

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

MISSION WEST PROPERTIES INC

Form 10-Q/A

November 09, 2005

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
-----

Amendment No. 1  
Form 10-Q/A

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2005

COMMISSION FILE NUMBER 1-8383

Mission West Properties, Inc.  
(Exact name of registrant as specified in its charter)

Maryland  
-----

95-2635431  
-----

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer Identification Number)

10050 Bandley Drive  
Cupertino, California 95014-2188  
(Address of principal executive offices)

Registrant's telephone number, including area code is (408) 725-0700  
-----

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  NO

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes  No

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes  No

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date:

18,421,291 shares outstanding as of November 4, 2005

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

Mission West Properties, Inc.

FORM 10-Q  
FOR THE QUARTER ENDED SEPTEMBER 30, 2005

INDEX

PART I FINANCIAL INFORMATION

Item 1. Financial Statements:

Consolidated Balance Sheets as of September 30, 2005 (unaudited)  
and December 31, 2004 .....

Consolidated Statements of Operations for the  
three and nine months ended September 30, 2005 and 2004 (unaudited) .....

Consolidated Statements of Cash Flows for the  
nine months ended September 30, 2005 and 2004 (unaudited) .....

Notes to Consolidated Financial Statements (unaudited) .....

Item 2. Management's Discussion and Analysis of Financial  
Condition and Results of Operations .....

Item 3. Quantitative and Qualitative Disclosures about Market Risk .....

Item 4. Controls and Procedures .....

PART II OTHER INFORMATION

Item 1. Legal Proceedings .....

Item 6. Exhibits .....

EXHIBITS

Exhibit 31.1 - Certification Pursuant to Rule 13a-14 of the  
Securities Exchange Act of 1934

Exhibit 31.2 - Certification Pursuant to Rule 13a-14 of the  
Securities Exchange Act of 1934

Exhibit 31.3 - Certification Pursuant to Rule 13a-14 of the  
Securities Exchange Act of 1934

Exhibit 32 - Certification of CEO and CFO Pursuant to 18 U.S.C.  
ss. 1350, as Adopted Pursuant to ss. 906 of the  
Sarbanes-Oxley Act of 2002

SIGNATURES .....

# Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

PART I - FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

MISSION WEST PROPERTIES, INC.

CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except share and per share amounts)

(unaudited)

-----

September 30, 2005

-----

ASSETS

Real estate assets, at cost:

Land	\$ 273,933
Buildings and improvements	766,209
Real estate related intangible assets	17,410
<hr/>	
Total investments in properties	1,057,552
Less accumulated depreciation and amortization	(124,670)
Assets held for sale, net of accumulated depreciation of \$1,770 and \$1,578 at 9/30/05 and 12/31/04, respectively	14,245
<hr/>	
Net investments in properties	947,127
Cash and cash equivalents	40,443
Restricted cash	1,551
Deferred rent receivable, net of \$2,000 allowance at 9/30/05 and 12/31/04	19,302
Investment in unconsolidated joint venture	3,472
Other assets, net of accumulated amortization of \$7,317 and \$5,667 at 9/30/05 and 12/31/04, respectively	24,812
<hr/>	
Total assets	\$1,036,707
<hr/> <hr/>	

LIABILITIES AND STOCKHOLDERS' EQUITY

Liabilities:

Mortgage notes payable	\$ 359,891
Mortgage notes payable (related parties)	10,146
Line of credit (related parties)	-
Revolving line of credit	-
Interest payable	327
Security deposits	8,434
Deferred rental income	11,691
Liabilities related to assets held for sale	80
Dividend/distribution payable	16,727
Accounts payable and accrued expenses	10,971
<hr/>	
Total liabilities	418,267
<hr/>	

Commitments and contingencies

Minority interests	503,769
--------------------	---------

Stockholders' equity:

Preferred stock, \$.001 par value, 20,000,000 shares authorized, none issued and outstanding	-
Common stock, \$.001 par value, 200,000,000 shares authorized, 18,367,691 and 18,097,191 shares issued and outstanding at 9/30/05 and 12/31/04, respectively	18

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

Paid-in-capital	137,217
Accumulated deficit	(22,564)
	-----
Total stockholders' equity	114,671
	-----
Total liabilities and stockholders' equity	\$1,036,707
	=====

The accompanying notes are an integral part of these consolidated financial statements.

(A) Derived from the Company's 2004 audited consolidated financial statements.

- 2 -

MISSION WEST PROPERTIES, INC  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(dollars in thousands, except share and per share amounts)  
(unaudited)  
-----

	Three months ended September 30, 2005	2004	N
	-----	-----	-----
Revenues:			
Rental revenue from real estate	\$24,692	\$29,494	
Tenant reimbursements	4,031	3,740	
Other income, including lease terminations, settlements and interest	426	396	
	-----	-----	
Total revenues	29,149	33,630	
	-----	-----	
Expenses:			
Property operating, maintenance and real estate taxes	5,301	4,805	
Interest	5,494	4,468	
Interest (related parties)	229	256	
General and administrative	424	395	
Depreciation and amortization of real estate	5,268	5,269	
	-----	-----	
Total expenses	16,716	15,193	
	-----	-----	
Income before equity in earnings of unconsolidated joint venture and minority interests	12,433	18,437	
Equity in earnings of unconsolidated joint venture	291	345	
Minority interests	(10,551)	(15,590)	
	-----	-----	
Income from continuing operations	2,173	3,192	
	-----	-----	
Discontinued operations, net minority interests:			
Gain from disposal of discontinued operations	291	-	
(Loss) attributable to discontinued operations	(13)	(19)	
	-----	-----	
Income/(loss) from discontinued operations	278	(19)	
	-----	-----	

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

Net income to common stockholders	\$ 2,451	\$ 3,173	
Net income to minority interests	\$11,541	\$15,488	
Income per share from continuing operations:			
Basic	\$0.12	\$0.18	
Diluted	\$0.12	\$0.18	
Income per share from discontinued operations:			
Basic	\$0.01	-	
Diluted	\$0.01	-	
Net income per share to common stockholders:			
Basic	\$0.13	\$0.18	
Diluted	\$0.13	\$0.18	
Weighted average shares of common stock outstanding (basic)	18,356,278	18,071,484	18
Weighted average shares of common stock outstanding (diluted)	18,407,891	18,098,174	18

The accompanying notes are an integral part of these consolidated financial statements.

- 3 -

MISSION WEST PROPERTIES, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(dollars in thousands)  
(unaudited)  
-----

Cash flows from operating activities:

Net income  
Adjustments to reconcile net income to net cash provided by operating activities:  
    Income allocated to minority interests, including discontinued operations  
    Depreciation and amortization of real estate and in place leases  
    Depreciation and amortization from discontinued operations  
    Amortization of above market rent intangible asset  
    Gain on sale of real estate  
    Equity in earnings of unconsolidated joint venture  
    Distributions from unconsolidated joint venture  
Changes in operating assets and liabilities, net of liabilities assumed:  
    Deferred rent receivable  
    Other assets  
    Interest payable  
    Security deposits

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

Deferred rental income  
Accounts payable and accrued expenses

Net cash provided by operating activities

Cash flows from investing activities:

Improvements to real estate assets  
Net proceeds from sales of real estate  
Purchase of real estate

Net cash used in investing activities

Cash flows from financing activities:

Proceeds from mortgage loan  
Principal payments on mortgage notes payable  
Principal payments on mortgage notes payable (related parties)  
Net payments under line of credit (related parties)  
Payment on mortgage loan payable  
Net payments under revolving line of credit  
Proceeds from revolving line of credit  
Restricted cash  
Proceeds from stock options exercised  
Minority interest distributions  
Dividends

Net cash used in financing activities

Net increase/(decrease) in cash and cash equivalents  
Cash and cash equivalents, beginning of period

Cash and cash equivalents, end of period

Supplemental information:

Cash paid for interest

Supplemental schedule of non-cash investing and financing activities:

Issuance of common stock upon conversion of O.P. units

The accompanying notes are an integral part of these consolidated financial statements.

- 4 -

MISSION WEST PROPERTIES, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(dollars in thousands, except share, per share, O.P. units and  
per square footage amounts)  
(unaudited)

1. ORGANIZATION AND FORMATION OF THE COMPANY

Mission West Properties, Inc. ("the Company") is a fully integrated, self-administered and self-managed real estate company that acquires and manages R&D/office properties in the portion of the San Francisco Bay Area commonly referred to as Silicon Valley. In July 1998, the Company purchased

## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

an approximate 12.11% of four existing limited partnerships (referred to collectively as the "operating partnerships") and obtained control of these partnerships by becoming the sole general partner in each one effective July 1, 1998 for financial accounting and reporting purposes. The Company purchased an approximate 12.11% interest in each of the operating partnerships. All limited partnership interests in the operating partnerships were converted into 59,479,633 operating partnership ("O.P.") units, which represented a limited partnership ownership interest of approximately 87.89% of the operating partnerships. The operating partnerships are the vehicles through which the Company holds its real estate investments, makes real estate acquisitions, and generally conducts its business.

On December 30, 1998, the Company was reincorporated under the laws of the State of Maryland through a merger with and into Mission West Properties, Inc. Accordingly, shares of the former company, Mission West Properties, a California corporation (no par), which were outstanding at December 30, 1998, were converted into shares of common stock (\$.001 par value per share) on a one-for-one basis.

As of September 30, 2005, the Company owns a controlling general partnership interest of 17.44%, 21.65%, 16.15% and 12.39% in Mission West Properties, L.P., Mission West Properties, L.P. I, Mission West Properties, L.P. II and Mission West Properties, L.P. III, respectively, which represents a 17.46% general partnership interest in the operating partnerships, taken as a whole, on a consolidated weighted average basis.

Through the operating partnerships, the Company owns interests in 108 R&D properties, all of which are located in Silicon Valley.

The Company has elected to be taxed as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended. Accordingly, no provision has been made for income taxes for the three and nine months ended September 30, 2005.

### BUSINESS SEGMENT INFORMATION

The Company's primary business is the ownership and management of R&D/office real estate with a geographic concentration in the Silicon Valley of the San Francisco Bay Area. Accordingly, the Company has concluded it currently has a single reportable segment for Statement of Financial Accounting Standards ("SFAS") No. 131, "Disclosures about Segments of an Enterprise and Related Information," purposes.

## 2. BASIS OF PRESENTATION

### PRINCIPLES OF CONSOLIDATION AND FINANCIAL STATEMENT PRESENTATION

The accompanying unaudited interim consolidated financial statements of the Company have been prepared in accordance with Rule 10-01 of Regulation S-X promulgated by the Securities and Exchange Commission and, therefore, do not include all information and footnotes necessary for a fair presentation of financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America. In the opinion of the Company, however, the accompanying unaudited interim consolidated financial statements contain all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the Company's consolidated financial position as of September 30, 2005, and its consolidated results of operations for the three and nine months ended September 30, 2005 and 2004, and its cash flows for the nine months ended September 30, 2005 and 2004, respectively. All significant intercompany balances have been eliminated in consolidation. The consolidated financial statements as of September 30, 2005 and for the three and nine months ended September 30, 2005 and 2004 and related

## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

footnote disclosures are unaudited. The results of operations for the three and nine months ended September 30, 2005 are not necessarily indicative of the results to be expected for the entire year.

The following notes, which present interim disclosures as required by the SEC, highlight significant changes to the notes to the Company's December 31, 2004 audited consolidated financial statements and should be read together with the consolidated financial statements and notes thereto included in the Company's 2004 Form 10-K filed on March 16, 2005.

### MINORITY INTERESTS

Minority interest represents the separate private ownership of the operating partnerships by the Berg Group (defined as Carl E. Berg, his brother Clyde J. Berg, members of their respective immediate families, and certain entities they control) and other non-affiliate interests. In total, these interests account for approximately 82.54% of the ownership interests in the real estate operations of the Company as of September 30, 2005. Minority interest in net income is calculated by taking the net income of the operating partnerships (on a stand-alone basis) multiplied by the respective minority interest ownership percentage.

- 5 -

### MISSION WEST PROPERTIES, INC.

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

(dollars in thousands, except share, per share, O.P. units and per square footage amounts)  
(unaudited)

Allocation of corporate general and administrative expenses to the operating partnerships is performed based upon shares and operating partnership units outstanding for each operating partnership in relation to the total for all four operating partnerships.

### RECLASSIFICATIONS

Certain reclassifications have been made to the previously reported 2004 consolidated financial statements in order to conform to the 2005 presentation.

### ACCOUNTING FOR STOCK-BASED COMPENSATION

SFAS No. 123, "Accounting for Stock-Based Compensation," encourages, but does not require companies to record compensation cost for stock-based employee compensation plans at fair value. The Company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees" and related interpretations. Accordingly, compensation cost for stock options is measured as the excess, if any, of the quoted market price of the Company's stock at the date of the grant over the amount an employee must pay to acquire the stock.

The following table illustrates the unaudited pro forma effect on consolidated net income available to common stockholders and consolidated earnings per share if the fair value method had been applied to all outstanding and unvested stock options for the three and nine months ended September 30, 2005 and 2004.

	Three Months Ended September 30,	N
	2005	2004

-----  
(dollars in thousands, exce



Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

Historical net income to common stockholders	\$2,451	\$3,173
Deduct compensation expense for stock options determined under fair value based method	(51)	(44)
Allocation of expense to minority interest	42	36
Pro forma net income to common stockholders	----- \$2,442 =====	----- \$3,165 =====
Earnings per share - basic:		
Historical net income to common stockholders	\$0.13	\$0.18
Pro forma net income to common stockholders	\$0.13	\$0.18
Earnings per share - diluted:		
Historical net income to common stockholders	\$0.13	\$0.18
Pro forma net income to common stockholders	\$0.13	\$0.17

Options were granted to four employees and three directors totaling 710,000 in 2005, which vest monthly for 33 months from date of grant, subject to continued employment or other service to the Company. Each option grant has a term of six years from the date of grant subject to earlier termination in certain events related to termination of employment. The options were granted at an exercise price of \$10.00 per share. The estimated fair value of the options granted in 2005 was \$1.12 per share on the date of grant using the Black-Scholes option pricing model with the following assumptions: dividend yield of 6.4%, volatility of 21.97%, risk free rates of 4.2% and an expected life of six years.

The following table shows the activity and detail for the 2004 Equity Incentive Plan.

	2004 Equity Incentive Plan	Weighted Average Option Price Per Share
	-----	-----
Balance, December 31, 2004	767,000	\$11.44
Options granted	710,000	\$10.00
Options exercised	(55,000)	\$8.73
Options cancelled	-	
Balance, September 30, 2005	----- 1,422,000 =====	\$10.83

- 6 -

MISSION WEST PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED  
(dollars in thousands, except share, per share, O.P. units and  
per square footage amounts)  
(unaudited)

3. STOCK TRANSACTIONS

During the nine months ended September 30, 2005, stock options to purchase 40,000 shares of common stock were exercised at \$8.25 per share and stock

## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

options to purchase 15,000 shares of common stock were exercised at \$10.00 per share. Total proceeds to the Company were \$480. During the same period, four limited partners exchanged 215,500 O.P. units for 215,500 shares of the Company's common stock under the terms of the December 1998 Exchange Rights Agreement among the Company and all limited partners of the operating partnerships resulting in a reclassification of \$2,197 from minority interest to paid-in-capital.

#### 4. DISCONTINUED OPERATIONS

Effective January 1, 2002, the Company adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which addresses financial accounting and reporting for the impairment and disposal of long lived assets. In general, income or loss attributable to the operations and sale of property and the operations related to property held for sale is classified as discontinued operations in the consolidated statements of operations. Prior period consolidated statements of operations presented in this report have been reclassified to reflect the income or loss related to properties that were held for sale or sold and presented as discontinued operations during the three and nine months ended September 30, 2005. Additionally, all periods presented in this report will likely require further reclassification in future periods if additional properties are held for sale or property sales occur.

As of September 30, 2005, there was one property under contract to be sold or otherwise disposed of which would qualify as an asset held for sale or discontinued operation. That property was sold for \$15,105 in October 2005. During the first quarter of 2005, the Company sold two properties for a combined sales price of \$12,750. Condensed results of operations for these properties for the three and nine months ended September 30, 2005 and 2004 are as follows:

	Three Months Ended September 30, Ni	
	2005	2004
	(dollars in tho (unaudited)	
<b>Revenues</b>		
Rental revenue from real estate	\$ -	\$ 86
Tenant reimbursements	-	26
Other income	-	1
Total revenues	-	113
<b>Expenses</b>		
Property operating, maintenance and real estate taxes	-	76
Depreciation	77	159
Total expenses	77	235
(Loss) from discontinued operations	(77)	(122)
Gain on disposition of property	1,345	-
Minority interest in earnings/(loss) attributable to discontinued operations	(990)	103
Income/(loss) from discontinued operations	\$ 278	(\$ 19)

## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

For the three and nine months ended September 30, 2005 and 2004, income from discontinued operations included results of operations from one asset held for sale at September 30, 2005 and the two properties that were sold in the first quarter of 2005.

A deferred gain of approximately \$1,408 was recorded on one of the disposed properties. The gain was recognized as revenue based on the installment method of profit recognition because the purchaser of the property did not make a sufficiently large down payment under SFAS No. 66, "Accounting for Sales of Real Estate" ("SFAS No. 66"). SFAS No. 66 establishes accounting standards for recognizing profit or loss on sales of real estate. Gain on the sale is recognized proportionately as the seller receives payments from the purchaser. Interest income is recognized on an accrual basis, when appropriate. The Company received the remaining balance of the sales price from the purchaser in September 2005 and all of the remaining deferred gain was recognized in the third quarter of 2005. The Company recorded a \$63 gain in the first quarter of 2005 and \$1,345 gain in the third quarter of 2005.

### 5. NET INCOME PER SHARE

Basic operating net income per share is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted operating net income per share is computed by dividing net income by the sum of the weighted-average number of common shares outstanding for the period plus the assumed exercise of all dilutive securities using the treasury stock method.

- 7 -

MISSION WEST PROPERTIES, INC.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED  
 (dollars in thousands, except share, per share, O.P. units and  
 per square footage amounts)  
 (unaudited)

The computation for weighted average shares is detailed below:

	Three Months Ended September 30, 2005	September 30, 2004
	-----	-----
Weighted average shares outstanding (basic)	18,356,278	18,071,484
Incremental shares from assumed option exercise	51,613	26,690
	-----	-----
Weighted average shares outstanding (diluted)	18,407,891	18,098,174
	=====	=====

Outstanding options to purchase 647,000 and 272,000 shares in 2005 and 2004 were excluded from the computation of diluted net income per share under the treasury stock method because the option exercise price was greater than the weighted average exercise price of the Company's common stock during the respective periods. The outstanding O.P. units, which are exchangeable at the unit holder's option, subject to certain conditions, for shares of common stock on a one-for-one basis have been excluded from the diluted net income per share calculation, as there would be no effect

## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

on the calculation after adding the minority interests' share of income back to net income. The total number of O.P. units outstanding at September 30, 2005 and 2004 was 86,169,195 and 86,404,695, respectively.

### 6. RELATED PARTY TRANSACTIONS

As of September 30, 2005, the Berg Group owned 77,572,028 O.P. units. The Berg Group's combined ownership of O.P. units and shares of common stock as of September 30, 2005 represented approximately 74% of the total equity interests, assuming conversion of the 86,169,195 O.P. units outstanding into the Company's common stock.

The Berg Group has extended to the Company a \$20,000 line of credit that bears interest at LIBOR plus 1.30%, or 4.99% as of September 30, 2005, and matures in March 2006. The Company believes that the terms of the Berg Group line of credit are more favorable than those available from commercial lenders. As of September 30, 2005, \$0 was due the Berg Group under the line of credit, and debt in the amount of \$10,146 was due the Berg Group under a mortgage note established on May 15, 2000 in connection with the acquisition of a 50% interest in Hellyer Avenue Limited Partnership, the obligor under the mortgage note. The mortgage note bears interest at 7.65% and is due in June 2010 with principal payments amortized over 20 years. Interest expense incurred in connection with the Berg Group line of credit and mortgage note was \$229 and \$256 for the three months ended September 30, 2005 and 2004, respectively, and \$779 and \$760 for the nine months ended September 30, 2005 and 2004, respectively.

During the first nine months of 2005 and 2004, Carl E. Berg or entities controlled by Mr. Berg held financial interests in several companies that lease space from the operating partnerships, which include three companies in which Mr. Berg has a greater than 10% ownership interest. These related tenants occupy approximately 48,000 square feet and contributed \$160 and \$217 in rental revenue during the three months ended September 30, 2005 and 2004, respectively, and \$570 and \$650 in rental revenue during the nine months ended September 30, 2005 and 2004, respectively. Under the Company's charter, bylaws and agreements with the Berg Group, the individual members of the Berg Group are prohibited from acquiring or holding shares of the Company's common stock if such acquisition would result in their beneficial ownership percentage of the Company's common stock causing the Company to violate any REIT qualification requirement.

The Berg Group has an approximately \$2,500 commitment to complete certain tenant improvements in connection with the Company's 2002 acquisition of 5345 Hellyer Avenue in San Jose. The Company recorded this portion of the purchase price paid to the Berg Group as an Other Asset on its Consolidated Balance Sheets. The Berg Group plans to satisfy this commitment to complete certain tenant improvements when requested by the Company following the approval of the Independent Directors Committee of the Company's board of directors (the "Independent Directors Committee").

The Berg Group has an approximately \$7,500 commitment to complete an approximately 75,000 to 90,000 square foot building in connection with the Company's 2001 acquisition of 245 Caspian in Sunnyvale which is comprised of approximately three acres of unimproved land. The Company recorded this portion of the purchase price paid to the Berg Group as an Other Asset on its Consolidated Balance Sheets. The Berg Group plans to satisfy this commitment to construct a building when requested by the Company following the approval of the Independent Directors Committee.

The Company currently leases office space owned by Berg & Berg Enterprises, Inc., an affiliate of Carl E. Berg and Clyde J. Berg. Rental amounts and overhead reimbursements paid to Berg & Berg Enterprises, Inc. were \$23 for

## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

each of the three-month periods ended September 30, 2005 and 2004 and \$68 for each of the nine-month periods ended September 30, 2005 and 2004.

### 7. COMMITMENTS AND CONTINGENCIES

Neither the operating partnerships, the Company's properties nor the Company are subject to any material litigation nor, to the Company's knowledge, is any material litigation threatened against the operating partnerships, the properties or the Company. From

- 8 -

MISSION WEST PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

(dollars in thousands, except share, per share, O.P. units and  
per square footage amounts)  
(unaudited)

time to time, the Company is engaged in legal proceedings arising in the ordinary course of business. The Company does not expect any of such proceedings to have a material adverse effect on its cash flows, financial condition or results of operations. The Company is currently involved in the following legal proceedings, and does not believe the ultimate outcome of any of these proceedings will have a material adverse effect on its financial condition or operating results.

Republic Properties Corporation ("RPC") v. Mission West Properties, L.P. ("MWP"), in the Circuit Court of Maryland for Baltimore City Case No. 24-C-00-005675. RPC is a former partner with Mission West Properties, L.P. in the Hellyer Avenue Limited Partnership ("Hellyer LP"). In April 2004, the Circuit Court for Baltimore City, Maryland issued a Memorandum Opinion in the case and awarded damages of approximately \$934 to the RPC plaintiffs, which represented a liability of the Company or MWP. The Company has a receivable from a Berg Group affiliate for the amount of distributions it received as the successor to RPC's interest in the Hellyer LP, which exceeds the amount of the damages awarded to the RPC parties and would be used to pay those damages in the event the decision of the Circuit Court is upheld ultimately. The Company has never accounted for the 50% interest in Hellyer LP that is claimed by RPC as an asset of the Company. In February 2001, the Company filed a suit against RPC in Superior Court of the State of California for the County of Santa Clara Case No. CV 796249 which was stayed pending resolution of the Maryland case. In March 2005, the Company voluntarily dismissed its California suit. On March 1, 2005, the Maryland Appeals Court ruled in favor of Mission West Properties, L.P., finding that the Circuit Court of Maryland lacked personal jurisdiction over MWP. In April 2005, the decision of the Maryland Appeals Court became final, and the Company obtained a court order for the release of a \$1,551 bond, which it posted to remove an attachment order issued to RPC. In April 2005, RPC submitted a motion to the Superior Court of the State of California effectively asking the court to prevent MWP from dismissing the previously dismissed California suit. In July 2005, the Maryland Supreme Court agreed to hear an appeal filed by RPC, which is scheduled to occur in December 2005.

In January 2004, the Global Crossing Estate Representative, for itself and the Liquidating Trustee of the Global Crossing Liquidating Trust v. Mission West Properties filed an action in United States Bankruptcy Court Southern District of New York Case No. 02-40188 (REG) asserting that payments of approximately \$815 made in the ordinary course of business within 90 days of the Global Crossing bankruptcy filing were preference payments. The Company has engaged legal counsel to defend itself in this claim and intend to vigorously contest the matter. On February 9, 2005, the Court held a

## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

hearing to consider the objection filed with respect to Mission West Properties' claim. In April 2005, the Company filed a motion for summary judgment in the United States Bankruptcy Court Southern District of New York requesting the Court to dismiss the preference claim. The motion for summary judgment was denied. Discovery continues by both parties and no trial date has been set.

### GUARANTEES AND INDEMNITIES

Under its articles of incorporation and bylaws, the Company has agreed to indemnify its officers and directors for certain events or occurrences arising as a result of the officer or director's serving in such capacity. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. The Company believes the estimated fair value of these indemnification agreements is minimal and has recorded no liabilities for these agreements as of September 30, 2005.

The Company also enters into indemnification provisions under its agreements with other companies in the ordinary course of business, typically with lenders, joint venture partners, contractors, and tenants. Under these provisions the Company typically agrees to indemnify and hold harmless the indemnified party for losses suffered or incurred by the indemnified party as a result of certain kinds of activities or inactions of the Company. These indemnification provisions generally survive termination of the underlying agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification provisions is unlimited. To date, the Company has not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the Company believes the estimated fair value of these agreements is minimal. Accordingly, the Company has recorded no liabilities for these agreements as of September 30, 2005.

### SEISMIC ACTIVITY

The Company's properties are located in an active seismic area of Silicon Valley. Insurance policies currently maintained by the Company do not cover seismic activity, although they do cover losses from fires after an earthquake.

### ENVIRONMENTAL ISSUES

The environmental investigations that have been conducted on the Company's properties have not revealed any environmental liability that the Company believes would have a material adverse effect on its financial condition, results of operations and assets, and the Company is not aware of any such liability. Nonetheless, it is possible that there are material environmental liabilities of which the Company is unaware. In addition, the Company cannot assure that future laws, ordinances, or regulations will not impose any material environmental liability, or that the current environmental condition of the properties has not been, or will not be, affected by tenants and occupants of the properties, by the condition of properties in the vicinity of the properties, or by third parties unrelated to the Company.

- 9 -

MISSION WEST PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

(dollars in thousands, except share, per share, O.P. units and  
per square footage amounts)

(unaudited)

BERG LAND HOLDINGS OPTION AGREEMENT

## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

On April 27, 2005, the Berg Group disclosed the receipt of an offer from an unrelated party to purchase a portion of the Piercy & Hellyer land comprised of approximately 10 acres in San Jose, California that is subject to the Berg Land Holdings Option Agreement with the Company. The prospective purchaser has disclosed its intention to develop "for sale" industrial type buildings. In light of the overcapacity in the market and the Company's current inventory of available buildings for lease in this submarket, the Independent Directors Committee, which is responsible for reviewing, evaluating and authorizing action with respect to any transaction between us and any member of the Berg Group, has authorized removal of this approximately 10 acre parcel of land from the scope of the Berg Land Holdings Option Agreement, subject to the completion of the sale to the unrelated party. In making this determination, the Independent Directors Committee considered a number of factors, including risks and other potentially adverse consequences that could be associated with acquiring undeveloped land for future development. In the event this parcel of land is not sold to this prospective purchaser, the parcel would not be deemed to be removed from the scope of the Berg Land Holdings Option Agreement and would remain eligible for potential future acquisition by the Company, under the Berg Land Holdings Option Agreement.

### 8. MORTGAGE NOTES PAYABLE AND OTHER DEBT

The following information is an update of mortgage notes payable obtained during the second quarter of 2005 and other debt transactions that occurred during the third quarter of 2005. For additional details regarding the Company's mortgage notes payable and other debt outstanding as of September 30, 2005, see Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Debt."

#### ALLIANZ LOAN I

On April 6, 2005, the Company obtained a \$25,800 secured mortgage loan from Allianz Life Insurance Company of North America ("Allianz Loan I"). The Allianz Loan I originally matures on April 10, 2020 and must be paid in full at that time unless payment is accelerated by reason of a default or sale of the property that secures the loan. The Company paid approximately \$251 in loan fees and financing costs, which are being amortized over the 20 year amended loan period, and used the proceeds primarily to pay down short-term debt and the Berg Group line of credit. On July 26, 2005, in connection with the Allianz Loan II, the Company entered into a "Loan Modification Agreement" with Allianz, which extended the amortization period and maturity date of the Allianz Loan I from April 10, 2020 to August 10, 2025. This loan bears a fixed interest rate of 5.56% and principal payments are amortized over 20 years. The mortgage loan is secured by one property.

#### ALLIANZ LOAN II

On July 27, 2005, the Company obtained a \$125,000 secured mortgage loan from Allianz Life Insurance Company of North America ("Allianz Loan II"). The Allianz Loan II matures on August 10, 2025, and must be paid in full at that time, unless payment is accelerated by reason of a default or sale of any property that secures the loan. This loan bears a fixed interest rate of 5.22% and principal payments are amortized over 20 years. The mortgage loan is secured by eight properties. The Company paid approximately \$838 in loan fees and financing costs, which are being amortized over the 20 year loan period, and used the proceeds primarily to pay down short-term debt and the Berg Group line of credit.

#### CUPERTINO NATIONAL BANK LINE OF CREDIT

The Company entered into a "Change in Terms Agreement" with Cupertino National Bank ("CNB") on July 22, 2005, which reduced the maximum borrowing amount on the Company's revolving line of credit facility with that bank

## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

from \$40,000 to \$9,000.

### 9. SUBSEQUENT EVENTS

On October 6, 2005, the Company paid dividends of \$0.16 per share of common stock to all common stockholders of record as of September 30, 2005. On the same date, the operating partnerships paid a distribution of \$0.16 per O.P. unit to all holders of O.P. units.

On October 12, 2005, the Company completed the sale of a 239,000 rentable square foot R&D property at 800 Embedded Way, San Jose, California. A gain of approximately \$800 will be recognized in the fourth quarter of 2005 on the total sales price of \$15,105.

On October 26, 2005, the Independent Directors Committee of the Board of Directors of the Company approved the termination of the \$20,000 line of credit agreement between the Company and the Berg Group (as defined in the Company's previously filed periodic reports), effective October 31, 2005. The Berg Group line of credit was originally scheduled to mature in March 2006. Based on existing cash reserves and credit facilities, the Company has determined that it no longer foresees a need for the Berg Group line of credit. There are no borrowings currently outstanding under the Berg Group line of credit. The Company will not incur any fees or charges for terminating the Berg Group line of credit.

- 10 -

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the accompanying consolidated financial statements and notes thereto contained herein and our consolidated financial statements and notes thereto contained in our Annual Report on Form 10-K as of and for the year ended December 31, 2004. The results for the three and nine months ended September 30, 2005 are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 2005. The following discussion includes forward-looking statements, including but not limited to, statements with respect to our future financial performance, operating results, plans and objectives. Actual results may differ materially from those currently anticipated depending upon a variety of factors, including those described under the sub-heading, "Forward-Looking Information."

### FORWARD-LOOKING INFORMATION

This quarterly report contains forward-looking statements within the meaning of the federal securities laws. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Reform Act of 1995, and are including this statement for purposes of complying with these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Company, are generally identifiable by use of the words "believe," "expect," "intend," "anticipate," "estimate," "project" or similar expressions. Additionally, all disclosures under Part I, Item 3 constitute forward-looking statements. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain.

Factors that could have a material adverse effect on our operations and future prospects include, but are not limited to, the following:

- economic conditions generally and the real estate market specifically,



## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

- legislative or regulatory provisions (including changes to laws governing the taxation of REITs),
- availability of capital,
- interest rates,
- competition,
- supply of and demand for R&D, office and industrial properties in our current and proposed market areas,
- tenant defaults and bankruptcies,
- lease term expirations and renewals, and
- changes in general accounting principles, policies and guidelines applicable to REITs.

In addition, the actual timing of development, construction, and leasing on any projects that we believe we may acquire in the future under the Berg Land Holdings Option Agreement is presently unknown, and reliance should not be placed on estimates concerning these projects. These risks and uncertainties, together with the other risks described from time to time in our reports and other documents filed with the Securities and Exchange Commission, should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

### OVERVIEW

We acquire, market, lease, and manage R&D/office properties, primarily located in the Silicon Valley portion of the San Francisco Bay Area. As of September 30, 2005, we owned and managed 108 properties totaling approximately 8.0 million rentable square feet through four limited partnerships, or operating partnerships, for which we are the sole general partner. This class of property is designed for research and development and office uses and, in some cases, includes space for light manufacturing operations with loading docks. We believe that we have one of the largest portfolios of R&D/office properties in the Silicon Valley. As of September 30, 2005, the six tenants who each leased in excess of 300,000 rentable square feet from us were Microsoft Corporation, Fujitsu America (a subsidiary of Fujitsu Limited), JDS Uniphase Corporation, NEC Electronics America, Inc. (a subsidiary of NEC Electronics Corporation), Ciena Corporation and Apple Computer, Inc. For federal income tax purposes, we have operated as a self-managed, self-administered and fully integrated real estate investment trust ("REIT") since fiscal 1999.

Our acquisition, growth and operating strategy incorporates the following elements:

- working with the Berg Group to take advantage of their abilities and resources to pursue development opportunities which we have an option to acquire, on pre-negotiated terms, upon completion and leasing;
- capitalizing on opportunistic acquisitions from third parties of high-quality R&D/office properties that provide attractive initial yields and significant potential for growth in cash-flow;
- focusing on general purpose, single-tenant Silicon Valley R&D/office properties for information technology companies in order to maintain low operating costs, reduce tenant turnover and capitalize on our relationships with these companies and our extensive knowledge of their real estate needs; and

- 11 -

- maintaining prudent financial management principles that emphasize current cash flow while building long-term value, the acquisition of pre-leased properties to reduce development and leasing risks and the maintenance of sufficient liquidity to acquire and finance properties on desirable terms.

## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

### CURRENT ECONOMIC ENVIRONMENT

All of our properties are located in the Northern California area known as Silicon Valley, which generally consists of portions of Santa Clara County, Southwestern Alameda County, Southeastern San Mateo County and Eastern Santa Cruz County. The Silicon Valley R&D property market has historically fluctuated with the local economy. The Silicon Valley economy and business activity have slowed markedly since 2001 after fast-paced growth in 1999 and 2000. According to a recent report by NAI BT Commercial Real Estate, the vacancy rate for Silicon Valley R&D property was approximately 22.4% in late 2004 and 20.6% at the end of the third quarter of 2005. Total vacant R&D square footage in Silicon Valley at the end of the third quarter of 2005 amounted to 31.8 million square feet, of which 23.0%, or 7.3 million square feet, was being offered under subleases. Total negative net absorption (which is the computation of gross square footage leased less gross new square footage vacated for the period presented) in 2004 amounted to approximately (0.3) million square feet. During the first nine months of 2005, there was total positive net absorption of approximately 2.1 million square feet. Average asking market rent per square foot at the end of the third quarter of 2005 remained the same at \$0.88 compared to late 2004, although individual properties within any particular submarket presently may be leased above or below the current average asking market rental rates within that submarket. The Silicon Valley R&D property market has been characterized by a substantial number of submarkets, with rent and vacancy rates varying by submarket and location within each submarket.

Our occupancy rate at September 30, 2005 was 67.5% compared to 69.0% at September 30, 2004. We believe that our occupancy rate could decline further going forward if key tenants seek the protection of bankruptcy laws, consolidate operations or discontinue operations. In addition, leases with respect to approximately 558,000 rentable square feet are expiring prior to the end of 2006. The properties subject to these leases may take anywhere from 24 to 36 months or longer to re-lease. We believe that the average 2006 renewal rental rates for our properties will be approximately equal to, or perhaps below, current market rents, but we cannot give any assurance that leases will be renewed or that available space will be re-leased at rental rates equal to or above the current quoted market rates.

In order to meet market conditions, we have been, and expect to continue leasing less than the entire premises of some of our R&D properties to a single tenant from time to time. Leasing our R&D properties, which generally have been built for single tenant occupancy, to multiple tenants can increase our leasing costs and operating expenses and reduce the profitability of our leasing activities.

If we are unable to lease a significant portion of any vacant space or space subject to expiring leases; if we experience significant tenant defaults as a result of the current economic downturn; if we are not able to lease space at or above current market rates; if we restructure existing leases and lower existing rents in order to retain tenants for an extended term; or if we increase our lease costs and operating expenses substantially to accommodate multiple tenants in our R&D properties, our results of operations and cash flows will be adversely affected. Furthermore, in this event it is probable that our board of directors will reduce the quarterly dividend on the common stock and the outstanding O.P. units. Our operating results and ability to pay dividends at current levels remain subject to a number of material risks, as indicated under the caption "Forward-Looking Information" above and in the section entitled "Risk Factors" in our most recent annual report on Form 10-K.

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

We prepare the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP"), which

## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

requires us to make certain estimates, judgments and assumptions that affect the reported amounts in the accompanying consolidated financial statements, disclosure of contingent assets and liabilities and related footnotes. Accounting and disclosure decisions with respect to material transactions that are subject to significant management judgments or estimates include impairment of long lived assets, deferred rent reserves, and allocation of purchase price relating to property acquisitions and the related depreciable lives assigned. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that require management to make estimates, judgments and assumptions, giving due consideration to materiality, in certain circumstances that affect amounts reported in the consolidated financial statements, and potentially result in materially different results under different conditions and assumptions. We believe that the following best describe our critical accounting policies:

**BUSINESS COMBINATIONS.** Statement of Financial Accounting Standards No. 141, "Business Combinations" ("SFAS No. 141"), was effective July 1, 2001. The acquisition costs of each property acquired prior to July 1, 2001 were allocated only to building, land and leasing commissions with building depreciation being computed based on an estimated weighted average composite useful life of 40 years and leasing commission amortization being computed over the term of the lease. Acquisitions of properties made subsequent to the effective date of SFAS No. 141 are based on an allocation of the acquisition cost to land, building, tenant improvements, and intangibles for at market, including lease origination and lease up period costs, and above market in place leases, and the determination of their useful lives are guided by a combination of SFAS No. 141 and management's estimates. If we do not appropriately allocate these

- 12 -

components or we incorrectly estimate the useful lives of these components, our computation of depreciation and amortization expense may not appropriately reflect the actual impact of these costs over future periods, which will affect net income.

**IMPAIRMENT OF LONG-LIVED ASSETS.** We review real estate assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with SFAS No. 144, "Accounting for the Impairment and Disposal of Long-Lived Assets" ("SFAS No. 144"). If the carrying amount of the asset exceeds its estimated undiscounted net cash flow, before interest, we will recognize an impairment loss equal to the difference between its carrying amount and its estimated fair value. If impairment is recognized, the reduced carrying amount of the asset will be accounted for as its new cost. For a depreciable asset, the new cost will be depreciated over the asset's remaining useful life. Generally, fair values are estimated using discounted cash flow, replacement cost or market comparison analyses. The process of evaluating for impairment requires estimates as to future events and conditions, which are subject to varying market factors, such as the vacancy rates, future rental rates, lease periods, deferred maintenance and operating costs for R&D facilities in the Silicon Valley area and related submarkets. Therefore, it is reasonably possible that a change in estimate resulting from judgments as to future events could occur which would affect the recorded amounts of the property.

**ALLOWANCE FOR DOUBTFUL ACCOUNTS AND DEFERRED RENT.** We must estimate the uncollectibility of our accounts receivable based on the evaluation of our tenants' financial position, analyses of accounts receivable and current economic trends. We also make estimates for reserves against our deferred rent receivable for existing tenants with the potential of early termination,

## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

bankruptcy or ceasing operations. We charge or credit rental income for increases or decreases to our deferred rent reserves. Our estimates are based on our review of tenants' payment histories, the remaining lease term, whether or not the tenant is currently occupying our building, publicly available financial information and such additional information about their financial condition as tenants provide to us. The information available to us might lead us to overstate or understate these reserve amounts. The use of different estimates or assumptions could produce different results. Moreover, actual future collections of accounts receivable or reductions in future reported rental income due to tenant bankruptcies or other business failures could differ materially from our estimates.

CONSOLIDATED JOINT VENTURES. We, through an operating partnership, own three properties that are in joint ventures of which we have controlling interests. We manage and operate all three properties. The recognition of these properties and their operating results are 100% reflected on our consolidated financial statements, with appropriate allocation to minority interest, because we have operational and financial control of the investments. We make judgments and assumptions about the estimated monthly payments made to our minority interest joint venture partners, which are reported with our periodic results of operations. Actual results may differ from these estimates under different assumptions or conditions.

INVESTMENT IN UNCONSOLIDATED JOINT VENTURE. We, through an operating partnership, have a 50% non-controlling limited partnership interest in one unconsolidated joint venture. This investment is not consolidated because we do not exercise significant control over major operating and financial decisions. We account for this joint venture interest using the equity method of accounting.

FAIR VALUE OF FINANCIAL INSTRUMENTS. Our financial instruments include cash and cash equivalents, accounts receivable, accounts payable, and debt. Considerable judgment is required in interpreting market data to develop estimates of fair value. Our estimates of fair value are not necessarily indicative of the amounts that we could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. Cash and cash equivalents, accounts receivable, and accounts payable are carried at amounts that approximate their fair values due to their short-term maturities. The carrying amounts of our variable rate debt approximate fair value since the interest rates on these instruments are equivalent to rates currently offered to us. For fixed rate debt, we estimate fair value by using discounted cash flow analyses based on borrowing rates for similar kinds of borrowing arrangements.

REVENUE RECOGNITION. Rental revenue is recognized on the straight-line method of accounting required by GAAP under which contractual rent payment increases are recognized evenly over the lease term, regardless of when the rent payments are received by us. The difference between recognized rental income and rental cash receipts is recorded as Deferred Rent Receivable on the consolidated balance sheets.

Rental revenue is affected if existing tenants terminate or amend their leases. We try to identify tenants who may be likely to declare bankruptcy, cease operations or are likely to seek a negotiated settlement of their obligation. By anticipating these events in advance, we expect to take steps to minimize their impact on our reported results of operations through lease renegotiations, reserves against deferred rent, and other appropriate measures. Our judgments and estimations about tenants' capacity to continue to meet their lease obligations will affect the rental revenue recognized. Material differences may result in the amount and timing of our rental revenue for any period if we made different judgments or estimations.

## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

SFAS No. 66, "Accounting for Sales of Real Estate" ("SFAS No. 66"), establishes accounting standards for recognizing profit or loss on sales of real estate. The gain on the sale is only recognized proportionately as the seller receives payments from the purchaser. Interest income is recognized on an accrual basis, when appropriate.

Lease termination fees are recognized as other income when there is a signed termination letter agreement, all of the conditions of the agreement have been met, and when the tenant no longer has the right to occupy the property. These fees are paid by tenants who want to

- 13 -

terminate their lease obligations before the end of the contractual term of the lease. We cannot predict or forecast the timing or amounts of future lease termination fees.

We recognize income from rent, tenant reimbursements and lease termination fees and other income once all of the following criteria are met in accordance with SEC Staff Accounting Bulletin 104:

- the agreement has been fully executed and delivered;
- services have been rendered;
- the amount is fixed and determinable; and
- collectibility is reasonably assured.

With regards to critical accounting policies, where applicable, we have explained and discussed the criteria for identification and selection, methodology in application and impact on the financial statements with the Audit Committee of our Board of Directors. The Audit Committee has reviewed the critical accounting policies we identified.

- 14 -

### RESULTS OF OPERATIONS

#### COMPARISON OF THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2005 TO THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2004

As of September 30, 2005, through our controlling interests in the operating partnerships, we owned 108 properties totaling approximately 8.0 million rentable square feet compared to 109 properties totaling approximately 7.9 million rentable square feet owned by us as of September 30, 2004. This represents a net increase of approximately 1% in total rentable square footage, as we acquired one property consisting of approximately 203,800 rentable square feet and disposed of two properties consisting of approximately 103,350 rentable square feet during the first quarter of 2005.

#### RENTAL REVENUE FROM REAL ESTATE FROM CONTINUING OPERATIONS

For the quarter ended September 30, 2005, rental revenue from real estate decreased by approximately (\$4.8) million, or 16.3%, from \$29.5 million for the three months ended September 30, 2004 to \$24.7 million for the same period of 2005. For the nine months ended September 30, 2005, rental revenue from real estate decreased by approximately (\$14.5) million, or 16.0%, from \$90.5 million for the nine months ended September 30, 2004 to \$76.0 million for the nine months ended September 30, 2005. Rental revenue includes approximately \$0.5 million in amortization for the three months ended September 30, 2005 and 2004 and approximately \$1.4 million in amortization for the nine months ended September 30, 2005 and 2004 for the amortization of the above-market lease

## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

intangible asset pursuant to SFAS No. 141. The decline in rental revenue was primarily a result of the lower rental rate under the new Microsoft blend and extend lease, which was signed in the first quarter of 2005 and accounted for over half the decline. Other factors contributing to the decline in rental revenue were lower rental rates on new leases and renewals and the loss of several tenants due to their bankruptcy, relocation or cessation of operations since September 30, 2004, all of which resulted from current adverse market conditions. Our occupancy rate at September 30, 2005 was approximately 67.5%, compared to approximately 69.0% at September 30, 2004. Due to an over supply of R&D properties and competition from other landlords in the Silicon Valley, our occupancy rate may drop further if the 72,000 rentable square feet scheduled to expire during the remainder of 2005 is not renewed or re-leased.

### EQUITY IN EARNINGS FROM UNCONSOLIDATED JOINT VENTURE

As of September 30, 2005, we had investments in four R&D buildings, totaling 593,000 rentable square feet, through an unconsolidated joint venture, TBI-MSW, in which we acquired a 50% interest in January 2003 from the Berg Group under the Berg Land Holdings Option Agreement. We have a non-controlling limited partnership interest in this joint venture, which we account for using the equity method of accounting. For the three months ended September 30, 2005, we recorded equity in earnings from the unconsolidated joint venture of approximately \$0.29 million compared to equity in earnings of \$0.34 million for the same period in 2004. Our equity in earnings from this unconsolidated joint venture declined in the third quarter of 2005 due to lower rents received as a result of lower occupancy rate. For the nine-month periods ended September 30, 2005 and 2004, equity in earnings from the unconsolidated joint venture was approximately \$0.68 million and \$1.56 million, respectively. The decline in equity in earnings from unconsolidated joint venture for the nine-month period ended September 30, 2005 resulted from the write-offs of leasing commission and tenant improvements for a tenant that terminated its lease agreement in December 2004 as well as lower rents received from the properties of this joint venture. The occupancy rate for the properties owned by this joint venture year to date through September 30, 2005 was approximately 78.7% compared to 100% at September 30, 2004.

### OTHER INCOME FROM CONTINUING OPERATIONS

Other income remained relatively the same at approximately \$0.4 million for the three months ended September 30, 2005 compared to the third quarter of 2004. For the nine months ended September 30, 2005 and 2004, other income was \$3.0 million and \$5.4 million, respectively. Other income was higher for the period ended September 30, 2004 because we realized higher lease termination fee and tenant bankruptcy settlement income in 2004. We do not consider those transactions to be recurring items.

### EXPENSES FROM CONTINUING OPERATIONS

Property operating expenses and real estate taxes during the third quarter of 2005 increased by approximately \$0.5 million, or 10.4%, from \$4.8 million to \$5.3 million for the three months ended September 30, 2004 and 2005, respectively, due primarily to higher assessments of our property value and increase in utility usage. Tenant reimbursements increased by approximately \$0.3 million, or 8.1%, from \$3.7 million for the three months ended September 30, 2004 to \$4.0 million for the three months ended September 30, 2005 due to tenant direct billing of operating expenses during the third quarter of 2005. Property operating expenses and real estate taxes decreased by approximately (\$1.1) million, or 7.2%, from \$15.2 million to \$14.1 million for the nine months ended September 30, 2004 and 2005, respectively, due to lower operating expenses from lower occupancy of our properties, the disposition of two properties during the first quarter of 2005 and property tax refunds totaling approximately \$0.7 million in 2005 and \$0.09 million in 2004. Tenant reimbursements decreased by approximately (\$0.4) million, or 3.4%, from \$11.6 million for the nine months ended September 30, 2004 to \$11.2 million for the nine months ended September 30, 2005. The decrease in tenant reimbursements for the nine months ended

## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

September 30, 2005 as compared to the same period in 2004 was due to lower occupancy. Certain expenses such as property insurance, real estate taxes, and other fixed expenses are not recoverable from vacant properties. General and administrative expenses remained relatively the same at approximately \$0.4 million for the three months ended September 30, 2004 and 2005. For the nine months ended September 30, 2004 and 2005, general and administrative expenses decreased by approximately (\$0.1) million, or 6.3%, from \$1.6 million to \$1.5 million, respectively. General and administrative expenses for the nine months ended September 30, 2004 included additional legal and accounting expenses in connection with the resignation of PricewaterhouseCoopers LLP, our former independent

- 15 -

accountants, and the need to re-audit consolidated financial statements for years 2001 and 2002 and audit 2003 results during the second quarter of 2004, which did not recur in 2005.

Real estate depreciation and amortization expense remained the same at \$5.3 million for the three months ended September 30, 2004 and 2005. Depreciation and amortization expense of real estate decreased by approximately (\$0.2) million, or 1.2%, from \$16.2 million to \$16.0 million for the nine months ended September 30, 2004 and 2005, respectively. The decrease for the nine months ended September 30, 2005 compared to the same period in 2004 was attributable, primarily, to the disposition of two properties during the first quarter of 2005 and a fully amortized in-place lease intangible asset in the second quarter of 2005.

Interest expense increased by approximately \$1.0 million, or 22.2%, from \$4.5 million for the three months ended September 30, 2004 to \$5.5 million for the three months ended September 30, 2005. Interest expense (related parties) decreased by approximately (\$27,000), or 10.5%, from \$256,000 for the three months ended September 30, 2004 to \$229,000 for the three months ended September 30, 2005 due to a lower balance on the Berg Group line of credit in 2005. Total debt outstanding, including amounts due related parties, increased by approximately \$36.6 million, or 11.0%, from \$333.4 million as of September 30, 2004 to \$370.0 million as of September 30, 2005. Overall interest expense, including amounts paid to related parties, for the quarter ended September 30, 2005 increased by approximately \$1.0 million compared to the same quarter a year ago principally due to new debt and the substitution of new debt at slightly higher rates for borrowings under the Berg Group line of credit.

Interest expense increased by approximately \$3.0 million, or 23.1%, from \$13.0 million for the nine months ended September 30, 2004 to \$16.0 million for the nine months ended September 30, 2005. The increase in interest expense resulted principally from losses of approximately \$0.8 million taken from a cash flow interest rate derivative, higher interest rates on variable rate debt, and two new fixed rate secured mortgage loans of \$25.8 million and \$125 million from Allianz Life Insurance Company ("Allianz Loan I" & "Allianz Loan II") obtained in early April 2005 and July 2005, respectively, which primarily paid off lower interest rate debt. Interest expense (related parties) increased by approximately \$19,000, or 2.5%, from \$760,000 for the nine months ended September 30, 2004 to \$779,000 for the nine months ended September 30, 2005 due to higher interest rates.

### INCOME FROM DISCONTINUED OPERATIONS

The following table depicts the amounts of income from discontinued operations for the three and nine months ended September 30, 2005 and 2004.

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

	Three Months Ended September 30, 2005	2004	
			(dollars in thousands) (unaudited)
Gain on disposition of property	\$1,345	\$ -	\$
(Loss) attributable to discontinued operations	(77)	(122)	
Minority interest in (loss)/earnings attributable to discontinued operations	(990)	103	
	-----	-----	
Income/(loss) from discontinued operations	\$ 278	(\$ 19)	\$
	=====	=====	==

In accordance with our adoption of SFAS No. 144, in the first quarter of 2005 we sold and classified as discontinued operations two properties consisting of 103,350 rentable square feet and recorded a gain of \$63,000, of which \$14,000 and \$49,000 were attributable to common stockholders and minority interests, respectively. In the third quarter of 2005, we classified one property as an asset held for sale and discontinued operations because we have committed to an action to sell the property, the property has a buyer and is available for immediate sale in its present condition (subject to terms that are usual and customary for sales of such property), the sale is probable and actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

In accordance with SFAS No. 66, in the third quarter of 2005 we received the remaining balance owed on one of the properties disposed of in the first quarter of 2005 and recorded the remaining gain of approximately \$1.3 million, of which \$0.3 million and \$1.0 million were attributable to common stockholders and minority interests, respectively.

The income/(loss) to common stockholders and minority interests attributable to discontinued operations from these three properties for the three months ended September 30, 2005 and 2004 was approximately \$278,000 and \$990,000, respectively, and (\$19,000) and (\$103,000), respectively. The income/(loss) to common stockholders and minority interests attributable to discontinued operations from these three properties for the nine months ended September 30, 2005 and 2004 was approximately \$207,000 and \$650,000, respectively, and (\$18,000) and (\$161,000), respectively.

- 16 -

NET INCOME TO COMMON STOCKHOLDERS AND NET INCOME TO MINORITY INTEREST

Minority interest in net income has been calculated by taking the net income of the operating partnerships (on a stand-alone basis) multiplied by the respective minority interest ownership percentage. Minority interest represents the ownership interest of all limited partners in the operating partnerships taken as a whole, which was approximately 82% and 83% as of September 30, 2005 and 2004, respectively.

Net income to common stockholders decreased by approximately (\$0.7) million, or 21.9%, from \$3.2 million for the three months ended September 30, 2004 to \$2.5 million for the same period in 2005. The minority interest portion of income decreased by approximately (\$4.0) million, or 25.8%, from \$15.5 million for the three months ended September 30, 2004 to \$11.5 million for the three months ended September 30, 2005. For the nine months ended September 30, 2005 and 2004, the minority interest portion of income was approximately \$35.8 million and



## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

\$51.6 million, respectively, resulting in net income to common stockholders of approximately \$7.6 million and \$10.5 million, respectively. The decline in net income for both common stockholders and minority interests was primarily due to lower rental revenue, the realization of higher termination fee and settlement income in 2004, increases in interest expense and higher non-reimbursable operating expenses from vacant properties.

- 17 -

### CHANGES IN FINANCIAL CONDITION

The most significant changes in our financial condition during the nine months ended September 30, 2005 resulted from the disposition of two R&D properties and acquisition of one R&D property. In addition, total stockholders' equity increased from the exchange of O.P. units for common stock and stock option exercises.

At September 30, 2005, total investments in properties had a net decrease of approximately (\$5.2) million from December 31, 2004 due to two property dispositions and one asset held for sale reclassification, which was partially offset by one property acquisition. During the first nine months of 2005, we acquired one vacant R&D property representing approximately 203,800 rentable square feet located in the Silicon Valley. The purchase price for this property was approximately \$14.0 million. We also disposed of two R&D properties consisting of approximately 103,350 rentable square feet for a total sales price of approximately \$12.8 million. One of the disposed properties was classified as an asset held for sale at December 31, 2004 for \$8.2 million. In the third quarter of 2005, we classified one R&D property consisting of 239,000 rentable square feet as asset held for sale. That property was sold in October 2005 for approximately \$15.1 million. A gain of approximately \$0.8 million will be recognized on this property in the fourth quarter of 2005.

Total stockholders' equity, net, increased by approximately \$1.5 million from December 31, 2004 as we obtained additional capital from the exchange of O.P. units for shares of our common stock and stock option exercises, while incurring a deficit of approximately (\$1.2) million due to dividends declared in excess of net income for the period. During the first nine months of 2005, four limited partners exchanged 215,500 O.P. units for 215,500 shares of our common stock under the Exchange Rights Agreement among us and the limited partners in the operating partnerships. In addition, stock options to purchase 55,000 shares of common stock were exercised. The newly issued shares increased additional paid in capital by approximately \$2.7 million.

### LIQUIDITY AND CAPITAL RESOURCES

We expect a continued decline in operating cash flows from our operating property portfolio in 2005 as compared to 2004. The reduction in cash flows reflects the overall reduced demand for R&D space, lower rental rates for new and renewed leases, and an increase in vacant properties in 2005. In addition, if we are unable to lease a significant portion of the approximately 72,000 rentable square feet scheduled to expire during the remainder of 2005 or an equivalent amount of our currently available space of approximately 2.5 million rentable square feet, our operating cash flows may be affected adversely. With the expectation of lower revenues for the remainder of 2005, we expect the properties' net operating income to continue to show year over year declines when compared to 2004. As noted above, we expect cash flows from operating activities to continue to show declines primarily driven by the general downturn in the Silicon Valley's economy in recent years, the softening of the Company's market specifically, and the expected weaker performance of our properties. We are also subject to risks of decreased occupancy through tenant defaults and

## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

bankruptcies and potential reduction in rental rates upon renewal of properties, which would result in reduced cash flow from operations. It is reasonably likely that vacancy rates may continue to increase and effective rental rates on new and renewed leases may continue to decrease.

We expect our principal source of liquidity for distributions to stockholders and O.P. unit holders, debt service, leasing commissions and recurring capital expenditures to come from cash provided by operations and/or the borrowings under the line of credit with Cupertino National Bank ("CNB"). We expect these sources of liquidity to be adequate to meet projected distributions to stockholders and other presently anticipated liquidity requirements in 2005. We expect to meet our long-term liquidity requirements for the funding of property development, property acquisitions and other material non-recurring capital improvements through cash and investments, long-term secured and unsecured indebtedness and the issuance of additional equity securities by us. We have the ability to meet short-term obligations or other liquidity needs based on a line of credit with CNB. We expect our total interest expense to increase as interest rates rise and through new financing activities. In the remainder of 2005, we will be obligated to make payments totaling approximately \$2.5 million of debt principal under mortgage notes without regard to any debt refinancing or new debt obligations that we might incur, or optional payments of debt principal.

### DISTRIBUTIONS

On October 6, 2005, we paid dividends of \$0.16 per share of common stock to all common stockholders of record as of September 30, 2005. On the same date, the operating partnerships paid a distribution of \$0.16 per O.P. unit to all holders of O.P. units. For the remainder of 2005, we expect to maintain our current quarterly dividend payment rate to common shareholders and O.P. unit holders of \$0.16 per share. However, distributions are declared at the discretion of our Board of Directors and are subject to actual cash available for distribution, our financial condition, capital requirements and such other factors, as our Board of Directors deems relevant.

### DEBT

At September 30, 2005, we had total indebtedness of \$370.0 million, including \$359.9 million of fixed rate mortgage debt and \$10.1 million under the Berg Group mortgage note (related parties), as detailed in the table below. In July 2005, the Citicorp USA and Washington Mutual loans were paid off in their entirety from proceeds received from the Allianz Loan II. Proceeds from the Allianz Loan II were also used to pay down balances on the CNB and Berg Group lines of credit. The CNB loan contains certain financial loan and reporting covenants as defined in the loan agreements. As of September 30, 2005, we were in compliance with these loan covenants.

- 18 -

On April 6, 2005, we obtained a \$25.8 million secured mortgage loan from Allianz Life Insurance Company of North America ("Allianz Loan I") that bears a fixed interest rate at 5.56% and originally matures in 15 years with principal payments amortized over 20 years. The mortgage loan is secured by one property. We paid approximately \$251,000 in loan fees and financing costs, which are being amortized over the 20 year amended loan period, and used the proceeds primarily to pay down short-term debt and the Berg Group line of credit. On July 26, 2005, in connection with the Allianz Loan II, we entered into a "Loan Modification Agreement" with Allianz, which extended the amortization period and maturity date of the Allianz Loan I from April 10, 2020 to August 10, 2025.

On July 26, 2005, we obtained a \$125 million secured mortgage loan from Allianz Life Insurance Company of North America ("Allianz Loan II"). The Allianz Loan II matures on August 10, 2025, and must be paid in full at that time, unless payment is accelerated by reason of a default or sale of one or more of the

## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

properties that secure the loan. This loan bears a fixed interest rate of 5.22% and principal payments are amortized over 20 years. The loan can be prepaid subject to certain yield maintenance provisions and is assumable with the payment of an assumption fee. The mortgage loan is secured by eight properties. We paid approximately \$0.8 million in loan fees and financing costs, which will be amortized over the 20 year loan period. The proceeds were used primarily to repay the Citicorp loan, retire the Washington Mutual loan, reduce the balance of the CNB and Berg Group lines of credit, and for other working capital needs. The Allianz Loans I and II now contain cross-default provisions.

On July 22, 2005, we entered into a "Change in Terms Agreement" with Cupertino National Bank, which reduced the maximum borrowing amount on the Company's revolving line of credit facility with that bank from \$40 million to \$9 million.

On October 26, 2005, the Independent Directors Committee of the Board of Directors of the Company approved the termination of the \$20 million line of credit agreement between the Company and the Berg Group (as defined in the Company's previously filed periodic reports), effective October 31, 2005. The Berg Group line of credit was originally scheduled to mature in March 2006. Based on existing cash reserves and credit facilities, we have determined that we no longer foresee a need for the Berg Group line of credit. There are no borrowings currently outstanding under the Berg Group line of credit. We will not incur any fees or charges for terminating the Berg Group line of credit.

- 19 -

The following table sets forth information regarding debt outstanding as of September 30, 2005:

Debt Description	Collateral Properties	Ba
(dollars)		
Line of Credit:		
Berg Group (related parties)	2033-2043 Samaritan Drive, San Jose, CA 2133 Samaritan Drive, San Jose, CA 2233-2243 Samaritan Drive, San Jose, CA 1310-1450 McCandless Drive, Milpitas, CA 1795-1845 McCandless Drive, Milpitas, CA	\$
Cupertino National Bank	Not Applicable	-----
Mortgage Notes Payable (related parties):	5300 & 5350 Hellyer Avenue, San Jose, CA	1
Mortgage Notes Payable (2):		-----
Prudential Insurance Company of America (3)	10300 Bubb Road, Cupertino, CA 10500 N. De Anza Blvd, Cupertino, CA 4050 Starboard Drive, Fremont, CA 45700 Northport Loop, Fremont, CA 45738 Northport Loop, Fremont, CA 450 National Avenue, Mountain View, CA 6311 San Ignacio Avenue, San Jose, CA 6321 San Ignacio Avenue, San Jose, CA 6325 San Ignacio Avenue, San Jose, CA 6331 San Ignacio Avenue, San Jose, CA 6341 San Ignacio Avenue, San Jose, CA	1

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

	6351 San Ignacio Avenue, San Jose, CA	
	3236 Scott Boulevard, Santa Clara, CA	
	3560 Bassett Street, Santa Clara, CA	
	3570 Bassett Street, Santa Clara, CA	
	3580 Bassett Street, Santa Clara, CA	
	1135 Kern Avenue, Sunnyvale, CA	
	1212 Bordeaux Lane, Sunnyvale, CA	
	1230 E. Arques, Sunnyvale, CA	
	1250 E. Arques, Sunnyvale, CA	
	1170 Morse Avenue, Sunnyvale, CA	
	1600 Memorex Drive, Santa Clara, CA	
	1688 Richard Avenue, Santa Clara, CA	
	1700 Richard Avenue, Santa Clara, CA	
	3540 Bassett Street, Santa Clara, CA	
	3542 Bassett Street, Santa Clara, CA	
	3544 Bassett Street, Santa Clara, CA	
	3550 Bassett Street, Santa Clara, CA	
Northwestern Mutual Life Insurance Company (5)	1750 Automation Parkway, San Jose, CA	
	1756 Automation Parkway, San Jose, CA	
	1762 Automation Parkway, San Jose, CA	
	6320 San Ignacio Avenue, San Jose, CA	
	6540-6541 Via Del Oro, San Jose, CA	
	6385-6387 San Ignacio Avenue, San Jose, CA	
	2251 Lawson Lane, Santa Clara, CA	
	1325 McCandless Drive, Milpitas, CA	
	1650-1690 McCandless Drive, Milpitas, CA	
	20605-20705 Valley Green Dr., Cupertino, CA	
Allianz Life Insurance Co. (Allianz Loan I) (6)	5900 Optical Court, San Jose, CA	
Allianz Life Insurance Co. (Allianz Loan II) (6)	5325-5345 Hellyer Avenue, San Jose, CA	1
	1768 Automation Parkway, San Jose, CA	
	2880 Scott Boulevard, Santa Clara, CA	
	2890 Scott Boulevard, Santa Clara, CA	
	2800 Scott Boulevard, Santa Clara, CA	
	20400 Mariani Avenue, Cupertino, CA	
	10450-10460 Bubb Road, Cupertino, CA	
Mortgage Notes Payable Subtotal		----- 3
TOTAL		----- \$3 =====

- (1) The Berg Group line of credit was terminated by agreement effective October 31, 2005.
- (2) Mortgage notes payable generally require monthly installments of interest and principal ranging from \$177,000 to \$840,000 over various terms extending through the year 2025. The weighted average interest rate of mortgage notes payable was 5.84% at September 30, 2005.
- (3) The Prudential Insurance loan is payable in monthly installments of \$827,000, which includes principal (based upon a 30-year amortization) and interest. A limited partner who is not a member of the Berg Group has guaranteed approximately \$12.0 million of this debt. Costs and fees incurred with obtaining this loan aggregated approximately \$900,000, which were deferred and amortized over the loan period.
- (4) Interest rate equal to LIBOR plus 2%. The Cupertino National Bank line of credit contains certain financial loan and reporting covenants as defined in the loan agreements, including minimum tangible net worth, debt service coverage ratio and combined average daily cash balances with the bank, and

## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

a maximum loan to value ratio. As of September 30, 2005, the Company was in compliance with these loan covenants.

- (5) The Northwestern loan is payable in monthly installments of \$696,000, which includes principal (based upon a 20-year amortization) and interest. Costs and fees incurred with obtaining this loan aggregated approximately \$675,000, which were deferred and amortized over the loan period.
- (6) The Allianz loans are payable in monthly installments of \$1,017,000, which includes principal (based upon a 20-year amortization) and interest. Costs and fees incurred with obtaining these loans aggregated approximately \$1,089,000, which were deferred and amortized over the loan periods. The Allianz loans contain certain customary covenants as defined in the loan agreements. As of September 30, 2005, the Company was in compliance with these loan covenants.

- 20 -

At September 30, 2005, our debt to total market capitalization ratio, which is computed as our total debt outstanding divided by the sum of total debt outstanding plus the market value of common stock (based upon the closing price of \$10.04 per share on September 30, 2005) on a fully diluted basis, including the conversion of all O.P. units into common stock, was approximately 26.1%. On September 30, 2005, the last trading day for the quarter, total market capitalization was approximately \$1.4 billion.

At September 30, 2005, the outstanding balance remaining under certain notes that we owed to the operating partnerships was \$1.7 million. The due date of these notes has been extended to September 30, 2006. The principal amount of these notes, along with the interest expense, which is interest income to the operating partnerships, is eliminated in consolidation and is not included in the corresponding line items within the consolidated financial statements. However, the interest income earned by the operating partnerships, which is interest expense to us, in connection with this debt, is included in the calculation of minority interest as reported on the consolidated statement of operations, thereby reducing our net income by this same amount. At present, our only means for repayment of this debt is through distributions that we receive from the operating partnerships that are in excess of the amount of dividends to be paid to our stockholders or by raising additional equity capital.

### HISTORICAL CASH FLOWS

#### COMPARISON OF THE NINE MONTHS ENDED SEPTEMBER 30, 2005 TO THE NINE MONTHS ENDED SEPTEMBER 30, 2004

Net cash provided by operating activities for the nine months ended September 30, 2005 was \$58.7 million compared to \$82.4 million for the same period in 2004. The decline resulted primarily from the decrease in rental revenue from our current portfolio of property and reduction in tenant expense reimbursements due to tenant lease obligation defaults, tenant re-locations, decrease in occupancy and lower rent renewal rates during the last three months of 2004 and the first nine months of 2005. The decline in cash flow from operating activities was also caused by payments of leasing commissions (included in other assets) which amounted to approximately \$4.0 million, including approximately \$2.9 million with respect to the modification and extension of our lease with Microsoft.

Net cash used in investing activities was approximately (\$2.6) million and (\$0.4) million for the nine months ended September 30, 2005 and 2004, respectively. Cash used in investing activities during the nine months ended September 30, 2005 related principally to the acquisition of the property at 5521 Hellyer Avenue for \$14.2 million and the disposition of two existing properties for a total of \$12.4 million. We partially financed one of the sales

## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

with a note receivable for approximately \$4.1 million, which was fully paid in the third quarter of 2005. Capital expenditures relating to real estate improvements were approximately \$0.9 million and \$0.4 million for the nine months ended September 30, 2005 and 2004, respectively.

Net cash used in financing activities was (\$17.2) million for the nine months ended September 30, 2005 compared to (\$84.5) million for the nine months ended September 30, 2004. During the first nine months of 2005, we received \$150.8 million from two new mortgage loans, received \$0.5 million from stock option exercises, used \$117.8 million to pay outstanding debt, and paid \$42.0 million for minority interest distributions and \$8.7 million for dividends to common stockholders. During the same period in 2004, we used \$9.9 million to repay outstanding debt, drew an additional \$2.5 million from the Cupertino National Bank line of credit, deposited \$1.5 million for an appeals bond, received \$0.2 million from stock option exercises and paid \$62.8 million to minority interests for distributions and \$13.0 million to common stockholders for dividends.

### FUNDS FROM OPERATIONS ("FFO")

FFO is a non-GAAP financial measurement used by real estate investment trusts to measure and compare operating performance. As defined by NAREIT, FFO represents net income (loss) before minority interest of O.P. unit holders, computed in accordance with GAAP, plus non-recurring events other than "extraordinary items" under GAAP, excluding gains and losses from sales of depreciable operating properties, plus real estate related depreciation and amortization, excluding amortization of deferred financing costs and depreciation of non-real estate assets, and after adjustments for unconsolidated partnerships and joint ventures. FFO does include impairment losses for properties held for sale and held for use. Management considers FFO to be an appropriate supplemental measure of the Company's operating and financial performance because when compared year over year, it reflects the impact to operations from trends in occupancy rates, rental rates, operating costs, general and administrative expenses and interest costs, providing a perspective not immediately apparent from net income. In addition, management believes that FFO provides useful information about the Company's financial performance when compared to other REITs since FFO is generally recognized as the industry standard for reporting the operations of REITs. In addition to the disclosure of operating earnings per share, we will continue to use FFO as a measure of our performance. FFO should not be considered as an alternative for net income as a measure of profitability nor is it comparable to cash flows provided by operating activities determined in accordance with GAAP, nor is FFO necessarily indicative of funds available to meet our cash needs, including the need to make cash distributions to satisfy REIT requirements. For example, FFO is not adjusted for payments of debt principal required under our debt service obligations.

Our definition of FFO also assumes conversion at the beginning of the period of all convertible securities, including minority interests that might be exchanged for common stock. FFO does not represent the amount available for management's discretionary use; as such funds may be needed for capital replacement or expansion, debt service obligations or other commitments and uncertainties.

- 21 -

Furthermore, FFO is not comparable to similarly entitled items reported by other REITs that do not define FFO exactly as we do.

FFO for the three and nine months ended September 30, 2005 and 2004, as reconciled to net income to common stockholders, are summarized in the following tables:

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

	Three Months Ended September 30,		
	2005	2004	
	(dollars in thousands)		
Net income to common stockholders	\$ 2,451	\$ 3,173	\$ 7
Add:			
Minority interests (1)	11,414	15,377	35
Depreciation & amortization of real estate (2)	6,008	5,969	18
Less:			
Gain on sale of asset	(1,345)	-	(1)
FFO	\$18,528	\$24,519	\$59

- (1) The minority interest for third parties totaling \$127 and \$111 for the three months ended September 30, 2005 and 2004, respectively, and \$382 and \$368 for the nine months ended September 30, 2005 and 2004, respectively, was deducted from total minority interest in calculating FFO.
- (2) Includes our portion of depreciation and amortization of real estate and leasing commissions from our unconsolidated joint venture totaling \$210 and \$218 for the three months ended September 30, 2005 and 2004, respectively, and \$774 and 655 for the nine months ended September 30, 2005 and 2004, respectively. Also includes amortization of leasing commissions of \$453 and \$322 for the three months ended September 30, 2005 and 2004, respectively, and \$1,295 and \$1,320 for the nine months ended September 30, 2005 and 2004, respectively. Amortization of leasing commissions is included in the property operating, maintenance and real estate taxes line item in the Company's consolidated statements of operations.

DISTRIBUTION POLICY

Our board of directors determines the amount and timing of distributions to our stockholders. The board of directors will consider many factors prior to making any distributions, including the following:

- the amount of cash available for distribution;
- our financial condition;
- whether to reinvest funds rather than to distribute such funds;
- our committed and projected capital expenditures;
- the amount of cash required for new property acquisitions, including acquisitions under existing agreements with the Berg Group;
- prospects of tenant renewals and re-leases of properties subject to expiring leases;
- cash required for re-leasing activities;
- the annual distribution requirements under the REIT provisions of the federal income tax laws; and
- such other factors as the board of directors deems relevant.

We cannot assure you that we will be able to meet or maintain our cash distribution objectives.

IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

We do not believe recently issued accounting standards will materially impact our financial position, results of operations, or cash flows.

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment" ("SFAS No. 123R"), which addresses the accounting for employee and director stock options. Statement 123R requires that the cost of all employee and director

## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

stock options, as well as other equity-based compensation arrangements, be reflected in the financial statements based on the estimated fair value of the awards. SFAS No. 123R is an amendment to SFAS No. 123 and supersedes APB Opinion No. 25 ("APB No. 25"). SFAS No. 123R is applicable to any award that is settled or measured in stock, including stock options, restricted stock, stock appreciation rights, stock units, and employee stock purchase plans. SFAS No. 123R will be effective for public companies starting with the first interim period commencing after June 15, 2005. On April 14, 2005, the SEC announced a new rule that delays the implementation of SFAS No. 123R until the beginning of the next fiscal year that begins after December 15, 2005. We will adopt the requirements of SFAS No. 123R beginning 2006. We expect that the adoption of this standard will reduce our net income and earnings per share; however, it will have no impact on cash flow. Although we have not yet determined whether the adoption of SFAS No. 123R will result in amounts that are similar to the current pro forma disclosures under SFAS No. 123, we are evaluating the requirements under SFAS No. 123R including the valuation methods and support for the assumptions that underlie the valuation of the awards and the transition methods (modified prospective transition method or the modified retrospective transition method).

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Non-monetary Assets" ("SFAS No. 153"). SFAS No. 153 amends the guidance in APB Opinion No. 29, "Accounting for Non-monetary Transactions" to eliminate certain exceptions to the principle that exchanges of non-monetary assets be measured based on the fair value of the assets exchanged. SFAS No. 153 eliminates the exception

- 22 -

for non-monetary exchanges of similar productive assets and replaces it with a general exception for exchanges of non-monetary assets that do not have commercial substance. This statement is effective for non-monetary asset exchanges in fiscal years beginning after June 15, 2005. The adoption of SFAS No. 153 is not expected to have an impact on our consolidated results of operations, financial position or cash flows.

- 23 -

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not generally hold market risk sensitive instruments for trading purposes. We use fixed and variable rate debt to finance our operations. Our exposure to market risk for changes in interest rates relates primarily to our current variable rate debt and future debt obligations. We are vulnerable to significant fluctuations of interest rates on our floating rate debt and pricing on our future debt. We manage our market risk by monitoring interest rates where we try to recognize the unpredictability of the financial markets and seek to reduce potentially adverse effect on the results of our operations. This takes frequent evaluation of available lending rates and examination of opportunities to reduce interest expense through new sources of debt financing. Several factors affecting the interest rate risk include governmental monetary and tax policies, domestic and international economics and other factors that are beyond our control. The following table provides information about the principal cash flows, weighted average interest rates, and expected maturity dates for debt outstanding as of September 30, 2005. The current terms of this debt are described in Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources."

For variable rate debt, the table presents the assumption that the outstanding principal balance at September 30, 2005 will be paid upon maturity. There was no



## Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

variable rate debt at September 30, 2005.

For fixed rate debt, the table presents the assumption that the outstanding principal balance at September 30, 2005 will be paid according to scheduled principal payments and that we will not prepay any of the outstanding principal balance.

	Three Months Remaining	Year Ending December 31,				Th
	2005	2006	2007	2008	2009	
	(dollars in thousands)					
Variable Rate Debt:						
Secured and unsecured debt	-	-	-	-	-	
Weighted average interest rate	-	-	-	-	-	
Fixed Rate Debt:						
Secured notes payable	\$2,504	\$10,427	\$11,046	\$121,623	\$9,598	\$
Weighted average interest rate	5.84%	5.84%	5.84%	5.84%	5.84%	

The primary market risks we face are interest rate fluctuations. Principal amounts outstanding under the Berg Group line of credit and the CNB line of credit, which are tied to a LIBOR based interest rate, were \$0.00, of the total \$370.0 million of outstanding debt as of September 30, 2005. As a result, we pay lower rates of interest in periods of decreasing interest rates and higher rates of interest in periods of increasing interest rates. All of our debt is denominated in United States dollars. We had no interest rate caps or interest rate swap contracts at September 30, 2005.

As of September 30, 2005, we had no interest rate risk since there was no variable rate debt outstanding.

- 24 -

#### ITEM 4. CONTROLS AND PROCEDURES

##### DISCLOSURE CONTROLS AND PROCEDURES

We strive to maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls.

As required by SEC Rule 13a-15(b) we conducted an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer, President and Vice President of Finance, of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, the Chief Executive Officer, President and Vice President of Finance concluded that our disclosure controls and procedures were effective

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-Q/A

in timely alerting them to material information relating to us (including our subsidiaries) required to be included in our periodic SEC filings as of September 30, 2005.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There was no material change in our internal control over financial reporting during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect our internal control over financial reporting.

- 25 -

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Legal proceedings are incorporated herein by reference from Part 1 "Item 1. - Financial Statements - Note 7 - Commitments and Contingencies."

ITEM 6. EXHIBITS

- 31.1 Section 1350 Certificate of CEO
- 31.2 Section 1350 Certificate of President & COO
- 31.3 Section 1350 Certificate of Principal Financial Officer
- 32 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

- 26 -

=====  
 Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereto duly authorized.

Mission West Properties, Inc.  
(Registrant)

Date: November 9, 2005

By: /s/ Carl E. Berg  
-----  
Carl E. Berg  
Chief Executive Officer

Date: November 9, 2005

By: /s/ Wayne N. Pham  
-----  
Wayne N. Pham  
Vice President of Finance and Controller  
(Principal Accounting Officer and Duly  
Authorized Officer)

- 27 -