

PROLOGIS
Form 10-Q
May 10, 2005

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**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 March 31, 2005

○ 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
(State or other jurisdiction of
incorporation or organization)

74-2604728
(I.R.S. Employer
Identification No.)

14100 East 35th Place, Aurora, Colorado
(Address or principal executive offices)

80011
(Zip Code)

(303) 375-9292
(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 No

Indicate by check mark whether the registrant is accelerated filer (as defined in Rule 12b-2 of the Securities Act of 1934).

Yes No

The number of shares outstanding of the Registrant's common shares as of May 5, 2005 was 186,666,413.

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(In thousands, except share data)

	March 31, 2005 (Unaudited)	December 31, 2004 (Audited)
ASSETS		
Real estate	\$ 6,610,537	\$ 6,333,731
Less accumulated depreciation	1,024,735	989,221
	5,585,802	5,344,510
Investments in and advances to unconsolidated investees	953,326	908,513
Cash and cash equivalents	347,440	236,529
Accounts and notes receivable	32,024	92,015
Other assets	418,053	401,564
Discontinued operations assets held for sale	102,744	114,668
Total assets	\$ 7,439,389	\$ 7,097,799
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Lines of credit	\$ 1,274,220	\$ 912,326
Short-term borrowings	48,005	47,676
Senior notes	1,944,217	1,962,316
Secured debt and assessment bonds	495,449	491,643
Accounts payable and accrued expenses	170,571	192,332
Construction costs payable	71,359	63,509
Other liabilities	214,083	196,240
Discontinued operations assets held for sale	62,849	62,991
Total liabilities	4,280,753	3,929,033
Minority interest	66,550	66,273
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 March 31, 2005 and December 31, 2004	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 March 31, 2005 and December 31, 2004	125,000	125,000
	125,000	125,000

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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 March 31, 2005 and
December 31, 2004

Common Shares; \$0.01 par value; 186,410,059 shares issued and outstanding at
March 31, 2005 and 185,788,783 shares issued and outstanding at December 31,
2004

	1,864	1,858
Additional paid-in capital	3,267,778	3,249,576
Accumulated other comprehensive income	179,649	194,445
Distributions in excess of net earnings	(707,205)	(693,386)
 Total shareholders' equity	 3,092,086	 3,102,493
 Total liabilities and shareholders' equity	 \$ 7,439,389	 \$ 7,097,799

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

Table of Contents**PROLOGIS****CONSOLIDATED CONDENSED STATEMENTS OF
EARNINGS AND COMPREHENSIVE INCOME****(Unaudited)****(In thousands, except per share data)**

	Three Months Ended March 31,	
	2005	2004
Revenues:		
Rental income, including expense recoveries from customers of \$26,534 and \$26,909 for the three months ended March 31, 2005 and 2004, respectively	\$ 136,697	\$ 137,097
Property management and other property fund fees	16,527	11,267
Development management fees and other CDFS income	131	1,522
Total revenues	153,355	149,886
Expenses:		
Rental expenses	39,150	36,235
General and administrative	24,161	19,566
Depreciation and amortization	43,253	42,462
Relocation expenses	2,751	
Other expenses	1,913	996
Total expenses	111,228	99,259
Gains on certain dispositions of CDFS business assets, net:		
Net proceeds from dispositions	282,591	155,880
Costs of assets disposed of	227,250	128,722
Total gains, net	55,341	27,158
Operating income	97,468	77,785
Income from unconsolidated property funds	11,771	9,537
Income from unconsolidated CDFS joint ventures	457	
Income from other unconsolidated investees, net	41	300
Interest expense	(36,608)	(39,623)
Interest and other income	1,374	738
Earnings before minority interest	74,503	48,737
Minority interest share in earnings	(1,341)	(1,226)
Earnings before net foreign currency exchange gains (expenses/losses)	73,162	47,511
Foreign currency exchange gains (expenses/losses), net	(114)	3,313

Earnings before income taxes	73,048	50,824
Income tax expense:		
Current	1,173	2,213
Deferred	839	2,739
Total income tax expense	2,012	4,952
Earnings from continuing operations	71,036	45,872

(Continued)

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

Table of Contents**PROLOGIS****CONSOLIDATED CONDENSED STATEMENTS OF
EARNINGS AND COMPREHENSIVE INCOME (CONTINUED)****(Unaudited)****(In thousands, except per share data)**

	Three Months Ended March 31,	
	2005	2004
Discontinued operations:		
Income (loss) attributable to assets held for sale	(11,370)	3,395
Assets disposed of:		
Operating income (loss) attributable to assets disposed of	(6)	280
Gains (losses) recognized on dispositions, net:		
Non-CDFS business assets	2,207	(545)
CDFS business assets	(439)	5,415
Total gains, net	1,768	4,870
Total discontinued operations	(9,608)	8,545
Net earnings	61,428	54,417
Less preferred share dividends	6,354	6,684
Less excess of redemption values over carrying values of Preferred Shares redeemed		4,236
Net earnings attributable to Common Shares	55,074	43,497
Other comprehensive income items:		
Foreign currency translation adjustments	(15,196)	42,774
Unrealized gains (losses) on derivative contracts, net	400	(410)
Comprehensive income	\$ 40,278	\$ 85,861
Weighted average Common Shares outstanding Basic	186,154	180,732
Weighted average Common Shares outstanding Diluted	196,180	185,255
Net earnings (loss) attributable to Common Shares per share Basic:		
Continuing operations	\$ 0.35	\$ 0.19
Discontinued operations	(0.05)	0.05
Net earnings attributable to Common Shares per share Basic	\$ 0.30	\$ 0.24
Net earnings (loss) attributable to Common Shares per share Diluted:		

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Continuing operations	\$ 0.34	\$ 0.19
Discontinued operations	(0.05)	0.04
Net earnings attributable to Common Shares per share Diluted	\$ 0.29	\$ 0.23
Distributions per Common Share	\$ 0.370	\$ 0.365

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

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

	Three Months Ended	
	March 31,	
	2005	2004
Operating activities:		
Net earnings	\$ 61,428	\$ 54,417
Minority interest share in earnings	1,341	1,226
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Straight-lined rents	(1,731)	(2,224)
Cost of share-based compensation awards	4,773	4,365
Depreciation and amortization	43,782	42,878
Impairment charge	13,084	
Adjustments to income and fees recognized from all unconsolidated investees	(11,976)	(9,104)
Amortization of deferred loan costs	1,179	1,492
(Gains) losses recognized on dispositions of non-CDFS business assets, net	(2,207)	545
Adjustments to foreign currency exchange amounts recognized	285	(3,547)
Deferred income tax expense	839	2,739
Increase in accounts and notes receivable and other assets	(20,565)	(5,759)
Increase (decrease) in accounts payable and accrued expenses and other liabilities	(4,481)	9,178
Net cash provided by operating activities	85,751	96,206
Investing activities:		
Real estate investments	(538,841)	(406,295)
Tenant improvements and lease commissions on previously leased space	(12,495)	(10,505)
Recurring capital expenditures	(2,706)	(5,009)
Proceeds from dispositions of real estate assets	255,871	217,500
Proceeds from repayment of notes receivable	59,991	
Net amounts received from (contributions/advances to) unconsolidated investees	(2,569)	15,131
Adjustments to cash balances resulting from reporting changes		3,284
Net cash used in investing activities	(240,749)	(185,894)
Financing activities:		
Net proceeds from sales and issuances of Common Shares under various Common Share plans	12,403	18,669
Redemption of Preferred Shares		(125,000)
Distributions paid on Common Shares	(68,894)	(65,993)
Distributions paid to minority interest holders	(2,128)	(1,776)
Dividends paid on Preferred Shares	(6,354)	(6,684)

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Debt and equity issuance costs paid		(473)
Principal payments on senior unsecured debt	(18,750)	(18,750)
Net proceeds from lines of credit and short-term borrowings	351,893	151,329
Regularly scheduled principal payments on secured debt and assessment bonds	(1,296)	(1,263)
Principal payments on secured debt and assessment bonds at maturity and prepayments		(18,612)
Purchases of derivative contracts	(965)	(412)
Net cash provided by (used in) financing activities	265,909	(68,965)
Net increase (decrease) in cash and cash equivalents	110,911	(158,653)
Cash and cash equivalents, beginning of period	236,529	331,503
Cash and cash equivalents, end of period	\$ 347,440	\$ 172,850

See Note 12 for information on non-cash investing and financing activities and other information.

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

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

March 31, 2005 and 2004

(Unaudited)

1. General:

Business

ProLogis (collectively with its consolidated subsidiaries and partnerships ProLogis) is a publicly held real estate investment trust (REIT) that owns, operates and develops (directly or through unconsolidated investees) industrial distribution properties in North America, Europe and Asia. ProLogis has elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended (the Code).

ProLogis business consists of two reportable business segments: property operations and the corporate distribution facilities services business (CDFS business). The property operations segment represents the long-term ownership, management and leasing of industrial distribution properties. The CDFS business segment primarily encompasses ProLogis development of industrial distribution properties that are either contributed to an unconsolidated property fund in which ProLogis has an ownership interest and acts as manager, or sold to third parties. Additionally, ProLogis will acquire industrial distribution properties that are generally rehabilitated and/or repositioned in the CDFS business segment prior to being contributed to a property fund. See Note 11.

Basis of Presentation

ProLogis Consolidated Condensed Financial Statements are prepared in accordance with U.S. generally accepted accounting principles (GAAP). ProLogis and its subsidiaries are included in the accompanying Consolidated Condensed Financial Statements and are presented in ProLogis functional currency, the U.S. dollar. All entities that ProLogis controls, either through ownership of a majority voting interest or otherwise, or entities in which ProLogis is the primary beneficiary, are consolidated. All material intercompany transactions with consolidated entities have been eliminated.

The Consolidated Condensed Financial Statements of ProLogis as of March 31, 2005 and for the three months ended March 31, 2005 and 2004 are unaudited and, pursuant to the rules of the U.S. Securities and Exchange Commission (the SEC), certain information and footnote disclosures normally included in financial statements have been omitted. Management of ProLogis believes that the disclosures presented in these financial statements are adequate. However, these interim Consolidated Condensed Financial Statements should be read in conjunction with ProLogis December 31, 2004 audited Consolidated Financial Statements contained in ProLogis 2004 Annual Report on Form 10-K/A#1.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of income and expenses during the reporting period. Although these estimates and assumptions are based on current expectations, actual results could differ from those estimates and assumptions.

Certain amounts included in ProLogis Consolidated Condensed Financial Statements for the prior period have been reclassified to conform to the 2005 financial statement presentation.

2. Keystone Transaction:

On May 3, 2004, ProLogis and affiliates of four investment funds managed by Eaton Vance Management (the Fund Affiliates) established five property funds (the Acquiring Property Funds and also referred to by ProLogis as ProLogis North American Properties Funds VI, VII, VIII, IX and X-see Note 5). ProLogis has a 20% ownership interest in each of the Acquiring Property Funds with the remainder owned by the Fund Affiliates. Also on May 3, 2004, ProLogis and the Acquiring Property Funds entered into an agreement to acquire the outstanding equity of

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Keystone Property Trust (Keystone), a publicly traded REIT, and the operating units of Keystone Operating Partnership, L.P., a subsidiary of Keystone. Keystone owned and leased industrial distribution properties located in New Jersey, Pennsylvania, Indiana, Florida, South Carolina and Ohio. The acquisition of Keystone by ProLogis and the Acquiring Property Funds was approved by Keystone s shareholders on July 30, 2004 and was closed on August 4, 2004.

3. Relocation:

ProLogis has relocated its information technology and corporate accounting functions from El Paso, Texas to Denver, Colorado and is moving its Denver corporate headquarters. The relocation from El Paso was completed in the first quarter of 2005. The relocation to the new corporate headquarters, which is located in Denver and is currently under development, is expected to be completed by the end of 2005.

For the three months ended March 31, 2005, ProLogis recognized total relocation expenses of \$2.8 million, including \$0.6 million of employee termination benefits, \$0.5 million of accelerated depreciation associated with non-real estate assets whose useful life has been shortened due to the relocation plans and \$1.7 million of costs associated with the hiring and training of new personnel and other costs, including travel and temporary facility costs. ProLogis began the relocation process in the second quarter of 2004.

4. Real Estate:*Real Estate Assets*

Real estate assets directly owned by ProLogis primarily consist of income producing industrial distribution properties, industrial distribution properties under development and land held for future development of industrial distribution properties. ProLogis real estate assets, presented at cost, include the following as of the dates indicated (in thousands of U.S. dollars):

	March 31, 2005	December 31, 2004
Operating properties(1):		
Improved land	\$ 809,884	\$ 816,943
Buildings and improvements	4,221,499	4,230,471
	5,031,383	5,047,414
Properties under development (including cost of land)(2)(3)	818,271	575,703
Land held for development(4)	624,256	596,001
Other investments(5)	136,627	114,613
Total real estate assets	6,610,537	6,333,731
Less accumulated depreciation	1,024,735	989,221
Net real estate assets	\$ 5,585,802	\$ 5,344,510

- (1) At March 31, 2005 and December 31, 2004, ProLogis had 1,220 and 1,228 operating properties, respectively. These properties consisted of 131.7 million square feet at March 31, 2005 and 133.6 million square feet at December 31, 2004.

- (2) Properties under development consisted of 77 properties aggregating 21.7 million square feet at March 31, 2005 and 58 properties aggregating 15.1 million square feet at December 31, 2004.
- (3) In addition to the construction costs payable balance of \$71.4 million, ProLogis had aggregate unfunded commitments on its contracts for properties under development of \$876.9 million at March 31, 2005.
- (4) Land held for future development consisted of 3,355 acres at March 31, 2005 and 2,991 acres at December 31, 2004.
- (5) Other investments primarily include: (i) restricted funds that are held in escrow pending the completion of tax-deferred exchange transactions involving operating properties (\$40.2 million at March 31, 2005 and zero

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at December 31, 2004); (ii) earnest money deposits associated with potential acquisitions; (iii) costs incurred during the pre-acquisition due diligence process; and (iv) costs incurred during the pre-construction phase related to future development projects.

ProLogis directly owns real estate assets in North America (United States, Mexico and Canada), Europe (France, United Kingdom, Poland, Netherlands, Italy, Germany, Spain, Czech Republic, Sweden, Hungary and Belgium) and Asia (Japan, China and Singapore). No individual market in any country, as defined by ProLogis and presented in Item 2 of ProLogis 2004 Annual Report on Form 10-K/A #1, represents more than 10% of ProLogis total real estate assets, before depreciation.

In conjunction with ProLogis development activities, during the three months ended March 31, 2005 and 2004, ProLogis capitalized interest of \$12.4 million and \$7.4 million, respectively.

Operating Lease Agreements

ProLogis leases its operating properties to customers under agreements that are generally classified as operating leases. At March 31, 2005, minimum lease payments, excluding expense recoveries from customers, on leases with lease periods greater than one year for space in ProLogis directly owned properties for the remainder of 2005 and the other years in the five-year period ending December 31, 2009 and thereafter are as follows (in thousands of U.S. dollars):

Remainder of 2005	\$ 286,680
2006	313,344
2007	243,318
2008	181,411
2009	121,035
2010 and thereafter	224,265
	\$ 1,370,053

For ProLogis directly owned properties, the largest customer and the 25 largest customers accounted for 1.25% and 16.01%, respectively, of ProLogis annualized collected base rents at March 31, 2005.

5. Unconsolidated Investees:*Summary of Investments and Income*

Since 1997, ProLogis has invested in various entities in which its ownership interest is less than 100% and in which it does not have control as defined under GAAP. Accordingly, these investments are presented under the equity method in ProLogis Consolidated Condensed Financial Statements. Certain of these investments were originally structured such that ProLogis ownership interest would allow ProLogis to continue to comply with the requirements of the Code to qualify as a REIT. However, with respect to ProLogis investments in property funds, having an ownership interest of 50% or less is part of ProLogis business strategy.

ProLogis investments in and advances to entities that are accounted for under the equity method are summarized by type of investee as follows as of the dates indicated (in thousands of U.S. dollars):

March 31, 2005	December 31, 2004
---------------------------	----------------------------------

Property funds	\$ 854,603	\$ 839,675
CDFS Joint Ventures	71,253	40,487
Other investees	27,470	28,351
Totals	\$ 953,326	\$ 908,513

ProLogis recognizes income or losses from its investments in unconsolidated investees consisting of its proportionate share of the earnings or losses of these investees and interest income on advances made to these investees, if any. Further, ProLogis earns fees for providing services to the property funds. The amounts recognized by ProLogis from its investments in unconsolidated investees are summarized as follows for the periods indicated (in thousands of U.S. dollars):

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	Three Months Ended March 31,	
	2005	2004
Equity in earnings (including interest income):		
Property funds	\$ 11,771	\$ 9,537
CDFS Joint Ventures	457	
Other investees	41	300
Totals	\$ 12,269	\$ 9,837
Fees earned:		
Property funds	\$ 16,527	\$ 11,267

Property Funds

Contributions of developed properties to a property fund allow ProLogis to realize, for financial reporting purposes, a portion of the profits from its development activities while at the same time allowing ProLogis to maintain a long-term ownership interest in its developed properties. This business strategy also provides liquidity to fund ProLogis future development activities and generates fee income to ProLogis. ProLogis has investments in 15 property funds with ownership interests in these property funds ranging from 11.4% to 50% at March 31, 2005. The property funds own operating properties that have generally been contributed to them by ProLogis, although certain property funds have also acquired properties from third parties and in the case of ProLogis North American Property Funds VI through X, the funds also acquired assets in the Keystone Transaction. ProLogis receives ownership interests in the property funds as part of the proceeds of contributions of properties to the property funds. ProLogis recognizes its proportionate share of the earnings or losses of each property fund. ProLogis earns fees for acting as the manager of each of the property funds and manager of the fund properties, and may earn additional fees by providing other services to certain of the property funds including, but not limited to, acquisition, development and leasing activities performed on their behalf.

ProLogis investments in the 15 property funds, presented under the equity method, were as follows as of the dates indicated (in thousands of U.S. dollars):

	March 31, 2005	December 31, 2004
ProLogis California(1)	\$ 115,897	\$ 117,579
ProLogis North American Properties Fund I(2)	35,163	35,707
ProLogis North American Properties Fund II(3)	5,534	5,864
ProLogis North American Properties Fund III(4)	4,780	4,908
ProLogis North American Properties Fund IV(5)	2,939	3,022
ProLogis North American Properties Fund V(6)	91,638	65,878
ProLogis North American Properties Fund VI(7)	45,822	45,721
ProLogis North American Properties Fund VII(7)	33,714	34,861
ProLogis North American Properties Fund VIII(7)	17,036	18,032