PROLOGIS
Form 10-Q
November 08, 2006

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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, 2006

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 2, 2006 was 247,446,519.

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

	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Revenues:				
Rental income	$ 237,521	$ 144,965	$ 683,429	$ 401,490
CDFS dispositions proceeds	311,840	355,524	1,050,704	956,110
Property management and other fees and incentives	20,421	17,321	79,318	50,326
Development management and other income	11,099	9,254	26,525	12,580
Total revenues	580,881	527,064	1,839,976	1,420,506
Expenses:				
Rental expenses	59,753	36,866	175,399	108,578
Cost of CDFS dispositions	234,216	290,658	821,054	762,955
General and administrative	37,787	24,688	110,362	72,731
Depreciation and amortization	70,964	45,215	211,782	126,919
Merger integration and relocation expenses		8,534	2,723	12,337
Other expenses	2,977	3,030	8,924	6,312
Total expenses	405,697	408,991	1,330,244	1,089,832
Operating income	175,184	118,073	509,732	330,674
Other income (expense):				
Earnings from unconsolidated property funds	11,215	12,217	78,629	34,992
Earnings from CDFS joint ventures and other unconsolidated investees	9,590	301	47,011	668
Interest expense	(77,417)	(42,549)	(216,933)	(113,803)
Interest income on long-term notes receivable	3,914	841	13,236	841
Interest and other income, net	5,313	3,210	10,596	6,657
Total other income (expense)	(47,385)	(25,980)	(67,461)	(70,645)
Earnings before minority interest	127,799	92,093	442,271	260,029
Minority interest	(565)	(1,327)	(2,541)	(3,929)
Earnings before certain net gains	127,234	90,766	439,730	256,100
Gains recognized on dispositions of certain non-CDFS business assets, net			13,709	
Foreign currency exchange gains, net	9,202	4,742	16,449	8,323

Earnings before income taxes	136,436	95,508	469,888	264,423
Income taxes:				
Current income tax expense	34,824	2,435	75,913	7,185
Deferred income tax (benefit) expense	(22,362)	5,369	(16,780)	8,190
Total income taxes	12,462	7,804	59,133	15,375
Earnings from continuing operations	123,974	87,704	410,755	249,048

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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,	
	2006	2005	2006	2005
Discontinued operations:				
Income attributable to disposed properties and assets held for sale	4,111	5,017	15,953	11,586
Losses related to temperature-controlled distribution assets				(25,150)
Gains recognized on dispositions:				
Non-CDFS business assets	29,386	36,633	80,037	38,840
CDFS business assets	15,188	6,402	30,178	6,383
Total discontinued operations	48,685	48,052	126,168	31,659
Net earnings	172,659	135,756	536,923	280,707
Less preferred share dividends	6,354	6,354	19,062	19,062
Net earnings attributable to common shares	166,305	129,402	517,861	261,645
Other comprehensive income items:				
Foreign currency translation gains (losses)	17,106	(13,055)	50,761	(45,998)
Unrealized gains (losses) on derivative contracts, net	(17,447)	15,594	(15,080)	7,827
Comprehensive income	$ 165,964	$ 131,941	$ 553,542	$ 223,474
Weighted average common shares outstanding Basic	245,460	196,323	244,918	189,768
Weighted average common shares outstanding Diluted	256,233	206,760	255,559	200,022
Net earnings per share attributable to common shares Basic:				
Continuing operations	$ 0.48	$ 0.42	$ 1.59	$ 1.21
Discontinued operations	0.20	0.24	0.52	0.17
Net earnings per share attributable to common shares Basic	$ 0.68	$ 0.66	$ 2.11	$ 1.38
Net earnings per share attributable to common shares Diluted:				
Continuing operations	$ 0.46	$ 0.40	$ 1.55	$ 1.17
Discontinued operations	0.19	0.23	0.49	0.16

Net earnings per share attributable to common shares				
Diluted	$ 0.65	$ 0.63	$ 2.04	$ 1.33
Distributions per common share	$ 0.40	$ 0.37	$ 1.20	$ 1.11

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

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

	September 30, 2006 (Unaudited)	December 31, 2005
ASSETS		
Real estate	$ 13,007,695	$ 11,875,130
Less accumulated depreciation	1,248,214	1,118,547
	11,759,481	10,756,583
Investments in and advances to unconsolidated investees	1,270,370	1,049,743
Cash and cash equivalents	519,234	203,800
Accounts and notes receivable	357,778	327,214
Other assets	955,519	788,840
Discontinued operations assets held for sale	134,717	
Total assets	$ 14,997,099	$ 13,126,180
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Debt	$ 7,886,442	$ 6,677,880
Accounts payable and accrued expenses	481,069	344,423
Other liabilities	678,679	557,210
Discontinued operations assets held for sale	5,144	
Total liabilities	9,051,334	7,579,513
Minority interest	52,679	58,644
Shareholders equity:		
Series C Preferred Shares at stated liquidation preference of $50.00 per share; $0.01 par value; 2,000,000 shares issued and outstanding at September 30, 2006 and December 31, 2005	100,000	100,000
Series F Preferred Shares at stated liquidation preference of $25.00 per share; $0.01 par value; 5,000,000 shares issued and outstanding at September 30, 2006 and December 31, 2005	125,000	125,000
Series G Preferred Shares at stated liquidation preference of $25.00 per share; $0.01 par value; 5,000,000 shares issued and outstanding at September 30, 2006 and December 31, 2005	125,000	125,000
Common Shares; $0.01 par value; 247,124,641 shares issued and outstanding at September 30, 2006 and 243,781,142 shares issued and outstanding at December 31, 2005	2,471	2,438
Additional paid-in capital	5,751,334	5,606,017
Accumulated other comprehensive income	185,267	149,586

Distributions in excess of net earnings	(395,986)	(620,018)
Total shareholders equity	5,893,086	5,488,023
Total liabilities and shareholders equity	$ 14,997,099	$ 13,126,180

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, 2006	Nine Months Ended September 30, 2005
Operating activities:		
Net earnings	$ 536,923	$ 280,707
Minority interest share in earnings	2,541	3,929
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Straight-lined rents	(25,683)	(5,230)
Cost of share-based compensation awards	16,430	17,936
Depreciation and amortization	217,024	134,611
Amortization of deferred loan costs and net (premium) discount on debt	(5,272)	3,352
Gains recognized on dispositions of non-CDFS business assets, net	(93,746)	(38,840)
Impairment charge and cumulative translation losses on assets held for sale		26,864
Equity in earnings from unconsolidated investees	(125,640)	(35,660)
Distributions from and changes in operating receivables of unconsolidated investees	86,118	40,098
Adjustments to foreign currency exchange amounts recognized	(9,141)	(5,799)
Deferred income tax (benefit) expense	(16,780)	8,190
Increase in accounts receivable and other assets	(235,438)	(86,449)
Increase (decrease) in accounts payable and accrued expenses and other liabilities	219,288	(36,865)
Net cash provided by operating activities	566,624	306,844
Investing activities:		
Real estate investments	(2,644,108)	(1,779,294)
Cash consideration paid in Catellus Merger, net of cash acquired		(1,296,652)
Purchase of ownership interests in property funds	(259,248)	
Tenant improvements and lease commissions on previously leased space	(53,415)	(35,098)
Recurring capital expenditures	(21,752)	(17,535)
Proceeds from dispositions of real estate assets	1,603,551	1,036,430
Proceeds from repayment of notes receivable	70,531	59,991
Increase in restricted cash for potential investment	(42,174)	
Investments in unconsolidated investees	(126,129)	(42,275)
Return of investment from unconsolidated investees	100,188	27,468
Net cash used in investing activities	(1,372,556)	(2,046,965)
Financing activities:		.
Net proceeds from sales and issuances of common shares under various common share plans	123,926	38,308
Distributions paid on common shares	(293,829)	(207,246)

Minority interest redemptions and distributions	(10,219)	(12,787)
Dividends paid on preferred shares	(19,062)	(19,062)
Debt and equity issuance costs paid	(8,727)	(1,336)
Repayment of debt assumed in Catellus Merger		(106,356)
Net proceeds from lines of credit and short-term borrowings	701,870	2,096,923
Proceeds from issuance of senior notes and secured debt `	1,101,236	
Payments on senior notes, secured debt and assessment bonds	(473,829)	(111,271)
Net cash provided by financing activities	1,121,366	1,677,173
Net increase (decrease) in cash and cash equivalents	315,434	(62,948)
Cash and cash equivalents, beginning of period	203,800	236,529
Cash and cash equivalents, end of period	$ 519,234	$ 173,581

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), is a publicly held real estate investment trust (REIT) that owns, manages 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) corporate distribution facilities services and other real estate development business (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, 2006 and our results of operations for the three and nine months ended September 30, 2006 and 2005, and cash flows for the nine months ended September 30, 2006 and 2005 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, 2005 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 2005 have been reclassified to conform to the 2006 financial statement presentation. These amounts include reclassifications in the consolidated statement of cash flows resulting in a decrease to operating cash flows of $20.8 million, an increase to investing cash flows of $27.5 million and a decrease to financing activities of $6.7 million, which we believe are immaterial to 2005.

Adoption of New Accounting Pronouncements. The Emerging Issues Task Force (EITF) reached a consensus in June 2005 regarding EITF Issue 04-5, *Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity when the Limited Partners Have Certain Rights* (EITF 04-5). The EITF agreed on a framework for evaluating when a general partner controls a limited partnership and whether the partnership should be consolidated. The Financial Accounting Standards Board (the FASB) ratified the consensus that was effective June 29, 2005 for all new or modified partnerships and effective January 1, 2006 for all existing partnerships. We adopted EITF 04-5 on January 1, 2006. As such, we performed an evaluation of each of our unconsolidated investees. We first determined whether the entity needed to be evaluated under EITF 04-5 based on the ownership and legal structure. Next, we evaluated whether the limited partners had substantive kick-out rights or participating rights, both as defined under EITF 04-5. We concluded that the unconsolidated investees that were subject to EITF 04-5 and needed to be evaluated should be accounted for under the equity method of accounting based on the rights provided to the limited partners under the governing documents of the respective entity.

On December 16, 2004, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 123R *Share Based Payment* (SFAS 123R) that required companies to measure the cost of employee services received in exchange for an award of an equity instrument based on the award s fair value on the grant date and recognize the cost over the period during which an employee is required to provide service in exchange for the award, generally the vesting period.

PROLOGIS
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

We adopted SFAS 123R on January 1, 2006 using the modified prospective application. Prior to that date, we recognized the costs of our share-based compensation plans under SFAS No. 123 *Accounting and Disclosure of Stock BasedCompensation* that allowed us to continue to account for these plans under Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25). The impact of adoption of SFAS 123R is the inclusion of compensation expense within our statements of earnings, which were previously disclosed as pro forma amounts within the notes to our Consolidated Financial Statements. See Note 4.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29* (APB 29) (SFAS 153), which was effective January 1, 2006. SFAS 153 amended APB 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaced it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. Previously under APB 29, in certain limited situations we were required to defer a portion of the proceeds received from a contribution of a property to an unconsolidated property fund that represented nonmonetary proceeds. SFAS 153 amended APB 29 such that we are no longer required to defer those nonmonetary proceeds. However, we are still required under SFAS No. 66, *Accounting for Sales of Real Estate* , to defer a portion of the gain based on the percentage of our continuing ownership interest in the property when we contribute a property to an unconsolidated investee. During the first nine months of 2006, we recognized $8.2 million of proceeds that historically would have been deferred under APB 29.

Recent Accounting Pronouncements. In July 2006, 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 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 are effective for fiscal years beginning after December 15, 2006 and are to be 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 is to be reported as an adjustment to the opening balance of retained earnings for the year of adoption. We are currently assessing what impact, if any, the adoption of FIN 48 on January 1, 2007 will have on our financial position and results of operations.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*, which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment (SAB 108). SAB 108 is effective for fiscal years ending after November 15, 2006, although early application is encouraged, but not required. We will adopt SAB 108 for our fiscal year ending December 31, 2006. We are currently assessing what impact, if any, the adoption of SAB 108 will have on our financial position and results of operations.

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 GAAP and expands disclosures about fair value measurements. This Statement applies to other accounting pronouncements that require or permit fair value measurements. Accordingly, this Statement does not require any new fair value measurements. SFAS 157 is effective for fiscal years beginning after December 15, 2007. We plan to adopt SFAS 157 beginning in the first quarter of 2008. We are currently assessing what impact, if any, the adoption of SFAS 157 will have on our financial position and results of operations.

2. Mergers and Acquisitions:

On September 15, 2005, Catellus Development Corporation, a publicly traded REIT, (Catellus) merged with and into Palmtree Acquisition Corporation, one of our subsidiaries, pursuant to an Agreement and Plan of Merger dated as of June 6, 2005 (the Merger Agreement), as amended (the Catellus Merger). At the time of the Catellus Merger, Catellus owned or held an ownership interest in 41.8 million square feet of industrial, office and retail properties of which approximately 92% was industrial space.

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

In connection with the Catellus Merger, we incurred merger integration costs, such as employee transition costs and severance costs for certain of our employees whose responsibilities became redundant after the Catellus Merger.

Under the terms of the Merger Agreement, Catellus stockholders had the opportunity to elect to receive cash or our common shares for their Catellus stock. As a result of the Catellus Merger, we issued approximately 55.9 million of our common shares to former Catellus stockholders. We financed the cash portion of the Catellus Merger primarily through borrowings of $1.5 billion on a short-term bridge facility, which has been repaid.

The following unaudited pro forma financial information for the three and nine months ended September 30, 2005, gives effect to the Catellus Merger as if it had occurred on January 1, 2005. The pro forma results (in millions, except per share amounts) are based on historical data and are not intended to be indicative of the results of future operations.

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Total revenues	$ 601.0	$ 1,710.6
Operating income	$ 132.3	$ 383.7
Net earnings attributable to common shares	$ 123.5	$ 269.2
Weighted average common shares outstanding Basic	242.6	242.4
Weighted average common shares outstanding Diluted	253.0	252.7
Net earnings per share attributable to common shares Basic	$ 0.51	$ 1.11
Net earnings per share attributable to common shares Diluted	$ 0.49	$ 1.08

3. Unconsolidated Investees:

Summary of Investments and Income

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, 2006	December 31, 2005
Property funds	$ 949,634	$ 755,320
CDFS joint ventures and other investees	320,736	294,423
Totals	$ 1,270,370	$ 1,049,743

We recognize earnings or losses from our investments in unconsolidated investees consisting of our proportionate share of the net earnings