstanding at December 31, 2006	2,573	2,5
ditional paid-in capital	6,386,977	6,000,1
cumulated other comprehensive income	301,054	216,9
ained earnings (distributions in excess of net earnings)	401,241	(170,9

al shareholders equity	7,441,845	6,398,5
al liabilities and shareholders equity	$ 18,651,072	$ 15,903,5

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)

	Nine months ended September 30, 2007	Nine months ended September 30, 2006
Operating activities:		
Net earnings	$ 954,704	$ 536,923
Minority interest share in earnings	2,751	2,541
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Straight-lined rents	(34,042)	(25,683)
Cost of share-based compensation awards	18,782	16,430
Depreciation and amortization	227,446	217,024
Amortization of deferred loan costs and net premium on debt	1,014	(5,272)
Gains recognized on dispositions of non-CDFS business assets	(184,106)	(93,746)
Impairment charges	12,600	
Equity in earnings from unconsolidated investees	(88,452)	(125,640)
Distributions from and changes in operating receivables of unconsolidated investees	50,258	86,118
Unrealized foreign currency exchange losses (gains)	11,706	(9,141)
Deferred income tax expense (benefit)	5,710	(16,780)
Increase in accounts receivable and other assets	(122,978)	(235,438)
Increase in accounts payable and accrued expenses and other liabilities	199,665	219,288
Net cash provided by operating activities	1,055,058	566,624
Investing activities:		
Real estate investments	(3,662,646)	(2,649,918)
Purchase of Macquarie ProLogis Trust (MPR), net of cash acquired	(1,137,028)	
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	(50,095)	(53,415)
Recurring capital expenditures	(28,482)	(21,752)
Proceeds from dispositions of real estate assets	3,087,967	1,603,551
Proceeds from repayment of notes receivable, net	42,008	70,531
Increase in restricted cash for potential investment		(42,174)
Investments in and advances to unconsolidated investees	(507,378)	(126,129)
Return of investment from unconsolidated investees	39,087	100,188
Net cash used in investing activities	(2,923,941)	(1,378,366)
Financing activities:		
Proceeds from sales and issuances of common shares under various common share plans	26,664	123,926
Distributions paid on common shares	(354,152)	(293,829)

Minority interest distributions	(7,065)	(10,219)
Dividends paid on preferred shares	(19,065)	(19,062)
Debt and equity issuance costs paid	(8,602)	(8,727)
Net proceeds from lines of credit	119,017	701,870
Proceeds from issuance of debt to finance MPR and Parkridge acquisitions	1,719,453	
Proceeds from issuance of convertible senior notes	1,228,125	
Proceeds from issuance of senior notes, secured and unsecured debt	6,459	1,101,236
Payments on senior notes, secured and unsecured debt and assessment bonds	(787,391)	(473,829)
Net cash provided by financing activities	1,923,443	1,121,366
Effect of exchange rate changes on cash	19,921	5,810
Net increase in cash and cash equivalents	74,481	315,434
Cash and cash equivalents, beginning of period	475,791	203,800
Cash and cash equivalents, end of period	$ 550,272	$ 519,234

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 September 30, 2007 and our results of operations for the three and nine months ended September 30, 2007 and 2006 and cash flows for the nine months ended September 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 issued proposed FASB Staff Position No. APB-14a, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* (the proposed FSP) that would require, if ratified, 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 ratified in the form expected, would be effective January 1, 2008 and 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 by us 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 senior unsecured facility (see Note 10 for more information on the credit facilities).

The acquisition included 6.3 million square feet of operating distribution properties, including 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 included in Other Assets in our Consolidated Balance Sheet. 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 nine months ended September 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 $106.4 million at September 30, 2007) upon the successful completion of pending land entitlements or achievement of certain incremental development profit targets.

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

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):

	September 30, 2007	December 31, 2006
Property funds	$ 1,722,778	$ 981,840
CDFS joint ventures and other unconsolidated investees	486,476	317,857
Totals	$ 2,209,254	$ 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 September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
Earnings from unconsolidated property funds:				
North America	$ 5,163	$ 5,874	$ 16,804	$ 53,731
Europe	37,167	2,973	51,635	16,622
Asia	4,358	2,368	13,017	8,276
Total earnings from unconsolidated property funds	$ 46,688	$ 11,215	$ 81,456	$ 78,629