

LSB INDUSTRIES INC  
Form 10-Q/A  
August 14, 2009  
LSB Industries, Inc.

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Form 10-Q/A (6-30-2009)

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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 the quarterly period ended June 30, 2009

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 I.R.S. Employer Identification No.  
incorporation or organization

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  
 No

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files).  Yes  No

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(Facing Sheet Continued)

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

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

The number of shares outstanding of the Registrant's voting common stock, as of July 31, 2009 was 21,484,308 shares, excluding 3,867,462 shares held as treasury stock.

Explanatory Note

The Form 10-Q for LSB Industries, Inc. for the quarterly period ended June 30, 2009 ("Form 10-Q"), as filed with the Securities and Exchange Commission ("SEC") on August 6, 2009, is being amended by this Amendment No. 1 solely to correct two typographical errors on the June 30, 2009 condensed consolidated balance sheet on page 5 of such Form 10-Q. The correct amount for total current liabilities is \$60,103 instead of \$60,1039 and the correct amount for retained earnings is \$39,971 instead of \$39,671. These amounts were correctly stated in our press release as to second quarter 2009 results and Exhibit 99.1 of our Form 8-K, as filed with the SEC on August 7, 2009. In addition, none of the other numbers contained in the condensed consolidated financial statements and notes thereto of the Form 10-Q reflect or were affected by the typographical errors.

In connection with filing of this Amendment No. 1 and pursuant to Rule 12b-15, certain certifications are attached as exhibits hereto. The remainder of the Form 10-Q is unchanged and is not reproduced in this Amendment No. 1. Except for the foregoing amended information, the Form 10-Q continues to describe conditions as of the date of the original filing of such Form 10-Q.

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PART I  
FINANCIAL INFORMATION

Item 1. Financial Statements

LSB INDUSTRIES, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Information at June 30, 2009 is unaudited)

|   | June 30,<br>2009 | December<br>31,<br>2008 |
|---|------------------|-------------------------|
|   | (In Thousands)   |                         |
| Assets                                  |                  |                         |
| Current assets:                         |                  |                         |
| Cash and cash equivalents               | \$ 63,008        | \$ 46,204               |
| Restricted cash                         | 375              | 893                     |
| Accounts receivable, net                | 64,122           | 78,846                  |
| Inventories:                            |                  |                         |
| Finished goods                          | 27,716           | 30,679                  |
| Work in process                         | 2,589            | 2,954                   |
| Raw materials                           | 21,376           | 27,177                  |
| Total inventories                       | 51,681           | 60,810                  |
| Supplies, prepaid items and other:      |                  |                         |
| Prepaid insurance                       | 1,467            | 3,373                   |
| Precious metals                         | 14,575           | 14,691                  |
| Supplies                                | 4,800            | 4,301                   |
| Other                                   | 1,841            | 1,378                   |
| Total supplies, prepaid items and other | 22,683           | 23,743                  |
| Deferred income taxes                   | 7,777            | 11,417                  |
| Total current assets                    | 209,646          | 221,913                 |
| Property, plant and equipment, net      | 108,780          | 104,292                 |
| Other assets:                           |                  |                         |
| Debt issuance costs, net                | 1,988            | 2,607                   |
| Investment in affiliate                 | 3,766            | 3,628                   |
| Goodwill                                | 1,724            | 1,724                   |
| Other, net                              | 1,812            | 1,603                   |
| Total other assets                      | 9,290            | 9,562                   |
|   | \$ 327,716       | \$ 335,767              |

(Continued on following page)

|   | June 30,<br>2009 | December<br>31,<br>2008 |
|---|------------------|-------------------------|
|   | (In Thousands)   |                         |
| <b>Liabilities and Stockholders' Equity</b>   |                  |                         |
| <b>Current liabilities:</b>   |                  |                         |
| Accounts payable  | \$ 31,222        | \$ 43,014               |
| Short-term financing  | 452              | 2,228                   |
| Accrued and other liabilities   | 26,393           | 39,236                  |
| Current portion of long-term debt   | 2,036            | 1,560                   |
| Total current liabilities   | 60,103           | 86,038                  |
| Long-term debt  | 97,305           | 103,600                 |
| Noncurrent accrued and other liabilities  | 9,950            | 9,631                   |
| Deferred income taxes   | 8,528            | 6,454                   |
| <b>Contingencies (Note 10)</b>  |                  |                         |
| <b>Stockholders' equity:</b>  |                  |                         |
| Series B 12% cumulative, convertible preferred stock, \$100 par value; 20,000 shares issued and outstanding             | 2,000            | 2,000                   |
| Series D 6% cumulative, convertible Class C preferred stock, no par value; 1,000,000 shares issued                      | 1,000            | 1,000                   |
| Common stock, \$.10 par value; 75,000,000 shares authorized, 25,348,770 shares issued (24,958,330 at December 31, 2008) | 2,535            | 2,496                   |
| Capital in excess of par value  | 129,076          | 127,337                 |
| Accumulated other comprehensive loss  | -                | (120)                   |
| Retained earnings   | 39,971           | 19,804                  |
|   | 174,582          | 152,517                 |
| <b>Less treasury stock at cost:</b>   |                  |                         |
| Common stock, 3,867,462 shares (3,848,518 at December 31, 2008)   | 22,752           | 22,473                  |
| Total stockholders' equity  | 151,830          | 130,044                 |
|   | \$ 327,716       | \$ 335,767              |

See accompanying notes.

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|  | Six Months                               |            | Three Months |            |
|--|--|------------|--------------|------------|
|  | 2009                                     | 2008       | 2009         | 2008       |
|  | (In Thousands, Except Per Share Amounts) |            |              |            |
| Net sales  | \$ 288,760                               | \$ 358,507 | \$ 138,563   | \$ 198,052 |
| Cost of sales  | 210,205                                  | 277,009    | 100,736      | 154,311    |
| Gross profit   | 78,555                                   | 81,498     | 37,827       | 43,741     |
| Selling, general and administrative expense  | 44,421                                   | 40,222     | 23,046       | 21,458     |
| Provisions for losses on accounts receivable   | 28                                       | 292        | (24)         | 202        |
| Other expense  | 334                                      | 657        | 291          | 476        |
| Other income   | (190)                                    | (8,329)    | (28)         | (7,719)    |
| Operating income   | 33,962                                   | 48,656     | 14,542       | 29,324     |
| Interest expense   | 2,939                                    | 3,720      | 1,028        | 1,266      |
| Gains on extinguishment of debt  | (1,743)                                  | -          | (421)        | -          |
| Non-operating other income, net  | (34)                                     | (862)      | (11)         | (345)      |
| Income from continuing operations before provisions for income taxes and equity in earnings of affiliate | 32,800                                   | 45,798     | 13,946       | 28,403     |
| Provisions for income taxes  | 12,800                                   | 17,429     | 5,451        | 10,709     |
| Equity in earnings of affiliate  | (488)                                    | (462)      | (248)        | (230)      |
| Income from continuing operations  | 20,488                                   | 28,831     | 8,743        | 17,924     |
| Net loss from discontinued operations  | 15                                       | 17         | 13           | 17         |
| Net income   | 20,473                                   | 28,814     | 8,730        | 17,907     |
| Dividends, dividend requirements and stock dividend on preferred stocks                                  | 306                                      | 306        | -            | -          |
| Net income applicable to common stock  | \$ 20,167                                | \$ 28,508  | \$ 8,730     | \$ 17,907  |
| Weighted-average common shares:  |  |            |              |            |
| Basic  | 21,174                                   | 21,115     | 21,238       | 21,172     |
| Diluted  | 23,587                                   | 24,908     | 23,674       | 24,827     |
| Income per common share:   |  |            |              |            |
| Basic  | \$ .95                                   | \$ 1.35    | \$ .41       | \$ .85     |
| Diluted  | \$ .89                                   | \$ 1.21    | \$ .38       | \$ .75     |

See accompanying notes.

LSB INDUSTRIES, INC.  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
(Unaudited)  
Six Months Ended June 30, 2009

|  | Common<br>Stock<br>Shares | Non-<br>Redeemable<br>Preferred<br>Stock | Common<br>Stock<br>Par<br>Value | Capital<br>in<br>Excess<br>of<br>Par<br>Value | Accumulated<br>Other<br>Comprehensive<br>Loss | Retained<br>Earnings | Treasury<br>Stock-<br>Common | Total     |
|--|---------------------------|--|---------------------------------|---|---|----------------------|------------------------------|-----------|
| (In Thousands)   |                           |  |                                 |   |   |                      |                              |           |
| Balance at December 31, 2008                                       | 24,958                    | \$3,000                                  | \$2,496                         | \$127,337                                     | \$ (120)                                      | \$19,804             | \$(22,473)                   | \$130,044 |
| Net income   |                           |  |                                 |   |   | 20,473               |                              | 20,473    |
| Amortization of cash flow hedge                                    |                           |  |                                 |   | 120   |                      |                              | 120       |
| Total comprehensive income   |                           |  |                                 |   |   |                      |                              | 20,593    |
| Dividends paid on preferred stock                                  |                           |  |                                 |   |   | (306)                |                              | (306)     |
| Stock-based compensation   |                           |  |                                 | 514   |   |                      |                              | 514       |
| Exercise of stock options  | 389                       |  | 39                              | 740   |   |                      | (279)                        | 500       |
| Excess income tax benefit associated with stock-based compensation |                           |  |                                 | 481   |   |                      |                              | 481       |
| Conversion of shares of redeemable preferred stock to common stock | 2                         |  |                                 | 4   |   |                      |                              | 4         |
| Balance at June 30, 2009   | 25,349                    | \$3,000                                  | \$2,535                         | \$129,076                                     | \$ -  | \$39,971             | \$(22,752)                   | \$151,830 |

Note: For the six and three months ended June 30, 2009, total comprehensive income was \$20,593,000 and \$8,778,000, respectively. For the six and three months ended June 30, 2008, total comprehensive income was \$28,903,000 and \$17,951,000, respectively.

See accompanying notes.



LSB INDUSTRIES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)  
Six Months Ended June 30, 2009 and 2008

|  | 2009           | 2008      |
|--|----------------|-----------|
|  | (In Thousands) |           |
| Cash flows from continuing operating activities:   |                |           |
| Net income   | \$ 20,473      | \$ 28,814 |
| Adjustments to reconcile net income to net cash provided by continuing operating activities:         |                |           |
| Net loss from discontinued operations  | 15             | 17        |
| Deferred income taxes  | 5,538          | 4,185     |
| Gain on extinguishment of debt   | (1,743)        | -         |
| Gain on litigation judgment associated with property, plant and equipment                            | -              | (3,943)   |
| Losses on sales and disposals of property and equipment  | 220            | 82        |
| Depreciation of property, plant and equipment  | 7,684          | 6,269     |
| Amortization   | 451            | 554       |
| Stock-based compensation   | 514            | 384       |
| Provisions for losses on accounts receivable   | 28             | 292       |
| Provision for (realization of) losses on inventory   | (3,024)        | 184       |
| Provision for losses on firm sales commitments   | 514            | -         |
| Provision for impairment of long-lived assets  | -              | 192       |
| Equity in earnings of affiliate  | (488)          | (462)     |
| Distributions received from affiliate  | 350            | 280       |
| Changes in fair value of commodities contracts   | 969            | (861)     |
| Changes in fair value of interest rate contracts   | (649)          | (709)     |
| Cash provided (used) by changes in assets and liabilities:   |                |           |
| Accounts receivable  | 15,790         | (25,338)  |
| Inventories  | 12,153         | (12,085)  |
| Other supplies and prepaid items   | 1,315          | (1,764)   |
| Accounts payable   | (11,703)       | 11,129    |
| Customer deposits  | (2,121)        | (1,395)   |
| Deferred rent expense  | (1,424)        | (4,733)   |
| Other current and noncurrent liabilities   | (9,730)        | 1,932     |
| Net cash provided by continuing operating activities   | 35,132         | 3,024     |
| Cash flows from continuing investing activities:   |                |           |
| Capital expenditures   | (12,406)       | (14,751)  |
| Proceeds from litigation judgment associated with property, plant and equipment                      | -              | 5,948     |
| Payment of legal costs relating to litigation judgment associated with property, plant and equipment | -              | (1,884)   |
| Proceeds from sales of property and equipment  | 3              | 58        |
| Proceeds from restricted cash  | 518            | 172       |
| Other assets   | (209)          | (352)     |
| Net cash used by continuing investing activities   | (12,094)       | (10,809)  |

(Continued on following page)



LSB INDUSTRIES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)  
(Unaudited)  
Six Months Ended June 30, 2009 and 2008

|   | 2009           | 2008       |
|---|----------------|------------|
|   | (In Thousands) |            |
| <b>Cash flows from continuing financing activities:</b>   |                |            |
| Proceeds from revolving debt facilities   | \$ 281,103     | \$ 288,793 |
| Payments on revolving debt facilities   | (281,103)      | (288,793)  |
| Proceeds from other long-term debt, net of fees   | 2,565          | -          |
| Acquisition of 5.5% convertible debentures  | (7,134)        | -          |
| Payments on other long-term debt  | (687)          | (519)      |
| Payments on short-term financing  | (1,776)        | (788)      |
| Proceeds from exercise of stock options   | 500            | 673        |
| Purchase of treasury stock  | -              | (3,421)    |
| Excess income tax benefit associated with stock-based compensation                                      | 657            | 2,552      |
| Dividends paid on preferred stock   | (306)          | (306)      |
| Net cash used by continuing financing activities  | (6,181)        | (1,809)    |
| <b>Cash flows of discontinued operations:</b>   |                |            |
| Operating cash flows  | (53)           | (106)      |
| Net increase (decrease) in cash and cash equivalents  | 16,804         | (9,700)    |
| Cash and cash equivalents at beginning of period  | 46,204         | 58,224     |
| Cash and cash equivalents at end of period  | \$ 63,008      | \$ 48,524  |
| <b>Supplemental cash flow information:</b>  |                |            |
| Cash payments for income taxes, net of refunds  | \$ 6,459       | \$ 9,582   |
| <b>Noncash investing and financing activities:</b>  |                |            |
| Receivable associated with a property insurance claim   | \$ 1,135       | \$ -       |
| Current other assets, accounts payable and long-term debt associated with property, plant and equipment | \$ 4,164       | \$ 2,618   |
| Debt issuance costs associated with the acquisition of the 5.5% convertible debentures                  | \$ 323         | \$ -       |

See accompanying notes.

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

Note 1: Basis of Presentation The accompanying condensed consolidated financial statements include the accounts of LSB Industries, Inc. (the "Company", "We", "Us", or "Our") and its subsidiaries. We are a manufacturing, marketing and engineering company which is primarily engaged, through our wholly-owned subsidiary ThermaClime, Inc. ("ThermaClime") and its subsidiaries, in the manufacture and sale of geothermal and water source heat pumps and air handling products (the "Climate Control Business") and the manufacture and sale of chemical products (the "Chemical Business"). The Company and ThermaClime are holding companies with no significant assets or operations other than cash and cash equivalents and our investments in our subsidiaries. Entities that are 20% to 50% owned and for which we have significant influence are accounted for on the equity method. All material intercompany accounts and transactions have been eliminated.

In the opinion of management, the unaudited condensed consolidated financial statements of the Company as of June 30, 2009 and for the six and three-month periods ended June 30, 2009 and 2008 include all adjustments and accruals, consisting only of normal, recurring accrual adjustments which are necessary for a fair presentation of the results for the interim periods. These interim results are not necessarily indicative of results for a full year due, in part, to the seasonality of our sales of agricultural products and the timing of performing our major plant maintenance activities. Our selling seasons for agricultural products are primarily during the spring and fall planting seasons, which typically extend from March through June and from September through November.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles ("GAAP") have been condensed or omitted in this Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). These condensed consolidated financial statements should be read in connection with the consolidated financial statements and notes thereto included in our Form 10-K for the year ended December 31, 2008 ("2008 Form 10-K").

Certain reclassifications have been made in our condensed consolidated financial statements for the six months ended June 30, 2008 to conform to our condensed consolidated financial statement presentation for the six months ended June 30, 2009, including the change in our classification of principal payments under capital lease obligations from "capital expenditures" that are included in net cash used by continuing investing activities to "payments on other long-term debt" that are included in net cash used by continuing financing activities. This change in classification is consistent with the underlying principles of Statement of Financial Accounting Standards ("SFAS") No. 95 – Statement of Cash Flows. This change resulted in a decrease in net cash used by continuing investing activities and an increase in net cash used by financing activities of \$235,000 for the six months ended June 30, 2008.

In connection with the preparation of our condensed consolidated financial statements and in accordance with the recently issued SFAS No. 165 - Subsequent Events ("SFAS 165"), we evaluated subsequent events after the balance sheet date of June 30, 2009 through August 6, 2009, which is the date our condensed consolidated financial statements were issued.

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(Unaudited)

Note 2: Recently Issued Accounting Pronouncements In March 2008, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 161 - Disclosures about Derivative Instruments and Hedging Activities; an Amendment of SFAS 133 (“SFAS 161”). SFAS 161 requires enhanced disclosures about an entity’s derivative and hedging activities for the purpose of improving the transparency of financial reporting. The new disclosure requirements of SFAS 161 became effective for the Company on January 1, 2009. The provisions of SFAS 161 were applied prospectively. See Note 11 - Derivatives, Hedges and Financial Instruments.

In April 2009, the FASB issued FASB Staff Position No. FAS 107-1 and APB 28-1 (“FSP”) that amends SFAS No. 107 - Disclosures about Fair Value of Financial Instruments and APB Opinion No. 28 - Interim Financial Reporting. This FSP requires disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies. The new disclosure requirements of this FSP became effective for the Company on April 1, 2009. The provisions of this FSP were applied prospectively. See Note 11 – Derivatives, Hedges and Financial Instruments.

In May 2009, the FASB issued SFAS 165 that establishes principles and requirements for reporting subsequent events. The requirements of SFAS 165 became effective for the Company for the three months ended June 30, 2009. The provisions of SFAS 165 were applied prospectively. See Note 1 – Basis of Presentation and Note 18 – Subsequent Events.

Note 3: Accounts Receivable

|                                 | June 30,<br>2009 | December<br>31,<br>2008 |
|---------------------------------|------------------|-------------------------|
| (In Thousands)                  |                  |                         |
| Trade receivables               | \$ 62,606        | \$ 78,092               |
| Insurance claims                | 1,271            | 252                     |
| Other                           | 910              | 1,231                   |
|                                 | 64,787           | 79,575                  |
| Allowance for doubtful accounts | (665)            | (729)                   |
|                                 | \$ 64,122        | \$ 78,846               |

Note 4: Inventories Inventories are priced at the lower of cost or market, with cost being determined using the first-in, first-out (“FIFO”) basis. Finished goods and work-in-process inventories include material, labor, and manufacturing overhead costs. At June 30, 2009 and December 31, 2008, inventory reserves for certain slow-moving inventory items (primarily Climate Control products) were \$641,000 and \$514,000, respectively. In addition, inventory reserves for certain nitrogen-based inventories provided by our Chemical Business were \$423,000 and \$3,627,000, at June 30, 2009 and December 31, 2008, respectively, because cost exceeded the net realizable value.

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(Unaudited)

## Note 4: Inventories (continued)

Changes in our inventory reserves are as follows:

|  | Six Months Ended |        | Three Months Ended |        |
|--|------------------|--------|--------------------|--------|
|  | June 30,         |        | June 30,           |        |
|  | 2009             | 2008   | 2009               | 2008   |
|  | (In Thousands)   |        |                    |        |
| Balance at beginning of period         | \$ 4,141         | \$ 473 | \$ 1,109           | \$ 610 |
| Provisions for (realization of) losses | (3,024)          | 184    | 8                  | 15     |
| Write-offs/disposals                   | (53)             | (74)   | (53)               | (42)   |
| Balance at end of period               | \$ 1,064         | \$ 583 | \$ 1,064           | \$ 583 |

The provision for (realization of) losses is included in cost of sales in the accompanying condensed consolidated statements of income.

Note 5: Precious Metals Precious metals are used as a catalyst in the Chemical Business manufacturing process. Precious metals are carried at cost, with cost being determined using the FIFO basis. Because some of the catalyst consumed in the production process cannot be readily recovered and the amount and timing of recoveries are not predictable, we follow the practice of expensing precious metals as they are consumed.

Occasionally, during major maintenance and/or capital projects, we may be able to perform procedures to recover precious metals (previously expensed) which have accumulated over time within our manufacturing equipment. When we accumulate precious metals in excess of our production requirements, we may sell a portion of the excess metals.

Precious metals expense (recoveries), net, consists of the following:

|                               | Six Months Ended |          | Three Months Ended |          |
|-------------------------------|------------------|----------|--------------------|----------|
|                               | June 30,         |          | June 30,           |          |
|                               | 2009             | 2008     | 2009               | 2008     |
|                               | (In Thousands)   |          |                    |          |
| Precious metals expense       | \$ 3,279         | \$ 4,354 | \$ 1,552           | \$ 1,894 |
| Recoveries of precious metals | (2,222)          | (792)    | (9)                | (792)    |
| Precious metals expense, net  | \$ 1,057         | \$ 3,562 | \$ 1,543           | \$ 1,102 |

Precious metals expense is included in cost of sales (recoveries of precious metals are reductions to cost of sales) in the accompanying condensed consolidated statements of income.

Note 6: Investment in Affiliate Cepolk Holding, Inc. ("CHI"), a subsidiary of the Company, is a limited partner and has a 50% equity interest in Cepolk Limited Partnership ("Partnership") which is accounted for on the equity method. The Partnership owns an energy savings project located at the Ft. Polk Army base in Louisiana ("Project"). As of June 30, 2009, the Partnership and general partner to the Partnership is indebted to a term lender ("Term Lender") of the Project for approximately \$2,849,000 with a term extending to December 2010. CHI has pledged its

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(Unaudited)

## Note 6: Investment in Affiliate (continued)

limited partnership interest in the Partnership to the Term Lender as part of the Term Lender's collateral securing all obligations under the loan. This guarantee and pledge is limited to CHI's limited partnership interest and does not expose CHI or the Company to liability in excess of CHI's limited partnership interest. No liability has been established for this pledge since it was entered into prior to adoption of FASB Interpretation ("FIN") 45. CHI has no recourse provisions or available collateral that would enable CHI to recover its partnership interest should the Term Lender be required to perform under this pledge.

Note 7: Product Warranty Our Climate Control Business sells equipment that has an expected life, under normal circumstances and use that extends over several years. As such, we provide warranties after equipment shipment/start-up covering defects in materials and workmanship.

Generally, the base warranty coverage for most of 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. The warranty provides that most equipment is required to be returned to the factory or an 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 generally disclaim and exclude warranties related to merchantability or fitness for any particular purpose and disclaim and exclude any liability for consequential or incidental damages. In some cases, the customer may purchase or a specific product may be sold with an extended warranty. The above discussion is generally applicable to such extended warranties, 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 measure and recognize the expense and liability for such warranty obligations using a percentage of net sales, based upon our historical warranty costs. We also recognize the additional warranty expense and liability to cover atypical costs associated with a specific product, or component thereof, or project installation, when such costs are probable and reasonably estimable. It is possible that future warranty costs could exceed our estimates.

Changes in our product warranty obligation are as follows:

|                                     | Six Months Ended |          | Three Months Ended |          |
|-------------------------------------|------------------|----------|--------------------|----------|
|                                     | June 30,         |          | June 30,           |          |
|                                     | 2009             | 2008     | 2009               | 2008     |
|                                     | (In Thousands)   |          |                    |          |
| Balance at beginning of period      | \$ 2,820         | \$ 1,944 | \$ 2,864           | \$ 2,056 |
| Add: Charged to costs and expenses  | 3,146            | 2,287    | 1,288              | 1,556    |
| Deduct: Costs and expenses incurred | (2,928)          | (1,953)  | (1,114)            | (1,334)  |
| Balance at end of period            | \$ 3,038         | \$ 2,278 | \$ 3,038           | \$ 2,278 |

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(Unaudited)

## Note 8: Current and Noncurrent Accrued and Other Liabilities

|   | June 30,<br>2009 | December<br>31,<br>2008 |
|---|------------------|-------------------------|
|   | (In Thousands)   |                         |
| Fair value of derivatives   | \$ 4,555         | \$ 8,347                |
| Deferred revenue on extended warranty contracts                             | 4,518            | 4,028                   |
| Accrued payroll and benefits  | 4,439            | 6,422                   |
| Accrued warranty costs  | 3,038            | 2,820                   |
| Accrued death benefits  | 3,017            | 2,687                   |
| Accrued insurance   | 2,707            | 2,971                   |
| Accrued income taxes  | 1,850            | 1,704                   |
| Accrued contractual manufacturing obligations                               | 1,477            | 2,230                   |
| Accrued property and franchise taxes  | 1,343            | 693                     |
| Accrued commissions   | 1,291            | 2,433                   |
| Customer deposits   | 1,121            | 3,242                   |
| Billings in excess of costs and estimated earnings on uncompleted contracts | 1,075            | 1,882                   |
| Accrued executive benefits  | 1,065            | 1,111                   |
| Accrued interest  | 822              | 2,003                   |
| Accrued precious metals costs   | 284              | 1,298                   |
| Deferred rent expense   | -                | 1,424                   |
| Other   | 3,741            | 3,572                   |
|   | 36,343           | 48,867                  |
| Less noncurrent portion   | 9,950            | 9,631                   |
| Current portion of accrued and other liabilities                            | \$ 26,393        | \$ 39,236               |

## Note 9: Long-Term Debt

|   | June 30,<br>2009 | December<br>31,<br>2008 |
|---|------------------|-------------------------|
|   | (In Thousands)   |                         |
| Working Capital Revolver Loan due 2012 (A)  | \$ -             | \$ -                    |
| 5.5% Convertible Senior Subordinated Notes due 2012 (B)   | 31,300           | 40,500                  |
| Secured Term Loan due 2012 (C)  | 50,000           | 50,000                  |
| Other, with a current weighted-average interest rate of 6.56%, most of which is secured by machinery, equipment and real estate | 18,041           | 14,660                  |
|   | 99,341           | 105,160                 |
| Less current portion of long-term debt  | 2,036            | 1,560                   |
| Long-term debt due after one year   | \$ 97,305        | \$ 103,600              |

(A) ThermaClime and its subsidiaries (the "Borrowers") are parties to 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 ThermaClime, and its subsidiaries. The Working Capital Revolver Loan, as amended, accrues interest at a base rate (generally equivalent to the prime rate) plus .50% or LIBOR plus 1.75% and matures on April 13, 2012. The interest rate at June 30, 2009 was 3.75%. Interest is paid monthly, if applicable.





LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(Unaudited)

Note 9: Long-Term Debt (continued)

The facility provides for up to \$8.5 million of letters of credit. All letters of credit outstanding reduce availability under the facility. At June 30, 2009, amounts available for additional borrowing under the Working Capital Revolver Loan were \$49.5 million. Under the Working Capital Revolver Loan, as amended, the lender also requires the Borrowers to pay a letter of credit fee equal to 1% per annum of the undrawn amount of all outstanding letters of credit, an unused line fee equal to .375% per annum for the excess amount available under the facility not drawn and various other audit, appraisal and valuation charges.

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, if any. The Working Capital Revolver Loan is secured by the assets of all the ThermaClime entities other than El Dorado Nitric Company and its subsidiaries ("EDNC") but excluding the assets securing the \$50 million secured term loan discussed in (C) below and certain distribution-related assets of El Dorado Chemical Company ("EDC"). EDNC is neither a borrower nor guarantor of the Working Capital Revolver Loan. The carrying value of the pledged assets is approximately \$214 million at June 30, 2009.

The Working Capital Revolver Loan, as amended, requires ThermaClime to meet certain financial covenants, including an EBITDA requirement of greater than \$25 million, a minimum fixed charge coverage ratio of not less than 1.10 to 1, and a maximum senior leverage coverage ratio of not greater than 4.50 to 1, which requirements are measured quarterly on a trailing twelve-month basis and as defined in the agreement. ThermaClime was in compliance with those covenants for the twelve-month period ended June 30, 2009. The Working Capital Revolver Loan also contains covenants that, among other things, limit the Borrowers' (which does not include the Company) ability, without consent of the lender and with certain exceptions, to:

- incur additional indebtedness,
- incur liens,
- make restricted payments or loans to affiliates who are not Borrowers,
- engage in mergers, consolidations or other forms of recapitalization, or
- dispose assets.

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.

(B) In June 2007, we entered into a purchase agreement with each of twenty two qualified institutional buyers ("QIBs"), pursuant to which we sold \$60 million aggregate principal amount of the 5.5% Convertible Senior Subordinated Notes (the "2007 Debentures") in a private placement to the QIBs pursuant to the exemptions from the registration requirements of the Securities Act of 1933, as amended (the "Act"), afforded by Section 4(2) of the Act and Regulation D promulgated under the Act. The 2007 Debentures are eligible for resale by the investors under Rule 144A under the Act. We received net proceeds of approximately \$57 million, after discounts and commissions. In connection with the closing, we entered into an indenture (the "Indenture") with UMB Bank, as trustee (the "Trustee"), governing the 2007 Debentures. The Trustee receives customary compensation from us for such services.

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
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Note 9: Long-Term Debt (continued)

The 2007 Debentures bear interest at the rate of 5.5% per year and mature on July 1, 2012. Interest is payable in arrears on January 1 and July 1 of each year, which began on January 1, 2008.

The 2007 Debentures are unsecured obligations and are subordinated in right of payment to all of our existing and future senior indebtedness, including indebtedness under our revolving debt facilities. The 2007 Debentures are effectively subordinated to all present and future liabilities, including trade payables, of our subsidiaries.

During the six and three months ended June 30, 2009, we acquired \$9.2 million and \$3.5 million, respectively, aggregate principal amount of the 2007 Debentures for approximately \$7.1 million and \$2.9 million, respectively, with each purchase being negotiated. As a result, we recognized a gain on extinguishment of debt of \$1.7 million and \$0.4 million, respectively, after writing off approximately \$0.4 million and \$0.2 million, respectively, of the unamortized debt issuance costs associated with the 2007 Debentures acquired.

As the result of the acquisitions made during the fourth quarter of 2008 and the first two quarters of 2009, only \$31.3 million of the 2007 Debentures remain outstanding at June 30, 2009. In addition, see discussion concerning \$5.0 million of the 2007 Debentures being held by Jack E. Golsen, our Chairman of the Board and Chief Executive Officer, members of his immediate family (spouse and children), including Barry H. Golsen, our Vice Chairman and President, entities owned by them and trusts for which they possess voting or dispositive power as trustee (collectively, the "Golsen Group") in Note 17-Related Party Transactions.

The 2007 Debentures are convertible by the holders in whole or in part into shares of our common stock prior to their maturity. The conversion rate of the 2007 Debentures for the holders electing to convert all or any portion of a debenture is 36.4 shares of our common stock per \$1,000 principal amount of debentures (representing a conversion price of \$27.47 per share of common stock), subject to adjustment under certain conditions as set forth in the Indenture.

We may redeem some or all of the 2007 Debentures at any time on or after July 2, 2010, at a price equal to 100% of the principal amount of the 2007 Debentures, plus accrued and unpaid interest, all as set forth in the Indenture. The redemption price will be payable at our option in cash or, subject to certain conditions, shares of our common stock (valued at 95% of the weighted average of the closing sale prices of the common stock for the 20 consecutive trading days ending on the fifth trading day prior to the redemption date), subject to certain conditions being met on the date we mail the notice of redemption.

If a designated event (as defined in the Indenture) occurs prior to maturity, holders of the 2007 Debentures may require us to repurchase all or a portion of their 2007 Debentures for cash at a repurchase price equal to 101% of the principal amount of the 2007 Debentures plus any accrued and unpaid interest, as set forth in the Indenture. If a fundamental change (as defined in the Indenture) occurs on or prior to June 30, 2010, under certain circumstances, we will pay, in addition to the repurchase price, a make-whole premium on the 2007 Debentures converted in connection with, or tendered for repurchase upon, the fundamental change. The make-whole

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(Unaudited)

Note 9: Long-Term Debt (continued)

premium will be payable in our common stock or the same form of consideration into which our common stock has been exchanged or converted in the fundamental change. The amount of the make-whole premium, if any, will be based on our stock price on the effective date of the fundamental change. No make-whole premium will be paid if our stock price in connection with the fundamental change is less than or equal to \$23.00 per share.

At maturity, we may elect, subject to certain conditions as set forth in the Indenture, to pay up to 50% of the principal amount of the outstanding 2007 Debentures, plus all accrued and unpaid interest thereon to, but excluding, the maturity date, in shares of our common stock (valued at 95% of the weighted average of the closing sale prices of the common stock for the 20 consecutive trading days ending on the fifth trading day prior to the maturity date), if the common stock is then listed on an eligible market, the shares used to pay the 2007 Debentures and any interest thereon are freely tradable, and certain required opinions of counsel are received.

(C) ThermaClime and certain of its subsidiaries are parties to a \$50 million loan agreement (the "Secured Term Loan") with a certain lender. The Secured Term Loan matures on November 2, 2012. The Secured Term Loan accrues interest at a defined LIBOR rate plus 3%, which LIBOR rate is adjusted on a quarterly basis. The interest rate at June 30, 2009 was approximately 4.02%. The Secured Term Loan requires only quarterly interest payments with the final payment of interest and principal at maturity.

The Secured Term Loan is secured by the real property and equipment located at our El Dorado, Arkansas chemical production facility ("El Dorado Facility") and at our Cherokee, Alabama chemical production facility ("Cherokee Facility"). The carrying value of the pledged assets is approximately \$59 million at June 30, 2009.

The Secured Term Loan borrowers are subject to numerous covenants under the 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. At June 30, 2009, the carrying value of the restricted net assets of ThermaClime and its subsidiaries was approximately \$70 million. As defined in the agreement, the Secured Term Loan borrowers are also subject to a minimum fixed charge coverage ratio of not less than 1.10 to 1 and a maximum leverage ratio of not greater than 4.50 to 1, both measured quarterly on a trailing twelve-month basis. The Secured Term Loan borrowers were in compliance with these financial covenants for the twelve-month period ended June 30, 2009.

The maturity date of the Secured Term Loan can be accelerated by the lender upon the occurrence of a continuing event of default, as defined.

The Working Capital Revolver Loan agreement (discussed in (A) above) and the Secured Term Loan contain cross-default provisions. If ThermaClime fails to meet the financial covenants of the Secured Term Loan, the lender may declare an event of default.

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(Unaudited)

Note 10: 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 or realizable and earned.

Following is a summary of certain legal matters 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 certain performance obligations, 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 effluents 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 in order to comply with the Environmental Laws and Health Laws and are reasonably expected to be incurred in the future.

We will recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated in accordance with FIN 47 - Accounting for Conditional Asset Retirement Obligations. We are obligated to monitor certain discharge water outlets at our Chemical Business facilities should we discontinue the operations of a facility. We also have certain facilities in our Chemical Business that contain asbestos insulation around certain piping and heated surfaces, which we plan to maintain or replace, as needed, with non-asbestos insulation through our standard repair and maintenance activities to prevent deterioration. Since we currently have no plans to discontinue the use of these facilities and the remaining life of the facilities is indeterminable, an asset retirement liability has not been recognized. Currently, there is insufficient information to estimate the fair value of the asset retirement obligations. However, we will continue to review these obligations and record a liability when a reasonable estimate of the fair value can be made.

1. Discharge Water Matters

The El Dorado Facility located in El Dorado, Arkansas within our Chemical Business generates process wastewater, which includes storm water and miscellaneous spills and leaks from process equipment. The process water discharge, storm-water runoff and miscellaneous spills and leaks are governed by a state National Pollutant Discharge Elimination System (“NPDES”) water discharge permit issued by the Arkansas Department of Environmental Quality (“ADEQ”), which permit is to be renewed every five years. The ADEQ issued to EDC a NPDES water discharge permit in 2004, and the El Dorado Facility had until June 1, 2007 to meet the compliance deadline for the more restrictive limits under the 2004 NPDES permit. In order to meet the El Dorado Facility’s June 2007 limits, the El Dorado Facility has significantly reduced the contaminant levels of its wastewater.

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(Unaudited)

Note 10: Contingencies (continued)

The El Dorado Facility has demonstrated its ability to comply with the more restrictive ammonia and nitrate permit limits but has not been able to demonstrate compliance with the more restrictive dissolved minerals permit levels. The El Dorado Facility and the ADEQ agreed to a rule change to address this issue. Although the rule is a state rule, any revisions must also be approved by the United States Environmental Protection Agency (“EPA”) before it can become effective. Once the rule change is complete, the permit limits can be modified to incorporate achievable dissolved minerals permit levels. The ADEQ and the El Dorado Facility also entered into a Consent Administrative Order (“CAO”) which authorized the El Dorado Facility to continue operating without incurring permit violations pending the modification of the permit to implement the revised rule. In March 2009, the EPA notified the ADEQ that it disapproved the dissolved mineral rulemaking due to insufficient documentation. EDC has met with the ADEQ to discuss how the ADEQ plans to address the EPA’s concerns. The ADEQ has held discussions with the EPA to determine what additional information the EPA requires. As a result, EDC submitted to the ADEQ a proposed study plan for developing additional information for the EPA. The ADEQ concurred to the proposed plan. Since this additional work will delay the final EPA approval of the dissolved mineral rulemaking, an extension of the CAO will be required.

In addition, EDC has entered into a CAO that recognizes the presence of nitrate contamination in the shallow groundwater at the El Dorado Facility. EDC is addressing the shallow groundwater contamination. The CAO requires the El Dorado Facility to continue semi-annual groundwater monitoring, to continue operation of a groundwater recovery system and to submit a human health and ecological risk assessment to the ADEQ. 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. The cost of any additional remediation that may be required will be determined based on the results of the investigation and risk assessment and cannot currently be reasonably estimated. Therefore, no liability has been established at June 30, 2009.

2. Air Matters

In August 2008, an air permit modification was issued to EDC by the ADEQ, which sets new limits for ammonia emissions for the nitric acid units at the El Dorado Facility. EDC recently completed required compliance testing but the results are still pending. Based on a previous study, the nitric acid units can meet these new limits.

In addition, the EPA has sent information requests to most, if not all, of the nitric acid plants in the United States, including to us relating to our El Dorado, Cherokee and Baytown Facilities, requesting information under Section 114 of the Clean Air Act as to construction and modification activities at each of these facilities over a period of years to enable the EPA to determine whether these facilities are in compliance with certain provisions of the Clean Air Act. In connection with a review by our Chemical Business of these facilities in obtaining information for the EPA pursuant to the EPA’s request, our Chemical Business management believes, subject to further review, investigation and discussion with the EPA, that certain changes to its production equipment may be needed in order to comply with the requirements of the Clean Air

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(Unaudited)

Note 10: Contingencies (continued)

Act. If changes to the production equipment at these facilities are required in order to bring this equipment into compliance with the Clean Air Act, the amount of capital expenditures necessary in order to bring the equipment into compliance is unknown at this time but could be substantial. Further, if the equipment at any of our El Dorado, Cherokee and/or Baytown Facilities does not meet the requirements of the Clean Air Act, our Chemical Business could be subject to penalties in an amount not to exceed \$27,500 per day as to each facility not in compliance and require such facility to be retrofitted with the "best available control technology." Currently, we are unable to determine the amount or likelihood of penalties, if any, resulting from this request, and, if any of these facilities need to be retrofitted, what equipment needs to be installed and the related amount of capital expenditures. Therefore, no liability has been established at June 30, 2009.

3. Other Environmental Matters

In December 2002, two of our subsidiaries within our Chemical Business, sold substantially all of their operating assets relating to a Kansas chemical facility ("Hallowell Facility") but retained ownership of the real property. At December 31, 2002, even though we continued to own the real property, we did not assess our continuing involvement with our former Hallowell Facility to be significant and therefore accounted for the sale as discontinued operations. In connection with this sale, our subsidiary leased the real property to the buyer under a triple net long-term lease agreement. However, our subsidiary retained the obligation to be responsible for, and perform the activities under, a previously executed consent order to investigate the surface and subsurface contamination at the real property and a corrective action strategy based on the investigation. In addition, certain of our subsidiaries agreed to indemnify the buyer of such assets for these environmental matters. The successor ("Chevron") of a prior owner of the Hallowell Facility has agreed, within certain limitations, to pay and has been paying one-half of the costs incurred under the consent order subject to reallocation.

Based on additional modeling of the site, our subsidiary and Chevron are pursuing a course with the state of Kansas of long-term surface and groundwater monitoring to track the natural decline in contamination, instead of the soil excavation proposed previously. Our subsidiary and Chevron submitted its final report on the groundwater monitoring and an addendum to the Mitigation Work Plan to the state of Kansas. The data from the monitoring program is being evaluated by the state of Kansas and the potential costs of additional monitoring or required remediation, if any, is unknown.

At June 30, 2009, the total estimated liability in connection with this remediation matter and Chevron's share for these costs were minimal (less than \$5,000) and are not discounted to their present value. It is reasonably possible that a change in estimate of our liability and receivable will occur in the near term.

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(Unaudited)

Note 10: Contingencies (continued)

B. Other Pending, Threatened or Settled Litigation

1. Climate Control Business

A proposed class action was filed in the Illinois state district court in September 2007 alleging that certain evaporator coils sold by one of our subsidiaries in the Climate Control Business, Climate Master, Inc. ("Climate Master"), in the state of Illinois from 1990 to approximately 2003 were defective. The complaint requests certification as a class action for the State of Illinois, which request has not yet been heard by the court. Climate Master has filed a motion for summary judgment as to the plaintiffs' claims, and that motion is pending. Climate Master has removed this action to federal court. Climate Master has also filed its answer denying the plaintiffs' claims and asserting several affirmative defenses. Climate Master's insurers have been placed on notice of this matter. One of these insurers has denied coverage, one is out of business and has been liquidated and one insurer advised that it will monitor the litigation subject to a reservation of rights to decline coverage. The policies associated with insurers that have not declined coverage in this matter and remain in business have a deductible of \$250,000. Climate Master intends to vigorously defend itself in connection with this matter. Currently, the Company is unable to determine the amount of damages or the likelihood of any losses resulting from this claim. Therefore, no liability has been established at June 30, 2009.

2. Other

The Jayhawk Group

In November 2006, we entered into an agreement with Jayhawk Capital Management, LLC, Jayhawk Investments, L.P., Jayhawk Institutional Partners, L.P. and Kent McCarthy, the manager and sole member of Jayhawk Capital, (collectively, the "Jayhawk Group"), in which the Jayhawk Group agreed, among other things, that if we undertook, in our sole discretion, within one year from the date of agreement a tender offer for our Series 2 \$3.25 convertible, exchangeable Class C preferred stock ("Series 2 Preferred") or to issue our common stock for a portion of our Series 2 Preferred pursuant to a private exchange, that it would tender or exchange an aggregate of no more than 180,450 shares of the 340,900 shares of the Series 2 Preferred beneficially owned by the Jayhawk Group, subject to, among other things, the entities owned and controlled by Jack E. Golsen, our Chairman and Chief Executive Officer ("Golsen"), and his immediate family, that beneficially own Series 2 Preferred only being able to exchange or tender approximately the same percentage of shares of Series 2 Preferred beneficially owned by them as the Jayhawk Group is able to tender or exchange under the terms of the agreement. In addition, under the agreement, the Jayhawk Group agreed to vote its shares of our common stock and Series 2 Preferred "for" an amendment to the Certificate of Designation covering the Series 2 Preferred to allow us:

- for a period of five years from the completion of an exchange or tender to repurchase, redeem or otherwise acquire shares of our common stock, without approval of the outstanding Series 2 Preferred irrespective that dividends are accrued and unpaid with respect to the Series 2 Preferred; or



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(Unaudited)

Note 10: Contingencies (continued)

- to provide that holders of Series 2 Preferred may not elect two directors to our Board of Directors when dividends are unpaid on the Series 2 Preferred if less than 140,000 shares of Series 2 Preferred remain outstanding.

During 2007, we made a tender offer for our outstanding Series 2 Preferred at the rate of 7.4 shares of our common stock for each share of Series 2 Preferred so tendered. In July 2007, we redeemed the balance of our outstanding shares of Series 2 Preferred. Pursuant to its terms, the Series 2 Preferred was convertible into 4.329 shares of our common stock for each share of Series 2 Preferred. As a result of the redemption, the Jayhawk Group converted the balance of its Series 2 Preferred pursuant to the terms of the Series 2 Preferred in lieu of having its shares redeemed.

During November 2008, the Jayhawk Group filed suit against us and Golsen in a lawsuit styled Jayhawk Capital Management, LLC, et al. v. LSB Industries, Inc., et al., in the United States District Court for the District of Kansas at Kansas City. During March 2009, the Jayhawk Group amended its complaint alleging that the Jayhawk Group should have been able to tender all of its Series 2 Preferred pursuant to the tender offer, notwithstanding the above-described agreement, based on the following claims against us and Golsen:

- fraudulent inducement and fraud,
- violation of 10(b) of the Exchange Act and Rule 10b-5,
- violation of 17-12A501 of the Kansas Uniform Securities Act, and
- breach of contract.

The Jayhawk Group seeks damages in an unspecified amount based on the additional number of common shares it allegedly would have received on conversion of all of its Series 2 Preferred through the February 2007 tender offer, plus punitive damages. In addition, the amended complaint seeks damages in the amount of approximately \$4,000,000 for accrued and unpaid dividends it purports are owed as a result of Jayhawk's July 2007 conversion of its remaining shares of Series 2 Preferred. In May 2008, the General Counsel for the Jayhawk Group offered to settle its claims against us and Golsen in return for a payment of \$100,000, representing the approximate legal fees it had incurred investigating the claims at that time. Through counsel, we verbally agreed to the settlement offer and confirmed the agreement by e-mail. Afterward, the Jayhawk Group's General Counsel purported to withdraw the settlement offer, and asserted that Jayhawk is not bound by any settlement agreement. We contend that the settlement agreement is binding on the Jayhawk Group. Both Golsen and we have filed motions to dismiss the plaintiff's complaint in the federal court, and such motions to dismiss are pending. We intend to contest the lawsuit vigorously, and will assert that Jayhawk is bound by an agreement to settle the claims for \$100,000. Our insurer, a subsidiary of AIG, has agreed to defend this lawsuit on our behalf and on behalf of Golsen and to indemnify under a reservation of rights to deny liability under certain conditions. We have incurred expenses associated with this matter in excess our insurance deductible of \$250,000. No liability has been established for the Jayhawk claims as of June 30, 2009.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(Unaudited)

Note 10: Contingencies (continued)

Securities and Exchange Commission

We have previously disclosed that the SEC was conducting an informal inquiry of us relating to the change in inventory accounting from LIFO to FIFO during 2004 involving approximately \$500,000 by one of our subsidiaries, which change resulted in the restatement of our financial statements for each of the three years in the period ended December 31, 2004 and our March 31, 2005 and June 30, 2005 quarterly financial statements. During April 2008, the staff of the SEC delivered a formal Wells Notice to us informing us that the staff has preliminarily decided to recommend to the SEC that it institute a civil enforcement action against us in connection with the above described matter. All assertions against us involve alleged violations of Section 13 of the 1934 Act and do not assert allegations of fraudulent conduct nor seek a monetary civil fine against us. In addition, the SEC also made assertions against our former principal accounting officer, Jimmie D. Jones, based on Section 13 of the 1934 Act, and the SEC staff delivered a Wells Notice to him and stated its intention to recommend civil proceedings against him. The former principal accounting officer resigned as principal accounting officer, effective August 15, 2008, but remains with the Company as a senior vice president and treasurer in charge of lending compliance and cash management and involved in our banking relationships, acquisitions and corporate planning. On July 17, 2009, the SEC entered an order, pursuant to an agreement, resolving the SEC inquiry. See discussion concerning an order entered by the SEC in Note 18 – Subsequent Events.

Other Claims and Legal Actions

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.

Note 11: Derivatives, Hedges and Financial Instruments We account for derivatives in accordance with SFAS 133 – Accounting for Derivative Instruments and Hedging Activities (“SFAS 133”), as amended, which 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.

We have three types of contracts that are accounted for on a fair value basis, which are interest rate contracts, commodities futures/forward contracts (“commodities contracts”) and foreign exchange contracts as discussed below. All of these contracts are used as economic hedges for risk management purposes but are not designated as hedging instruments under SFAS 133. The valuation of these contracts was determined based on quoted market prices or, in instances where market quotes are not available, other valuation techniques or models used to estimate fair values. The valuations of contracts classified as Level 1 are based on quoted prices in active markets for identical contracts. The valuations of contracts classified as Level 2 are based on quoted prices for similar contracts and valuation inputs other than quoted prices that are observable for these contracts. At December 31, 2008, the valuations of contracts classified as Level 3 were based on the average ask/bid prices obtained from a broker relating to a low volume market.

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(Unaudited)

Note 11: Derivatives, Hedges and Financial Instruments (continued)

Interest Rate Contracts

As part of our interest rate risk management, we periodically purchase and/or enter into various interest rate contracts. These contracts are free-standing derivatives and are accounted for on a mark-to-market basis in accordance with SFAS 133. In March 2005, we purchased two interest rate cap contracts for a cost of \$590,000, which matured in March 2009. In April 2008, we entered into an interest rate swap at no cost, which sets a fixed three-month LIBOR rate of 3.24% on \$25 million and matures in April 2012. In September 2008, we acquired an interest rate swap at a cost basis of \$354,000, which sets a fixed three-month LIBOR rate of 3.595% on \$25 million and matures in April 2012. Although no purchases requiring cash occurred during the six and three months ended June 30, 2009 and 2008, the cash flows relating to the purchase of interest rate contracts are included in cash flows from continuing investing activities. In addition, the cash flows associated with the interest rate swap payments are included in cash flows from continuing operating activities.

Commodities Contracts

Raw materials for use in our manufacturing processes include copper used by our Climate Control Business and anhydrous ammonia and natural gas used by our Chemical Business. As part of our raw material price risk management, we periodically enter into futures/forward contracts for these materials, which contracts are generally accounted for on a mark-to-market basis in accordance with SFAS 133. At June 30, 2009, our purchase commitments under copper contracts were for 750,000 pounds of copper through December 2009 at a weighted-average cost of \$1.93 per pound. Also our Chemical Business had purchase commitments under natural gas contracts for approximately 1,069,000 MMBtu of natural gas through December 2009 at a weighted-average cost of \$6.88 per MMBtu. In addition, our Chemical Business had contractual rights and obligations under natural gas collars for approximately 460,000 MMBtu of natural gas through September 2009 at a weighted-average floor price of \$3.76 per MMBtu and a weighted-average cap price of \$5.76 per MMBtu. The cash flows relating to these contracts are included in cash flows from continuing operating activities.

Foreign Exchange Contracts

One of our business operations purchases industrial machinery and related components from vendors outside of the United States. As part of our foreign currency risk management, we periodically enter into foreign exchange contracts, which set the U.S. Dollar/Euro exchange rates. These contracts are free-standing derivatives and are accounted for on a mark-to-market basis in accordance with SFAS 133. At June 30, 2009, we had no commitments under these contracts. The cash flows relating to these contracts are included in cash flows from continuing operating activities.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(Unaudited)

## Note 11: Derivatives, Hedges and Financial Instruments (continued)

The following details our assets and liabilities that are measured at fair value on a recurring basis at June 30, 2009 and December 31, 2008:

| Description  | Fair Value Measurements at<br>June 30, 2009 Using |  |   |  | Total Fair<br>Value at<br>December<br>31,<br>2008 |
|--|---|--|---|--|---|
|  | Total Fair<br>Value at<br>June 30,<br>2009        | Quoted<br>Prices<br>in Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |   |
| (In Thousands)   |   |  |   |  |   |
| <b>Assets – Supplies, prepaid items and other:</b>                         |   |  |   |  |   |
| Foreign exchange contracts   | \$ -  | \$ -   | \$ -  | \$ -   | \$ 35   |
| <b>Liabilities – Current and noncurrent accrued and other liabilities:</b> |   |  |   |  |   |
| Commodities contracts  | \$ 2,767  | \$ 224   | \$ 2,543  | \$ -   | \$ 5,910  |
| Interest rate contracts  | 1,788   | -  | 1,788   | -  | 2,437   |
| Total  | \$ 4,555  | \$ 224   | \$ 4,331  | \$ -   | \$ 8,347  |

The following is a reconciliation of the beginning and ending balances for liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the six months ended June 30, 2009 (not applicable for the six months ended June 30, 2008 and the three months ended June 30, 2009 and 2008):

|   | Commodities<br>Contracts<br>(In<br>Thousands) |
|---|---|
| Beginning balance                                       | \$ (1,388)                                    |
| Total realized and unrealized gain included in earnings | 493   |
| Purchases, issuances, and settlements                   | 895   |
| Transfers in and/or out of Level 3                      | -   |
| Ending balance  | \$ -  |

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(Unaudited)

## Note 11: Derivatives, Hedges and Financial Instruments (continued)

Realized and unrealized gains (losses) included in earnings and the income statement classifications are as follows:

|  | Six Months Ended |          | Three Months Ended |          |
|--|------------------|----------|--------------------|----------|
|  | June 30,         |          | June 30,           |          |
|  | 2009             | 2008     | 2009               | 2008     |
|  | (In Thousands)   |          |                    |          |
| <b>Total gains (losses) included in earnings:</b>  |                  |          |                    |          |
| Cost of sales – Commodities contracts  | \$ (1,148)       | \$ 4,488 | \$ 8               | \$ 1,291 |
| Cost of sales – Foreign exchange contracts   | (31)             | (35)     | (1)                | (35)     |
| Interest expense – Interest rate contracts   | 158              | 708      | 427                | 877      |
|  | \$ (1,021)       | \$ 5,161 | \$ 434             | \$ 2,133 |
| <b>Change in unrealized gains and losses relating to contracts still held at period end:</b> |                  |          |                    |          |
| Cost of sales – Commodities contracts  | \$ (969)         | \$ 861   | \$ 30              | \$ 808   |
| Cost of sales – Foreign exchange contracts   | -                | (15)     | -                  | (15)     |
| Interest expense – Interest rate contracts   | 649              | 709      | 719                | 896      |
|  | \$ (320)         | \$ 1,555 | \$ 749             | \$ 1,689 |

In accordance with SFAS 107 - Disclosures about Fair Value of Financial Instruments (“SFAS 107”), as amended, the following discussion of fair values is not indicative of the overall fair value of our assets and liabilities since the provisions of SFAS 107 do not apply to all assets, including intangibles.

Our long-term debt is the only financial instrument with fair values significantly different from their carrying amounts. At June 30, 2009 and December 31, 2008, the fair value for variable debt, excluding the Secured Term Loan, was believed to approximate their carrying value. At June 30, 2009 and December 31, 2008, the estimated fair value of the Secured Term Loan is based on defined LIBOR rates plus 9% and 10%, respectively, utilizing information obtained from the lender. The fair values of fixed rate borrowings, other than the 2007 Debentures, are estimated using a discounted cash flow analysis that applies interest rates currently being offered on borrowings of similar amounts and terms to those currently outstanding while also taking into consideration our current credit worthiness. At June 30, 2009 and December 31, 2008, the estimated fair value of the 2007 Debentures is based on quoted prices obtained from a broker for these debentures. The estimated fair value and carrying value of our long-term debt are as follows:

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(Unaudited)

## Note 11: Derivatives, Hedges and Financial Instruments (continued)

|  | June 30, 2009           |                   | December 31, 2008       |                   |
|--|-------------------------|-------------------|-------------------------|-------------------|
|  | Estimated<br>Fair Value | Carrying<br>Value | Estimated<br>Fair Value | Carrying<br>Value |
| (In Thousands)                             |                         |                   |                         |                   |
| <b>Variable Rate:</b>                      |                         |                   |                         |                   |
| Secured Term Loan                          | \$ 23,548               | \$ 50,000         | \$ 20,939               | \$ 50,000         |
| Working Capital Revolver Loan              | -                       | -                 | -                       | -                 |
| Other bank debt and financing              | 2,608                   | 2,608             | 8                       | 8                 |
| <b>Fixed Rate:</b>                         |                         |                   |                         |                   |
| 5.5% Convertible Senior Subordinated Notes | 27,857                  | 31,300            | 27,338                  | 40,500            |
| Other bank debt and equipment financing    | 15,793                  | 15,433            | 14,949                  | 14,652            |
|  | \$ 69,806               | \$ 99,341         | \$ 63,234               | \$ 105,160        |

Note 12: Income Per Common Share Net income applicable to common stock is computed by adjusting net income by the amount of preferred stock dividends. Basic income per common share is based upon net income applicable to common stock and the weighted-average number of common shares outstanding during each period.

Diluted income per share is based on net income applicable to common stock plus preferred stock dividends on preferred stock assumed to be converted, if dilutive, and interest expense including amortization of debt issuance cost, net of income taxes, on convertible debt assumed to be converted, if dilutive, and the weighted-average number of common shares and dilutive common equivalent shares outstanding, and the assumed conversion of dilutive convertible securities outstanding.

The following is a summary of certain transactions which affected basic income per share or diluted income per share, if dilutive:

During the six months ended June 30, 2009,

- we issued 389,000 shares of our common stock as the result of the exercise of stock options,
- we acquired \$9,200,000 aggregate principal amount of our 2007 Debentures; and
- we paid cash dividends on our Series B 12% cumulative, convertible preferred stock ("Series B Preferred"), Series D 6% cumulative, convertible Class C preferred stock ("Series D Preferred") and noncumulative redeemable preferred stock ("Noncumulative Preferred") totaling approximately \$240,000, \$60,000 and \$6,000, respectively.

During the six months ended June 30, 2008,

- we acquired 200,000 shares of our common stock;
- we issued 367,304 shares of our common stock as the result of the exercise of stock options;
- we paid cash dividends on our Series B Preferred, Series D Preferred and Noncumulative Preferred totaling approximately \$240,000, \$60,000 and \$6,000, respectively.

At June 30, 2009, there were no dividends in arrears.

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(Unaudited)

## Note 12: Income Per Common Share (continued)

The following table sets forth the computation of basic and diluted net income per common share:

(Dollars In Thousands, Except Per Share Amounts)

|   | Six Months Ended<br>June 30, |            | Three Months Ended<br>June 30, |            |
|---|------------------------------|------------|--------------------------------|------------|
|   | 2009                         | 2008       | 2009                           | 2008       |
| <b>Numerator:</b>   |                              |            |                                |            |
| Net income  | \$ 20,473                    | \$ 28,814  | \$ 8,730                       | \$ 17,907  |
| Dividends on Series B Preferred   | (240)                        | (240)      | -                              | -          |
| Dividends on Series D Preferred   | (60)                         | (60)       | -                              | -          |
| Dividends on Noncumulative Preferred  | (6)                          | (6)        | -                              | -          |
| Total dividends on preferred stock  | (306)                        | (306)      | -                              | -          |
| Numerator for basic net income per common share - net income applicable to common stock   | 20,167                       | 28,508     | 8,730                          | 17,907     |
| Dividends on preferred stock assumed to be converted, if dilutive   | 306                          | 306        | -                              | -          |
| Interest expense including amortization of debt issuance costs, net of income taxes, on convertible debt assumed to be converted, if dilutive | 627                          | 1,203      | 314                            | 601        |
| Numerator for diluted net income per common share   | \$ 21,100                    | \$ 30,017  | \$ 9,044                       | \$ 18,508  |
| <b>Denominator:</b>   |                              |            |                                |            |
| Denominator for basic net income per common share - weighted-average shares   | 21,174,210                   | 21,114,506 | 21,237,904                     | 21,172,227 |
| <b>Effect of dilutive securities:</b>   |                              |            |                                |            |
| Convertible notes payable   | 1,143,320                    | 2,188,000  | 1,143,320                      | 2,188,000  |
| Convertible preferred stock   | 938,006                      | 940,016    | 937,825                        | 939,966    |
| Stock options   | 331,607                      | 665,198    | 354,899                        | 526,801    |
| Dilutive potential common shares  | 2,412,933                    | 3,793,214  | 2,436,044                      | 3,654,767  |
| Denominator for diluted net income per common share - adjusted weighted-average shares and assumed conversions                                | 23,587,143                   | 24,907,720 | 23,673,948                     | 24,826,994 |
| Basic net income per common share   | \$ .95                       | \$ 1.35    | \$ .41                         | \$ .85     |
| Diluted net income per common share   | \$ .89                       | \$ 1.21    | \$ .38                         | \$ .75     |

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(Unaudited)

## Note 12: Income Per Common Share (continued)

The following weighted-average shares of securities were not included in the computation of diluted net income per common share as their effect would have been antidilutive:

|               | Six Months Ended<br>June 30, |         | Three Months Ended<br>June 30, |         |
|---------------|------------------------------|---------|--------------------------------|---------|
|               | 2009                         | 2008    | 2009                           | 2008    |
| Stock options | 766,646                      | 425,000 | 412,363                        | 425,000 |

## Note 13: Income Taxes Provisions for income taxes are as follows:

|                             | Six Months Ended<br>June 30, |           | Three Months Ended<br>June 30, |           |
|-----------------------------|------------------------------|-----------|--------------------------------|-----------|
|                             | 2009                         | 2008      | 2009                           | 2008      |
|                             | (In Thousands)               |           |                                |           |
| Current:                    |                              |           |                                |           |
| Federal                     | \$ 6,490                     | \$ 11,520 | \$ 1,682                       | \$ 6,625  |
| State                       | 772                          | 1,724     | 182                            | 909       |
| Total current provisions    | \$ 7,262                     | \$ 13,244 | \$ 1,864                       | \$ 7,534  |
| Deferred:                   |                              |           |                                |           |
| Federal                     | \$ 4,970                     | \$ 3,539  | \$ 3,219                       | \$ 2,709  |
| State                       | 568                          | 646       | 368                            | 466       |
| Total deferred provisions   | 5,538                        | 4,185     | 3,587                          | 3,175     |
| Provisions for income taxes | \$ 12,800                    | \$ 17,429 | \$ 5,451                       | \$ 10,709 |

For the six and three months ended June 30, 2009 and 2008, the current provision for federal income taxes shown above includes regular federal income tax after the consideration of permanent and temporary differences between income for GAAP and tax purposes. For the six and three months ended June 30, 2009 and 2008, the current provision for state income taxes shown above includes regular state income tax and provisions for uncertain state income tax positions. At December 31, 2008, we had state net operating loss ("NOL") carryforwards totaling approximately \$35,000,000, which begin expiring in 2009.

Our overall effective tax rate in 2009 is reduced by permanent tax differences, including the domestic manufacturer's deduction and other permanent items.

We account for income taxes in accordance with FIN No. 48 - Accounting for Uncertainty in Income Taxes, which requires that realization of an uncertain income tax position must be "more likely than not" (i.e., greater than 50% likelihood) that the position will be sustained upon examination by taxing authorities before it can be recognized in the financial statements.



LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(Unaudited)

## Note 13: Income Taxes (continued)

We believe that we do not have any material uncertain tax positions other than the failure to file state income tax returns in some jurisdictions where we or some of our subsidiaries may have a filing responsibility (i.e, nexus). We had approximately \$712,000 and \$898,000 accrued for uncertain tax liabilities at June 30, 2009 and December 31, 2008, respectively, which are included in current and noncurrent accrued and other liabilities.

We and certain of our subsidiaries file income tax returns in the U.S. federal jurisdiction and various state jurisdictions. The federal tax returns for 1994 through 2004 remain subject to examination for the purpose of determining the amount of remaining tax NOL and other carryforwards. With few exceptions, the 2005-2007 years remain open for all purposes of examination by the IRS and other major tax jurisdictions.

## Note 14: Other Expense, Other Income and Non-Operating Other Income, net

|  | Six Months Ended<br>June 30, |                 | Three Months Ended<br>June 30, |                 |
|--|------------------------------|-----------------|--------------------------------|-----------------|
|  | 2009                         | 2008            | 2009                           | 2008            |
|  | (In Thousands)               |                 |                                |                 |
| <b>Other expense:</b>  |                              |                 |                                |                 |
| Losses on sales and disposals of property and equipment        | \$ 220                       | \$ 82           | \$ 207                         | \$ 82           |
| Potential litigation settlements                               | 75                           | 367             | 75                             | 192             |
| Impairment of long-lived assets (1)                            | -                            | 192             | -                              | 192             |
| Other miscellaneous expense (2)                                | 39                           | 16              | 9                              | 10              |
| <b>Total other expense</b>                                     | <b>\$ 334</b>                | <b>\$ 657</b>   | <b>\$ 291</b>                  | <b>\$ 476</b>   |
| <b>Other income:</b>   |                              |                 |                                |                 |
| Litigation judgment, settlements and potential settlements (3) | \$ 50                        | \$ 8,235        | \$ -                           | \$ 7,710        |
| Other miscellaneous income (2)                                 | 140                          | 94              | 28                             | 9               |
| <b>Total other income</b>                                      | <b>\$ 190</b>                | <b>\$ 8,329</b> | <b>\$ 28</b>                   | <b>\$ 7,719</b> |
| <b>Non-operating other income, net:</b>                        |                              |                 |                                |                 |
| Interest income  | \$ 78                        | \$ 899          | \$ 33                          | \$ 358          |
| Miscellaneous income (2)                                       | -                            | 11              | -                              | 11              |
| Miscellaneous expense (2)                                      | (44)                         | (48)            | (22)                           | (24)            |
| <b>Total non-operating other income, net</b>                   | <b>\$ 34</b>                 | <b>\$ 862</b>   | <b>\$ 11</b>                   | <b>\$ 345</b>   |

(1) Based on an unsuccessful effort to sell certain corporate assets in an auction, we recognized an impairment of long-lived assets.

(2) Amounts represent numerous unrelated transactions, none of which are individually significant requiring separate disclosure.

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(Unaudited)

Note 14: Other Expense, Other Income and Non-Operating Other Income, net (continued)

(3) For the six and three months ended June 30, 2008, income from litigation judgment and settlements included approximately \$7.6 million, net of attorneys' fees, relating to a litigation judgment involving a subsidiary within our Chemical Business. On June 6, 2008, we received proceeds of approximately \$11.2 million for this litigation judgment, which includes interest of approximately \$1.4 million and from which we paid attorneys' fees of approximately \$3.6 million. The payment of attorneys' fees of 31.67% of our recovery was contingent upon the cash receipt of the litigation judgment. Cash flows relating to this litigation judgment are included in cash flows from continuing operating activities, except for the portion of the judgment associated with the recovery of damages relating to property, plant and equipment and its pro-rata portion of the attorneys' fees. These cash flows are included in cash flows from continuing investing activities. In addition during the six months ended June 30, 2008, a settlement was reached for \$0.4 million for the recovery of certain environmental-related costs incurred in previous periods relating to property used by Corporate and other business operations.

Note 15: Business Interruption and Property Insurance Claims Our accounting policy for insurance claims is if an insurance claim relates to a recovery of our losses, we recognize the recovery when it is probable and reasonably estimable. If our insurance claim relates to a contingent gain, we recognize the recovery when it is realized or realizable and earned.

On February 5, 2009, a small nitric acid plant located at the Cherokee Facility suffered damage due to a fire. The fire was immediately extinguished and there were no injuries. The extent of the damage to the nitric acid plant has been determined; however, the final repair option, detail design and total cost of repair are yet unknown. The nitric acid plant that suffered the fire, with a current 182 ton per day capacity, is the smaller of the two nitric acid plants at the Cherokee Facility. While the volume of production of finished product at the Cherokee Facility has been and will be impacted, the Cherokee Facility continues production with the larger of the nitric acid plants. Our insurance provides for business interruption coverage after a 30-day waiting period for lost profits and extra expense coverage and for replacement cost coverage relating to property damage with a \$1,000,000 property loss deductible. As of June 30, 2009, a recovery, if any, from our business interruption coverage has not been recognized. Because our replacement cost coverage for property damages is estimated to exceed our property loss deductible and the net book value of the damaged property, we have not recognized a loss relating to property damage from this fire but we have recorded a property insurance claim receivable of \$1,267,000 relating to this event at June 30, 2009.

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
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## Note 16: Segment Information

|   | Six Months Ended<br>June 30, |          | Three Months Ended<br>June 30, |            |            |
|---|------------------------------|----------|--------------------------------|------------|------------|
|   | 2009                         | 2008     | 2009                           | 2008       |            |
| (In Thousands)  |                              |          |                                |            |            |
| <b>Net sales:</b>   |                              |          |                                |            |            |
| Climate Control   | \$                           | 139,030  | \$ 146,949                     | \$ 66,982  | \$ 80,626  |
| Chemical  |                              | 144,371  | 204,788                        | 69,893     | 113,458    |
| Other   |                              | 5,359    | 6,770                          | 1,688      | 3,968      |
|   | \$                           | 288,760  | \$ 358,507                     | \$ 138,563 | \$ 198,052 |
| <b>Gross profit: (1)</b>  |                              |          |                                |            |            |
| Climate Control (2)   | \$                           | 47,426   | \$ 47,454                      | \$ 24,998  | \$ 25,932  |
| Chemical (3)  |                              | 29,429   | 31,852                         | 12,281     | 16,499     |
| Other   |                              | 1,700    | 2,192                          | 548        | 1,310      |
|   | \$                           | 78,555   | \$ 81,498                      | \$ 37,827  | \$ 43,741  |
| <b>Operating income (loss): (4)</b>                               |                              |          |                                |            |            |
| Climate Control (2)   | \$                           | 21,204   | \$ 21,182                      | \$ 12,226  | \$ 11,855  |
| Chemical (3) (5) (6)  |                              | 18,835   | 32,627                         | 6,197      | 20,502     |
| General corporate expenses and other business operations, net (7) |                              | (6,077)  | (5,153)                        | (3,881)    | (3,033)    |
|   |                              | 33,962   | 48,656                         | 14,542     | 29,324     |
| Interest expense  |                              | (2,939)  | (3,720)                        | (1,028)    | (1,266)    |
| Gains on extinguishment of debt                                   |                              | 1,743    | -                              | 421        | -          |
| <b>Non-operating other income (expense), net:</b>                 |                              |          |                                |            |            |
| Climate Control   |                              | -        | 1                              | -          | -          |
| Chemical  |                              | 6        | 64                             | 3          | 60         |
| Corporate and other business operations                           |                              | 28       | 797                            | 8          | 285        |
| Provisions for income taxes                                       |                              | (12,800) | (17,429)                       | (5,451)    | (10,709)   |
| Equity in earnings of affiliate-Climate Control                   |                              | 488      | 462                            | 248        | 230        |
| Income from continuing operations                                 | \$                           | 20,488   | \$ 28,831                      | \$ 8,743   | \$ 17,924  |

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

(2) During the six and three months ended June 30, 2009, we recognized gains totaling \$789,000 and \$326,000, respectively, on our futures contracts for copper. During the six and three months ended June 30, 2008, we recognized gains on our copper futures contracts totaling \$2,685,000 and \$109,000, respectively. These gains contributed to an increase in gross profit and operating income.

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(Unaudited)

Note 16: Segment Information (continued)

- (3) As the result of entering into sales commitments with higher firm sales prices during 2008, we recognized sales with a gross profit of \$3,558,000 and \$1,058,000 higher than our comparable product sales made at lower market prices available during the six and three months ended June 30, of 2009, respectively. In addition, during the six and three months ended June 30, 2009, we recognized recoveries of precious metals totaling \$2,222,000 and \$9,000, respectively, compared to \$792,000 for each of the same periods in 2008. These transactions contributed to an increase in gross profit and operating income for each respective period. During the six and three months ended June 30, 2009, we recognized losses totaling \$1,937,000 and \$318,000, respectively, on our futures/forward contracts for natural gas and ammonia compared to gains totaling \$1,803,000 and \$1,182,000 for each of the same periods in 2008, respectively. These losses contributed to a decrease (gains contributed to an increase) in gross profit and operating income for each respective period.
- (4) Our chief operating decision makers use operating income by industry segment for purposes of making decisions which include resource allocations and performance evaluations. Operating income by industry segment represents gross profit by industry segment less selling, general and administration expense (“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.
- (5) For each of the six and three-month periods ended June 30, 2008, we recognized income of \$7,560,000, net of attorneys’ fees, relating to a litigation judgment.
- (6) During the six and three months ended June 30, 2009, we incurred expenses of \$5,213,000 and \$3,217,000, respectively, associated with the start up of our idle chemical facility located in Pryor, Oklahoma (the “Pryor Facility”) that we are in the process of activating. For the six and three months ended June 30, 2008, we incurred expenses of \$919,000 and \$498,000, respectively, associated with maintaining the Pryor Facility.
- (7) 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 as follows:

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
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## Note 16: Segment Information (continued)

|   | Six Months Ended<br>June 30, |            | Three Months Ended<br>June 30, |            |
|---|------------------------------|------------|--------------------------------|------------|
|   | 2009                         | 2008       | 2009                           | 2008       |
|   | (In Thousands)               |            |                                |            |
| Gross profit-Other  | \$ 1,700                     | \$ 2,192   | \$ 548                         | \$ 1,310   |
| Selling, general and administrative:                                |                              |            |                                |            |
| Personnel   | (4,326)                      | (4,070)    | (2,601)                        | (2,478)    |
| Professional fees   | (1,818)                      | (1,987)    | (834)                          | (806)      |
| Office overhead   | (345)                        | (377)      | (157)                          | (201)      |
| Maintenance and repairs   | (174)                        | (85)       | (152)                          | (61)       |
| Property, franchise and other taxes                                 | (160)                        | (216)      | (77)                           | (90)       |
| Advertising   | (132)                        | (137)      | (62)                           | (67)       |
| All other   | (733)                        | (677)      | (370)                          | (410)      |
| Total selling, general and administrative                           | (7,688)                      | (7,549)    | (4,253)                        | (4,113)    |
| Other income  | 133                          | 704        | 23                             | 169        |
| Other expense   | (222)                        | (500)      | (199)                          | (399)      |
| Total general corporate expenses and other business operations, net | \$ (6,077)                   | \$ (5,153) | \$ (3,881)                     | \$ (3,033) |

Information about our total assets by industry segment is as follows:

|                            | June 30,<br>2009 | December<br>31,<br>2008 |
|----------------------------|------------------|-------------------------|
|                            | (In Thousands)   |                         |
| Climate Control            | \$ 110,466       | \$ 117,260              |
| Chemical                   | 134,563          | 145,518                 |
| Corporate assets and other | 82,687           | 72,989                  |
| Total assets               | \$ 327,716       | \$ 335,767              |

## Note 17: Related Party Transactions

## Golsen Group

In March 2008 and March 2009, we paid, in each respective period, the dividends totaling approximately \$240,000 and \$60,000 on our Series B Preferred and our Series D Preferred, respectively, all of the outstanding shares of which are owned by the Golsen Group.

During 2008, the Golsen Group acquired from an unrelated third party \$5,000,000 of the 2007 Debentures. As a result, during the six months ended June 30, 2009, we paid interest of \$275,000 relating to the debentures held by the Golsen Group, of which \$137,500 was incurred during the first six months of 2009 and the remaining \$137,500 was accrued at December 31, 2008.

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
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Note 18: Subsequent Events

**Loan Agreement** - On July 6, 2009, one of our non-ThermaClima subsidiaries borrowed \$6.0 million from a lender pursuant to the terms of a business loan agreement between our subsidiary and the lender ("Loan Agreement"). Under the terms of the Loan Agreement, the loan is payable in 60 monthly payments of principal and interest of approximately \$115,000 each. The rate of interest on the unpaid principal balance of the loan is 5.5% per year. The loan matures on June 13, 2014. If any event of default, as defined in the Loan Agreement, shall occur, the lender may, at its option, declare the unpaid balance of the loan due and payable. The loan is secured by certain equipment owned by our subsidiary. We have guaranteed the payment obligations of our subsidiary under the Loan Agreement.

**SEC Inquiry** - Concerning a SEC inquiry discussed in Note 10, we reached an agreement with the SEC, and on July 17, 2009, the SEC entered an order pursuant to the agreement, resolving the SEC inquiry. Under the order, LSB has agreed not to violate Sections 13(a) and 13(b)(2)(A) of the Securities Exchange Act of 1934, as amended, and Rules 13a-1 and 13a-13 thereunder. LSB consented to this order without, and the order provides that LSB is not, admitting or denying any wrongdoing. The SEC's order contains no finding of securities fraud or violation of any anti-fraud provision of the federal securities laws and related SEC rules. Under the terms of the order, we are not required to pay any fines or monetary penalties in connection with this matter.

In addition, Mr. Jones also consented to the order, without admitting or denying any wrongdoing, to cease and desist from committing or causing any violations of Sections 13(b)(2)(A) and 13(b)(5) of the Exchange Act and Exchange Act Rule 13b2-1 and from causing any violations and future violations of Sections 13(a) and Rules 13a-1 and 13a-13. The SEC's order also contains a finding of a violation by Mr. Jones of Section 4C(a)(3) of the Exchange Act and Rule 102(e)(1)(iii) of the Commission's Rules of Practice, and Mr. Jones has consented in the order not to appear or practice before the SEC as an accountant, subject to submitting application for reinstatement two years after the date of the final order. Under the terms of the order, Mr. Jones is not required to pay any fines or other monetary penalties in connection with this matter.

**Fire at Bryan, Texas Chemical Distribution Center** - On July 30, 2009, an agricultural distribution center located in Bryan, Texas ("Bryan Center"), owned and operated by our Chemical Business, was destroyed by fire, resulting in the cessation of operations at this center. The fire was immediately reported to appropriate authorities. As a result of the fire, local authorities evacuated certain areas around Bryan and College Station, Texas. Our general liability and pollution insurance carrier, Chartis (an insurance unit of AIG), and property insurance carrier, FM Global, were immediately notified and are actively involved in the handling of this matter. Chartis is defending and indemnifying us and our Chemical Business in connection with claims arising from the fire under a reservation of rights. Reports provided to us indicated that approximately 40 individuals went to local hospital emergency rooms for treatment, with the exact number and the extent of health issues unknown. The Bryan Center stored and sold agricultural chemical products, including fertilizer grade ammonium nitrate, potash and certain other fertilizer products, and was one of fifteen agricultural distribution centers operated by our Chemical Business. It is the current intention of our Chemical Business to rebuild the Bryan Center. We believe that we maintain adequate insurance, including general

LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(Unaudited)

Note 18: Subsequent Events (continued)

liability, property and pollution, to cover any currently foreseeable losses arising from the fire, subject to applicable deductibles totaling approximately \$350,000, and do not believe that this incident will have a material adverse effect on us or our Chemical Business. However, we are currently unable to estimate the possible losses as the result of this fire.

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PART II  
OTHER INFORMATION

Item 6. Exhibits

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

- 10.1 Business Loan Agreement, dated effective June 30, 2009, between Prime Financial Corporation and INTRUST Bank, N.A. \*
- 10.2 Promissory Note, dated July 6, 2009, between Prime Financial Corporation and INTRUST Bank, N.A. \*
- 10.3 Urea Ammonium Nitrate Purchase and Sale Agreement, dated May 7, 2009, between Pryor Chemical Company and Koch Nitrogen Company, LLC., which the Company hereby incorporates by reference from Exhibit 99.1 to the Company's Form 8-K, filed May 13, 2009. CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A COMMISSION ORDER CF#23659, DATED JUNE 9, 2009, GRANTING REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT.
- 10.4 Railcar Management Agreement, dated May 7, 2009, between Pryor Chemical Company and Koch Nitrogen Company, LLC, which the Company hereby incorporates by reference from Exhibit 99.2 to the Company's Form 8-K, filed May 13, 2009.
- 10.5 Omnibus Termination Agreement, dated June 23, 2009, by and among Bayer MaterialScience LLC (as successor in interest to Bayer Corporation); El Dorado Nitrogen, L.P. (as successor in interest to El Dorado Nitrogen Company); El Dorado Chemical Company; Wells Fargo Bank Northwest, N.A. (as successor in interest to Boatmen's Trust Company of Texas); Bal Investment & Advisory, Inc. (as successor in interest to Security Pacific Leasing Corporation); Wilmington Trust Company; and Bayerische Landesbank, New York Branch, which the Company hereby incorporates by reference from Exhibit 99.1 to the Company's Form 8-K, filed June 29, 2009.
- 10.6 Assignment of Fixed Price Purchase Option, dated June 23, 2009, between El Dorado Nitrogen, L.P. and Bayer MaterialScience LLC., which the Company hereby incorporates by reference from Exhibit 99.2 to the Company's Form 8-K, filed June 29, 2009.
- 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.
- 32.2 Certification of Tony M. Shelby, Chief Financial Officer, furnished pursuant to Sarbanes-Oxley Act of 2002, Section 906.

\*



Exhibit was included with the Company's original Form 10-Q for the quarterly period ended June 30, 2009, filed on August 6, 2009.

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 14th day of August 2009.

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/ Harold L. Rieker, Jr.  
Harold L. Rieker, Jr.  
Vice President and Principal Accounting Officer