ProLogis European Properties
Presenters: Robert Watson, Peter Cassells, Ralf Wessel
Thursday 26th July 2007
17h00 CET

Operator: Good afternoon, my name is Elaine and I will be your conference facilitator today. I would like to welcome everyone to ProLogis European Properties Second Quarter and Half Year 2007 Financial Results Conference Call. Today's call is being recorded. All lines are currently in a listen-only mode to prevent any background noise. After the speakers' presentation there will be a question and answer session. If you would like to ask a question during the session, simply press *1 on your telephone keypad. The questions will be taken in the order in which they are received. At this time I would like to turn the call over to Jennifer van der Eem, Vice President of Investor Relations with ProLogis European Properties. Please go ahead.

Jennifer van der Eem: Thank you Elaine, good afternoon. Before we get underway I would like to state that this conference call will contain forward-looking statements. These statements are based on current expectations, estimates and projections about the market and the industry in which ProLogis European Properties operates as well as management's beliefs and assumptions. Forward-looking statements are not guarantees of performance and actual operating results may be affected by a variety of factors. Robert Watson, Chief Executive Officer will give an overall view on performance and outlook; and then Peter Cassells, CFO will cover financial performance; and finally Ralf Wessel, Head of Asset Management will talk about operating performance and leasing activity. At the end of the presentations we will be happy to take your questions from either the call or from the webcast. Robert, please begin.

Robert Watson: Thank you Jen and good afternoon everyone. We are delighted to be reporting another strong set of financial and operating results for the second quarter and half year 2007. Adjusted net asset value per unit increased 3% to 14.41 per unit for the half year reflecting the strength of our portfolio. Our adjusted earnings increased 11.1% to €81.6 million for the same period. These results have enabled us to deliver a second quarter distribution to unit holders of €0.23 per unit, a 5.3% increase over Q1 and continuing PEPR's trend of providing steadily increasing distributions. Peter Cassells will go into more detail on our financial results in a moment. However I believe the financial results demonstrate our ability to drive operational performance from our portfolio.

Leasing results were exemplary with over 332,000 square metres of transactions completed in the first half year. Having strong relationships with global customers and a critical mass of properties in the most important markets across Europe allows ProLogis European Properties to maximise returns and serve customers well. One example of this was a series of transactions in the London market where we were able to let a global customer out of its remaining eight year lease term. We signed a new 20 year lease on the same space with another global customer and received a €6 million lease termination fee. The building remains fully occupied, both customers are very satisfied and we have improved portfolio performance. These lease termination fees are a normal part of business in the active management of a large flexible platform such as ProLogis European Properties. Ralf Wessel will speak about our markets and leasing activity directly but we were pleased to report that the portfolio remains very well leased and an enviable 96.4% occupancy with an average lease term of just under seven years to lease expiry. During the second quarter ProLogis European Properties acquired a 36,100 square metre distribution centre at Evry, south of Paris in a sale and leaseback transaction with a major European customer for €18.5 million. This was the second of two such acquisitions from this customer at this important logistics location in the Isle-de-France. As announced this morning we have agreed to sell a portfolio of French assets for €425 million to Foncière Europe Logistique, equating to an over 18% net premium to the latest valuation. The portfolio covers some 556,000 square metres in four locations, three of which are in the Isle-de-France, Garonor, Senart and Cergy Pontoise and one at Vitrolles outside Marseilles. The majority of the portfolio was acquired from ProLogis in 2000 and since that time the respective sites have reached full build-out with the addition of newly developed ProLogis assets and the acquisition of third party assets. As we carried out our continual review of our platform to ensure we maximise returns for our unit holders, we look very carefully at the Garonor portfolio.

Our review of these assets lead to the decision to market them for sale for the following reasons. Firstly they contain mainly local or regional customers with an average customer size of 2,200 square metres as compared to 8,500 square metres for the whole portfolio. Large customers tend to be global with multiple lease transactions with us and better credit. Whilst the possibility of redevelopment at Garonor especially the Aulnay site for instance may be available, we believe it to be a long term and with an uncertain outcome. The market for second generation space has been very favourable as the premium on this sale shows. Finally the ProLogis European pipeline is much larger than it was at our IPO and we would like to take full advantage of the accretive opportunities offered therein to invest in that pipeline.

In short we still believe that the Garonor assets are well located but that we can more effectively carry out our business plan and accretively invest in new facilities with our global customer base having disposed of this portfolio at an attractive premium to NAV. Following the completion of the sale expected on or before the 31st July, our French platform will consist of 61 distribution facilities covering 1.6 million square metres of space and yielding 7.5%. The average size of our French properties will increase from 19,600 square metres to 25,700 square metres, occupancy levels will improve to 97.4% from 94.3% and the average age of these facilities will decrease from 10.6 years to 5.9. In total our platform’s occupancy will grow from 96.4% to 97.1% after the disposal.

As we have discussed in the past ProLogis European Properties’ primary opportunity for future growth is its right to invest in private equity funds and joint ventures sponsored by ProLogis in Europe. At the end of June ProLogis’ existing European pipeline contained $3 billion of properties and a land bank of some 6,000 acres, a significant opportunity for growth. We are confident in our ability to access this pipeline through investing in a ProLogis sponsored private equity fund by the end of 2007. The sale of the Garonor assets and the redeployment of this capital allows ProLogis European Properties to fully take advantage of that pipeline.

Ralf will comment in more detail on our individual markets, however overall the favourable economic climate in Europe combined with strong global trade growth has continued to drive occupier demand for warehouse space in Europe. Overall we are delighted with the financial and operating performance delivered in the first six months of the year. We are delivering on the targets we set for ourselves at our IPO. We will continue to focus on enhancing returns from the portfolio and are excited about the prospect of growing the business further through invest in new ProLogis private equity funds this year.

Now let me hand over to Peter Cassells to cover the financials.

Peter Cassells: Thanks Robert and good afternoon. Before I begin let me point out that we are comparing our Q2 performance with Q1 as there are no published figures for the second quarter of 2006 on a standalone basis. However figures for the six months to June 2007 are compared to the six months of June 2006 which were published in the prospectus at the time of the IPO last year. Adjusted earnings, our preferred measure of underlying profitability increased 11% to €81.6 million for the first six months of the year driven by a 15% increase in rental income. As Robert mentioned this includes a fee of €6 million received from a customer in the UK upon the termination of a lease. On a per unit basis adjusted earnings were down two cents to €0.42 for the half year. Under IFRS a comparison of the two six month periods of June 2006 and 2007 show that net earnings have decrease from €374 million in 2006 to €122 million this year. This is a direct result of the significant revaluation of the entire portfolio in June 2006 as we prepared for the IPO.

On a quarterly per unit basis IFRS earnings increased from €0.22 for quarter one to €0.42 for Q2 2007. This is due to the revaluation of half our portfolio at the end of June offset by the impact of our related deferred tax charge. Rental income has increased 5.7% to €81.5 million for the second quarter primarily as a result of a full quarter's rental income from the portfolio acquired from ProLogis at the end of March and two weeks' rent from the Evry acquisition referred to earlier by Robert. Property operating expenses for Q2 have remained in line with those of the first quarter of the year and on a year to date basis are consistent with the level incurred in 2006. Fund operating expenses for the second quarter have increased by €4.7 million due almost entirely to a provision for an incentive fee potentially payable to ProLogis early in 2009. The fee is calculated on the basis of PEPR's annual return to unit holders with the first measurement period extending from the date of the IPO to the end of 2008. If you ignore this provision for the half year as well as the expenses of the IPO incurred in the first half of 2006, the overall level of operating expenses has increased by just 4.7% to €20.2 million due in large part to the increase in the size and value of PEPR's portfolio over the last 12 months. Disposal proceeds of €4.8 million for the half year 2007 represent those proceeds received earlier in the year following the release of escrowed funds related to a portfolio sale in 2003.

Although the disposal of the Garonor assets will reduce rental income for the reminder of the year by approximately $10 million this loss will be offset by savings in assets and fund management fees, debt service costs and ongoing capital expenditures. Net proceeds of approximately €395 million on the disposal will be used to repay borrowings under our €800 million debt facility, thereby creating additional leveraged capacity from which to invest in ProLogis sponsored private equity funds and joint ventures. Following this debt repayment it is anticipated that leverage levels will reduce from 45.7% at the end of June to 40%. Although the impact of the disposal may be slightly dilutive in the short term, recycling the capital into more accretive investment opportunities over the next three quarters will significantly enhance investor returns overall. Looking back at the activities for the six months to June 2007 ProLogis European Properties incurred interest expense of €49.4 million for the period, up 23.5% compare to €40 million for the corresponding period last year. This increase is primarily due to the increased used of PEPR's debt facilities to finance the €153.2 million redemption of preferred equity in Q3 2006 and the expenditure of over €250 million on properties in the last six months alone. In addition the increase in euro and sterling interest rates over the last 12 months has also impacted the cost of servicing this debt. Whilst ProLogis European Properties' weighted average interest rate for the six months end of June 2007 was 4.9% up from 4.6% for the same period in 2006. As I mentioned earlier on at the end of the period June 2007 leverage levels have increased to 45% from 44.7% at the end of 2006.

In anticipation of the disposal of the properties in France the decision was made to redeem €144 million of related CMBS debt which had been in place since 2002 and costing 5.7% fixed per annum. The redemption took place after quarter end on July 16th last. In the interim this has been re-financed with the proceeds of a new short term €400 million bridge facility at Euribor plus 45 basis points. We took the opportunity to also redeem €201.6 million of additional CMBS debt issued in 2001 at fixed rates of 5.7% per annum. This redemption took place on July 16th also with proceeds from the same bridge facility. Year to date the effective tax rate on the operating activities of ProLogis European Properties is between 12-14% compared to 5.5% for the same period last year. Historically we have tended to report a conservative tax rate for the first half of each year, last year however the reversal of a relatively significant tax provision in the Netherlands from earlier years greatly reduced the comparative rate.

The second quarter distribution will be €0.23 per unit, a 4.8% increase over the first quarter of the year. This distribution will be made on August 7th next and total distributions for the half year have equalled 45 cents per unit implying a dividend yield of 7% based on 29th June 2007 closing price of €12.95 per unit. During the last number of months we have conducted a review of our financing strategy. In the past ProLogis European Properties has predominantly relied on CMBS issuances for its financing needs. In the second quarter we were successful in obtaining an A3 investment grade rating with a stable outlook from Moody's enabling us to explore a broader range of product instruments. We have taken the opportunity to investigate the possibility of issuing a debut benchmark Eurobond, however given the recent volatility in the debt markets this opportunity has been postponed until later in the year.

With that let me hand you over to Ralf to discuss operations and the European markets in which we compete.

Ralf Wessel: Thank you Peter. We have enjoyed an active half year operationally with the acquisition of 15 distribution facilities, a high level of leasing transactions and a recent sale agreement for a portfolio of French assets. The acquisition of 14 buildings covering 285,000 square metres from ProLogis for €201 million in the first quarter enabled us to complete certain logistic parts and substantially increase our critical mass in some of the prime markets in Europe. The purchase of Evry DC5, a 32,000 square metre building for €18.5 million in the second quarter helps us to achieve critical mass in ProLogis Park Evry. This is a park where PEPR already owns four existing facilities. We now own 165,000 square metres at ProLogis Park Evry, one of the prime logistic locations just south of Paris. As Robert mentioned we have agreed to the sale of 55,000 square metres of the French portfolio to Foncière Europe Logistique, a subsidiary of Foncière des Regions, one of Europe’s leading property investment companies. The net consideration of €397 million produces an over 18% premium to the portfolio’s net asset value.

As you are aware the entire portfolio was independently re-valued at the end of June 2006 prior to our IPO and since that date approximately half the portfolio was re-valued at the end of December ‘06 and the other half at the end of June 2007. 134 properties, 49% of current portfolio value were independently re-valued at the end of June 2007 resulting in a valuation surplus. In the future we will begin to value the whole portfolio twice a year to more accurately capture NAV. Total portfolio value increase from €4.2 billion at the end of 2006 to €4.5 billion at the end of June 2007 and its risk profile remains attractive given its 6.8% net yield, diversified customer base and 96.4 occupancy level with just under seven years on average to lease expiry.

Leasing activity has continued to build momentum over the second quarter with the ProLogis team concluding 39 lease transactions covering over 195,000 square metres of leasable space. These include 15 new leases covering 90,000 square metres with global customers such as Christian Salvesen, Geodis and Schneider Electric. In addition five of our customers including Iron Mountain and Keuhne and Nagel expanded their relationship with us by taking an additional 38,000 square metres of space. Finally 90 leases were renewed covering 61,000 square metres of space. As anticipated our core markets have show a slower rate of yield compression with the exception of some central European countries. As such rental growth is expected to return particularly in prime assets as a result of the increase in land prices and construction costs over the last couple of years. Indeed there has already been evidence of prime rental growth in Germany and the UK.

Let me move over to cover the major markets in some more details and as I used to do I have also split Europe in four parts. Let's start with Southern Europe. France remains an attractive logistic market with Paris a prime sub market. Business confidence is improving on the back of the election of pro business government. Demand for prime space has been improving, yield compression is bottoming out and rental growth is expected in the coming years, especially as indexation has calmed. We believe the Garonor sale further enables us to more effectively service our global customer base in France. The Italian market is benefiting from the improving German economy. Yields have stabilised although rents are slowly declining. ProLogis European Properties is over 97% leased in Italy. Spain is one of the most dynamic markets in Southern Europe, there is active demand for prime location and further rental growth is anticipated. We are almost 100% occupied in our Spanish portfolio and Spanish yields have fallen below 6%. If I move over to the UK, the UK remains a strong market with healthy demands from occupiers for logistic space. As expected yield compression has eased and rental growth of some 2% has been achieved in the general market over the last 12 months. As ProLogis European Property is 100% let in the UK we will remain focused on maximising portfolio opportunities as they occur. As Robert mentioned earlier, we were pleased to be able to negotiate the London market transaction which improved earnings as well as our portfolio quality in the UK.

If I move over to Northern Europe, let's start with Germany, the German economy is revitalising with solid economic growth anticipated, yields and rental levels have stabilised following strong demand for large properties in prime locations. Given these conditions we are pleased to have increased our exposure to this market during the year with the acquisitions we have made. We are looking forward to invest more in the German market. Demand in the Belgium and Dutch market has been improving in response to increased economic activities. Rents have stabilised and growth is expected in prime assets due to limited supply. Investment yields remain strong in both Belgium and the Netherlands.

The last section that I would like to cover is Central Europe. The economic growth in Central Europe is higher than Western levels partly due to a lower base. The Czech Republic remains one of the most dynamic markets and has seen increased activity. During the second quarter we had leasing success in Prague on some 29,000 square metres and improved occupancy levels to 92% from 86% at the end of the first quarter. The Polish economy has been buoyant and demand in this market remains high. The last two years we have seen a rise in number of lease contracts signed outside Warsaw eroding the differential between the capital and other cities such as Posnan and Wroclaw. During the second quarter Keuhne and Nagel increased their floor space with us in Wroclaw by some 3,500 square metres; and of the 14,000 square metres of lease transactions completed 8,000 square meters was outside the Warsaw area. The Hungarian market has become more stable and demand for prime logistics space is expected to grow. Leasing activity in our portfolio has increased occupancy levels to over 95%. Given the market dynamics, the high quality of our portfolio and the experience of the ProLogis operations team we are confident we can maintain a high level of portfolio occupancy and thereby grow portfolio income.

With that let me hand back to Robert.

Robert Watson: Thank you Ralf. In summary we are pleased with our financial and operating performance for the first half of the year and with the level of activity across the business. We believe we are well positioned to capitalise on favourable marketing conditions and continue to grow the business in the future.

With that I'd like to ask the operator to open up for questions please.

Operator: Thank you sir. The question and answer session will be conducted electronically. If you would like to ask a question, please press the * or asterisk key followed by the digit 1 on your telephone keypad. Please ensure that the mute function on your telephone is switched off to allow your signal to reach our equipment. We will take questions in the order received and we will take as many as time permits. If you find that your question has been answered you may remove yourself from the queue by pressing *2. Again, please press *1 to ask a question. We will pause for just a moment to allow everyone to signal for questions.

Our first question today comes from Robert Woerdeman of Kempen & Co. Please go ahead sir.

Robert Woerdeman: Good afternoon, this is Robert Woerdeman from Kempen. I have a question concerning your reversionary potential because it was always negative, but looking at the markets it seems quite favourable. What can we expect going forward that the negative reversionary decreases rapidly and can you elaborate on that? How rapidly?

Robert Watson: Ralf, do you want to take that?

Ralf Wessel: Sure. As mentioned what we've seen is that generally in Europe with the UK probably leading the European logistic landscape we see that yield compression is easing off with the increase of construction costs and in certain markets also a very strong increase of land prices we expect that we will see rental growth in certain markets, even very strong rental growth coming in to the market. Over time we expect that our reversionary yields will demonstrate a positive trend.

Robert Watson: Rob, this is an addition to that. In France we've seen annual increases through the construction index of upwards of 8%, that's now running at less than 2. The index running that high has been one of the major reasons that we've had some over-running in the French market, so we think the combination of that annual indexation going down somewhat and as well as we've talked about the anticipation of rental rate growth over 2% which we've seen here in the UK and others will help us. Now just as an aside the sale of Garonor will reduce the overrunning in the French portfolio by 1/3.

Robert Woerdeman: Ok, thank you for your answer. So to summarise on page 15 we've seen an annualised rental income of 328 and an ERV of 308 so going forward we can expect that figure to be almost equal or even that the ERF is higher?

Robert Watson: I think over the next year we'll certainly move in that direction.

Robert Woerdeman: That's clear, very clear, thank you. Another thing is that basically during the IPO you expected to grow with approximately €200 million per annum, however the pipeline looks favourable and therefore €300 million per annum was reasonable. Now that you sold off 425 what do you expect of net acquisitions in 2007?

Robert Watson: We'll certainly…what we said in the past was that in 2007 we expected to buy the €200 million portfolio from ProLogis which we've done and we felt that we would invest another

€150-200 million within the ProLogis Fund or joint venture. We still feel good about that and we feel good about the high end of that number.

Robert Woerdeman: Ok, so going forward for 2007 you expect approximately a flat acquisition assumption, approximately around zero? The growth of the portfolio in millions.

Robert Watson: Are you saying if you take the reduction, the disposal of Garonor?

Robert Woerdeman: Yes, and the new acquisitions.

Robert Watson: I think if you look at it that way we will be flat to positive somewhat, I think we will be. I would expect us to deploy the proceeds from the Garonor sale over the next 2-3 quarters.

Robert Woerdeman: That's very helpful. Thank you for your answers. I think those were my questions.

Robert Watson: Alright, thank you for listening.

Robert Woerdeman: Thank you very much, bye.

Operator: Thank you. We'll now take our next question from Juliana Weiss Dalton of Morgan Stanley. Please go ahead.

Juliana Weiss Dalton: Hi guys, just a couple of quick questions, I think I joined a bit late. Did you talk about a lease termination fee?

Robert Watson: We did.

Juliana Weiss Dalton: Which line item is that in.

Peter Cassells: Hi Juliana, Peter here. That's in the other property income line on page 9 with the consolidated income statement.

Juliana Weiss Dalton: Ok, and you said that's about €6 million.

Peter Cassells: It is, £4 million or €6 million.

Juliana Weiss Dalton: Ok, and is that the first time or is it in prior quarters as well? Is that something you've had recur?

Peter Cassells: It's not the first time. It's probably the first time it's been that significant and I think it's the only one this year so far, we've had others before.

Robert Watson: Juliana, we will pick up more and more lease termination fees, if you have a large platform like we do and you're able to take advantage of customers that need to change their supply chain. It's not necessarily like the one time payment fee that we got last quarter from a transaction in 2003, we will continually do this. This one is a large one though.

Juliana Weiss Dalton: Ok, great. Also we very much appreciate an announcement on revaluation twice a year, I think that's great and the increased disclosure in your statement. In terms of the sale that you announced this morning I think you indicated that added an 18% premium to the June valuation?

Robert Watson: Yes.

Juliana Weiss Dalton: What's the yield on that?

Robert Watson: There's a lot of different ways to look at the yield. The way we would look at that is a low 6s.

Juliana Weiss Dalton: Ok. Great, I appreciate that.

Robert Watson: Ok.

Operator: Thank you. As a reminder, if you wish to ask a question, please press *1 to signal. Miss van der Eem, we have no questions at this time. Are there any questions from the web?

Jennifer van der Eem: There are no questions from the website.

Operator: We have no further questions at this time from the audio conference.

Robert Watson: Ok operator. I'd like to thank all of you for participating in the call today and we'll speak to you all in the next quarter if not sooner. Thank you.

Operator: That will conclude today's conference call. Thank you for your participation ladies and gentlemen, you may now disconnect.