CAPITAL AUTOMOTIVE REIT
Form 10-Q
May 09, 2005

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For quarterly period ended March 31, 2005

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 000-23733

CAPITAL AUTOMOTIVE REIT

(Exact name of registrant as specified in its charter)

Maryland	54-1870224
(State of organization)	(I.R.S. Employer Identification Number)

8270 Greensboro Drive, Suite 950, McLean, Virginia 22102
(Address of principal executive offices and zip code)

(703) 288-3075
(Registrant s telephone Number, including area code)

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 requirements for the past 90 days.

Yes þ No o

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

Yes þ No o

Number of common shares of beneficial interest outstanding as of April 30, 2005 was 43,684,272.

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ITEM I FINANCIAL STATEMENTS
CAPITAL AUTOMOTIVE REIT
CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

	March 31, 2005 (unaudited)	December 31, 2004
ASSETS		
Real estate:		
Land	$ 872,971	$ 866,480
Buildings and improvements	1,363,717	1,330,843
Accumulated depreciation	(153,833)	(143,886)
	2,082,855	2,053,437
Cash and cash equivalents	40,816	8,332
Other assets, net	96,579	96,388
Total Assets	$ 2,220,250	$ 2,158,157
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Mortgage debt	$ 547,146	$ 634,365
Unsecured debt	555,148	381,592
Borrowings under credit facilities		30,000
Accounts payable and accrued expenses	22,565	23,731
Security deposits payable	10,128	9,665
Total Liabilities	1,134,987	1,079,353
Minority Interest	145,428	144,877
Shareholders Equity		
Preferred shares, par value $.01 per share; 20 million shares authorized, 3,950,000 Series A Cumulative Redeemable Preferred Shares issued and outstanding as of March 31, 2005 and December 31, 2004	40	40
2,600,000 Series B Cumulative Redeemable Preferred Shares issued and outstanding as of March 31, 2005 and December 31, 2004	26	26
Common shares, par value $.01 per share; 100 million shares authorized, 43,682,563 shares issued and outstanding as of March 31, 2005 and 43,406,280 shares issued and outstanding as of December 31, 2004	437	434
Additional paid-in capital	966,045	957,938

Deferred compensation	(7,737)	(3,816)
Accumulated other comprehensive loss		
Distributions in excess of accumulated earnings	(18,976)	(20,695)
Total Shareholders Equity	939,835	933,927
Total Liabilities and Shareholders Equity	$ 2,220,250	$ 2,158,157

See accompanying Notes to Consolidated Financial Statements.

CAPITAL AUTOMOTIVE REIT
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004
Revenue:		
Rental	$ 55,568	$ 46,505
Interest and other	1,087	970
Total revenue	56,655	47,475
Expenses:		
Depreciation and amortization	10,133	8,575
General and administrative	3,284	2,741
Interest	15,976	17,005
Total expenses	29,393	28,321
Income from continuing operations before minority interest	27,262	19,154
Minority interest	(3,810)	(3,215)
Income from continuing operations	23,452	15,939
Income from discontinued operations, net of minority interest	88	1,654
Gain on sale of real estate, net of minority interest	84	953
Total discontinued operations	172	2,607
Net income	23,624	18,546
Preferred share dividends	(3,152)	(1,852)
Net income available to common shareholders basic and diluted	$ 20,472	$ 16,694
Common shares outstanding used to compute basic earnings per common share	43,235	34,049
Basic earnings per common share:		
Income from continuing operations	$ 0.47	$ 0.41
Net income	$ 0.47	$ 0.49

Common shares outstanding used to compute diluted earnings per common share		43,538		34,673
Diluted earnings per common share:				
Income from continuing operations	$	0.47	$	0.41
Net income	$	0.47	$	0.48
Dividends declared per common share	$	0.4305	$	0.4165

See accompanying Notes to Consolidated Financial Statements.

CAPITAL AUTOMOTIVE REIT
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Three Months Ended March 31,	
	2005	**2004**
Cash flows from operating activities:		
Net income	$ 23,624	$ 18,546
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on disposition of real estate net of minority interest	(84)	(953)
Stock compensation expense	576	328
Depreciation and amortization	11,056	9,587
Minority interest expense including amounts attributable to discontinued operations	3,826	3,592
Changes in operating assets and liabilities:		
Increase in other assets	(1,074)	(2,540)
(Decrease) increase in accounts payable and accrued expenses	(1,715)	2,844
Increase in security deposits payable	463	55
Net cash provided by operating activities	36,672	31,459
Cash flows from investing activities:		
Purchase of furniture and equipment, net of disposals	(41)	(12)
Property acquisitions and improvements	(40,443)	(35,989)
Investments in mortgage notes receivable and construction advances	(7,875)	(5,891)
Proceeds from mortgage notes receivable and construction advances	10,872	
Property dispositions	986	16,501
Net cash used in investing activities	(36,501)	(25,391)
Cash flows from financing activities:		
Proceeds from borrowings under credit facilities	95,000	23,000
Proceeds from debt issuance	175,000	11,900
Repayment of borrowings under credit facilities	(125,000)	(80,000)
Repayment of debt	(81,465)	
Debt principal payments	(5,754)	(6,852)
Payments for debt issuance costs	(1,347)	(311)
Increase in restricted cash	(2,142)	(317)
Payment of common share dividends	(15,410)	(11,544)
Payment of preferred share dividends	(3,152)	(1,029)
Distributions to minority partners	(3,477)	(3,229)
Series A Cumulative Redeemable Preferred Shares issuance costs		(93)
Proceeds from the issuance of common shares, net of costs and forfeitures	60	61,638
Net cash provided by (used in) financing activities	32,313	(6,837)

Net increase (decrease) in cash and cash equivalents		32,484		(769)
Cash and cash equivalents at beginning of period		8,332		13,352
Cash and cash equivalents at end of period	$	40,816	$	12,583
Supplemental Data:				
Real estate acquisitions in exchange for like-kind property	$		$	14,968
Interest paid during the period	$	12,735	$	11,067
Dividends and distributions reinvested to purchase common shares	$	3,351	$	3,069
Change in valuation of fair value swap	$	(1,444)	$	(1,146)

See accompanying Notes to Consolidated Financial Statements.

CAPITAL AUTOMOTIVE REIT
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY AND OTHER COMPREHENSIVE INCOME
(in thousands, except share data)

	Preferred Shares Series A	Preferred Shares Series B	Common Shares	Preferred Shares Par Value Series A	Preferred Shares Par Value Series B	Common Shares Par Value	Additional Paid-in Capital	Distributions in Excess of Accumulated Earnings	Deferred Compensation	Accumulated Other Comprehensive Income (Loss)	Total	C
December 31, 2004	3,950,000	2,600,000	43,406,280	$ 40	$ 26	$ 434	$ 957,938	$ (20,695)	$ (3,816)	$	$ 933,92	
of minority interest Partnership							(195)				(19	
004 common share follow-on ance costs							(37)				(3	
common shares from dividend t and share purchase plan, net			112,840			1	3,703				3,70	
estricted shares, net of			124,621			2	4,172		(4,467)		(29	
n of deferred compensation									546		54	
phantom shares, net of			18,572				128				12	
common share options			20,250				306				30	
npensation							30				3	
are dividends								(3,152)			(3,15	
are dividends								(18,753)			(18,75	
								23,624			23,62	
March 31, 2005 (unaudited)	3,950,000	2,600,000	43,682,563	$ 40	$ 26	$ 437	$ 966,045	$ (18,976)	$ (7,737)	$	$ 939,83	

See accompanying Notes to Consolidated Financial Statements.

CAPITAL AUTOMOTIVE REIT
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. ORGANIZATION AND BASIS OF PRESENTATION

Organization

Capital Automotive REIT, which we refer to as the Company, is a Maryland real estate investment trust formed in October 1997. We own interests in real estate and conduct our operations, directly or indirectly, through Capital Automotive L.P., which we refer to as the Partnership, and its subsidiaries. We are the sole general partner of the Partnership and, as of March 31, 2005, owned approximately 84.2% of the common units of limited partnership interest in the Partnership, which we refer to as Common Units, as well as 100% of the Series A and Series B preferred units of limited partnership interest in the Partnership, which we refer to as Preferred Units. References to we, us and our refer to the Company or, if the context requires, the Partnership and our business and operations conducted through the Partnership and/or directly or indirectly owned subsidiaries.

Our primary business strategy is to purchase real estate (land, buildings and other improvements) or leasehold interests therein, which we simultaneously lease to operators of franchised automobile dealerships and motor vehicle service, repair or parts businesses, used vehicle businesses and other related businesses under long-term, triple-net leases. In addition, we provide mortgages, facility improvements, construction financing and takeout commitments in certain circumstances. Triple-net leases typically require the tenant to pay all operating expenses of a property, including, but not limited to, all real estate taxes, assessments and other government charges, insurance, utilities, repairs and maintenance. We use (i) the term dealerships to refer to these types of businesses that are operated on our properties and (ii) the terms dealer group, tenant or operators of dealerships to refer to the persons and entities that lease our properties from us or mortgage their properties with us. We focus on leasing properties or providing mortgages to dealer groups that have a long history of operating multi-site, multi-franchised dealerships, generally targeting the largest dealer groups in terms of revenues in the largest metropolitan areas in the U.S. in terms of population.

As of March 31, 2005, we had real estate investments of nearly $2.3 billion, primarily consisting of interests in 343 properties located in 31 states, including approximately 2,594 acres of land and containing approximately 15.0 million square feet of buildings and improvements. Our tenants operate 505 motor vehicle franchises on our properties, representing 44 brands of motor vehicles, which include all of the top selling brands in the U.S. The initial lease terms generally range from 10 to 20 years (with a weighted average initial lease term for leases entered into during the quarter ended March 31, 2005 of 17.7 years), with our entire portfolio having a weighted average initial lease term of approximately 15.1 years. As of March 31, 2005, our portfolio had a weighted average remaining lease term of approximately 11.7 years. The leases typically have options to renew upon generally the same terms and conditions for one or more additional periods of five to 10 years each, exercisable at the option of the tenants (with renewal options typically ranging from a total of five to 40 years).

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in the United States, commonly referred to as GAAP, for interim financial information and in conformity with the rules and regulations of the Securities and Exchange Commission, commonly referred to as the SEC. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. The results of operations for the three months ended March 31, 2005, are not necessarily indicative of the results that may be expected for the full year. These financial statements should be read in conjunction with our audited consolidated financial statements and footnotes thereto, included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2004.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The accompanying consolidated financial statements of the Company have been prepared in accordance with GAAP and include the accounts of the Company, its wholly-owned subsidiaries, and other entities where the Company has a majority ownership, all of which it controls. The equity interests of other limited partners are reflected as minority interest. All significant intercompany transactions and balances have been eliminated in consolidation.

Real Estate and Depreciation

The purchase price of real estate properties acquired is allocated to the various components, such as land, buildings and improvements, and in-place leases as appropriate, in accordance with the Financial Accounting Standards Board, commonly referred to as the FASB, Statement of Financial Accounting Standards, commonly referred to as SFAS, No. 142, Goodwill and Other Intangible Assets. The purchase price is allocated based on the fair value of each component at the time of acquisition. The fair value of the buildings and improvements are recorded at the cost of our acquisition which we believe approximates their replacement costs. We generally do not acquire real estate assets that have in-place leases. We typically execute our leases simultaneously with the purchase of the real estate, and because of this, no value has been ascribed to any in-place leases because we do not believe any exist. Therefore, we have not recorded any lease intangible assets or liabilities on our consolidated balance sheets as of March 31, 2005 and December 31, 2004.

Depreciation is computed on our buildings and improvements or leasehold interest assets using the straight-line method over the lesser of the estimated useful life or ground lease term, generally 20 to 45 years. Real estate depreciation expense, including depreciation expense related to discontinued operations, was approximately $10.0 million and $8.8 million for the three months ended March 31, 2005 and 2004, respectively.

Furniture, Fixtures and Equipment

Furniture, fixtures and equipment are recorded at cost. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets, ranging from three to five years. Total depreciation expense related to our furniture, fixtures and equipment was approximately $30,000 and $17,000 for the three months ended March 31, 2005 and 2004, respectively.

Facility Improvements

From time to time, we fund facility improvements on our existing properties. Improvements include costs incurred on facilities during which the tenant s business continues to operate. Facility improvements are recorded as buildings and improvements on our consolidated balance sheets and the rents charged to the tenant on these improvements during the project are recorded as rental revenue. Once the project is completed, the remaining useful life of the buildings and improvements is determined and depreciation expense is adjusted accordingly on a prospective basis.

Construction Financing

We may provide construction financing to our tenants in circumstances in which we own or have a ground lease on the underlying land, which in either case is leased to the tenant. Construction financing includes fundings for the construction of new facilities for which operations have not commenced or fundings for major improvements to existing facilities that cause operations to cease during the construction period. Fundings are recorded as construction advances during the period of construction and the amounts charged to our tenant during that time are recorded as interest income. After completion of the project, the construction advances are paid down simultaneously with our purchase of the buildings and improvements. We are not obligated to purchase the property if certain conditions are not met. The buildings and improvements are acquired at fair market value and recorded as real estate on our consolidated financial statements. Construction advances are included in other assets and totaled approximately $12.9 million and $12.1 million as of March 31, 2005 and December 31, 2004, respectively.

Cash and Cash Equivalents

Cash and cash equivalents consist of highly liquid instruments purchased with original maturities of three months or less.

Restricted Cash

Restricted cash consists primarily of cash reserved to fund debt service payments and funds held in cash collateral accounts. The purpose of the cash collateral accounts is to hold funds, generally in the amount of the interest rate swap valuations at any point in time, to protect lenders in case of an early termination of the existing swaps by us. The cash collateral accounts are controlled by the lenders; however, we earn interest on the funds invested. Restricted cash is included in other assets and totaled approximately $7.2 million and $5.0 million as of March 31, 2005 and December 31, 2004, respectively.

Deferred Loan Costs

Certain costs incurred in connection with the issuance of debt instruments are capitalized and generally amortized over the terms of the respective issuance using the effective interest method or on a straight-line basis, which approximates the effective interest method. Deferred loan costs include lender fees and other third party costs. These costs, net of accumulated amortization, are included in other assets and totaled approximately $23.2 million and $22.7 million as of March 31, 2005 and December 31, 2004, respectively. Loan cost amortization expense was approximately $921,000 and $764,000 for the three months ended March 31, 2005 and 2004, respectively. Upon the early extinguishment of debt instruments, we expense any associated unamortized deferred loan costs in the period the debt is retired. We did not have any such expenses during the three months ended March 31, 2005 and 2004.

Capitalized Leasing Costs

Certain direct costs incurred by us in negotiating and consummating a successful lease are capitalized and generally amortized over the initial base term of the lease. Capitalized leasing costs include employee compensation and payroll-related fringe benefits directly related to time spent performing successful leasing-related activities. These activities include evaluating the financial condition of prospective clients, evaluating and recording guarantees, collateral and other security arrangements, negotiating lease terms, preparing lease documents and closing the transaction. These costs, net of accumulated amortization, are included in other assets and totaled approximately $1.9 million and $1.8 million as of March 31, 2005 and December 31, 2004, respectively. Leasing cost amortization expense was approximately $55,000 and $49,000 for the three months ended March 31, 2005 and 2004, respectively.

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Income Taxes

We believe we are qualified and will continue to qualify as a real estate investment trust, commonly referred to as a REIT, under the provisions of the Internal Revenue Code of 1986, as amended. As a REIT, we are required to distribute at least 90% of our taxable income (excluding any net capital gains) to our shareholders and comply with certain other requirements. We generally will not be subject to federal income tax on taxable income that we distribute to our shareholders. The Company is subject to certain state and local income and franchise taxes.

Rental Revenue Recognition

We lease our real estate pursuant to long-term, triple-net leases, under which the tenants typically pay all operating expenses of a property, including, but not limited to, all real estate taxes, assessments and other government charges, insurance, utilities, repairs and maintenance. Our leases are recorded as operating leases under SFAS No. 13, Accounting for Leases, for financial reporting purposes. As such, the leased assets remain on our balance sheet and we depreciate them based on their estimated useful lives. Rental income attributable to the leases is recorded monthly when due from tenants. Rental income attributable to the majority of our leases is fixed by the lease agreement. However, under our variable rate lease program, monthly base rent is calculated based on a spread over an applicable index, typically LIBOR. As of March 31, 2005, approximately $404 million of our real estate portfolio, or 18%, was subject to variable rate leases. This compares to $412 million of our real estate portfolio, or 21%, that was subject to variable rate leases as of March 31, 2004. The vast majority of our variable rate lease agreements contain minimum lease rates, generally between 8% and 9%, and fixed rate conversion features generally with minimum rates of 10.0% to 10.25%, and none of these leases contain a maximum rate.

Our leases typically provide for upward periodic adjustments in base rent due from our tenants, usually based on a factor of the change in the consumer price index, commonly referred to as CPI. In addition, certain of our leases are subject to fixed minimum and/or maximum rent escalators during the initial lease term and extension periods. Our leases typically reset to market during certain renewal periods. The fixed minimum rent escalations are straight-lined into rental income over the initial lease term. Any rent adjustments above the fixed minimum escalations are recorded as revenue in the period they are due from the tenants. Straight-lined rents are included in other assets and totaled approximately $21.1 million and $20.2 million as of March 31, 2005 and December 31, 2004, respectively. Straight-lined rental revenue, including revenue related to discontinued operations, was approximately $939,000 and $1.1 million for the three months ended March 31, 2005 and 2004, respectively.

Interest Rate Swaps

During the normal course of business, we are exposed to certain financial market risks, including fluctuations in interest rates. In general, our strategy of match-funding our long-term debt to our leases reduces our exposure to interest rate fluctuations by substantially locking in our investment spreads during the initial term of the leases. As part of this strategy, we have used and may continue to use interest rate swap arrangements to manage or hedge our risk related to the effect of interest rate fluctuations on our investment spreads. We do not enter into interest rate swap arrangements for speculative purposes. We will either hedge our variable rate debt to convert it to a fixed interest rate, designating such hedge as a cash flow hedge, or hedge our fixed rate debt to convert it to a variable interest rate, designating such hedge as a fair value hedge.

The cash flow and fair value hedges were designed to mirror the underlying debt in terms of index, spread, reset, amortization, compounding and maturity. Due to the identical nature of the terms of the swap arrangements and the underlying terms of the debt, the swap arrangements we have entered into with third parties were designated as highly effective at the inception of the swap arrangements.

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For all swap arrangements, we are required to post collateral, generally in the amount of the swap valuations at any point in time, to protect the lenders in case of an early termination by us. The collateral posted by us related to our hedges, totaling approximately $5.9 million and $3.3 million as of March 31, 2005 and December 31, 2004, respectively, is included in other assets on our consolidated balance sheets.

For a derivative qualifying as a cash flow hedge, the change in the unrealized gain or loss is recorded as a component of accumulated other comprehensive income (loss) within shareholders equity on our consolidated balance sheets. The fair value of the swap is recorded as either an asset or liability on our consolidated balance sheets.

As of March 31, 2005 and December 31, 2004, we did not have any outstanding interest rate swap arrangements designated as cash flow hedges. Therefore, we did not have any associated unrealized gains or losses as of March 31, 2005 and December 31, 2004. Total comprehensive income for the three months ended March 31, 2005 and 2004 was approximately $23.6 million and $14.9 million, respectively. Total comprehensive income equaled net income for the three months ended March 31, 2005.

For a derivative qualifying as a fair value hedge, the change in the net unrealized gain or loss upon measuring the fair value hedge and the fair value of the debt instrument being hedged is recorded on our consolidated statements of operations. Generally, these amounts offset each other. The fair value of the swap is recorded as either an asset or liability, with a corresponding increase or decrease recorded to the carrying value of the debt instrument being hedged on our consolidated balance sheets.

The unrealized loss on our fair value hedge was approximately $4.9 million and $3.4 million as of March 31, 2005 and December 31, 2004, respectively. The net unrealized gain or loss on our fair value hedge and the debt being hedged had no impact on our net income for the three months ended March 31, 2005 and 2004, respectively. We have evaluated our fair value hedge as of March 31, 2005 and believe it continues to be highly effective.

Upon the early termination of swap arrangements or when we believe it is probable we are not subject to interest rate risk, we recognize the realized gain or loss in our results of operations in the period of the swap breakage. We did not have any such expenses during the three months ended March 31, 2005 and 2004.

Share-Based Compensation

The Capital Automotive Group Second Amended and Restated 1998 Equity Incentive Plan, which we refer to as the Plan, provides equity compensation to our employees, officers, non-employee trustees and certain other service providers. At March 31, 2005, we accounted for our Plan under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations. All options granted under this Plan had exercise prices equal to or greater than the market value of the underlying common stock on the date of grant. Therefore, no compensation expense is reflected in net income for stock option-based awards.

In December 2004, the FASB issued a revision to SFAS No. 123, Accounting for Stock-Based Compensation. SFAS No. 123(R), Share-Based Payment, supercedes APB Opinion No. 25 and its related Interpretations and was to be effective for the first interim or annual period that begins after June 15, 2005 for public companies (other than those filing as small business issuers). In April 2005, the SEC amended the effective date of SFAS No. 123(R) to require adoption of this Statement to commence in the first annual period that begins after June 15, 2005 (other than those filing as small business issuers). SFAS No. 123(R) requires the fair-value-based recognition method to be applied to all awards granted after the required effective date and to awards modified, repurchased, or cancelled after that date. In addition, the cumulative effect of initially applying this Statement, if any, must be recognized as of the effective date. The adoption of SFAS No. 123(R) is not expected to have a significant impact on our financial condition or results of operations.

The following table illustrates the effect on net income and earnings per share if we had applied the fair-value-based recognition method (in thousands, except per share data).

	For the Three Months Ended March 31,	
	2005	**2004**
Net income available to common shareholders, as reported	$ 20,472	$ 16,694
Add: Share-based compensation expense included in reported net income, net of minority interest	484	267
Deduct: Total share-based compensation expense determined under the fair-value-based method for all awards, net of minority interest	(522)	(303)
Pro forma net income	$ 20,434	$ 16,658
Basic earnings per common share:		