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LSB INDUSTRIES INC  
Form 10-Q/A  
December 30, 2005

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q/A  
Amendment No. 1

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

For Quarterly period ended

March 31, 2005

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-7677

LSB Industries, Inc.

Exact name of Registrant as specified in its charter

Delaware

73-1015226

State or other jurisdiction of  
incorporation or organization

I.R.S. Employer Identification No.

16 South Pennsylvania Avenue, Oklahoma City, Oklahoma 73107

Address of principal executive offices (Zip Code)

(405) 235-4546

Registrant's telephone number, including area code

None

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 X NO \_\_\_

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES \_\_\_ NO X

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The number of shares outstanding of the Registrant's voting common stock, as of May 2, 2005 was 13,711,738 shares, excluding 3,321,607 shares held as treasury stock.

-1-

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FORM  
10-Q/A,  
AMENDMENT  
NO.  
1,  
OF  
LSB  
INDUSTRIES,  
INC.

TABLE  
OF  
CONTENTS

|   | <u>Page</u> |
|---|-------------|
| Explanatory Introduction Note   | 3           |
| PART I - Financial Information  |             |
| Item 1. Financial Statements  | 5           |
| Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations | 38          |
| Item 3. Quantitative and Qualitative Disclosures About Market Risk                            | 48          |
| Item 4. Controls and Procedures   | 49          |
| PART II - Other Information   |             |
| Item 1. Legal Proceedings   | 54          |
| Item 2. Unregistered Sales of Equity Securities and Use of Proceeds                           | 54          |
| Item 3. Defaults Upon Senior Securities   | 54          |
| Item 4. Submission of Matters to a Vote of Security Holders                                   | 55          |
| Item 5. Other Information   | 55          |
| Item 6. Exhibits  | 55          |

-2-

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Explanatory Introduction Note:

As part of the Securities and Exchange Commission's ("SEC") requirements to periodically review reports filed by issuers under the Securities Exchange Act of 1934, we received comments from the SEC regarding our Annual Report on Form 10-K for year ended December 31, 2004 ("2004 Form 10-K") and our quarterly report on Form 10-Q for quarter ended March 31, 2005 ("2005 Form 10-Q").

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As a result of comments received from the SEC, we have filed a restated and amended 2004 Form 10-K/A and we have restated and amended in this Form 10-Q/A ("2005 Form 10-Q/A") as follows:

- Amend our 2004 audited Consolidated Statements of Income contained in our 2004 Form 10-K to appropriately classify other income relating to the sale of assets and other expense relating to the impairment of certain assets and certain other items from non-operating to operating income. These restated classifications did not change or affect "net income" reflected in our Consolidated Statement of Income in our 2004 Form 10-K.
- Amend our 2005 Condensed Consolidated Statement of Operations contained in our 2005 Form 10-Q to appropriately classify a gain resulting from the sale of certain operating assets and certain other items from non-operating to operating income. These restated classifications did not change or affect "net income" reflected in our Condensed Consolidated Statement of Operations in our 2005 Form 10-Q.
- Restate our audited financial statements contained in our 2004 Form 10-K to appropriately reflect the change from LIFO to FIFO method of accounting for certain inventory of heat pump products within our Climate Control segment in accordance with Accounting Principles Board Opinion No. 20. The effect for the three years in the period ended December 31, 2004 decreased reported net income in 2004 and 2003 by \$503,000 and \$198,000, respectively, and increased 2002 net income by \$23,000. The effect of this restatement increased stockholders' equity by \$678,000 at December 31, 2001. There was no effect on the balance sheet at December 31, 2004 resulting from this restatement. We did not disclose this change in our financial statements contained in the 2004 Form 10-K since we believed that this was not a material change pursuant to Staff Accounting Bulletin 99. The effect of this restatement reduced net income contained in our 2004 Consolidated Statement of Income from \$1.9 million to \$1.4 million. In addition, the effect changed the 2004 results of operations reflected in our 2005 Form 10-Q by increasing our net loss by \$125,000 for the three months ended March 31, 2004 (from a net loss of \$.1 million to a net loss of \$.2 million).

We revised our disclosure controls and procedures reports contained in our 2005 Form 10-Q by removing any qualifying language to the effectiveness of such disclosure controls and procedures and by discussing the facts and circumstances surrounding the above described restatements and amendments and how such restatements and amendments impacted our CEO's and CFO's original conclusions regarding effectiveness of our disclosure controls and procedures and concluded that our disclosure controls and procedures were not effective at March 31, 2005.

Accordingly, this 2005 Form 10Q/A includes our restated financial statements for the three-month periods ended March 31, 2005 and 2004 with accompanying notes.

-3-

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Except for the foregoing amended information and certain other changes in classifications discussed in Note 2 of Notes to Condensed Consolidated Financial Statements, this 2005 Form 10-Q/A continues to describe conditions as of the date of the original filing and we have not updated the disclosures contained herein to reflect events that occurred at a later date. Other events occurring after the original filing or other disclosures necessary to reflect subsequent events have been or will be addressed in reports filed with the SEC subsequent to the date of the original filing.

For the convenience of the reader, this 2005 Form 10-Q/A sets forth the original filing in its entirety; however, as a result of the items noted above, this 2005 Form 10-Q/A only amends and/or restates the condensed consolidated financial statements and accompanying notes of Item 1, Item 2, Special Note Regarding Forward-Looking Statements, and Item 4 of the original filing. In each case, solely as a result of the items noted above (including certain other changes in classifications discussed in Note 2 of Notes to Condensed Consolidated Financial Statements), and no other information in the original filing is amended hereby. The foregoing items have not been updated to reflect other events occurring after the original filing or to modify or update those disclosures affected by subsequent events. In addition, pursuant to the rules of the SEC, the original filing has been amended to contain currently dated certifications for our Chief Executive Officer and Chief Financial Officer are attached to this 2005 Form 10-Q/A, as Exhibits 31.1, 31.2, 32.1 and 32.2, respectively.

-4-

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LSB INDUSTRIES, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Information at March 31, 2005 is unaudited)  
(As restated, See Note 2)

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(Dollars in thousands)

Item 1.

| <u>ASSETS</u>                           | March 31,<br>2005 | December 31,<br>2004 |
|---|-------------------|----------------------|
| Current assets:                         |                   |                      |
| Cash                                    | \$ 1,013          | \$ 1,020             |
| Restricted cash                         | -                 | 158                  |
| Accounts receivable, net                | 47,723            | 41,888               |
| Inventories:                            |                   |                      |
| Finished goods                          | 22,009            | 17,180               |
| Work in process                         | 2,564             | 2,364                |
| Raw materials                           | 9,520             | 9,113                |
| Total inventories                       | 34,093            | 28,657               |
| Supplies, prepaid items and other:      |                   |                      |
| Deferred rent expense                   | -                 | 938                  |
| Prepaid insurance                       | 3,178             | 4,498                |
| Precious metals                         | 4,744             | 5,616                |
| Other                                   | 4,489             | 3,736                |
| Total supplies, prepaid items and other | 12,411            | 14,788               |
| Total current assets                    | 95,240            | 86,511               |
| Property, plant and equipment, net      | 69,576            | 70,219               |
| Other assets:                           |                   |                      |
| Debt issuance and other costs, net      | 3,174             | 2,517                |
| Investment in affiliate                 | 3,205             | 3,111                |
| Goodwill                                | 1,724             | 1,724                |
| Other, net                              | 2,630             | 2,833                |
| Total other assets                      | 10,733            | 10,185               |
|   | \$ 175,549        | \$ 166,915           |

(Continued on following page)

-5-

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LSB INDUSTRIES, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Information at March 31, 2005 is unaudited)  
(As restated, See Note 2)  
(Dollars in thousands)

| <u>LIABILITIES AND STOCKHOLDERS' EQUITY</u> | March 31,<br>2005 | December 31,<br>2004 |
|---|-------------------|----------------------|
| Current liabilities:                        |                   |                      |
| Accounts payable                            | \$ 25,338         | \$ 27,698            |
| Short-term financing and drafts payable     | 2,309             | 3,707                |
| Accrued liabilities:                        |                   |                      |
| Customer deposits                           | 2,126             | 3,421                |
| Deferred rent expense                       | 361               | -                    |
| Other                                       | 15,513            | 13,006               |

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|  |            |            |
|--|------------|------------|
| Total accrued liabilities  | 18,000     | 16,427     |
| Current portion of long-term debt  | 4,653      | 4,833      |
| Total current liabilities  | 50,300     | 52,665     |
| Long-term debt   | 111,244    | 101,674    |
| Other noncurrent liabilities   | 4,081      | 4,178      |
| Contingencies (Note 7)   |            |            |
| Stockholders' equity:  |            |            |
| Series B 12% cumulative, convertible preferred stock, \$100 par value;   |            |            |
| 20,000 shares issued and outstanding; aggregate liquidation preference of \$3,260,000 (\$3,020,000 in 2004)  | 2,000      | 2,000      |
| Series 2 \$3.25 convertible, exchangeable Class C preferred stock, \$50 stated value; 623,550 shares issued; aggregate liquidation preference of \$42,737,000 (\$42,234,000 in 2004) | 31,177     | 31,177     |
| Series D 6% cumulative, convertible Class C preferred stock, no par value; 1,000,000 shares issued; aggregate liquidation preference of \$1,180,000                                  | 1,000      | 1,000      |
| Common stock, \$.10 par value; 75,000,000 shares authorized, 17,017,805 shares issued (16,400,985 in 2004)   | 1,702      | 1,640      |
| Capital in excess of par value   | 57,329     | 57,352     |
| Accumulated other comprehensive loss   | (1,207)    | (1,280)    |
| Accumulated deficit  | (65,426)   | (66,840)   |
|  | 26,575     | 25,049     |
| Less treasury stock at cost:   |            |            |
| Series 2 Preferred, 5,000 shares   | 200        | 200        |
| Common stock, 3,321,607 shares   | 16,451     | 16,451     |
| Total stockholders' equity   | 9,924      | 8,398      |
|  | \$ 175,549 | \$ 166,915 |

(See accompanying notes)

-6-

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LSB INDUSTRIES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)  
Three Months Ended March 31, 2005 and 2004  
(As restated, See Note 2)  
(Dollars in thousands, except per share amounts)

|  | 2005      | 2004      |
|--|-----------|-----------|
| Net sales  | \$ 86,681 | \$ 83,669 |
| Cost of sales  | 72,132    | 72,638    |
| Gross profit   | 14,549    | 11,031    |
| Selling, general and administrative                              | 12,266    | 11,183    |
| Other expense  | 216       | 137       |
| Other income (Note 12)   | (504)     | (72)      |
| Operating income (loss)  | 2,571     | (217)     |
| Interest expense (Note 6)  | 2,737     | 1,432     |
| Non-operating other income, net (Note 12)                        | (1,398)   | (1,787)   |
| Income from operations before provision for income taxes, equity |           |           |
| in earnings of affiliate and cumulative effect of accounting     | 1,232     | 138       |

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change

|   |            |            |
|---|------------|------------|
| Provision for income taxes                                  | -          | (4)        |
| Equity in earnings of affiliate (Note 4)                    | 182        | 159        |
| Income before cumulative effect of accounting change        | 1,414      | 293        |
| Cumulative effect of accounting change (Note 14)            | -          | (536)      |
| Net income (loss)   | 1,414      | (243)      |
| Preferred stock dividend requirements                       | (562)      | (567)      |
| Net income (loss) applicable to common stock (Note 10)      | \$ 852     | \$ (810)   |
| <hr/>   |            |            |
| Weighted average common shares (Note 10):                   |            |            |
| Basic   | 13,234,509 | 12,657,849 |
|   | <hr/>      | <hr/>      |
| Diluted   | 14,833,375 | 12,657,849 |
|   | <hr/>      | <hr/>      |
| Net income (loss) per common share (Note 10):               |            |            |
| Basic and diluted:  |            |            |
| Income (loss) before cumulative effect of accounting change | \$ .06     | \$ (.02)   |
| Cumulative effect of accounting change                      | -          | (.04)      |
| Net income (loss)   | \$ .06     | \$ (.06)   |
|   | <hr/>      | <hr/>      |

(See accompanying notes)

-7-

LSB INDUSTRIES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)  
Three Months Ended March 31, 2005 and 2004  
(As restated, See Note 2)  
(Dollars in thousands)

|  | 2005     | 2004     |
|--|----------|----------|
| Cash flows from operating activities:  |          |          |
| Net income (loss)  | \$ 1,414 | \$ (243) |
| Adjustments to reconcile net income (loss) to net cash used by operating activities:   |          |          |
| Cumulative effect of accounting change   | -        | 536      |
| Gains on sales of property and equipment   | (422)    | (5)      |
| Realization and reversal of firm sales commitments   | -        | (55)     |
| Depreciation of property, plant and equipment  | 2,538    | 2,608    |
| Amortization   | 374      | 228      |
| Provision for losses on accounts receivables   | 94       | 250      |
| Provisions for losses on (realization and reversal of) inventory   | (242)    | 827      |
| Provision for impairment on long-lived assets  | 75       | -        |
| Cash provided (used) by changes in assets and liabilities (net of effects of the consolidation of a variable interest entity - Note 14): |          |          |
| Accounts receivable  | (5,847)  | (7,169)  |
| Inventories  | (5,194)  | (2,699)  |
| Supplies, prepaid items and other  | 1,139    | 825      |

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|   |         |         |
|---|---------|---------|
| Accounts payable                              | (2,360) | 3,856   |
| Customer deposits                             | (1,295) | (1,839) |
| Deferred rent expense                         | 1,299   | 1,451   |
| Other accrued and noncurrent liabilities      | 2,412   | (445)   |
| Net cash used by operating activities         | (6,015) | (1,874) |
| Cash flows from investing activities:         |         |         |
| Capital expenditures                          | (2,156) | (3,158) |
| Proceeds from sales of property and equipment | 508     | 5       |
| Net change in restricted cash                 | 158     | -       |
| Other assets                                  | (571)   | (184)   |
| Net cash used by investing activities         | (2,061) | (3,337) |

(See accompanying notes)

-8-

LSB INDUSTRIES, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)  
 (Unaudited)  
 Three Months Ended March 31, 2005 and 2004  
 (As restated, See Note2)  
 (Dollars in thousands)

|  | 2005      | 2004      |
|--|-----------|-----------|
| Cash flows from financing activities:                        |           |           |
| Proceeds from revolving debt facilities                      | \$ 82,143 | \$ 72,509 |
| Payments on revolving debt facilities                        | (72,087)  | (65,109)  |
| Proceeds from long-term and other debt                       | 38        | -         |
| Payments on long-term and other debt                         | (665)     | (1,617)   |
| Proceeds from short-term financing and drafts payable        | 41        | 101       |
| Payments on short-term financing and drafts payable          | (1,439)   | (1,280)   |
| Net proceeds from issuance of common stock                   | 38        | 526       |
| Net cash provided by financing activities                    | 8,069     | 5,130     |
| Net increase in cash from variable interest entity (Note 14) | -         | 711       |
| Net increase (decrease) in cash                              | (7)       | 630       |
| Cash at beginning of period                                  | 1,020     | 3,189     |
| Cash at end of period  | \$ 1,013  | \$ 3,819  |

Supplemental cash flow information includes:

|   | 2005 | 2004       |
|---|------|------------|
| Noncash investing and financing activities:                           |      |            |
| Effects of the consolidation of a variable interest entity (Note 14): |      |            |
| Increase in property, plant and equipment                             | \$ - | \$ 4,107   |
| Elimination of notes receivable                                       | \$ - | \$ (2,558) |
| Increase in other assets  | \$ - | \$ 311     |



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Three Months Ended March 31, 2005 and 2004

classifications will not change or affect "net income" reflected in our Condensed Consolidated Statement of Operations in our 2005 Form 10-Q.

- Restate our audited financial statements contained in our 2004 Form 10-K to appropriately reflect the change from LIFO to FIFO method of accounting for certain inventory of heat pump products within our Climate Control Business in accordance with Accounting Principles Board Opinion No. 20. The effect of this restatement reduced net income contained in our Consolidated Statement of Income for the year ended December 31, 2004 by \$503,000 (from \$1.9 million to \$1.4 million) and increased stockholder's equity at December 31, 2003 by \$503,000. There was no effect on the balance sheet at December 31, 2004 resulting from this restatement. In addition, the effect changed the 2004 results of operations reflected in our 2005 Form 10-Q by increasing our net loss by \$125,000 for the three months ended March 31, 2004 (from a net loss of \$.1 million to a net loss of \$.2 million) as reflected below.

Since we have restated and amended our 2004 consolidated financial statements, this resulted in the restatement of our condensed consolidated statements of operations and cash flows for three-month periods ended March 31, 2004.

In addition, based on internal reviews of our accounting policies and financial presentation, we have made the following classification changes to our consolidated financial statements. These changes in classifications did not change or affect net income (loss) reflected in our Condensed Consolidated Statements of Operations.

- Change our classification of the premium financing of certain insurance policies previously offset against the related prepaid insurance in our condensed consolidated balance sheets at March 31, 2005 and December 31, 2004 to be in accordance with Accounting Principles Board Opinion ("APB") No. 10. At March 31, 2005 and December 31, 2004, this change resulted in an increase to current assets and current liabilities of \$2.2 million and \$3.5 million, respectively. In addition, make a conforming change in our classification of the financing portion of prepaid insurance in our condensed consolidated statements of cash flows for the three months ended March 31, 2005 and 2004 to be in accordance with Statement of Financial Accounting Standards ("SFAS") No. 95. This change resulted in a decrease in net cash used by operating activities and a decrease in net cash provided by financing activities of \$1.3 million for 2005 and 2004.
- Change our classification of certain debt issuance costs previously classified as a current asset in our condensed consolidated balance sheets at March 31, 2005 and December 31, 2004 since it related to long-term debt. At March 31, 2005 and December 31, 2004, this change resulted in a decrease to current assets of \$781,000 and \$540,000, respectively, and an increase to non-current assets of \$781,000 and \$540,000, respectively. In addition, change our classification of the amortization expense of debt issuance costs previously classified as selling, general and administrative expenses ("SG&A") in our condensed consolidated statements of operations for the three months ended March 31, 2005 and 2004 to be in accordance with APB No 21. This change resulted in a decrease to SG&A and an increase to interest expense of \$202,000 and \$134,000 for the three-month periods ended March 31, 2005 and 2004, respectively.

-11-

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 2005 and 2004

- Change our classification of the elimination of certain intercompany transactions (primarily relating to leases and corporate management fees) used in our consolidation process to prepare our condensed consolidated statement of operations for the three months ended March 31, 2004. This change resulted in a decrease to cost of sales and an increase to SG&A of \$318,000 for the three-month period ended March 31, 2004.
- Change our classification of certain shipping costs previously classified as SG&A in our condensed consolidated statement of operations for the three months ended March 31, 2004 to be consistent with the classification of other shipping cost that relate to amounts billed to our customers. This change resulted in a decrease to net sales and SG&A of \$123,000 for the three-month period ended March 31, 2004.

The following table shows our 2005 condensed consolidated financial statements and the balance sheet at December 31, 2004 as originally reported in our March 31, 2005 Form 10-Q and our 2004 condensed consolidated

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financial statements as originally reported in our March 31, 2004 Form 10-Q, showing restatements and amendments (Column 2) to our condensed consolidated financial statements resulting from comments received from the SEC which restatements due to the change from the LIFO method to the FIFO method of accounting for certain inventories, affects net income as discussed above, and amends our Condensed Consolidated Statements of Operations to reclassify certain items originally reported as Other Income or Other Expense below the Operating Income (Loss) line to be included in the determination of Operating Income (Loss). The table also shows the effects of reclassifications (Column 1) discussed above that resulted from our internal reviews. As stated above, the changes in classifications had no effect on net income (loss) in our Condensed Consolidated Statements of Operations.

### Consolidated Balance Sheet - At March 31, 2005:

|  | As<br>Originally<br>Reported | Reclassifications<br>(Column 1) | Restatements<br>and/or<br>Amendments<br>(Column 2) | As<br>Restated |
|--|------------------------------|---------------------------------|--|----------------|
|  | (in thousands)               |                                 |  |                |
| Supplies, prepaid items and other          | \$ 11,008                    | \$ 1,403                        | \$ -   | \$ 12,411      |
| Total current assets                       | \$ 93,837                    | \$ 1,403                        | \$ -   | \$ 95,240      |
| Debt issuance costs, net                   | \$ 2,393                     | \$ 781                          | \$ -   | \$ 3,174       |
| Total assets                               | \$ 173,365                   | \$ 2,184                        | \$ -   | \$ 175,549     |
| Accounts and drafts payable                | \$ 25,463                    | \$ (25,463)                     | \$ -   | \$ -           |
| Accounts payable                           | \$ -                         | \$ 25,338                       | \$ -   | \$ 25,338      |
| Short-term financing and drafts payable    | \$ -                         | \$ 2,309                        | \$ -   | \$ 2,309       |
| Total current liabilities                  | \$ 48,116                    | \$ 2,184                        | \$ -   | \$ 50,300      |
| Total liabilities and stockholders' equity | \$ 173,365                   | \$ 2,184                        | \$ -   | \$ 175,549     |

-12-

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 2005 and 2004

### Consolidated Balance Sheet - At December 31, 2004:

|                                   | As<br>Originally<br>Reported | Reclassifications<br>(Column 1) | Restatements<br>and/or<br>Amendments<br>(Column 2) | As<br>Restated |
|-----------------------------------|------------------------------|---------------------------------|--|----------------|
|                                   | (in thousands)               |                                 |  |                |
| Supplies, prepaid items and other | \$ 11,815                    | \$ 2,973                        | \$ -   | \$ 14,788      |

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|  |            |             |      |            |
|--|------------|-------------|------|------------|
| Total current assets                       | \$ 83,538  | \$ 2,973    | \$ - | \$ 86,511  |
| Debt issuance costs, net                   | \$ 1,977   | \$ 540      | \$ - | \$ 2,517   |
| Total assets                               | \$ 163,402 | \$ 3,513    | \$ - | \$ 166,915 |
| Accounts and drafts payable                | \$ 27,892  | \$ (27,892) | \$ - | \$ -       |
| Accounts payable                           | \$ -       | \$ 27,698   | \$ - | \$ 27,698  |
| Short-term financing and drafts payable    | \$ -       | \$ 3,707    | \$ - | \$ 3,707   |
| Total current liabilities                  | \$ 49,152  | \$ 3,513    | \$ - | \$ 52,665  |
| Total liabilities and stockholders' equity | \$ 163,402 | \$ 3,513    | \$ - | \$ 166,915 |

Condensed Consolidated Statement of Operations - For the three months ended March 31, 2005:

|   | As<br>Originally<br>Reported | Reclassifications<br>(Column 1) | Restatements<br>and/or<br>Amendments<br>(Column 2) | As<br>Restated |
|---|------------------------------|---------------------------------|--|----------------|
|   | (in thousands)               |                                 |  |                |
| Net sales   | \$ 86,681                    |                                 |  | \$ 86,681      |
| Costs of sales  | 72,132                       |                                 |  | 72,132         |
| Gross profit  | 14,549                       |                                 |  | 14,549         |
| Selling, general and administrative expenses                  | 12,468                       | \$ (202)                        |  | 12,266         |
| Other expense   | -                            |                                 | \$ 216 (B)   | 216            |
| Other income  | -                            |                                 | (504)(B)   | (504)          |
| Operating income  | 2,081                        | 202                             | 288  | 2,571          |
| Interest expense  | 2,535                        | 202                             |  | 2,737          |
| Other income  | (2,106)                      |                                 | 2,106  | -              |
| Other expense   | 238                          |                                 | (238)  | -              |
| Non-operating other income, net                               | -                            |                                 | (1,398)(B)   | (1,398)        |
| Income from operations before equity in earnings of affiliate | 1,414                        | -                               | (182)  | 1,232          |
| Equity in earnings of affiliate                               | -                            |                                 | 182 (C)  | 182            |
| Net income  | 1,414                        | -                               | -  | 1,414          |
| Preferred stock dividend requirement                          | (562)                        |                                 |  | (562)          |
| Net income applicable to common stock                         | \$ 852                       | \$ -                            | \$ -   | \$ 852         |

-13-

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 2005 and 2004

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Condensed Consolidated Statement of Operations - For the three months ended March 31, 2004:

|  | As<br>Originally<br>Reported             | Reclassifications<br>(Column 1) | Restatements<br>and/or<br>Amendments<br>(Column 2) | As<br>Restated |
|--|--|---------------------------------|--|----------------|
|  | (in thousands, except per share amounts) |                                 |  |                |
| Net sales  | \$ 83,792                                | \$ (123)                        |  | \$ 83,669      |
| Costs of sales   | 72,831                                   | (318)                           | \$ 125 (A)   | 72,638         |
| Gross profit   | 10,961                                   | 195                             | (125)  | 11,031         |
| Selling, general and administrative<br>expenses  | 11,122                                   | 61                              |  | 11,183         |
| Other expense  | -  |                                 | 137 (B)  | 137            |
| Other income   | -  |                                 | (72)(B )   | (72)           |
| Operating loss   | (161)                                    | 134                             | (190)  | (217)          |
| Interest expense   | 1,298                                    | 134                             |  | 1,432          |
| Other income   | (2,096)                                  |                                 | 2,096  | -              |
| Other expense  | 215                                      |                                 | (215)  | -              |
| Non-operating other income, net  | -  |                                 | (1,787)(B )  | (1,787)        |
| Income from operations before<br>provision<br>for income taxes, equity in earnings<br>of affiliate and cumulative effect of<br>accounting change | 422                                      | -                               | (284)  | 138            |
| Provision for income taxes   | (4)                                      |                                 |  | (4)            |
| Equity in earnings of affiliate  | -  |                                 | 159 (C)  | 159            |
| Income before cumulative effect of<br>accounting change  | 418                                      | -                               | (125)  | 293            |
| Cumulative effect of accounting change   | (536)                                    |                                 |  | (536)          |
| Net loss   | (118)                                    | -                               | (125)  | (243)          |
| Preferred stock dividend requirement   | (567)                                    |                                 |  | (567)          |
| Net loss applicable to common stock  | \$ (685)                                 | \$ -                            | \$ (125)   | \$ (810)       |
| <hr/>  |  |                                 |  |                |
| Loss per common share  |  |                                 |  |                |
| Basic and diluted:   |  |                                 |  |                |
| Loss before cumulative effect of<br>accounting change  | \$ (.01)                                 | \$ -                            | \$ (.01)(A )                                       | \$ (.02)       |
| Cumulative effect of accounting change   | (.04)                                    |                                 | -  | (.04)          |
| Net loss   | \$ (.05)                                 | \$ -                            | \$ (.01)   | \$ (.06)       |

Condensed Consolidated Statement of Cash Flows - For the three months ended March 31, 2005:

|  | As<br>Originally<br>Reported | Reclassifications<br>(Column 1) | Restatements<br>and/or<br>Amendments<br>(Column 2) | As<br>Restated |
|--|------------------------------|---------------------------------|--|----------------|
|  | (in thousands)               |                                 |  |                |

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|  |            |            |      |            |
|--|------------|------------|------|------------|
| Cash provided (used) by changes in supplies, prepaid items and other | \$ (190)   | \$ 1,329   | \$ - | \$ 1,139   |
| Net cash used by operating activities                                | \$ (7,344) | \$ 1,329   | \$ - | \$ (6,015) |
| Net change in drafts payable   | \$ (69)    | \$ 69      | \$ - | \$ -       |
| Proceeds from short-term financing and drafts payable                | \$ -       | \$ 41      | \$ - | \$ 41      |
| Payments on short-term financing and drafts payable                  | \$ -       | \$ (1,439) | \$ - | \$ (1,439) |
| Net cash provided by financing activities                            | \$ 9,398   | \$ (1,329) | \$ - | \$ 8,069   |

-14-

**LSB INDUSTRIES, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**  
**Three Months Ended March 31, 2005 and 2004**

Condensed Consolidated Statement of Cash Flows - For the three months ended March 31, 2004:

|  | As<br>Originally<br>Reported | Reclassifications<br>(Column 1) | Restatements<br>and/or<br>Amendments<br>(Column 2) | As<br>Restated |
|--|------------------------------|---------------------------------|--|----------------|
|  | (in thousands)               |                                 |  |                |
| Net loss   | \$ (118)                     | \$ -                            | \$ (125)(A)  | \$ (243)       |
| Cash used by changes in inventories                                  | \$ (2,824)                   | \$ -                            | \$ 125 (A)   | \$ (2,699)     |
| Cash provided (used) by changes in supplies, prepaid items and other | \$ (436)                     | \$ 1,261                        | \$ -   | \$ 825         |
| Net cash used by operating activities                                | \$ (3,135)                   | \$ 1,261                        | \$ -   | \$ (1,874)     |
| Net change in drafts payable   | \$ 82                        | \$ (82)                         | \$ -   | \$ -           |
| Proceeds from short-term financing and drafts payable                | \$ -                         | \$ 101                          | \$ -   | \$ 101         |

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|   |                   |                   |                   |                   |
|---|-------------------|-------------------|-------------------|-------------------|
| Payments on short-term financing and drafts payable | \$ -              | \$ (1,280)        | \$ -              | \$ (1,280)        |
|   | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Net cash provided by financing activities           | \$ 6,391          | \$ (1,261)        | \$ -              | \$ 5,130          |
|   | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |

(A) Amount relates to the change from LIFO to FIFO method of accounting for certain inventory.

(B) See detail in Note 12 - Other Expense and Other Income.

(C) Amount previously included in other income. See Note 4 - Investment in Affiliate.

Note 3: Change in Method of Accounting for Certain Inventories

In January 2004, we changed our method of accounting for certain heat pump product inventories from the LIFO method to the FIFO method. We believe the FIFO method is preferable because it: (i) increases the transparency of our financial reporting through a more balanced presentation of our financial position and results of operations; (ii) results in the valuation of all of our inventories at more recent cost in our financial statements; and (iii) conforms all of our inventories to a single method of accounting.

As a result, we have restated our financial statements for the year ended December 31, 2004 and have restated our financial statements for the three months ended March 31, 2004 in accordance with APB No. 20 as discussed in Note 2 - Restatement of Financial Statements. The effect of this restatement decreased net income by \$503,000 for the year ended December 31, 2004 and increased stockholders' equity by \$503,000 at December 31, 2003. For the three months ended March 31, 2004, the effect of this restatement increased our net loss by \$125,000.

Note 4: Investment in Affiliate

One of our subsidiaries has a 50% equity interest in an energy conservation joint venture which is accounted for on the equity method. At March 31, 2005 and December 31, 2004, our investment was \$3,205,000 and \$3,111,000, respectively. For the three months ended March 31, 2005 and 2004, our equity in the joint-venture earnings were \$182,000 and \$159,000, respectively.

-15-

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**LSB INDUSTRIES, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**  
**Three Months Ended March 31, 2005 and 2004**

Summarized financial information of the joint venture is as follows (in thousands):

|                        | March 31,<br>2005 | December 31,<br>2004 |
|------------------------|-------------------|----------------------|
| Current assets         | \$ 2,589          | \$ 2,575             |
|                        | <u>          </u> | <u>          </u>    |
| Noncurrent assets      | \$ 9,082          | \$ 9,333             |
|                        | <u>          </u> | <u>          </u>    |
| Current liabilities    | \$ 1,619          | \$ 1,815             |
|                        | <u>          </u> | <u>          </u>    |
| Noncurrent liabilities | \$ 6,876          | \$ 7,019             |
|                        | <u>          </u> | <u>          </u>    |
| Partners' capital      | \$ 3,176          | \$ 3,074             |

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|                  | Three Months Ended |          |
|------------------|--------------------|----------|
|                  | March 31,          |          |
|                  | 2005               | 2004     |
| Total revenues   | \$ 1,090           | \$ 1,078 |
| Operating income | \$ 548             | \$ 536   |
| Net income       | \$ 364             | \$ 319   |

Note 5: Product Warranty

Our Climate Control Business sells equipment that has an expected life, under normal circumstances and use, that extends over many years. As such, we provide warranties after equipment shipment/start-up covering defects in materials and workmanship.

Generally, the warranty coverage for the manufactured equipment in the Climate Control Business is limited to eighteen months from the date of shipment or twelve months from the date of start-up, whichever is shorter, and to ninety days for spare parts. In most cases, equipment is required to be returned to the factory or its authorized representative and the warranty is limited to the repair and replacement of the defective product, with a maximum warranty of the refund of the purchase price. Furthermore, companies within the Climate Control Business do not make any warranties related to merchantability or fitness for any particular purpose and disclaim and exclude any liability for consequential or incidental damages. In some cases, an extended warranty may be purchased. The above discussion is generally applicable but variations do occur depending upon specific contractual obligations, certain system components and local laws.

Our accounting policy and methodology for warranty arrangements is to periodically measure and recognize the expense and liability for such warranty obligations using a percentage of net sales, based upon our historical warranty costs.

The carrying amount of the product warranty obligation is as follows:

|                                    | Three Months Ended |          |
|------------------------------------|--------------------|----------|
|                                    | March 31,          |          |
|                                    | 2005               | 2004     |
| Balance at beginning of period     | \$ 1,999           | \$ 1,693 |
| Add: Charged to costs and expenses | 411                | 379      |
| Deduct: Costs incurred             | (300)              | (350)    |
| Balance at end of period           | \$ 2,110           | \$ 1,722 |

-16-

LSB INDUSTRIES, INC.  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 (Unaudited)  
 Three Months Ended March 31, 2005 and 2004

Note 6: Long-Term Debt

Long-term debt consists of the following:

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|   | March 31,<br>2005 | December 31,<br>2004 |
|---|-------------------|----------------------|
|   | (In thousands)    |                      |
| Senior Secured Loan due 2009 (A)  | \$ 50,000         | \$ 50,000            |
| Working Capital Revolver Loan - ThermaClima (B)   | 37,568            | 27,489               |
| 10-3/4% Senior Unsecured Notes due 2007 (C)   | 13,300            | 13,300               |
| Other, with interest at rates of 2% to 14.13%, most of which is secured by machinery, equipment and real estate | 15,029            | 15,718               |
|   | 115,897           | 106,507              |
| Less current portion of long-term debt  | 4,653             | 4,833                |
| Long-term debt due after one year   | \$ 111,244        | \$ 101,674           |

(A) In September 2004, ThermaClima and certain of its subsidiaries (the "Borrowers") completed a \$50 million term loan ("Senior Secured Loan") with a certain lender (the "Lender"). The Senior Secured Loan is to be repaid as follows:

- quarterly interest payments which began September 30, 2004;
- quarterly principal payments of \$312,500 beginning September 30, 2007;
- a balloon payment of the remaining outstanding principal of \$47.5 million and accrued interest on September 16, 2009.

The Senior Secured Loan accrues interest at the applicable LIBOR rate, as defined, plus an applicable LIBOR margin, as defined or, at the election of the Borrowers, the alternative base rate, as defined, plus an applicable base rate margin, as defined, with the annual interest rate not to exceed 11% or 11.5% depending on the leverage ratio. At March 31, 2005 the effective interest rate was 11.09%.

The Borrowers are subject to numerous covenants under the Senior Secured Loan agreement including, but not limited to, limitation on the incurrence of certain additional indebtedness and liens, limitations on mergers, acquisitions, dissolution and sale of assets, and limitations on declaration of dividends and distributions to us, all with certain exceptions. The Borrowers are also subject to a minimum fixed charge coverage ratio, measured quarterly on a trailing twelve-month basis. The Borrowers' fixed charge coverage ratio exceeded the required ratio for the twelve-month period ended March 31, 2005. The maturity date of the Senior Secured Loan can be accelerated by the Lender upon the occurrence of a continuing event of default, as defined.

The Senior Secured Loan agreement includes a prepayment fee equal to 3% of the principal amount should the Borrowers elect to prepay any principal amount prior to September 15, 2005. This fee is reduced to 2% during the second twelve-month period and to 1% during the third twelve-month period and 0% thereafter.

-17-

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 2005 and 2004

The Senior Secured Loan is secured by (a) a first lien on (i) certain real property and equipment located at the El Dorado Facility, (ii) certain real property and equipment located at the Cherokee Facility, (iii) certain equipment of the Climate Control Business, and (iv) the equity stock of certain of ThermaClima's subsidiaries, and (b) a second lien on the assets upon which ThermaClima's Working Capital Revolver lender has a first lien. The Senior Secured Loan is guaranteed by the Company and is also secured with the stock of ThermaClima.

A portion of the proceeds of the Senior Secured Loan was used to repay the outstanding balance under a former financing agreement ("Financing Agreement"). There was no interest expense recognition on the Financing Agreement indebtedness from May 2002 through September 2004 since that transaction was accounted for as a voluntary debt restructuring in 2002.

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(B) In April 2001, ThermaClimate and its subsidiaries ("the Borrowers") entered into a \$50 million revolving credit facility (the "Working Capital Revolver Loan") that provides for advances based on specified percentages of eligible accounts receivable and inventories for ThermaClimate and its subsidiaries. Effective February 28, 2005 the Working Capital Revolver Loan was amended which, among other things, extended the maturity date to April 2009 and removed language considered as a subjective acceleration provision. The Working Capital Revolver Loan, as amended, accrues interest at a base rate (generally equivalent to the prime rate) plus .75% or LIBOR plus 2% (formerly base rate plus 2% or LIBOR plus 4.50%). The effective rate at March 31, 2005 was 5.22%. The facility provides for up to \$8.5 million of letters of credit. Under the Working Capital Revolver Loan, as amended, the lender also requires the borrowers to pay a letter of credit fee equal to 1% (formerly 2.75%) per annum of the undrawn amount of all outstanding letters of credit, an unused line fee equal to .5% per annum for the excess amount available under the facility not drawn and various other audit, appraisal and valuation charges. All letters of credit outstanding reduce availability under the facility. Amounts available for additional borrowing under the Working Capital Revolver Loan at March 31, 2005 were \$9.8 million.

In March 2005, we purchased two interest rate cap contracts for a cost of \$590,000 which contracts are accounted for on a mark-to-market basis and are included in other assets in the accompanying condensed consolidated balance sheet. These contracts set a maximum three-month LIBOR base rate of 4.59% on \$30 million and mature on March 29, 2009.

The lender may, upon an event of default, as defined, terminate the Working Capital Revolver Loan and make the balance outstanding due and payable in full. The Working Capital Revolver Loan is secured by receivables, inventories and intangibles of all the ThermaClimate entities other than El Dorado Nitric Company and its subsidiaries ("EDNC") and a second lien on certain real property and equipment. EDNC is neither a borrower nor guarantor of the Working Capital Revolver Loan.

-18-

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**LSB INDUSTRIES, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**  
**Three Months Ended March 31, 2005 and 2004**

A prepayment premium equal to 3% of the facility is due to the lender should the borrowers elect to prepay the facility prior to April 13, 2006. This premium is reduced to 2% during the second twelve-month period and to 1% during the third twelve-month period and 0% thereafter.

The Working Capital Revolver Loan, as amended, requires ThermaClimate to maintain minimum quarterly earnings before interest, taxes, depreciation and amortization ("EBITDA"), as defined, for ThermaClimate and its Climate Control Business on a trailing twelve-month basis. ThermaClimate and its Climate Control Business's EBITDA for the twelve-month period ended March 31, 2005 was in excess of the required amounts. The trailing twelve-months EBITDA requirements for the remainder of 2005 range from \$13.7 to \$17.7 million for ThermaClimate and is fixed at \$10 million for the Climate Control Business. The Working Capital Revolver Loan also requires ThermaClimate to achieve an annual fixed charge coverage ratio and limits capital expenditures, as defined, measured quarterly on a trailing twelve-month basis. The Working Capital Revolver Loan also contains covenants that, among other things, limit the borrowers' ability to: (a) incur additional indebtedness, (b) incur liens, (c) make restricted payments or loans to affiliates who are not Borrowers, (d) engage in mergers, consolidations or other forms of recapitalization, (e) dispose of assets, or (f) repurchase ThermaClimate's 10-3/4% Senior Unsecured Notes. The Working Capital Revolver Loan also requires all collections on accounts receivable be made through a bank account in the name of the lender or their agent.

(C) In 1997, ThermaClimate completed the sale of its 10-3/4% Senior Unsecured Notes due 2007 (the "Notes"). The Notes bear interest at an annual rate of 10-3/4% payable semiannually in arrears on June 1 and December 1 of each year. The Notes are senior unsecured obligations of ThermaClimate and rank equal in right of payment to all existing and future senior unsecured indebtedness of ThermaClimate and its subsidiaries. The Notes are effectively subordinated to all existing and future secured indebtedness of ThermaClimate.

ThermaClimate's payment obligations under the Notes are fully, unconditionally and joint and severally guaranteed by all of the existing subsidiaries of ThermaClimate, except for EDNC ("Non-Guarantor Subsidiaries").

Set forth below is consolidating financial information of ThermaClimate's Guarantor Subsidiaries, the Non-Guarantor Subsidiaries, and ThermaClimate.

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 2005 and 2004

Note 6: Long-Term Debt (continued)

ThermaCline, Inc.  
Condensed Consolidating Balance Sheet  
As of March 31, 2005  
(As restated)  
(In thousands)

|   | Combined<br>Guarantor<br>Subsidiaries | Consolidated<br>Non-Guarantor<br>Subsidiaries | ThermaCline,<br>Inc. (Parent) | Eliminations | Consolidated |
|---|---------------------------------------|---|-------------------------------|--------------|--------------|
| <b>Assets</b>                               |                                       |   |                               |              |              |
| <b>Current assets:</b>                      |                                       |   |                               |              |              |
| Cash  | \$ 98                                 | \$ -  | \$ 529                        |              | \$ 627       |
| Accounts receivable, net                    | 40,781                                | 4,835   | 15                            |              | 45,631       |
| Inventories                                 | 32,643                                | 109   | -                             |              | 32,752       |
| Supplies, prepaid items and other           | 4,450                                 | 155   | 3,445                         |              | 8,050        |
| Deferred income taxes                       | -                                     | -   | 4,675                         |              | 4,675        |
| Total current assets                        | 77,972                                | 5,099   | 8,664                         |              | 91,735       |
| Property, plant and equipment, net          | 62,088                                | 2,311   | 26                            |              | 64,425       |
| Investment in and advances to affiliates    | -                                     | -   | 106,004                       | \$ (106,004) | -            |
| Receivable from Parent                      | 28,165                                | 9,995   | -                             | (38,160)     | -            |
| Other assets, net                           | 5,328                                 | 24  | 3,434                         | -            | 8,786        |
|   | \$ 173,553                            | \$ 17,429                                     | \$ 118,128                    | \$ (144,164) | \$ 164,946   |
| <b>Liabilities and Stockholders' Equity</b> |                                       |   |                               |              |              |
| <b>Current liabilities:</b>                 |                                       |   |                               |              |              |
| Accounts payable                            | \$ 20,339                             | \$ 2,288                                      | \$ 361                        |              | \$ 22,988    |
| Short-term financing                        | -                                     | -   | 2,184                         |              | 2,184        |
| Accrued liabilities                         | 13,243                                | 1,935   | 1,693                         |              | 16,871       |
| Due to LSB and affiliates                   | -                                     | -   | 1,091                         |              | 1,091        |
| Current portion of long-term debt           | 427                                   | 353   | -                             |              | 780          |
| Total current liabilities                   | 34,009                                | 4,576   | 5,329                         |              | 43,914       |
| Long-term debt                              | 6,134                                 | 765   | 97,795                        |              | 104,694      |
| Deferred income taxes                       | -                                     | -   | 1,735                         |              | 1,735        |
| Other non-current liabilities               | 2,078                                 | 463   | -                             |              | 2,541        |
| <b>Stockholders' equity:</b>                |                                       |   |                               |              |              |
| Common stock                                | 66                                    | 1   | 1                             | \$ (67)      | 1            |
| Capital in excess of par value              | 166,212                               | -   | 13,052                        | (166,212)    | 13,052       |
| Accumulated other comprehensive             | -                                     | (1,207)                                       | -                             | -            | (1,207)      |

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|                             |            |           |            |              |            |
|-----------------------------|------------|-----------|------------|--------------|------------|
| loss                        |            |           |            |              |            |
| Due from LSB and affiliates | -          | -         | (2,558)    | -            | (2,558)    |
| Retained earnings (deficit) | (34,946)   | 12,831    | 2,774      | 22,115       | 2,774      |
| Total stockholders' equity  | 131,332    | 11,625    | 13,269     | (144,164)    | 12,062     |
|                             | \$ 173,553 | \$ 17,429 | \$ 118,128 | \$ (144,164) | \$ 164,946 |

-20-

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 2005 and 2004

Note 6 Long-Term Debt (continued)

ThermaClime, Inc.  
Condensed Consolidating Balance Sheet  
As of December 31, 2004  
(As restated)  
(In thousands)

|   | Combined<br>Guarantor<br>Subsidiaries | Consolidated<br>Non-Guarantor<br>Subsidiaries | ThermaClime,<br>Inc. (Parent) | Eliminations | Consolidated |
|---|---------------------------------------|---|-------------------------------|--------------|--------------|
| <b>Assets</b>                               |                                       |   |                               |              |              |
| <b>Current assets:</b>                      |                                       |   |                               |              |              |
| Cash  | \$ 174                                | \$ -  | \$ 676                        |              | \$ 850       |
| Restricted cash                             | -                                     | -   | 158                           |              | 158          |
| Accounts receivable, net                    | 36,075                                | 4,716   | 17                            |              | 40,808       |
| Inventories                                 | 27,345                                | 195   | -                             |              | 27,540       |
| Supplies, prepaid items and other           | 4,349                                 | 887   | 4,467                         |              | 9,703        |
| Deferred rent expense                       | -                                     | 938   | -                             |              | 938          |
| Deferred income taxes                       | -                                     | -   | 4,675                         |              | 4,675        |
| Total current assets                        | 67,943                                | 6,736   | 9,993                         |              | 84,672       |
| Property, plant and equipment, net          | 62,482                                | 2,393   | 32                            |              | 64,907       |
| Investment in and advances to<br>affiliates | -                                     | -   | 96,127                        | \$ (96,127)  | -            |
| Receivable from Parent                      | 39,163                                | 8,364   | -                             | (47,527)     | -            |
| Other assets, net                           | 5,271                                 | 25  | 2,783                         |              | 8,079        |
|   | \$ 174,859                            | \$ 17,518                                     | \$ 108,935                    | \$ (143,654) | \$ 157,658   |
| <b>Liabilities and Stockholders' Equity</b> |                                       |   |                               |              |              |
| <b>Current liabilities:</b>                 |                                       |   |                               |              |              |
| Accounts payable                            | \$ 22,560                             | \$ 2,663                                      | \$ 390                        |              | \$ 25,613    |
| Short-term financing                        | -                                     | -   | 3,513                         |              | 3,513        |
| Accrued liabilities                         | 11,592                                | 2,279   | 1,178                         |              | 15,049       |
| Due to LSB and affiliates, net              | -                                     | -   | 1,480                         |              | 1,480        |
| Current portion of long-term debt           | 444                                   | 353   | -                             |              | 797          |
| Total current liabilities                   | 34,596                                | 5,295   | 6,561                         |              | 46,452       |
| Long-term debt                              | 6,353                                 | 853   | 87,538                        |              | 94,744       |

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|                                      |            |           |            |              |            |
|--------------------------------------|------------|-----------|------------|--------------|------------|
| Deferred income taxes                | -          | -         | 1,735      |              | 1,735      |
| Other non-current liabilities        | 2,449      | 457       | -          |              | 2,906      |
| Stockholders' equity:                |            |           |            |              |            |
| Common stock                         | 66         | 1         | 1          | \$ (67)      | 1          |
| Capital in excess of par value       | 166,212    | -         | 13,052     | (166,212)    | 13,052     |
| Accumulated other comprehensive loss | -          | (1,280)   | -          |              | (1,280)    |
| Due from LSB and affiliates          | -          | -         | (2,558)    |              | (2,558)    |
| Retained earnings (deficit)          | (34,817)   | 12,192    | 2,606      | 22,625       | 2,606      |
| Total stockholders' equity           | 131,461    | 10,913    | 13,101     | (143,654)    | 11,821     |
|                                      | \$ 174,859 | \$ 17,518 | \$ 108,935 | \$ (143,654) | \$ 157,658 |

-21-

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 2005 and 2004

Note 6: Long-Term Debt (continued)

ThermaClime, Inc.  
Condensed Consolidating Statement of Operations  
Three Months Ended March 31, 2005 and 2004  
(As restated)  
(In thousands)

|  | Combined<br>Guarantor<br>Subsidiaries | Consolidated<br>Non-Guarantor<br>Subsidiaries | ThermaClime,<br>Inc. (Parent) | Eliminations | Consolidated |
|--|---------------------------------------|---|-------------------------------|--------------|--------------|
| <b>2005</b>  |                                       |   |                               |              |              |
| Net sales  | \$ 74,840                             | \$ 10,599                                     |                               |              | \$ 85,439    |
| Cost of sales  | 62,606                                | 9,603   | \$ 120                        |              | 72,329       |
| Gross profit (loss)  | 12,234                                | 996   | (120)                         |              | 13,110       |
| Selling, general and administrative  | 10,214                                | 90  | 500                           | \$ (2)       | 10,802       |
| Other expense (income), net  | 86                                    | 69  | (33)                          | 2            | 124          |
| Operating income (loss)  | 1,934                                 | 837   | (587)                         | -            | 2,184        |
| Interest expense   | 2,408                                 | 10  | 2,417                         | (2,332)      | 2,503        |
| Non-operating other income, net  | (81)                                  | (221)   | (2,335)                       | 2,332        | (305)        |
| Income (loss) from operations before<br>income taxes and equity in earnings<br>of affiliate and subsidiaries | (393)                                 | 1,048   | (669)                         | -            | (14)         |
| Equity in earnings of subsidiaries   | -                                     | -   | 510                           | (510)        | -            |
| Equity in earnings of affiliate  | 182                                   | -   | -                             |              | 182          |
| Benefit (provision) for income taxes   | 82                                    | (409)   | 327                           |              | -            |
| Net income (loss)  | \$ (129)                              | \$ 639  | \$ 168                        | \$ (510)     | \$ 168       |

2004 (As restated)

|   |            |           |          |          |           |
|---|------------|-----------|----------|----------|-----------|
| Net sales   | \$ 71,312  | \$ 11,360 |          |          | \$ 82,672 |
| Cost of sales   | 62,530     | 10,380    | \$ 225   |          | 73,135    |
| Gross profit (loss)   | 8,782      | 980       | (225)    |          | 9,537     |
| Selling, general and administrative   | 9,196      | 102       | 345      | \$ (2)   | 9,641     |
| Other expense (income), net   | (6)        | 89        | 13       | 2        | 98        |
| Operating income (loss)   | (408)      | 789       | (583)    | -        | (202)     |
| Interest expense  | 2,622      | 8         | 1,072    | (2,542)  | 1,160     |
| Non-operating other expense (income), net   | 21         | -         | (2,543)  | 2,542    | 20        |
| Income (loss) from operations before income taxes and equity in earnings (losses) of affiliate and subsidiaries | (3,051)    | 781       | 88       | -        | (1,382)   |
| Equity in losses of subsidiaries  | -          | -         | (1,287)  | 1,287    | -         |
| Equity in earnings of affiliate   | 159        | -         |          |          | 159       |
| Benefit (provision) for income taxes  | 1,128      | (304)     | (424)    |          | 400       |
| Net income (loss)   | \$ (1,764) | \$ 477    | \$ (823) | \$ 1,287 | \$ (823)  |

-22-

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 2005 and 2004

Note 6: Long-Term Debt (continued)

|  | ThermaClime, Inc.<br>Condensed Consolidating Statement of Cash Flows<br>Three Months Ended March 31, 2005 and 2004<br>(In thousands) |   |                               |              |              |
|--|--|---|-------------------------------|--------------|--------------|
|  | Combined<br>Guarantor<br>Subsidiaries  | Consolidated<br>Non-<br>Guarantor<br>Subsidiaries | ThermaClime,<br>Inc. (Parent) | Eliminations | Consolidated |
| <u>2005</u>  |  |   |                               |              |              |
| Cash flows provided (used) by operating activities | \$ (8,723)   | \$ 1,719  | \$ 1,066                      |              | \$ (5,938)   |
| Cash flows from investing activities:              |  |   |                               |              |              |
| Capital expenditures                               | (2,017)  | (1)   | (3)                           |              | (2,021)      |
| Proceeds from sale of property and equipment       | 1  | -   | -                             |              | 1            |
| Net change in restricted cash                      | -  | -   | 158                           |              | 158          |
| Other assets                                       | (107)  | 1   | (545)                         |              | (651)        |

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|  |         |         |         |         |
|--|---------|---------|---------|---------|
| Net cash used by investing activities            | (2,123) | -       | (390)   | (2,513) |
| Cash flows from financing activities:            |         |         |         |         |
| Payments on long-term debt                       | (17)    | (88)    |         | (105)   |
| Net change in revolving debt                     | (178)   | -       | 10,257  | 10,079  |
| Proceeds from short-term financing               | -       | -       | 2       | 2       |
| Payments on short-term financing                 | -       | -       | (1,331) | (1,331) |
| Net change in due to/from LSB and affiliates     | -       | -       | (417)   | (417)   |
| Advances to/from affiliates                      | 10,965  | (1,631) | (9,334) | -       |
| Net cash provided (used) by financing activities | 10,770  | (1,719) | (823)   | 8,228   |
| Net decrease in cash from all activities         | (76)    | -       | (147)   | (223)   |
| Cash at the beginning of period                  |         |         |         |         |
|  | 174     | -       | 676     | 850     |
| Cash at the end of period                        | \$ 98   | \$ -    | \$ 529  | \$ 627  |

2004 (As restated)

|  |            |          |          |            |
|--|------------|----------|----------|------------|
| Cash flows provided (used) by operating activities | \$ (8,091) | \$ 1,075 | \$ 3,312 | \$ (3,704) |
| Cash flows from investing activities:              |            |          |          |            |
| Capital expenditures                               | (2,864)    | (267)    | -        | (3,131)    |
| Other assets                                       | (137)      | -        | -        | (137)      |
| Net cash used by investing activities              | (3,001)    | (267)    | -        | (3,268)    |
| Cash flows from financing activities:              |            |          |          |            |
| Payments on long-term debt                         | (125)      | (88)     | (909)    | (1,122)    |
| Net change in revolving debt                       | -          | -        | 7,352    | 7,352      |
| Payments on short-term financing                   | -          | -        | (1,261)  | (1,261)    |
| Net change in due to/from LSB and affiliates       | -          | -        | (813)    | (813)      |
| Advances to/from affiliates                        | 11,105     | (720)    | (10,385) | -          |
| Net cash provided (used) by financing activities   | 10,980     | (808)    | (6,016)  | 4,156      |
| Net decrease in cash from all activities           | (112)      | -        | (2,704)  | (2,816)    |
| Cash at the beginning of period                    |            |          |          |            |
|  | 208        | -        | 2,712    | 2,920      |
| Cash at the end of period                          | \$ 96      | \$ -     | \$ 8     | \$ 104     |

-23-

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### Note 7: Contingencies

We accrue for contingent losses when such losses are probable and reasonably estimable. In addition, we recognize contingent gains when such gains are realizable.

Following is a summary of certain legal matters and other contingencies involving the Company:

#### A. Environmental Matters

Our operations are subject to numerous environmental laws ("Environmental Laws") and to other federal, state and local laws regarding health and safety matters ("Health Laws"). In particular, the manufacture and distribution of chemical products are activities which entail environmental risks and impose obligations under the Environmental Laws and the Health Laws, many of which provide for substantial fines and criminal sanctions for violations. There can be no assurance that material costs or liabilities will not be incurred by us in complying with such laws or in paying fines or penalties for violation of such laws. The Environmental Laws and Health Laws and enforcement policies thereunder relating to our Chemical Business have in the past resulted, and could in the future result, in compliance expenses, cleanup costs, penalties or other liabilities relating to the handling, manufacture, use, emission, discharge or disposal of pollutants or other substances at or from our facilities or the use or disposal of certain of its chemical products. Historically, significant expenditures have been incurred by subsidiaries within our Chemical Business, including, but not limited to, EDC at its El Dorado, Arkansas plant (the "El Dorado Facility"), in order to comply with the Environmental Laws and Health Laws. Our Chemical Business could be required to make significant additional site or operational modifications at this or other facilities involving substantial expenditures. We have a legal obligation to monitor certain discharge water outlets at our El Dorado Facility should we discontinue the operations of the facility. We do not believe that the annual costs of the required monitoring activities would be significant and as we currently have no plans to discontinue the use of the facility and the remaining life is indeterminable, an asset retirement liability has not been recognized. However, we will continue to review this obligation and record a liability when a reasonable estimate of the fair value can be made. Currently, there is insufficient information to estimate the fair value of the asset retirement obligation.

#### 1. Water Matters

##### Discharge Water Issues

The El Dorado Facility generates process wastewater. This wastewater is transported at the El Dorado Facility to a small pond for pH adjustment and then to a larger pond for biological oxidation. The process water discharge and storm-water run off are governed by a state NPDES water discharge permit renewed every five years. During 2004, EDC entered into a settlement agreement with the state of Arkansas Department of Environmental Quality ("ADEQ") that provided, in part, for effluent limits which EDC believes are acceptable. Pursuant to the settlement agreement, the ADEQ issued the final revised NPDES water discharge permit, which became effective on June 1, 2004. In order to release EDC's discharge water, we plan for EDC to utilize a pipeline to be built by the City of El Dorado, Arkansas (the "City").

-24-

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 2005 and 2004

We believe that the NPDES permit, as issued, will require additional capital expenditures by EDC, estimated to be approximately \$3 to \$4 million, which would be expended over the next three years, plus reimbursement to the City for our pro-rata portion of pipeline engineering and construction costs as those costs are incurred. It is anticipated that EDC will be required to pay approximately \$1.8 million over the next three years of the City's engineering and construction costs to build the pipeline. This estimate assumes that the City timely builds its own discharge pipeline to a nearby river and we are permitted to tie our pipeline into the City's pipeline. The City council has approved the joint pipeline. We do not have any reliable estimates of the cost of an alternative solution in the event that the pipeline is not built, or timely built, by the City.

In addition, EDC has entered into a Consent Administrative Order ("CAO") that recognizes the presence of nitrate contamination in the shallow groundwater at the El Dorado Facility. A new CAO is being completed to address the shallow groundwater contamination, which will include an evaluation of the current conditions and remediation based upon a risk assessment. The final remedy for shallow groundwater contamination, should any remediation be required, will be selected pursuant to the new CAO and based upon the risk assessment.

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There are no known users of this shallow groundwater in the area, and preliminary risk assessments have not identified any public health risk that would require remediation. At March 31, 2005 the estimated costs to complete the requested investigation and known remediation is approximately \$358,000. A liability of \$358,000 has been established for the estimated investigation and remediation costs. However, this estimate may be revised in the near term based on the final remedy selected pursuant to the new CAO.

### Drainage of Pond at El Dorado Facility and Plea Agreement

In response to a maintenance emergency and to prevent an uncontrolled release, the equalization pond located at the El Dorado Facility was drained to accommodate repairs to an underground discharge pipe in September 2001. Although, no adverse environmental conditions were noted at the time of discharge, the sustained discharge was out of compliance with the mass effluent limits contained in the facility's permit. An environmental compliance employee of EDC determined that proper procedure would be to notify the state of Arkansas in the month-end report. The state disagreed and took the position that they should have been notified immediately. EDC and the state of Arkansas have agreed to a Consent Administrative Order to settle any civil penalty claims relating to this discharge event whereby EDC paid a \$50,000 civil penalty and has funded \$50,000 on supplemental environmental projects.

In January 2002, the United States began a criminal investigation as a result of the drainage of the pond. EDC and one of its employees have entered into a Plea Agreement with the United States, with EDC and the employee pleading guilty to one misdemeanor count for negligently violating a permit, to wit: failing to report a discharge within 24 hours, a misdemeanor. Under the Plea Agreement, EDC paid a fine of \$45,000 and is placed on probation for one year, and the employee is placed on probation for one year. The Plea Agreement was approved by the United States District Court during February 2005. Although there are no assurances, as of the date of this report, the Company does not believe that the Plea Agreement will have a material adverse effect on the Company.

-25-

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 2005 and 2004

### 2. Air Matters

EDC and the ADEQ have entered into a consent administrative order ("AirCAO") resolving certain air regulatory alleged violations associated with EDC's sulfuric acid plant and certain other alleged air emission violations. The AirCAO became effective during February 2004. The AirCAO requires EDC to implement additional air emission controls at the El Dorado Facility and to install a continuous air monitoring system. The air monitoring system is to operate for twelve months. The ultimate cost of any technology changes required cannot presently be determined but is believed to cost between \$1.5 million to \$3 million of capital expenditures depending on the technology changes ultimately required by the ADEQ. The implementation of the technological change and related expenditures will be made over the next three to six years.

### 3. Other Environmental Matters

In April 2002, Slurry Explosive Corporation ("Slurry"), a subsidiary within our Chemical Business, entered into a Consent Administrative Order ("Slurry Consent Order") with the state of Kansas, regarding Slurry's Hallowell, Kansas manufacturing facility ("Hallowell Facility"). The Slurry Consent Order addressed the release of contaminants from the facility into the soils and groundwater and surface water at the Hallowell Facility. There are no known users of the groundwater in the area. The adjacent strip pit is used for fishing. Under the terms of the Slurry Consent Order, Slurry is required to, among other things, submit an environmental assessment work plan to the state of Kansas for review and approval, and agree with the state as to any required corrective actions to be performed at the Hallowell Facility.

In connection with the sale of substantially all of the operating assets of Slurry and UTeC, both subsidiaries within our Chemical Business, in December 2002, UTeC leased the Hallowell Facility to the buyer under a triple net long-term lease agreement. However, Slurry retained the obligation to be responsible for, and perform the activities under, the Slurry Consent Order. In addition, certain of our subsidiaries agreed to indemnify the buyer of such assets for these environmental matters. Slurry has placed the prior owners (Chevron/Texaco) of the Hallowell Facility on notice of their responsibility for contribution towards the costs to investigate and remediate this site. Representatives of the prior owner have agreed to pay for one-half of the costs of the investigation on an interim, non-binding basis. At March 31, 2005 a liability of \$168,000 has been established for our share of the estimated investigation and remediation costs. No

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additional liabilities can be estimated until the required testing and investigations are complete. However, these estimates may be revised in the near term based on the results of our investigation and remediation.

Grand Jury Investigation - Slurry - Hallowell Facility

The U.S. Alcohol Tobacco and Firearms Agency ("AT&F") previously conducted an investigation at Slurry. In August 2003, the Company learned that a federal grand jury for the District of Kansas was investigating Slurry and certain of its former employees relating to the conduct at Slurry's commercial explosives manufacturing plant at the Hallowell, Kansas facility ("Hallowell Facility") related to compliance with federal explosives statutes. Active operations at the Hallowell Facility were discontinued in February 2002 after its license to possess explosives was revoked by the AT&F. Thereafter, as stated above, Slurry's business was sold to

-26-

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### LSB INDUSTRIES, INC. NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) Three Months Ended March 31, 2005 and 2004

a third party. As of the date of this report, no target letters indicating a decision by the United States to seek criminal charges in connection with this investigation have been received and we are estimating no fines or penalties to be recognized in connection with this matter.

#### B. Other Pending or Threatened Litigation

##### 1. Climate Control Business

A lawsuit was filed in August 2002, against Trison Construction, Inc. ("Trison"), a subsidiary within our Climate Control Business, in the District Court, State of Oklahoma, Pontotoc County, in the case styled Trade Mechanical Contractors, Inc., et al. v. Trison Construction, Inc. In this lawsuit, the plaintiff alleges that Trison breached its contract with the plaintiff by delaying contract performance and refusal of payment, and that the actions by Trison damaged the plaintiff. The plaintiff alleges that Trison owes it approximately \$231,000, inclusive of overhead, cost and profit; approximately \$94,000 in extended overhead and expenses. Trison has asserted a counterclaim against the plaintiff for recovery of its costs and attorneys fees associated with the defense of this case and approximately \$306,000 in damages due to plaintiff's breach of contract. As of the date of this report, we are unable to provide an evaluation of the likelihood of an unfavorable outcome or an estimate of the amount or range of potential loss to Trison at this time. In June 2004, Johnson Controls, Inc. ("JCI") filed a formal demand for arbitration against Trison and its bonding company. JCI is alleging that it has sustained damages of approximately \$1.7 million as a result of alleged defects in Trison's work in connection with a facility located in Pontotoc County, Oklahoma. We are unable to provide an evaluation of the likelihood of an unfavorable outcome or an estimate of the amount or range of potential loss to Trison at this time. In addition, in accordance with demands by the Company's bonding company, the Company has agreed to increase the security deposited with the bonding company from a \$1 million letter of credit to \$1.5 million letter of credit.

International Environmental Corporation ("IEC"), a subsidiary within our Climate Control Business, has been sued, together with 18 other defendants and 8 other parties added by the original named defendants, in the case styled Hilton Hotels, et al. v. International Environmental Corporation, et al., pending in the First Circuit Court of Hawaii. The plaintiffs' claims arise out of construction of a hotel in Hawaii. The plaintiffs claim that it was necessary to close the hotel approximately one year after it was opened due to an infestation of mold, requiring the hotel owner to undertake a mold remediation project. The owner of the hotel sued many of the parties involved in the design and construction, or supply of equipment, for the hotel, alleging the improper design, construction, installation and/or air conditioning equipment. IEC supplied certain portions of the air conditioning equipment, which the plaintiffs allege was defective. IEC believes that it has meritorious defenses to this lawsuit. The plaintiffs have not specified the amount of damages and therefore the amount of our potential liability cannot be estimated. The Company has notified its insurance carrier, which is providing a defense under a reservation of rights. Our deductible under the product liability coverage is \$150,000 which we incurred in the form of legal defense costs and recognized as an expense of \$98,000 in 2004 and \$52,000 in 2003.

-27-

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 2005 and 2004

### 2. Chemical Business

Cherokee Nitrogen, Inc. ("Cherokee"), a subsidiary within our Chemical Business, has been sued for an undisclosed amount of money based on a claim that the subsidiary breached an agreement by overcharging the plaintiff for ammonium nitrate as a result of inflated prices for natural gas used to manufacture the ammonium nitrate. The suit is Nelson Brothers, LLC v. Cherokee Nitrogen v. Dynegey Marketing, and is pending in Alabama state court in Colbert County. Cherokee has filed a third party complaint against Dynegey and a subsidiary asserting that Dynegey was the party responsible for fraudulently causing artificial natural gas prices to exist and seeking an undisclosed amount from Dynegey, including any amounts which may be recovered by the plaintiff. Dynegey has filed a counterclaim against Cherokee for monies allegedly owed on account, which is alleged by Dynegey to be \$600,000. Although there is no assurance, counsel for Cherokee has advised the company that, at this time, they believe that there is a good likelihood that Cherokee will recover monies from Dynegey over and above any monies which may be recovered by the plaintiff or owed to Dynegey.

### 3. Other

#### Zeller Pension Plan

In February 2000, the Company's Board of Directors authorized management to proceed with the sale of the automotive business, since the automotive business was no longer a "core business" of the Company. In May 2000, the Company sold substantially all of its assets in its automotive business. After the authorization by the board, but prior to the sale, the automotive business purchased the assets and assumed certain liabilities of Zeller Corporation ("Zeller"). The liabilities of Zeller assumed by the automotive business included Zeller's pension plan, which is not a multi-employer pension plan. In June 2003, the principal owner ("Owner") of the buyer of the automotive business was contacted by a representative of the Pension Benefit Guaranty Corporation ("PBGC") regarding the plan. The Owner has been informed by the PBGC of a possible under-funding of the plan and a possible takeover of the plan by the PBGC. The Owner has notified the Company of these events. The Company has also been contacted by the PBGC and has been advised that the PBGC considers the Company to be potentially liable for the under-funding of the Zeller Plan in the event that the plan is taken over by the PBGC and has alleged that the under-funding is approximately \$.6 million. The Company has been advised by ERISA counsel that, based upon numerous representations made by the Company and the assumption that the trier of fact determining the Company's obligations with respect to the plan would find that: we disposed, in May 4, 2000 of interest in the automotive business including the Zeller assets and business pursuant to a bona fide purchase agreement under the terms of which the purchaser assumed all obligations with respect to the operation, including funding of the Zeller plan, the purpose of the sale of the automotive business did not include an attempt to evade liability for funding the Zeller plan, at the time we disposed of our interest in the automotive business, the Zeller plan was adequately funded, on an ongoing basis and all required contributions had been made, and the Zeller plan did not terminate at anytime that any member of the Company's controlled group of entities was a contribution sponsor to the Zeller plan, that the possibility of an unfavorable outcome to us in a lawsuit if the PBGC attempts to hold us liable for the under-funding of the Zeller plan is remote.

-28-

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 2005 and 2004

#### Asserting Financing Fee

On December 4, 2003, the Company and Southwest Securities, Inc. ("Southwest") entered into a letter agreement whereby the Company agreed to retain Southwest to assist the Company in obtaining financing for the Company. Southwest's right to a fee under the Agreement is limited to a refinancing occurring during "a period of sixty days, to be extended if a transaction is ongoing." A financing did not occur within sixty days of the date of the Agreement, nor was a funding transaction "ongoing" at the end of that period. In September 2004, more than ten months after the date of the Agreement between the Company and Southwest, ThermaClima borrowed \$50 million from Orix Capital Markets, LLC ("Orix"). It is the Company's position that the Orix financing transaction was not the result of any efforts by Southwest, nor was it the culmination of any negotiations or transaction commenced during the sixty-day term of the Agreement. Nonetheless, Southwest

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has asserted that it is entitled to a fee of \$1.7 million pursuant to the Agreement. The Company brought an action against Southwest in Oklahoma state court in a lawsuit styled LSB Industries, Inc. v. Southwest Securities, Inc. pending in the Oklahoma District Court, Oklahoma County, for a declaratory judgment that the Company is not liable to Southwest under the Agreement as a result of the Orix financing transaction. The Company intends to vigorously defend itself against the claim by Southwest. As of the date of this report, no liability has been established relating to the fee asserted by Southwest.

We are also involved in various other claims and legal actions which in the opinion of management, after consultation with legal counsel, if determined adversely to us, would not have a material effect on our business, financial condition or results of operations.

-29-

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 2005 and 2004

Note 8: Stockholders' Equity

The table below provides detail (in thousands) of activity in the stockholders' equity accounts for the three months ended March 31, 2005:

|   | Non-Redeemable<br>Preferred Stock | Common<br>Stock Par<br>Value | Capital<br>in<br>Excess<br>of Par<br>Value | Accumulated<br>Other<br>Comprehensive<br>Loss | Accumulated<br>Deficit | Treasury<br>Stock-Preferred | Treasury<br>Stock-Common | Total       |          |
|---|-----------------------------------|------------------------------|--|---|------------------------|-----------------------------|--------------------------|-------------|----------|
| Balance at December 31, 2004  | 16,401                            | \$ 34,177                    | \$ 1,640                                   | \$ 57,352                                     | \$ (1,280)             | \$ (66,840)                 | \$ (200)                 | \$ (16,451) | \$ 8,398 |
| Net income  |                                   |                              |  |   |                        | 1,414                       |                          | 1,414       |          |
| Amortization of cash flow hedge (Note 9)                              |                                   |                              |  |   | 73                     |                             |                          | 73          |          |
| Total comprehensive income  |                                   |                              |  |   |                        |                             |                          | 1,487       |          |
| Exercise of warrants (1)  |                                   | 586                          |  | 59  | (59)                   |                             |                          |             | -        |
| Exercise of stock options   |                                   | 30                           |  | 3   | 35                     |                             |                          |             | 38       |
| Conversion of 17 shares of redeemable preferred stock to common stock |                                   | 1                            |  |   | 1                      |                             |                          |             | 1        |
| Balance at March 31, 2005   | (2) 17,018                        | \$ 34,177                    | \$ 1,702                                   | \$ 57,329                                     | \$ (1,207)             | \$ (65,426)                 | \$ (200)                 | \$ (16,451) | \$ 9,924 |

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(1) In March 2005, the lenders of the loans under a former financing agreement exercised warrants, under a cashless exercise provision, to purchase 586,140 shares of our common stock.

(2) Includes 3,321,607 shares of the Company's common stock held in treasury. Excluding the 3,321,607 shares held in treasury, the outstanding shares of the Company's common stock at March 31, 2005 were 13,696,198.

-30-

LSB INDUSTRIES, INC.  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 (Unaudited)  
 Three Months Ended March 31, 2005 and 2004

Note 8: Stockholders' Equity (continued)

Stock Options

As of March 31, 2005 we have several Qualified and Non-Qualified Stock Option Plans. We currently account for those plans under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. See discussion in Note 14 - Recently Issued Pronouncements. No stock-based compensation cost is reflected in net income (loss) applicable to common stock for the three months ended March 31, 2005 and 2004 and no options were granted under those plans during these periods.

The following table illustrates the effect on net income (loss) applicable to common stock and net income (loss) per share if we had applied the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation, to stock-based compensation. The fair value for the underlying options was estimated at their respective date of grant using a Black-Scholes option pricing model.

For purposes of pro forma disclosures, the estimated fair value of the qualified and non-qualified stock options is amortized to expense over the options' vesting period.

|  | Three Months Ended<br>March 31,          |                       |
|--|--|-----------------------|
|  | 2005                                     | 2004<br>(As restated) |
|  | (In thousands, except per share amounts) |                       |
| Net income (loss) applicable to common stock, as reported  | \$ 852                                   | \$ (810)              |
| Deduct: Total stock-based compensation expense determined under fair value based method for all awards | (50)                                     | (59)                  |
| Pro forma net income (loss) applicable to common stock   | \$ 802                                   | \$ (869)              |
| Net income (loss) per common share:  |  |                       |
| Basic - as reported  | \$ .06                                   | \$ (.06)              |
| Basic - pro forma  | \$ .06                                   | \$ (.07)              |
| Diluted - as reported  | \$ .06                                   | \$ (.06)              |
| Diluted - pro forma  | \$ .05                                   | \$ (.07)              |

Note 9: Derivatives, Hedges and Financial Instruments

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We account for derivatives in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No.133 requires the recognition of derivatives in the balance sheet and the measurement of these instruments at fair value. Changes in fair value of derivatives are recorded in results of operations unless the normal purchase or sale exceptions apply or hedge accounting is elected.

-31-

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 2005 and 2004

In 1997, we entered into an interest rate forward agreement to effectively fix the interest rate of a long-term lease commitment (not for trading purposes). In 1999, we executed a long-term lease agreement and terminated the forward agreement at a net cost of \$2.8 million. We historically accounted for this cash flow hedge under the deferral method (as an adjustment of the initial term lease rentals). Upon adoption of SFAS No. 133 in 2001, the remaining deferred cost amount was reclassified from other assets to accumulated other comprehensive loss and is being amortized to operations over the term of the lease arrangement. At March 31, 2005 and December 31, 2004, accumulated other comprehensive loss consisted of the remaining deferred cost of \$1,207,000 and \$1,280,000, respectively. The amount amortized to operations was \$73,000 and \$72,000 for the three months ended March 31, 2005 and 2004, respectively. There were no income tax benefits related to these expenses.

In March 2005, we purchased two interest rate cap contracts for a cost of \$590,000. These contracts are free-standing derivatives and are accounted for on a mark-to-market basis in accordance with SFAS No.133. At March 31, 2005 the market value of these contracts was \$534,000 and is included in other assets in the accompanying condensed consolidated balance sheet. The change in the value of these contracts is included in interest expense.

Raw materials for use in our manufacturing processes include copper used by our Climate Control Business and natural gas used by our Chemical Business. As part of our raw material price risk management, we periodically enter into exchange-traded futures contracts for these materials, which contracts are generally accounted for on a mark-to-market basis in accordance with SFAS No. 133. At March 31, 2005 the unrealized gains on these contracts was \$342,000 (minimal at December 31, 2004) and are included in supplies, prepaid items and other in the accompanying consolidated balance sheet, as the term of these contracts are for periods of twelve months or less. Gains of \$422,000 and losses of \$13,000 on such contracts for the three months ended March 31, 2005 and 2004, respectively, are included in cost of sales.

### Note 10: Net Income (Loss) Per Share

Net income (loss) applicable to common stock is computed by adjusting net income (loss) by the amount of preferred stock dividends. Basic net income (loss) per common share is based upon net income (loss) applicable to common stock and the weighted average number of common shares outstanding during each period. Diluted income (loss) per share is based on the weighted average number of common shares and dilutive common equivalent shares outstanding, if any, and the assumed conversion of dilutive convertible securities outstanding, if any.

For the three months ended March 31, 2005, our Board of Directors did not declare and we did not pay the regular quarterly dividends of \$.8125 on our Series 2 \$3.25 Convertible Class C preferred stock ("Series 2 Preferred"). Also our Board of Directors did not declare and we did not pay the January 1, 2005 regular dividend on our Series B 12% Convertible, Cumulative preferred stock ("Series B Preferred"). As of March 31, 2005 the aggregate amount of unpaid dividends in arrears on our Series 2 Preferred, Series B Preferred and Series D 6% Cumulative, Convertible Class C preferred stock ("Series D Preferred") totaled approximately \$11.6 million, \$1.3 million and \$.2 million respectively. During 2005, we have purchased 10,000 shares of our Series 2 Preferred at \$45.00 a share. As of May 6, 2005 we or our subsidiaries own as treasury stock 15,000 shares of our Series 2 Preferred.

-32-

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 2005 and 2004

The following table sets forth the computation of basic and diluted income (loss) per share:

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(Dollars in thousands, except per share amounts)

|  | Three Months Ended<br>March 31, |                       |
|--|---------------------------------|-----------------------|
|  | 2005                            | 2004<br>(As restated) |
| Numerator:   |                                 |                       |
| Net income (loss)  | \$ 1,414                        | \$ (243)              |
| Preferred stock dividend requirements  | (562)                           | (567)                 |
| Numerator for basic and diluted net income (loss) per share - net income (loss) applicable to common stock       | \$ 852                          | \$ (810)              |
| Denominator:   |                                 |                       |
| Denominator for basic net income (loss) per share - weighted - average shares                                    | 13,234,509                      | 12,657,849            |
| Effect of dilutive securities:   |                                 |                       |
| Employee stock options   | 1,249,359                       | -                     |
| Warrants   | 54,767                          | -                     |
| Convertible preferred stock  | 290,740                         | -                     |
| Convertible note payable   | 4,000                           | -                     |
| Dilutive potential common shares   | 1,598,866                       | -                     |
| Denominator for diluted net income (loss) per share - adjusted weighted - average shares and assumed conversions | 14,833,375                      | 12,657,849            |
| Basic net income (loss) per share  | \$ .06                          | \$ (.06)              |
| Diluted net income (loss) per share  | \$ .06                          | \$ (.06)              |

The following shares of securities were not included in the computation of diluted net income (loss) per share as their effect would have been antidilutive.

|                             | Three Months Ended<br>March 31, |                       |
|-----------------------------|---------------------------------|-----------------------|
|                             | 2005                            | 2004<br>(As restated) |
| Employee stock options      | -                               | 2,331,704             |
| Warrants                    | -                               | 708,085               |
| Convertible preferred stock | 3,326,431                       | 3,641,191             |
| Convertible note payable    | -                               | 4,000                 |
|                             | 3,326,431                       | 6,684,980             |

-33-

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 2005 and 2004

### Note 11: Income Taxes

At December 31, 2004, we had regular-tax net operating loss ("NOL") carryforwards of \$71.8 million (\$51.8 million alternative minimum tax NOLs). Due to NOL carryforwards, no provisions for income taxes were necessary for the three-month periods of 2005 and 2004 except for certain state income taxes for 2004. Due to a valuation allowance on deferred tax assets (principally related to NOL carryforwards), no benefit for

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income taxes was recognized for the three-month period of 2004.

### Note 12: Other Expense and Other Income

Other expense, other income and non-operating other income, net consists of the following:

|   | Three Months Ended<br>March 31, |                       |
|---|---------------------------------|-----------------------|
|   | 2005<br>(As<br>restated)        | 2004<br>(As restated) |
| (In thousands)  |                                 |                       |
| Other expense:  |                                 |                       |
| Other miscellaneous expense (1)   | \$ 216                          | \$ 137                |
| Total other expense   | \$ 216                          | \$ 137                |
| Other income:   |                                 |                       |
| Gains on sales of property and equipment  | \$ 422                          | \$ 5                  |
| Other (1)   | 82                              | 67                    |
| Total other income  | \$ 504                          | \$ 72                 |
| Non-operating other income:   |                                 |                       |
| Proceeds from certain key individual life insurance policies in excess of benefit obligations (2) | \$ 1,138                        | \$ -                  |
| Gains on sales of certain current assets, primarily precious metals                               | 220                             | 1,809                 |
| Miscellaneous income  | 62                              | 56                    |
| Miscellaneous expense   | (22)                            | (78)                  |
| Total non-operating other income, net   | \$ 1,398                        | \$ 1,787              |

(1) Amounts represent numerous unrelated transactions associated with our operations, none of which are individually significant requiring separate disclosure.

(2) Amount relates to the recognition in proceeds receivable from certain key individual life insurance policies in excess of the present value of our obligations for benefits due to the untimely death of one of our executives in January 2005.

-34-

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 2005 and 2004

### Note 13: Segment Information

|                 | Three Months Ended<br>March 31, |                       |
|-----------------|---------------------------------|-----------------------|
|                 | 2005<br>(As<br>restated)        | 2004<br>(As restated) |
| (In thousands)  |                                 |                       |
| Net sales:      |                                 |                       |
| Climate Control | \$ 35,504                       | \$ 31,549             |

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|   |           |           |
|---|-----------|-----------|
| Chemical  | 49,935    | 51,123    |
| Other   | 1,242     | 997       |
|   | \$ 86,681 | \$ 83,669 |
|   |           |           |
| Gross profit: (1)   |           |           |
| Climate Control   | \$ 10,008 | \$ 10,257 |
| Chemical (2)  | 4,111     | 445       |
| Other   | 430       | 329       |
|   | \$ 14,549 | \$ 11,031 |
|   |           |           |
| Operating income (loss): (3)                                      |           |           |
| Climate Control   | \$ 2,397  | \$ 3,414  |
| Chemical (2)  | 1,561     | (1,834)   |
| General corporate expenses and other business operations, net (4) | (1,387)   | (1,797)   |
|   | 2,571     | (217)     |
| Interest expense  | (2,737)   | (1,432)   |
| Non-operating other income, net:                                  |           |           |
| Chemical (5)  | 257       | 1,843     |
| Corporate and other business operations (6)                       | 1,141     | (56)      |
| Provision for income taxes  | -         | (4)       |
| Equity in earnings of affiliate-Climate Control                   | 182       | 159       |
| Income before cumulative effect of accounting change              | \$ 1,414  | \$ 293    |

(1) Gross profit by industry segment represents net sales less cost of sales. Gross profit classified as "Other" relates to industrial machinery and components.

(2) We follow the practice of expensing precious metals used as a catalyst in the Chemical Business manufacturing processes as they are used, because the amount and timing of recovery is not predictable. Periodically, we recover a portion of the amount previously expensed. During the first quarter of 2005, a recovery of \$1 million contributed to an increase in gross profit. During the first quarter of 2004, we wrote down the carrying value of certain nitrate-based inventories by an additional \$.8 million.

(3) Our chief operating decision makers use operating income (loss) by industry segment for purposes of making decisions which include resource allocations and performance evaluations.

-35-

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 2005 and 2004

Operating income (loss) by industry segment represents gross profit by industry segment less selling, general and administrative expenses ("SG&A") incurred by each industry segment plus other income and other expense earned/incurred by each industry segment before general corporate expenses and other business operations, net. General corporate expenses and other business operations, net consist of unallocated portions of gross profit, SG&A, other income and other expense.

(4) The amounts included are not allocated to our Climate Control and Chemical Businesses since these items are not included in the operating results reviewed by our chief operating decision makers for purposes of making decisions as discussed above. A detail of these amounts are shown in footnote (7) below.

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(5) During the first quarter of 2004, we recognized a gain of \$1.8 million from the sales of certain current assets (primarily precious metals) acquired in 2003.

(6) As discussed in Note 12, we recognized \$1.1 million in proceeds receivable from certain key man life insurance policies in excess of the present value of our obligations for benefits during the first quarter of 2005.

(7) General corporate expenses and other business operations, net consist of the following:

|   | Three Months Ended    |                       |
|---|-----------------------|-----------------------|
|   | March 31,             |                       |
|   | 2005<br>(As restated) | 2004<br>(As restated) |
|   | (In thousands)        |                       |
| Gross profit-Other  | \$ 430                | \$ 329                |
| Selling, general and administrative:                                |                       |                       |
| Personnel   | (1,164)               | (1,081)               |
| Professional fees   | (443)                 | (441)                 |
| Office overhead   | (207)                 | (220)                 |
| Property, franchise and other taxes                                 | (54)                  | (75)                  |
| All other   | (344)                 | (395)                 |
| Total selling, general and administrative                           | (2,212)               | (2,212)               |
| Other income (A)  | 526                   | 91                    |
| Other expense   | (131)                 | (5)                   |
| Total general corporate expenses and other business operations, net | <u>\$ (1,387)</u>     | <u>\$ (1,797)</u>     |

(A) For the three months ended March 31, 2005, we recognized a gain of \$.4 million from the sale of corporate assets.

### Note 14: Recently Issued Pronouncements

On December 16, 2004 the Financial Accounting Standards Board (FASB) issued FASB Statement No. 123 (revised 2004), Share-Based Payment, which is a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation. Statement 123(R) supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and amends FASB Statement No. 95, Statement of Cash Flows. Generally, the approach in

-36-

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 2005 and 2004

Statement 123(R) is similar to the approach described in Statement 123. However, Statement 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative.

As amended by the Securities and Exchange Commission, Statement 123(R) must be adopted at the beginning of the next fiscal year that begins after June 15, 2005. We expect to adopt Statement 123(R) on January 1, 2006. Our Board of Directors is considering a plan to accelerate the vesting schedule of both qualified and non-qualified stock options currently outstanding. At December 31, 2005 we currently estimate that there will be 45,000 shares that will not be fully vested. If the plan is executed, at December 31, 2005 all outstanding stock options will be fully vested and no cumulative effect of accounting change adjustment will be required on our financial statements when Statements 123(R) is adopted.

In January 2003, the FASB issued Interpretation No. 46 ("FIN 46") "Consolidation of Variable Interest Entities." FIN 46 addresses the consolidation of variable interest entities which meet certain

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characteristics. In December 2003, the FASB revised FIN 46 that included changes to the effective dates depending on the characteristics of the variable interest entities and the date of involvement.

Prior to 2003, we, through our subsidiaries, entered into loan agreements where we loaned funds to the parent company of MultiClima, S.A. ("MultiClima") a French manufacturer of HVAC equipment, whose product line is compatible with our Climate Control Business. Under the loan agreements, one of our subsidiaries has the option ("Option") to exchange its rights under the loan agreements for 100% of the borrower's outstanding common stock. This subsidiary also obtained a security interest in the stock of MultiClima to secure its loans. Based on our assessment of the parent company and MultiClima in relation to FIN 46, as revised, we were required to consolidate this entity effective March 31, 2004. Prior to consolidating this entity, the outstanding notes receivable balance, net of reserve, was \$2,558,000.

As a result of consolidating the consolidated assets and liabilities of the parent company of MultiClima, at March 31, 2004 we recorded a cumulative effect of accounting change of \$536,000 which is included in the accompanying condensed consolidated statement of operations. The cumulative effect of accounting change primarily relates to the elimination of embedded profit included in the cost of inventory which was purchased from MultiClima by certain of our subsidiaries.

For the three months ended June 30, 2004 the parent company of MultiClima had a consolidated net loss of \$575,000 (after all material intercompany transactions have been eliminated). Based on our assessment of the parent company and MultiClima's historical and forecasted liquidity and results of operations during 2004, we concluded that the outstanding notes receivable were not collectable. As a result, effective July 1, 2004 we forgave and canceled the loan agreements in exchange for extending the Option's expiration date from June 15, 2005 to June 15, 2008. We recognized a provision for loss of \$1,447,000 for the three months ended September 30, 2004. As a result of the cancellation and our valuation of this Option at zero, we no longer had a variable interest in this entity and were no longer required to consolidate this entity.

-37-

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### Item 2.

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

### Amendment to Item 2

As fully discussed under "Explanatory Introduction Note" on page 3 of this 2005 Form 10-Q/A, we amend Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations" ("MD&A") for the following reasons:

- We have amended our 2004 audited Consolidated Statements of Income contained in our Annual Report on Form 10-K for the year ended December 31, 2004 ("2004 Form 10-K") to appropriately classify other income relating to the sale of assets and other expense relating to the impairment of certain assets and certain other items from non-operating to operating income. These restated classifications did not change or affect "net income" reflected in our Consolidated Statement of Income in our 2004 Form 10-K. As a result of these restated classifications, we have amended the Condensed Consolidated Statement of Operations for the three months ended March 31, 2004.
- We have amended our 2005 Condensed Consolidated Statement of Operations contained in our quarterly report on Form 10-Q ("2005 Form 10-Q") for the quarter ended March 31, 2005 to appropriately classify a gain resulting from the sale of certain operating assets and certain other items from non-operating to operating income. These restated classifications did not change or affect "net income" reflected in our Condensed Consolidated Statement of Operations in our 2005 Form 10-Q.
- We have restated our audited financial statements contained in our 2004 Form 10-K to appropriately reflect the change from LIFO to FIFO method of accounting for certain inventory of heat pump products within our Climate Control segment in accordance with Accounting Principles Board Opinion No. 20. The effect for each of the three years in the period ended December 31, 2004 decreased reported net income in 2004 and 2003 by \$503,000 and \$198,000, respectively, and increased 2002 net income by \$23,000. The effect of this restatement increased stockholders' equity by \$678,000 at December 31, 2001. There was no effect on the balance sheet at December 31, 2004 resulting from this restatement. We did not disclose this change in our financial statements contained in the 2004 Form 10-K since we believed that this was not a material change pursuant to Staff Accounting Bulletin 99. As a result, the effect changed the 2004 results of operations reflected in our 2005 Form 10-Q by increasing our net loss by \$125,000 for the three months ended March 31, 2004 (from a net loss of \$.1 million to a net loss of \$.2 million).

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- We have changed classifications of certain items in our condensed consolidated balance sheets relating to prepaid insurance and the related financing of that insurance and classification of debt issuance costs. In addition, we have changed classifications of certain items in our condensed consolidated statements of operations primarily relating to shipping costs and amortization of debt issuance costs. Also we made conforming changes to restatements of our classifications of certain items in our condensed consolidated statement of cash flows relating to the prepaid insurance discussed above.

-38-

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The following MD&A should be read in conjunction with our March 31, 2005 Condensed Consolidated Financial Statements (As restated).

Certain statements contained in this MD&A may be deemed forward-looking statements. See "Special Note Regarding Forward-Looking Statements".

### Overview

#### General

We are a diversified holding company. Our wholly-owned subsidiary, ThermaClime, through its subsidiaries, owns substantially all of our core businesses consisting of the:

- Climate Control Business engaged in the manufacturing and selling of a broad range of water source heat pumps (including geothermal heat pumps) and hydronic fan coils, as well as other products including large custom air handlers, used in commercial and residential air conditioning systems and
- Chemical Business engaged in the manufacturing and selling of chemical products for the agricultural, varied industrial and mining markets.

#### Climate Control Business

Most of the products of the Climate Control Business are produced to customer orders that are placed well in advance of required delivery dates. As a result, the Climate Control Business carries significant backlogs that eliminate the necessity to carry substantial inventories other than for firm customer orders.

In recent periods, the Climate Control Business' profitability was affected by operating losses of certain new product lines being developed over the past few years. In 2005, the emphasis is to move these new operations into an operating profit by increasing the sales levels above the breakeven point.

The Climate Control Business has historically generated consistent annual profits and positive cash flows. The Climate Control Business' objectives include the continued emphasis on increasing the sales and operating margins of existing products and on new product development.

#### Chemical Business

The primary raw material feedstocks (anhydrous ammonia and natural gas) of the Chemical Business are commodities, subject to significant price fluctuations and are purchased at prices in effect at time of purchase. Due to the uncertainty of the spot sales price, we have pursued a strategy of developing customers that purchase substantial quantities of products pursuant to sales agreements and/or formulas that provide for the pass through of raw material costs, variable costs, and certain fixed costs, plus in most cases, a profit margin. These pricing arrangements provide a hedge against the commodity risk inherent in the raw material feedstocks of natural gas and ammonia. In addition we hedge most sales commitments made at fixed sales prices.

-39-

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The remaining sales are primarily into agricultural markets at the price in effect at time of shipment. The cost of the anhydrous ammonia and gas feedstock costs are decoupled from the sales price of the Company's agricultural products resulting in profitability problems in this market in recent periods.

Irrespective of our strategy of developing customers that purchase substantial quantities of our products based on formulas as discussed above, our Chemical Business continues to sustain losses due, in large part,

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to our inability to generate sufficient sales volume to operate our manufacturing facilities at optimum levels. As a result, we are exploring numerous alternatives regarding our Chemical Business and have been discussing alternatives with various investment bankers. We have not made any decisions as to our Chemical Business as of the date of this report and have not yet retained an investment banker to assist us in our review.

During October 2004, the Chemical Business's El Dorado Facility sustained a mechanical failure of one of its four nitric acid plants adversely affecting our fourth quarter 2004 and first quarter 2005 results as discussed below under "Liquidity and Capital Resources."

### Liquidity and Capital Resources

As a diversified holding company, cash requirements are primarily dependent upon credit agreements and our ability to obtain funds from our ThermaClime and non-ThermaClime subsidiaries.

Historically, ThermaClime's primary cash needs have been for working capital and capital expenditures. ThermaClime and its subsidiaries depend upon credit agreements, internally generated cash flows, and secured equipment financing in order to fund operations and pay obligations.

ThermaClime and its subsidiaries depend upon its Working Capital Revolver Loan, in addition to internally generated cash flows, to fund operations and pay their obligations. The Senior Secured Loan and the Working Capital Revolver Loan both have financial covenants that are described along with other details of the loans in "Loan Agreements - Terms and Conditions".

ThermaClime's ability to maintain an adequate amount of borrowing availability under its Working Capital Revolver Loan depends on its ability to comply with the terms and conditions of agreements and its ability to generate cash flow from operations. ThermaClime is restricted under its credit agreements as to the funds it may transfer to LSB and its affiliates and certain ThermaClime subsidiaries. This limitation does not prohibit payment of amounts due under a Services Agreement, Management Agreement and a Tax Sharing Agreement. As of March 31, 2005 ThermaClime had availability under its Working Capital Revolver Loan of \$9.8 million, based on eligible collateral, plus cash on hand of \$.6 million.

The Chemical Business in recent years has been unable to generate significant positive cash flows due to lower than optimum sales volume levels, margin problems and extensive capital expenditure requirements to maintain plants and to comply with changing environmental regulations.

-40-

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The ability to generate a positive margin on Chemical sales is affected by the volatility of the raw material feedstocks of natural gas and anhydrous ammonia, as well as the necessity to produce at the optimum production levels to fully absorb the fixed plant costs. The predominant production costs of a process chemical plant, other than the raw material costs, tend to be fixed costs.

The majority, approximately 70%, of the Chemical Business' sales are made pursuant to sales agreements that provide for the pass through of raw material costs, variable costs, and certain fixed costs, plus in most cases, a profit margin. Even though 70% of our sales are based upon the above described sales agreements, our Chemical Business has sustained losses due, in part, to the sales volume not being sufficient to run the plants at optimum production levels.

Our primary efforts to improve the results of the Chemical Business include sales efforts to increase the sales volume of the Alabama and Arkansas plants with an emphasis on customers that will accept the commodity risk inherent with natural gas and anhydrous ammonia.

Beginning in October 2004 and continuing throughout the first quarter 2005, the Chemical Business' results were, adversely affected as a result of a mechanical failure of one of the four nitric acid plants at the El Dorado, Arkansas plant. The failure, which resulted in major damage to a gas expander, caused the plant that normally produces 10,000 tons per month of nitric acid to go down on October 7, 2004. We estimate that the plant will not be back to normal production until the middle of May 2005 and that approximately \$4.5 million will be required to repair and rebuild the plant to allow it to resume normal production. Our property insurance provides for replacement cost coverage subject to a \$1 million deductible and our business interruption insurance is subject to a forty-five day waiting period before covering losses resulting from this incident. We are unable, at this point, to estimate the exact cash flow and earnings impact resulting

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from the incident. However preliminary indications are that the negative impact on earnings resulting from the lost production was approximately \$3.5 to \$4 million from October 7, 2004 through March 31, 2005 approximately \$1.5 to \$2 million of which occurred in the first quarter 2005. At this time we are unable to determine the amount of proceeds to be received from our business interruption insurance, therefore, we have not made an adjustment to record any business interruption insurance recovery. The business interruption recovery from the insurance company will be recorded when the amount is agreed to.

One of our non-ThermaClime subsidiaries continues to actively market its investment in a chemical plant located in Pryor, Oklahoma. We do not currently have a contract for the sale of this plant.

### Capital Expenditures

Our Chemical Business has historically required significant investment to fund capital expenditures, while our Climate Control Business has been much less capital intensive. We believe we have approximately \$6 million of committed capital expenditures for the remainder of 2005 related to our Chemical Business, not including the expenditures required as a result of the mechanical failure of the acid plant as discussed above. The \$6 million includes \$5 million relating to operations, and \$1 million for environmental compliance.

-41-

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Other capital expenditures are believed to be discretionary and are dependent upon an adequate amount of liquidity and/or obtaining acceptable funding. We have carefully managed those expenditures to projects necessary to execute our business plans and those for environmental and safety compliance.

We currently expect to incur capital expenditures of approximately \$3 to \$4 million over the next three years to construct a new water treatment collection and discharge facility. In addition our pro-rata portion of engineering and construction costs for the City to build a pipeline for the discharged water is approximately \$1.8 million. Certain additional expenditures will be required to bring the sulfuric acid plant's air emissions to lower limits. The ultimate cost is believed to be between \$1.5 and \$3 million, to be expended over a six-year period, which began with minimal expenditures in 2004.

### Dividends

Due to previous operating losses and limited borrowing ability under credit facilities, we discontinued payment of cash dividends on our outstanding capital stock for periods subsequent to January 1, 1999. Although dividends on all of our outstanding series of preferred stock are payable if and when declared by the Board of Directors, the terms of each outstanding series of preferred stock provide that dividends are cumulative, except for the redeemable, non-cumulative, convertible preferred stock. As of March 31, 2005 there is approximately \$13 million of accrued and unpaid dividends on our outstanding preferred stocks. We do not anticipate paying dividends on our stock for the foreseeable future.

During 2005, we have purchased 10,000 shares of our Series 2 Preferred at \$45.00 a share. As of May 6, 2005 we or our subsidiaries own as treasury stock 15,000 shares of our Series 2 Preferred.

### Summary

Cash flow and liquidity will continue to be managed very carefully. We believe, based upon current forecasts, that we will have adequate cash in 2005 from internal cash flows and financing sources to enable us to satisfy our cash requirements, as they are due in 2005. However, due to the volatility of the cost for major raw materials used in our Chemical Business, we have historically experienced revisions to financial forecasts on a frequent basis during the course of a year. As a result, actual results may be significantly different than our forecast, which could have a material adverse impact on our liquidity and future operating results.

### Loan Agreements - Terms and Conditions

#### Working Capital Revolver Loan

- ThermaClime finances its working capital requirements through borrowings under a Working Capital Revolver Loan. Under the Working Capital Revolver Loan, ThermaClime and its subsidiaries may borrow on a revolving basis up to \$50 million based on specific percentages of eligible accounts receivable and inventories. Effective February 28, 2005 the Working Capital Revolver Loan was amended which, among other things, extended the maturity date to April 2009 and removed language considered as a subjective acceleration

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provision. As of March 31, 2005 borrowings outstanding were \$37.6 million and the net credit available for additional borrowings was \$9.8 million. The Working Capital Revolver

-42-

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Loan requires that ThermaClimate and its Climate Control Business meet certain financial covenants and minimum EBITDA amounts under the Working Capital Revolver Loan. The EBITDA requirements are measured quarterly on a trailing twelve-month basis. The ThermaClimate and its Climate Control Business EBITDA amounts exceeded the required EBITDA amounts for the twelve-month period ended March 31, 2005. The trailing twelve-month EBITDA requirements for the remainder of 2005 range from \$13.7 to \$17.7 million for ThermaClimate and is fixed at \$10 million for the Climate Control Business. The EBITDA requirements were set at amounts based upon our forecasts which are presently considered by management to be achievable. See discussion under "Liquidity and Capital Resources - Summary" as to the historical viability of our forecasts.

We have the ability to set our financial covenants under the Working Capital Revolver Loan agreement with our lenders on an annual basis each January. In setting these covenants, we provide the lenders with a forecast that we believe to be a very conservative estimate of our operating results for the coming year. For 2005, we have established mutually agreeable limits that we believe are well within our ability to achieve.

### Senior Secured Loan -

In September 2004, ThermaClimate and certain of its subsidiaries (the "Borrowers") completed a \$50 million term loan ("Senior Secured Loan") with a certain lender (the "Lender"). The Senior Secured Loan is to be repaid as follows:

- quarterly interest payments which began September 30, 2004;
- quarterly principal payments of \$312,500 beginning September 30, 2007;
- a balloon payment of the remaining outstanding principal of \$47.5 million and accrued interest on September 16, 2009.

The Senior Secured Loan accrues interest at the applicable LIBOR rate, as defined, plus an applicable LIBOR margin, as defined or, at the election of the Borrowers, the alternative base rate, as defined, plus an applicable base rate margin, as defined, with the annual interest rate not to exceed 11% or 11.5% depending on the leverage ratio. At March 31, 2005 the effective interest rate was 11.09%.

The Borrowers are subject to numerous affirmative and negative covenants under the Senior Secured Loan agreement including, but not limited to, limitation on the incurrence of certain additional indebtedness and liens, limitations on mergers, acquisitions, dissolution and sale of assets, and limitations on declaration of dividends and distributions to us, all with certain exceptions. The Borrowers are also subject to a minimum fixed charge coverage ratio, measured quarterly on a trailing twelve-month basis. The Borrowers' fixed charge coverage ratio exceeded the required ratio for the twelve-month period ended March 31, 2005. The maturity date of the Senior Secured Loan can be accelerated by the Lender upon the occurrence of a continuing event of default, as defined.

For the remainder of 2005, ThermaClimate will incur interest expense of approximately \$4.2 million relating to the Senior Secured Loan.

### Cross - Default Provisions

- The Working Capital Revolver Loan agreement and the Senior Secured Loan contain cross-default provisions. If ThermaClimate fails to meet the financial covenants of the Senior Secured Loan, the lender may declare an event of default, making the

-43-

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debt due on demand. If this should occur, there are no assurances that we would have funds available to pay such amount or that alternative borrowing arrangements would be available. Accordingly, ThermaClimate could be required to curtail operations and/or sell key assets as discussed above. These actions could result in the recognition of losses that may be material.

### Seasonality

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We believe that the only seasonal products are fertilizer and related chemical products sold by our Chemical Business to the agricultural industry. The selling seasons for those products are primarily during the spring and fall planting seasons, which typically extend from March through June and from September through November in the geographical markets in which the majority of our agricultural products are distributed. As a result, our Chemical Business increases its inventory of ammonium nitrate and UAN prior to the beginning of each planting season. In addition, the amount and timing of sales to the agricultural markets depend upon weather conditions and other circumstances beyond our control.

### RESULTS OF OPERATIONS

Three months ended March 31, 2005 vs. Three months ended March 31, 2004

#### Net Sales

Net sales for the three-month period ended March 31, 2005 were \$86.7 million compared to \$83.7 million for the same period in 2004 or an increase of \$3 million. This net increase is due primarily to the following:

- an increase of \$4 million in our Climate Control Business, as result of increased demand for our heat pump products and continued growth in certain start-up operations,
- offset by a decrease in sales of our hydronic fan coil products, due to temporary production delays in the first two months of 2005 during the implementation of a new business enterprise system and
- a decrease of \$1.2 million in our Chemical Business primarily related to lower sales in the first quarter 2005 vs. 2004, of certain industrial nitrogen products to a customer that is subject to an annual minimum quantity and lost production from one of our nitric acid plants at the El Dorado, Arkansas plant due to a mechanical failure as discussed under "Liquidity and Capital Resources".

#### Gross Profit

Gross profit was \$14.5 million or 16.8% as a percentage of net sales for the three months ended March 31, 2005 compared to \$11 million or 13.2% for the three-month period ended March 31, 2004. The net increase in gross profit is due primarily to:

an increase of \$3.7 million in our Chemical Business primarily related to:

- improved margins on sales;
- increased fixed cost absorption at the Cherokee, Alabama nitrogen plant in the first quarter 2005 compared to 2004, during which time in 2004 the plant was down for several weeks for a planned major maintenance activity ("Turnaround");

-44-

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- the recovery of \$1 million of production catalyst (precious metals) in 2005 and
  - offset by lower absorption of fixed costs due to lost production from one of our nitric acid plants at the El Dorado, Arkansas plant as discussed above,

The above increase was partially offset by a decrease in the Climate Control Business. Although our Climate Control sales were \$4 million higher in the first quarter than in the same period last year, gross profit was \$.2 million less than last year. The lower gross profit relative to sales volume is primarily a result of our inability to increase selling prices quickly enough to offset the increase in costs of our steel and copper raw materials and purchased components. Also, affecting the gross profit, was the disruption in the production of our hydronic fan coil product as discussed above.

#### Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$12.3 million or 14.2% as a percentage of net sales for the first quarter ended March 31, 2005 compared to \$11.2 million or 13.4% for the same period in 2004. The increase is due primarily to increased personnel, shipping and advertising costs.

#### Other Income

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Other income for the first quarter of 2005 includes a gain of \$.4 million from the sale of corporate assets.

### Interest Expense

Interest expense was \$2.7 million for the three-month period ended March 31, 2005 compared to \$1.4 million for the same period in 2004. The increase of \$1.3 million relates primarily to interest expense incurred on the \$50 million Senior Secured Loan that was completed in September 2004 as discussed under "Loan Agreements-Terms and Conditions". A portion of the proceeds of the Senior Secured Loan was used to repay the outstanding balance under a former financing agreement ("Financing Agreement"). There was no interest expense recognition on the Financing Agreement indebtedness from May 2002 through September 2004 since that transaction was accounted for as a voluntary debt restructuring in 2002.

### Non-operating Other Income, Net

Non-operating other income, net for the first quarter of 2005 includes \$1.1 million in proceeds receivable from certain key man life insurance policies in excess of the present value of our obligations for benefits due to the untimely death of one of our executives. For the first quarter of 2004, non-operating other income, net includes a gain of \$1.8 million in our Chemical Business from the sales of certain current assets (primarily precious metals) acquired in 2003.

### Cumulative Effect of Accounting Change

Effective March 31, 2004, we included in our consolidated balance sheet the consolidated assets and liabilities of the parent company of MultiClima as required under FIN 46 (Also see Note 14 of Notes to Condensed Consolidated Financial Statements). As a result, we recorded a

-45-

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cumulative effect of accounting change of \$.5 million primarily relating to the elimination of embedded profit included in the cost of inventory which was purchased from MultiClima by certain of our subsidiaries.

### Cash Flow From Operating Activities

Historically, our primary cash needs have been for operating expenses, working capital and capital expenditures. We have financed our cash requirements primarily through internally generated cash flow, borrowings under our revolving credit facilities, secured asset financing and the sale of assets. See additional discussion concerning cash flows from our Climate Control and Chemical Businesses in "Liquidity and Capital Resources."

For 2005, cash used by operations included \$9.8 million for increases in accounts receivable, inventories and other prepaid supplies and a decrease in accounts payable and customer deposits partially offset by the change in deferred rent expense, decrease in prepaid insurance and supplies of precious metals, and increase in other accrued liabilities.

Cash provided by operations from net income plus depreciation and amortization less other non-cash adjustments was \$3.8 million.

Net cash used by operating activities was \$6 million.

The increase in accounts receivable resulted, in part, from:

- a receivable for proceeds from certain key man life insurance policies,
- increased sales of our large custom air handlers in the first quarter of 2005 compared to the fourth quarter of 2004 in our Climate Control Business and
- increased sales of our agricultural products in our Chemical Business as a result of the spring planting season.

The increase in accounts receivable was partially offset from proceeds received from certain insurance claims outstanding at December 31, 2004.

The increase in inventories relates primarily to:

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- increased costs of raw materials and increased number of modular chiller systems to meet expected increase in demand in our Climate Control Business and
- increased volume of agricultural products in our Chemical Business due to the anticipated demands relating to the spring fertilizing season.

The increase in other prepaid items resulted, in part, from:

- the increase in market value of our exchange-traded futures contracts which are accounted for on a mark-to-market basis relating to the Climate Control and Chemical Businesses as discussed in Item 3 under "Commodity Price Risk" and
- the increase in vendor deposits for purchases of products for our Climate Control Business.

-46-

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The decrease in accounts payable relates primarily to:

- payments made on outstanding payables at December 31, 2004 relating to the costs incurred as a result of a mechanical failure at one of our nitric acid plants as discussed under "Liquidity and Capital Resources" and a reduction of purchases of anhydrous ammonia in late March 2005 in our Chemical Business.

The decrease in customer deposits relates to the realization of former prepaid sales of our agricultural products in the Chemical Business.

The change in deferred rent expense is due to the rent expense incurred exceeded the scheduled lease payments for the first quarter of 2005.

The decrease in prepaid insurance results from the recognition of related insurance expense for the three months ended March 31, 2005.

The decrease in supplies of precious metals relates primarily to the sale of an excess supply of precious metals and the utilization of precious metals used as a catalyst in our manufacturing process offset, in part, to a recovery of precious metals at our El Dorado Facility in the Chemical Business.

The increase in other accrued liabilities includes:

- an increase in accrued payroll-related expenses because a majority of the payroll period ended on December 31, 2004 and
- an increase in accrued Turnaround costs in our Chemical Business.

The increase in other accrued liabilities was partially offset by a decrease in accrued property taxes as a result of these taxes being paid in 2005.

### Cash Flow from Investing Activities

Net cash used by investing activities for the three months ended March 31, 2005 included \$2.2 million for capital expenditures of which \$1.8 million is for the benefit of our Chemical Business.

### Cash Flow from Financing Activities

Net cash provided by financing activities primarily consisted of a net increase in the Working Capital Revolver Loan of \$10.1 million partially offset by payments on short-term financing and drafts payable of \$1.4 million and on long-term debt of \$.7 million.

### Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of Regulation S-K under the Securities Exchange Act of 1934, as amended.

-47-

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### Aggregate Contractual Obligations

In the operation of our businesses, we enter into contracts, leases and borrowing arrangements. In connection with a series of agreements with Bayer Corporation ("Bayer"), under which we are to supply nitric acid with a provision for pass through of production costs subject to certain performance obligations on our part, a subsidiary of ThermaClima entered into a 10 year lease ("Baytown Lease") in June 1999 that requires minimum future net lease rentals of approximately \$35 million at March 31, 2005. The lease payments are includable costs in these agreements. These lease rentals are made monthly on a straight-line basis over the term of the agreements, typically with one annual payment representing a majority of the amount due for the year. The next annual lease payment of approximately \$5.8 million due in January 2006, has been considered in evaluating our liquidity. Our ability to perform on this lease commitment is contingent upon Bayer's performance under the related purchase agreement and our liquidity.

As discussed in our Form 10-K/A, Amendment No. 1, for the year ended December 31, 2004, we had certain contractual obligations at December 31, 2004, with various maturity dates, related to the following:

- long-term debt,
- interest payments on long-term debt,
- capital expenditures,
- operating leases,
- exchange-traded futures contracts,
- purchase obligations and
- other long-term liabilities.

As discussed under "Cash Flow from Financing Activities" of this MD&A during the first three months of 2005, the borrowings under the Working Capital Revolver Loan increased \$10.1 million since December 31, 2004 to provide working capital primarily as a result of the increases in accounts receivable and inventories as discussed under "Cash Flow from Operating Activities."

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

#### General

Our results of operations and operating cash flows are impacted by changes in market interest rates and changes in market prices of copper, steel, anhydrous ammonia and natural gas.

#### Forward Sales Commitments Risk

Periodically our Chemical Business enters into forward firm sales commitments of chemical products for deliveries in future periods. As a result, we could be exposed to embedded losses should our product costs exceed the firm sales prices. To minimize this risk, our Chemical Business enters into exchange-traded futures for natural gas as discussed below. At March 31, 2005 our sales commitments included 3,925 tons of UAN and 2,243 tons of ammonia through June 2005.

-48-

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#### Commodity Price Risk

Our Climate Control Business buys substantial quantities of copper and steel for use in manufacturing processes and our Chemical Business buys substantial quantities of anhydrous ammonia and natural gas as feedstocks generally at market prices. Periodically, our Climate Control Business enters into exchange-traded futures for copper and our Chemical Business enters into exchange-traded futures for natural gas, which contracts are generally accounted for on a mark-to-market basis in accordance with SFAS No. 133. At March 31, 2005 our purchase commitments under these contracts were for 750,000 pounds of copper through December 2005 at a weighted average cost of \$1.18 per pound (\$887,000) and a weighted average market value of \$1.46 per pound (\$1,095,000) and for 130,000 MMBtu of natural gas through May 2005 at a weighted average cost of \$6.63 per MMBtu (\$862,000) and a weighted average market value of \$7.65 per MMBtu (\$995,000).

#### Interest Rate Risk

Our interest rate risk exposure results from our debt portfolio which is impacted by short-term rates, primarily index-based borrowings from commercial banks, and long-term rates, primarily fixed-rate notes, some of which prohibit prepayment or require substantial prepayment penalties.

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Reference is made to our Form 10-K/A, Amendment No. 1, for the year ended December 31, 2004, for an expanded analysis of expected maturities of long-term debt and its weighted average interest rates.

In addition, we purchased two interest rate cap contracts for a cost of \$590,000 in March 2005 to help minimize our interest rate risk exposure relating to the Working Capital Revolver Loan. These contracts are free-standing derivatives and are accounted for on a mark-to-market basis in accordance with SFAS no. 133. These contracts set a maximum three-month LIBOR base rate of 4.59% on \$30 million. These contracts mature on March 29, 2009. At March 31, 2005 the market value of these contracts was \$534,000.

As of March 31, 2005, our variable rate and fixed rate debt, which aggregated \$115.9 million exceeded the debt's fair market value by approximately \$6.6 million (\$6.1 million at December 31, 2004).

### Item 4. Controls and Procedures

As noted on the cover of this Form 10-Q/A, we are not an "accelerated filer". Due to the definitions, certain areas contained within the disclosure controls and procedures, as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), overlap with the definition of internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act).

In response to comments raised by the staff of the SEC concerning the lack of disclosure relating to our change from the LIFO method of accounting to the FIFO method for inventory of heat pump products within our Climate Control segment, our management agreed with the SEC

-49-

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to disclose the change and restate our 2004 audited financial statements and prior years in accordance with APB No. 20. See "Explanatory Introduction Note". In connection with the restatement, under the direction of our CEO and CFO, and the benefit of hind sight, we re-evaluated our disclosure controls and procedures that were in effect as of March 31, 2005 and identified the following material weakness:

- incorrectly assessing the materiality of the change from the LIFO method to the FIFO method of accounting relative to net income resulting in the decision at the time of the change not to disclose and not to restate the prior years' financial statements.

Solely as a result of this material weakness, we have concluded that our disclosure controls and procedures were not effective as of March 31, 2005. Our management has discussed our disclosure controls and procedures with our Audit Committee and our independent auditors. We are in the process of correcting the above described material weakness.

In addition, we made the following classification changes to our condensed consolidated financial statements:

- Changed our classification of other income relating to the sale of assets and certain other items and other expense relating to certain other items from non-operating to operating income in our condensed consolidated statements of operations for the three months ended March 31, 2005 and 2004 in response to comments raised by the staff of the SEC since these transactions were associated with our operations.
- Changed our classification of the premium financing of certain insurance policies previously offset against the related prepaid insurance to current liabilities in our condensed consolidated balance sheets at March 31, 2005 and December 31, 2004 to be in accordance with APB No. 10. In addition, make a conforming change in our classification of the financing portion of prepaid insurance in our condensed consolidated statements of cash flows for the three months ended March 31, 2005 and 2004 to be in accordance with Statement of Financial Accounting Standards ("SFAS") No. 95.
- Changed our classification of certain debt issuance costs previously classified as a current asset in our condensed consolidated balance sheets at March 31, 2005 and December 31, 2004 since it related to long-term debt. In addition, change our classification of the amortization expense of debt issuance costs previously classified as SG&A to interest expense in our condensed consolidated statements of operations for the three months ended March 31, 2005 and 2004 to be in accordance with APB No 21.
- Changed our classification (from SG&A to cost of sales) of the elimination of certain intercompany transactions (primarily relating to leases and corporate management fees) used in our consolidation process to correct our condensed consolidated statements of operations for the three months ended March 31, 2004.
- Changed our classification of certain shipping costs previously classified as SG&A to net sales in our condensed consolidated statements of operations for the three months ended March 31, 2004 to be consistent with the classification of other shipping cost that relate to amounts billed to our customers.

In connection with the above changes in classification which did not change or affect net income (loss) in our condensed consolidated statements of operations, we performed a quantitative and qualitative analysis of these changes and concluded that these classification changes did not result from a material weakness in our disclosure controls and procedures.

In October 2005, we began to formalize a Disclosure Committee. The committee was formed, a chairman was appointed and an outline of tasks was adopted that includes the development of a charter and formal policies and procedures. In December 2005, the charter of the committee was adopted. The committee reports to our CEO and CFO and includes the following:

- Senior Vice President - Corporate Controller
- Vice President - General Counsel
- Vice President - Financial Services
- Vice President - Controller - Climate Control Business
- Vice President - Controller - Chemical Business
- Manager - Financial Reporting
- Director - Internal Audit

The committee will involve, when and as needed, the top executives responsible for the Company's two core businesses. The Disclosure Committee, in addition to maintaining the existing oversight activities, will examine and re-evaluate the Company's policies, procedures and criteria for determining materiality of items relative to operating and net income and the financial statements taken as a whole.

We corrected the material weakness during December 2005. During the quarter ended March 31, 2005, there were no significant changes to our internal controls over financial reporting. However, subsequent to March 31, 2005, we took certain steps to correct the material weakness as described above.

SPECIAL NOTE REGARDING  
FORWARD-LOOKING STATEMENTS

Certain statements contained within this report may be deemed "Forward-Looking Statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements in this report other than statements of historical fact are Forward-Looking Statements that are subject to known and unknown risks, uncertainties and other factors which could cause actual results and performance of the Company to differ materially from such statements. The words "believe", "expect", "anticipate", "intend", "will", and similar expressions identify Forward-Looking Statements. Forward-Looking Statements contained herein relate to, among other things,

the agricultural products are the only seasonal products,

- as it relates to the Chemical Business, our efforts include increasing sales volume of the Alabama and Arkansas plants with an emphasis on customers that will accept the commodity risk inherent with natural gas and anhydrous ammonia, the anticipated consent order for Slurry will not have a material adverse effect on the Company,

- the amount of committed capital expenditures related to our Chemical Business,

- amounts to be spent relating to compliance with federal, state and local environmental laws at the El Dorado Facility including matters relating to the sulfuric acid plant,

- liquidity and availability of funds,

- anticipated financial performance,

- adequate cash in 2005 from internal cash flows and financing sources to meet our presently anticipated working capital requirements,

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adequate resources to meet our obligations as they come due,  
ability to make planned capital improvements,

- amount of and ability to obtain financing for the Discharge Water disposal project,

- ThermaClime's forecasts for 2005 for ThermaClime's operating results meeting all required covenant tests for all quarters and the year ending in 2005,

- maintain compliance with all loan covenants,

- EDC's ability to comply with the terms of the Discharge Water permit,

- the amount of additional expenditures relating to the AirCAO,

- the good likelihood that Cherokee will recover monies from Dynegy over and above any monies which may be recovered by the plaintiff or owed to Dynegy,

- one of the nitric acid plants will not be back to normal production until the middle of May 2005,

- the amount to repair and rebuild the damaged nitric acid plant,

- the amount of interest to be incurred for the remainder of 2005 relating to the Senior Secured Loan and

- the Climate Control Business' objectives include the continued emphasis on increasing the sales and operating margins of existing products and on new product development.

-52-

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While we believe the expectations reflected in such Forward-Looking Statements are reasonable, we can give no assurance such expectations will prove to have been correct. There are a variety of factors which could cause future outcomes to differ materially from those described in this report, including, but not limited to,

- decline in general economic conditions, both domestic and foreign,

- material reduction in revenues,

- material increase in interest rates,

- ability to collect in a timely manner a material amount of receivables,

- increased competitive pressures,

- changes in federal, state and local laws and regulations, especially environmental regulations, or in interpretation of such, pending,

- additional releases (particularly air emissions) into the environment,

- material increases in equipment, maintenance, operating or labor costs not presently anticipated by us,

- the requirement to use internally generated funds for purposes not presently anticipated,

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the inability to secure additional financing for planned capital expenditures,  
the cost for the purchase of anhydrous ammonia and natural gas,  
•  
changes in competition,  
•  
the loss of any significant customer,  
•  
changes in operating strategy or development plans,  
•  
inability to fund the working capital and expansion of our businesses,  
•  
adverse results in any of our pending litigation,  
•  
possible negative effects as to the restatements discussed in the "Explanatory Introduction Note",  
•  
inability to obtain necessary raw materials and  
•  
other factors described in "Management's Discussion and Analysis of Financial Condition and Results of Operation" contained in this report.  
•

Given these uncertainties, all parties are cautioned not to place undue reliance on such Forward-Looking Statements. We disclaim any obligation to update any such factors or to publicly announce the results of any revisions to any of the Forward-Looking Statements contained herein to reflect future events or developments.

-53-

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### PART II OTHER INFORMATION

#### Item 1. Legal Proceedings

There are no material legal proceedings pending against the Company and/or its subsidiaries not previously reported in Item 3 of the Company's 10-K/A Amendment No. 1, for year ended December 31, 2004 except the following matters have been resolved or settled during the first quarter of 2005:

As previously reported, EDC and one of its employees have entered into a Plea Agreement with the United States as a result of the drainage of the equalization pond at the El Dorado Facility in response to a maintenance emergency and to permit an uncontrolled release in September 2001, in which it was alleged that the sustained discharge was out of compliance with the mass effluent limits contained in the facility's permit. An environmental compliance employee of EDC incorrectly determined that the proper procedure was to notify the state of Arkansas of the discharge in the month end report and not within 24 hours of the discharge. EDC and the employee have each pled guilty to one misdemeanor count for negligently violating a permit, to-wit: Failing to report a discharge within 24 hours, a misdemeanor. Under the Plea Agreement, EDC paid a fine of \$45,000 and is placed on probation for one year and the employee is placed on probation for one year. The Plea Agreement was approved by the United States District Court during February 2005.

#### Marty Davis, et al. v. El Dorado Chemical Company

, pending in the United States District Court, Western District of Arkansas, El Dorado Division, brought against EDC by the owners of 283 acres of property adjacent to the El Dorado Facility, was settled in February 2005 for an immaterial amount.

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### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Not applicable

### Item 3. Defaults upon Senior Securities

(b) Although dividends on our Series 2 Preferred are payable if and when declared by the Board of Directors, the terms of the Series 2 Preferred provide that dividends are cumulative. Our Board of Directors have not declared and paid dividends on our outstanding Series 2 Preferred since June 1999. The amount of the total arrearage of unpaid dividends on the outstanding Series 2 Preferred is \$11.6 million as of March 31, 2005. If the June 15 dividend on the Series 2 Preferred is not paid, the amount of the total arrearage of unpaid dividends payable on the outstanding Series 2 Preferred will be \$12.1 million.

The terms of Series 2 Preferred provide that whenever dividends on the Series 2 Preferred are in arrears and unpaid in an amount equal to at least six quarterly dividends: (i) the number of members of our Board of Directors shall be increased by two effective as of the time of election of such directors; (ii) we shall, upon the written request of the record holder of 10% of the shares of Series 2 Preferred, call a special meeting of the Preferred Stockholders for the purpose of electing such two additional directors; (iii) the Preferred Stockholders have the exclusive right to vote for and elect such

-54-

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two additional directors; and (iv) the Preferred Stockholders right to elect two additional directors will terminate when all cumulative and unpaid dividends on the Series 2 Preferred have been declared and set apart for payment.

At the request of Jayhawk Capital Management, L.L.C. ("Jayhawk"), a special meeting was held on March 11, 2002 for the purpose of electing the two additional directors to our Board of Directors. At this special meeting, the holders of the Series 2 Preferred elected two members of our Board of Directors, Dr. Allen Ford and Mr. Grant Donovan, as permitted pursuant to the terms of the Series 2 Preferred. The election of Dr. Ford and Mr. Donovan increased the number of directors from 10 to 12.

Also our Board of Directors did not declare and pay the January 1 regular dividend on our Series B Preferred since 1999. Dividends in arrears at March 31, 2005 related to the Series B Preferred was \$1.3 million.

In addition, dividends in arrears related to our Series D Preferred was \$.2 million as of March 31, 2005.

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

Not applicable

### Item 5. Other Information

Not applicable

### Item 6. Exhibits

(a) 9; 9; Exhibits The Company has included the following exhibits in this report:

- 31.1 Certification of Jack E. Golsen, Chief Executive Officer, pursuant to Sarbanes-Oxley Act of 2002, Section 302.
- 31.2 Certification of Tony M. Shelby, Chief Financial Officer, pursuant to Sarbanes-Oxley Act of 2002, Section 302.
- 32.1 Certification of Jack E. Golsen, Chief Executive Officer, furnished pursuant to Sarbanes-Oxley Act of 2002, Section 906.

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32.2 Certification of Tony M. Shelby, Chief Financial Officer, furnished pursuant to Sarbanes-Oxley Act of 2002, Section 906.

-55-

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### SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Company has caused the undersigned, duly authorized, to sign this report on its behalf on this 30th day of December 2005.

LSB INDUSTRIES, INC.  
By: /s/ Tony M. Shelby

Tony M. Shelby  
Executive Vice President of Finance and Chief Financial  
Officer  
(Principal Financial Officer)  
By: /s/ Jim D. Jones

Jim D. Jones  
Senior Vice President, Corporate Controller and Treasurer  
(Principal Accounting Officer)

-56-