

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549**

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**FORM 10-Q**



**Quarterly Report Pursuant to Section 13 or 15(d)  
of the Securities Exchange Act of 1934**

**For Quarterly Period Ended June 30, 2004  
or**



**Transition Report Pursuant to Section 13 or 15(d)  
of the Securities Exchange Act of 1934**

**For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number 1-11533**

**Parkway Properties, Inc.**

(Exact name of registrant as specified in its charter)

**Maryland**

(State or other jurisdiction of  
incorporation or organization)

**74-2123597**

(IRS Employer Identification No.)

**One Jackson Place Suite 1000  
188 East Capitol Street  
P. O. Box 24647  
Jackson, Mississippi 39225-4647**

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code **(601) 948-4091**

Registrant's web site **www.pky.com**

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

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

11,279,237 shares of Common Stock, \$.001 par value, were outstanding as of August 2, 2004.

**PARKWAY PROPERTIES, INC.**  
**FORM 10-Q**  
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**PARKWAY PROPERTIES, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share data)

	<b>June 30 2004</b>	<b>December 31 2003</b>
	(Unaudited)	
<b>Assets</b>		
Real estate related investments:		
Office and parking properties	\$ 990,733	\$ 844,168
Parking development	302	-
Accumulated depreciation	(131,679)	(115,473)
	<u>859,356</u>	<u>728,695</u>
Land available for sale	3,528	3,528
Note receivable from Moore Building Associates LP	-	5,926
Mortgage loans	-	861
Investment in unconsolidated joint ventures	19,997	20,026
	<u>882,881</u>	<u>759,036</u>
Interest, rents receivable and other assets	45,153	42,804
Cash and cash equivalents	1,742	468
	<u>\$ 929,776</u>	<u>\$ 802,308</u>
<b>Liabilities</b>		
Notes payable to banks	\$ 129,161	\$ 110,075
Mortgage notes payable without recourse	326,315	247,190
Accounts payable and other liabilities	38,458	37,022
	<u>493,934</u>	<u>394,287</u>
<b>Minority Interest</b>		
Minority Interest – unit holders	40	41
Minority Interest – real estate partnerships	3,774	-
	<u>3,814</u>	<u>41</u>
<b>Stockholders' Equity</b>		
8.34% Series B Cumulative Convertible Preferred stock, \$.001 par value, 2,142,857 shares authorized, 1,867,857 and 1,942,857 shares issued and outstanding in 2004 and 2003, respectively	65,375	68,000
Series C Preferred stock, \$.001 par value, 400,000 shares authorized, no shares issued	-	-
8.00% Series D Preferred stock, \$.001 par value, 2,400,000 shares authorized, issued and outstanding	57,976	57,976
Preferred membership interests	15,491	-
Common stock, \$.001 par value, 65,057,143 shares authorized, 11,278,470 and 10,808,131 shares issued and outstanding in 2004 and 2003, respectively	11	11
Excess stock, \$.001 par value, 30,000,000 shares authorized, no shares issued	-	-
Common stock held in trust, at cost, 130,000 and 128,000 shares in 2004 and 2003, respectively	(4,400)	(4,321)
Additional paid-in capital	269,304	252,695
Unearned compensation	(4,241)	(4,634)
Accumulated other comprehensive income	166	-
Retained earnings	32,346	38,253
	<u>432,028</u>	<u>407,980</u>
	<u>\$ 929,776</u>	<u>\$ 802,308</u>

See notes to consolidated financial statements.

**PARKWAY PROPERTIES, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(In thousands, except per share data)

	<b>Three Months Ended June 30</b>	
	<b>2004</b>	<b>2003</b>
	(Unaudited)	
<b>Revenues</b>		
Income from office and parking properties	\$ 40,224	\$ 35,162
Management company income	431	681
Interest on note receivable from Moore Building Associates LP	-	204
Incentive management fee from Moore Building Associates LP	-	87
Other income and deferred gains	3	281
	<u>40,658</u>	<u>36,415</u>
<b>Expenses</b>		
Office and parking properties:		
Operating expense	18,574	15,817
Interest expense:		
Contractual	4,805	4,056
Amortization of loan costs	159	75
Depreciation and amortization	8,290	6,598
Operating expense for other real estate properties	10	10
Interest expense on bank notes:		
Contractual	930	494
Amortization of loan costs	103	187
Management company expenses	96	175
General and administrative	933	962
	<u>33,900</u>	<u>28,374</u>
<b>Income before equity in earnings, gain and minority interest</b>	6,758	8,041
Equity in earnings of unconsolidated joint ventures	367	623
Gain on sale of joint venture interests and real estate	-	4,545
Minority interest - unit holders	(1)	-
Minority interest - real estate partnerships	101	-
	<u>7,225</u>	<u>13,209</u>
<b>Net income</b>	7,225	13,209
Change in market value of interest rate swap	206	8
<b>Comprehensive income</b>	<u>\$ 7,431</u>	<u>\$ 13,217</u>
<b>Net income available to common stockholders:</b>		
Net income	\$ 7,225	\$ 13,209
Original issue costs associated with redemption of preferred stock	-	(2,619)
Dividends on preferred stock	(1,467)	(1,503)
Dividends on convertible preferred stock	(1,363)	(1,564)
<b>Net income available to common stockholders</b>	<u>\$ 4,395</u>	<u>\$ 7,523</u>
<b>Net income per common share:</b>		
Basic	<u>\$ 0.40</u>	<u>\$ 0.74</u>
Diluted	<u>\$ 0.39</u>	<u>\$ 0.72</u>
<b>Dividends per common share</b>	<u>\$ 0.65</u>	<u>\$ 0.65</u>
<b>Weighted average shares outstanding:</b>		
Basic	<u>11,085</u>	<u>10,224</u>
Diluted	<u>11,258</u>	<u>10,457</u>

See notes to consolidated financial statements.

**PARKWAY PROPERTIES, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(In thousands, except per share data)

	<b>Six Months Ended June 30</b>	
	<b>2004</b>	<b>2003</b>
	(Unaudited)	
<b>Revenues</b>		
Income from office and parking properties	\$ 77,131	\$ 72,219
Management company income	837	1,142
Interest on note receivable from Moore Building Associates LP	-	406
Incentive management fee from Moore Building Associates LP	-	155
Other income and deferred gains	17	487
	<u>77,985</u>	<u>74,409</u>
<b>Expenses</b>		
Office and parking properties:		
Operating expense	36,143	32,379
Interest expense:		
Contractual	9,317	8,026
Prepayment expenses	271	-
Amortization of loan costs	248	132
Depreciation and amortization	15,919	13,952
Operating expense for other real estate properties	20	20
Interest expense on bank notes:		
Contractual	1,764	1,523
Amortization of loan costs	215	364
Management company expenses	172	241
General and administrative	1,967	2,144
	<u>66,036</u>	<u>58,781</u>
<b>Income before equity in earnings, gain and minority interest</b>	11,949	15,628
Equity in earnings of unconsolidated joint ventures	1,110	1,054
Gain on note receivable, sale of joint venture interests and real estate	774	5,641
Minority interest - unit holders	(1)	(1)
Minority interest - real estate partnerships	123	-
	<u>13,955</u>	<u>22,322</u>
<b>Net income</b>	13,955	22,322
Change in market value of interest rate swap	166	60
<b>Comprehensive income</b>	<u>\$ 14,121</u>	<u>\$ 22,382</u>
<b>Net income available to common stockholders:</b>		
Net income	\$ 13,955	\$ 22,322
Original issue costs associated with redemption of preferred stock	-	(2,619)
Dividends on preferred stock	(2,667)	(2,952)
Dividends on convertible preferred stock	(2,772)	(3,128)
<b>Net income available to common stockholders</b>	<u>\$ 8,516</u>	<u>\$ 13,623</u>
<b>Net income per common share:</b>		
Basic	<u>\$ 0.78</u>	<u>\$ 1.38</u>
Diluted	<u>\$ 0.76</u>	<u>\$ 1.36</u>
<b>Dividends per common share</b>	<u>\$ 1.30</u>	<u>\$ 1.30</u>
<b>Weighted average shares outstanding:</b>		
Basic	<u>10,974</u>	<u>9,839</u>
Diluted	<u>11,178</u>	<u>10,039</u>

See notes to consolidated financial statements.

**PARKWAY PROPERTIES, INC.**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
(In thousands)

	<b>Six Months Ended</b>	
	<b>June 30</b>	
	<b>2004</b>	<b>2003</b>
	(Unaudited)	
<b>8.75% Series A Preferred stock, \$.001 par value</b>		
Balance at beginning of period	\$ -	\$ 66,250
Redemption of preferred stock	-	(66,250)
Balance at end of period	-	-
<b>8.34% Series B Cumulative Convertible Preferred stock, \$.001 par value</b>		
Balance at beginning of period	68,000	75,000
Conversion of preferred stock to common stock	(2,625)	-
Balance at end of period	65,375	75,000
<b>8.00% Series D Preferred stock, \$.001 par value</b>		
Balance at beginning of period	57,976	-
Shares issued	-	58,094
Balance at end of period	57,976	58,094
<b>Preferred Membership Interests</b>		
Balance at beginning of period	-	-
Preferred membership interests issued	15,491	-
Balance at end of period	15,491	-
<b>Common stock, \$.001 par value</b>		
Balance at beginning of period	11	9
Shares issued - stock offering	-	1
Balance at end of period	11	10
<b>Common stock held in trust</b>		
Balance at beginning of period	(4,321)	-
Shares contributed to deferred compensation plan	(79)	(4,321)
Balance at end of period	(4,400)	(4,321)
<b>Additional paid-in capital</b>		
Balance at beginning of period	252,695	199,979
Stock options exercised	2,605	3,532
Shares issued in lieu of Directors' fees	137	70
Restricted shares issued	-	4,645
Shares issued - employee excellence recognition program	-	3
Shares issued - DRIP plan	11,242	224
Shares issued - stock offering	-	24,183
Conversion of preferred stock to common stock	2,625	-
Original issue costs associated with redemption of preferred stock	-	2,619
Purchase of Company stock	-	(366)
Balance at end of period	269,304	234,889
<b>Unearned compensation</b>		
Balance at beginning of period	(4,634)	-
Restricted shares issued	-	(4,645)
Amortization of unearned compensation	393	332
Balance at end of period	(4,241)	(4,313)
<b>Accumulated other comprehensive income (loss)</b>		
Balance at beginning of period	-	(170)
Change in market value of interest rate swaps	166	60
Balance at end of period	166	(110)
<b>Retained earnings</b>		
Balance at beginning of period	38,253	35,753
Net income	13,955	22,322
Original issue costs associated with redemption of preferred stock	-	(2,619)
Preferred stock dividends declared	(2,667)	(2,952)
Convertible preferred stock dividends declared	(2,772)	(3,128)
Common stock dividends declared	(14,423)	(12,815)
Balance at end of period	32,346	36,561
<b>Total stockholders' equity</b>	<b>\$ 432,028</b>	<b>\$ 395,810</b>

See notes to consolidated financial statements.

**PARKWAY PROPERTIES, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)

	<b>Six Months Ended June 30</b>	
	<b>2004</b>	<b>2003</b>
	(Unaudited)	
<b>Operating activities</b>		
Net income	\$ 13,955	\$ 22,322
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	15,919	13,952
Amortization of above market leases	131	-
Amortization of loan costs	463	496
Amortization of unearned compensation	393	332
Income (loss) allocated to minority interests	(122)	1
Gain on note receivable, sale of joint venture interests and real estate	(774)	(5,641)
Equity in earnings of unconsolidated joint ventures	(1,110)	(1,054)
Other	-	(5)
Changes in operating assets and liabilities:		
Increase in receivables and other assets	(2,884)	(1,178)
Increase (decrease) in accounts payable and accrued expenses	841	(7,899)
<b>Cash provided by operating activities</b>	<u>26,812</u>	<u>21,326</u>
<b>Investing activities</b>		
Payments received on mortgage loans	774	3
Distributions from unconsolidated joint ventures	1,336	1,703
Investments in unconsolidated joint ventures	(197)	(272)
Purchases of real estate related investments	(59,390)	(13,046)
Proceeds from sale of joint venture interests and real estate	-	70,040
Real estate development	(302)	-
Improvements to real estate related investments	(13,984)	(12,743)
<b>Cash (used in) provided by investing activities</b>	<u>(71,763)</u>	<u>45,685</u>
<b>Financing activities</b>		
Principal payments on mortgage notes payable	(12,613)	(9,913)
Net proceeds from (payments on) bank borrowings	19,252	(73,990)
Proceeds from long-term financing	28,950	18,800
Stock options exercised	2,605	3,532
Dividends paid on common stock	(14,238)	(12,730)
Dividends paid on preferred stock	(5,227)	(7,235)
Purchase of Company stock	-	(366)
Proceeds from DRIP Plan	11,242	224
Redemption of preferred stock	-	(66,250)
Proceeds from stock offerings and preferred membership interests	15,491	82,278
<b>Cash provided by (used in) financing activities</b>	<u>45,462</u>	<u>(65,650)</u>
<b>Impact on cash of consolidation of MBALP</b>	<u>763</u>	<u>-</u>
<b>Change in cash and cash equivalents</b>	1,274	1,361
<b>Cash and cash equivalents at beginning of period</b>	<u>468</u>	<u>1,594</u>
<b>Cash and cash equivalents at end of period</b>	<u>\$ 1,742</u>	<u>\$ 2,955</u>

See notes to consolidated financial statements.

**Parkway Properties, Inc.**  
**Notes to Consolidated Financial Statements (Unaudited)**  
**June 30, 2004**

**(1) Basis of Presentation**

The consolidated financial statements include the accounts of Parkway Properties, Inc. ("Parkway" or "the Company") and its subsidiaries. All significant intercompany transactions and accounts have been eliminated.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

The accompanying financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair statement of the results for the interim periods presented. All such adjustments are of a normal recurring nature. Operating results for the six months ended June 30, 2004 are not necessarily indicative of the results that may be expected for the year ended December 31, 2004. The financial statements should be read in conjunction with the annual report and the notes thereto.

The balance sheet at December 31, 2003 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

In January 2003, the Financial Accounting Standards Board issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51" ("FIN 46"). FIN 46 requires the consolidation of entities in which a company absorbs a majority of the entity's expected losses, receives a majority of the entity's expected residual returns, or both, as a result of ownership, contractual or other financial interests in the entity.

Effective January 1, 2004, Parkway began consolidating its ownership interest in Moore Building Associates LP ("MBALP"). Parkway has less than .1% ownership interest in MBALP and acts as the managing general partner of this partnership. MBALP was established for the purpose of owning a commercial office building (the Toyota Center in Memphis, Tennessee) and is primarily funded with financing from a third party lender, which is secured by a first lien on the rental property of the partnership. The creditors of MBALP do not have recourse to Parkway. In acting as the general partner, Parkway is committed to providing additional funding to meet partnership operating deficits up to an aggregate amount of \$1 million. MBALP has a fixed rate non-recourse first mortgage in the amount of \$13,592,000 that is secured by the Toyota Center, which has a carrying amount of \$23,858,000.

Parkway receives income from MBALP in the form of interest from a construction note receivable, incentive management fees and property management fees. As a result of the consolidation of MBALP, Parkway has eliminated any intercompany asset, liability, revenue and expense accounts between Parkway and MBALP.

**(2) Reclassifications**

Certain reclassifications have been made in the 2003 consolidated financial statements to conform to the 2004 classifications.



### (3) Supplemental Cash Flow Information

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

	Six Months Ended June 30	
	2004	2003
	(in thousands)	
Cash paid for interest	\$ 5,091	\$ 9,551
Income taxes (refunded) paid	(4)	62
Mortgage assumed in purchase	49,073	21,153
Restricted shares	-	4,645
Shares issued in lieu of Directors' fees	137	70
Original issue costs associated with redemption of preferred stock	-	2,619

### (4) Acquisitions

On January 29, 2004, the Company purchased Maitland 200, a 206,000 square-foot, four-story office building located in the Maitland Center submarket of Orlando, Florida. Maitland 200 is 84% occupied and 95% leased and was purchased for \$26.3 million plus \$1.4 million in closing costs and anticipated capital expenditures and leasing costs during the first two years of ownership. The purchase was funded with the Company's existing lines of credit and represents the reinvestment of proceeds from the sale of properties through joint ventures in 2003. Maitland 200 was constructed in 1984 and includes 885 surface parking spaces on 10.27 acres.

On April 2, 2004, the Company purchased Capital City Plaza, a 410,000 square-foot, 17-story Class A office building in the Buckhead submarket of Atlanta, Georgia. The acquisition also includes an adjoining five-story parking garage containing 726 spaces, a surface parking lot containing 81 parking spaces and rights to an adjacent lot containing 349 parking spaces. The property is currently 92% leased and was acquired for \$76.3 million plus \$2.3 million in closing costs and anticipated capital expenditures and leasing costs during the first two years of ownership. The purchase was funded with the Company's existing lines of credit, assumption of an existing non-recourse first mortgage of approximately \$44 million and the issuance of \$15.5 million in preferred membership interests to the seller.

### (5) Investment in Unconsolidated Joint Ventures

As of June 30, 2004, the Company is invested in four joint ventures. As required by generally accepted accounting principles, these joint ventures are accounted for using the equity method of accounting, as Parkway has significant influence over, but does not control any of these joint ventures and is not the primary beneficiary. As a result, the assets and liabilities of the joint ventures are not included on Parkway's consolidated balance sheets as of June 30, 2004. Information relating to the unconsolidated joint ventures is detailed below (in thousands).

Joint Ventures	Property Name	Location	Square Feet	Parkway's Ownership Interest	Percentage Leased
Parkway 233 North Michigan, LLC	233 North Michigan Avenue	Chicago, IL	1,070	30%	91.6%
Phoenix OfficeInvest, LLC	Viad Corporate Center	Phoenix, AZ	481	30%	95.9%
Parkway Joint Venture, LLC	UBS Building/River Oaks	Jackson, MS	170	20%	90.8%
Wink-Parkway Partnership	Wink Building	New Orleans, LA	32	50%	100.0%
			<u>1,753</u>		<u>92.8%</u>

Balance sheet information for the unconsolidated joint ventures is summarized below as of June 30, 2004 and December 31, 2003 (in thousands):

<b>Balance Sheet Information</b>					
<b>June 30, 2004</b>					
	<b>233 North Michigan</b>	<b>Viad Corp Center</b>	<b>Wink Building</b>	<b>Jackson JV</b>	<b>Combined Total</b>
<b>Unconsolidated Joint Ventures:</b>					
Real Estate, Net	\$ 169,801	\$ 59,394	\$ 1,271	\$ 16,739	\$ 247,205
Other Assets	13,829	3,128	206	440	17,603
Total Assets	\$ 183,630	\$ 62,522	\$ 1,477	\$ 17,179	\$ 264,808
Mortgage Debt (a)	\$ 101,084	\$ 42,500	\$ 488	\$ 11,357	\$ 155,429
Other Liabilities	9,975	2,185	4	415	12,579
Partners' and Shareholders' Equity	72,571	17,837	985	5,407	96,800
Total Liabilities and Partners'/Shareholders' Equity	\$ 183,630	\$ 62,522	\$ 1,477	\$ 17,179	\$ 264,808
<b>Parkway's Share of Unconsolidated Joint Ventures:</b>					
Real Estate, Net (a)	\$ 50,940	\$ 17,818	\$ 635	\$ 3,348	\$ 72,741
Mortgage Debt (a)	\$ 30,325	\$ 12,750	\$ 244	\$ 2,271	\$ 45,590
Net Investment in Joint Ventures (a)	\$ 14,992	\$ 4,535	\$ 446	\$ 24	\$ 19,997
<b>December 31, 2003</b>					
	<b>233 North Michigan</b>	<b>Viad Corp Center</b>	<b>Wink Building</b>	<b>Jackson JV</b>	<b>Combined Total</b>
<b>Unconsolidated Joint Ventures:</b>					
Real Estate, Net	\$ 171,396	\$ 59,587	\$ 1,282	\$ 16,595	\$ 248,860
Other Assets	13,417	2,939	158	723	17,237
Total Assets	\$ 184,813	\$ 62,526	\$ 1,440	\$ 17,318	\$ 266,097
Mortgage Debt (a)	\$ 102,002	\$ 42,500	\$ 526	\$ 11,442	\$ 156,470
Other Liabilities	9,054	2,048	4	434	11,540
Partners' and Shareholders' Equity	73,757	17,978	910	5,442	98,087
Total Liabilities and Partners'/Shareholders' Equity	\$ 184,813	\$ 62,526	\$ 1,440	\$ 17,318	\$ 266,097
<b>Parkway's Share of Unconsolidated Joint Ventures:</b>					
Real Estate, Net (a)	\$ 51,419	\$ 17,876	\$ 641	\$ 3,319	\$ 73,255
Mortgage Debt (a)	\$ 30,601	\$ 12,750	\$ 263	\$ 2,288	\$ 45,902
Net Investment in Joint Ventures (a)	\$ 14,963	\$ 4,577	\$ 455	\$ 31	\$ 20,026

(a) The mortgage debt, all of which is non-recourse, is collateralized by the individual real estate properties within each venture.

The terms related to Parkway's share of unconsolidated joint venture mortgage debt are summarized below (in thousands):

<b>Joint Venture</b>	<b>Type of Debt Service</b>	<b>Interest Rate</b>	<b>Maturity</b>	<b>Monthly Debt Service</b>	<b>Loan Balance 06/30/04</b>	<b>Loan Balance 12/31/03</b>
233 North Michigan Avenue	Amortizing	7.350%	07/11/11	\$229	\$30,325	\$30,601
Viad Corporate Center	Interest Only	LIBOR + 2.600%	03/11/05	45	12,750	12,750
Jackson JV	Amortizing	5.840%	05/01/13	70	2,271	2,288
Wink Building	Amortizing	8.625%	07/01/09	5	244	263
				<u>\$349</u>	<u>\$45,590</u>	<u>\$45,902</u>

Weighted average interest rate at end of period	<u>6.376%</u>	<u>6.396%</u>
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The following table presents Parkway's share of principal payments due for mortgage debt in unconsolidated joint ventures (in thousands):

	<b>233 North Michigan</b>	<b>Viad Corporate Center</b>	<b>Wink Building</b>	<b>Jackson JV</b>	<b>Total</b>
2004*	\$ 285	\$ -	\$ 19	\$ 18	\$ 322
2005	602	12,750	42	37	13,431
2006	647	-	45	39	731
2007	695	-	50	41	786
2008	747	-	54	44	845
2009	803	-	34	46	883
Thereafter	26,546	-	-	2,046	28,592
	<u>\$ 30,325</u>	<u>\$ 12,750</u>	<u>\$ 244</u>	<u>\$ 2,271</u>	<u>\$ 45,590</u>

\*Remaining six months

Income statement information for the unconsolidated joint ventures is summarized below for the three months and six months ending June 30, 2004 and 2003 (in thousands):

<b>Results of Operations</b>					
<b>Three Months Ended June 30, 2004</b>					
	<b>233 North Michigan</b>	<b>Viad Corp Center</b>	<b>Wink Building</b>	<b>Jackson JV</b>	<b>Combined Total</b>
<b>Unconsolidated Joint Ventures (100%):</b>					
Revenues	\$ 7,851	\$ 2,900	\$ 82	\$ 704	\$ 11,537
Operating Expenses	(3,702)	(1,373)	(27)	(310)	(5,412)
Net Operating Income	4,149	1,527	55	394	6,125
Interest Expense	(1,818)	(432)	(11)	(166)	(2,427)
Loan Cost Amortization	(30)	(92)	(1)	(1)	(124)
Depreciation and Amortization	(1,411)	(400)	(5)	(97)	(1,913)
Preferred Distributions	(418)	-	-	-	(418)
Net Income	\$ 472	\$ 603	\$ 38	\$ 130	\$ 1,243
<b>Parkway's Share of Unconsolidated Joint Ventures:</b>					
Net Income	\$ 141	\$ 181	\$ 19	\$ 26	\$ 367
Depreciation and Amortization	\$ 423	\$ 120	\$ 2	\$ 20	\$ 565
Interest Expense	\$ 545	\$ 130	\$ 5	\$ 34	\$ 714
Loan Cost Amortization	\$ 9	\$ 28	\$ -	\$ -	\$ 37
Preferred Distributions	\$ 126	\$ -	\$ -	\$ -	\$ 126
<b>Other Supplemental Information:</b>					
Distributions from Unconsolidated JVs	\$ 386	\$ 124	\$ 46	\$ 22	\$ 578
<b>Three Months Ended June 30, 2003</b>					
	<b>233 North Michigan</b>	<b>Viad Corp Center</b>	<b>Wink Building</b>	<b>Jackson JV</b>	<b>Combined Total</b>
<b>Unconsolidated Joint Ventures (100%):</b>					
Revenues	\$ 8,584	\$ 3,095	\$ 76	\$ 256	\$ 12,011
Operating Expenses	(3,772)	(1,348)	(23)	(113)	(5,256)
Net Operating Income	4,812	1,747	53	143	6,755
Interest Expense	(1,850)	(451)	(12)	(56)	(2,369)
Loan Cost Amortization	(30)	(93)	(1)	-	(124)
Depreciation and Amortization	(1,381)	(352)	(6)	(31)	(1,770)
Preferred Distributions	(418)	-	-	-	(418)
Net Income	\$ 1,133	\$ 851	\$ 34	\$ 56	\$ 2,074
<b>Parkway's Share of Unconsolidated Joint Ventures:</b>					
Net Income	\$ 340	\$ 255	\$ 17	\$ 11	\$ 623
Depreciation and Amortization	\$ 414	\$ 106	\$ 3	\$ 6	\$ 529
Interest Expense	\$ 555	\$ 136	\$ 6	\$ 11	\$ 708
Loan Cost Amortization	\$ 9	\$ 28	\$ 1	\$ -	\$ 38
Preferred Distributions	\$ 125	\$ -	\$ -	\$ -	\$ 125
<b>Other Supplemental Information:</b>					
Distributions from Unconsolidated JVs	\$ 561	\$ 322	\$ 50	\$ -	\$ 933

## Results of Operations

Six Months Ended June 30, 2004					
	233 North Michigan	Viad Corp Center	Wink Building	Jackson JV	Combined Total
<b>Unconsolidated Joint Ventures (100%):</b>					
Revenues	\$ 16,791	\$ 5,728	\$ 159	\$ 1,420	\$ 24,098
Operating Expenses	(7,397)	(2,581)	(50)	(611)	(10,639)
Net Operating Income	9,394	3,147	109	809	13,459
Interest Expense	(3,651)	(886)	(22)	(333)	(4,892)
Loan Cost Amortization	(59)	(185)	(2)	(2)	(248)
Depreciation and Amortization	(2,773)	(780)	(11)	(185)	(3,749)
Preferred Distributions	(823)	-	-	-	(823)
Net Income	\$ 2,088	\$ 1,296	\$ 74	\$ 289	\$ 3,747

### Parkway's Share of Unconsolidated Joint Ventures:

Net Income	\$ 626	\$ 389	\$ 37	\$ 58	\$ 1,110
Depreciation and Amortization	\$ 832	\$ 234	\$ 5	\$ 37	\$ 1,108
Interest Expense	\$ 1,095	\$ 266	\$ 11	\$ 67	\$ 1,439
Loan Cost Amortization	\$ 18	\$ 56	\$ -	\$ -	\$ 74
Preferred Distributions	\$ 247	\$ -	\$ -	\$ -	\$ 247

### Other Supplemental Information:

Distributions from Unconsolidated JVs	\$ 794	\$ 431	\$ 46	\$ 65	\$ 1,336
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Six Months Ended June 30, 2003					
	233 North Michigan	Viad Corp Center	Wink Building	Jackson JV	Combined Total
<b>Unconsolidated Joint Ventures (100%):</b>					
Revenues	\$ 17,084	\$ 3,939	\$ 152	\$ 256	\$ 21,431
Operating Expenses	(7,517)	(1,725)	(42)	(113)	(9,397)
Net Operating Income	9,567	2,214	110	143	12,034
Interest Expense	(3,715)	(595)	(25)	(56)	(4,391)
Loan Cost Amortization	(60)	(124)	(2)	-	(186)
Depreciation and Amortization	(2,619)	(469)	(11)	(31)	(3,130)
Preferred Distributions	(843)	-	-	-	(843)
Net Income	\$ 2,330	\$ 1,026	\$ 72	\$ 56	\$ 3,484

### Parkway's Share of Unconsolidated Joint Ventures:

Net Income	\$ 699	\$ 308	\$ 36	\$ 11	\$ 1,054
Depreciation and Amortization	\$ 786	\$ 141	\$ 5	\$ 6	\$ 938
Interest Expense	\$ 1,114	\$ 179	\$ 13	\$ 11	\$ 1,317
Loan Cost Amortization	\$ 18	\$ 37	\$ 1	\$ -	\$ 56
Preferred Distributions	\$ 253	\$ -	\$ -	\$ -	\$ 253

### Other Supplemental Information:

Distributions from Unconsolidated JVs	\$ 1,006	\$ 647	\$ 50	\$ -	\$ 1,703
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## (6) Stock based compensation

The Company has granted stock options for a fixed number of shares to employees and directors with an exercise price equal to or above the fair value of the shares at the date of grant. The Company accounts for stock option grants in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees" (the intrinsic value method), and accordingly, recognizes no compensation expense for the stock option grants.

The following table illustrates the effect on net income and earnings per share if the company had applied the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation (in thousands).

	Six Months Ended June 30	
	2004	2003
Net income available to common stockholders	\$ 8,516	\$13,623
Stock based employee compensation costs assuming fair value method	(167)	(190)
Pro forma net income available to common stockholders	<u>\$ 8,349</u>	<u>\$13,433</u>
Pro forma net income per common share:		
Basic:		
Net income available to common stockholders	\$ .78	\$ 1.38
Stock based employee compensation costs assuming fair value method	(.02)	(.02)
Pro forma net income per common share	<u>\$ .76</u>	<u>\$ 1.36</u>
Diluted:		
Net income available to common stockholders	\$ .76	\$ 1.36
Stock based employee compensation costs assuming fair value method	(.02)	(.02)
Pro forma net income per common share	<u>\$ .74</u>	<u>\$ 1.34</u>

The Company also accounts for restricted stock in accordance with APB No. 25 and accordingly, compensation expense is recognized over the expected vesting period. At the Annual Meeting of Stockholders held May 6, 2004, shareholders approved the 2001 Non-Employee Directors Equity Compensation Plan, as amended. Under the Plan, 142,000 restricted shares of common stock have been granted to officers of the Company. Beginning in 2003, Parkway replaced the grant of stock options with the grant of restricted shares or share equivalents to employees and officers of the Company. Accordingly, 5,246 deferred incentive share units were granted to employees of the Company in 2003 in lieu of a similar value of stock options. Compensation expense related to the restricted stock and deferred incentive shares units of \$393,000 was recognized for the six months ending June 30, 2004.

## (7) Capital and Financing Transactions

On February 6, 2004, the Company closed a new three-year \$170,000,000 line of credit led by Wachovia Bank and syndicated to ten other banks. The interest rate on the line is equal to the 30-day LIBOR rate plus 100 to 150 basis points (currently 132.5 basis points), depending upon overall Company leverage. The new line replaces the line of credit with JP Morgan Chase Bank in the amount of \$135,000,000, which was scheduled to mature June 2004. The new line with Wachovia affords the Company greater financial flexibility at a lower interest cost.

Effective February 24, 2004, the Company entered into an interest rate swap agreement with a notional amount of \$60 million. The interest rate swap agreement fixed the 30-day LIBOR interest rate at 1.293%, which equates to a current interest rate of 2.618%. The agreement matures December 31, 2004.

In connection with the purchase of the Capital City Plaza in Atlanta, Georgia on April 2, 2004, Parkway assumed a \$44 million fixed rate, non-recourse mortgage and issued \$15.5 million in preferred membership interests to the seller. The mortgage matures September 2008 and bears interest at 6.75%. In accordance with generally accepted accounting principles, the mortgage was recorded at approximately \$49 million to reflect the fair value of the financial instrument based on the rate of 3.7% on the date of purchase. The preferred membership interests pay the seller a 7% coupon rate and were issued to accommodate their tax planning needs. The seller has the right to redeem \$5.5 million of the membership interests within six months of closing and \$10 million of the membership interests within nine months of closing. Parkway has the right to retire the preferred interest in August 2007.

On May 26, 2004 the Company closed with a lender two non-recourse first mortgages totaling \$28,950,000, which were secured by two properties. The mortgages are interest only in years one and two, have a fixed interest

rate of 4.39% with a 7-year term and a 25-year amortization. Proceeds from the mortgage were used to reduce amounts outstanding under the Company's lines of credit.

To protect against the potential for rapidly rising interest rates, the Company entered into two interest rate swap agreements in May 2004. The first interest rate swap agreement is for a \$40 million notional amount and fixed the 30-day LIBOR interest rate at 3.53% for the period January 1, 2005 through June 30, 2006. The second interest rate swap agreement is for a \$20 million notional amount and fixed the 30-day LIBOR interest rate at 3.18% for the period January 1, 2005 through December 31, 2005.

Through the Company's Dividend Reinvestment and Stock Purchase Plan ("DRIP Plan"), 287,652 common shares were issued during second quarter 2004. Net proceeds received on the issuance of shares were \$11,120,000, which equates to an average net per share price of \$38.66. Proceeds from the issuance were used to reduce amounts outstanding under the Company's lines of credit. For the six months ending June 30, 2004, 290,307 common shares were issued through the DRIP Plan for net proceeds of \$11,242,000, which equates to an average net per share price of \$38.72.

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

### **Overview**

Parkway is a self-administered and self-managed REIT specializing in the acquisition, operations and leasing of office properties. The Company is geographically focused on the Southeastern and Southwestern United States and Chicago. As of July 31, 2004 Parkway owned or had an interest in 61 office properties located in 11 states with an aggregate of approximately 11.3 million square feet of leasable space. The Company generates revenue primarily by leasing office space to its customers and providing management and leasing services to third-party office property owners (including joint venture interests). The primary drivers behind Parkway's revenues are occupancy, rental rates and customer retention.

*Occupancy.* Parkway's revenues are dependent on the occupancy of its office buildings. Over the past few years, as a result of job losses and oversupply of office properties in some markets, vacancy rates increased nationally and in Parkway's markets. The office sector currently is experiencing modest declines from these high vacancy rates. As of July 1, 2004, occupancy of Parkway's office portfolio was 89.7% compared to 88.4% as of April 1, 2004 and 91.8% as of July 1, 2003. Not included in the July 1, 2004 occupancy rate are 31 signed leases totaling 244,000 square feet, which commence during the third and fourth quarters of 2004 and first quarter of 2005. After adjusting for the additional leasing, Parkway's percentage leased is raised to 91.8%. To maintain its occupancy, Parkway utilizes innovative approaches to produce new leases. These include the Broker Bill of Rights, a short-form lease and customer advocacy programs which are models in the industry and have helped the Company maintain occupancy around 90% during a time when the national occupancy rate is approximately 83%. Parkway projects occupancy ranging from 87% to 91% in 2004 for its office properties.

*Rental Rates.* An increase in vacancy rates has the effect of reducing market rental rates and vice versa. Parkway's leases typically have three to seven year terms. As leases expire, the Company replaces the existing leases with new leases at the current market rental rate, which today is often lower than the existing lease rate. Customer retention is increasingly important in controlling costs and preserving revenue.

*Customer Retention.* Keeping our existing customers is important as high customer retention leads to increased occupancy, less downtime between leases, and reduced tenant improvement and leasing costs. Parkway estimates that it costs six times more to replace an existing customer with a new one. This ratio represents the sum of downtime on the space plus leasing costs, which rise as market vacancies increase. Therefore, Parkway focuses a great deal of energy on customer retention. Parkway's operating philosophy is based on the premise that we are in the customer retention business. Parkway seeks to retain its customers by continually focusing on operations at its office properties. The Company believes in providing superior customer service; hiring, training, retaining and empowering each employee; and creating an environment of open communication both internally and externally with our customers and our stockholders. Over the past seven years, Parkway maintained an approximate 75% customer retention rate. Parkway's customer retention for the three months ending June 30, 2004 was 70.9% compared to 69.1% for the quarter ending March 31, 2004 and 66.1% for the quarter ending June 30, 2003.

In 2003, customer retention was below the Company's historical average primarily as a result of the loss of two major customers effective December 31, 2003: Burlington Industries, which occupied 137,000 square feet at 400

North Belt in Houston, Texas and Skytel, a subsidiary of MCI/WorldCom, Inc. ("WorldCom"), which occupied 156,000 square feet at the Skytel Centre in Jackson, Mississippi. The Company received approximately \$2,314,000 annually in total revenue (\$1,300,000 after expenses) from Burlington and \$2,500,000 annually in total revenue (\$1,800,000 after expenses) from WorldCom. These spaces have been leased as described in the following paragraph. The related tenant improvements are in process and as the customers take occupancy, Parkway will begin to receive rental revenue with respect to the space, which will cause its financial results to improve.

During the first six months of 2004, the Company signed eight leases for 127,000 square feet within the former Burlington space at 400 North Belt raising the percentage leased to 87% for that building. During the first six months of 2004, the Company announced the renaming of the Skytel Centre to City Centre, the signing of leases which raise the City Centre building occupancy to approximately 92% and the development of a \$6.5 million, 500-space parking facility to accommodate building customers. The largest lease at City Centre was signed with Forman Perry Watkins Krutz & Tardy LLP for 145,000 square feet, commencing upon completion of the improvements to the space primarily in the fourth quarter of 2004. Forman Perry will occupy the space through December 31, 2011, subject to certain termination rights in December 2005 and again in July 2008. The firm is consolidating employees from two buildings in Jackson and will vacate approximately 70,000 square feet in One Jackson Place, another Parkway-owned asset. The other large new customers at City Centre include Entergy Mississippi, Inc. and Ross & Yerger, which leased 19,500 and 14,500 square feet, respectively.

*Strategic Planning.* For many years, Parkway has been engaged in a process of strategic planning and goal setting. The material goals and objectives of Parkway's earlier strategic plans have been achieved, and benefited Parkway's stockholders through increased FFO and dividend payments per share. Effective January 1, 2003, the Company adopted a three-year strategic plan referred to as Value<sup>2</sup> (Value Square). This plan reflects the employees' commitment to create value for its shareholders while holding firm to the core values as espoused in the Parkway Commitment to Excellence. The Company plans to create value by Venturing with best partners, Asset recycling, Leverage neutral growth, Uncompromising focus on operations and providing an Equity return to its shareholders that is 10% greater than that of its peer group, the National Association of Real Estate Investment Trusts ("NAREIT") office index. Equity return is defined as growth in funds from operations ("FFO") per diluted share.

The highlights of 2003 and 2004 reflect the strategy set forth in Value<sup>2</sup> as described below:

- **Venture with Best Partners.** During 2003 we sold joint venture interests in three office properties. Parkway continues to evaluate its existing portfolio for joint venture candidates and anticipates joint venturing more properties, as well as purchasing new properties with the intention of joint venturing them.
- **Asset Recycling.** During 2003, the Company sold one office property, while maintaining a 10-year non-cancelable management contract, and a .74 acre parcel of land. Using the proceeds from the joint ventures, property sales and stock offerings, Parkway purchased four buildings totaling \$125 million in 2003 and two office buildings totaling \$103 million in 2004.
- **Leverage Neutral Growth.** Parkway began 2003 with a debt to total market capitalization of 45% and operated most of the year well below 40%. The decrease in debt to total market capitalization is a result of timing delays in reinvesting proceeds from joint ventures, asset sales and stock offerings. The Company anticipates that the debt to total market capitalization will average around 45% for the three years of Value<sup>2</sup>. During 2003, we closed four mortgages for approximately \$100 million, issued 690,000 common shares for a net \$24 million, redeemed 2,650,000 shares of 8.75% Series A Preferred stock and issued 2.4 million shares of 8.0% Series D Preferred stock. During the six months ending June 30, 2004, Parkway assumed a \$44 million mortgage in connection with the Capital City Plaza purchase in Atlanta and placed two mortgages totaling \$29 million. As of June 30, 2004, the Company's debt-to-total market capitalization ratio was 43.2% as compared to 40.6% as of March 31, 2004 and 38.4% as of June 30, 2003.
- **Uncompromising Focus on Operations.** Recognizing that in this difficult real estate environment, operating efficiently and consistently is more important than ever, Parkway implemented the Uncompromising Focus on Operations ("UFO") program in the first quarter of 2003, whereby Parkway's Customer Advocate grades each property in all areas of consistency and high standards. This is done in conjunction with the Customer Advocate interviews with each customer each year. Parkway continues to focus on the basics of our business: customer retention, leasing, and controlling



operating expenses and capital expenditures, to maintain our occupancy, which have the effect of maintaining and increasing revenues.

- Equity Returns to Shareholders 10% Greater than the NAREIT Office Index. Parkway is one-half of the way through the Value<sup>2</sup> plan and achieved this financial goal for the first year of the plan. FFO growth for the first twelve months of Value<sup>2</sup> was negative 1.1% for the Company, which exceeded the FFO growth of the NAREIT Office Index by more than 10%.

## **Financial Condition**

***Comments are for the balance sheet dated June 30, 2004 compared to the balance sheet dated December 31, 2003***

*Office and Parking Properties.* In 2004, Parkway continued the application of its strategy of operating and acquiring office properties, joint venturing interests in office assets, as well as liquidating non-core assets and office assets that no longer meet the Company's investment criteria and/or the Company has determined value will be maximized by selling. During the six months ending June 30, 2004, total assets increased \$127,468,000 and office properties (before depreciation) increased \$146,867,000 or 17%.

## **Purchases and Improvements**

Parkway's direct investment in office and parking properties increased \$130,661,000 net of depreciation to a carrying amount of \$859,356,000 at June 30, 2004, and consisted of 57 office and parking properties. The primary reason for the increase in office and parking properties relates to the purchase of two office properties and the consolidation of MBALP as required under FIN 46. The impact of the consolidation of MBALP on Parkway's investment in office and parking properties was an increase of \$24,184,000.

On January 29, 2004, the Company purchased Maitland 200, a 206,000 square-foot, four-story office building located in the Maitland Center submarket of Orlando, Florida. Maitland 200 is currently 95% leased and was purchased for \$26.3 million plus \$1.4 million in closing costs and anticipated capital expenditures and leasing costs during the first two years of ownership. The purchase was funded with the Company's existing lines of credit and represents the reinvestment of proceeds from the sale of properties through joint ventures in 2003. Maitland 200 was constructed in 1984 and includes 885 surface parking spaces on 10.27 acres.

On April 2, 2004, the Company purchased Capital City Plaza, a 410,000 square-foot, 17-story Class A office building in the Buckhead submarket of Atlanta, Georgia. The acquisition also includes an adjoining five-story parking garage containing 726 spaces, a surface parking lot containing 81 parking spaces and rights to an adjacent lot containing 349 parking spaces. The property is currently 92% leased and was acquired for \$76.3 million plus \$2.3 million in closing costs and anticipated capital expenditures and leasing costs during the first two years of ownership. The purchase was funded with the Company's existing lines of credit, assumption of an existing non-recourse first mortgage of approximately \$44 million and the issuance of \$15.5 million in preferred membership interests to the seller.

During the six months ending June 30, 2004, the Company also capitalized building improvements and additional purchase expenses of \$12,413,000 and recorded depreciation expense of \$14,308,000 related to its operating property portfolio and development of a 500-space parking facility to accommodate customers at City Centre in Jackson, Mississippi.

*Note Receivable from Moore Building Associates LP.* In accordance with FIN 46, Parkway began consolidating MBALP effective January 1, 2004. Accordingly, the note receivable from MBALP reported in the financial statements at December 31, 2003 in the amount of \$5,926,000 has been eliminated in consolidation at June 30, 2004.

*Mortgage Loans.* During the six months ending June 30, 2004, the mortgage loan secured by a retail center was paid in full. A gain of \$774,000 was recognized on the note receivable during the first quarter of 2004 as the note was fully reserved. This was the only outstanding mortgage loan held by Parkway.

*Notes Payable to Banks.* Notes payable to banks increased \$19,086,000 during the six months ended June 30, 2004. At June 30, 2004, notes payable to banks totaled \$129,161,000 and the increase is primarily attributable to advances under bank lines of credit to purchase additional properties and make improvements to office properties.

*Mortgage Notes Payable Without Recourse.* During the six months ended June 30, 2004, mortgage notes payable without recourse increased \$79,125,000 or 32%. The increase is due to the following factors (in thousands):

	<b>Increase (Decrease)</b>
Assumption of first mortgage on Capital City Plaza purchase	\$49,073
Placement of mortgage debt	28,950
Impact of consolidation of MBALP	13,822
Scheduled principal payments	(5,818)
Principal paid on early extinguishment of debt	(6,795)
Market value adjustment on reverse swap interest rate contract	(107)
	<u>\$79,125</u>

In connection with the purchase of the Capital City Plaza in Atlanta, Georgia on April 2, 2004, Parkway assumed a \$44 million fixed rate, non-recourse mortgage, which matures in September 2008 and bears interest at 6.75%. In accordance with generally accepted accounting principles, the mortgage was recorded at approximately \$49 million to reflect the fair value of the financial instrument based on the rate of 3.7% on the date of purchase.

On May 26, 2004 the Company closed with a lender two non-recourse first mortgages totaling \$28,950,000, which were secured by two properties. The mortgages are interest only in years one and two, have a fixed interest rate of 4.39% with a 7-year term and a 25-year amortization. Proceeds from the mortgage were used to reduce amounts outstanding under the Company's lines of credit.

The Company expects to continue seeking fixed rate, non-recourse mortgage financing at terms ranging from five to ten years typically amortizing over 25 to 30 years on select office building investments as additional capital is needed. The Company targets a debt to total market capitalization rate at a percentage in the mid-40's. This rate may vary at times pending acquisitions, sales and/or equity offerings. In addition, volatility in the price of the Company's common stock may affect the debt to total market capitalization ratio. However, over time the Company plans to maintain a percentage in the mid-40's. In addition to this debt ratio, the Company monitors interest and fixed charge coverage ratios. The interest coverage ratio is computed by comparing the cash interest accrued to earnings before interest, taxes, depreciation and amortization ("EBITDA"). The fixed charge coverage ratio is computed by comparing the cash interest accrued, principal payments made on mortgage loans and preferred dividends paid to EBITDA.

The computation of the interest and fixed charge coverage ratios and the reconciliation of net income to EBITDA is as follows for the six months ended June 30, 2004 and 2003 (in thousands):

	<b>Six Months Ended June 30</b>	
	<b>2004</b>	<b>2003</b>
<b>Net income</b>	\$13,955	\$22,322
<b>Adjustments to net income:</b>		
Interest expense	11,081	9,549
Amortization of financing costs	463	496
Prepayment expenses - early extinguishment of debt	271	-
Depreciation and amortization	15,919	13,952
Amortization of deferred compensation	393	332
Gain on note receivable, sale of joint venture interests and real estate	(774)	(5,641)
Tax expenses	-	88
EBITDA adjustments - unconsolidated joint ventures	2,868	2,564
EBITDA adjustments - minority interest in real estate partnerships	(975)	-
<b>EBITDA (1)</b>	<b>\$43,201</b>	<b>\$43,662</b>
<b>Interest coverage ratio:</b>		
EBITDA	\$43,201	\$43,662
Interest expense:		
Interest expense	\$11,081	\$ 9,549
Interest expense - unconsolidated joint ventures	1,439	1,317
Interest expense - minority interest in real estate partnerships	(637)	-
Total interest expense	\$11,883	\$10,866
<b>Interest coverage ratio</b>	<b>3.64</b>	<b>4.02</b>
<b>Fixed charge coverage ratio:</b>		
EBITDA	\$43,201	\$43,662
Fixed charges:		
Interest expense	\$11,883	\$10,866
Preferred dividends	5,439	6,080
Preferred distributions - unconsolidated joint ventures	247	253
Principal payments (excluding early extinguishment of debt)	5,818	5,692
Principal payments - unconsolidated joint ventures	311	277
Principal payments - minority interest in real estate partnerships	(230)	-
Total fixed charges	\$23,468	\$23,168
<b>Fixed charge coverage ratio</b>	<b>1.84</b>	<b>1.88</b>

(1) EBITDA, a non-GAAP financial measure, means operating income before mortgage and other interest expense, income taxes, depreciation and amortization. We believe that EBITDA is useful to investors and Parkway's management as an indication of the Company's ability to service debt and pay cash distributions. EBITDA, as calculated by us, is not comparable to EBITDA reported by other REITs that do not define EBITDA exactly as we do. EBITDA does not represent cash generated from operating activities in accordance with generally accepted accounting principles, and should not be considered an alternative to operating income or net income as an indicator of performance or as an alternative to cash flows from operating activities as an indicator of liquidity.

Stockholders' equity increased \$24,048,000 during the six months ended June 30, 2004, as a result of the following (in thousands):

	<b>Increase (Decrease)</b>
Net income	\$ 13,955
Change in market value of interest rate swap	166
Comprehensive income	14,121
Common stock dividends declared	(14,423)
Preferred stock dividends declared	(2,667)
Convertible preferred stock dividends declared	(2,772)
Exercise of stock options	2,605
Amortization of unearned compensation	393
Shares issued through DRIP plan	11,242
Preferred membership interests issued	15,491
Shares issued – Directors' fees	137
Shares contributed to deferred compensation plan	(79)
	<u>\$24,048</u>

In connection with the Capital City Plaza purchase, Parkway issued \$15.5 million in preferred membership interests to the seller. The preferred membership interests pay the seller a 7% coupon rate and were issued to accommodate their tax planning needs. The seller has the right to redeem \$5.5 million of the membership interests within six months of closing and \$10 million of the membership interests within nine months of closing. Parkway has the right to retire the preferred interest 40 months after closing.

Through the Company's Dividend Reinvestment and Stock Purchase Plan ("DRIP Plan"), 287,652 common shares were issued during second quarter 2004. Net proceeds received on the issuance of shares were \$11,120,000, which equates to an average net per share price of \$38.66. Proceeds from the issuance were used to reduce amounts outstanding under the Company's lines of credit. For the six months ending June 30, 2004, 290,307 common shares were issued through the DRIP Plan for net proceeds of \$11,242,000, which equates to an average net per share price of \$38.72.

## **Results of Operations**

***Comments are for the three months and six months ended June 30, 2004 compared to the three months and six months ended June 30, 2003.***

Net income available to common stockholders for the three months ended June 30, 2004, was \$4,395,000 (\$.40 per basic common share) as compared to \$7,523,000 (\$.74 per basic common share) for the three months ended June 30, 2003. Net income available to common stockholders for the six months ended June 30, 2004 was \$8,516,000 (\$.78 per basic common share) compared to \$13,623,000 (\$1.38 per basic common share) for the six months ended June 30, 2003. Net income included a gain on a note receivable in the amount of \$774,000 for the six months ended June 30, 2004. Net income included a gain from the sale of joint venture interests and land in the amount of \$5,641,000 for the six months ended June 30, 2003. Additionally, a \$2,619,000 non-cash adjustment for original issue costs related to the redemption of Series A Preferred Stock was included in net income available to common stockholders for the six months ended June 30, 2003. The Series A Preferred Stock was originally issued in April of 1998.

*Office and Parking Properties.* The primary reason for the change in the Company's net income from office and parking properties for 2004 as compared to 2003 is the net effect of the operations of the following properties purchased, property sold and joint venture interests sold (in thousands):

**Properties Purchased:**

<u>Office Properties</u>	<u>Purchase Date</u>	<u>Square Feet</u>
Citrus Center	02/11/03	258
Peachtree Dunwoody Pavilion	08/28/03	366
Wells Fargo Building	09/12/03	135
Carmel Crossing	11/24/03	324
Maitland 200	01/29/04	206
Capital City Plaza	04/02/04	410

**Property Sold:**

<u>Office Property</u>	<u>Date Sold</u>	<u>Square Feet</u>
BB&T Financial Center	08/01/03	240

**Joint Venture Interests Sold:**

<u>Office Property/Interest Sold</u>	<u>Date Sold</u>	<u>Square Feet</u>
Viad Corporate Center/70%	03/06/03	481
UBS Building & River Oaks Place/80%	05/28/03	170

Operations of office and parking properties are summarized below (in thousands):

	<u>Three Months Ended June 30</u>		<u>Six Months Ended June 30</u>	
	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>
Income	\$ 40,224	\$ 35,162	\$ 77,131	\$ 72,219
Operating expense	(18,574)	(15,817)	(36,143)	(32,379)
	21,650	19,345	40,988	39,840
Interest expense	(4,964)	(4,131)	(9,836)	(8,158)
Depreciation and amortization	(8,290)	(6,598)	(15,919)	(13,952)
Income from office and parking properties	<u>\$ 8,396</u>	<u>\$ 8,616</u>	<u>\$ 15,233</u>	<u>\$ 17,730</u>

*Interest on Note Receivable from Moore Building Associates LP and Incentive Management Fee Income from Moore Building Associates LP.* In accordance with FIN 46, Parkway began consolidating MBALP effective January 1, 2004. Due to the consolidation, the intercompany revenue and expense from MBALP was eliminated from the financial statements. Therefore, interest income and incentive management fee income from MBALP for the six months ending June 30, 2004 has been eliminated in consolidation.

*Interest Expense.* The \$1,678,000 increase in interest expense on office properties for the six months ended June 30, 2004 compared to the same period in 2003 is due to the net effect of the early extinguishment of two mortgages in 2004 and two mortgages in 2003, new loans placed or assumed in 2003 and 2004 and the impact of consolidating MBALP. The average interest rate on mortgage notes payable as of June 30, 2004 and 2003 was 6.2% and 7.1%, respectively.

**Liquidity and Capital Resources**

**Statement of Cash Flows**

Cash and cash equivalents were \$1,742,000 and \$468,000 at June 30, 2004 and December 31, 2003, respectively. Cash flows provided by operating activities for the six months ending June 30, 2004 were \$26,812,000 compared to \$21,326,000 for the same period of 2003. The change in cash flows from operating activities is primarily attributable to the timing of receipt of revenues and payment of expenses.

Cash used in investing activities was \$71,763,000 for the six months ended June 30, 2004 compared to cash provided by investing activities of \$45,685,000 for the same period of 2003. The decrease in cash provided by investing activities of \$117,448,000 is primarily due to increased office property purchases in 2004 of \$46,344,000 and the proceeds received on the sale of joint venture interests and real estate in 2003 of \$70,040,000.

Cash provided by financing activities was \$45,462,000 for the six months ended June 30, 2004 compared to cash used by financing activities of \$65,650,000 for the same period of 2003. The increase in cash provided by financing activities of \$111,112,000 is primarily due to the additional bank borrowings of \$19,252,000 in 2004 to fund office property purchases compared to a reduction in bank borrowings for the same period of 2003 of \$73,990,000 principally from the proceeds from the sale of joint venture interests and real estate and a stock offering.

## Liquidity

The Company plans to continue pursuing the acquisition of additional investments that meet the Company's investment criteria and intends to use bank lines of credit, proceeds from the sale of non-core assets and office properties, proceeds from the sale of portions of owned assets through joint ventures, possible sales of securities and cash balances to fund those acquisitions. At June 30, 2004, the Company had \$129,161,000 outstanding under two bank lines of credit.

The Company's cash flows are exposed to interest rate changes primarily as a result of its lines of credit used to maintain liquidity and fund capital expenditures and expansion of the Company's real estate investment portfolio and operations. The Company's interest rate risk management objective is to limit the impact of interest rate changes on earnings and cash flows and to lower its overall borrowing costs. To achieve its objectives, the Company borrows at fixed rates, but also utilizes a three-year unsecured revolving credit facility and a one-year unsecured line of credit.

On February 6, 2004, Parkway entered into a Credit Agreement with a consortium of 11 banks with Wachovia Capital Markets, LLC as Sole Lead Arranger and Sole Book Runner, Wachovia Bank, National Association as Administrative Agent, PNC Bank, National Association as Syndication Agent, and other banks as participants. The Credit Agreement provides for a three-year \$170 million unsecured revolving credit facility (the "\$170 million line"). The \$170 million line replaces the previous \$135 million unsecured revolving credit facility and the \$20 million term loan with JP Morgan Chase Bank. The interest rate on the \$170 million line is equal to the 30-day LIBOR rate plus 100 to 150 basis points, depending upon overall Company leverage (with the current rate set at 132.5 basis points). The interest rate on the \$170 million line was 2.5% at June 30, 2004.

The \$170 million line matures February 6, 2007 and allows for a one-year extension option available at maturity. The line is expected to fund acquisitions of additional investments. The Company paid a facility fee of \$170,000 (10 basis points) and origination fees of \$556,000 (32.71 basis points) upon closing of the loan agreement and pays an annual administration fee of \$35,000. The Company also pays fees on the unused portion of the line based upon overall Company leverage, with the current rate set at 12.5 basis points.

On February 6, 2004, Parkway amended and renewed the one-year \$15 million unsecured line of credit with PNC Bank (the "\$15 million line"). This line of credit matures February 4, 2005, is unsecured and is expected to fund the daily cash requirements of the Company's treasury management system. The interest rate on the \$15 million line is equal to the 30-day LIBOR rate plus 100 to 150 basis points, depending upon overall Company leverage (with the current rate set at 132.5 basis points). The interest rate on the \$15 million line was 2.5% at June 30, 2004. The Company paid a facility fee of \$15,000 (10 basis points) upon closing of the loan agreement. Under the \$15 million line, the Company does not pay annual administration fees or fees on the unused portion of the line.

The Company's interest rate hedge contracts as of June 30, 2004 are summarized as follows (in thousands):

Type of Hedge	Notional Amount	Maturity Date	Reference Rate	Fixed Rate	Fair Market Value
Swap	\$60,000	12/31/04	1-Month LIBOR	1.293%	\$166
Reverse Swap	\$ 4,715	07/15/06	1-Month LIBOR + 3.455%	8.080%	135
					<u>\$301</u>

Effective February 24, 2004, the Company entered into a \$60 million interest rate swap agreement effectively locking the LIBOR rate on this portion of outstanding unsecured, floating rate bank debt at 1.293%, which equates to a current interest rate of 2.618%. The agreement matures December 31, 2004. The Company designated the swap as a hedge of the variable interest rates on the Company's borrowings under the \$170 million line. Accordingly, changes in the fair value of the swap are recognized in accumulated other comprehensive income until the hedged item is recognized in earnings.

To protect against the potential for rapidly rising interest rates, the Company entered into two interest rate swap agreements in May 2004. The first interest rate swap agreement is for a \$40 million notional amount and fixed the 30-day LIBOR interest rate at 3.53% for the period January 1, 2005 through June 30, 2006. The second interest rate swap agreement is for a \$20 million notional amount and fixed the 30-day LIBOR interest rate at 3.18% for the period January 1, 2005 through December 31, 2005.

The effect of the reverse swap is to convert a fixed rate mortgage note payable to a variable rate. The Company does not hold or issue these types of derivative contracts for trading or speculative purposes.

At June 30, 2004, the Company had \$326,315,000 of non-recourse fixed rate mortgage notes payable with an average interest rate of 6.2% secured by office properties and \$129,161,000 drawn under bank lines of credit. Parkway's pro rata share of unconsolidated joint venture debt was \$45,590,000 with an average interest rate of 6.4% at June 30, 2004. Based on the Company's total market capitalization of approximately \$1.1 billion at June 30, 2004 (using the June 30, 2004 closing price of \$44.45 per common share), the Company's debt represented approximately 43.2% of its total market capitalization. The Company targets a debt to total market capitalization rate at a percentage in the mid-40's. This rate may vary at times pending acquisitions, sales and/or equity offerings. In addition, volatility in the price of the Company's common stock may affect the debt to total market capitalization ratio. However, over time the Company plans to maintain a percentage in the mid-40's. In addition to this debt ratio, the Company monitors interest and fixed charge coverage ratios. The interest coverage ratio is computed by comparing the cash interest accrued to earnings before interest, taxes, depreciation and amortization. This ratio for the six months ending June 30, 2004 and 2003 was 3.64 and 4.02 times, respectively. The fixed charge coverage ratio is computed by comparing the cash interest accrued, principal payments made on mortgage loans and preferred dividends paid to earnings before interest, taxes, depreciation and amortization. This ratio for the six months ending June 30, 2004 and 2003 was 1.84 and 1.88 times, respectively.

The table below presents the principal payments due and weighted average interest rates for the fixed rate debt.

	<b>Average Interest Rate</b>	<b>Fixed Rate Debt (In thousands)</b>
2004*	6.16%	\$ 6,234
2005	6.14%	13,892
2006	6.09%	19,245
2007	6.06%	33,714
2008	6.40%	97,644
2009	6.62%	29,024
Thereafter	7.42%	126,562
Total		<u>\$326,315</u>
Fair value at 06/30/04		<u>\$334,819</u>

\*Remaining six months

The Company presently has plans to make additional capital improvements at its office properties in 2004 of approximately \$20 million. These expenses include tenant improvements, capitalized acquisition costs and capitalized building improvements. Approximately \$3 million of these improvements relate to upgrades on properties acquired in recent years that were anticipated at the time of purchase. All such improvements are expected to be financed by cash flow from the properties and advances on the bank lines of credit.

During the first quarter of 2004, the Company signed a lease at City Centre in Jackson, Mississippi with Forman Perry Watkins Krutz & Tardy LLP for 145,000 square feet, commencing upon completion of \$3.2 million in improvements to the space primarily in the fourth quarter of 2004. Additionally, Parkway committed to the

development of a \$6.5 million, 500-space parking facility to accommodate the building customers at City Centre. Parkway anticipates utilizing its current cash balance, operating cash flows and borrowings under the working capital line of credit to fund the \$3.2 million in improvements. The construction of the garage will be financed with a construction loan, which will bear interest at a rate equal to the 30-day LIBOR rate plus 125 basis points.

The Company anticipates that its current cash balance, operating cash flows, proceeds from the sale of office properties, proceeds from the sale of portions of owned assets through joint ventures, possible sales of securities and borrowings (including borrowings under the working capital line of credit and the construction loan for the City Centre parking garage) will be adequate to pay the Company's (i) operating and administrative expenses, (ii) debt service obligations, (iii) distributions to shareholders, (iv) capital improvements, and (v) normal repair and maintenance expenses at its properties, both in the short and long term.

### Contractual Obligations

See information appearing under the caption "Financial Condition – Mortgage Notes Payable Without Recourse" in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations for a discussion of changes in long-term debt.

### Funds From Operations

Management believes that funds from operations ("FFO") is an appropriate measure of performance for equity REITs and computes this measure in accordance with the National Association of Real Estate Investment Trusts' ("NAREIT") definition of FFO. FFO as reported by Parkway may not be comparable to FFO reported by other REITs that do not define the term in accordance with the current NAREIT definition. We believe FFO is helpful to investors as a supplemental measure that enhances the comparability of our operations by adjusting net income for items not reflective of our principal and recurring operations. In addition, FFO has widespread acceptance and use within the REIT and analyst communities. Funds from operations is defined by NAREIT as net income (computed in accordance with generally accepted accounting principles "GAAP"), excluding gains or losses from sales of property and extraordinary items under GAAP, plus depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures. Adjustments for unconsolidated partnerships and joint ventures will be calculated to reflect funds from operations on the same basis. We believe that in order to facilitate a clear understanding of our operating results, FFO should be examined in conjunction with the net income as presented in our consolidated financial statements and notes thereto included elsewhere in this Form 10-Q. Funds from operations do not represent cash generated from operating activities in accordance with accounting principles generally accepted in the United States and is not an indication of cash available to fund cash needs. Funds from operations should not be considered an alternative to net income as an indicator of the Company's operating performance or as an alternative to cash flow as a measure of liquidity.

The following table presents a reconciliation of the Company's net income to FFO for the three months and six months ended June 30, 2004 and 2003 (in thousands):

	<b>Three Months Ended June 30</b>		<b>Six Months Ended June 30</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
Net income	\$ 7,225	\$13,209	\$13,955	\$22,322
Adjustments to derive funds from operations:				
Depreciation and amortization	8,290	6,598	15,919	13,952
Minority interest depreciation and amortization	(164)	-	(326)	-
Adjustments for unconsolidated joint ventures	565	529	1,108	938
Preferred dividends	(1,467)	(1,503)	(2,667)	(2,952)
Convertible preferred dividends	(1,363)	(1,564)	(2,772)	(3,128)
Original issue costs – redemption of preferred stock	-	(2,619)	-	(2,619)
Gain on sale of joint venture interests	-	(4,183)	-	(5,279)
Amortization of deferred gains and other	-	(1)	1	(3)
Funds from operations applicable to common Shareholders	<u>\$13,086</u>	<u>\$10,466</u>	<u>\$25,218</u>	<u>\$23,231</u>



## **Inflation**

In the last five years, inflation has not had a significant impact on the Company because of the relatively low inflation rate in the Company's geographic areas of operation. Most of the leases require the tenants to pay their pro rata share of operating expenses, including common area maintenance, real estate taxes and insurance, thereby reducing the Company's exposure to increases in operating expenses resulting from inflation. In addition, the Company's leases typically have three to seven-year terms, which may enable the Company to replace existing leases with new leases at market base rent, which may be higher or lower than the existing lease rate.

## **Forward-Looking Statements**

In addition to historical information, certain sections of this Form 10-Q may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, such as those that are not in the present or past tense, that discuss the Company's beliefs, expectations or intentions or those pertaining to the Company's capital resources, profitability and portfolio performance and estimates of market rental rates. Forward-looking statements involve numerous risks and uncertainties. The following factors, among others discussed herein and in the Company's filings under the Securities Exchange Act of 1934, could cause actual results and future events to differ materially from those set forth or contemplated in the forward-looking statements: defaults or non-renewal of leases, increased interest rates and operating costs, failure to obtain necessary outside financing, difficulties in identifying properties to acquire and in effecting acquisitions, failure to qualify as a real estate investment trust under the Internal Revenue Code of 1986, as amended, environmental uncertainties, risks related to natural disasters, financial market fluctuations, changes in real estate and zoning laws and increases in real property tax rates. The success of the Company also depends upon the trends of the economy, including interest rates, income tax laws, governmental regulation, legislation, population changes and those risk factors discussed elsewhere in this Form 10-Q and in the Company's filings under the Securities Exchange Act of 1934. Readers are cautioned not to place undue reliance on forward-looking statements, which reflect management's analysis only as the date hereof. The Company assumes no obligation to update forward-looking statements.

## **Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

See information appearing under the caption "Liquidity" in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations.

## **Item 4. Controls and Procedures**

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that as of the end of the Company's most recent fiscal quarter, the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic SEC filings.

In addition, the Company reviewed its internal controls, and there have been no significant changes in the Company's internal controls or in other factors that could significantly affect those controls subsequent to the date of their last evaluation.

## PART II. OTHER INFORMATION

### Item 4. Submission of Matters to a Vote of Security Holders

On May 6, 2004, the Company held its Annual Meeting of Stockholders. At the Annual Meeting, the following nine directors were elected to serve until the next Annual Meeting.

	<u>SHARES OF COMMON STOCK</u>		<u>SHARES OF SERIES B PREFERRED STOCK</u>	
	<u>FOR</u>	<u>WITHHOLD AUTHORITY</u>	<u>FOR</u>	<u>WITHHOLD AUTHORITY</u>
Daniel P. Friedman	10,029,723	68,313	1,892,857	-
Roger P. Friou	9,440,961	657,074	1,892,857	-
Martin L. Garcia	10,029,384	68,652	1,892,857	-
Matthew W. Kaplan	9,440,922	657,113	1,892,857	-
Michael J. Lipsey	9,829,441	268,595	1,892,857	-
Joe F. Lynch	10,027,814	70,221	1,892,857	-
Steven G. Rogers	10,026,041	71,995	1,892,857	-
Leland R. Speed	10,024,532	73,503	1,892,857	-
Lenore M. Sullivan	9,979,779	118,256	1,892,857	-

In addition, the following item was also approved at the May 6, 2004 meeting.

Approval for the proposal to adopt the Company's 2001 Non-Employee Directors Equity Compensation Plan, as amended.

	<u>SHARES OF COMMON STOCK</u>	<u>SHARES OF SERIES B PREFERRED STOCK</u>
FOR	8,245,837	1,892,857
AGAINST	427,773	-
ABSTAIN	59,181	-

### Item 6. Exhibits and Reports on Form 8-K

10.1 The Parkway Properties, Inc. 2001 Non-employee Directors Equity Compensation Plan, as amended (incorporated by reference to Appendix A to the Company's Proxy Material for its May 6, 2004 Annual Meeting).

- (a) 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

#### (b) Reports on Form 8-K

- (1) 8-K Furnished – May 3, 2004  
Press release of the Company dated May 3, 2004, announcing the results of operations of the Company for the quarter ended March 31, 2004.
- (2) 8-K Filed – June 14, 2004  
Reporting the purchase of Carmel Crossing in Charlotte, North Carolina and Capital City Plaza in Atlanta, Georgia.

## **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 thereunto duly authorized.

DATE: August 4, 2004

**PARKWAY PROPERTIES, INC.**

BY: /s/ Mandy M. Pope  
Mandy M. Pope, CPA  
Senior Vice President and  
Chief Accounting Officer