

LSB INDUSTRIES INC  
Form 10-K/A  
July 18, 2007

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

(Mark One)

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

**For the fiscal year ended December 31, 2006**

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  
(State of Incorporation)

73-1015226  
(I.R.S. Employer  
Identification No.)

16 South Pennsylvania Avenue  
Oklahoma City, Oklahoma  
(Address of Principal Executive Offices)

73107  
(Zip Code)

Registrant's Telephone Number, Including Area Code: (405) 235-4546

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange On Which Registered
Common Stock, Par Value \$.10	American Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act: Preferred Share Purchase Rights and \$3.25 Convertible Exchangeable Class C Preferred Stock, Series 2



(Facing Sheet Continued)

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  Yes  No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.  Yes  No

Indicate by check mark whether the Registrant (1) has filed all reports required by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for the shorter period that the Registrant has had to file the reports), and (2) has been subject to the filing requirements for the past 90 days.  Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

The aggregate market value of the Registrant's voting common equity held by non-affiliates of the Registrant, computed by reference to the price at which the voting common stock was last sold as of June 30, 2006, was approximately \$69 million. For purposes of this computation, shares of the Registrant's common stock beneficially owned by each executive officer and director of the Registrant and by Jayhawk Capital Management, L.L.C. and its affiliates (together "Jayhawk") are deemed to be owned by affiliates of the Registrant. Such determination should not be deemed an admission that such executive officers, directors and other beneficial owners of our common stock are, in fact, affiliates of the Registrant. In addition, this computation does not include the 719 shares of voting Convertible Non-Cumulative Preferred Stock (the "Non-Cumulative Preferred") held by non-affiliates of the Company. An active trading market does not exist for the shares of Non-Cumulative Preferred.

As of March 19, 2007 the Registrant had 19,479,139 shares of common stock outstanding (excluding 3,447,754 shares of common stock held as treasury stock).

(i)

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OF LSB INDUSTRIES, INC.

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**Explanatory Introductory Note**

As previously disclosed in our Form 10-Q for the quarter ended March 31, 2007, during September 2006, the Financial Accounting Standards Board (“FASB”) completed a project adopting a new accounting principle as to the methods of accounting for planned major maintenance activities (“Turnarounds”). Under the new accounting principle for Turnarounds, FASB issued FASB Staff Position No. AUG AIR-1 (“FSP”), which eliminated the accrue-in-advance method of accounting for Turnarounds which was the method we were using. Under the new FSP, there were three acceptable accounting methods for Turnarounds that we could adopt. Effective January 1, 2007, we have adopted the direct expensing method which requires us to expense Turnaround costs as they are incurred. The adoption of the FSP accounting for Turnarounds is considered a change in accounting principle adopted by the FASB with retroactive application as described in SFAS 154 - Accounting Changes and Error Corrections. We are required to file this Amendment to update our 2006 Form 10-K in order to file a registration statement to register certain securities sold by us in a private placement as required by our recently completed \$60 million principal amount 5.5% Convertible Senior Subordinated Debentures, due 2012, to a limited number of qualified institutional buyers, as such term is defined in Rule 144A under the Securities Act of 1933, as amended. This Amendment reflects the new Turnaround accounting method for the three years ended December 31, 2006, with accompanying notes and quarterly financial data.

As a result of the new FSP for Turnarounds, this Amendment is amending the following Items contained in the Form 10-K:

- Selected Financial Data;
- Management’s Discussion and Analysis of Financial Condition and Results of Operations;
  - Financial Statements and Supplemental Data; and
  - Exhibits and Financial Statement Schedules

All other Items contained in the Form 10-K remain as set forth in the Form 10-K.

Except for the foregoing amended information, as more fully discussed in Note 2 of Notes to Consolidated Financial Statements, the Form 10-K for year ended December 31, 2006, (“Form 10-K”), as amended by this Amendment, continues to describe conditions as of the date of the original filing of such Form 10-K, and we have not updated the disclosures contained therein to reflect events that have occurred at a later date, other than subsequent events that are considered to be significant which are disclosed under “Subsequent Events” of Item 7 and in Note 23 of Notes to Consolidated Financial Statements.

Table of Contents**ITEM 6. SELECTED FINANCIAL DATA (AS ADJUSTED)****Years ended December 31,**

	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
	(Dollars in thousands, except per share data)				
<b>Selected Statement of Operations Data (1):</b>					
Net sales	\$ 491,952	\$ 397,115	\$ 363,984	\$ 317,026	\$ 283,553
Interest expense (2)	\$ 11,915	\$ 11,407	\$ 7,393	\$ 6,097	\$ 8,218
Income from continuing operations before cumulative effect of accounting changes (2) (3)	\$ 15,768	\$ 5,634	\$ 745	\$ 3,705	\$ 2,867
Cumulative effect of accounting changes	\$ -	\$ -	\$ (536)	\$ -	\$ 860
Net income	\$ 15,515	\$ 4,990	\$ 209	\$ 3,705	\$ 266
Net income (loss) applicable to common stock	\$ 12,885	\$ 2,707	\$ (2,113)	\$ 1,378	\$ (2,061)
Income (loss) per common share applicable to common stock:					
Basic:					
Income (loss) from continuing operations before cumulative effect of accounting changes	\$ .92	\$ .25	\$ (.12)	\$ .11	\$ .05
Net loss from discontinued operations	\$ (.02)	\$ (.05)	\$ -	\$ -	\$ (.29)
Cumulative effect of accounting changes	\$ -	\$ -	\$ (.04)	\$ -	\$ .07
Net income (loss)	\$ .90	\$ .20	\$ (.16)	\$ .11	\$ (.17)
Diluted:					
Income (loss) from continuing operations before cumulative effect of accounting changes	\$ .77	\$ .22	\$ (.12)	\$ .10	\$ .04
Net loss from discontinued operations	\$ (.01)	\$ (.04)	\$ -	\$ -	\$ (.27)
Cumulative effect of accounting changes	\$ -	\$ -	\$ (.04)	\$ -	\$ .07
Net income (loss)	\$ .76	\$ .18	\$ (.16)	\$ .10	\$ (.16)

- (1) As fully discussed under "Explanatory Introduction Note" on page 1 of this Form 10-K/A and Note 2 of the Notes to the Consolidated Financial Statements, we adjusted the selected statement of operations data as the result of the change in accounting for Turnarounds.
- (2) In May 2002, the repurchase of Senior Unsecured Notes using proceeds from a Financing Agreement was accounted for as a voluntary debt restructuring. As a result, subsequent interest payments associated with the Financing Agreement debt were recognized against the unrecognized gain on the transaction. The Financing Agreement debt was repaid in September 2004.
- (3) Income from continuing operations before cumulative effect of accounting changes includes gains on extinguishment of debt of \$4.4 million and \$1.5 million for 2004 and 2002, respectively.

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	<b>Years ended December 31,</b>				
	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
	(Dollars in thousands, except per share data)				
<b>Selected Balance Sheet Data (1):</b>					
Total assets	\$ 219,927	\$ 188,963	\$ 167,568	\$ 161,813	\$ 166,276
Redeemable preferred stock	\$ 65	\$ 83	\$ 97	\$ 103	\$ 111
Long-term debt, including current portion	\$ 97,692	\$ 112,124	\$ 106,507	\$ 103,275	\$ 113,361
Stockholders' equity	\$ 43,634	\$ 14,861	\$ 9,915	\$ 8,862	\$ 3,090
<b>Selected other data:</b>					
Cash dividends declared per common share	\$ -	\$ -	\$ -	\$ -	\$ -

(1) As fully discussed under “Explanatory Introduction Note” on page 1 of this Form 10-K/A and Note 2 of the Notes to the Consolidated Financial Statements, we adjusted the selected balance sheet data as the result of the change in accounting for Turnarounds.

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**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with a review of the other Items included in this Form 10-K, as amended by this Amendment, and our December 31, 2006 Consolidated Financial Statements (As Adjusted) included elsewhere in this report. Certain statements contained in this MD&A may be deemed to be forward-looking statements. See "Special Note Regarding Forward-Looking Statements."

**Overview**

**General**

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

- Climate Control Business engaged in the manufacturing and selling of a broad range of air conditioning and heating products in the niche markets we serve consisting of geothermal and water source heat pumps, hydronic fan coils, large custom air handlers and other products used in commercial and residential new building construction, renovation of existing buildings and replacement of existing systems.
- Chemical Business engaged in the manufacturing and selling of chemical products produced from three plants located in Arkansas, Alabama and Texas for the industrial, mining and agricultural markets.

**2006 Results**

LSB's 2006 sales were \$492.0 million compared to \$397.1 million in 2005, operating income was \$27.1 million compared to \$14.9 million in 2005 and income from continuing operations was \$15.8 million compared to \$5.6 million in 2005. Net income was \$15.5 million compared to \$5.0 million for 2005.

The Climate Control Business continued to report strong sales and operating results due to record high backlogs and new order flow. Their sales were \$221.2 million compared to \$156.9 million in 2005. Their operating income before allocation of corporate overhead was \$25.4 million, an 80% increase over the \$14.1 million in 2005.

Our Chemical Business reported improved results in 2006 with sales of \$260.7 million compared to \$233.4 million in 2005. Operating income before allocation of corporate overhead was \$9.8 million, a 29% increase over the \$7.6 million in 2005.

**Climate Control Business**

The Climate Control Business has historically and consistently generated annual profits and positive cash flows and continues to do so. Climate Control's sales for 2006 were \$221 million, a

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41% increase from the same period last year. As indicated above the Climate Control Business' sales and operating income for 2006 were higher than in 2005. The increase in 2006 sales and operating income as compared to 2005 is attributable to strong demand for the geothermal and water source heat pumps that reported a 57% sales increase and to the fan coil and other products that reported a 21% increase. Management's objectives for the Climate Control Business include the continued emphasis on:

- increasing the sales and operating margins of all products,
- developing and introducing new and energy efficient products, and
- increasing production to meet customer demand.

Most of the products of the Climate Control Business are produced to customer orders that are placed well in advance of required delivery dates. As a result, the Climate Control Business maintains significant backlogs that eliminate the necessity to carry substantial inventories other than for firm customer orders. Due to the increase in the demand for Climate Control's products, the backlog of confirmed orders has also increased. The backlog of confirmed orders at December 31, 2006, was approximately \$80 million as compared to \$56 million at 2005 and \$28 million at 2004. We anticipate shipping substantially all of this backlog within twelve months.

Management is taking certain actions to increase the production level to reduce the product delivery lead times and the current backlog. In response to record intake level of customer orders, we recently increased our unit output through additional shifts and overtime. Management has also invested \$4.9 million in fabrication equipment, plant-wide process control systems and other upgrades during 2006 and has plans for additional production equipment during 2007 including \$3.6 million already committed. This investment is expected to increase capacity and reduce overtime. In addition, during the fourth quarter of 2006, we acquired a 46,000 sq. ft. building adjacent to our existing 270,000 sq. ft. geothermal and water source heat pump production facility at an approximate cost of \$2.5 million to increase production and warehouse space. We have also committed approximately \$1.2 million to renovate an existing building as a distribution center for our geothermal and water source heat pumps. At December 31, 2006, approximately \$0.3 million of the \$1.2 million commitment had been expended. Both of these real property investments have been financed by mortgages.

In October 2006, Trison Construction, Inc. ("Trison"), a subsidiary within our Climate Control Business, was awarded reimbursement of defense costs of \$1.2 million in connection with a binding arbitration filed with the American Arbitration Association. The amount was paid in the fourth quarter and is classified as other income which is included in operating income.

Our Climate Control Business will continue to launch new products and product upgrades in an effort to maintain our current market position and to establish a presence in new markets. In recent periods, the Climate Control Business's profitability was affected by operating losses of certain new product lines being developed over the past few years. Our emphasis has been to increase the sales levels of these operations above the breakeven point. During 2006, the results for these new products have not improved appreciably. We believe that the prospects for these new product lines are improving and that these products will contribute favorably in the future.

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**Chemical Business**

The Chemical Business has production facilities in Baytown, Texas (the “Baytown” facility), El Dorado, Arkansas (the “El Dorado” facility) and Cherokee, Alabama (the “Cherokee” facility). Baytown and El Dorado produce nitrogen products from anhydrous ammonia that is delivered by pipeline. Cherokee produces nitrogen products from natural gas that is delivered by pipeline. As indicated above, for 2006, the Chemical Business reported a sales increase of \$27.2 million or 12% and a \$2.2 million or 29% increase in operating income before allocation of corporate overhead.

Sales in all product lines were higher in 2006 in tons shipped, while our average price per ton remained consistent with 2005. Industrial acids and other chemical products increased \$15.0 million or 18.7%; agricultural products increased \$9.1 million or 11.3%; and mining products increased \$3.1 million or 4.3%. Agricultural volumes increased in spite of a severe drought throughout the mid-south and southeast United States. The increase in agricultural volume is attributable to our ability to reach outside our traditional geographic markets and sell into markets previously served by competitors that have exited the market.

The increase in operating income is attributable to higher industrial acid and agricultural sales, the improvement in production performance due to higher throughput volumes, and an improvement in the natural gas supply and corresponding average costs as the result of the hurricane disruptions of 2005.

Our raw materials, anhydrous ammonia and natural gas, are commodities subject to significant price fluctuations, and generally purchased at prices in effect at time of purchase. Due to the uncertainty of the sales prices of our products in relation to the cost of anhydrous ammonia and natural gas, we have developed some customers that purchase substantial quantities of products pursuant to sales agreements and/or formulas that provide for the pass through of these raw material costs. These pricing arrangements help mitigate the commodity price risk inherent in anhydrous ammonia and natural gas. Approximately 65% of the Chemical Business’ sales in 2006 were subject to these pricing arrangements.

Although anhydrous ammonia is produced from natural gas, the price of anhydrous ammonia does not necessarily follow the price of natural gas in the United States. Much of the anhydrous ammonia consumed in the U.S. is produced off shore and delivered inland by pipeline, barge and rail with originations at or near the Gulf of Mexico. Our raw material cost of anhydrous ammonia is based upon formulas indexed to published industry ammonia prices tied to import prices.

Most of the production from Baytown is sold pursuant to a long-term supply agreement that provides for the pass through of certain production costs including anhydrous ammonia. This facility continues to generate consistent operating profits and reported higher sales and profits in 2006 than in 2005.

El Dorado produces approximately 500,000 tons of products per year from purchased anhydrous ammonia. Approximately 59% of the volume sold in 2006 was sold pursuant to pricing arrangements that allow for the pass through of the cost of anhydrous ammonia to the customer. The balance of these products sold during 2006 was primarily agricultural and was

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sold at the spot market price in effect at the time of shipment. During August 2006, a sales agreement for El Dorado to supply a significant amount of industrial grade ammonium nitrate each year pursuant to pricing arrangements was amended with mutual benefit to the parties for a term extending through 2010. The amendment provides for, among other things, an increase of 10% of the minimum annual tons beginning in 2007 and a price increase in the profit-per-ton component.

Following a trial in October 2006, a jury verdict awarded El Dorado approximately \$9.8 million in damages due to the faulty repair of a hot gas expander in one of EDC's nitric acid plants. EDC will pay attorneys fees equal to 31.67% of any recovery. The award is under appeal and will be recognized if and when realized.

As previously reported, Cherokee incurred losses in the third and fourth quarters of 2005 and continuing into the first quarter 2006, related to disruptions at the plant caused by the record climb in natural gas costs due to the hurricanes in the U.S. Gulf. Although Cherokee's operating results were negative for 2006, due to high natural gas costs in the first quarter and downtime in the third and fourth quarters, the 2006 operating loss was reduced from 2005.

Natural gas prices continue to be unpredictable. Daily spot prices per MMBtu, excluding transportation, during 2006 ranged from a high of \$9.90 to a low of \$3.54. During 2006, approximately 71% of Cherokee's sales were priced to include the cost of natural gas.

Our Chemical Business will continue to focus on growing our non-seasonal industrial customer base with an emphasis on customers that accept the risk inherent with raw material costs, while maintaining a strong presence in the seasonal agricultural sector. The operations strategy is to maximize production of the plants, thereby lowering the fixed cost of each ton of production.

## **Stock Options**

On June 19, 2006, the Executive Compensation and Option Committee of our Board of Directors granted 450,000 shares of non-qualified stock options to certain employees which are subject to shareholders' approval. The option price of these options is \$8.01 per share which is based on the market value of our common stock at the date of authorization. These options will vest over a ten-year period at a rate of 10% per year and expire on September 16, 2016 with certain restrictions. Under SFAS 123(R), the fair value for these options will be estimated, using an option pricing model, as of the date we receive shareholders' approval which is currently expected to be no later than our 2007 annual shareholders' meeting. In general, a ratable portion of the total estimated fair value relating to these options will be charged to selling, general, and administrative expense ("SG&A") at the date of shareholders' approval and the remaining balance amortized to SG&A over the options' remaining vesting period.

## **Preferred Stock Exchanges and Completion of Exchange Offer**

During October 2006, we entered into Exchange Agreements with certain holders of our Series 2 Preferred. Pursuant to the terms of the Exchange Agreements we issued 773,655 shares of our common stock in exchange for 104,548 shares of Series 2 Preferred. The holders that were

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parties to an Exchange Agreement waived their rights to all unpaid dividends on the Series 2 Preferred exchanged which totaled approximately \$2.43 million.

As discussed under “Sale of Unregistered Securities” of Item 5, during November 2006, the Company entered into the Jayhawk Agreement with the Jayhawk Group. Under the Jayhawk Agreement, the Jayhawk Group agreed to tender in an exchange offer (discussed below) 180,450 shares of Series 2 Preferred owned by the Jayhawk Group. In addition, as a condition to the Jayhawk Group’s obligation to tender such shares of Series 2 Preferred in an exchange offer, the Jayhawk Agreement further provided that the Golsen Group would exchange 26,467 shares of Series 2 Preferred beneficially owned by them.

Our Board of Directors approved and on February 9, 2007, we began an exchange offer to exchange shares of our common stock for up to 309,807 shares of the Series 2 Preferred. The terms of the exchange offer provided for the issuance by the Company of 7.4 shares of common stock in exchange for each share of Series 2 Preferred tendered in the exchange offer and the waiver of all rights to accrued and unpaid dividends on the Series 2 Preferred tendered. As a result of this exchange offer, we issued 2,262,965 shares of our common stock for 305,807 shares of Series 2 Preferred that were tendered. In addition, an aggregate of approximately \$7.3 million in accrued and unpaid dividends were waived as a result of this exchange offer. This exchange transaction qualified as an induced conversion under SFAS 84. As a result, in the first quarter of 2007, we will record a charge (stock dividend) to accumulated deficit which will equal the excess of the fair value of the common stock issued over the fair value of the common stock issuable pursuant to the original conversion terms. In addition, such stock dividend will decrease net income applicable to common stock, thereby negatively impacting earnings per common share for the first quarter of 2007.

Pursuant to the Jayhawk Agreement and the terms of the exchange offer, the Jayhawk Group and the Golsen Group tendered 180,450 and 26,467 shares, respectively, of Series 2 Preferred for 1,335,330 and 195,855 shares, respectively, of our common stock and waived a total of approximately \$5.0 million in accrued and unpaid dividends.

**Amendments to the Series 2 Preferred**

On March 6, 2007, our stockholders approved two amendments to the Series 2 Preferred, which amendments became effective on that date. The first amendment provides that the right of the holders of the Series 2 Preferred to elect two directors to our board of directors when at least six quarterly dividends on the Series 2 Preferred are in arrears and unpaid may be exercised only if and so long as at least 140,000 shares of Series 2 Preferred are issued and outstanding. The second amendment permits us to purchase or otherwise acquire shares of our common stock for a five-year period even though cumulative accrued and unpaid dividends exist on the Series 2 Preferred. The five-year period commenced on March 13, 2007, upon the completion of the exchange offer.

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**Business Interruption and Property Insurance Claims**

**El Dorado** - Beginning in October 2004 and continuing into June 2005, the Chemical Business' results were adversely affected as a result of the loss of production due to a mechanical failure of one of the four nitric acid plants at the El Dorado, Arkansas plant. The plant was restored to normal production in June 2005. We filed a property damage insurance claim for \$3.8 million, net of a \$1.0 million deductible. We also filed a business interruption claim for \$5.0 million, net of the forty-five day waiting period. As of December 31, 2006, the insurers have paid claims totaling \$5.5 million. The insurers are contesting our remaining claims.

On March 23, 2006, we filed a lawsuit in Federal Court in the Western District of Arkansas, El Dorado Division, to collect amounts from our insurers to which we believe we are owed under the policy. The total amount claimed under the lawsuit which includes business interruption and property claims, is approximately \$2.3 million, plus attorney fees. Additional recoveries, if any, will be recognized when realized.

**Cherokee** - As a result of damage caused by Hurricane Katrina, the natural gas pipeline servicing the Cherokee Facility suffered damage and the owner of the pipeline declared an event of Force Majeure. This event of Force Majeure caused curtailments and interruption in the delivery of natural gas to the Cherokee Facility. Cherokee Nitrogen Company's ("CNC") insurer was promptly put on notice of a claim, but the quantification of the claim amount took time and involved the retention of a gas market expert and a business interruption consultant.

On September 25, 2006, CNC filed a contingent business interruption claim. CNC is now in discussions with, and providing additional documentation to, the forensic accountant hired by CNC's insurers to examine the claim. The recovery of this claim, if any, will be recognized when realized.

**Liquidity and Capital Resources**

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

On March 14, 2006, we completed an \$18.0 million private placement of the Company's 7% Convertible Senior Subordinated Debentures due 2011 (the "Debentures"). Interest on the Debentures is payable semi-annually each year beginning September 1, 2006. We used substantially all of the net proceeds of \$16.5 million from the Debentures to purchase or redeem higher interest rate debt, including ThermaClime's 10 3/4% Senior Unsecured Notes due 2007 ("Senior Unsecured Notes"). The remaining balance was used for general corporate purposes.

Our total outstanding debt at December 31, 2006 was \$97.7 million compared to \$112.1 million at December 31, 2005.

During the third and fourth quarters of 2006, \$14.0 million of the Debentures were converted into common stock at \$7.08 per common share. At December 31, 2006, there were \$4.0 million of Debentures outstanding. In February 2007, there were additional conversions of \$3.0 million

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leaving \$1.0 million currently outstanding. The conversions from debt to stockholders' equity of \$17.0 million improves the Company's debt leverage ratio. As a result of the \$17.0 million conversions, annual interest expense will be reduced by approximately \$1.2 million.

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

The Working Capital Revolver Loan and the Senior Secured Loan have financial covenants that are discussed below under "Loan Agreements - Terms and Conditions".

ThermaClime's ability to maintain an adequate amount of borrowing availability under its Working Capital Revolver Loan depends on its ability to comply with the terms and conditions of its loan agreements and its ability to generate cash flow from operations. ThermaClime is restricted under its credit agreements as to the funds it may transfer to the Company and its non-ThermaClime affiliates and certain ThermaClime subsidiaries. This limitation does not prohibit payment to the Company of amounts due under a Services Agreement, Management Agreement and a Tax Sharing Agreement. ThermaClime's Working Capital Revolver is a \$50.0 million facility. As of December 31, 2006, ThermaClime had availability for additional borrowing under its Working Capital Revolver Loan of \$22.8 million. Borrowing availability is based upon certain percentages of accounts receivable and inventory.

The Company is discussing with prospective lenders, the possibilities of refinancing certain outstanding debt at more favorable terms, including, among other issues, reduced interest rates. As of the date of this report, the Company has not entered into definitive negotiations with any prospective lender to provide such refinancing. There are no assurances that the Company will be successful in their efforts to refinance portions of its outstanding debt, or that if the Company is successful in refinancing any of its outstanding debt that the terms will be more favorable than the terms of the outstanding debt.

## **Capital Expenditures**

### General

Capital expenditures in 2006 were \$14.7 million, including \$7.7 million primarily for additional capacity in the Climate Control Business and \$7.0 million for the Chemical Business, primarily for process and reliability improvements of existing facilities. As discussed below, our current commitment for 2007 includes spending for production equipment, facilities upgrades and capacity expansion in the Climate Control Business and spending for production equipment and environmental compliance in the Chemical Business.

Other capital expenditures for 2007 are believed to be discretionary and are dependent upon an adequate amount of liquidity and/or obtaining acceptable funding. We have carefully managed those expenditures to projects necessary to execute our business plans and those for environmental and safety compliance.

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### Current Commitments

As of the date of this report, we have committed capital expenditures of approximately \$8.4 million for production equipment, facilities upgrades and environmental compliance in 2007. The expenditures include \$4.8 million for the Chemical Business and \$3.6 million for the Climate Control Business. We plan to finance approximately \$3.6 million and the balance will be funded from working capital.

In addition, we plan to spend approximately \$0.9 million in 2007 (\$1.2 million in total) on an existing building to expand the distribution facilities of our geothermal and water source heat pump business which has been funded by mortgage debt.

In addition, certain additional capital expenditures will be required to bring the sulfuric acid plant's air emissions to lower limits. There have been minimal expenditures on this project since 2004. The ultimate cost is believed to be between \$2.5 million and \$4.0 million, to be expended through February 2010. Currently, there are no committed capital expenditures for the project.

The ADEQ issued to El Dorado a new revised NPDES water discharge permit in 2004, and El Dorado has until June 2007 to meet the compliance deadline for the more restrictive limits under the recently issued NPDES permit. In order to meet El Dorado's June 2007 limits, El Dorado is considering three options to discharge its wastewater.

The estimated remaining capital expenditures to meet the requirements of the NPDES permit ranges from \$0.8 million to \$2.8 million, depending on which option El Dorado utilizes or is required to utilize to meet the permit requirements.

### **Dividends**

We have not paid cash dividends on our outstanding common stock in many years, and from 1999 through 2005, we had not paid any dividends on our outstanding cumulative preferred stock. During each of the quarters of 2006, our Board of Directors declared and we paid partial dividends on certain outstanding series of our preferred stock as follows: \$.10 per share on our outstanding Series 2 Preferred, \$.37 per share on our outstanding Series B Preferred, and \$.31 per share on our outstanding Non-Cumulative Preferred. These dividends were not for the full amount of the required quarterly dividends pursuant to the terms of all of our outstanding series of preferred stock. See discussion under "Dividends" and "Sale of Unregistered Securities" of Item 5 concerning the issuance of common stock in exchange for a portion of the Series 2 Preferred in October 2006 and March 2007. As of March 19, 2007, there were approximately \$6.8 million of unpaid dividends on our outstanding cumulative preferred stock. We intend to retain most of our future earnings, if any, to provide funds for our operations and/or expansion of our business.

We do not anticipate paying cash dividends on our outstanding common stock in the foreseeable future, and until all unpaid dividends are paid on our outstanding cumulative preferred stock, no dividends may be paid on our common stock.

Table of Contents**Compliance with Long-Term Debt Covenants**

As discussed below under “Loan Agreements - Terms and Conditions”, the Senior Secured Loan and Working Capital Revolver Loan, as amended, of ThermaClime and its subsidiaries require, among other things, that ThermaClime meet certain financial covenants. ThermaClime's forecasts for 2007 indicate that ThermaClime will be able to meet all required covenant tests.

**Summary**

Cash flow and liquidity will continue to be managed very carefully. We believe, with the \$15.9 million net income for 2006 and the infusion of new capital as a result of the debenture offering and the subsequent conversion of the debentures to stockholders' equity, our capital base is improved. Based upon current forecasts, we should have adequate cash from internal cash flows and financing sources to enable us to satisfy our cash requirements for 2007. Due to the volatility of the cost of major raw materials, we have historically experienced revisions to financial forecasts on a frequent basis during the course of a year. As a result, actual results may differ from our forecast, which could have a material impact on our liquidity and future operating results.

**Loan Agreements - Terms and Conditions**

**7% Convertible Senior Subordinated Debentures** - On March 14, 2006, we completed a private placement to six qualified institutional buyers, pursuant to which we sold \$18.0 million aggregate principal amount of our 7% Convertible Senior Subordinated Debentures due 2011 (the “Debentures”). Interest on the Debentures is payable semi-annually in arrears on March 1 and September 1 of each year which began September 1, 2006.

The Debentures are convertible by holders, in whole or in part, into shares of the Company's common stock prior to their maturity on March 1, 2011. Holders of Debentures electing to convert all or any portion of a Debenture will obtain the following conversion rate per \$1,000 principal amount of Debentures during the dates indicated:

	Shares Per \$1,000 Principal Amount	Conversion Price Per Share
March 1, 2007 - August 31, 2007	141.04	\$ 7.09
September 1, 2007 - February 29, 2008	137.27	\$ 7.28
March 1, 2008 - August 31, 2008	133.32	\$ 7.50
September 1, 2008 - February 28, 2009	129.23	\$ 7.74
March 1, 2009 - March 1, 2011	125.00	\$ 8.00

The conversion rates will be adjusted to reflect dividends, stock splits, issuances of rights to purchase shares of common stock and other events, as set forth in the Indenture.

We have used substantially all of the net proceeds for the purchase or redemption of our higher interest rate debt or debt of our subsidiaries, including ThermaClime's Senior Unsecured Notes. The remaining balance was used for general corporate purposes.

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Approximately \$13.6 million of the net proceeds have been used to purchase or redeem all of the Senior Unsecured Notes held by unrelated third parties and Jayhawk at ThermaClime's carrying value (which includes \$1.0 million that was held by Jayhawk) including accrued interest of \$0.3 million. Approximately \$6.95 million of the Senior Unsecured Notes held by us remain outstanding.

During 2006, \$14 million of the Debentures were converted into 1,977,499 shares of our common stock at the conversion price of \$7.08 per share. Certain of the conversions related to offers received from the holders and accepted by us which included additional consideration of \$277,000 to be paid to the holders. Because the offer met the criteria within SFAS 84-Induced Conversions of Convertible Debt, the additional consideration was expensed. During February 2007, an additional \$3.0 million of the Debentures were converted into common stock at the conversion price of \$7.08 per common share.

**Working Capital Revolver Loan** - ThermaClime finances its working capital requirements through borrowings under a Working Capital Revolver Loan. Under the Working Capital Revolver Loan, ThermaClime and its subsidiaries may borrow on a revolving basis up to \$50.0 million based on specific percentages of eligible accounts receivable and inventories. The Working Capital Revolver Loan matures in April 2009. As of December 31, 2006, borrowings outstanding were \$26.0 million and the net credit available for additional borrowings was \$22.8 million. The Working Capital Revolver Loan requires that ThermaClime and its Climate Control Business meet certain financial covenants measured quarterly. ThermaClime and its Climate Control Business were in compliance with those covenants for the twelve-month period ended December 31, 2006.

**Senior Secured Loan** - In September 2004, ThermaClime and certain of its subsidiaries (the "Borrowers") completed a \$50.0 million term loan ("Senior Secured Loan") with a certain lender (the "Lender"). The Senior Secured Loan is to be repaid as follows:

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

The Senior Secured Loan accrues interest at the applicable LIBOR rate, as defined, plus an applicable LIBOR margin, as defined or, at the election of the Borrowers, the alternative base rate, as defined, plus an applicable base rate margin, as defined, with the annual interest rate not to exceed 11% or 11.5% depending on the leverage ratio. At December 31, 2006, the annual interest rate was 11%.

The Borrowers are subject to numerous affirmative and negative covenants under the Senior Secured Loan agreement including, but not limited to, limitation on the incurrence of certain additional indebtedness and liens, limitations on mergers, acquisitions, dissolution and sale of assets, and limitations on declaration of dividends and distributions to us, all with certain exceptions. The Borrowers are also subject to a minimum fixed charge coverage ratio, measured

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quarterly on a trailing twelve-month basis. The Borrowers were in compliance with the required minimum ratio for the twelve-month period ended December 31, 2006 and the coverage ratio is considered to be achievable for 2007. The maturity date of the Senior Secured Loan can be accelerated by the Lender upon the occurrence of a continuing event of default, as defined.

**Cross - Default Provisions** - The Working Capital Revolver Loan agreement and the Senior Secured Loan contain cross-default provisions. If ThermaClime fails to meet the financial covenants of the Senior Secured Loan, the lender may declare an event of default, making the debt due on demand. If this should occur, there are no assurances that we would have funds available to pay such amount or that alternative borrowing arrangements would be available. Accordingly, ThermaClime could be required to curtail operations and/or sell key assets. These actions could result in the recognition of losses that may be material.

## Seasonality

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

## Related Party Transactions

One of the manufacturing facilities within our Climate Control Business sustained substantial water damage in its office area resulting from the improper installation by an unrelated third-party vendor of certain plumbing to a water line. As a result of the water damage, it became necessary to replace all of the carpet in the office area of the facility. During 2006, we purchased replacement carpet from a company ("Designer Rugs") owned by Linda Golsen Rappaport, the daughter of Jack E. Golsen, our Chairman and Chief Executive Officer, and sister of Barry H. Golsen, our President. We paid approximately \$159,000 to Designer Rugs for the new carpet, removal of the damaged carpeting and installation of the new carpet. During the second quarter of 2006, we were reimbursed under our insurance coverage for the cost of the carpet and installation except for a deductible amount of \$25,000.

In addition, another subsidiary within our Climate Control Business is in the process of remodeling their offices including the replacement of carpet and flooring throughout the office area. Payments totaling \$69,000 were made during 2006 towards a purchase totaling \$75,000 from Designer Rugs. Substantially all of the carpet was delivered and installed in 2006. Final completion expected early in 2007.

During 2006, Jayhawk purchased \$1.0 million principal amount of the Debentures. In addition, we purchased \$1.0 million principal amount of the Notes held by Jayhawk. Jayhawk earned interest of \$117,000 relating to these debt instruments in 2006.

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During 2006 we paid nominal cash dividends to holders of certain series of our preferred stock. These dividend payments included \$91,000 and \$133,000 to the Golsen Group and the Jayhawk Group, respectively. Additionally, the dividend payments included \$23,000 collectively to the significant shareholders discussed below.

As discussed above under “Overview-Preferred Stock Exchanges and Completion of Exchange Offer”, in October 2006, we issued 773,655 shares of our common stock to certain holders of our Series 2 Preferred in exchange for 104,548 shares of Series 2 Preferred. The shares of common stock issued included 303,400 and 262,167 shares issued for exchange for 41,000 and 35,428 shares of Series 2 Preferred stock to Paul Denby and James Sight (“Significant Shareholders”), respectively, or to entities controlled by the Significant Shareholders.

As discussed above under “Overview-Preferred Stock Exchanges and Completion of Exchange Offer”, during November 2006, we entered into the Jayhawk Agreement with the Jayhawk Group. Under the Jayhawk Agreement, the Jayhawk Group agreed, if we made an exchange offer for the Series 2 Preferred, to tender 180,450 shares of the 346,662 shares of Series 2 Preferred owned by the Jayhawk Group. In addition, as a condition to the Jayhawk Group’s obligation to tender the shares of Series 2 Preferred in an exchange offer, the Jayhawk Agreement further provided that the Golsen Group would exchange 26,467 shares of Series 2 Preferred beneficially owned by them. Pursuant to the Jayhawk Agreement and the terms of the exchange offer, during March 2007, the Jayhawk Group and the Golsen Group tendered 180,450 and 26,467 shares, respectively, of Series 2 Preferred for 1,335,330 and 195,855 shares, respectively, of our common stock and waived a total of approximately \$5.0 million in accrued and unpaid dividends.

## Subsequent Events

On June 28, 2007, the Company entered into a Purchase Agreement, with each of 22 qualified institutional buyers (the “Purchasers”), pursuant to which the Company sold \$60.0 million aggregate principal amount of its 5.5% Convertible Senior Subordinated Debentures due 2012 (the “2007 Debentures”) in a private placement to qualified institutional buyers 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 bear interest at the rate of 5.5% per year. Interest is payable on January 1 and July 1 of each year, beginning on January 1, 2008. The net proceeds received by the Company in connection with this sale, after discounts and commissions were approximately \$57 million. The Company has currently invested the net proceeds in money market investments and has or intends to use the net proceeds, to redeem its outstanding shares of \$3.25 Convertible Exchangeable Class C Preferred Stock, Series 2 (“Series 2 Preferred”); to repay certain outstanding mortgages and equipment loans; to pay accrued and unpaid dividends on its outstanding shares of Series B 12% Cumulative Convertible Preferred Stock and Series D 6% Cumulative Convertible Class C Preferred Stock; and the balance to initially reduce outstanding borrowing under existing revolving working credit facility, for certain discretionary capital expenditures and general working capital purposes.

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The 2007 Debentures are convertible by holders in whole or in part into shares of the Company's common stock prior to their maturity on July 1, 2012. The conversion rate of the 2007 Debentures for holders electing to convert all or any portion of a 2007 Debenture is 36.4 shares of the Company's 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.

The Company has also entered into a Registration Rights Agreement with the Purchasers, which required the Company to register the 2007 Debentures, and the shares of common stock into which they are convertible, within 60 days of the closing of the Purchase Agreement, and to use commercially reasonable efforts to have the registration statement declared effective within 150 days of such closing date. The Company is also required to use its commercially reasonable efforts to keep the registration statement effective until July 1, 2010

As of June 29, 2007, we became an accelerated filer because our public float held by non-affiliates exceeded the \$75 million threshold. As a result, we will be required to provide a management's report on our internal control over financial reporting and an assessment of such report by our independent auditors in our Form 10-K for the year ending December 31, 2007. In addition, we will incur additional costs to meet the requirements as an accelerated filer for the year ending December 31, 2007.

On July 11, 2007, our Board of Directors approved the redemption of all of our outstanding Series 2 Preferred. We mailed a notice of redemption to all holders of record of our Series 2 Preferred on July 12, 2007. The redemption date is scheduled for August 27, 2007, and the redemption price is \$50.00 per share of Series 2 Preferred, plus \$26.25 per share in accrued and unpaid dividends pro-rata to the date of redemption. As of the date of this report, 193,295 shares of Series 2 Preferred were outstanding. The Series 2 Preferred will be redeemed using a portion of the proceeds of the 2007 Debentures.

The holders of shares of Series 2 Preferred have the right to convert each share into 4.329 shares of our common stock, which right to convert terminates 10 days prior to the redemption date. If a holder converts its shares of Series 2 Preferred, the holder would not be entitled to any accrued and unpaid dividends as to the shares of Series 2 Preferred converted. If all of the outstanding shares Series 2 Preferred are converted, 836,774 shares of our common stock would be issuable.

As stated above, we intend to use a portion of the net proceeds from the sale of the 2007 Debentures to redeem our Series 2 Preferred. The Series 2 Preferred is a cumulative preferred. As a result, if we redeem the Series 2 Preferred, we are obligated to pay, in cash, a redemption price for each share redeemed of \$50.00 per share, plus \$26.25 per share of accrued and unpaid dividends thereon pro-rata to the date of redemption. If, after notice of redemption is given, a holder of the Series 2 Preferred elects to convert his, her or its shares into our common stock pursuant to its terms, the Certificate of Designation for the Series 2 Preferred provides, and it is

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the Company's position, that the holder that so converts will not be entitled to receive payment of any accrued and unpaid dividends on the shares so converted. The Company has been advised by an affiliate that is the Company's second largest stockholder, Jayhawk Capital Management, Inc. and other Jayhawk entities, through their manager, Kent McCarthy (the "Jayhawk Group"), that if the Company redeems the Series 2 Preferred and the Jayhawk Group thereafter converts its holding of Series 2 Preferred, the Jayhawk Group may bring legal proceedings against us for all accrued and unpaid dividends on the Series 2 Preferred that the Jayhawk Group may convert after receiving a notice of redemption. As of the date of this report, there was approximately \$4.0 million of accrued and unpaid dividends on the Series 2 Preferred held by the Jayhawk Group.

Upon completion of the redemption of our outstanding Series 2 Preferred, the two independent directors elected by the holders of our Series 2 Preferred will no longer serve as directors on our board of directors. The American Stock Exchange ("ASE") requires that at least a majority of the directors on the board of directors of companies listed on the ASE be independent. When the two directors elected by the Series 2 Preferred cease to be directors, the independent directors will no longer be a majority of our board of directors. If upon completion of the redemption we are unable, or otherwise fail, to appoint two additional independent directors to our board of directors or reduce the number of our non-independent directors, our board would no longer have a majority of independent directors, and we would not meet the required listing standards of the ASE. In such event, the ASE could issue a warning letter or a deficiency letter or it could delist our common stock.

## Critical Accounting Policies and Estimates

Our critical accounting policy relating to plant turnaround costs has been changed as discussed under "Explanatory Introduction Note."

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amount of assets, liabilities, revenues and expenses, and disclosures of contingencies. In addition, the more critical areas of financial reporting impacted by management's judgment, estimates and assumptions include the following:

**Receivables and Credit Risk** - Our sales to contractors and independent sales representatives are generally subject to a mechanics lien in the Climate Control Business. Our other sales are generally unsecured. Credit is extended to customers based on an evaluation of the customer's financial condition and other factors. Credit losses are provided for in the financial statements based on historical experience and periodic assessment of outstanding accounts receivable, particularly those accounts which are past due (determined based upon how recently payments have been received). Our periodic assessment of accounts and credit loss provisions are based on our best estimate of amounts that are not recoverable. Concentrations of credit risk with respect to trade receivables are limited due to the large number of customers comprising our customer bases and their dispersion across many different industries and geographic areas, however, 10 customers account for approximately 30% of our total net receivables at December 31, 2006. We do not believe this concentration in these 10 customers represents a significant credit risk due to the financial stability of these customers. At December 31, 2006 and 2005, our allowance for doubtful accounts of \$2.3 million and \$2.7 million, respectively, were netted against our accounts receivable.

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**Inventory Valuations** - Inventories are priced at the lower of cost or market, with cost being determined using the first-in, first-out basis. Finished goods and work-in-process inventories include material, labor and manufacturing overhead costs. At December 31, 2006 and 2005, the carrying value of certain nitrogen-based inventories produced by our Chemical Business was reduced to market because cost exceeded the net realizable value by \$0.4 million and \$1.4 million, respectively. In addition, the carrying value of certain slow-moving inventory items (primarily Climate Control products) was reduced to market because cost exceeded the net realizable value by \$0.8 million and \$1.0 million at December 31, 2006 and 2005, respectively.

**Precious Metals** - Precious metals are used as a catalyst in the Chemical Business manufacturing processes. Precious metals are carried at cost, with cost being determined using the first-in, first-out ("FIFO") basis. As of December 31, 2006 and 2005, precious metals were \$6.4 million and \$5.0 million, respectively, and are included in supplies, prepaid items and other in the consolidated balance sheets. 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. For 2006, 2005 and 2004, the amounts expensed for precious metals were approximately \$5.1 million, \$3.5 million and \$3.3 million, respectively, and are included in cost of sales. Periodically, during major maintenance or capital projects we may be able to perform procedures to recover precious metals (previously expensed) which have accumulated within the manufacturing equipment. For 2006, 2005 and 2004, we recognized recoveries of precious metals at historical FIFO costs of approximately \$2.4 million, \$2.1 million and \$0.2 million, respectively, which are reductions to cost of sales.

**Impairment of Long-Lived Assets and Goodwill** - Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable and goodwill is reviewed for impairment at least annually. If assets to be held and used are considered to be impaired, the impairment to be recognized is the amount by which the carrying amounts of the assets exceed the fair values of the assets as measured by the present value of future net cash flows expected to be generated by the assets or their appraised value. Assets to be disposed of are reported at the lower of the carrying amounts of the assets or fair values less costs to sell. At December 31, 2006, we had no long-lived assets that met the criteria presented in SFAS 144 to be classified as assets held for sale. We have considered impairment of our long-lived assets and goodwill. We obtained third party appraisals of the fair values associated with Cherokee and made estimates of fair values for others. The timing of impairments cannot be predicted with reasonable certainty and are primarily dependent on market conditions outside our control. Should sales prices permanently decline dramatically without a similar decline in the raw material costs or should other matters, including the environmental requirements and/or operating requirements set by Federal and State agencies change substantially from our current expectations, a provision for impairment may be required based upon such event or events. See Item 1 "Business-Environmental Matters." Based on estimates obtained from external sources and internal estimates based on inquiry and other techniques, we recognized impairments relating to certain non-core equipment of \$0.1 million and \$0.4 million relating to Corporate assets during 2005 and 2004, respectively, (none in 2006) and \$0.3 million, \$0.1 million and \$0.4 million relating to certain capital spare parts and idle assets in our Chemical Business during 2006, 2005 and 2004, respectively. These impairments are included in other expense in the consolidated statements of income.

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**Accrued Insurance Liabilities** - We are self-insured up to certain limits for group health, workers' compensation and general liability insurance claims. Above these limits, we have insurance coverage, which management considers to be adequate. Our accrued insurance liabilities are based on estimates of the self-insured portions of the claims, which include the incurred claims amounts plus estimates of future claims development calculated by applying our historical claims development factors to our incurred claims amounts. We also consider the reserves established by our insurance adjustors and/or estimates provided by attorneys handling the claims, if any. In addition, our accrued insurance liabilities include estimates of incurred, but not reported, claims and other insurance-related costs. At December 31, 2006 and 2005, our claims liabilities were \$1.6 million and \$1.4 million, respectively, and are included in accrued and other liabilities. It is possible that the actual development of claims could exceed our estimates.

**Product Warranty** - Our Climate Control Business sells equipment for which we provide warranties covering defects in materials and workmanship. Generally, the base warranty coverage for most of the manufactured equipment is limited to 18 months from the date of shipment or 12 months from the date of start-up, whichever is shorter, and to 90 days for spare parts. In some cases, the customer may purchase an extended warranty. Our accounting policy and methodology for warranty arrangements is to periodically measure and recognize the expense and liability for such warranty obligations using a percentage of net sales, based on historical warranty costs. It is possible that future warranty costs could exceed our estimates. At December 31, 2006 and 2005, our accrued product warranty obligations were \$1.3 million and \$0.9 million, respectively and are included in current and noncurrent accrued and other liabilities in the consolidated balance sheets.

**Plant Turnaround Costs** - As discussed under "Explanatory Introduction Note," we expense the costs as they are incurred relating to planned major maintenance activities ("Turnarounds") of our Chemical Business as described as the direct expensing method within Financial Accounting Standards Board ("FASB") Staff Position No. AUG AIR-1.

**Executive Benefit Agreements** - We have entered into benefit agreements with certain key executives. Costs associated with these individual benefit agreements are accrued when they become probable over the estimated remaining service period. Total costs accrued equal the present value of specified payments to be made after benefits become payable. In 1992, we entered into individual benefit agreements with certain key executives ("1992 Agreements") that provide for annual benefit payments for life (in addition to salary). As of December 31, 2006 and 2005, the liability for these benefits under the 1992 Agreements is \$1.0 million and \$0.9 million, respectively, which is included in current and noncurrent accrued and other liabilities in the accompanying consolidated balance sheets.

In 1981, we entered into individual death benefit agreements with certain key executives. In addition, as part of the 1992 Agreements, should the executive die prior to attaining the age of 65, we will pay the beneficiary named in the agreement in 120 equal monthly installments aggregating to an amount specified in the agreement. In 2005, we entered into a death benefit agreement with our CEO. As of December 31, 2006, the liability for death benefits is \$1.4 million (\$0.9 million at December 31, 2005) which is included in current and noncurrent accrued and noncurrent liabilities.

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**Environmental and Regulatory Compliance** - The Chemical Business is subject to specific federal and state regulatory and environmental compliance laws and guidelines. We have developed policies and procedures related to environmental and regulatory compliance. We must continually monitor whether we have maintained compliance with such laws and regulations and the operating implications, if any, and amount of penalties, fines and assessments that may result from noncompliance. At December 31, 2006, liabilities totaling \$1.4 million have been accrued relating to a consent administrative order (“CAO”) covering El Dorado and a CAO covering our former Hallowell facility. These liabilities are included in current and noncurrent accrued and other liabilities and are based on current estimates that may be revised in the near term based on results of our investigation, risk assessment and remediation pursuant to the new CAO and Slurry Consent Order. In addition, we will be required to make capital expenditures as it relates to the NPDES permit and Air CAO.

**Asset Retirement Obligations** - We have a legal obligation to monitor certain discharge water outlets at our Chemical Business facilities should we discontinue the operations of a facility. We do not believe that the annual costs of the required monitoring activities would be significant and as we currently have no plans to discontinue the use of the facilities and the remaining life of either facility is indeterminable, an asset retirement liability has not been recognized. Currently, there is insufficient information to estimate the fair value of the asset retirement obligation. However, we will continue to review this obligation and record a liability when a reasonable estimate of the fair value can be made.

**Deferred Income Taxes** - Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes, and the amounts used for income tax purposes. Valuation allowances are provided against deferred tax assets when it is more likely than not that some portion or all of the deferred tax asset will not be realized. We are able to realize deferred tax assets up to an amount equal to the future reversals of existing taxable temporary differences. The taxable temporary differences will turn around in the loss carry forward period as the differences reverse. Other differences will turn around as the assets are realized or liabilities are paid in the normal course of business. At December 31, 2006 and 2005, our deferred tax assets were net of a valuation allowance of \$18.9 million and \$25.6 million, respectively. The decrease in the valuation allowance is due primarily to the utilization of net operating loss carry forwards in 2006.

**Contingencies** - We accrue for contingent losses when such losses are probable and reasonably estimable. In addition, we recognize contingent gains when such gains are realized. We are a party to various litigation and other contingencies, the ultimate outcome of which is not presently known. Should the ultimate outcome of these contingencies be adverse, such outcome could create an event of default under ThermaClime's Working Capital Revolver Loan and the Senior Secured Loan and could adversely impact our liquidity and capital resources.

**Revenue Recognition** - We recognize revenue for substantially all of our operations at the time title to the goods transfers to the buyer and there remains no significant future performance obligations by us. Revenue relating to construction contracts is recognized using the percentage-of-completion method based primarily on contract costs incurred to date compared with total estimated contract costs. Changes to total estimated contract costs or losses, if any, are

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recognized in the period in which they are determined. Sales of warranty contracts are recognized as revenue ratably over the life of the contract. See discussion above under “Product Warranty” for our accounting policy for recognizing warranty expense.

**Recognition of Insurance Recoveries-** 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.

Management's judgment and estimates in these areas are based on information available from internal and external resources at that time. Actual results could differ materially from these estimates and judgments, as additional information becomes known.

Table of Contents**Results of Operations**

Our Consolidated Financial Statements have been amended and adjusted as discussed under “Explanatory Introduction Note.” In addition, the following Results of Operations should be read in conjunction with our Consolidated Financial Statements for the years ended December 31, 2006, 2005 and 2004 and accompanying notes (As Adjusted) and the discussions above under “Overview” And “Liquidity and Capital Resources.”

The following table contains certain information about our continuing operations in different industry segments for each of the three years ended December 31:

	<b>2006</b> <b>(As</b> <b>Adjusted)</b>	<b>2005</b> <b>(As</b> <b>Adjusted)</b>	<b>2004</b> <b>(As</b> <b>Adjusted)</b>
	(In thousands)		
<b>Net sales:</b>			
Climate Control	\$ 221,161	\$ 156,859	\$ 141,014
Chemical	260,651	233,447	216,264
Other	10,140	6,809	6,706
	<b>\$ 491,952</b>	<b>\$ 397,115</b>	<b>\$ 363,984</b>
<b>Gross profit:</b>			
Climate Control	\$ 65,496	\$ 48,122	\$ 42,721
Chemical	22,023	16,314	7,756
Other	3,343	2,330	2,145
	<b>\$ 90,862</b>	<b>\$ 66,766</b>	<b>\$ 52,622</b>
<b>Operating income (loss):</b>			
Climate Control	\$ 25,428	\$ 14,097	\$ 11,707
Chemical	9,785	7,591	(2,038)
General corporate expense and other business operations, net	(8,074)	(6,835)	(7,586)
	27,139	14,853	2,083
Interest expense	(11,915)	(11,407)	(7,393)
Gains on extinguishment of debt	-	-	4,400
Provision for loss on notes receivable-Climate Control	-	-	(1,447)
<b>Non-operating income (expense), net:</b>			
Climate Control	1	-	-
Chemical	311	362	2,463
Corporate and other business operations	312	1,199	(29)
Provision for income taxes	(901)	(118)	-
Equity in earnings of affiliate - Climate Control	821	745	668
Income from continuing operations before cumulative effect of accounting change	<b>\$ 15,768</b>	<b>\$ 5,634</b>	<b>\$ 745</b>

Table of Contents**Year Ended December 31, 2006 Compared to Year Ended December 31, 2005****Net Sales**

The following table contains certain information about our net sales in different industry segments for 2006 and 2005:

	2006	2005	Change	Percentage Change
	(Dollars in thousands)			
Net sales:				
Climate Control:				
Geothermal and water source heat pumps	\$ 134,210	\$ 85,268	\$ 48,942	57.4%
Hydronic fan coils	59,497	53,564	5,933	11.1%
Other HVAC products	27,454	18,027	9,427	52.3%
Total Climate Control	\$ 221,161	\$ 156,859	\$ 64,302	41.0%
Chemical:				
Industrial acids and other chemical products	\$ 95,208	\$ 80,228	\$ 14,980	18.7%
Agricultural products	89,735	80,638	9,097	11.3%
Mining products	75,708	72,581	3,127	4.3%
Total Chemical	\$ 260,651	\$ 233,447	\$ 27,204	11.7%
Other	\$ 10,140	\$ 6,809	\$ 3,331	48.9%
Total net sales	\$ 491,952	\$ 397,115	\$ 94,837	23.9%

**Climate Control Business**

- Net sales of our geothermal and water source heat pump products increased primarily as a result of a 52% increase in the number of units sold in the commercial and residential markets due to customer demand representing an approximate 4% gain in market share based on data supplied by the ARI;
- Net sales of our hydronic fan coils increased primarily due to a 10% increase in overall average unit sales prices as the result of lowering discounting and higher selling prices driven by raw material cost increases;
- Net sales of our other HVAC products increased as the result of an increase in the number of larger custom air handlers sold primarily relating to three large projects.

**Chemical Business**

El Dorado and Cherokee produce all the chemical products described in the table above and Baytown produces only industrial acids products. Overall, volume of tons sold for the Chemical Business increased 12% while sales prices remained consistent with 2005.

- Volume at El Dorado increased 14% primarily related to agricultural products as the result of the loss of production during the first half of 2005 as discussed below, to industrial acid and other chemical products due to spot sales opportunities, and to mining products relating to the growth of coal mining in the mining industry;



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- Volume at Baytown increased 24% as the result of a closing of a chemical facility within our market and other various spot sales opportunities;
- Volume at Cherokee decreased 6% resulting from the suspension of production during the first half of January 2006 as the result of a reduction in orders from several key customers due to the increased natural gas costs and further production curtailments throughout the first quarter of 2006.

**Other** - Net sales classified as “Other” consists of sales of industrial machinery and related components. The increase in net sales relates primarily to increased customer demand for our machine tool products.

Gross Profit

Gross profit by industry segment represents net sales less cost of sales. The following table contains certain information about our gross profit in different industry segments for 2006 and 2005:

	2006	2005	Change	Percentage Change
	(Dollars in thousands)			
Gross profit:				
Climate Control	\$ 65,496	\$48,122	\$ 17,374	36.1%
Chemical	22,023	16,314	5,709	35.0%
Other	3,343	2,330	1,013	43.5%
	\$ 90,862	\$66,766	\$24,096	36.1%

In addition to the information presented in the above table, our Climate Control Business’ gross profit percentage (as a percentage of net sales) was 29.6% for 2006 compared to 30.7% for 2005. The gross profit percentage of our Chemical Business was 8.4% for 2006 compared to 7.0% for 2005. The gross profit percentage relating to “Other” (see discussion above) was 33.0% for 2006 compared to 34.2% for 2005.

The increase in gross profit in our Climate Control Business was a direct result of the increase in sales volume as discussed above. The decline in our gross profit percentage was primarily due to raw material costs increases being incurred ahead of customer price increases becoming effective.

The net increase in gross profit of our Chemical Business relates primarily to:

- Cherokee as the result of not incurring the disruptions at the plant caused by the rise in natural gas costs due to the hurricanes in the U.S. Gulf in 2005 and a decrease in electricity costs as a result of a negotiated reduction in utility rates in 2006;
  - Baytown due primarily to the increase in sales volume as discussed above;
  - El Dorado as the result of the increase in sales volume as discussed above.

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As previously reported, beginning in October 2004 and continuing into June 2005, the Chemical Business' results were adversely affected as a result of the loss of production due to a mechanical failure of one of the four nitric acid plants at El Dorado. The plant was restored to normal production in June 2005. We recognized insurance recoveries of \$0.9 million and \$1.9 million under our business interruption insurance policy relating to this claim for 2006 and 2005, respectively, which is recorded as a reduction to cost of sales. The negative impact on gross profit resulting from the lost production was approximately \$4.1 million in 2005.

The increase in gross profit classified as "Other" (see discussion above) is due primarily to the increase in sales as discussed above.

Operating Income

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 administrative 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. The following table contains certain information about our operating income for 2006 and 2005:

	2006	2005	Change
	(In thousands)		
Operating income:			
Climate Control	\$ 25,428	\$ 14,097	\$ 11,331
Chemical	9,785	7,591	2,194
General corporate expense and other business operations, net	(8,074)	(6,835)	(1,239)
	\$ 27,139	\$ 14,853	\$ 12,286

**Operating Income - Climate Control:** The net increase in operating income of our Climate Control Business resulted primarily from the net increase of gross profit of \$17.4 million as discussed above, an arbitration award of \$1.2 million received in 2006 relating to the arbitration case involving Trison as discussed under "Climate Control Business" of Item 3, and a decrease in professional fees of \$1.0 million primarily as the result of fees incurred during 2005 relating to this arbitration case. This increase in operating income was partially offset by increased shipping and handling costs of \$3.9 million due to increased sales volume and rising fuel costs, increased commissions of \$1.8 million due to increased sales volume and distribution mix and increased personnel cost of \$1.6 million as the result of increased number of personnel and higher incentives, and increased warranty costs of \$0.7 million due to the increased sales volume.

**Operating Income - Chemical:** The net increase of our Chemical Business' operating income primarily relates to the net increase in gross profit of \$5.7 million as discussed above. This increase in operating income was partially offset by an increase in handling costs of \$0.8 million due primarily to increased sales volume and an increase in professional fees of \$0.4 million relating to legal costs associated with ammonium nitrate anti-dumping tariffs. In addition, we recognized gains of \$1.6 million from certain property insurance claims in 2005.

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**General Corporate Expense and Other Business Operations, Net:** The net increase in our general corporate expense and other business operations, net relates primarily to an increase of \$0.6 million in personnel costs relating to increased group health care costs of \$0.4 million and commissions of \$0.3 million on the increased sales classified as “Other” as discussed above, an increase in professional fees of \$0.6 million due, in part, for assistance in our evaluation of our internal controls and procedures and related documentation for Sarbanes-Oxley requirements, a litigation settlement of \$0.3 million relating to an asserted financing fee, and a decrease in gains of \$0.7 million from the sales of corporate assets. The increase was partially offset by the increase in gross profit classified as “Other” of \$1.0 million and a refund of \$0.4 million relating to insurance brokerage fees.

**Interest Expense** - Interest expense was \$11.9 million for 2006 compared to \$11.4 million for 2005, an increase of \$0.5 million. This net increase in interest expense includes \$1.1 million relating to the Debentures sold in March 2006 and \$0.3 million of additional consideration paid in conjunction with the conversion of a portion of the Debentures during 2006 which was partially offset by a decrease of \$0.8 million relating to the Notes which were purchased or redeemed during 2006.

**Non-Operating Other Income, net** - Our non-operating other income, net was \$0.6 million for 2006 compared to \$1.6 million for 2005. In 2005, we recognized net proceeds from life insurance policies of \$1.2 million.

**Provision For Income Taxes** - Due to net operating loss (“NOL”) carryforwards, provisions for income taxes consist of federal alternative minimum taxes and state income taxes for 2006 and federal alternative minimum taxes for 2005.

**Net Loss From Discontinued Operations** - Net loss from discontinued operations includes provisions of \$0.2 million and \$0.6 million for 2006 and 2005, respectively, for our share of estimated environmental remediation costs to investigate and delineate a site in Hallowell, Kansas as a result of meetings with the KDHE. There are no income tax benefits related to these expenses.

Table of ContentsYear Ended December 31, 2005 Compared to Year Ended December 31, 2004Net Sales

The following table contains certain information about our net sales in different industry segments for 2005 and 2004:

	2005	2004	Change	Percentage Change
	(Dollars in thousands)			
Net sales:				
Climate Control:				
Geothermal and water source heat pumps	\$ 85,268	\$ 73,920	\$ 11,348	15.4 %
Hydronic fan coils	53,564	48,760	4,804	9.9 %
Other HVAC products	18,027	18,334	(307)	(1.7)%
Total Climate Control	\$ 156,859	\$ 141,014	\$ 15,845	11.2 %
Chemical:				
Agricultural products	\$ 80,638	\$ 72,154	\$ 8,484	11.8 %
Industrial acids and other chemical products	80,228	82,040	(1,812)	(2.2)%
Mining products	72,581	62,070	10,511	16.9 %
Total Chemical	\$ 233,447	\$ 216,264	\$ 17,183	7.9 %
Other	\$ 6,809	\$ 6,706	\$ 103	1.5 %
Total net sales	\$ 397,115	\$ 363,984	\$ 33,131	9.1 %

**Climate Control Business**

- Net sales of our geothermal and water source heat pump products increased primarily as a result of stronger customer demand, a 7% increase in overall average unit sales prices due to the increase in our raw material costs as discussed below, and change in product mix;
- Net sales of our hydronic fan coils increased primarily from a 6% increase in overall average unit sales prices due to the increase in our raw material costs as well as an improvement in product mix;
- Net sales of our other HVAC products decreased \$0.3 million. For 2004, net sales of other HVAC products includes \$3.8 million as a result of consolidating MultiClima's operating results in the second quarter of 2004 as required under FIN 46. Effective July 1, 2004, we were no longer required to consolidate MultiClima's operating results. Excluding the effect of MultiClima, sales of other HVAC products increased \$3.5 million which includes an increase in sales of \$1.1 million relating to our modular chiller systems, \$0.9 million relating to our large custom air handlers, \$0.9 million as a result of an increase in construction projects and \$0.7 million relating to a new product line with increasing demand.

Table of Contents**Chemical Business**

As discussed above, El Dorado and Cherokee produce all the chemical products described in the table above and Baytown produces only industrial acids products. Overall sales prices for the Chemical Business increased 13% but overall volume of tons sold decreased 5%.

- The overall increase in sales prices reflects, in part, higher sales prices resulting from the increased cost of the raw material feedstocks (anhydrous ammonia and natural gas) as discussed below;
- The volume at Baytown was down 14% due to lower demand for nitric acid by Bayer resulting from the shutdown of one of North America's consuming locations;
- The volume at Cherokee decreased 4% due primarily to the suspension of production resulting from the hurricanes in the U.S. Gulf as discussed above under "Overview-Chemical Business."

**Other** - Net sales classified as "Other" consists of sales of industrial machinery and related components.

**Gross Profit**

Gross profit by industry segment represents net sales less cost of sales. The following table contains certain information about our gross profit in different industry segments for 2005 and 2004:

	<b>2005</b>	<b>2004</b>	<b>Change</b>	<b>Percentage Change</b>
	(Dollars in thousands)			
Gross profit:				
Climate Control	\$48,122	\$42,721	\$ 5,401	12.6 %
Chemical	16,314	7,756	8,558	110.3 %
Other	2,330	2,145	185	8.6 %
	\$66,766	\$52,622	\$14,144	26.9 %

In addition to the information presented in the above table, our Climate Control Business' gross profit percentage (as a percentage of net sales) was 30.7% for 2005 compared to 30.3% for 2004. The gross profit percentage of our Chemical Business was 7.0% for 2005 compared to 3.6% for 2004. The gross profit percentage relating to "Other" (see discussion above) was 34.2% for 2005 compared to 32.0% for 2004.

The net increase in gross profit of our Climate Control Business resulted primarily by the increase in sales of our geothermal and water source heat pumps and hydronic fan coils as discussed above. This increase in gross profit was partially offset by a change in product/customer mix and our inability to fully pass on to our customers in the form of product price increases the increase in the raw material cost of copper. The spot market increases through the twelve months of 2005 for copper were approximately 40%. In addition, a decrease of \$0.8 million relates to MultiClima in the second quarter of 2004 as discussed above.

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The net increase in gross profit of our Chemical Business is due primarily to improved margins on certain agricultural and industrial acid products and cost recoveries during 2005 of \$2.1 million of production catalyst (precious metals) used in our manufacturing processes compared to \$0.2 million during 2004. In addition, costs relating to Turnarounds decreased approximately \$1.0 million in 2005 compared to 2004 primarily as the result of our sulfuric acid plant and one of our nitric acid plants not requiring Turnarounds during 2005 but were performed during 2004. The increase in gross profit was offset, in part, by our inability to fully pass on to our customers the 25% increase in costs of anhydrous ammonia during the spring and fall planting seasons incurred by El Dorado, the 34% increase in costs of natural gas sustained by Cherokee and the suspension of production at Cherokee resulting from the hurricanes in the U.S. Gulf as discussed above under "Overview-Chemical Business". Cherokee also incurred an increase of \$2.2 million of electricity costs primarily as the result of increased rates charged by their utility company. In addition in 2004, net settlements of \$1.5 million (which increased gross profit) were reached with insurance carriers relating to a vendor's faulty repair work to a chemical plant boiler.

As discussed above and previously reported, the Chemical Business' results were adversely affected as a result of the loss of production due to a mechanical failure of one of the four nitric acid plants at El Dorado. We recognized insurance recoveries of \$1.9 million under our business interruption insurance policy relating to this claim for 2005 which is recorded as a reduction to cost of sales. The negative impact on gross profit resulting from the lost production was approximately \$4.1 million in 2005 and approximately \$1.0 million in 2004.

See discussion above for products sold which are classified as "Other".

Operating Income (Loss)

See discussion above concerning the definition and use of operating income (loss) by industry segment by our chief operating decision makers. The following table contains certain information about our operating income (loss) for 2005 and 2004:

	2005	2004	Change
	(In thousands)		
Operating income (loss):			
Climate Control	\$ 14,097	\$ 11,707	\$ 2,390
Chemical	7,591	(2,038)	9,629
General corporate expense and other business operations, net	(6,835)	(7,586)	751
	\$ 14,853	\$ 2,083	\$ 12,770

**Operating Income - Climate Control:** The net increase in our Climate Control Business' operating income resulted primarily by selling, general and administrative expenses of \$1.4 million relating to MultiClima which were only incurred in the second quarter of 2004 and the net increase in gross profit of \$5.4 million as discussed above. This increase in operating income was partially offset by increased shipping and handling costs of \$1.0 million as a result of increased sales volume and rising fuel costs, increased professional fees of \$0.9 million primarily relating to litigation and related arbitrations between Trison and a customer (as discussed under "Climate Control Business" of Item 3), increased commissions of \$0.8 million due to increased

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sales volume, increased personnel costs of \$0.6 million due primarily to increased group health insurance costs and increased provision for losses on accounts receivable of \$0.5 million due primarily to lower than usual incidence in 2004 and the increased sales volumes in 2005.

**Operating Income (Loss) - Chemical:** The net increase in our Chemical Business' operating income included the net increase in gross profit of \$8.6 million as discussed above and gains of \$1.6 million from replacement cost property insurance recoveries which includes \$1.5 million of recoveries discussed under "Business Interruption and Property Insurance Claims" of Item 3 and a decrease in personnel costs of \$0.3 million as a result of a reduction in personnel at El Dorado. This increase was partially offset by an increase in handling costs of \$1.0 million due primarily to higher railcar lease and maintenance costs as the result of increasing the number of railcars used to support our agricultural business.

**General Corporate Expense and Other Business Operations, Net:** The decrease in our general corporate expense and other business operations, net relates primarily to an increase in gains of \$0.7 million from the sales of corporate assets, a decrease in professional fees of \$0.3 million which includes costs incurred during 2004 relating to a proposed unregistered offering of Senior Secured Notes which was terminated, a decrease of \$0.3 million of provisions for impairments on corporate assets and a decrease of approximately \$0.6 million due to other individually immaterial items. This decrease was partially offset by an increase in personnel costs of \$1.1 million which includes the recognition of death benefit obligations, an increase in group health insurance costs and net premium costs associated with key individual life insurance policies including policies associated with a death benefit agreement entered into with our CEO during the second quarter of 2005.

**Interest Expense** - Interest expense was \$11.4 million for 2005 compared to \$7.4 million for 2004. The increase of \$4.0 million relates primarily to interest expense incurred on the \$50.0 million term loan that was completed in September 2004 as discussed under "Loan Agreements - Terms and Conditions." A portion of the proceeds of the Senior Secured Loan was used to repay the outstanding balance under a former financing agreement ("Financing Agreement"). There was no interest expense recognition on the Financing Agreement indebtedness from May 2002 through September 2004 since that transaction was accounted for as a voluntary debt restructuring in 2002. This increase was partially offset due to the repurchase of \$5.0 million of the Senior Unsecured Notes in September 2004.

**Provision for Loss on Notes Receivable** - Based on our assessment of the liquidity and results of operations of MultiClima and its parent company, we concluded that the outstanding notes receivable were not recoverable. As a result, effective July 1, 2004, we forgave and cancelled the loan agreements in exchange for extending the Option's expiration date from June 15, 2005 to June 15, 2008 with an estimated value of zero. We recognized a provision for loss of \$1.4 million for 2004.

**Gain on Extinguishment of Debt** - As a result of the repayment in September 2004 of the Financing Agreement prior to the maturity date of June 30, 2005, we recognized the remaining unearned interest of \$4.4 million as a gain on extinguishment of debt.

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**Non-Operating Other Income, net** - Our non-operating other income, net was \$1.6 million for 2005 compared to \$2.4 million for 2004, a decrease of \$0.8 million. In 2005, we received net proceeds from life insurance policies of \$1.2 million. In addition, we recognized gains of \$0.2 million from the sales of certain current assets (primarily precious metals) in 2005 compared to gains of \$2.3 million in 2004.

**Loss from Discontinued Operations** - Net loss from discontinued operations in 2005 consists of provisions of \$0.6 million for our share of estimated environmental remediation costs to investigate and delineate a site in Hallowell, Kansas as a result of meetings held during 2005 with the KDHE. There are no income tax benefits related to these expenses.

**Cumulative Effect of Accounting Change** - Effective March 31, 2004, we included in our condensed consolidated balance sheet the consolidated assets and liabilities of the parent company of MultiClima as required under FIN 46. As a result, we recorded a cumulative effect of accounting change of \$0.5 million primarily relating to the elimination of embedded profit included in the cost of inventory which was purchased from MultiClima by certain of our subsidiaries. Effective July 1, 2004, we no longer had a variable interest in this entity and were no longer required to consolidate this entity.

**Cash Flow From Operating Activities**

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

For 2006, net cash provided by continuing operating activities was \$17.7 million, including net income (which includes insurance recoveries of \$0.9 million under our business interruption insurance policy), plus depreciation and amortization and other adjustments offset by cash used by changes in assets and liabilities.

Accounts receivable increased \$18.1 million relating primarily to the Climate Control Business as the result of increased sales of our heat pump products, large custom air handlers, and hydronic fan coils as discussed above under "Results of Operations."

Inventories increased a net \$7.3 million including:

- an increase of \$10.4 million relating to the Climate Control Business primarily relating to the increased cost of certain raw materials and the increased quantities of raw materials on hand due to increasing sales volume, partially offset by
- a decrease of \$3.2 million relating to the Chemical Business as the results of the decline in the average cost of anhydrous ammonia and natural gas in December 2006 compared to December 2005 and reduced inventory on hand at Cherokee due to a Turnaround performed in December 2006.

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Other supplies and prepaid items increased \$1.9 million primarily due to a net increase of \$1.4 million in precious metals as a result of the increased cost of precious metals and recoveries performed and additional precious metals purchased net of the amount consumed in the manufacturing process in the Chemical Business.

Accounts payable increased \$11.2 million primarily due to:

- an increase of \$5.4 million in our Climate Control Business resulting from increased production of our heat pump products, large custom air handlers, and hydronic fan coils, increased cost of certain raw materials, and increased levels of raw materials on hand and
- an increase of \$5.1 million in our Chemical Business resulting primarily from Baytown's property taxes and scheduled lease payments, costs incurred by Cherokee relating to a Turnaround performed in December 2006, and increased sales volume at Baytown in December 2006 compared to December 2005.

Customer deposits increased \$1.0 million primarily due to the increase in deposits received on sales commitments by Cherokee and as down payments on two customer orders of large air handlers in the Climate Control Business.

The increase in other current and noncurrent liabilities of \$3.9 million includes primarily:

- an increase of \$1.2 million of accrued commissions primarily as the result of increased sales volume in the Climate Control Business,
- an increase of \$1.0 million of deferred revenue on extended warranty contracts as the result of increased sales volume in the Climate Control Business,
- an increase in accrued contractual manufacturing obligations of \$1.0 million pursuant to EDC's supply agreement and EDNC's Bayer Agreement in the Chemical Business,
  - an increase of \$0.7 million in accrued payroll and benefits due primarily to an increase in the number of employees and to salary and wage incentives in the Climate Control Business,
  - an increase of \$0.6 million of accrued death benefits relating to our benefit agreements with certain key executives partially offset by,
- a decrease of \$1.1 million of accrued property and franchise taxes primarily due to Baytown's property taxes being processed and included in accounts payable at December 31, 2006 as discussed above.

**Cash Flow from Investing Activities**

Net cash used by continuing investing activities was \$18.4 million for 2006 which included \$14.7 million for capital expenditures of which \$7.7 million and \$7.0 million are for the benefit of our Climate Control Business and Chemical Business, respectively. In addition, we made deposits of \$3.5 million of current and noncurrent restricted cash which is to be used for capital expenditures in the Climate Control Business, working capital, and to fund an unrealized loss on exchange-traded contracts.

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**Cash Flow from Financing Activities**

Net cash used by continuing financing activities was \$1.4 million and primarily consisted of:

- the acquisition of \$13.3 million of the Notes as discussed above under “Loan Agreements - Terms and Conditions”,
  - payments of \$6.9 million on other long-term debt, and
  - payments of \$6.1 million on revolving debt facilities, net of proceeds, offset, in part, by
- proceeds of \$16.5 million from the Debentures, net of fees of \$1.5 million, as discussed above under “Loan Agreements - Terms and Conditions” and
  - net proceeds of \$8.2 million from other long-term debt.

**Off-Balance Sheet Arrangements**

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

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”). At December 31, 2006, our investment was \$3.3 million. For 2006, distributions received from this Partnership were \$0.9 million and our equity in earnings was \$0.8 million. As of December 31, 2006, the Partnership and general partner to the Partnership is indebted to a term lender (“Lender”) of the Project, in the amount of approximately \$5.3 million, net of restricted cash for debt service of \$0.9 million, with a term extending to December 2010 (“Loan”). CHI has pledged its limited partnership interest in the Partnership to the Lender as part of the 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 FIN 45. CHI has no recourse provisions or available collateral that would enable CHI to recover its partnership interest should the Lender be required to perform under this pledge.

**Aggregate Contractual Obligations**

Our aggregate contractual obligations as of December 31, 2006 are summarized in the following table.

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Contractual Obligations	Payments Due in the Year Ending December 31,						
	Total	2007	2008	2009	2010	2011	Thereafter
	(In thousands)						
<b>Long-term debt:</b>							
Working Capital Revolver Loan (1)	\$ 26,048	\$ 5,492	\$ -	\$ 20,556	\$ -	\$ -	\$ -
Senior Secured Loan due 2009	50,000	625	1,250	48,125	-	-	-
7% Convertible Senior Subordinated Notes	4,000	-	-	-	-	4,000	-
Capital leases	767	342	360	34	31	-	-
Other	16,877	5,120	2,293	954	1,047	1,079	6,384
<b>Total long-term debt</b>	<b>97,692</b>	<b>11,579</b>	<b>3,903</b>	<b>69,669</b>	<b>1,078</b>	<b>5,079</b>	<b>6,384</b>
Interest payments on long-term debt (2)	26,858	9,388	9,059	5,732	860	676	1,143
Capital expenditures (3)	8,169	8,169	-	-	-	-	-
<b>Operating leases:</b>							
Baytown lease	26,351	10,297	11,173	4,881	-	-	-
Other operating leases	12,052	3,120	2,244	1,794	1,226	819	2,849
Exchange-traded futures contracts	3,208	3,208	-	-	-	-	-
Accrued contractual manufacturing obligations	2,161	2,161	-	-	-	-	-
Purchase obligations	3,828	1,044	1,044	1,044	696	-	-
Contractual obligations included in noncurrent accrued and other liabilities	2,700	-	171	174	171	171	2,013
<b>Total</b>	<b>\$ 183,019</b>	<b>\$ 48,966</b>	<b>\$ 27,594</b>	<b>\$ 83,294</b>	<b>\$ 4,031</b>	<b>\$ 6,745</b>	<b>\$ 12,389</b>

(1) We primarily utilize a cash management system with a series of separate accounts consisting of several “zero-balance” disbursement accounts for funding of payroll and accounts payable. As a result of our cash management system, checks issued, but not presented to the banks for payment, may create negative book cash balances. These negative book cash balances are included in current portion of long-term debt since these accounts are primarily funded by our Working Capital Revolver Loan.

(2) The estimated interest payments relating to variable interest rate debt are based on the effective interest rates at December 31, 2006. In addition, we used the balance of the Working Capital Revolver Loan at December 31,

2006 as the average outstanding balance of the Working Capital Revolver Loan through maturity.

- (3) Capital expenditures include only non-discretionary amounts in our 2007 capital expenditure budget. These amounts do not include, as discussed in “Environmental Matters” under Item 1, an estimated range from \$0.8 million to \$2.8 million as required under a NPDES permit effective June 2007 based on current assumptions and an estimated \$2.5 million to \$4.0 million over the next four years relating to the Air CAO.

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**Availability of Company's Loss Carry-Overs**

For a discussion on our net operating loss carry-overs, see Note 13 of Notes to Consolidated Financial Statements.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

We have included the financial statements and supplementary financial information required by this item immediately following Part IV of this report and hereby incorporate by reference the relevant portions of those statements and information into this Item 8.

As fully discussed under “Explanatory Introduction Note” on page 1 of this Form 10-K/A and in Note 2 of Notes to Consolidated Financial Statements, we amended and adjusted the accompanying consolidated financial statements and the financial statement schedules I and II.

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PART IV

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

**(a) (1) Financial Statements (As Adjusted)**

The following consolidated financial statements of the Company appear immediately following this Part IV:

	<b>Pages</b>
Report of Independent Registered Public Accounting Firm	F- 2
Consolidated Balance Sheets at December 31, 2006 and 2005 (As Adjusted)	F-3 to F-4
Consolidated Statements of Income for each of the three years in the period ended December 31, 2006 (As Adjusted)	F-5
Consolidated Statements of Stockholders' Equity for each of the three years in the period ended December 31, 2006 (As Adjusted)	F-6
Consolidated Statements of Cash Flows for each of the three years in the period ended December 31, 2006 (As Adjusted)	F-7 to F-8
Notes to Consolidated Financial Statements (As Adjusted)	F-9 to F-66
Quarterly Financial Data (As Adjusted and Unaudited)	F-67 to F-72

**(a) (2) Financial Statement Schedules**

The Company has included the following schedules in this report:

I - Condensed Financial Information of Registrant (As Adjusted)	F-73 to F-76
II - Valuation and Qualifying Accounts (As Adjusted)	F-77

We have omitted all other schedules because the conditions requiring their filing do not exist or because the required information appears in our Consolidated Financial Statements (As Adjusted), including the notes to those statements.

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**(a)(3) Exhibits**

- 3.1 Restated Certificate of Incorporation, filed September 2, 1987 \*.
- 3.2 Certificate of Designations, filed February 21, 1989 \*.
- 3.3 Certificate of Elimination, filed May 13, 1993 \*.
- 3.4 Certificate of Designations, filed May 21, 1993 \*.
- 3.5 Certificate of Amendment, filed September 3, 1993 \*.
- 3.6 Certificate of Change of Registered Agent, filed November 24, 1998 \*.
- 3.7 Certificate of Designations, filed February 5, 1999 \*.
- 3.8 Certificate of Elimination, filed April 16, 1999 \*.
- 3.9 Certificate of Designations, filed November 15, 2001 \*.
- 3.10 Certificate of Amendment to Certificate of Designations of the \$3.25 Convertible Exchangeable Class C Preferred Stock, Series 2, filed March 6, 2007 \*.
- 3.11 Bylaws, as amended, which the Company hereby incorporates by reference from Exhibit 3(ii) to the Company's Form 10-Q for the quarter ended June 30, 1998. See SEC file number 001-07677
- 4.1 Specimen Certificate for the Company's Non-cumulative Preferred Stock, having a par value of \$100 per share which the Company incorporates by reference from Exhibit 4.1 to the Company's Form 10-K for the fiscal year ended December 31, 2005.
- 4.2 Specimen Certificate for the Company's Series B Preferred Stock, having a par value of \$100 per share, which the Company hereby incorporates by reference from Exhibit 4.27 to the Company's Registration Statement No. 33-9848.
- 4.3 Specimen Certificate for the Company's Series 2 Preferred, which the Company hereby incorporates by reference from Exhibit 4.5 to the Company's Registration Statement No. 33-61640.
- 4.4 Specimen of Certificate of Series D 6% Cumulative, Convertible Class C Preferred Stock which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2001.

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- 4.5 Specimen Certificate for the Company's Common Stock, which the Company incorporates by reference from Exhibit 4.4 to the Company's Registration Statement No. 33-61640.
- 4.6 Renewed Rights Agreement, dated January 6, 1999 between the Company and Bank One, N.A., which the Company hereby incorporates by reference from Exhibit No. 1 to the Company's Form 8-A Registration Statement, dated January 27, 1999.
- 4.7 Loan and Security Agreement, dated April 13, 2001 by and among LSB Industries, Inc., ThermaClime and each of its Subsidiaries that are Signatories, the Lenders that are Signatories and Foothill Capital Corporation, which the Company hereby incorporates by reference from Exhibit 10.51 to ThermaClime, Inc.'s amendment No. 1 to Form 10-K for the fiscal year ended December 31, 2000. See SEC file number 001-07677
- 4.8 Second Amendment to Loan and Security Agreement, dated May 24, 2002 by and among the Company, LSB, certain subsidiaries of the Company, Foothill Capital Corporation and Congress Financial Corporation (Southwest), which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 8-K, dated May 24, 2002. Omitted are exhibits and schedules attached thereto. The Agreement contains a list of such exhibits and schedules, which the Company agrees to file with the Commission supplementally upon the Commission's request.
- 4.9 Third Amendment, dated as of November 18, 2002 to the Loan and Security Agreement dated as of April 13, 2001 as amended by the First Amendment dated as of August 3, 2001 and the second Amendment dated as of May 24, 2002 by and among LSB Industries, Inc., ThermaClime, Inc., and certain subsidiaries of ThermaClime, Congress Financial Corporation (Southwest) and Foothill Capital Corporation which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2002.
- 4.10 Fourth Amendment, dated as of March 3, 2003 to the Loan and Security Agreement dated as of April 13, 2001 as amended by the First, Second, and Third Amendments, by and among LSB Industries, Inc., ThermaClime, Inc., and certain subsidiaries of ThermaClime, Inc., Congress Financial Corporation (Southwest) and Foothill Capital Corporation, which the Company hereby incorporates by reference from Exhibit 4.18 to the Company's Form 10-K for the fiscal year ended December 31, 2002.
- 4.11 Fifth Amendment, dated as of December 31, 2003 to the Loan and Security Agreement dated as of April 13, 2001 as amended by the First, Second, Third and Fourth Amendments, by and among LSB Industries, Inc., ThermaClime, Inc., and certain subsidiaries of ThermaClime, Inc., Congress Financial Corporation (Southwest) and Wells Fargo Foothill, Inc., which the Company hereby incorporates by reference from Exhibit 4.15 to the Company's Form 10-K for the fiscal year ended December 31, 2004.
- 4.12 Waiver and Consent, dated March 25, 2004 to the Loan and Security Agreement, dated as of April 13, 2001 (as amended to date), by and among LSB Industries, Inc., ThermaClime, Inc., and certain subsidiaries of ThermaClime, Inc. and Wells Fargo Foothill, Inc. which the Company hereby incorporates by reference from Exhibit 4.16

to the Company's Form 10-K for the fiscal year ended December 31, 2004.

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- 4.13Sixth Amendment, dated as of June 29, 2004 to the Loan and Security Agreement dated as of April 13, 2001 as amended, by and among LSB Industries, Inc., ThermaClime, Inc. and certain subsidiaries of ThermaClime, Inc., Congress Financial Corporation (Southwest) and Wells Fargo Foothill, Inc., which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2004.
- 4.14Seventh Amendment, dated as of September 15, 2004 to the Loan and Security Agreement dated as of April 13, 2001 as amended, by and among LSB Industries, Inc., ThermaClime, Inc. and certain subsidiaries of ThermaClime, Inc., Congress Financial Corporation (Southwest) and Wells Fargo Foothill, Inc., which the Company hereby incorporates by reference from Exhibit 4.2 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2004.
- 4.15Eighth Amendment to Loan and Security Agreement, dated February 28, 2005, between LSB Industries, Inc., ThermaClime, Inc., the subsidiaries of ThermaClime, Inc. that are signatories thereto, and Wells Fargo Foothill, Inc., as arranger and administrative agent for various lenders, which the Company hereby incorporates by reference from Exhibit 10.1 to the Company's Form 8-K, dated February 28, 2005.
- 4.16Ninth amendment to Loan and Security Agreement, dated February 22, 2006, between LSB Industries, Inc., ThermaClime, Inc., the subsidiaries of ThermaClime, Inc. that are signatories thereto, and Wells Fargo Foothill, Inc., as arranger and administrative agent for various lenders which the Company hereby incorporates by reference from Exhibit 4.20 to the Company's Form 10-K for the year ended December 31, 2005.
- 4.17Wells Fargo Foothill consent, dated May 5, 2006 to the redemption of the Senior Notes by ThermaClime which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 10-Q for the fiscal quarter ended June 30, 2006.
- 4.18Tenth amendment to Loan and Security Agreement, dated March 21, 2007, between LSB Industries, Inc., ThermaClime, Inc., the subsidiaries of ThermaClime, Inc. that are signatories thereto, and Wells Fargo Foothill, Inc., as arranger and administrative agent for various lenders \*.
- 4.19Loan Agreement, dated September 15, 2004 between ThermaClime, Inc. and certain subsidiaries of ThermaClime, Inc., Cherokee Nitrogen Holdings, Inc., Orix Capital Markets, L.L.C. and LSB Industries, Inc. ("Loan Agreement") which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 8-K, dated September 16, 2004. The Loan Agreement lists numerous Exhibits and Schedules that are attached thereto, which will be provided to the Commission upon the commission's request.
- 4.20First Amendment, dated February 18, 2005 to Loan Agreement, dated as of September 15, 2004, among ThermaClime, Inc., and certain subsidiaries of ThermaClime, Cherokee Nitrogen Holdings, Inc., and Orix Capital Markets, L.L.C. which the Company hereby incorporates by reference from Exhibit 4.21 to the Company's Form 10-K for the year ended December 31, 2004.



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- 4.21 Waiver and Consent, dated as of January 1, 2006 to the Loan Agreement dated as of September 15, 2004 among ThermaClime, Inc., and certain subsidiaries of ThermaClime, Inc., Cherokee Nitrogen Holdings, Inc., Orix Capital Markets, L.L.C. and LSB Industries, Inc. which the Company hereby incorporates by reference from Exhibit 4.23 to the Company's Form 10-K for the year ended December 31, 2005.
- 4.22 Consent of Orix Capital Markets, LLC and the Lenders of the Senior Credit Agreement, dated May 12, 2006, to the interest rate of a loan between LSB and ThermaClime and the utilization of the loan proceeds by ThermaClime and the waiver of related covenants which the Company hereby incorporates by reference from Exhibit 4.2 to the Company's Form 10-Q for the fiscal quarter ended June 30, 2006.
- 4.23 Indenture, dated March 3, 2006, by and among the Company and UMB Bank, which the Company hereby incorporates by reference from Exhibit 99.2 to the Company's Form 8-K, dated March 14, 2006.
- 4.24 Certificate of 7% Senior Subordinated Convertible Debentures which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 8-K, dated March 14, 2006.
- 10.1 Limited Partnership Agreement dated as of May 4, 1995 between the general partner, and LSB Holdings, Inc., an Oklahoma Corporation, as limited partner which the Company hereby incorporates by reference from Exhibit 10.11 to the Company's Form 10-K for the fiscal year ended December 31, 1995. See SEC file number 001-07677.
- 10.2 Form of Death Benefit Plan Agreement between the Company and the employees covered under the plan, which the Company incorporates by reference from Exhibit 10.2 to the company's Form 10-K for the fiscal year ended December 31, 2005.
- 10.3 The Company's 1993 Stock Option and Incentive Plan, which the Company incorporates by reference, which the Company incorporates by reference from Exhibit 10.3 to the company's Form 10-K for the fiscal year ended December 31, 2005.
- 10.4 First Amendment to Non-Qualified Stock Option Agreement, dated March 2, 1994 and Second Amendment to Stock Option Agreement, dated April 3, 1995 each between the Company and Jack E. Golsen, which the Company hereby incorporates by reference from Exhibit 10.1 to the Company's Form 10-Q for the fiscal quarter ended March 31, 1995. See SEC file number 001-07677.
- 10.5 Non-Qualified Stock Option Agreement, dated April 22, 1998 between the Company and Robert C. Brown, M.D., which the Company hereby incorporates by reference from Exhibit 10.43 to the Company's Form 10-K for the fiscal year ended December 31, 1998. The Company entered into substantially identical agreements with Bernard G. Ille, Raymond B. Ackerman, Horace G. Rhodes, and Donald W. Munson. The Company will provide copies of these agreements to the Commission upon request. See SEC file number 001-07677.



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- 10.6 The Company's 1998 Stock Option and Incentive Plan, which the Company hereby incorporates by reference from Exhibit 10.44 to the Company's Form 10-K for the year ended December 31, 1998. See SEC file number 001-07677.
- 10.7 LSB Industries, Inc. 1998 Stock Option and Incentive Plan, which the Company hereby incorporates by reference from Exhibit "B" to the LSB Proxy Statement, dated May 24, 1999 for Annual Meeting of Stockholders. See SEC file number 001-07677.
- 10.8 LSB Industries, Inc. Outside Directors Stock Option Plan, which the Company hereby incorporates by reference from Exhibit "C" to the LSB Proxy Statement, dated May 24, 1999 for Annual Meeting of Stockholders. See SEC file number 001-07677.
- 10.9 Nonqualified Stock Option Agreement, dated November 7, 2002 between the Company and John J. Bailey Jr, which the Company hereby incorporates by reference from Exhibit 55 to the Company's Form 10-K/A Amendment No.1 for the fiscal year ended December 31, 2002.
- 10.10 Nonqualified Stock Option Agreement, dated November 29, 2001 between the Company and Dan Ellis, which the Company hereby incorporates by reference from Exhibit 10.56 to the Company's Form 10-K/A Amendment No.1 for the fiscal year ended December 31, 2002.
- 10.11 Nonqualified Stock Option Agreement, dated July 20, 2000 between the Company and Claude Rappaport for the purchase of 80,000 shares of common stock, which the Company hereby incorporates by reference from Exhibit 10.57 to the Company's Form 10-K/A Amendment No.1 for the fiscal year ended December 31, 2002. Substantially similar nonqualified stock option agreements were entered into with Mr. Rappaport (40,000 shares at an exercise price of \$1.25 per share, expiring on July 20, 2009), (5,000 shares at an exercise price of \$5.362 per share, expiring on July 20, 2007), and (60,000 shares at an exercise price of \$1.375 per share, expiring on July 20, 2009), copies of which will be provided to the Commission upon request.
- 10.12 Nonqualified Stock Option Agreement, dated July 8, 1999 between the Company and Jack E. Golsen, which the Company hereby incorporates by reference from Exhibit 10.58 to the Company's Form 10-K/A Amendment No.1 for the fiscal year ended December 31, 2002. Substantially similar nonqualified stock options were granted to Barry H. Golsen (55,000 shares), Stephen J. Golsen (35,000 shares), David R. Goss (35,000 shares), Tony M. Shelby (35,000 shares), David M. Shear (35,000 shares), Jim D. Jones (35,000 shares), and four other employees (130,000 shares), copies of which will be provided to the Commission upon request.
- 10.13 Severance Agreement, dated January 17, 1989 between the Company and Jack E. Golsen, which the Company hereby incorporates by reference from Exhibit 10.13 to the Company's Form 10-K for the year ended December 31, 2005. The Company also entered into identical agreements with Tony M. Shelby, David R. Goss, Barry H. Golsen, David M. Shear, and Jim D. Jones and the Company will provide copies thereof to the Commission upon request.



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- 10.14 Employment Agreement and Amendment to Severance Agreement dated January 12, 1989 between the Company and Jack E. Golsen, dated March 21, 1996 which the Company hereby incorporates by reference from Exhibit 10.15 to the Company's Form 10-K for fiscal year ended December 31, 1995. See SEC file number 001-07677.
- 10.15 First Amendment to Employment Agreement, dated April 29, 2003 between the Company and Jack E. Golsen, which the Company hereby incorporates by reference from Exhibit 10.52 to the Company's Form 10-K/A Amendment No.1 for the fiscal year ended December 31, 2002.
- 10.16 Baytown Nitric Acid Project and Supply Agreement dated June 27, 1997 by and among El Dorado Nitrogen Company, El Dorado Chemical Company and Bayer Corporation which the Company hereby incorporates by reference from Exhibit 10.2 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #5551, DATED SEPTEMBER 25, 1997 GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.** See SEC file number 001-07677.
- 10.17 First Amendment to Baytown Nitric Acid Project and Supply Agreement, dated February 1, 1999 between El Dorado Nitrogen Company and Bayer Corporation, which the Company hereby incorporates by reference from Exhibit 10.30 to the Company's Form 10-K for the year ended December 31, 1998. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #7927, DATED JUNE 9, 1999 GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.** See SEC file number 001-07677.
- 10.18 Service Agreement, dated June 27, 1997 between Bayer Corporation and El Dorado Nitrogen Company which the Company hereby incorporates by reference from Exhibit 10.3 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #5551, DATED SEPTEMBER 25, 1997, GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.** See SEC file number 001-07677.
- 10.19 Ground Lease dated June 27, 1997 between Bayer Corporation and El Dorado Nitrogen Company which the Company hereby incorporates by reference from Exhibit 10.4 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #5551, DATED SEPTEMBER 25, 1997 GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.** See SEC file number 001-07677.



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- 10.20 Participation Agreement, dated as of June 27, 1997 among El Dorado Nitrogen Company, Boatmen's Trust Company of Texas as Owner Trustee, Security Pacific Leasing Corporation, as Owner Participant and a Construction Lender, Wilmington Trust Company, Bayerische Landes Bank, New York Branch, as a Construction Lender and the Note Purchaser, and Bank of America National Trust and Savings Association, as Construction Loan Agent which the Company hereby incorporates by reference from Exhibit 10.5 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #5551, DATED SEPTEMBER 25, 1997 GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.** See SEC file number 001-07677.
- 10.21 Lease Agreement, dated as of June 27, 1997 between Boatmen's Trust Company of Texas as Owner Trustee and El Dorado Nitrogen Company which the Company hereby incorporates by reference from Exhibit 10.6 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. See SEC file number 001-07677.
- 10.22 Security Agreement and Collateral Assignment of Construction Documents, dated as of June 27, 1997 made by El Dorado Nitrogen Company which the Company hereby incorporates by reference from Exhibit 10.7 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. See SEC file number 001-07677.
- 10.23 Security Agreement and Collateral Assignment of Facility Documents, dated as of June 27, 1997 made by El Dorado Nitrogen Company and consented to by Bayer Corporation which the Company hereby incorporates by reference from Exhibit 10.8 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. See SEC file number 001-07677.
- 10.24 Loan Agreement dated December 23, 1999 between Climate Craft, Inc. and the City of Oklahoma City, which the Company hereby incorporates by reference from Exhibit 10.49 to the Company's Amendment No. 2 to its 1999 Form 10-K. See SEC file number 001-07677.
- 10.25 Assignment, dated May 8, 2001 between Climate Master, Inc. and Prime Financial Corporation, which the Company hereby incorporates by reference from Exhibit 10.2 to the Company's Form 10-Q for the fiscal quarter ended March 31, 2001.
- 10.26 Agreement for Purchase and Sale, dated April 10, 2001 by and between Prime Financial Corporation and Raptor Master, L.L.C. which the Company hereby incorporates by reference from Exhibit 10.3 to the Company's Form 10-Q for the fiscal quarter ended March 31, 2001.
- 10.27 Amended and Restated Lease Agreement, dated May 8, 2001 between Raptor Master, L.L.C. and Climate Master, Inc. which the Company hereby incorporates by reference from Exhibit 10.4 to the Company's Form 10-Q for the fiscal quarter ended March 31, 2001.



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- 10.28 Option Agreement, dated May 8, 2001 between Raptor Master, L.L.C. and Climate Master, Inc., which the Company hereby incorporates by reference from Exhibit 10.5 to the Company's Form 10-Q for the fiscal quarter ended March 31, 2001.
- 10.29 Stock Purchase Agreement, dated September 30, 2001 by and between Summit Machinery Company and SBL Corporation, which the Company hereby incorporates by reference from Exhibit 10.1 to the Company' Form 10-Q for the fiscal quarter ended September 30, 2001.
- 10.30 Asset Purchase Agreement, dated October 22, 2001 between Orica USA, Inc. and El Dorado Chemical Company and Northwest Financial Corporation, which the Company hereby incorporates by reference from Exhibit 99.1 to the Company's Form 8-K dated December 28, 2001. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF 12179, DATED MAY 24, 2006, GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.**
- 10.31 AN Supply Agreement, dated November 1, 2001 between Orica USA, Inc. and El Dorado Company, which the Company hereby incorporates by reference from Exhibit 99.2 to the Company's Form 8-K dated December 28, 2001. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF 12179, DATED MAY 24, 2006, GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.**
- 10.32 Second Amendment to AN Supply Agreement, executed August 24, 2006, to be effective as of January 1, 2006, between Orica USA, Inc. and El Dorado Company which the Company hereby incorporates by reference from Exhibit 10.1 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2006. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST.**
- 10.33 Agreement, dated August 1, 2004, between El Dorado Chemical Company and Paper, Allied-Industrial, Chemical and Energy Workers International Union AFL-CIO and its Local 5-434, which the Company hereby incorporates by reference from Exhibit 10.36 to the Company's Form 10-K for the fiscal year ended December 31, 2004.
- 10.34 Agreement, dated October 17, 2004, between El Dorado Chemical Company and International Association of Machinists and Aerospace Workers, AFL-CIO Local No. 224, which the Company hereby incorporates by reference from Exhibit 10.37 to the

Company's Form 10-K for the fiscal year ended December 31, 2004.

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- 10.35 Agreement, dated November 12, 2004, between The United Steelworkers of America International Union, AFL-CIO, CLC, Cherokee Local No. 417-G and Cherokee Nitrogen Division of El Dorado Chemical Company, which the Company hereby incorporates by reference from Exhibit 10.38 to the Company's Form 10-K for the fiscal year ended December 31, 2004.
- 10.36 Warrant, dated May 24, 2002 granted by the Company to a Lender for the right to purchase up to 132,508 shares of the Company's common stock at an exercise price of \$0.10 per share, which the Company hereby incorporates by reference from Exhibit 99.1 to the Company's Form 8-K, dated May 24, 2002. Four substantially similar Warrants, dated May 24, 2002 for the purchase of an aggregate additional 463,077 shares at an exercise price of \$0.10 were issued. Copies of these Warrants will be provided to the Commission upon request.
- 10.37 Asset Purchase Agreement, dated as of December 6, 2002 by and among Energetic Systems Inc. LLC, UTec Corporation, LLC, SEC Investment Corp. LLC, DetaCorp Inc. LLC, Energetic Properties, LLC, Slurry Explosive Corporation, Universal Tech Corporation, El Dorado Chemical Company, LSB Chemical Corp., LSB Industries, Inc. and Slurry Explosive Manufacturing Corporation, LLC, which the Company hereby incorporates by reference from Exhibit 2.1 to the Company's Form 8-K, dated December 12, 2002. The asset purchase agreement contains a brief list identifying all schedules and exhibits to the asset purchase agreement. Such schedules and exhibits are not filed herewith, and the Registrant agrees to furnish supplementally a copy of the omitted schedules and exhibits to the commission upon request.
- 10.38 Anhydrous Ammonia Sales Agreement, dated effective January 3, 2005 between Koch Nitrogen Company and El Dorado Chemical Company which the Company hereby incorporates by reference from Exhibit 10.41 to the Company's Form 10-K for the year ended December 31, 2004. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST.**
- 10.39 First Amendment to Anhydrous Ammonia Sales Agreement, dated effective August 29, 2005, between Koch Nitrogen Company and El Dorado Chemical Company, which the Company hereby incorporates by reference from Exhibit 10.42 to the Company's Form 10-K for the fiscal year ended December 31, 2005, filed March 31, 2006. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST.**



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- 10.40 Purchase Confirmation, dated July 1, 2006, between Koch Nitrogen Company and Cherokee Nitrogen Company. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST. \***
- 10.41 Second Amendment to Anhydrous Ammonia Sales Agreement, dated November 3, 2006, between Koch Nitrogen Company and El Dorado Chemical Company. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST. \***
- 10.42 Warrant Agreement, dated March 25, 2003 between LSB Industries, Inc. and Jayhawk Institutional Partners, L.P., which the Company hereby incorporates by reference from Exhibit 10.51 to the Company's Form 10-K for the fiscal year ended December 31, 2002.
- 10.43 Registration Rights Agreement, dated March 25, 2003 among LSB Industries, Inc., Kent C. McCarthy, Jayhawk Capital management, L.L.C., Jayhawk Investments, L.P. and Jayhawk Institutional Partners, L.P., which the Company hereby incorporates by reference from Exhibit 10.49 to the Company's Form 10-K for the fiscal year ended December 31, 2002.
- 10.44 Subscription Agreement, dated March 25, 2003 by and between LSB Industries, Inc. and Jayhawk Institutional Partners, L.P., which the Company hereby incorporates by reference from Exhibit 10.50 to the Company's Form 10-K for the fiscal year ended December 31, 2002.
- 10.45 Agreement, dated November 10, 2006 by and among LSB Industries, Inc., Kent C. McCarthy, Jayhawk Capital Management, L.L.C., Jayhawk Institutional Partners, L.P. and Jayhawk Investments, L.P., which the Company hereby incorporates by reference from Exhibit 99d1 to the Company's Schedule TO-I, filed February 9, 2007.
- 10.46 Second Amendment and Extension of Stock Purchase Option, effective July 1, 2004, between LSB Holdings, Inc., an Oklahoma corporation and Dr. Hauri AG, a Swiss corporation, which the Company hereby incorporates by reference from Exhibit 10.1 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2004.

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- 10.47Debt Forgiveness Agreement, effective July 1, 2004, by and between Companie Financiere du Taraois, a French corporation and LSB Holding, Inc., an Oklahoma corporation which the Company hereby incorporates by reference from Exhibit 10.2 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2004.
- 10.48Purchase Agreement, dated March 3, 2006, by and among the Company and the investors identified on the Schedule of Purchasers which the Company hereby incorporates by reference from Exhibit 99.1 to the Company's Form 8-K, dated March 14, 2006.
- 10.49Registration Rights Agreement, dated March 3, 2006, by and among the Company and the Purchasers set fourth in the signature pages which the Company hereby incorporates by reference from Exhibit 99.3 to the Company's Form 8-K, dated March 14, 2006.
- 10.50Exchange Agreement, dated October 6, 2006, between LSB Industries, Inc., Paul Denby, Trustee of the Paul Denby Revocable Trust, U.A.D. 10/12/93, The Paul J. Denby IRA, Denby Enterprises, Inc., Tracy Denby, and Paul Denby which the Company hereby incorporates by reference from Exhibit 10.2 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2006. Substantially similar Exchange Agreements (each having the same exchange rate) were entered with the following individuals or entities on the dates indicated for the exchange of the number of shares of LSB's \$3.25 Convertible Exchangeable Class C Preferred Stock, Series 2 (the "Series 2 Preferred") noted: October 6, 2006 - James W. Sight (35,428 shares of Series 2 Preferred), Paul Denby, Trustee of the Paul Denby Revocable Trust, U.A.D. 10/12/93 (25,000 shares of Series 2 Preferred), The Paul J. Denby IRA (11,000 shares of Series 2 Preferred), Denby Enterprises, Inc. (4,000 shares of Series 2 Preferred), Tracy Denby (1,000 shares of Series 2 Preferred); October 12, 2006 - Harold Seidel (10,000 shares of Series 2 Preferred); October 11, 2006 -Brent Cohen (4,000 shares of Series 2 Preferred), Brian J. Denby and Mary Denby (1,200 shares of Series 2 Preferred), Brian J. Denby, Trustee, Money Purchase Pension Plan (5,200 shares of Series 2 Preferred), Brian Denby, Inc. Profit Sharing Plan (600 shares of Series 2 Preferred); October 25, 2006 - William M. and Laurie Stern ( 400 shares of Series 2 Preferred), William M. Stern Revocable Living Trust, UTD July 9, 1992 (1,570 shares of Series 2 Preferred), the William M. Stern IRA (2,000 shares of Series 2 Preferred), and William M. Stern, Custodian for David Stern (1,300 shares of Series 2 Preferred), John Cregan (500 shares of Series 2 Preferred), and Frances Berger (1,350 shares of Series 2 Preferred). Copies of the foregoing Exchange Agreements will be provided to the Commission upon request.
- 14.1Code of Ethics for CEO and Senior Financial Officers of Subsidiaries of LSB Industries, Inc., which the Company hereby incorporates by reference from Exhibit 14.1 to the Company's Form 10-K for the fiscal year ended December 31, 2003.
- 21.1Subsidiaries of the Company \*.
- 23.1Consent of Independent Registered Public Accounting Firm.



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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.

\* Filed as an exhibit to the Company's original Form 10-K for the fiscal year ended December 31, 2006



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Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Dated: By: /s/ Jack E. Golsen  
July 18, 2007 Jack E. Golsen, Director

Dated: By: /s/ Tony M. Shelby  
July 18, 2007 Tony M. Shelby, Director

Dated: By: /s/ David R. Goss  
July 18, 2007 David R. Goss, Director

Dated: By: /s/ Barry H. Golsen  
July 18, 2007 Barry H. Golsen, Director

Dated: By: /s/ Robert C. Brown MD  
July 18, 2007 Robert C. Brown MD, Director

Dated: By: /s/ Bernard G. Ille  
July 18, 2007 Bernard G. Ille, Director

Dated: By: /s/  
July 18, 2007 Raymond B. Ackerman, Director

Dated: By: /s/ Horace G. Rhodes  
July 18, 2007 Horace G. Rhodes, Director

Dated: By: /s/ Donald W. Munson  
July 18, 2007 Donald W. Munson, Director

Dated: By: /s/ Charles A. Burtch  
July 18, 2007 Charles A. Burtch, Director

Dated: By: /s/ John A. Shelley  
July 18, 2007 John A. Shelley, Director

Dated: By: /s/ Grant J. Donovan  
July 18, 2007 Grant J. Donovan, Director

Dated: By: /s/ N. Allen Ford  
July 18, 2007 N. Allen Ford, Director

LSB Industries, Inc.

Consolidated Financial Statements  
for Inclusion in Form 10-K/A  
Amendment No.1  
Years ended December 31, 2006, 2005 and 2004

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Report of Independent Registered  
Public Accounting Firm

The Board of Directors and Stockholders of LSB Industries, Inc.

We have audited the accompanying consolidated balance sheets of LSB Industries, Inc. as of December 31, 2006 and 2005, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2006. Our audits also included the financial statement schedules listed in the Index at Item 15(a)(2). These financial statements and schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audits also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of LSB Industries, Inc. at December 31, 2006 and 2005, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 2 to the consolidated financial statements, the consolidated balance sheets as of December 31, 2006 and 2005 and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2006 have been adjusted to appropriately reflect the change in the Company's method of accounting for planned major maintenance activities and Schedules I and II as listed in the Index at Item 15(a)(2) have been amended to be consistent with the adjusted amounts.

ERNST & YOUNG LLP

Oklahoma City, Oklahoma

March 23, 2007, except for Notes 2, 3, 10, 13 and 21

and the financial statements schedules listed in the

Index at Item 15(a)(2) as to which the date is July 16, 2007

## LSB Industries, Inc.

Consolidated Balance Sheets  
(As adjusted, see Note 2)

	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
	(In Thousands)	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 2,255	\$ 4,653
Restricted cash	2,479	177
Accounts receivable, net	67,571	49,437
Inventories	45,449	37,271
Supplies, prepaid items and other:		
Prepaid insurance	3,443	3,453
Precious metals	6,406	4,987
Supplies	3,424	3,050
Other	1,468	1,382
Total supplies, prepaid items and other	14,741	12,872
Total current assets	132,495	104,410
Property, plant and equipment, net	76,404	74,082
Other assets:		
Noncurrent restricted cash	1,202	-
Debt issuance and other debt-related costs, net	2,221	2,573
Investment in affiliate	3,314	3,368
Goodwill	1,724	1,724
Other, net	2,567	2,806
Total other assets	11,028	10,471
	<b>\$ 219,927</b>	<b>\$ 188,963</b>

(Continued on following page)

## LSB Industries, Inc.

Consolidated Balance Sheets (continued)  
(As adjusted, see Note 2)

	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
	(In Thousands)	
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 42,870	\$ 31,687
Short-term financing and drafts payable	2,986	2,790
Accrued and other liabilities	26,816	21,970
Current portion of long-term debt	11,579	7,088
Total current liabilities	84,251	63,535
Long-term debt	86,113	105,036
Noncurrent accrued and other liabilities	5,929	5,531
Commitments and contingencies (Note 14)		
Stockholders' equity:		
Series B 12% cumulative, convertible preferred stock, \$100 par value; 20,000 shares issued and outstanding; aggregate liquidation preference of \$3,650,400 in 2006 (\$3,440,000 in 2005)	2,000	2,000
Series 2 \$3.25 convertible, exchangeable Class C preferred stock, \$50 stated value; 517,402 shares issued (623,550 in 2005); aggregate liquidation preference of \$37,836,070 in 2006 (\$43,963,406 in 2005)	25,870	31,177
Series D 6% cumulative, convertible Class C preferred stock, no par value; 1,000,000 shares issued; aggregate liquidation preference of \$1,300,000 in 2006 (\$1,240,000 in 2005)	1,000	1,000
Common stock, \$.10 par value; 75,000,000 shares authorized, 20,215,339 shares issued (17,082,265 in 2005)	2,022	1,708
Capital in excess of par value	79,838	57,547
Accumulated other comprehensive loss	(701)	(990)
Accumulated deficit	(47,962)	(60,333)
	62,067	32,109
Less treasury stock, at cost:		
Series 2 preferred, 18,300 shares	797	797
Common stock, 3,447,754 shares (3,321,607 in 2005)	17,636	16,451
Total stockholders' equity	43,634	14,861
	\$ 219,927	\$ 188,963

See accompanying notes.

## LSB Industries, Inc.

Consolidated Statements of Income  
(As adjusted, see Note 2)

**Year ended December 31,**  
**2006                      2005                      2004**  
(In Thousands, Except Per Share  
Amounts)

Net sales	<b>\$ 491,952</b>	\$ 397,115	\$ 363,984
Cost of sales	<b>401,090</b>	330,349	311,362
Gross profit	<b>90,862</b>	66,766	52,622
Selling, general and administrative expense	<b>64,134</b>	53,453	49,891
Provisions for losses on accounts receivable	<b>426</b>	810	211
Other expense	<b>722</b>	332	1,111
Other income	<b>(1,559)</b>	(2,682)	(674)
Operating income	<b>27,139</b>	14,853	2,083
Interest expense	<b>11,915</b>	11,407	7,393
Provision for loss on notes receivable	-	-	1,447
Gains on extinguishment of debt	-	-	(4,400)
Non-operating other income, net	<b>(624)</b>	(1,561)	(2,434)
Income from continuing operations before provision for income taxes, equity in earnings of affiliate and cumulative effect of accounting change	<b>15,848</b>	5,007	77
Provision for income taxes	<b>901</b>	118	-
Equity in earnings of affiliate	<b>(821)</b>	(745)	(668)
Income from continuing operations before cumulative effect of accounting change	<b>15,768</b>	5,634	745
Net loss from discontinued operations	<b>253</b>	644	-
Cumulative effect of accounting change	-	-	536
Net income	<b>15,515</b>	4,990	209
Dividend requirements and stock dividend on preferred stock	<b>2,630</b>	2,283	2,322
Net income (loss) applicable to common stock	<b>\$ 12,885</b>	\$ 2,707	\$ (2,113)
Income (loss) per common share:			
Basic:			
Income (loss) from continuing operations before cumulative effect of accounting change	<b>\$ .92</b>	\$ .25	\$ (.12)
Net loss from discontinued operations	<b>(.02)</b>	(.05)	-
Cumulative effect of accounting change	-	-	(.04)
Net income (loss)	<b>\$ .90</b>	\$ .20	\$ (.16)
Diluted:			
Income (loss) from continuing operations before cumulative effect of accounting change	<b>\$ .77</b>	\$ .22	\$ (.12)

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Net loss from discontinued operations	(.01)	(.04)	-
Cumulative effect of accounting change	-	-	(.04)
Net income (loss)	\$ .76	\$ .18	\$ (.16)

See accompanying notes.

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## LSB Industries, Inc.

Consolidated Statements of Stockholders' Equity  
(As adjusted, see Note 2)

	Common Stock Shares	Non- Redeemable Preferred Stock	Common Stock Par Value	Capital in Excess of Par Value	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Treasury Stock - Preferred	Treasury Stock - Common	Total	
(In Thousands)										
Balance at December 31, 2003	15,820		\$ 34,427	\$ 1,582	\$ 56,223	\$ (1,570)	\$ (65,532)	\$ (200)	\$ (16,068)	\$ 8,862
Net income						209				209
Amortization of cash flow hedge					290					290
Total comprehensive income										499
Exercise of stock options		579		58	1,145			(383)		820
Acquisition of 5,000 shares of non-redeemable preferred stock			(250)		(21)					(271)
Conversion of 57 shares of redeemable preferred stock to common stock		2			5					5
Balance at December 31, 2004	16,401		34,177	1,640	57,352	(1,280)	(65,323)	(200)	(16,451)	9,915
Net income						4,990				4,990
Amortization of cash flow hedge					290					290
Total comprehensive income										5,280
Exercise of stock warrants		586		59	(59)					-
Exercise of stock options		89		8	240					248
Acquisition of 13,300 shares of non-redeemable preferred stock							(597)			(597)
Conversion of 156 shares of redeemable preferred stock to common stock										