

MONARCH CEMENT CO  
Form 10-Q  
November 10, 2008

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

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.  
For the quarterly period ended **September 30, 2008**, 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: **0-2757**

THE MONARCH CEMENT COMPANY

(Exact name of registrant as specified in its charter)

**KANSAS**

(state or other jurisdiction of incorporation or organization)

**48-0340590**

(IRS employer identification no.)

**P.O. BOX 1000, HUMBOLDT, KANSAS**

(address of principal executive offices)

**66748-0900**

(zip code)

Registrant's telephone number, including area code: **(620) 473-2222**

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES  NO

As of **October 28, 2008**, there were 2,521,168 shares of Capital Stock, par value \$2.50 per share outstanding and 1,505,790 shares of Class B Capital Stock, par value \$2.50 per share outstanding.

PART I - FINANCIAL INFORMATION

The condensed consolidated financial statements included in this report have been prepared by our Company without audit. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. Our Company believes that the disclosures are adequate to make the information presented not misleading. The accompanying consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of the results of operations for the interim periods presented. Those adjustments consist only of normal, recurring adjustments. The condensed consolidated balance sheet of the Company as of December 31, 2007 has been derived from the audited consolidated balance sheet of the Company as of that date. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Company's most recent annual report on Form 10 K for 2007 filed with the Securities and Exchange

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Commission. The results of operations for the period are not necessarily indicative of the results to be expected for the full year.

### Item 1. Financial Statements

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THE MONARCH CEMENT COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

September 30, 2008 and December 31, 2007

ASSETS	2 0 0 8	2 0 0 7
CURRENT ASSETS:	(Unaudited)	
Cash and cash equivalents	\$ 2,982,435	\$ 4,404,116
Receivables, less allowances of \$715,000 in 2008 and \$640,000 in 2007 for doubtful accounts	22,306,938	13,531,221
Inventories, priced at cost which is not in excess of market-		
Finished cement	\$ 2,969,671	\$ 6,110,974
Work in process	158,597	2,569,641
Building products	5,076,604	4,518,379
Fuel, gypsum, paper sacks and other	6,521,199	4,606,447
Operating and maintenance supplies	10,760,327	9,759,949
Total inventories	\$ 25,486,398	\$ 27,565,390
Deferred income taxes	635,000	635,000
Prepaid expenses	591,867	248,380
Total current assets	\$ 52,002,638	\$ 46,384,107
PROPERTY, PLANT AND EQUIPMENT, at cost, less accumulated depreciation and depletion of \$148,471,281 in 2008 and \$140,661,628 in 2007	92,606,509	93,301,169
DEFERRED INCOME TAXES	15,241,534	13,155,534
INVESTMENTS, \$2,119,175 in 2008 and \$2,060,850 in 2007 carried at cost with the balance at fair market value	13,288,338	13,468,319
OTHER ASSETS	1,413,015	1,179,116
	\$ 174,552,034	\$ 167,488,245
LIABILITIES AND STOCKHOLDERS' INVESTMENT		
CURRENT LIABILITIES:		
Accounts payable	\$ 10,319,420	\$ 6,413,945
Current portion of advancing term loan	2,169,256	2,181,524
Accrued liabilities	7,640,234	6,749,711
Total current liabilities	\$ 20,128,910	\$ 15,345,180
LONG-TERM DEBT	16,262,361	18,024,478
ACCRUED POSTRETIREMENT BENEFITS	28,380,726	27,206,515
ACCRUED PENSION EXPENSE	5,427,816	5,848,510
MINORITY INTEREST IN CONSOLIDATED SUBSIDIARIES	708,864	709,038
STOCKHOLDERS' INVESTMENT:		
Capital stock, par value \$2.50 per share, one vote per share -		

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Authorized 10,000,000 shares, Issued 2,521,168 shares at 9/30/2008 and 2,510,708 shares at 12/31/2007	\$ 6,302,920	\$ 6,276,770
Class B capital stock, par value \$2.50 per share, supervoting rights of ten votes per share, restricted transferability, convertible at all times into Capital Stock on a share-for- share basis - Authorized 10,000,000 shares, Issued 1,505,790 shares at 9/30/2008 and 1,516,250 shares at 12/31/2007	3,764,475	3,790,625
Retained earnings	104,843,460	98,488,627
Accumulated other comprehensive loss	(11,267,498)	(8,201,498)
Total stockholders' investment	\$ 103,643,357	\$ 100,354,524
	\$ 174,552,034	\$ 167,488,245

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See notes to condensed consolidated financial statements

### THE MONARCH CEMENT COMPANY AND SUBSIDIARIES

#### CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS

For the Three Months and Nine Months Ended September 30, 2008 and 2007 (Unaudited)

	For the Three Months Ended		For the Nine Months Ended	
	Sept. 30, 2008	Sept. 30, 2007	Sept. 30, 2008	Sept. 30, 2007
NET SALES	\$ 48,876,781	\$ 44,404,159	\$116,962,489	\$108,707,478
COST OF SALES	36,074,978	32,797,073	93,876,580	84,032,598
Gross profit from operations	\$ 12,801,803	\$ 11,607,086	\$ 23,085,909	\$ 24,674,880
SELLING, GENERAL AND				
ADMINISTRATIVE EXPENSES	3,973,522	3,628,773	11,867,519	11,020,204
Income from operations	\$ 8,828,281	\$ 7,978,313	\$ 11,218,390	\$ 13,654,676
OTHER INCOME (EXPENSE):				
Interest income	\$ 53,413	\$ 57,401	\$ 191,149	\$ 193,454
Interest expense	(236,550)	(455,529)	(771,220)	(1,479,791)
Gains on equity investments	-	297,012	-	2,410,698
Dividend income	75,869	54,746	177,382	141,520
Other, net	153,925	2,472	591,533	686,544
	\$ 46,657	\$ (43,898)	\$ 188,844	\$ 1,952,425
Income before taxes on income	\$ 8,874,938	\$ 7,934,415	\$ 11,407,234	\$ 15,607,101
PROVISION FOR INCOME TAXES	2,470,000	2,450,000	3,200,000	4,850,000
NET INCOME	\$ 6,404,938	\$ 5,484,415	\$ 8,207,234	\$ 10,757,101
RETAINED EARNINGS, beg. of period	99,364,723	91,184,698	98,488,627	86,797,943
Less cash dividends	926,201	885,931	1,852,401	1,771,862
RETAINED EARNINGS, end of period	\$ 104,843,460	\$ 95,783,182	\$104,843,460	\$ 95,783,182
Basic earnings per share	\$ 1.59	\$ 1.36	\$ 2.04	\$ 2.67
Cash dividends per share	\$ 0.23	\$ 0.22	\$ 0.46	\$ 0.44

#### CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the Three Months and Nine Months Ended September 30, 2008 and 2007 (Unaudited)

	For the Three Months Ended		For the Nine Months Ended	
	Sept. 30, 2008	Sept. 30, 2007	Sept. 30, 2008	Sept. 30, 2007
NET INCOME	\$ 6,404,938	\$ 5,484,415	\$ 8,207,234	\$ 10,757,101

#### UNREALIZED APPRECIATION (DEPRECIATION)

ON AVAILABLE FOR SALE SECURITIES (Net

of deferred tax expense (benefit) of \$(524,000), (\$804,000),

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\$(2,044,000), and \$48,000, respectively)	(786,000)	(1,208,988)	(3,066,000)	72,698
<b>LESS: RECLASSIFICATION ADJUSTMENT FOR</b>				
<b>REALIZED GAINS INCLUDED IN</b>				
<b>NET INCOME</b> (net of deferred tax expense				
of \$-0-, \$120,000, \$-0-,and \$964,000, respectively)	-	177,012	-	1,446,698
<b>COMPREHENSIVE INCOME</b>	<b>\$ 5,618,938</b>	<b>\$ 4,098,415</b>	<b>\$ 5,141,234</b>	<b>\$ 9,383,101</b>

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See notes to condensed consolidated financial statements

THE MONARCH CEMENT COMPANY AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Nine Months Ended September 30, 2008 and 2007 (Unaudited)

	2008	2007
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 8,207,234	\$ 10,757,101
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion and amortization	8,830,955	8,791,339
Minority interest in losses of subsidiaries	(174)	(124,511)
Deferred income taxes	(42,000)	(442)
Gain on disposal of assets	(216,899)	(468,784)
Realized gain on sale of equity investments	-	(2,410,698)
Change in assets and liabilities:		
Receivables, net	(8,775,717)	(4,616,376)
Inventories	2,305,770	(4,429,252)
Refundable income taxes	-	739,574
Prepaid expenses	(343,487)	(340,197)
Other assets	105,413	15,992
Accounts payable and accrued liabilities	7,069,265	3,256,719
Accrued postretirement benefits	1,174,211	1,262,173
Accrued pension expense	(420,694)	(128,517)
Net cash provided by operating activities	\$ 17,893,877	\$ 12,304,121
<b>INVESTING ACTIVITIES:</b>		
Acquisition of property, plant and equipment	\$ (6,899,507)	\$ (5,955,849)
Proceeds from disposals of property, plant and equipment	232,550	528,134
Payment for acquisition of business	(2,319,934)	-
Payment for purchases of equity investments	(4,930,019)	(2,641,074)
Proceeds from disposals of equity investments	-	3,448,365
Purchases of subsidiaries' stock	-	(189,741)
Net cash used for investing activities	\$ (13,916,910)	\$ (4,810,165)
<b>FINANCING ACTIVITIES:</b>		
Decrease in line of credit, net	\$ -	\$ (2,542,439)
Payments on bank loans	(1,532,394)	(1,509,387)
Payments on other long-term debt	(241,991)	(164,349)
Cash dividends paid	(3,624,263)	(3,463,184)
Net cash used for financing activities	\$ (5,398,648)	\$ (7,679,359)
Net decrease in cash and cash equivalents	\$ (1,421,681)	\$ (185,403)
Cash and Cash Equivalents, beginning of period	4,404,116	2,410,623
Cash and Cash Equivalents, end of period	\$ 2,982,435	\$ 2,225,220
Interest paid, net of amount capitalized	\$ 788,714	\$ 1,496,680

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Income taxes paid, net of refunds	\$ 1,790,000	\$ 2,991,280
Capital equipment additions included in accounts payable	\$ 44,680	\$ 707,736



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See notes to condensed consolidated financial statements

THE MONARCH CEMENT COMPANY AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2008 and 2007 (Unaudited), and December 31, 2007

1. For a summary of accounting policies, the reader should refer to Note 1 of the consolidated financial statements included in our Company's most recent annual report on Form 10 K.
2. For the nine months ended September 30, 2008, we incurred a temporary LIFO liquidation gain due to reductions in finished cement and work in process inventory of \$.8 million which we expect to be restored by the end of the year. The temporary LIFO liquidation gain has been deferred as a component of accrued liabilities. We did not have any temporary LIFO liquidation gains during the nine months ended September 30, 2007. For the three months ended September 30, 2008, we incurred a temporary LIFO liquidation gain due to reductions in finished cement and work in process inventory of \$.8 million which we expect to be restored by the end of the year. We did not have any temporary LIFO liquidation gains during the three months ended September 30, 2007.

During the nine months ended September 30, 2008 we incurred a permanent reduction in the LIFO layers of work in process and cement inventories in the amount of \$.7 million. The \$.7 million liquidation gain was recognized as a reduction of cost of sales. We did not recognize any LIFO liquidation gains during the nine months ended September 30, 2007. We did not incur any permanent reductions in the LIFO layers during the three months ended September 30, 2008 or September 30, 2007.

3. Basic earnings per share of capital stock has been calculated based on the weighted average shares outstanding during each of the reporting periods. The weighted average number of shares outstanding was 4,026,958 in the third quarter of 2008 and 2007 and in the first nine months of 2008 and 2007. The Company has no common stock equivalents and therefore, does not report diluted earnings per share.
4. Our Company groups its operations into two lines of business - Cement Business and Ready-Mixed Concrete Business. The "Cement Business" refers to our manufacture and sale of cement and "Ready-Mixed Concrete Business" refers to our ready-mixed concrete, concrete products, precast concrete construction, and sundry building materials business. Corporate assets for 2008 and 2007 include cash and cash equivalents, deferred income taxes, investments and other assets. Following is information for each line for the periods indicated:

	Cement Business	Ready-Mixed Concrete Business	Adjustments and Eliminations	Consolidated
<b>For the Three Months Ended 9/30/08</b>				
Sales to unaffiliated customers	\$ 23,898,613	\$ 24,978,168	\$	\$ 48,876,781
Intersegment sales	4,788,475	1,079	(4,789,554)	
Total net sales	\$ 28,687,088	\$ 24,979,247	\$ (4,789,554)	\$ 48,876,781
Income from operations	\$ 8,220,387	\$ 607,894		\$ 8,828,281
Other income, net				46,657
Income before income taxes				\$ 8,874,938
Capital Expenditures	\$ 1,201,958	\$ 827,443		\$ 2,029,401
<b>For the Three Months Ended 9/30/07</b>				
Sales to unaffiliated customers	\$ 20,650,604	\$ 23,753,555	\$	\$ 44,404,159
Intersegment sales	4,364,836	-	(4,364,836)	-
Total net sales	\$ 25,015,440	\$ 23,753,555	\$ (4,364,836)	\$ 44,404,159

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Income from operations	\$ 7,090,156	\$ 888,157	\$ 7,978,313
Other income (expense), net			(43,898)
Income before income taxes			\$ 7,934,415
Capital Expenditures	\$ 2,025,171	\$ 488,584	\$ 2,513,755

	Cement Business	Ready-Mixed Concrete Business	Adjustments and Eliminations	Consolidated
<b>For the Nine Months Ended 9/30/08</b>				
Sales to unaffiliated customers	\$ 53,060,536	\$ 63,901,953	\$	\$ 116,962,489
Intersegment sales	12,006,567	1,079	(12,007,646)	
Total net sales	\$ 65,067,103	\$ 63,903,032	\$ (12,007,646)	\$ 116,962,489
Income (loss) from operations	\$ 11,539,045	\$ (320,655)		\$ 11,218,390
Other income, net				188,844
Income before income taxes				\$ 11,407,234
Capital Expenditures	\$ 2,192,725	\$ 5,743,533		\$ 7,936,258

	Cement Business	Ready-Mixed Concrete Business	Adjustments and Eliminations	Consolidated
<b>For the Nine Months Ended 9/30/07</b>				
Sales to unaffiliated customers	\$ 50,676,721	\$ 58,030,757	\$	\$ 108,707,478
Intersegment sales	10,606,279	-	(10,606,279)	-
Total net sales	\$ 61,283,000	\$ 58,030,757	\$ (10,606,279)	\$ 108,707,478
Income from operations	\$ 13,651,260	\$ 3,416		\$ 13,654,676
Other income, net				1,952,425
Income before income taxes				\$ 15,607,101
Capital Expenditures	\$ 4,802,868	\$ 1,699,189		\$ 6,502,057

	Cement Business	Ready-Mixed Concrete Business	Consolidated
<b>Balance as of 9/30/08</b>			
Identifiable Assets	\$ 96,894,209	\$ 44,097,503	\$ 140,991,712
Corporate Assets			33,560,322
			\$ 174,552,034
<b>Balance as of 12/31/07</b>			
Identifiable Assets	\$ 98,071,562	\$ 36,574,598	\$ 134,646,160
Corporate Assets			32,842,085
			\$ 167,488,245

4. The following table presents the components of net periodic pension and postretirement benefit costs allocated to Cost of Sales and Selling, General and Administrative expenses for the nine months ended September 30, 2008 and 2007:

	Pension Benefits		Other Benefits	
	2008	2007	2008	2007
Service cost	\$ 589,949	\$ 319,371	\$ 367,193	\$ 391,857
Interest cost	1,831,407	994,064	1,134,506	1,233,191
Expected return on plan assets	(2,143,163)	(1,100,509)	-	-

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Amortization of prior service cost	77,786	43,604	-	-
Recognized net actuarial gain	130,938	133,357	-	-
Unrecognized net loss	-	-	723,942	617,121
Net periodic expense	\$ 486,917	\$ 389,887	\$ 2,225,641	\$ 2,242,169

The following table presents the components of net periodic costs for the three months ended September 30, 2008 and 2007:

	<u>Pension Benefits</u>		<u>Other Benefits</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
Service cost	\$ 248,352	\$ 108,637	\$ 109,560	\$ 130,469
Interest cost	770,969	338,139	338,506	410,591
Expected return on plan assets	(902,210)	(374,347)	-	-
Amortization of prior service cost	32,746	14,832	-	-
Recognized net actuarial gain	55,121	45,362	-	-
Unrecognized net loss	-	-	216,004	205,470
Net periodic expense	\$ 204,978	\$ 132,623	\$ 664,070	\$ 746,530

Monarch expects to contribute approximately \$1,490,000 to the pension fund in 2008. As of September 30, 2008, we have contributed about \$920,000 in 2008 and anticipate contributing an additional \$570,000 to this plan in 2008 for a total of \$1,490,000. The other benefits consist of postretirement benefits that are self-insured by Monarch and are paid out of Monarch's general assets. As previously disclosed in our financial statements for the year ended December 31, 2007, Monarch expects to contribute approximately \$1,650,000 to this plan in 2008. As of September 30, 2008, we have contributed about \$1,050,000 in 2008 and anticipate contributing an additional \$600,000 to this plan in 2008 for a total of \$1,650,000.

5. A Monarch subsidiary, Monarch and three of its officers are involved in a lawsuit with the former officers of that subsidiary and companies formed by those officers. All claims against Monarch, its subsidiary and officers have been dismissed by the court; on the counterclaims asserted by Monarch and the subsidiary, summary judgment on liability has been granted against the former officers. For additional information on this matter, see Item 1, Part II of this report on Form 10-Q.
6. The Company or one of its subsidiaries files income tax returns in the U.S. Federal jurisdiction and various state jurisdictions. With few exceptions, the Company is no longer subject to U.S. Federal or state income tax examinations by tax authorities for years before 2004.
7. As of September 30, 2008, the amount of accounts payable related to property, plant and equipment was \$44,680 compared to December 31, 2007 which was \$546,085.
8. The Company adopted the provisions of the Financial Accounting Standards Board (FASB) SFAS No. 157, "Fair Value Measurements". SFAS No. 157 establishes a single definition of fair value and a framework for measuring fair value, sets out a fair value hierarchy to be used to classify the source of information used in fair value measurements and requires new disclosures of assets and liabilities measured at fair value based on their level in the hierarchy. The standard describes three levels of inputs that may be used to measure fair value. Level 1 uses quoted prices in active markets for identical assets or liabilities. Level 2 uses observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in active markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 3 uses unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. SFAS No. 157 is effective on a prospective basis for all fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. In February 2008, the FASB issued Staff Positions (FSP) No. 157-1 and No. 157-2 which partially defer the effective date of SFAS No. 157 for one year for certain nonfinancial assets and liabilities and remove certain leasing transactions from its scope. The Company is evaluating the impact, if any, the adoption of these FSPs will have on the Company's consolidated financial statements.

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The following table summarizes the bases used to measure certain assets at fair value on a recurring basis in the balance sheet:

Fair Value Measurements at Reporting Date Using:

	Balance at 09/30/08	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Available-for-sale securities	\$ 11,169,163	\$ 11,169,163	\$ -	\$ -
Total	\$ 11,169,163	\$ 11,169,163	\$ -	\$ -

	Balance at 12/31/07	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Available-for-sale securities	\$ 11,407,469	\$ 11,407,469	\$ -	\$ -
Total	\$ 11,407,469	\$ 11,407,469	\$ -	\$ -

The Company has no liabilities in either year requiring remeasurement to fair value on a recurring basis in the balance sheet. The Company also has no assets or liabilities in either year requiring remeasurement to fair value on a non-recurring basis in the balance sheet.

9. Other, net contains miscellaneous nonoperating income (expense) items other than interest income, interest expense, gains on equity investments and dividend income. Material items in other, net included income from oil properties of \$379,714 and income from scrap sales of \$167,225 for the first nine months of 2008. Material items in other, net for the first nine months of 2007 included income from oil properties of \$293,116. For the three months ending September 30, 2008 and September 30, 2007, the material items in other, net included income from oil properties of \$172,342, and \$118,795, respectively.

THE MONARCH CEMENT COMPANY AND SUBSIDIARIES

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**FORWARD-LOOKING STATEMENTS**

Certain statements under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations," and elsewhere in this Form 10-Q report filed with the Securities and Exchange Commission, constitute "forward-looking statements". Except for historical information, the statements made in this report are forward-looking statements that involve risks and uncertainties. You can identify these statements by forward-looking words such as "should", "expect", "anticipate", "believe", "intend", "may", "hope", "forecast" or similar words. In particular, statements with respect to variations in future demand for our products in our market area or the future activity of federal and state highway programs and other major construction projects, the timing, scope, cost and benefits of our proposed and recently completed capital improvements and expansion plans, including the resulting increase in production capacity, our forecasted cement sales, the timing and source of funds for the repayment of our revolving line of credit, our ability to pay dividends at the current level, our anticipated expenditures for benefit plans, and our anticipated increase in solid fuels and electricity required to operate our facilities and equipment are all forward-looking statements. You should be aware that forward-looking statements involve known and unknown risks, uncertainties, and other factors that may affect the actual results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others:

- general economic and business conditions;
- competition;
- raw material and other operating costs;
- costs of capital equipment;
- changes in business strategy or expansion plans;
- demand for our Company's products;
- cyclical and seasonal nature of our business;
- the effect weather has on our business;
- the effect of environmental and other government regulation; and
- the effect of federal and state funding on demand for our products.

**RESULTS OF OPERATIONS - CRITICAL ACCOUNTING POLICIES**

Reference is made to the Management's Discussion and Analysis of Financial Condition and Results of Operations - Accounting Policies incorporated herein by reference to Item 7 of the Company's Annual Report on Form 10-K for the year ended December 31, 2007 for accounting policies which are considered by management to be critical to an understanding of the Company's financial statements.

**RESULTS OF OPERATIONS - OVERVIEW**

Our products are used in residential, commercial and governmental construction. In recent years, the Company has spent substantial sums on major plant modifications designed to increase our cement production capacity to meet our customers' needs and to improve our production processes. Improvements are planned over the next few years to further improve our production processes, particularly in the handling and processing of raw materials.

Based on sales forecasts and inventory levels at the beginning of 2008, the Company elected to reduce cement production in the first quarter of 2008 and use that opportunity to undertake major plant repairs and maintenance, largely using our own production personnel. In addition to this planned maintenance project, we have shut down one kiln from time to time in order to coordinate production levels with projected sales. Initially these shutdowns

adversely impacted our gross profits since the ongoing costs of the cement plant, such as depreciation, supplies and labor, were allocated to fewer units produced and expensed rather than added to inventory. Over time, these shutdowns combined with improved sales volumes reduced inventory to the point of liquidating LIFO layers at historical costs that were lower than our current production costs which favorably impacted gross profits (see Footnote 2). The Company expects interim temporary reductions in LIFO layers to be replenished by year end.

Residential construction has slowed throughout our market area and generally throughout the United States. This downturn has been offset somewhat by strong commercial and institutional construction. A reduction in cement sales, and accordingly ready-mix concrete sales, was projected by the Portland Cement Association, but the decrease is more severe in other areas of the country than in most of our market. Within our market area the most severe downward impact has been felt in northwest Arkansas where, due to overbuilding and the tightening of the credit markets, volume has declined substantially. These decreases were partially offset by increased volume in more rural areas, such as western Kansas, where we have benefited from improved farm and oil prices. Sales of building materials, such as block, brick, retaining wall block and pavers, have also increased due primarily to their use in commercial and institutional construction projects. In addition, cement sales benefited from an increase in sales to paving contractors.

#### **RESULTS OF OPERATIONS - THIRD QUARTER OF 2008 COMPARED TO THIRD QUARTER OF 2007**

Consolidated net sales for the three months ended September 30, 2008 increased by \$4.5 million when compared to the three months ended September 30, 2007. Sales in our Cement Business were higher by \$3.3 million and sales in our Ready-Mixed Concrete Business were higher by \$1.2 million. Cement Business sales increased \$3.3 million due to a 16.0% increase in volume sold. Ready-Mixed Concrete Business sales increased \$1.4 million due to price increases which were offset by volume decreases of \$1.2 million in ready-mix concrete sales. Other sundry building materials sales increased by \$2.3 million while construction contract sales declined by \$1.3 million for the three months ended September 30, 2008 compared to the three months ended September 30, 2007.

Consolidated cost of sales for the three months ended September 30, 2008 increased by \$3.3 million when compared to the three months ended September 30, 2007. Cost of sales in our Cement Business was higher by \$1.9 million and cost of sales in our Ready-Mixed Concrete Business was higher by \$1.4 million. Cement Business cost of sales increased \$1.9 million due to the increase in volume sold. Ready-Mixed Concrete Business cost of sales increased \$.8 million and \$.5 million due to material cost increases and increased delivery costs, respectively, for the three months ended September 30, 2008 over the three months ended September 30, 2007. The remaining \$.1 million increase is the net result of increased sales volume of other sundry building materials offset by reductions in construction contract sales.

As a result of the above sales and cost of sales factors, our overall gross profit rate for the three months ended September 30, 2008 was 26.2% versus 26.1% for the three months ended September 30, 2007.

Selling, general, and administrative expenses increased by 9.5% for the three months ended September 30, 2008 compared to the same period of 2007. These costs are normally considered fixed costs that do not vary significantly with changes in volume. This increase is mainly due to an increase in personnel, primarily in the sales departments of our Ready-Mixed Concrete Business, and the costs related to their activities.

For the three months ended September 30, 2008, there were no gains realized on equity investment sales as compared to the same period in 2007 when the Company realized a gain of approximately \$.3 million.

Interest expense decreased about \$.2 million for the three months ended September 30, 2008 as compared to the three months ended September 30, 2007 due to a decrease in interest rates and a decrease in borrowings. The Company utilized these loans for increases in receivables, capital improvements, increases in purchases of equity investments, and temporary operating funds.

The effective tax rates for the three months ended September 30, 2008 and 2007 were 27.9% and 30.9%, respectively. The Company's effective tax rate differs from the federal and state statutory income tax rate primarily due to the effects of percentage depletion, Federal domestic production activities deduction, minority interest in consolidated income and valuation allowance. Taxes for the current year are estimated based on prior year effective tax rates.

**RESULTS OF OPERATIONS - FIRST NINE MONTHS OF 2008 COMPARED TO THE FIRST NINE MONTHS OF 2007**

Consolidated net sales for the nine months ended September 30, 2008, increased by \$8.3 million when compared to the nine months ended September 30, 2007. Sales in our Cement Business were higher by \$2.4 million and sales in our Ready-Mixed Concrete Business were higher by \$5.9 million. Cement Business sales increased \$1.7 million due to a 3.3% increase in volume sold and increased \$.7 million due to price increases. The Ready-Mixed Concrete Business sales increased by \$3.6 million due to price increases in the price per cubic yard of ready-mixed concrete which was offset \$1.2 million due to a 3.0% decrease in the volume of cubic yards of ready-mixed concrete sold. The remaining \$3.5 million increase is primarily due to an increase in sales of other items such as brick, block, and other sundry building materials.

Consolidated cost of sales for the nine months ended September 30, 2008, increased by \$9.8 million when compared to the nine months ended September 30, 2007. Cost of sales in our Cement Business was higher by \$4.3 million and cost of sales in our Ready-Mixed Concrete Business was higher by \$5.5 million. Cement Business cost of sales increased primarily due to the reduction in volume produced during the first quarter as discussed in "Overview" above offset \$.7 million due to the permanent reduction in LIFO layers discussed in Footnote 2. Tons of cement produced in the first nine months of 2008 declined by 8.1%, as compared to the first nine months of 2007. Ready-Mixed Concrete Business cost of sales decreased \$.7 million due to a 3.0% decline in ready-mixed concrete cubic yards sold. However, cost of sales as a whole increased due to the \$2.7 million increase in direct material costs in ready-mixed concrete, the \$1.3 million increase in delivery costs, with the remaining increase primarily due to the increased sales volume for brick, block, and other sundry building materials.

As a result of the above sales and cost of sales factors, our overall gross profit rate for the nine months ended September 30, 2008 was 19.7% versus 22.7% for the nine months ended September 30, 2007. The decline was primarily due to the Cement Business which dropped from 37.7% gross profit in the first nine months ended September 30, 2007 to 32.3% for the first nine months ended September 30, 2008.

Selling, general, and administrative expenses increased by 7.7% during the first nine months of 2008 compared to the first nine months of 2007. These costs are normally considered fixed costs that do not vary significantly with changes in volume. This increase is partially due to an increase in sales staff in our Ready-Mixed Concrete Business and the costs related to their activities. In addition, fringe benefit costs increased due to increased health insurance costs while legal fees related to litigation declined. For additional information on legal proceedings, see Item 1, Part II of this report on Form 10-Q.

For the first nine months of 2008, there were no gains realized on equity investment sales as compared to the same period in 2007 when the Company realized a gain of approximately \$2.4 million.

Interest expense decreased about \$.7 million for the first nine months of 2008 as compared to the first nine months of 2007 due to a decrease in interest rates and a decrease in borrowings. The Company utilized these loans for increases in receivables, capital improvements, increases in purchases of equity investments, and temporary operating funds.

The effective tax rates for the nine months ended September 30, 2008 and 2007 were 28.1% and 31.1%, respectively. The Company's effective tax rate differs from the federal and state statutory income tax rate primarily due to the effects of percentage depletion, Federal domestic production activities deduction, minority interest in

consolidated income and valuation allowance. Taxes for the current year are estimated based on prior year effective tax rates.

## LIQUIDITY

We are able to meet our cash needs primarily from a combination of operations and bank loans.

Net cash provided by operating activities totaled \$17.9 million and \$12.3 million for the nine months ended September 30, 2008 and September 30, 2007, respectively. This was an increase in cash provided of \$5.6 million for 2008 over the same period in 2007. Net income decreased by \$2.5 million from 2007 to 2008 mainly due to the decline in the gross profit margin that resulted primarily from the reduction in volume produced as discussed under "Overview" above and the \$2.4 million decrease in realized gains on the sale of equity investments. Accounts receivables consumed \$8.8 and \$4.6 million of cash in the first nine months of 2008 and 2007, respectively, primarily as a result of increased sales in September as compared to December. Refundable federal and state income taxes receivable decreased during the first nine months of 2007 by \$.7 million to provide cash while no change occurred for the same period of 2008. Inventories used less cash in 2008 than 2007 as a result of the decision to reduce production as described under "Overview" above in conjunction with increased sales volume for our cement segment. As a result of the reduction, finished cement inventory decreased \$3.1 million during the first nine months of 2008 and work-in-process decreased \$2.4 million while finished cement increased \$2.3 million and work-in-process decreased \$.2 million during the first nine months of 2007. Less cash was used in the first nine months of 2008 than 2007 due primarily to the \$3.4 million increase in payables excluding property, plant and equipment acquisitions, a \$1.4 million increase in federal and state income tax liability, a \$.7 million increase in miscellaneous tax liability and a \$.6 million increase in accrued liabilities primarily due to the temporary LIFO liquidation (discussed in Footnote 2) during the first nine months of 2008 as compared to a \$1.7 million increase in payables excluding property, plant and equipment acquisitions and a \$1.1 million increase in federal and state income tax liability for 2007.

Net cash used for investing activities totaled \$13.9 million and \$4.8 million for the first nine months of 2008 and 2007, respectively. The \$9.1 million increase in net cash used for investing activities during the first nine months of 2008 as compared to the same period in 2007 is principally due to the increase in purchases of equity investments and the acquisition of a business while there was a \$3.4 million decrease in proceeds from disposals of equity investments. Payments for purchases of equity investments totaled \$4.9 million and \$2.6 million in 2008 and 2007, respectively. Proceeds from disposals totaled \$3.4 million in 2007 while no investments were disposed of in 2008. Payments for the acquisition of a business consisted of \$.2 million of inventory, \$.6 million of other assets, and \$1.5 million of property, plant and equipment in 2008. There were no business acquisitions in 2007.

Net cash used for financing activities totaled \$5.4 million and \$7.7 million for the first nine months ending September 30, 2008 and September 30, 2007, respectively. The difference is primarily due to the \$2.5 million reduction in the revolving line of credit in 2007. The line of credit was used to cover increases in receivables and equity investments, plus approximately \$8.4 million and \$6.0 million for cash expenditures on property, plant and equipment in 2008 and 2007, respectively.

In December 2007, we renewed and modified our revolving line of credit with our current lender. Our current credit facilities consist of an unsecured \$25 million advancing term loan maturing December 31, 2009 and a \$15 million revolving line of credit maturing December 31, 2008. The term loan bears a floating interest rate based on JP Morgan Chase prime rate less .75% and the revolving line of credit bears a floating interest rate based on lender's national prime rate less 1.25% for 2008. The loan agreement contains a financial covenant related to net worth which the Company was in compliance with at the end of the third quarter of 2008. The bank has agreed to extend the term loan maturity to December 31, 2014 and the revolving line of credit maturity to December 31, 2009 under similar terms as the current loans. We plan to finalize these agreements prior to year end. As of September 30, 2008, we had borrowed \$17.8 million on the advancing term loan and nothing on the revolving line of credit, leaving a balance available on the revolving line of credit of \$15.0 million. The annual weighted average interest rate we paid on the



advancing term loan during the third quarter of 2008 and 2007 was 4.25% and 7.43%, respectively, and for the first nine months of 2008 and 2007 was 4.69% and 7.48%, respectively. The annual weighted average interest rate we paid on the revolving line of credit during the third quarter of 2008 and 2007 was 3.75% and 7.18%, respectively, and for the first nine months of 2008 and 2007 was 4.19% and 7.23%, respectively. As of September 30, 2008, the applicable interest rate was 4.25% on the advancing term loan and 3.75% on the revolving line of credit. The advancing term loan was used to help finance the expansion project at our cement manufacturing facility. The revolving line of credit was used during the year to fund increases in receivables, capital improvements, increases in purchases of equity investments, and temporary operating expenses. Our board of directors has given management the authority to borrow an additional \$10 million for a maximum of \$50 million. No assurances can be given that we will be able to obtain this additional borrowing on favorable terms, if at all.

Projects in the planning and design phases include improvements to our fuel handling system and installation of an overland conveyor system to improve efficiencies in moving raw materials. The improvements to the fuel handling system are expected to be completed in mid 2009 at a cost of approximately \$4.0 million. Installation of the overland conveyor system will take eighteen to twenty-four months to complete after the purchase order is issued, which is expected to occur in 2009. We anticipate capital expenditures for 2008 to be higher than 2007 levels, but we do not anticipate the need for additional bank financing other than that available under our existing revolving line of credit.

For several years the Company has paid a \$.20 per share dividend in January, March, June and September. Beginning with the April 2006 Board of Directors meeting, the Board elected to increase these dividends to \$.21 per share; at the April 2007 Board of Directors meeting, the Board increased the dividend to \$.22 per share; and at the April 2008 Board of Directors meeting, the Board increased the dividend to \$.23 per share. Although dividends are declared at the Board's discretion, we project future earnings will support the continued payment of dividends at the current level.

#### **FINANCIAL CONDITION**

Total assets as of September 30, 2008 were \$174.6 million, an increase of \$7.1 million since December 31, 2007. Receivables increased approximately \$8.8 million since December 31, 2007. Such an increase is common during the first nine months of the year due to the seasonality of our business (see Seasonality below). Deferred income tax asset increased \$2.1 million primarily due to a reduction in deferred income tax liability resulting from the \$3.1 million decrease in net unrealized holding gains related to equity investments. Inventories decreased by \$2.1 million primarily due to lower cement production early in the year in combination with increased cement sales volumes discussed in "Overview" above.

Accounts payable increased \$3.9 million as of September 30, 2008 compared to December 31, 2007 primarily due to the expenses related to increased sales volume in September over December. Accrued postretirement benefits liability increased \$1.2 million since December 31, 2007 due to net periodic benefit cost in excess of contributions. Indebtedness decreased \$1.8 million during the first nine months of 2008 primarily as a result of utilizing cash provided by operations to reduce our bank loans.

#### **CAPITAL RESOURCES**

The Company regularly invests in miscellaneous equipment and facility improvements in both the Cement Business and Ready-Mixed Concrete Business. Capital expenditures during the first nine months of 2008 included expenditures to improve efficiencies in moving raw materials. We also invested in routine equipment purchases during 2008, primarily in the Ready-Mixed Concrete Business.

The Company is heavily involved in the planning and design phases for two future capital expenditure projects in the Cement Business. These projects include improvements to our fuel handling system and installation of an overland conveyor system to improve efficiencies in moving raw materials. The improvements to the fuel handling

system are expected to be completed in mid 2009 at a cost of approximately \$4.0 million. Installation of the overland conveyor system is anticipated to take eighteen to twenty-four months to complete after the purchase order is issued, which is expected to occur in 2009. The Company also plans to invest in other miscellaneous equipment and facility improvements in both the Cement Business and Ready-Mixed Concrete Business in 2008. During the first nine months of 2008, the Company's cash expenditures for property, plant and equipment totaled approximately \$8.4 million, excluding the amounts that are included in accounts payable. These expenditures are expected to reach approximately \$10.0 million during 2008 and will be funded with a mixture of cash from operations and temporary bank loans. We do not anticipate the need for additional bank financing beyond the amount available through our existing revolving line of credit.

#### **MARKET RISK**

Market risks relating to the Company's operations result primarily from changes in demand for our products. A significant increase in interest rates could lead to a reduction in construction activities in both the residential and commercial market. Budget shortfalls during economic slowdowns could cause money to be diverted away from highway projects, schools, detention facilities and other governmental construction projects. Reduction in construction activity lowers the demand for cement, ready-mixed concrete, concrete products and sundry building materials. As demand decreases, competition to retain sales volume could create downward pressure on sales prices. The manufacture of cement requires a significant investment in property, plant and equipment and a trained workforce to operate and maintain this equipment. These costs do not materially vary with the level of production. As a result, by operating at or near capacity, regardless of demand, companies can reduce per unit production costs. The continual need to control production costs encourages overproduction during periods of reduced demand.

#### **INFLATION**

Inflation directly affects the Company's operating costs. The manufacture of cement requires the use of a significant amount of energy. The Company burns primarily solid fuels, such as coal and petroleum coke, and to a lesser extent natural gas, in its kilns. Increases above the rate of inflation in the cost of these solid fuels, natural gas, or in the electricity required to operate our cement manufacturing equipment could adversely affect our operating profits. We anticipate an increase in our fuel cost in 2009 as a result of the expiration of a five year coal contract at the end of 2008. Prices of the specialized replacement parts and equipment the Company must continually purchase tend to increase directly with the rate of inflation causing manufacturing costs to increase.

#### **ENVIRONMENTAL REGULATIONS**

Regulation of carbon dioxide emissions are currently being discussed by both state and federal legislative bodies and regulators. As part of the chemical process involved in the production of portland cement, carbon dioxide is driven off raw materials. While management is studying practices and technology which may reduce or sequester carbon dioxide emissions, the current state of technology has yet to provide a solution. The effect of regulation may increase taxes, penalties, and the cost of production, as well as require additional capital expenditures for equipment.

#### **SEASONALITY**

Portland cement is the basic material used in the production of ready-mixed concrete that is used in highway, bridge and building construction. These construction activities are seasonal in nature. During winter months when the ground is frozen, groundwork preparation cannot be completed. Cold temperatures affect concrete set-time, strength and durability, limiting its use in winter months. Dry ground conditions are also required for construction activities to proceed. During the summer, winds and warmer temperatures tend to dry the ground quicker creating fewer delays in construction projects.

Variations in weather conditions from year-to-year significantly affect the demand for our products during any

particular quarter; however, our Company's highest revenue and earnings historically occur in its second and third fiscal quarters, April through September.

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

The Company owns \$13.3 million of equity securities, primarily of publicly traded entities, as of September 30, 2008. The aggregate amount of securities carried at cost, for which the Company has not elected the fair value option, was \$2.1 million as of September 30, 2008. The balance of these investments, which are stated at fair market value, are not hedged and are exposed to the risk of changing market prices. The Company classifies all securities as "available-for-sale" for accounting purposes and marks them to market on the balance sheet at the end of each period unless they are securities for which the Company has not elected the fair value option. Management estimates that its publicly traded investments will generally be consistent with trends and movements of the overall stock market excluding any unusual situations. An immediate 10% change in the market price of our equity securities would have a \$.7 million effect on comprehensive income. Although the stock market has shown extreme volatility in the first nine months of 2008, the Company has determined that it has not, at this time, incurred an impairment loss on its equity investments that is other than temporary. These assets are classified as available for sale; however, the Company plans to hold these securities indefinitely and has the ability to do so. The Company is not aware of any events or changes in circumstances that occurred during the first nine months of 2008 that had a significant adverse effect on the fair value of the investments carried at cost.

The Company also has \$17.8 million of bank loans as of September 30, 2008. Interest rates on the Company's advancing term loan and revolving line of credit are variable and are based on the JP Morgan Chase prime rate less .75% and lender's national prime rate less 1.25%, respectively. The bank has agreed to extend the term loan maturity to December 31, 2014 and the revolving line of credit maturity to December 31, 2009 under similar terms as the current loans. We plan to finalize these agreements prior to year end.

**Item 4. Controls and Procedures**

The Company maintains disclosure controls and procedures (as defined in Rules 13a-5(e) and 15d-15(e) under the Exchange Act) that are designed to ensure that information required to be disclosed in the Company's reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to the Company's management, including its President and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. Any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

As of the end of the period covered by this report, an evaluation was carried out by the Company's management, including its President and Chairman of the Board of Directors and Chief Financial Officer, of the effectiveness of its disclosure controls and procedures (as defined in Rules 13a-5(e) under the Securities Exchange Act of 1934). Based upon that evaluation, the Company's President and Chairman of the Board of Directors and Chief Financial Officer concluded that these disclosure controls and procedures were effective as of the end of the period covered by this report.

There were no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2008 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

Item 1. Legal Proceedings

The Company and Tulsa Dynaspan, Inc. ("TDI") a subsidiary of the Company, are defendants in a case brought by David Markle, Richard Evilsizer, and five other named plaintiffs, filed in the District Court of Tulsa County, Oklahoma, on December 29, 2004 and amended on January 19, 2005, January 6, 2006, August 18, 2006, and January 12, 2007. Prior to the August 18, 2006 amendment, Plaintiffs dismissed claims they had previously asserted for defamation and various business torts, derivative claims brought on behalf of the Company, and claims to ownership of an invention relating to parking garage construction. Markle and Evilsizer remain as Plaintiffs; the five other original Plaintiffs remain in the action only as counterclaim defendants. Plaintiffs seek an award of actual and exemplary damages from the Company, one of its directors and four of TDI's directors for alleged breach of fiduciary duties owed to TDI, based upon derivative and breach of contract claims. The Company has asserted a counterclaim based upon breach of contract against Markle and TDI has asserted counterclaims based upon breach of fiduciary duty, misappropriation, violations of the Computer Fraud and Abuse Act and the Oklahoma Trade Secrets Act, unjust enrichment, and various business torts against all of the original plaintiffs. Plaintiffs also seek an order from the Court that the Company purchase Plaintiffs' shares of TDI stock for fair value. On April 10, 2007, the Court heard arguments on various motions and subsequently entered the following orders: Monarch and the individual directors' motion for summary judgment dismissing all of Plaintiffs' claims was granted; Monarch's motion for summary judgment on its pre-termination competition claim against Markle was granted; TDI's motion for summary judgment against Plaintiffs for unjust enrichment and breach of fiduciary duty was granted; Markle's motion for partial summary judgment on the non-compete agreement executed by the parties was denied. Additional hearings to establish TDI's and Monarch's damages will be necessary; all of Plaintiffs' claims have now been dismissed. Because of the failure of certain plaintiffs to participate in a pretrial conference the proceedings are now bifurcated. Markle and Evilsizer have filed bankruptcy. Complaints to collect damages from Markle and Evilsizer have been filed in the Bankruptcy courts. A hearing on actual and punitive damages against Parking Builders, GBS and ENCO was held on February 1, 2008. On February 29, 2008, TDI was awarded \$3,117,574 in actual damages and an additional \$3,117,574 in punitive damages against GBS and ENCO; TDI was awarded \$1,614,720 in actual damages and an additional \$1,614,720 in punitive damages against Parking Builders. No assurances can be given as to the collectability of these damage awards. TDI has settled its claims against Martin and Bobbitt.

Item 6. Exhibits

31.1 Certificate of the President and Chairman of the Board pursuant to Section 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934.

31.2 Certificate of the Chief Financial Officer pursuant to Section 13a 14(a)/15d 14(a) of the Securities Exchange Act of 1934.

32.1 18 U.S.C. Section 1350 Certificate of the President and Chairman of the Board dated November 7, 2008.

32.2 18 U.S.C. Section 1350 Certificate of the Chief Financial Officer dated November 7, 2008.

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.

The Monarch Cement Company

(Registrant)

Date November 7, 2008

/s/ Walter H. Wulf, Jr.

Walter H. Wulf, Jr.

President and  
Chairman of the Board

Date November 7, 2008

/s/ Debra P. Roe

Debra P. Roe, CPA

Chief Financial Officer and  
Assistant Secretary Treasurer

EXHIBIT INDEX

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