PRUDENTIAL FINANCIAL INC
Form 10-Q
November 04, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2011

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 001-16707

Prudential Financial, Inc.

(Exact Name of Registrant as Specified in its Charter)

New Jersey	**22-3703799**
(State or Other Jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**Identification Number)**

751 Broad Street

Newark, New Jersey 07102

(973) 802-6000

(Address and Telephone Number of Registrant s Principal Executive Offices)

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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of the Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ 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 x

As of October 31, 2011, 470 million shares of the registrant s Common Stock (par value $0.01) were outstanding. In addition, 2 million shares of the registrant s Class B Stock, for which there is no established public trading market, were outstanding.

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Forward-Looking Statements

Certain of the statements included in this Quarterly Report on Form 10-Q, including but not limited to those in Management s Discussion and Analysis of Financial Condition and Results of Operations, constitute forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Words such as expects, believes, anticipates, includes, plans, assumes, estimates, projects, should, will, shall or variations of such words are generally part of forward-looking statements. Forward-looking statements are made based on management s current expectations and beliefs concerning future developments and their potential effects upon Prudential Financial, Inc. and its subsidiaries. There can be no assurance that future developments affecting Prudential Financial, Inc. and its subsidiaries will be those anticipated by management. These forward-looking statements are not a guarantee of future performance and involve risks and uncertainties, and there are certain important factors that could cause actual results to differ, possibly materially, from expectations or estimates reflected in such forward-looking statements, including, among others: (1) general economic, market and political conditions, including the performance and fluctuations of fixed income, equity, real estate and other financial markets; (2) the availability and cost of additional debt or equity capital or external financing for our operations; (3) interest rate fluctuations or prolonged periods of low interest rates; (4) the degree to which we choose not to hedge risks, or the potential ineffectiveness or insufficiency of hedging or risk management strategies we do implement, with regard to variable annuity or other product guarantees; (5) any inability to access our credit facilities; (6) reestimates of our reserves for future policy benefits and claims; (7) differences between actual experience regarding mortality, morbidity, persistency, surrender experience, interest rates or market returns and the assumptions we use in pricing our products, establishing liabilities and reserves or for other purposes; (8) changes in our assumptions related to deferred policy acquisition costs, value of business acquired or goodwill; (9) changes in assumptions for retirement expense; (10) changes in our financial strength or credit ratings; (11) statutory reserve requirements associated with term and universal life insurance policies under Regulation XXX and Guideline AXXX; (12) investment losses, defaults and counterparty non-performance; (13) competition in our product lines and for personnel; (14) difficulties in marketing and distributing products through current or future distribution channels; (15) changes in tax law; (16) economic, political, currency and other risks relating to our international operations; (17) fluctuations in foreign currency exchange rates and foreign securities markets; (18) regulatory or legislative changes, including the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act; (19) inability to protect our intellectual property rights or claims of infringement of the intellectual property rights of others; (20) adverse determinations in litigation or regulatory matters and our exposure to contingent liabilities, including in connection with our divestiture or winding down of businesses; (21) domestic or international military actions, natural or man-made disasters including terrorist activities or pandemic disease, or other events resulting in catastrophic loss of life; (22) ineffectiveness of risk management policies and procedures in identifying, monitoring and managing risks; (23) effects of acquisitions, divestitures and restructurings, including possible difficulties in integrating and realizing the projected results of acquisitions, including risks associated with the acquisition of certain insurance operations in Japan; (24) interruption in telecommunication, information technology or other operational systems or failure to maintain the security, confidentiality or privacy of sensitive data on such systems; (25) changes in statutory or U.S. GAAP accounting principles, practices or policies; (26) Prudential Financial, Inc. s primary reliance, as a holding company, on dividends or distributions from its subsidiaries to meet debt payment obligations and the ability of the subsidiaries to pay such dividends or distributions in light of our ratings objectives and/or applicable regulatory restrictions; and (27) risks due to the lack of legal separation between our Financial Services Businesses and our Closed Block Business. Prudential Financial, Inc. does not intend, and is under no obligation, to update any particular forward-looking statement included in this document. See Risk Factors included in the Annual Report on Form 10-K for the year ended December 31, 2010 for discussion of certain risks relating to our businesses and investment in our securities.

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Throughout this Quarterly Report on Form 10-Q, Prudential Financial and the Registrant refer to Prudential Financial, Inc., the ultimate holding company for all of our companies. Prudential Insurance refers to The Prudential Insurance Company of America, before and after its demutualization on December 18, 2001. Prudential, the Company, we and our refer to our consolidated operations before and after demutualization.

PART I - FINANCIAL INFORMATION

ITEM 1. ***Financial Statements***

PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Consolidated Statements of Financial Position

September 30, 2011 and December 31, 2010 (in millions, except share amounts)

	September 30, 2011	December 31, 2010
ASSETS		
Fixed maturities, available for sale, at fair value (amortized cost: 2011-$238,534; 2010- $187,754)(1)	$ 252,112	$ 194,983
Fixed maturities, held to maturity, at amortized cost (fair value: 2011-$5,484; 2010- $5,477)(1)	5,195	5,226
Trading account assets supporting insurance liabilities, at fair value(1)	19,535	17,771
Other trading account assets, at fair value	6,562	4,225
Equity securities, available for sale, at fair value (cost: 2011-$7,082; 2010- $6,469)	7,462	7,741
Commercial mortgage and other loans (includes $219 and $364 measured at fair value under the fair value option at September 30, 2011 and December 31, 2010, respectively)(1)	34,401	31,831
Policy loans	11,483	10,667
Other long-term investments (includes $338 and $258 measured at fair value under the fair value option at September 30, 2011 and December 31, 2010, respectively)(1)	7,903	6,171
Short-term investments	7,907	5,297
Total investments	352,560	283,912
Cash and cash equivalents(1)	15,526	12,915
Accrued investment income(1)	2,820	2,377
Deferred policy acquisition costs	16,278	16,435
Other assets(1)	16,923	16,439
Separate account assets(1)	207,366	207,776
TOTAL ASSETS	$ 611,473	$ 539,854
LIABILITIES AND EQUITY		
LIABILITIES		
Future policy benefits	$ 169,391	$ 133,874
Policyholders account balances	134,560	106,441
Policyholders dividends	5,420	3,378
Securities sold under agreements to repurchase	6,234	5,885
Cash collateral for loaned securities	3,189	2,171
Income taxes	8,319	6,353
Short-term debt	2,899	1,982
Long-term debt	23,920	23,653

Other liabilities(1)	12,371	15,413
Separate account liabilities(1)	207,366	207,776
Total liabilities	573,669	506,926
COMMITMENTS AND CONTINGENT LIABILITIES (See Note 15)		
EQUITY		
Preferred Stock ($.01 par value; 10,000,000 shares authorized; none issued)	0	0
Common Stock ($.01 par value; 1,500,000,000 shares authorized; 660,110,939 and 660,110,810 shares issued at September 30, 2011 and December 31, 2010, respectively)	6	6
Class B Stock ($.01 par value; 10,000,000 shares authorized; 2,000,000 shares issued and outstanding at September 30, 2011 and December 31, 2010, respectively)	0	0
Additional paid-in capital	24,257	24,223
Common Stock held in treasury, at cost (188,213,961 and 176,312,047 shares at September 30, 2011 and December 31, 2010, respectively)	(11,738)	(11,173)
Accumulated other comprehensive income (loss)	5,292	2,978
Retained earnings	19,332	16,381
Total Prudential Financial, Inc. equity	37,149	32,415
Noncontrolling interests	655	513
Total equity	37,804	32,928
TOTAL LIABILITIES AND EQUITY	$ 611,473	$ 539,854

(1) See Note 5 for details of balances associated with variable interest entities.

See Notes to Unaudited Interim Consolidated Financial Statements

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PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Consolidated Statements of Operations

Three and Nine Months Ended September 30, 2011 and 2010 (in millions, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
REVENUES				
Premiums	$ 6,092	$ 4,654	$ 17,892	$ 13,500
Policy charges and fee income	958	761	2,911	2,436
Net investment income	3,333	3,016	9,778	8,800
Asset management fees and other income	2,006	1,457	3,823	3,211
Realized investment gains (losses), net:				
Other-than-temporary impairments on fixed maturity securities	(402)	(435)	(1,606)	(2,198)
Other-than-temporary impairments on fixed maturity securities transferred to Other Comprehensive Income	286	345	1,233	1,715
Other realized investment gains (losses), net	2,644	119	3,319	2,687
Total realized investment gains (losses), net	2,528	29	2,946	2,204
Total revenues	14,917	9,917	37,350	30,151
BENEFITS AND EXPENSES				
Policyholders benefits	6,208	4,538	17,676	13,668
Interest credited to policyholders account balances	1,463	1,174	3,477	3,640
Dividends to policyholders	679	512	1,961	1,547
Amortization of deferred policy acquisition costs	1,786	(6)	2,888	1,412
General and administrative expenses	2,447	1,949	7,138	5,619
Total benefits and expenses	12,583	8,167	33,140	25,886
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES	2,334	1,750	4,210	4,265
Income tax expense	848	524	1,370	1,301
INCOME FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES	1,486	1,226	2,840	2,964
Equity in earnings of operating joint ventures, net of taxes	67	14	183	33
INCOME FROM CONTINUING OPERATIONS	1,553	1,240	3,023	2,997
Income (loss) from discontinued operations, net of taxes	(9)	2	21	20
NET INCOME	1,544	1,242	3,044	3,017
Less: Income (loss) attributable to noncontrolling interests	10			

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net income	$ 5,663	3,406	$ 10,325	6,142
Change in fair value of interest rate hedges, net of taxes	(440)	933	(605)	1,211

Comprehensive income	$ 5,223	4,339	$ 9,720	7,353

Accumulated other comprehensive loss consisted of the following (in thousands):

	June 30, 2010	December 31, 2009
Mark-to-market for interest rate hedges, net of tax benefit	$ (2,660)	$ (2,055)
Minimum pension liability adjustments, net of tax benefit	(663)	(663)
Accumulated other comprehensive loss	$ (3,323)	$ (2,718)

7. Inventories

Inventories are valued principally at the lower of cost, determined using the average cost method, or market. Costs for raw materials and finished goods include materials, labor, and production overhead. Inventories consisted of the following (in thousands):

	June 30, 2010	December 31, 2009
Lime and limestone inventories:		
Raw materials	$ 3,291	$ 3,373
Finished goods	1,303	1,351
	4,594	4,724
Service parts inventories	4,734	4,736
Total inventories	$ 9,328	$ 9,460

8. Banking Facilities

The Company s credit agreement includes a ten-year $40 million term loan (the Term Loan), a ten-year $20 million multiple draw term loan (the Draw Term Loan) and a $30 million revolving credit facility (the Revolving Facility) (collectively, the Credit Facilities). At June 30, 2010, the Company had $322 thousand of letters of credit issued, which count as draws under the Revolving Facility.

The Term Loan requires quarterly principal payments of $833 thousand, which began on March 31, 2006, equating to a 12-year amortization, with a final principal payment of $7.5 million due on December 31, 2015. The Draw Term Loan requires quarterly principal payments of $417 thousand, based on a 12-year amortization, which began on March 31, 2007, with a final principal payment on December 31, 2015 equal to any remaining principal then outstanding. The maturity of the Term Loan, the Draw Term Loan and the Revolving Facility can be accelerated if any event of default, as defined under the Credit Facilities, occurs.

As of June 1, 2010, the Company entered into an amendment to its Credit Facilities (the Amendment) primarily to remove or reduce certain restrictions and to extend, by more than three years, the maturity date of the Revolving Facility. In return for these improvements, the Company agreed to increase the commitment fee for the Revolving Facility, increase the interest rate margins on existing and new borrowings, reduce the Company s maximum Cash Flow Leverage Ratio (defined below) and pay a $100 thousand amendment fee.

The Amendment removed from the Credit Facilities: (1) the annual $10 million maximum non-oil and gas-related capital expenditures limitation; (2) the $40 million maximum acquisition limitation over the life of the Credit Facilities; and (3) the annual $1.5 million maximum dividend restriction. In addition, pursuant to the Amendment, the Company may now purchase, redeem or otherwise acquire shares of its common stock so long as its pro forma Cash Flow Leverage Ratio is less than 3.00 to 1.00 and no default or event of default exists or would exist after giving effect to such stock repurchase. The Amendment extended the maturity date of the Revolving Facility to June 1, 2015; previously, the maturity date for the Revolving Facility was April 2, 2012.

As a result of the Amendment, the Revolving Facility commitment fee was increased to a range of 0.250% (previously 0.200%) to 0.400% (previously 0.350%). In addition, the Credit Facilities will now bear interest, at the Company s option, at either LIBOR plus a margin of 1.750% (previously 1.125%) to 2.750% (previously 2.125%), or the Lender s Prime Rate plus a margin of 0.000% (previously minus 0.500%) to plus 1.000% (previously plus 0.375%). The Revolving Facility commitment fee and the interest rate margins are determined quarterly in accordance with a pricing grid based upon the Company s Cash Flow Leverage Ratio, defined as the ratio of the Company s total funded senior indebtedness to earnings before interest, taxes, depreciation, depletion and amortization (EBITDA) for the twelve months ended on the last day of the most recent calendar quarter, plus, added by the Amendment, pro forma EBITDA from any businesses acquired during the period. Lastly, the Amendment reduced the Company s maximum Cash Flow Leverage Ratio to 3.25 to 1 (previously 3.50 to 1).

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The Amendment did not amend the security agreement, dated August 25, 2004, pursuant to which the Credit Facilities continue to be secured by the Company s existing and hereafter acquired tangible assets, intangible assets and real property. The Amendment also did not amend the Company s interest rate hedges, discussed below, with respect to the outstanding balances on the Term Loan and the Draw Term Loan that the Company has entered into with Wells Fargo Bank, N.A as counterparty to the hedges.

The Company has hedges that fix LIBOR through maturity at 4.695%, 4.875% and 5.500% on the outstanding balance of the Term Loan, 75% of the outstanding balance on the Draw Term Loan and 25% of the outstanding balance of the Draw Term Loan, respectively. As a result of the Amendment, and based on the current LIBOR margin of 1.750% (1.125% prior to the Amendment), as of June 1, 2010 the Company s interest rates are: 6.445% (5.820% prior to the Amendment) on the outstanding balance of the Term Loan; 6.625% (6.000% prior to the Amendment) on 75% of the outstanding balance of the Draw Term Loan; and 7.250% (6.625% prior to the Amendment) on 25% of the outstanding balance of the Draw Term Loan.

The hedges have been effective as defined under applicable accounting rules. Therefore, changes in fair value of the interest rate hedges are reflected in comprehensive income (loss). The Company will be exposed to credit losses in the event of non-performance by the counterparty to the hedges. Due to interest rate declines, the Company s mark-to-market of its interest rate hedges at June 30, 2010 and December 31, 2009, resulted in liabilities of $4.2 million and $3.2 million, respectively, which are included in accrued expenses ($1.6 and $1.7 million, respectively) and other liabilities ($2.6 million and $1.5 million, respectively) on the Company s Condensed Consolidated Balance Sheets. The Company paid $462 thousand and $938 thousand in quarterly settlement payments pursuant to its hedges during the three- and six-month periods ended June 30, 2010, respectively, compared to payments of $416 thousand and $811 thousand in the comparable prior year three- and six-month periods, respectively. These payments were included in interest expense.

A summary of outstanding debt at the dates indicated is as follows (in thousands):

	June 30, 2010	December 31, 2009
Term Loan	$ 25,000	$ 26,666
Draw Term Loan	14,167	15,000
Revolving Facility [1]		
Subtotal	39,167	41,666
Less current installments	5,000	5,000
Debt, excluding current installments	$ 34,167	$ 36,666

[1] The Company had letters of credit totaling $322 issued on the Revolving Facility at June 30, 2010 and December 31, 2009.

As the Company s debt bears interest at floating rates, the Company estimates the carrying values of its debt at June 30, 2010 and December 31, 2009 approximate fair value.

9. Contingencies

In the second quarter 2010, there was an accident at the Company s St. Clair plant in Oklahoma, resulting in a fatality. The Company incurred and accrued costs associated with the accident during the quarter, including an accrual for estimated costs of Mine Safety and Health Administration (MSHA) penalties, legal expenses and other costs, as well as transportation and other logistics and operating costs incurred. The Company is cooperating fully with the MSHA investigation into the accident. Actual costs could be more or less than the current estimate, and the Company will refine its estimate as additional information becomes available. It is not possible at this time to estimate a range of possible additional costs, if any, related to this accident.

10. Income Taxes

The Company has estimated its effective income tax rate for 2010 will be approximately 28.8%. As in prior periods, the primary reason for the effective rate being below the federal statutory rate is due to statutory depletion, which is allowed for income tax purposes and is a permanent difference between net income for financial reporting purposes and taxable income. The Company s effective income tax rate for 2010 increased compared to its 2009 rate primarily because of the $6.7 million increase in income before income taxes in the current year six-month period compared to the comparable prior year period.

ITEM 2: MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements. Any statements contained in this Report that are not statements of historical fact are forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements in this Report, including without limitation statements relating to the Company s plans, strategies, objectives, expectations, intentions, and adequacy of resources, are identified by such words as will, could, should, would, believe, expect, intend, plan, schedule, estimate, anticipate, and project. The Compa obligation to publicly update or revise any forward-looking statements. The Company cautions that forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from expectations, including without limitation the following: (i) the Company s plans, strategies, objectives, expectations, and intentions are subject to change at any time at the Company s discretion; (ii) the Company s plans and results of operations will be affected by its ability to maintain and manage its growth; (iii) the Company s ability to meet short-term and long-term liquidity demands, including servicing the Company s debt, conditions in the credit and equity markets, and changes in interest rates on the Company s debt, including the ability of the Company s customers and the counterparty to the Company s interest rate hedges to meet their obligations; (iv) interruptions to operations and increased expenses at its facilities resulting from inclement weather conditions, accidents or regulatory requirements; (v) increased fuel, electricity, transportation and freight costs; (vi) unanticipated delays, difficulties in financing, or cost overruns in completing construction projects; (vii) the Company s ability to expand its Lime and Limestone Operations through acquisitions of businesses with related or similar operations, including obtaining financing for such acquisitions, and to successfully integrate acquired operations; (viii) inadequate demand and/or prices for the Company s lime and limestone products due to the state of the U.S. economy, recessionary pressures in particular industries, including highway and housing related construction and steel, and inability to continue to increase prices for the Company s products; (ix) the uncertainties of development, production and prices with respect to the Company s Natural Gas Interests, including reduced drilling activities pursuant to the Company s O & G Lease and Drillsite Agreement, unitization of existing wells, inability to explore for new reserves and declines in production rates; (x) on-going and possible new environmental and other regulations, investigations, enforcement actions and costs, penalties and fines, taxes and limitations on operations, including those related to climate change and health and safety; and (xi) other risks and uncertainties set forth in this Report or indicated from time to time in the Company s filings with the SEC, including the Company s Form 10-K for the fiscal year ended December 31, 2009.

Overview.

The Company has two business segments: Lime and Limestone Operations and Natural Gas Interests.

Through its Lime and Limestone Operations, the Company is a manufacturer of lime and limestone products, supplying primarily the construction, steel, municipal sanitation and water treatment, aluminum, paper, utilities, glass, roof shingle and agriculture industries. The Company operates lime and limestone plants and distribution facilities in Arkansas, Colorado, Louisiana, Oklahoma and Texas through its wholly owned subsidiaries, Arkansas Lime Company, Colorado Lime Company, Texas Lime Company, U.S. Lime Company, U.S. Lime Company Shreveport, U.S. Lime Company St. Clair, and U.S. Lime Company Transportation. The Lime and Limestone Operations represent the Company s principal business.

The Company s Natural Gas Interests are held through its wholly owned subsidiary, U.S. Lime Company O & G, LLC, and consist of royalty and non-operating working interests under the O & G Lease with EOG Resources, Inc. and the Drillsite Agreement with XTO Energy Inc. related to the Company s Johnson County, Texas property, located in the Barnett Shale Formation, on which Texas Lime Company conducts its lime and limestone operations. The Company reported its first revenues and gross profit for natural gas production from its Natural Gas Interests in the first quarter 2006.

During the first six months 2010, the increase in lime and limestone revenues primarily resulted from increased lime sales and average product price increases realized during the period of approximately 8.6% for the Company s lime and limestone products. Sales volumes of the Company s lime products increased compared to the significantly depressed demand for the Company s lime products in the prior year first six months. The increased demand in the first half 2010 was principally from steel customers, while construction demand related to housing developments remains anemic. In the second quarter 2010, there was an accident at the Company s St. Clair plant in Oklahoma, resulting in a fatality. In addition to the tragic loss of a long-time valued employee, the accident resulted in additional operating costs during the quarter, including an accrual for estimated costs of MSHA penalties, legal expenses and other costs, as well as transportation and other logistics and operating costs incurred. The Company is cooperating fully with the MSHA investigation into the accident. Actual costs could be more or less than the current estimate, and the Company will refine its estimate as additional information becomes available. It is not possible at this time to estimate a range of possible additional costs, if any, related to this accident.

Due to the weakened economy, the Company initiated steps to reduce its operating expenses in the fourth quarter 2008. These efforts continued throughout 2009 and are ongoing. The Company s improved gross profit and gross profit margin as a percentage of revenues for the Company s Lime and Limestone Operations in the first half 2010, compared to last year s first half, resulted primarily from increased revenues and operating efficiencies, partially offset by costs incurred and accrued as a result of the accident at St. Clair. While construction demand related to housing developments remains anemic, the Company believes highway construction demand is improving, although governmental funding of public sector projects is a concern, and demand from the steel industry has leveled off.

Revenues and gross profit from the Company s Natural Gas Interests increased in the first half 2010, as increased prices for liquids contained in the Company s natural gas, and, for the second quarter, increased natural gas prices compared to the comparable prior year quarter, more than offset the declines in production volumes. Prices for natural gas liquids generally follow crude oil prices, which increased significantly in the first half 2010 compared to the prior year first half. The number of producing wells remained at 30 in the first half 2010. Eight new wells drilled in the fourth quarter 2009 and the first quarter 2010 pursuant to the O & G Lease are expected to be completed as producing wells by the fourth quarter 2010. Two new wells drilled in the first quarter 2010 pursuant to the Drillsite Agreement are currently in the process of being completed. The Company cannot predict the number of additional wells that ultimately will be drilled, if any, or their results.

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Liquidity and Capital Resources.

Net cash provided by operating activities was $15.6 million in the six months ended June 30, 2010, compared to $11.7 million in the comparable 2009 period, an increase of $3.9 million, or 32.9%. Net cash provided by operating activities is composed of net income, depreciation, depletion and amortization (DD&A), deferred income taxes and other non-cash items included in net income, and changes in working capital. In the first half 2010, cash provided by operating activities was principally composed of $10.3 million net income, $6.6 million DD&A and $1.8 million deferred income taxes, compared to $6.1 million net income, $6.9 million DD&A and $1.2 million deferred income taxes in the first half 2009. The most significant changes in working capital in the first half 2010 were net increases in trade receivables and accounts payable and accrued expenses of $5.4 million and $900 thousand, respectively, and a $1.1 million decrease in prepaid expenses and other current assets. The most significant changes in working capital items in the first half 2009 were net increase in trade receivables of $1.3 million and net decreases in accounts payable and accrued expenses, inventories and other liabilities of $1.9 million, $1.3 million and $1.0 million, respectively. The net increases in trade receivables in the 2010 and 2009 periods primarily resulted from an increase in revenues in the second quarters 2010 and 2009, compared to the fourth quarters 2009 and 2008, respectively.

The Company invested $5.1 million in capital expenditures in the first half 2010, compared to $3.8 million in the same period last year. The first half 2009 included $1.0 million for the quarry development at the Company s Arkansas facilities. Included in capital expenditures during the first half 2010 and 2009 were $1.8 million and $34 thousand, respectively, for drilling and workover costs for the Company s non-operating working interests in natural gas wells.

Net cash used in financing activities was $2.6 million in the first half 2010, including $2.5 million for repayments of term loan debt. Net cash used in financing activities was $7.1 million in the first half 2009, including $2.5 million for repayments of term loan debt and $4.7 million for repayments of the Company s revolving credit facility.

The Company s credit agreement includes a ten-year $40 million term loan (the Term Loan), a ten-year $20 million multiple draw term loan (the Draw Term Loan) and a $30 million revolving credit facility (the Revolving Facility) (collectively, the Credit Facilities). At June 30, 2010, the Company had $322 thousand of letters of credit issued, which count as draws under the Revolving Facility.

The Term Loan requires quarterly principal payments of $833 thousand, which began on March 31, 2006, equating to a 12-year amortization, with a final principal payment of $7.5 million due on December 31, 2015. The Draw Term Loan requires quarterly principal payments of $417 thousand, based on a 12-year amortization, which began on March 31, 2007, with a final principal payment on December 31, 2015 equal to any remaining principal then outstanding. The maturity of the Term Loan, the Draw Term Loan and the Revolving Facility can be accelerated if any event of default, as defined under the Credit Facilities, occurs.

As of June 1, 2010, the Company entered into an amendment to its Credit Facilities (the Amendment) primarily to remove or reduce certain restrictions and to extend, by more than three years, the maturity date of the Revolving Facility. In return for these improvements, the Company agreed to increase the commitment fee for the Revolving Facility, increase the interest rate margins on existing and new borrowings, reduce the Company s maximum Cash Flow Leverage Ratio (defined below) and pay a $100 thousand amendment fee. The Amendment should provide the Company with much more flexibility going forward.

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The Amendment removed from the Credit Facilities: (1) the annual $10 million maximum non-oil and gas-related capital expenditures limitation; (2) the $40 million maximum acquisition limitation over the life of the Credit Facilities; and (3) the annual $1.5 million maximum dividend restriction. In addition, pursuant to the Amendment, the Company may now purchase, redeem or otherwise acquire shares of its common stock so long as its pro forma Cash Flow Leverage Ratio is less than 3.00 to 1.00 and no default or event of default exists or would exist after giving effect to such stock repurchase. The Amendment extended the maturity date of the Revolving Facility to June 1, 2015; previously, the maturity date for the Revolving Facility was April 2, 2012.

As a result of the Amendment, the Revolving Facility commitment fee was increased to a range of 0.250% (previously 0.200%) to 0.400% (previously 0.350%). In addition, the Credit Facilities will now bear interest, at the Company s option, at either LIBOR plus a margin of 1.750% (previously 1.125%) to 2.750% (previously 2.125%), or the Lender s Prime Rate plus a margin of 0.000% (previously minus 0.500%) to plus 1.000% (previously plus 0.375%). The Revolving Facility commitment fee and the interest rate margins are determined quarterly in accordance with a pricing grid based upon the Company s Cash Flow Leverage Ratio, defined as the ratio of the Company s total funded senior indebtedness to earnings before interest, taxes, depreciation, depletion and amortization (EBITDA) for the twelve months ended on the last day of the most recent calendar quarter, plus, added by the Amendment, pro forma EBITDA from any businesses acquired during the period. Lastly, the Amendment reduced the Company s maximum Cash Flow Leverage Ratio to 3.25 to 1 (previously 3.50 to 1).

The Amendment did not amend the security agreement, dated August 25, 2004, pursuant to which the Credit Facilities continue to be secured by the Company s existing and hereafter acquired tangible assets, intangible assets and real property. The Amendment also did not amend the Company s interest rate hedges, discussed below, with respect to the outstanding balances on the Term Loan and the Draw Term Loan that the Company has entered into with Wells Fargo Bank, N.A as counterparty to the hedges.

The Company has hedges that fix LIBOR through maturity at 4.695%, 4.875% and 5.500% on the outstanding balance of the Term Loan, 75% of the outstanding balance on the Draw Term Loan and 25% of the outstanding balance of the Draw Term Loan, respectively. As a result of the Amendment, and based on the current LIBOR margin of 1.750% (1.125% prior to the Amendment), as of June 1, 2010 the Company s interest rates are: 6.445% (5.820% prior to the Amendment) on the outstanding balance of the Term Loan; 6.625% (6.000% prior to the Amendment) on 75% of the outstanding balance of the Draw Term Loan; and 7.250% (6.625% prior to the Amendment) on 25% of the outstanding balance of the Draw Term Loan.

The hedges have been effective as defined under applicable accounting rules. Therefore, changes in fair value of the interest rate hedges are reflected in comprehensive income (loss). The Company will be exposed to credit losses in the event of non-performance by the counterparty to the hedges. Due to interest rate declines, the Company s mark-to-market of its interest rate hedges at June 30, 2010 and December 31, 2009, resulted in liabilities of $4.2 million and $3.2 million, respectively, which are included in accrued expenses ($1.6 and $1.7 million, respectively) and other liabilities ($2.6 million and $1.5 million, respectively) on the Company s Condensed Consolidated Balance Sheets. The Company paid $462 thousand and $938 thousand in quarterly settlement payments pursuant to its hedges during the three- and six-month periods ended June 30, 2010, respectively, compared to payments of $416 thousand and $811 thousand in the comparable prior year three- and six-month periods, respectively. These payments were included in interest expense.

The Company is not contractually committed to any planned capital expenditures for its Lime and Limestone Operations until actual orders are placed for equipment. Under the Company s O & G Lease, and pursuant to the Company s subsequent elections to participate as a 20% non-operating working interest owner, unless, within five days after receiving an AFE (authorization for expenditures) for a proposed well, the Company provides notice otherwise, the Company is deemed to have elected to participate as a 20% working interest owner. As a 20% non-operating working interest owner, the Company is responsible for 20% of the costs to drill, complete and workover the well. Pursuant to the Drillsite Agreement, the Company, as a 12.5% non-operating working interest owner, is responsible for 12.5% of the costs to drill, complete and workover each well. As of June 30, 2010, the Company had no material open orders or commitments that are not included in current liabilities on the June 30, 2010 Condensed Consolidated Balance Sheet.

As of June 30, 2010, the Company had $39.2 million in total debt outstanding.

Results of Operations.

Revenues in the second quarter 2010 increased to $37.9 million from $29.1 million in the comparable prior year quarter, an increase of $8.8 million, or 30.2%. Revenues from the Company s Lime and Limestone Operations in the second quarter 2010 increased $8.5 million, or 30.8%, to $36.2 million from $27.6 million in the comparable 2009 quarter, while revenues from its Natural Gas Interests increased $278 thousand, or 18.6%, to $1.8 million from $1.5 million in the comparable prior year quarter. For the six months ended June 30, 2010, revenues increased to $71.5 million from $57.4 million in the comparable 2009 period, an increase of $14.1 million, or 24.5%. Revenues from the Company s Lime and Limestone Operations in the first six months 2010 increased $13.5 million, or 24.9%, to $67.6 million from $54.2 million in the comparable 2009 period, while revenues from its Natural Gas Interests increased $612 thousand, or 18.6%, to $3.9 million from $3.3 million in the comparable prior year period. The increase in lime and limestone revenues in the 2010 periods as compared to last year s comparable periods primarily resulted from increased sales volumes of the Company s lime products due to improved demand, principally from its steel customers, and increased prices realized during the periods for the Company s lime and limestone products.

The Company s gross profit was $10.6 million for the second quarter 2010, compared to $6.8 million in the comparable 2009 quarter, an increase of $3.7 million, or 55.0%. Gross profit for the first six months 2010 was $20.1 million, an increase of $7.0 million, or 54.0%, from $13.0 million in the first six months 2009. Included in gross profit for the second quarter and first half 2010 were $9.3 million and $17.2 million, respectively, from the Company s Lime and Limestone Operations, compared to $5.9 million and $11.1 million, respectively, in the comparable 2009 periods. The improved gross profits and gross profit margins as a percentage of revenues for the Company s Lime and Limestone Operations in the second quarter and first half of 2010, compared to the 2009 comparable periods, primarily resulted from the increased revenues and operating efficiencies, partially offset by costs incurred and accrued as a result of the accident at St. Clair.

Gross profit from the Company s natural gas interests increased to $1.3 million and $2.9 million for the second quarter and first half 2010, respectively, from $863 thousand and $1.9 million, respectively, in the comparable 2009 periods, primarily due to the increase in prices for natural gas liquids, compared to the comparable prior year periods, and, for the second quarter 2010, increased natural gas prices compared to the 2009 quarter, partially offset by reduced production volumes. Production volumes from the Company s Natural Gas Interests for the second quarter 2010 totaled 229 thousand MCF from 30 wells, sold at an average price of $7.75 per MCF, compared to 343 thousand MCF from 30 wells, sold at an average price of $4.73 per MCF, in the comparable 2009 quarter. Production volumes for the first half 2010 from Natural Gas Interests totaled 465 thousand MCF at an average price of $8.40 per MCF, compared to the first half 2009 when 707 thousand MCF was produced and sold at an average price of $5.24 per MCF. The unitization of 11 natural gas wells during the first half 2009 resulted in retroactive net adjustments of approximately $125 thousand and $375 thousand that reduced gross profit for the second quarter and first half 2009, respectively.

Selling, general and administrative expenses (SG&A) were $1.9 million in the second quarters 2010 and 2009. As a percentage of revenues, SG&A decreased to 5.1% in the 2010 quarter compared to 6.6% in the comparable 2009 quarter. SG&A increased to $4.3 million in the first six months 2010 from $3.8 million in the comparable 2009 period, an increase of $470 thousand, or 12.2%. As a percentage of revenues, SG&A in the first six months 2010 decreased to 6.0%, compared to 6.7% in the comparable 2009 period. The increase in SG&A in the 2010 first half was primarily due to increased insurance costs and an increase in allowance for doubtful accounts in the first quarter 2010.

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Interest expense in the second quarter 2010 decreased $65 thousand, or 8.9%, to $666 thousand from $731 thousand in the second quarter 2009. Interest expense in the first six months 2010 decreased to $1.3 million from $1.5 million in the first six months 2009, a decrease of $161 thousand, or 10.9%. The decrease in interest expense in the 2010 periods primarily resulted from decreased average outstanding debt due to the repayment of $10 million of debt since June 30, 2009, partially offset by an increase in interest rates for June 2010 resulting from the Amendment. Interest expense included payments of $462 thousand and $938 thousand that were made pursuant to the Company s interest rate hedges during the three- and six-month periods ended June 30, 2010, respectively, compared to payments of $416 thousand and $811 thousand in the comparable prior year three- and six-month periods, respectively.

Income tax expense increased to $2.3 million in the second quarter 2010 from $863 thousand in the second quarter 2009, an increase of $1.5 million, or 170.0%. For the first six months 2010, income tax expense increased to $4.2 million from $1.7 million in the comparable 2009 period, an increase of $2.5 million, or 147.7%. The increases in income taxes in the 2010 periods compared to the comparable 2009 periods were primarily due to the increases in the Company s effective income tax rates and income before income taxes. The Company s effective income tax rate for the 2010 periods increased compared to the rates for the comparable 2009 periods primarily because of the $6.7 million increase in income before income taxes in the first half 2010 compared to the first half 2009.

The Company s net income was $5.7 million ($0.88 per share diluted) in the second quarter 2010, compared to net income of $3.4 million ($0.53 per share diluted) in the second quarter 2009, an increase of $2.3 million, or 66.3%. Net income in the first half 2010 was $10.3 million, an increase of $4.2 million, or 68.1%, compared to the first half 2009 net income of $6.1 million.

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk.

The Company is exposed to changes in interest rates, primarily as a result of floating interest rates on the Revolving Facility. At June 30, 2010, the Company had $39.2 million of indebtedness outstanding under floating rate debt. The Company has entered into interest rate hedge agreements to swap floating rates for fixed LIBOR rates at 4.695%, plus the applicable margin, through maturity on the Term Loan balance of $25.0 million, 4.875%, plus the applicable margin, on $10.6 million of the Draw Term Loan balance and 5.50%, plus the applicable margin, on the remaining $3.5 million of the Draw Term Loan balance. There was no outstanding balance on the Revolving Facility subject to interest rate risk at June 30, 2010. Any future borrowings under the Revolving Facility would be subject to interest rate risk. See Note 8 of Notes to Condensed Consolidated Financial Statements.

ITEM 4: CONTROLS AND PROCEDURES

The Company s management, with the participation of the Company s Chief Executive Officer (CEO) and Chief Financial Officer (CFO), evaluated the effectiveness the Company s disclosure controls and procedures as of the end of the period covered by this Report. Based on that evaluation, the CEO and CFO concluded that the Company s disclosure controls and procedures as of the end of the period covered by this Report were effective.

No change in the Company s internal control over financial reporting occurred during the Company s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Information with respect to an accident at the Company s St. Clair plant in Oklahoma resulting in a fatality is set forth in Note 9 of Notes to Condensed Consolidated Financial Statements, and is hereby incorporated by reference in response to this Item.

ITEM 2: UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The Company s Amended and Restated 2001 Long-Term Incentive Plan allows employees and directors to pay the exercise price for stock options and the tax withholding liability for the lapse of restrictions on restricted stock by payment in cash and/or delivery of shares of the Company s common stock. In the second quarter 2010, pursuant to these provisions the Company received a total of 2,403 shares of its common stock (1,412 shares in payment to exercise stock options and 991 shares for the payment of tax withholding liability for the lapse of restrictions on restricted stock). The 2,403 shares were valued at $38.52 to $39.99 per share (weighted average of $39.39 per share), the fair market value of one share of the Company s common stock on the date they were tendered to the Company.

ITEM 6: EXHIBITS

31.1	Rule 13a-14(a)/15d-14(a) Certification by the Chief Executive Officer.
31.2	Rule 13a-14(a)/15d-14(a) Certification by the Chief Financial Officer.
32.1	Section 1350 Certification by the Chief Executive Officer.
32.2	Section 1350 Certification by the Chief Financial Officer.

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.

UNITED STATES LIME & MINERALS, INC.

July 28, 2010

By: /s/ Timothy W. Byrne
Timothy W. Byrne
President and Chief Executive Officer
(Principal Executive Officer)

July 28, 2010

By: /s/ M. Michael Owens
M. Michael Owens
Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

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EXHIBIT NUMBER	DESCRIPTION
31.1	Rule 13a-14(a)/15d-14(a) Certification by the Chief Executive Officer.
31.2	Rule 13a-14(a)/15d-14(a) Certification by the Chief Financial Officer.
32.1	Section 1350 Certification by the Chief Executive Officer.
32.2	Section 1350 Certification by the Chief Financial Officer.