PROLOGIS
Form 10-Q
November 10, 2008

Table of Contents

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, 2008

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, a non-accelerated filer or a smaller reporting company. See definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company 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 3, 2008 was 265,658,322.

PROLOGIS
INDEX

Table of Contents

PART 1.
Item 1. Financial Statements

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

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Revenues:				
Rental income	$ 253,499	$ 280,514	$ 784,223	$ 807,677
CDFS disposition proceeds:				
Developed and repositioned properties	613,443	735,428	3,013,511	2,092,081
Acquired property portfolios	190,711	2,406,795	353,886	2,406,795
Property management and other fees and incentives	35,502	27,095	97,572	72,679
Development management and other income	7,991	10,321	18,522	23,936
Total revenues	1,101,146	3,460,153	4,267,714	5,403,168
Expenses:				
Rental expenses	85,822	74,835	262,710	216,658
Cost of CDFS dispositions:				
Developed and repositioned properties	542,311	572,668	2,464,228	1,488,343
Acquired property portfolios	190,711	2,338,186	353,886	2,338,186
General and administrative	57,836	50,208	173,523	146,973
Depreciation and amortization	81,889	71,852	243,893	223,610
Other expenses	3,689	3,550	11,792	21,484
Total expenses	962,258	3,111,299	3,510,032	4,435,254
Operating income	138,888	348,854	757,682	967,914
Other income (expense):				
Earnings from unconsolidated property funds, net	18,299	46,688	36,285	81,456
Earnings (losses) from CDFS joint ventures and other unconsolidated investees, net	2,192	4,679	(1,414)	6,996
Interest expense	(83,327)	(107,964)	(252,587)	(287,255)
Interest and other income, net	1,822	11,613	17,082	32,522
Total other income (expense)	(61,014)	(44,984)	(200,634)	(166,281)
Earnings before minority interest	77,874	303,870	557,048	801,633
Minority interest share in loss (income), net	1,031	(1,855)	4,510	(2,751)

Earnings before certain net gains	78,905	302,015	561,558	798,882
Gains recognized on dispositions of certain non-CDFS business assets	1,152	21,289	5,814	145,374
Foreign currency exchange gains (losses), net	(10,344)	991	(34,950)	10,145
Earnings before income taxes	69,713	324,295	532,422	954,401
Income taxes:				
Current income tax expense	11,577	14,204	49,101	58,949
Deferred income tax expense	10,742	11,892	19,478	5,710
Total income taxes	22,319	26,096	68,579	64,659
Earnings from continuing operations	47,394	298,199	463,843	889,742

(Continued)

Table of Contents

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

	Three months ended September 30, 2008	Three months ended September 30, 2007	Nine months ended September 30, 2008	Nine months ended September 30, 2007
Discontinued operations:				
Income (loss) attributable to disposed properties and assets held for sale, net	$ (189)	$ 992	$ (296)	$ 3,693
Gains recognized on dispositions:				
Non-CDFS business assets	2,492	6,607	8,161	38,732
CDFS business assets	108		2,232	22,537
Total discontinued operations	2,411	7,599	10,097	64,962
Net earnings	49,805	305,798	473,940	954,704
Less preferred share dividends	6,333	6,354	19,071	19,065
Net earnings attributable to common shares	43,472	299,444	454,869	935,639
Other comprehensive income (loss) items:				
Foreign currency translation gains (losses), net	(279,436)	88,700	(144,737)	93,366
Unrealized gains (losses) on derivative contracts, net	827	(9,987)	(7,966)	(9,234)
Comprehensive income (loss)	$ (235,137)	$ 378,157	$ 302,166	$ 1,019,771
Weighted average common shares outstanding Basic	263,139	257,435	261,665	256,270
Weighted average common shares outstanding Diluted	266,133	267,871	270,665	267,177
Net earnings per share attributable to common shares Basic:				
Continuing operations	$ 0.16	$ 1.13	$ 1.70	$ 3.40
Discontinued operations	0.01	0.03	0.04	0.25
Net earnings per share attributable to common shares Basic	$ 0.17	$ 1.16	$ 1.74	$ 3.65
Net earnings per share attributable to common shares Diluted:				
Continuing operations	$ 0.15	$ 1.09	$ 1.65	$ 3.27
Discontinued operations	0.01	0.03	0.04	0.24

Net earnings per share attributable to common shares Diluted	$ 0.16	$ 1.12	$ 1.69	$ 3.51
Distributions per common share	$ 0.5175	$ 0.46	$ 1.5525	$ 1.38

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

Table of Contents

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

	September 30, 2008 (Unaudited)	December 31, 2007
ASSETS		
Real estate	$ 17,285,584	$ 16,578,845
Less accumulated depreciation	1,523,778	1,368,458
	15,761,806	15,210,387
Investments in and advances to unconsolidated investees	2,570,571	2,345,277
Cash and cash equivalents	341,087	399,910
Accounts and notes receivable	301,116	340,039
Other assets	1,490,996	1,408,814
Discontinued operations assets held for sale	1,487	19,607
Total assets	$ 20,467,063	$ 19,724,034
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Debt	$ 11,097,901	$ 10,506,068
Accounts payable and accrued expenses	925,365	933,075
Other liabilities	759,887	769,408
Discontinued operations assets held for sale	38	424
Total liabilities	12,783,191	12,208,975
Minority interest	111,615	78,661
Shareholders equity:		
Series C Preferred Shares at stated liquidation preference of $50 per share; $0.01 par value; 2,000 shares issued and outstanding at September 30, 2008 and December 31, 2007	100,000	100,000
Series F Preferred Shares at stated liquidation preference of $25 per share; $0.01 par value; 5,000 shares issued and outstanding at September 30, 2008 and December 31, 2007	125,000	125,000
Series G Preferred Shares at stated liquidation preference of $25 per share; $0.01 par value; 5,000 shares issued and outstanding at September 30, 2008 and December 31, 2007	125,000	125,000
Common Shares; $0.01 par value; 262,652 shares issued and outstanding at September 30, 2008 and 257,712 shares issued and outstanding at December 31, 2007	2,627	2,577
Additional paid-in capital	6,660,352	6,412,473
Accumulated other comprehensive income	122,619	275,322

Retained earnings	436,659	396,026
Total shareholders equity	7,572,257	7,436,398
Total liabilities and shareholders equity	$ 20,467,063	$ 19,724,034

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

Table of Contents

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

	Nine months ended September 30, 2008	Nine months ended September 30, 2007
Operating activities:		
Net earnings	$ 473,940	$ 954,704
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Minority interest share in (losses) earnings	(4,510)	2,751
Straight-lined rents	(24,806)	(34,042)
Cost of share-based compensation awards	27,732	18,782
Depreciation and amortization	244,529	227,445
Equity in earnings from unconsolidated investees	(34,871)	(88,452)
Changes in operating receivables and distributions from unconsolidated investees	14,152	50,258
Amortization of deferred loan costs	9,140	7,827
Amortization of debt premium, net	(1,593)	(6,813)
Gains recognized on dispositions of non-CDFS business assets	(13,975)	(184,106)
Gains recognized on dispositions of CDFS business assets included in discontinued operations	(2,232)	(22,537)
Impairment charges		12,600
Unrealized foreign currency exchange losses, net	27,218	11,706
Deferred income tax expense	19,478	5,710
Increase in accounts and notes receivable and other assets	(59,020)	(122,977)
(Decrease) increase in accounts payable and accrued expenses and other liabilities	(11,471)	199,665
Net cash provided by operating activities	663,711	1,032,521
Investing activities:		
Real estate investments	(4,306,323)	(3,640,109)
Tenant improvements and lease commissions on previously leased space	(44,333)	(50,095)
Recurring capital expenditures	(27,208)	(28,482)
Purchase of Macquarie ProLogis Trust (MPR), net of cash acquired		(1,137,028)
Cash consideration paid in Parkridge acquisition, net of cash acquired		(707,374)
Investments in and net advances to unconsolidated investees	(149,347)	(507,378)
Return of investment from unconsolidated investees	98,046	39,087
Proceeds from dispositions of real estate assets	3,209,094	3,087,967
Proceeds from repayment of notes receivable	1,497	42,008
Net cash used in investing activities	(1,218,574)	(2,901,404)
Financing activities:		
Proceeds from sales and issuances of common shares under various common share plans	217,107	26,664

Distributions paid on common shares	(414,236)	(354,152)
Dividends paid on preferred shares	(19,071)	(19,065)
Minority interest contributions (distributions), net	24,833	(7,065)
Debt and equity issuance costs paid	(11,448)	(8,602)
Net proceeds from credit facilities	537,694	119,017
Proceeds from issuance of debt to finance MPR and Parkridge acquisitions		1,719,453
Proceeds from issuance of convertible senior notes	544,500	1,228,125
Proceeds from issuance of senior notes, secured and unsecured debt	599,612	6,459
Payments on senior notes, secured and unsecured debt and assessment bonds	(963,363)	(787,391)
Net cash provided by financing activities	515,628	1,923,443
Effect of foreign currency exchange rate changes on cash	(19,588)	19,921
Net (decrease) increase in cash and cash equivalents	(58,823)	74,481
Cash and cash equivalents, beginning of period	399,910	475,791
Cash and cash equivalents, end of period	$ 341,087	$ 550,272

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 Financial Statements.

6

Table of Contents

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) investment management; and (iii) CDFS business. Our property operations segment represents the direct long-term ownership of industrial distribution and retail properties. Our investment 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 11 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 (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, 2008 and our results of operations for the three and nine months ended September 30, 2008 and 2007 and cash flows for the nine months ended September 30, 2008 and 2007 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, 2007 Consolidated Financial Statements, as filed with the SEC in our Annual Report on Form 10-K, as amended.

Certain amounts included in the accompanying consolidated financial statements for 2007 have been reclassified to conform to the 2008 financial statement presentation.

Adoption of New Accounting Pronouncements. In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (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 measurements. In February 2008, the FASB issued FASB Staff Position No. FAS 157-2, *Effective Date of FASB Statement No.157* (FSP FAS 157-2), that delays the effective date of SFAS 157 s fair value measurement requirements for nonfinancial assets and liabilities that are not required or permitted to be measured at fair value on a recurring basis. The adoption of SFAS 157 on January 1, 2008 for financial assets and liabilities, primarily derivative contracts that we or our unconsolidated investees are party to, did not have a material impact on our financial position and results of operations. Fair value measurements identified in FSP FAS 157-2 will be effective for our fiscal year beginning January 1, 2009. We are currently assessing the impact, if any, that SFAS 157 will have on our financial position and results of operations, as it relates to nonfinancial assets and liabilities.

Recent Accounting Pronouncements. In December 2007, the FASB issued SFAS No. 141R, *Business Combinations* (SFAS 141R) and SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB No. 51* (SFAS 160). SFAS 141R and SFAS 160 require most identifiable assets, liabilities, noncontrolling interests and goodwill acquired in a business combination to be recorded at full fair value and require noncontrolling interests (previously referred to as minority interests) to be reported as a

Table of Contents

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

component of equity, which changes the accounting for transactions with noncontrolling interest holders. The provisions of SFAS 141R and SFAS 160 are effective for our fiscal year beginning January 1, 2009. SFAS 141R will be applied to business combinations occurring after the effective date and SFAS 160 will be applied prospectively to all changes in noncontrolling interests, including any that existed at the effective date. We are currently assessing what impact the adoption of SFAS 141R and SFAS 160 will have on our financial position and results of operations.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133* (SFAS 161). SFAS 161 requires enhanced disclosures related to derivative instruments and hedging activities. SFAS 161 will require disclosures relating to: (i) how and why an entity uses derivative instruments; (ii) how derivative instruments and related hedge items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* ; and (iii) how derivative instruments and related hedged items affect an entity s financial position, financial performance and cash flows. SFAS 161 must be applied prospectively and will be effective for our fiscal year beginning January 1, 2009, although early adoption is allowed. We do not expect the adoption of SFAS 161 in 2009 to have an impact on our financial position or results of operations.

In May 2008, the FASB issued FASB Staff Position No. APB 14-1 *Accounting for Convertible Debt Instruments that May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement)* that requires separate accounting for the debt and equity components of convertible debt. The value assigned to the debt component is the estimated fair value of a similar bond without the conversion feature, which would result in the debt being recorded at a discount. The resulting debt discount would be amortized over the period during which the debt is expected to be outstanding (for example, through the first optional redemption date) as additional non-cash interest expense. The effective date is January 1, 2009 with the application of the new accounting applied retrospectively to both new and existing convertible instruments, including the convertible notes we issued in 2007 and 2008. As a result of the new accounting, beginning in 2009, we will recognize an additional non-cash interest expense, for purposes of calculating earnings, of between $64 million and $82 million per annum, prior to the capitalization of interest as a result of our development activities. In addition, we will be required to restate our 2007 and 2008 results to reflect the additional non-cash interest expense for the periods the convertible notes were outstanding in those years.

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 $733.9 million in cash, $339.5 million of equity (4.8 million common shares valued for accounting purposes at $71.01 per share) and the remainder through the assumption of debt and other liabilities. The cash portion of the acquisition was funded with borrowings under our global senior credit facility (Global Line) and a new multi-currency credit facility.

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, 2008	December 31, 2007
Property funds	$ 1,865,609	$ 1,755,113
CDFS joint ventures and other unconsolidated investees	704,962	590,164
Totals	$ 2,570,571	$ 2,345,277

8

Table of Contents

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

Property Funds

We recognize fees and incentives and our proportionate share of net earnings or losses, related to our investments in property funds, as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2008	**2007**	**2008**	**2007**
Earnings (losses) from unconsolidated property funds:				
North America	$ 4,408	$ 5,163	$ (1,798)	$ 16,804
Europe	7,277	37,167	16,977	51,635
Asia	6,614	4,358	21,106	13,017
Total earnings from unconsolidated property funds	$ 18,299	$ 46,688	$ 36,285	$ 81,456