

Edgar Filing: LSB INDUSTRIES INC - Form 10-Q/A

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

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

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

For Quarterly period ended

June 30, 2005

OR

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

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

Commission file number 1-7677  
-

LSB Industries, Inc.

Exact name of Registrant as specified in its charter

Delaware

73-1015226

State or other jurisdiction of  
incorporation or organization

I.R.S. Employer Identification No.

16 South Pennsylvania Avenue, Oklahoma City, Oklahoma 73107

Address of principal executive offices (Zip Code)

(405) 235-4546

Registrant's telephone number, including area code

None

Former name, former address and former fiscal year, if changed since last report.

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

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

The number of shares outstanding of the Registrant's voting common stock, as of August 1, 2005 was 13,748,738 shares, excluding 3,321,607 shares held as treasury stock.

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

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#### Explanatory Introduction Note:

As part of the Securities and Exchange Commission's ("SEC") requirements to periodically review reports filed by issuers under the Securities Exchange Act of 1934, we received comments from the SEC regarding our Annual Report on Form 10-K for year ended December 31, 2004 ("2004 Form 10-K") and our quarterly reports on Form 10-Q for quarters ended March 31, 2005 and June 30, 2005 ("2005 Forms 10-Q").

As a result of comments received from the SEC, we have filed a restated and amended 2004 Form 10-K/A and Form 10Q/A for the quarter ended March 31, 2005. In addition, we have restated and amended in this Form 10-Q/A ("2005 Form 10-Q/A") as follows:

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- Amend our 2004 audited Consolidated Statements of Income contained in our 2004 Form 10-K to appropriately classify other income relating to the sale of assets and other expense relating to the impairment of certain assets and certain other items from non-operating to operating income. These restated classifications did not change or affect "net income" reflected in our Consolidated Statement of Income in our 2004 Form 10-K.
- Amend our 2005 Condensed Consolidated Statements of Income contained in our 2005 Forms 10-Q to appropriately classify a gain resulting from the sale of certain operating assets and certain other items from non-operating to operating income. These restated classifications did not change or affect "net income" reflected in our Condensed Consolidated Statements of Operations in our 2005 Forms 10-Q.
- Restate our audited financial statements contained in our 2004 Form 10-K to appropriately reflect the change from LIFO to FIFO method of accounting for certain inventory of heat pump products within our Climate Control segment in accordance with Accounting Principles Board Opinion No. 20. The effect for the three years in the period ended December 31, 2004 decreased reported net income in 2004 and 2003 by \$503,000 and \$198,000, respectively, and increased 2002 net income by \$23,000. The effect of this restatement increased stockholders' equity by \$678,000 at December 31, 2001. There was no effect on the balance sheet at December 31, 2004 resulting from this restatement. We did not disclose this change in our financial statements contained in the 2004 Form 10-K since we believed that this was not a material change pursuant to Staff Accounting Bulletin 99. The effect of this restatement reduced net income contained in our 2004 Consolidated Statement of Income from \$1.9 million to \$1.4 million. In addition, the effect changed the 2004 results of operations reflected in our 2005 Forms 10-Q by increasing our net loss by \$125,000 for the three months ended March 31, 2004 (from a net loss of \$.1 million to a net loss of \$.2 million) and reducing our net income by \$250,000 for the six months ended June 30, 2004 (from net income of \$1.6 million to net income of \$1.4 million).

We revised our disclosure controls and procedures reports contained in our 2005 Forms 10-Q by removing any qualifying language to the effectiveness of such disclosure controls and procedures and by discussing the facts and circumstances surrounding the above described restatements and amendments and how such restatements and amendments impacted our CEO's and CFO's original conclusions regarding effectiveness of our disclosure controls and procedures and concluded that our disclosure controls and procedures were not effective at June 30, 2005.

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Accordingly, this 2005 Form 10Q/A includes our restated financial statements for the six and three-month periods ended June 30, 2005 and 2004 with accompanying notes.

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

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

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LSB INDUSTRIES, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Information at June 30, 2005 is unaudited)  
(As restated, see Note 2)  
(Dollars in thousands)

Item 1.

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<u>ASSETS</u>	June 30, 2005	December 31, 2004
Current assets:		
Cash	\$ 2,869	\$ 1,020
Restricted cash	-	158
Accounts receivable, net	49,598	41,888
Inventories:		
Finished goods	17,161	17,180
Work in process	1,572	2,364
Raw materials	9,236	9,113
Total inventories	27,969	28,657
Supplies, prepaid items and other:		
Deferred rent expense	-	938
Prepaid insurance	2,417	4,498
Precious metals	5,455	5,616
Other	3,614	3,736
Total supplies, prepaid items and other	11,486	14,788
Total current assets	91,922	86,511
Property, plant and equipment, net	71,156	70,219
Other assets:		
Debt issuance and other costs, net	2,757	2,517
Investment in affiliate	3,303	3,111
Goodwill	1,724	1,724
Other, net	2,564	2,833
Total other assets	10,348	10,185
	<u>\$ 173,426</u>	<u>\$ 166,915</u>

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LSB INDUSTRIES, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Information at June 30, 2005 is unaudited)  
(As restated, see Note 2)  
(Dollars in thousands)

<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>	June 30, 2005	December 31, 2004
Current liabilities:		
Accounts payable	\$ 27,009	\$ 27,698
Short-term financing and drafts payable	1,744	3,707
Accrued liabilities:		

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Customer deposits	273	3,421
Deferred rent expense	1,940	-
Other	17,406	13,006
Total accrued liabilities	19,619	16,427
Current portion of long-term debt	2,962	4,833
Total current liabilities	51,334	52,665
Long-term debt	106,268	101,674
Other noncurrent liabilities	4,016	4,178
Contingencies (Note 8)		
Stockholders' equity:		
Series B 12% cumulative, convertible preferred stock, \$100 par value; 20,000 shares issued and outstanding; aggregate liquidation preference of \$3,320,000 (\$3,020,000 in 2004)	2,000	2,000
Series 2 \$3.25 convertible, exchangeable Class C preferred stock, \$50 stated value; 623,550 shares issued; aggregate liquidation preference of \$43,044,000 (\$42,234,000 in 2004)	31,177	31,177
Series D 6% cumulative, convertible Class C preferred stock, no par value; 1,000,000 shares issued; aggregate liquidation preference of \$1,180,000	1,000	1,000
Common stock, \$.10 par value; 75,000,000 shares authorized, 17,065,345 shares issued (16,400,985 in 2004)	1,707	1,640
Capital in excess of par value	57,510	57,352
Accumulated other comprehensive loss	(1,135)	(1,280)
Accumulated deficit	(63,349)	(66,840)
	28,910	25,049
Less treasury stock at cost:		
Series 2 Preferred; 15,000 shares (5,000 in 2004)	651	200
Common stock; 3,321,607 shares	16,451	16,451
Total stockholders' equity	11,808	8,398
	\$ 173,426	\$ 166,915

(See accompanying notes)

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LSB INDUSTRIES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
(Unaudited)  
Six and Three Months Ended June 30, 2005 and 2004  
(As restated, see Note 2)  
(In thousands, except per share amounts)

	Six Months		Three Months	
	2005	2004	2005	2004
Net sales (Notes 14 and 15)	\$ 196,189	\$ 187,579	\$ 109,508	\$ 103,910
Cost of sales	163,920	160,064	91,788	87,426
Gross profit	32,269	27,515	17,720	16,484
Selling, general and administrative expense	26,153	25,375	13,887	14,192

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Other expense (Note 13)	177	194	(39)	57
Other income (Note 13)	(1,555)	(317)	(1,051)	(245)
Operating income	7,494	2,263	4,923	2,480
Interest expense	5,828	3,029	3,091	1,597
Non-operating other income, net (Note 13)	(1,458)	(2,337)	(60)	(550)
Income from operations before provision for				
income taxes, equity in earnings of affiliate	3,124	1,571	1,892	1,433
and cumulative effect of accounting				
change				
Provision for income taxes (Note 12)	-	(4)	-	-
Equity in earnings of affiliate (Note 4)	367	327	185	168
Income before cumulative effect of				
accounting	3,491	1,894	2,077	1,601
change				
Cumulative effect of accounting change				
(Note 15)	-	(536)	-	-
Net income	3,491	1,358	2,077	1,601
Preferred stock dividend requirements	(1,117)	(1,134)	(555)	(567)
Net income applicable to common stock				
(Note 11)	\$ 2,374	\$ 224	\$ 1,522	\$ 1,034
	<hr/>	<hr/>	<hr/>	<hr/>
Weighted average common shares (Note				
11):				
Basic	13,481	12,729	13,727	12,803
	<hr/>	<hr/>	<hr/>	<hr/>
Diluted	15,061	15,195	15,289	15,163
	<hr/>	<hr/>	<hr/>	<hr/>
Income per common share (Note 11):				
Basic:				
Income before cumulative effect of				
accounting change	\$ .18	\$ .06	\$ .11	\$ .08
	<hr/>	<hr/>	<hr/>	<hr/>
Cumulative effect of accounting change	-	(.04)	-	-
Net income	\$ .18	\$ .02	\$ .11	\$ .08
	<hr/>	<hr/>	<hr/>	<hr/>
Diluted:				
Income before cumulative effect of				
accounting change	\$ .16	\$ .05	\$ .10	\$ .07
	<hr/>	<hr/>	<hr/>	<hr/>
Cumulative effect of accounting change	-	(.04)	-	-
Net income	\$ .16	\$ .01	\$ .10	\$ .07
	<hr/>	<hr/>	<hr/>	<hr/>

(See accompanying notes)

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LSB INDUSTRIES, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (Unaudited)  
 Six Months Ended June 30, 2005 and 2004  
 (As restated, see Note 2)  
 (In thousands)

	2005	2004
Cash flows from operating activities:		
Net income	\$ 3,491	\$ 1,358
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Cumulative effect of accounting change	-	536
Gains on property insurance recoveries	(523)	-
Gains on sales of property and equipment	(744)	(143)
Provision for (realization and reversal of) losses on firm sales commitments	-	(105)
Depreciation of property, plant and equipment	5,293	5,196
Amortization	682	449
Provision for losses on accounts receivables	256	340
Provisions for (realization and reversal of) losses on inventory	(916)	29
Provision for impairment on long-lived assets	75	-
Other	87	1
Cash provided (used) by changes in assets and liabilities (net of effects of the consolidation of a variable interest entity - Note 15):		
Accounts receivable	(8,465)	(13,398)
Inventories	1,604	250
Supplies, prepaid items and other	2,180	1,742
Accounts payable	(687)	2,705
Customer deposits	(3,148)	(4,292)
Deferred rent expense	2,878	2,903
Other accrued and noncurrent liabilities	4,239	1,459
Net cash provided (used) by operating activities	6,302	(970)
Cash flows from investing activities:		
Capital expenditures	(6,797)	(5,388)
Proceeds from property insurance recoveries	1,255	-
Proceeds from sales of property and equipment	1,076	286
Net change in restricted cash	158	(349)
Other assets	(651)	(392)
Net cash used by investing activities	(4,959)	(5,843)

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LSB INDUSTRIES, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)  
 (Unaudited)  
 Six Months Ended June 30, 2005 and 2004  
 (As restated, see Note 2)  
 (In thousands)

	2005	2004
Cash flows from financing activities:		
Proceeds from revolving debt facilities	\$ 173,699	\$ 160,881
Payments on revolving debt facilities	(171,259)	(148,787)
Proceeds from long-term and other debts	1,764	178
Payments on long-term and other debt	(1,507)	(3,312)
Proceeds from short-term financing and drafts payable	843	301
Payments on short-term financing and drafts payable	(2,806)	(2,248)
Purchases of preferred stock	(451)	-
Net proceeds from issuance of common stock	223	664
Net cash provided by financing activities	506	7,677
Net increase in cash from variable interest entity (Note 15)	-	711
Net increase in cash	1,849	1,575
Cash at beginning of period	1,020	3,189
Cash at end of period	\$ 2,869	\$ 4,764

Supplemental cash flow information includes:

	2005	2004
Noncash investing and financing activities:		
Effects of the consolidation of a variable interest entity (Note 15):		
Increase in property, plant and equipment	\$ -	\$ 5,847
Elimination of notes receivable	\$ -	\$ (2,558)
Increase in other assets	\$ -	\$ 311
Increase in long-term debt	\$ -	\$ (581)

(See accompanying notes)

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LSB INDUSTRIES, INC.  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 (Unaudited)  
 Six Months Ended June 30, 2005 and 2004

Note 1: Basis of Presentation

The accompanying Condensed Consolidated Financial Statements include the accounts of LSB Industries, Inc. (the "Company", "We", "Us" or "Our") and its subsidiaries. We are a diversified holding company which is engaged, through our wholly-owned subsidiary ThermaClime, Inc. ("ThermaClime") and its subsidiaries, in the manufacture and sale of a broad range of air handling and heat pump products (the "Climate Control Business") and the manufacture and sale of chemical products (the "Chemical Business"). See Note 14 - Segment Information. ThermaClime is a holding company with no significant assets or operations other than its investments in its subsidiaries. Entities that are 20% to 50% owned and for which we have significant



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influence are accounted for on the equity method. See Note 4 - Investment in Affiliate. All material intercompany accounts and transactions have been eliminated.

In the opinion of management, the unaudited Condensed Consolidated Financial Statements of the Company as of June 30, 2005 and for the six and three month periods ended June 30, 2005 and 2004 include all adjustments and accruals, consisting only of normal, recurring accrual adjustments, except for the cumulative effect of accounting change as discussed in Note 15 which are necessary for a fair presentation of the results for the interim periods. These interim results are not necessarily indicative of results for a full year.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted in this Form 10-Q/A, Amendment No. 1, pursuant to the rules and regulations of the Securities and Exchange Commission. These Condensed Consolidated Financial Statements should be read in connection with the consolidated financial statements and notes thereto included in our Form 10-K/A, Amendment No. 1, for the year ended December 31, 2004 ("2004 Form 10-K/A").

### Note 2: Restatement of Financial Statements

As part of the Securities and Exchange Commission's ("SEC") requirements to periodically review reports filed by issuers under the Securities Exchange Act of 1934, we received comments from the SEC regarding our Annual Report on Form 10-K for year ended December 31, 2004 ("2004 Form 10-K") and our quarterly reports on Form 10-Q for quarters ended March 31, 2005 and June 30, 2005 ("2005 Forms 10-Q").

As a result of comments received from the SEC, we have filed a restated and amended 2004 Form 10-K/A and Form 10Q/A for the quarter ended March 31, 2005. In addition, we have restated and amended in this Form 10-Q/A ("2005 Form 10-Q/A") as follows:

- Amend our 2004 audited Consolidated Statements of Income contained in our 2004 Form 10-K to appropriately classify other income relating to the sale of assets and other expense relating to the impairment of certain assets and certain other items from non-operating to operating income. These restated classifications did not change or affect "net income" reflected in our Consolidated Statement of Income in our 2004 Form 10-K.
- Amend our 2005 Condensed Consolidated Statements of Income contained in our 2005 Forms 10-Q to appropriately classify a gain resulting from the sale of certain operating assets and certain other items from non-operating to operating income. These restated

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Six Months Ended June 30, 2005 and 2004

classifications did not change or affect "net income" reflected in our Condensed Consolidated Statements of Operations in our 2005 Forms 10-Q.

- Restate our audited financial statements contained in our 2004 Form 10-K to appropriately reflect the change from LIFO to FIFO method of accounting for certain inventory of heat pump products within our Climate Control segment in accordance with Accounting Principles Board Opinion No. 20. The effect for the three years in the period ended December 31, 2004 decreased reported net income in 2004 and 2003 by \$503,000 and \$198,000, respectively, and increased 2002 net income by \$23,000. The effect of this restatement increased stockholders' equity by \$678,000 at December 31, 2001. There was no effect on the balance sheet at December 31, 2004 resulting from this restatement. We did not disclose this change in our financial statements contained in the 2004 Form 10-K since we believed that this was not a material change pursuant to Staff Accounting Bulletin 99. The effect of this restatement reduced net income contained in our 2004 Consolidated Statement of Income from \$1.9 million to \$1.4 million. In addition, the effect changed the 2004 results of operations reflected in our 2005 Forms 10-Q by increasing our net loss by \$125,000 for the three months ended March 31, 2004 (from a net loss of \$.1 million to a net loss of \$.2 million) and reducing our net income by \$250,000 for the six months ended June 30, 2004 (from net income of \$1.6 million to net income of \$1.4 million) as reflected below.

Since we have restated and amended our 2004 consolidated financial statements, this resulted in the restatement of our Condensed Consolidated Statements of Income for the six and three-month periods ended June 30, 2004 and Condensed Consolidated Statement of Cash Flows for the six-month period ended June 30,

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2004.

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

- Change our classification of the premium financing of certain insurance policies previously offset against the related prepaid insurance in our condensed consolidated balance sheet at December 31, 2004 to be in accordance with Accounting Principles Board Opinion ("APB") No. 10. At December 31, 2004, this change resulted in an increase to current assets and current liabilities of \$3.5 million. In addition, make a conforming change in our classification of the financing portion of prepaid insurance in our condensed consolidated statements of cash flows for the six months ended June 30, 2005 and 2004 to be in accordance with Statement of Financial Accounting Standards ("SFAS") No. 95. This change resulted in an increase in net cash provided by operating activities for 2005 and a decrease in net cash used by operating activities for 2004 and a decrease in net cash provided by financing activities of \$2 million and \$2.1 million for 2005 and 2004, respectively.
- Change our classification of certain debt issuance costs previously classified as a current asset in our condensed consolidated balance sheet at December 31, 2004 since it related to long-term debt. At December 31, 2004, this change resulted in a decrease to current assets of \$540,000 and an increase to non-current assets of \$540,000. In addition, change

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Six Months Ended June 30, 2005 and 2004

our classification of the amortization expense of debt issuance costs previously classified as selling, general and administrative expenses ("SG&A") in our condensed consolidated statements of income for the six and three months ended June 30, 2004 to be in accordance with APB No 21. This change resulted in a decrease to SG&A and an increase to interest expense of \$269,000 and \$135,000 for the six and three-month periods ended June 30, 2004, respectively.

- Change our classification of the elimination of certain intercompany transactions (primarily relating to leases and corporate management fees) used in our consolidation process to prepare our condensed consolidated statements of income for the six and three months ended June 30, 2004. This change resulted in a decrease to cost of sales and an increase to SG&A of \$637,000 and \$319,000 for the six and three-month periods ended June 30, 2004, respectively.
- Change our classification of certain shipping costs previously classified as SG&A in our condensed consolidated statements of income for the six and three months ended June 30, 2004 to be consistent with the classification of other shipping cost that relate to amounts billed to our customers. This change resulted in a decrease to net sales and SG&A of \$327,000 and \$204,000 for the six and three-month periods ended June 30, 2004, respectively.
- Change our classification of proceeds from property insurance recoveries and their related gains previously included in net cash provided by operating activities in our condensed consolidated statement of cash flows for the six months ended June 30, 2005 to be in accordance with SFAS No. 95. This change resulted in a decrease in net cash provided by operating activities and a decrease in net cash used by investing activities of \$1.1 million.

The following table shows our Condensed Consolidated Balance Sheet at June 30, 2005 as originally reported in our June 30, 2005 Form 10-Q and our Condensed Consolidated Balance Sheet at December 31, 2004 as originally reported in our 2004 Form 10-K and our 2005 Condensed Consolidated Statements of Income and Cash Flows as originally reported in our June 30, 2005 Form 10-Q and our 2004 Condensed Consolidated Statements of Income and Cash Flows as originally reported in our June 30, 2004 Form 10-Q, showing restatements and amendments (Column 2) to our Condensed Consolidated Statements of Income and Cash Flows resulting from comments received from the SEC which restatements, due to the change from the LIFO method to the FIFO method of accounting for certain inventories, affects net income as discussed above, and amends our Condensed Consolidated Statements of Income to reclassify certain items originally reported as Other Income or Other Expense below the Operating Income (Loss) line to be included in the determination of Operating Income (Loss). The table also shows the effects of reclassifications (Column 1) discussed above that resulted from our internal reviews. As stated above, the changes in classifications had no effect on net income in our

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Condensed Consolidated Statements of Income.

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LSB INDUSTRIES, INC.  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 (Unaudited)  
 Six Months Ended June 30, 2005 and 2004

Condensed Consolidated Balance Sheet - At June 30, 2005:

	As Originally Reported	Reclassifications (Column 1)	Restatements and/or Amendments (Column 2)	As Restated
	(in thousands)			
Accounts and drafts payable	\$ 28,753	\$ (28,753)	\$ -	\$ -
Accounts payable	\$ -	\$ 27,009	\$ -	\$ 27,009
Short-term financing and drafts payable	\$ -	\$ 1,744	\$ -	\$ 1,744

Condensed Consolidated Balance Sheet - At December 31, 2004:

	As Originally Reported	Reclassifications (Column 1)	Restatements and/or Amendments (Column 2)	As Restated
	(in thousands)			
Supplies, prepaid items and other	\$ 11,815	\$ 2,973	\$ -	\$ 14,788
Total current assets	\$ 83,538	\$ 2,973	\$ -	\$ 86,511
Debt issuance costs, net	\$ 1,977	\$ 540	\$ -	\$ 2,517
Total assets	\$ 163,402	\$ 3,513	\$ -	\$ 166,915
Accounts and drafts payable	\$ 27,892	\$ (27,892)	\$ -	\$ -
Accounts payable	\$ -	\$ 27,698	\$ -	\$ 27,698
Short-term financing and drafts payable	\$ -	\$ 3,707	\$ -	\$ 3,707
Total current liabilities	\$ 49,152	\$ 3,513	\$ -	\$ 52,665
Total liabilities and stockholders' equity	\$ 163,402	\$ 3,513	\$ -	\$ 166,915

Condensed Consolidated Statement of Income - For the six months ended June 30, 2005:

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	As Originally Reported	Reclassifications (Column 1)	Restatements and/or Amendments (Column 2)	As Restated
		(in thousands)		
Net sales	\$ 196,189			\$ 196,189
Costs of sales	163,920			163,920
Gross profit	32,269			32,269
Selling, general and administrative expenses	26,153			26,153
Other expense	-		\$ 177 (B)	177
Other income	-		(1,555)(B)	(1,555)
Operating income	6,116		1,378	7,494
Interest expense	5,828			5,828
Other income	(3,441)		3,441	-
Other expense	238		(238)	-
Non-operating other income, net	-		(1,458)(B)	(1,458)
Income from operations before equity in earnings of affiliate	3,491		(367)	3,124
Equity in earnings of affiliate	-		367 (C)	367
Net income	3,491		-	3,491
Preferred stock dividend requirement	(1,117)			(1,117)
Net income applicable to common stock	\$ 2,374		\$ -	\$ 2,374

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Six Months Ended June 30, 2005 and 2004

Condensed Consolidated Statement of Income - For the three months ended June 30, 2005:

	As Originally Reported	Reclassifications (Column 1)	Restatements and/or Amendments (Column 2)	As Restated
		(in thousands)		
Net sales	\$ 109,508			\$ 109,508
Costs of sales	91,788			91,788
Gross profit	17,720			17,720
Selling, general and administrative expenses	13,887			13,887
Other expense	-		\$ (39)	(39)
Other income	-		(1,051)(B)	(1,051)
Operating income	3,833		1,090	4,923
Interest expense	3,091			3,091

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Other income	(1,335)	1,335	-
Other expense	-		-
Non-operating other income, net	-	(60)(B)	(60)
Income from operations before equity in earnings of affiliate	2,077	(185)	1,892
Equity in earnings of affiliate	-	185 (C)	185
Net income	2,077	-	2,077
Preferred stock dividend requirement	(555)		(555)
Net income applicable to common stock	\$ 1,522	\$ -	\$ 1,522

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Six Months Ended June 30, 2005 and 2004

Condensed Consolidated Statement of Income - For the six months ended June 30, 2004:

	As Originally Reported	Reclassifications (Column 1)	Restatements and/or Amendments (Column 2)	As Restated
	<i>(in thousands, except per share amounts)</i>			
Net sales	\$ 187,906	\$ (327)		\$ 187,579
Costs of sales	160,451	(637)	\$ 250 (A)	160,064
Gross profit	27,455	310	(250)	27,515
Selling, general and administrative expenses	25,334	41		25,375
Other expense	-		194 (B)	194
Other income	-		(317)(B)	(317)
Operating income	2,121	269	(127)	2,263
Interest expense	2,760	269		3,029
Other income	(3,098)		3,098	-
Other expense	311		(311)	-
Non-operating other income, net	-		(2,337)(B)	(2,337)
Income from operations before provision for income taxes, equity in earnings of affiliate and cumulative effect of accounting change	2,148	-	(577)	1,571
Provision for income taxes	(4)			(4)
Equity in earnings of affiliate	-		327 (C)	327
Income before cumulative effect of accounting change	2,144	-	(250)	1,894
Cumulative effect of accounting change	(536)			(536)

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Net income	1,608	-	(250)	1,358
Preferred stock dividend requirement	(1,134)			(1,134)
Net income applicable to common stock	\$ 474	\$ -	\$ (250)	\$ 224
<hr/>				
Income per common share				
Basic:				
Income before cumulative effect of accounting change	\$ .08	\$ -	\$ (.02)	\$ .06
Cumulative effect of accounting change	(.04)	-	-	(.04)
Net income	\$ .04	\$ -	\$ (.02)(A)	\$ .02
<hr/>				
Income per common share				
Diluted:				
Income before cumulative effect of accounting change	\$ .06	\$ -	\$ (.01)	\$ .05
Cumulative effect of accounting change	(.03)	-	(.01)	(.04)
Net income	\$ .03	\$ -	\$ (.02)(A)	\$ .01
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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Six Months Ended June 30, 2005 and 2004

Condensed Consolidated Statement of Income - For the three months ended June 30, 2004:

	As Originally Reported	Reclassifications (Column 1)	Restatements and/or Amendments (Column 2)	As Restated
(in thousands, except per share amounts)				
Net sales	\$ 104,114	\$ (204)		\$ 103,910
Costs of sales	87,620	(319)	\$ 125 (A)	87,426
Gross profit	16,494	115	(125)	16,484
Selling, general and administrative expenses	14,212	(20)		14,192
Other expense	-		57 (B)	57
Other income	-		(245)(B)	(245)
Operating income	2,282	135	63	2,480
Interest expense	1,462	135		1,597
Other income	(1,002)		1,002	-
Other expense	96		(96)	-
Non-operating other income, net	-		(550)(B)	(550)
Income from operations before equity in earnings of affiliate	1,726	-	(293)	1,433

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Equity in earnings of affiliate	-		168 (C)	168
Net income	1,726	-	(125)	1,601
Preferred stock dividend requirement	(567)			(567)
Net income applicable to common stock	<u>\$ 1,159</u>	<u>\$ -</u>	<u>\$ (125)</u>	<u>\$ 1,034</u>
Income per common share				
Basic:				
Net income	<u>\$ .09</u>	<u>\$ -</u>	<u>\$ (.01)(A)</u>	<u>\$ .08</u>
Diluted:				
Net income	<u>\$ .08</u>	<u>\$ -</u>	<u>\$ (.01)(A)</u>	<u>\$ .07</u>

Condensed Consolidated Statement of Cash Flows - For the six months ended June 30, 2005:

	As Originally Reported	Reclassifications (Column 1)	Restatements and/or Amendments (Column 2)	As Restated
	(in thousands)			
Gains on property insurance recoveries	<u>\$ -</u>	<u>\$ (523)</u>	<u>\$ -</u>	<u>\$ (523)</u>
Gains on sales of property and equipment	<u>\$ (899)</u>	<u>\$ 155</u>	<u>\$ -</u>	<u>\$ (744)</u>
Cash used by changes in accounts receivable	<u>\$ (7,733)</u>	<u>\$ (732)</u>	<u>\$ -</u>	<u>\$ (8,465)</u>
Cash used in changes in accounts payable	<u>\$ (2,704)</u>	<u>\$ 2,017</u>	<u>\$ -</u>	<u>\$ (687)</u>
Net cash provided by operating activities	<u>\$ 5,385</u>	<u>\$ 917</u>	<u>\$ -</u>	<u>\$ 6,302</u>
Proceeds from property insurance recoveries	<u>\$ -</u>	<u>\$ 1,255</u>	<u>\$ -</u>	<u>\$ 1,255</u>
Proceeds from sales of property equipment	<u>\$ 1,231</u>	<u>\$ (155)</u>	<u>\$ -</u>	<u>\$ 1,076</u>
Net cash used by investing activities	<u>\$ (6,059)</u>	<u>\$ 1,100</u>	<u>\$ -</u>	<u>\$ (4,959)</u>
Net change in drafts payable	<u>\$ 54</u>	<u>\$ (54)</u>	<u>\$ -</u>	<u>\$ -</u>
Proceeds from short-term financing and drafts payable	<u>\$ -</u>	<u>\$ 843</u>	<u>\$ -</u>	<u>\$ 843</u>
Payments on short-term financing and drafts payable	<u>\$ -</u>	<u>\$ (2,806)</u>	<u>\$ -</u>	<u>\$ (2,806)</u>

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Net cash provided by financing activities	\$	2,523	\$	(2,017)	\$	-	\$	506
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LSB INDUSTRIES, INC.  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 (Unaudited)  
 Six Months Ended June 30, 2005 and 2004

Condensed Consolidated Statement of Cash Flows - For the six months ended June 30, 2004:

	As Originally Reported	Reclassifications (Column 1)	Restatements and/or Amendments (Column 2)	As Restated
	(in thousands)			
Net income	\$ 1,608	\$ -	\$ (250)(A)	\$ 1,358
Cash provided by changes in inventories	\$ -	\$ -	\$ 250 (A)	\$ 250
Cash provided (used) by changes in supplies, prepaid items and other	\$ (380)	\$ 2,122	\$ -	\$ 1,742
Net cash used by operating activities	\$ (3,092)	\$ 2,122	\$ -	\$ (970)
Net change in drafts payable	\$ 175	\$ (175)	\$ -	\$ -
Proceeds from short-term financing and drafts payable	\$ -	\$ 301	\$ -	\$ 301
Payments on short-term financing and drafts payable	\$ -	\$ (2,248)	\$ -	\$ (2,248)
Net cash provided by financing activities	\$ 9,799	\$ (2,122)	\$ -	\$ 7,677

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

(B) See detail in Note 13 - Other Expense and Other Income.

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

Note 3: Change in Method of Accounting for Certain Inventories

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



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As a result, we have restated our financial statements for the year ended December 31, 2004 and have restated our financial statements for the six and three months ended June 30, 2004 in accordance with APB No. 20 as discussed in Note 2 - Restatement of Financial Statements. The effect of this restatement decreased net income by \$503,000 for the year ended December 31, 2004 and increased stockholders' equity by \$503,000 at December 31, 2003. For the six and three months ended June 30, 2004, the effect of this restatement decreased our net income by \$250,000 and \$125,000, respectively.

### Note 4: Investment in Affiliate

One of our subsidiaries has a 50% equity interest in an energy conservation joint venture which is accounted for on the equity method. At June 30, 2005 and December 31, 2004, our investment was \$3,303,000 and \$3,111,000, respectively. Our equity in joint-venture earnings are as follows:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2005	2004	2005	2004
	(In thousands)			
Equity in earnings of affiliate	\$ 367	\$ 327	\$ 185	\$ 168

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Six Months Ended June 30, 2005 and 2004

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

	June 30, 2005	December 31, 2004
Current assets	\$ 2,604	\$ 2,575
Noncurrent assets	\$ 8,830	\$ 9,333
Current liabilities	\$ 1,645	\$ 1,815
Noncurrent liabilities	\$ 6,506	\$ 7,019
Partners' capital	\$ 3,283	\$ 3,074

	Six Months Ended June 30,		Three Months Ended June 30,	
	2005	2004	2005	2004
Total revenues	\$ 2,180	\$ 2,155	\$ 1,090	\$ 1,077
Operating income	\$ 1,096	\$ 1,077	\$ 548	\$ 541
Net income	\$ 733	\$ 654	\$ 369	\$ 335

### Note 5: Life Insurance Policies

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We maintain life insurance policies on various individuals. As of June 30, 2005, the total face amount of these policies was \$22 million of which \$2.5 million of the proceeds is required to be paid as discussed below. Some of these life insurance policies have cash surrender values and we have borrowed against these cash surrender values. The cash surrender values are included in other assets in the amounts of \$.7 million and \$.6 million, net of borrowings of \$2.4 million at June 30, 2005 and December 31, 2004, respectively. Increases in cash surrender values of \$.2 million and \$.3 million are netted against the premiums paid for life insurance policies of \$.6 million and \$.4 million for the six months ended June 30, 2005 and 2004, respectively, and are included in selling, general and administrative expenses.

On May 12, 2005 the Company entered into a certain death benefit agreement ("Death Benefit Agreement") with Jack E. Golsen. The Death Benefit Agreement provides that, upon Mr. Golsen's death, the Company will pay to Mr. Golsen's family or designated beneficiary \$2.5 million to be funded from the net proceeds received by the Company under certain new life insurance policies on Mr. Golsen's life that have been purchased and are owned by the Company. The Company is obligated to keep in existence no less than \$2.5 million of the stated death benefit. The new life insurance policies owned by the Company provide a stated death benefit of \$7 million.

**Note 6: Product Warranty** Our Climate Control Business sells equipment that has an expected life, under normal circumstances and use, that extends over many years. As such, we provide warranties after equipment shipment/start-up covering defects in materials and workmanship.

Generally, the warranty coverage for the manufactured equipment in the Climate Control Business is limited to eighteen months from the date of shipment or twelve months from the date of start-up, whichever is shorter, and to ninety days for spare parts. In most cases, equipment is required to be returned to the factory or its authorized representative and the warranty is limited to the repair and replacement of the defective product, with a maximum warranty of the refund

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Six Months Ended June 30, 2005 and 2004

of the purchase price. Furthermore, companies within the Climate Control Business do not make any warranties related to merchantability or fitness for any particular purpose and disclaim and exclude any liability for consequential or incidental damages. In some cases, an extended warranty may be purchased. The above discussion is generally applicable but variations do occur depending upon specific contractual obligations, certain system components and local laws.

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

The carrying amount of the product warranty obligation which is classified as other current and noncurrent accrued liabilities is as follows:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2005	2004	2005	2004
	(in thousands)			
Balance at beginning of period	\$ 1,999	\$ 1,693	\$ 2,110	\$ 1,722
Add: Charged to costs and expenses	991	941	580	562
Deduct: Costs incurred	(743)	(691)	(443)	(341)
Balance at end of period	\$ 2,247	\$ 1,943	\$ 2,247	\$ 1,943

**Note 7: Long-Term Debt**

Long-term debt consists of the following:

June 30,	December 31,
2005	2004

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	(In thousands)		
Senior Secured Loan due 2009 (A)	\$	50,000	\$ 50,000
Working Capital Revolver Loan - ThermaClima (B)		29,996	27,489
10-3/4% Senior Unsecured Notes due 2007 (C)		13,300	13,300
Other, with interest at rates of 3.59% to 12%, most of which is secured by machinery, equipment and real estate		15,934	15,718
		109,230	106,507
Less current portion of long-term debt		2,962	4,833
Long-term debt due after one year	\$	106,268	\$ 101,674

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

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

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Six Months Ended June 30, 2005 and 2004

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 June 30, 2005 the annual interest rate was 11.49%.

The Borrowers are subject to numerous covenants under the Senior Secured Loan agreement including, but not limited to, limitation on the incurrence of certain additional indebtedness and liens, limitations on mergers, acquisitions, dissolution and sale of assets, and limitations on declaration of dividends and distributions to us, all with certain exceptions. The Borrowers are also subject to a minimum fixed charge coverage ratio, measured quarterly on a trailing twelve-month basis. The Borrowers were in compliance with the required minimum ratio for the twelve-month period ended June 30, 2005. The maturity date of the Senior Secured Loan can be accelerated by the Lender upon the occurrence of a continuing event of default, as defined.

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

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

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

(B) In April 2001, ThermaClima and its subsidiaries ("the Borrowers") entered into a \$50 million revolving credit facility (the "Working Capital Revolver Loan") that provides for advances based on specified percentages of eligible accounts receivable and inventories for ThermaClima and its subsidiaries. Effective February 28, 2005 the Working Capital Revolver Loan was amended which, among other things, extended the maturity date to April 2009 and removed language considered as a subjective acceleration provision. The Working Capital Revolver Loan, as amended, accrues interest at a base rate (generally equivalent to the

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prime rate) plus .75% or LIBOR plus 2% (formerly base rate plus 2% or LIBOR plus 4.50%). The annual interest rate at June 30, 2005 was 5.51%. The facility provides for up to \$8.5 million of letters of credit. Under the Working Capital Revolver Loan, as amended, the lender also requires the borrowers to pay a letter of credit fee equal to 1% (formerly 2.75%) per annum of the undrawn amount of all outstanding letters of credit, an unused line fee equal to .5% per annum for the excess amount available under the facility not drawn and

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Six Months Ended June 30, 2005 and 2004

various other audit, appraisal and valuation charges. All letters of credit outstanding reduce availability under the facility. Amounts available for additional borrowing under the Working Capital Revolver Loan at June 30, 2005 were \$18.2 million.

In March 2005, we purchased two interest rate cap contracts which set a maximum three-month LIBOR base rate of 4.59% on \$30 million and mature on March 29, 2009. See Note 10 - Derivatives, Hedges and Financial Instruments.

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

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

The Working Capital Revolver Loan, as amended, requires ThermaClime to maintain minimum quarterly earnings before interest, taxes, depreciation and amortization ("EBITDA"), as defined, for ThermaClime and its Climate Control Business on a trailing twelve-month basis. ThermaClime and its Climate Control Business were in compliance with the required minimum EBITDA amounts for the twelve-month period ended June 30, 2005. The trailing twelve-months EBITDA requirements for the remainder of 2005 range from \$13.7 to \$16 million for ThermaClime and is fixed at \$10 million for the Climate Control Business. The Working Capital Revolver Loan also requires ThermaClime to achieve an annual fixed charge coverage ratio and limits capital expenditures, as defined, measured quarterly on a trailing twelve-month basis. The Working Capital Revolver Loan also contains covenants that, among other things, limit the borrowers' ability to: (a) incur additional indebtedness, (b) incur liens, (c) make restricted payments or loans to affiliates who are not Borrowers, (d) engage in mergers, consolidations or other forms of recapitalization, (e) dispose of assets, or (f) repurchase ThermaClime's 10-3/4% Senior Unsecured Notes. The Working Capital Revolver Loan also requires all collections on accounts receivable be made through a bank account in the name of the lender or their agent.

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

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Six Months Ended June 30, 2005 and 2004

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

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

Note 7: Long-Term Debt (continued)

ThermaClime, Inc.  
Condensed Consolidating Balance Sheet  
As of June 30 2005  
(In thousands)

	Combined Guarantor Subsidiaries	Consolidated Non-Guarantor Subsidiaries	ThermaClime, Inc. (Parent)	Eliminations	Consolidated
<b>Assets</b>					
<b>Current assets:</b>					
Cash	\$ 92	\$ -	\$ 669		\$ 761
Accounts receivable, net	44,762	3,985	14		48,761
Inventories	26,540	122	-		26,662
Supplies, prepaid items and other	4,377	154	2,470		7,001
Deferred income taxes	-	-	4,675		4,675
Total current assets	75,771	4,261	7,828		87,860
Property, plant and equipment, net	63,123	2,774	27		65,924
Investment in and advances to affiliates	-	-	100,429	\$ (100,429)	-
Receivable from Parent	32,353	13,096	-	(45,449)	-
Other assets, net	5,397	23	3,055		8,475
	\$ 176,644	\$ 20,154	\$ 111,339	\$ (145,878)	\$ 162,259
<b>Liabilities and Stockholders' Equity</b>					
<b>Current liabilities:</b>					
Accounts payable	\$ 22,547	\$ 2,242	\$ 240		\$ 25,029
Short-term financing	-	-	1,496		1,496
Accrued liabilities	13,027	4,245	1,084		18,356
Due to LSB and affiliates	-	-	1,715		1,715
Current portion of long-term debt	413	353	-		766
Total current liabilities	35,987	6,840	4,535		47,362
Long-term debt	6,112	676	90,205		96,993
Deferred income taxes	-	-	1,735		1,735
Other non-current liabilities	2,050	390	-		2,440
<b>Stockholders' equity:</b>					
Common stock	66	1	1	\$ (67)	1
Capital in excess of par value	166,212	-	13,052	(166,212)	13,052
Accumulated other comprehensive loss	-	(1,135)	-		(1,135)
Due from LSB and affiliates	-	-	(2,558)		(2,558)
Retained earnings (deficit)	(33,783)	13,382	4,369	20,401	4,369
Total stockholders' equity	132,495	12,248	14,864	(145,878)	13,729
	\$ 176,644	\$ 20,154	\$ 111,339	\$ (145,878)	\$ 162,259

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Six Months Ended June 30, 2005 and 2004

Note 7: Long-Term Debt (continued)

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

	Combined Guarantor Subsidiaries	Consolidated Non-Guarantor Subsidiaries	ThermaClime, Inc. (Parent)	Eliminations	Consolidated
<b>Assets</b>					
<b>Current assets:</b>					
Cash	\$ 174	\$ -	\$ 676		\$ 850
Restricted cash	-	-	158		158
Accounts receivable, net	36,075	4,716	17		40,808
Inventories	27,345	195	-		27,540
Supplies, prepaid items and other	4,349	887	4,467		9,703
Deferred rent expense	-	938	-		938
Deferred income taxes	-	-	4,675		4,675
Total current assets	67,943	6,736	9,993		84,672
Property, plant and equipment, net	62,482	2,393	32		64,907
Investment in and advances to affiliates	-	-	96,127	\$ (96,127)	-
Receivable from Parent	39,163	8,364	-	(47,527)	-
Other assets, net	5,271	25	2,783	-	8,079
	\$ 174,859	\$ 17,518	\$ 108,935	\$ (143,654)	\$ 157,658
<b>Liabilities and Stockholders' Equity</b>					
<b>Current liabilities:</b>					
Accounts payable	\$ 22,560	\$ 2,663	\$ 390		\$ 25,613
Short-term financing	-	-	3,513		3,513
Accrued liabilities	11,592	2,279	1,178		15,049
Due to LSB and affiliates, net	-	-	1,480		1,480
Current portion of long-term debt	444	353	-		797
Total current liabilities	34,596	5,295	6,561		46,452
Long-term debt	6,353	853	87,538		94,744
Deferred income taxes	-	-	1,735		1,735
Other non-current liabilities	2,449	457	-		2,906
<b>Stockholders' equity:</b>					
Common stock	66	1	1	\$ (67)	1

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Capital in excess of par value	166,212	-	13,052	(166,212)	13,052
Accumulated other comprehensive loss	-	(1,280)	-	-	(1,280)
Due from LSB and affiliates	-	-	(2,558)	-	(2,558)
Retained earnings (deficit)	(34,817)	12,192	2,606	22,625	2,606
Total stockholders' equity	131,461	10,913	13,101	(143,654)	11,821
	\$ 174,859	\$ 17,518	\$ 108,935	\$ (143,654)	\$ 157,658

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Six Months Ended June 30, 2005 and 2004

Note 7: Long-Term Debt (continued)

ThermaClime, Inc.  
Condensed Consolidating Statement of Operations  
Six Months Ended June 30, 2005 and 2004  
(As restated)  
(In thousands)

	Combined Guarantor Subsidiaries	Consolidated Non-Guarantor Subsidiaries	ThermaClime, Inc. (Parent)	Eliminations	Consolidated
<b>2005</b>					
Net sales	\$ 171,462	\$ 21,557			\$ 193,019
Cost of sales	144,220	19,545	\$ 476		164,241
Gross profit (loss)	27,242	2,012	(476)		28,778
Selling, general and administrative	21,613	194	1,150	\$ (4)	22,953
Other expense (income), net	(583)	69	(6)	4	(516)
Operating income (loss)	6,212	1,749	(1,620)	-	6,341
Interest expense	5,035	21	5,154	(4,884)	5,326
Non-operating other income, net	(151)	(222)	(4,892)	4,884	(381)
Income (loss) from operations before income taxes and equity in earnings of affiliate and subsidiaries	1,328	1,950	(1,882)	-	1,396
Equity in earnings of subsidiaries	-	-	2,224	(2,224)	-
Equity in earnings of affiliate	367	-	-		367
Benefit (provision) for income taxes	(661)	(760)	1,421		-
Net income	\$ 1,034	\$ 1,190	\$ 1,763	\$ (2,224)	\$ 1,763
<b>2004</b>					
Net sales	\$ 158,032	\$ 22,930			\$ 180,962
Cost of sales	135,904	20,914	\$ 394		157,212
Gross profit (loss)	22,128	2,016	(394)		23,750

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Selling, general and administrative	19,014	207	1,555	\$ (4)	20,772
Other expense (income), net	(116)	106	(11)	4	(17)
Operating income (loss)	3,230	1,703	(1,938)	-	2,995
Interest expense	5,465	16	2,261	(5,258)	2,484
Non-operating other income, net	(38)	(2)	(5,260)	5,258	(42)
Income (loss) from operations before income taxes and equity in earnings (losses) of affiliate and subsidiaries	(2,197)	1,689	1,061	-	553
Equity in losses of subsidiaries	-	-	(110)	110	-
Equity in earnings of affiliate	327	-	-	-	327
Benefit (provision) for income taxes	729	(658)	(478)	-	(407)
Net income (loss)	\$ (1,141)	\$ 1,031	\$ 473	\$ 110	\$ 473

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Six Months Ended June 30, 2005 and 2004

Note 7: Long-Term Debt (continued)

ThermaClime, Inc.  
Condensed Consolidating Statement of Operations  
Three Months Ended June 30, 2005 and 2004  
(As restated)  
(In thousands)

	Combined Guarantor Subsidiaries	Consolidated Non-Guarantor Subsidiaries	ThermaClime, Inc. (Parent)	Eliminations	Consolidated
<b>2005</b>					
Net sales	\$ 96,622	\$ 10,958			\$ 107,580
Cost of sales	81,614	9,942	\$ 356		91,912
Gross profit (loss)	15,008	1,016	(356)		15,668
Selling, general and administrative	11,399	104	650	\$ (2)	12,151
Other expense (income), net	(669)	-	27	2	(640)
Operating income (loss)	4,278	912	(1,033)	-	4,157
Interest expense	2,627	11	2,737	(2,552)	2,823
Non-operating other income, net	(70)	(1)	(2,557)	2,552	(76)
Income (loss) from operations before income taxes and equity in earnings of affiliate and subsidiaries	1,721	902	(1,213)	-	1,410
Equity in earnings of subsidiaries	-	-	1,714	(1,714)	-
Equity in earnings of affiliate	185	-	-	-	185
Benefit (provision) for income taxes	(743)	(351)	1,094	-	-



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Net income	\$	1,163	\$	551	\$	1,595	\$	(1,714)	\$	1,595
<hr/>										
<b>2004</b>										
Net sales	\$	86,720	\$	11,570					\$	98,290
Cost of sales		73,374		10,534	\$	169				84,077
Gross profit (loss)		13,346		1,036		(169)				14,213
Selling, general and administrative		9,818		105		1,210	\$	(2)		11,131
Other expense (income), net		(110)		17		(24)		2		(115)
Operating income (loss)		3,638		914		(1,355)		-		3,197
Interest expense		2,843		8		1,189		(2,716)		1,324
Non-operating other income, net		(59)		(2)		(2,717)		2,716		(62)
Income from operations before										
income										
taxes and equity in earnings of		854		908		173		-		1,935
affiliate and subsidiaries										
Equity in earnings of subsidiaries		-		-		1,177		(1,177)		-
Equity in earnings of affiliate		168		-		-				168
Provision for income taxes		(399)		(354)		(54)				(807)
Net income	\$	623	\$	554	\$	1,296	\$	(1,177)	\$	1,296
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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Six Months Ended June 30, 2005 and 2004

Note 7: Long-Term Debt (continued)

ThermaClime, Inc.  
Condensed Consolidating Statement of Cash Flows  
Six Months Ended June 30, 2005 and 2004  
(As restated)  
(In thousands)

	Combined Guarantor Subsidiaries	Consolidated Non- Guarantor Subsidiaries	ThermaClime, Inc. (Parent)	Eliminations	Consolidated
<b>2005</b>					
Cash flows provided (used) by operating activities	\$ (1,727)	\$ 5,461	\$ 1,154		\$ 4,888
Cash flows from investing activities:					
Capital expenditures	(5,497)	(551)	(7)		(6,055)
Proceeds from property insurance recoveries	1,255	-	-		1,255

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Proceeds from sale of property and equipment	1	-	-	1
Net change in restricted cash	-	-	158	158
Other assets	(17)	(1)	(779)	(797)
Net cash used by investing activities	(4,258)	(552)	(628)	(5,438)
Cash flows from financing activities:				
Payments on long-term debt	(31)	(177)	-	(208)
Net change in revolving debt	-	-	2,507	2,507
Proceeds from short-term financing	-	-	681	681
Payments on short-term financing	-	-	(2,698)	(2,698)
Net change in due to/from LSB and affiliates	-	-	179	179
Advances to/from affiliates	5,934	(4,732)	(1,202)	-
Net cash provided (used) by financing activities	5,903	(4,909)	(533)	461
Net decrease in cash from all activities	(82)	-	(7)	(89)
Cash at the beginning of period	174	-	676	850
Cash at the end of period	\$ 92	\$ -	\$ 669	\$ 761

2004

Cash flows provided (used) by operating activities	\$ (10,502)	\$ 2,746	\$ 4,428	\$ (3,328)
Cash flows from investing activities:				
Capital expenditures	(4,662)	(617)	-	(5,279)
Proceeds from sales of property and equipment	218	-	-	218
Other assets	(360)	4	1	(355)
Net cash provided (used) by investing activities	(4,804)	(613)	1	(5,416)
Cash flows from financing activities:				
Payments on long-term debt	(406)	(176)	(1,817)	(2,399)
Net change in revolving debt	1,087	-	10,826	11,913
Proceeds from short-term financing	-	-	63	63
Payments on short-term financing	-	-	(2,185)	(2,185)
Net change in due to/from LSB and affiliates	-	-	390	390
Advances to/from affiliates	14,930	(529)	(14,401)	-
Net cash provided (used) by financing activities	15,611	(705)	(7,124)	7,782
Net increase (decrease) in cash from all activities	305	1,428	(2,695)	(962)
Cash at the beginning of period	208	-	2,712	2,920
Cash at the end of period	\$ 513	\$ 1,428	\$ 17	\$ 1,958

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Six Months Ended June 30, 2005 and 2004

### Note 8: Contingencies

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

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

#### A. Environmental Matters

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

#### 1. Water Matters

##### Discharge Water Issues

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

We believe that the NPDES permit, as issued, will require additional capital expenditures by EDC through June 2007, estimated to be approximately \$3 to \$4 million, plus reimbursement to the City of approximately \$1.8 million for our pro-rata portion of pipeline engineering and

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Six Months Ended June 30, 2005 and 2004

construction costs as those costs are incurred. This estimate assumes that the City timely builds its own discharge pipeline to a nearby river and we are permitted to tie our pipeline into the City's pipeline. The City council has approved the joint pipeline, but construction of the pipeline by the City is subject to the City receiving a permit from the ADEQ. The ADEQ has not issued the necessary permit to discharge wastewater into the pipeline and, as a result, this has caused a delay of unknown duration in construction of the pipeline. This delay may impact our ability to meet our compliance schedule under the NPDES permit. We do not have any reliable estimates of the cost of an alternative solution in the event that the pipeline is not

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built, or timely built, by the City.

In addition, EDC has entered into a Consent Administrative Order ("CAO") that recognizes the presence of nitrate contamination in the shallow groundwater at the El Dorado Facility. A new CAO is being completed to address the shallow groundwater contamination, which will include an evaluation of the current conditions and remediation based upon a risk assessment. The final remedy for shallow groundwater contamination, should any remediation be required, will be selected pursuant to the new CAO and based upon the risk assessment. There are no known users of this shallow groundwater in the area, and preliminary risk assessments have not identified any public health risk that would require remediation. During the second quarter of 2005, we spent \$325,000 relating to the dredging of our neutralization pond to increase its efficiency. At June 30, 2005 the estimated cost to complete the requested investigation and risk assessment is approximately \$33,000 which liability has been established. The cost of any additional remediation that may be required will be determined based on the results of the investigation and risk assessment and cannot currently be reasonably estimated.

### 2. Air Matters

EDC and the ADEQ have entered into a consent administrative order ("AirCAO") resolving certain air regulatory alleged violations associated with EDC's sulfuric acid plant and certain other alleged air emission violations. The AirCAO became effective during February 2004. The AirCAO requires EDC to implement additional air emission controls at the El Dorado Facility. The ultimate cost of any technology changes required cannot presently be determined but is believed to cost between \$1.5 million to \$3 million of capital expenditures, depending on the technology changes ultimately required by the ADEQ. The implementation of the technological change and related capital expenditures will be incurred through February 2010.

### 3. Other Environmental Matters

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

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Six Months Ended June 30, 2005 and 2004

In connection with the sale of substantially all of the operating assets of Slurry and UTeC, both subsidiaries within our Chemical Business, in December 2002, UTeC leased the Hallowell Facility to the buyer under a triple net long-term lease agreement. However, Slurry retained the obligation to be responsible for, and perform the activities under, the Slurry Consent Order. In addition, certain of our subsidiaries agreed to indemnify the buyer of such assets for these environmental matters. Slurry has placed the prior owners (Chevron/Texaco) of the Hallowell Facility on notice of their responsibility for contribution towards the costs to investigate and remediate this site. Representatives of a prior owner have agreed to pay for one-half of the costs of the investigation on an interim, non-binding basis. At June 30, 2005 a liability of \$147,000 has been established for our share of the estimated remaining investigation and known remediation costs. No additional liabilities can be estimated until the requested testing and investigation is complete. However, these estimates may be revised based on the results of our investigation and testing.

#### Grand Jury Investigation - Slurry - Hallowell Facility

The U.S. Alcohol Tobacco and Firearms Agency ("AT&F") previously conducted an investigation at Slurry. In August 2003, the Company learned that a federal grand jury for the District of Kansas was investigating Slurry and certain of its former employees relating to the conduct at Slurry's commercial explosives manufacturing plant at the Hallowell, Kansas facility ("Hallowell Facility") related to compliance with federal explosives statutes. Active operations at the Hallowell Facility were discontinued in February 2002 after its license to possess explosives was revoked by the AT&F. Thereafter, as stated above, Slurry's business was sold to a third party. As of the date of this report, no target letters indicating a decision by the United States to seek criminal charges in connection with this investigation have been received and

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we are estimating no fines or penalties to be recognized in connection with this matter.

### Threatened Litigation

During July 2005, we received correspondence from the Purchaser ("Purchaser") of the assets of our explosive subsidiary advising that they had received a letter threatening them and others with legal action due to alleged blasting activities in Millbury, Massachusetts, that the threatening parties claimed caused ammonium perchlorate contamination in the drinking water. It has been alleged that prior to the time our explosive company sold its assets to the Purchaser, it sold certain of the blasting products to the blasting companies that performed the blasting activities at the site that caused the contamination. The initial claims were made by the landowner and owners of certain water wells in the area against the drilling and blasting companies. The drilling and blasting activities were performed on the landowner's site as part of construction of a shopping mall. These claims have been made against numerous parties, including the Purchaser and other parties that performed blasting and drilling activities at the site, alleging that the costs of remediation will be several million dollars. We are investigating this matter and intend to vigorously defend ourselves, and, if required, the Purchaser in this matter. As of June 30, 2005, no liability has been established since we are unable to provide an evaluation of the likelihood of an unfavorable outcome or an estimate of the amount or range of potential loss to the Company at this time.

### B. Other Pending or Threatened Litigation

#### 1. Climate Control Business

A lawsuit was filed in August 2002, against Trison Construction, Inc. ("Trison"), a subsidiary within our Climate Control Business, in the District Court, State of Oklahoma, Pontotoc County, in the case styled Trade Mechanical Contractors, Inc., et al. v. Trison Construction, Inc. In this lawsuit, the plaintiff alleges that Trison breached its contract with the plaintiff by delaying contract performance and refusal of payment, and that the actions by Trison damaged the plaintiff. The plaintiff alleges that Trison owes it approximately \$231,000, inclusive of overhead, cost and profit; approximately \$94,000 in extended overhead and expenses Trison has asserted a counterclaim against the plaintiff for recovery of its costs and attorneys fees associated with the defense of this case and approximately \$306,000 in damages due to plaintiff's breach of contract. We intend to vigorously defend this action. Since the case is in discovery, we are unable to provide an evaluation of the likelihood of an unfavorable outcome or an estimate of the amount or range of potential loss to Trison at this time.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Six Months Ended June 30, 2005 and 2004

Johnson Controls, Inc. ("JCI") filed a formal demand for arbitration against Trison and its bonding company. JCI is alleging that it has sustained damages of approximately \$1.7 million as a result of alleged defects in Trison's work in connection with a facility located in Pontotoc County, Oklahoma. Arbitration proceedings began during the second quarter of 2005. We are unable to provide an evaluation of the likelihood of an unfavorable outcome or an estimate of the amount or range of potential loss to Trison at this time. In addition, in accordance with demands by the Company's bonding company, the Company has agreed to increase the security deposited with the bonding company from a \$1 million letter of credit to \$1.5 million letter of credit.

The Company and one of our subsidiaries within the Climate Control Business, ClimaCool Corp., ("ClimaCool") have been sued, together with two unrelated companies, in the United States District Court for the Northern District of Illinois, Eastern Division, in a case styled Multistack LLC v. ClimaCool Corp., et al., alleging that we, ClimaCool and others infringed on a patent in connection with certain modular air chillers that ClimaCool purchased from a French air conditioning company for resale in the United States. The Company is planning to manufacture modular air chillers similar to the design that is subject to this litigation. The complaint alleges that the defendants have infringed and continue to infringe on a certain patent and request:

- an injunction restraining the defendants from further infringement of the patent;
- actual damages and an award of increased damages in an amount not less than three times the amount of damages assessed by the court; and
- attorney fees.

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We have answered the allegations, denying infringement and raising various affirmative defenses, including the assertion of counterclaims for unfair competition, abuse of process, and declaratory judgment of non-infringement and non-enforceability. We intend to vigorously defend this action. We are unable to provide an evaluation of the likelihood of an unfavorable outcome or an estimate of the amount or range of potential loss to ClimaCool at this time.

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Six Months Ended June 30, 2005 and 2004

### 2. Chemical Business

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

### 3. Other

#### Zeller Pension Plan

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

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Six Months Ended June 30, 2005 and 2004

Asserting Financing Fee

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On December 4, 2003, the Company and Southwest Securities, Inc. ("Southwest") entered into a letter agreement whereby the Company agreed to retain Southwest to assist the Company in obtaining financing for the Company. Southwest's right to a fee under the Agreement is limited to a refinancing occurring during "a period of sixty days, to be extended if a transaction is ongoing." A financing did not occur within sixty days of the date of the Agreement, nor was a funding transaction "ongoing" at the end of that period. In September 2004, more than ten months after the date of the Agreement between the Company and Southwest, ThermaClima borrowed \$50 million from Orix Capital Markets, LLC ("Orix"). It is the Company's position that the Orix financing transaction was not the result of any efforts by Southwest, nor was it the culmination of any negotiations or transaction commenced during the sixty-day term of the Agreement. Nonetheless, Southwest has asserted that it is entitled to a fee of \$1.7 million pursuant to the Agreement. The Company brought an action against Southwest in Oklahoma state court in a lawsuit styled LSB Industries, Inc. v. Southwest Securities, Inc. pending in the Oklahoma District Court, Oklahoma County, for a declaratory judgment that the Company is not liable to Southwest under the Agreement as a result of the Orix financing transaction. The Company intends to vigorously defend itself against the claim by Southwest. As of the date of this report, no liability has been established relating to the fee asserted by Southwest since we are unable to provide an evaluation of the likelihood of an unfavorable outcome or an estimate of the amount or range of potential loss to the Company at this time.

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

### Insurance Recovery Contingency

Beginning in October 2004 and continuing into June 2005, the Chemical Business' results were adversely affected as a result of a mechanical failure of one of the four nitric acid plants at the El Dorado, Arkansas plant. The failure, which resulted in major damage, caused the plant that normally produces 10,000 tons per month of nitric acid to go down on October 7, 2004. The plant was restored to normal production in June 2005. Approximately \$5.5 million was expended to repair the plant. Our property insurance provides for replacement cost coverage subject to a \$1 million deductible. As of June 30, 2005 we recognized insurance claims of \$1.6 million relating to this property damage claim which we have received from our insurance carriers as of the date of this report. The effect of this property insurance recovery to the accompanying statements of income was \$.4 million for the six and three-month periods ended June 30, 2005, which was classified as other income. We have additional property damage claims pending. Recoveries related to pending claims will be recognized when the claim amounts are agreed to by our insurers and will impact our financial statements in the near term.

In addition, our business interruption insurance policy contains a forty-five day waiting period before covering losses resulting from business interruptions. As of June 30, 2005 we have not filed a claim for recovery of the business interruption related to this incident. As a result, we have not recognized any insurance recoveries. Since the business interruption period related to this incident has ended, we are currently compiling the information necessary to submit the claim. Recoveries related to this business interruption will be recognized when the claim amount is agreed to by our insurers.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Six Months Ended June 30, 2005 and 2004

### Note 9: Stockholders' Equity

The table below provides detail (in thousands) of activity in the stockholders' equity accounts for the six months ended June 30, 2005:

Common Stock Shares	Non-Redeemable Preferred Stock	Common Stock Par Value	Capital in Excess of Par Value	Accumulated Other Comprehensive Loss	Accumulated Deficit	Treasury Stock-Preferred	Treasury Stock-Common	Total		
		16,401	\$34,177	\$1,640	\$57,352	\$ (1,280)	\$ (66,840)	\$ (200)	\$ (16,451)	\$ 8,398

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Balance at December  
31, 2004

Net income					3,491				3,491
Amortization of cash flow hedge (Note 10)					145				145
Total comprehensive income									3,636
Exercise of warrants (1)	586		59	(59)					-
Exercise of stock options	77		8	215					223
Purchases of non-redeemable preferred stock							(451)		(451)
Conversion of 18 shares of redeemable preferred stock to common stock	1			2					2
Balance at June 30, 2005	(2) 17,065	\$34,177	\$ 1,707	\$ 57,510	\$ (1,135)	\$ (63,349)	\$ (651)	\$ (16,451)	\$11,808

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

(2) Includes 3,321,607 shares of the Company's common stock held in treasury. Excluding the 3,321,607 shares held in treasury, the outstanding shares of the Company's common stock at June 30, 2005 were 13,743,738.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Six Months Ended June 30, 2005 and 2004

Note 9: Stockholders' Equity (continued)

Stock Options

As of June 30, 2005 we have several Qualified and Non-Qualified Stock Option Plans. We currently account for those plans under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. See discussion in Note 15 - Recently Issued Pronouncements. No stock-based compensation cost is reflected in net income applicable to common stock for the six and three months ended June 30, 2005 and 2004 and no options were granted under those plans during these periods.

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

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



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	Six Months Ended		Three Months Ended	
	June 30,		June 30,	
	2005	2004	2005	2004
		(As restated)		(As restated)
	(In thousands, except per share amounts)			
Net income applicable to common stock, as reported	\$ 2,374	\$ 224	\$ 1,522	\$ 1,034
Deduct: Total stock-based compensation expense determined under fair value based method for all awards	(107)	(117)	(57)	(58)
Pro forma net income applicable to common stock	<u>\$ 2,267</u>	<u>\$ 107</u>	<u>\$ 1,465</u>	<u>\$ 976</u>
Net income per common share:				
Basic - as reported	<u>\$ .18</u>	<u>\$ .02</u>	<u>\$ .11</u>	<u>\$ .08</u>
Basic - pro forma	<u>\$ .17</u>	<u>\$ .01</u>	<u>\$ .11</u>	<u>\$ .08</u>
Diluted - as reported	<u>\$ .16</u>	<u>\$ .01</u>	<u>\$ .10</u>	<u>\$ .07</u>
Diluted - pro forma	<u>\$ .15</u>	<u>\$ .01</u>	<u>\$ .10</u>	<u>\$ .06</u>

### Note 10: Derivatives, Hedges and Financial Instruments

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

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In 1997, we entered into an interest rate forward agreement to effectively fix the interest rate of a long-term lease commitment (not for trading purposes). In 1999, we executed a long-term lease agreement and terminated the forward agreement at a net cost of \$2.8 million. We historically accounted for this cash flow hedge under the deferral method (as an adjustment of the initial term lease rentals). Upon adoption of SFAS No. 133 in 2001, the remaining deferred cost amount was reclassified from other assets to accumulated other comprehensive loss and is being amortized to operations over the term of the lease arrangement. At June 30, 2005 and December 31, 2004, accumulated other comprehensive loss consisted of the remaining deferred cost of \$1,135,000 and \$1,280,000, respectively. The amount amortized to operations was \$145,000 for the six months ended June 30, 2005 and 2004. There were no income tax benefits related to these expenses.

Raw materials for use in our manufacturing processes include copper used by our Climate Control Business and natural gas used by our Chemical Business. As part of our raw material price risk management, we periodically enter into exchange-traded futures contracts for these materials, which contracts are generally accounted for on a mark-to-market basis in accordance with SFAS No. 133. At June 30, 2005 the unrealized gains on these contracts was \$124,000 (minimal at December 31, 2004) and are included in supplies, prepaid items and other in the accompanying consolidated balance sheet, as the term of these contracts are for periods of twelve months or less. Gains of \$296,000 and \$21,000 for the six months ended June 30, 2005 and 2004, respectively, and a loss of \$126,000 and a gain of \$34,000 for the three months ended June 30, 2005 and 2004, respectively, on such contracts are included in cost of sales.

In March 2005, we purchased two interest rate cap contracts for a cost of \$590,000. These contracts are free-standing derivatives and are accounted for on a mark-to-market basis in accordance with SFAS No.133. At June 30, 2005 the market basis of these contracts was \$312,000 and is included in other assets in the accompanying condensed consolidated balance sheet. The change in the value of these contracts is included in

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interest expense in the accompanying condensed consolidated statement of income.

### Note 11: Net Income Per Share

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

For the six months ended June 30, 2005 our Board of Directors did not declare and we did not pay the regular quarterly dividends of \$.8125 on our Series 2 \$3.25 Convertible Class C preferred stock ("Series 2 Preferred"). Also our Board of Directors did not declare and we did not pay the January 1, 2005 regular dividend on our Series B 12% Convertible, Cumulative preferred stock ("Series B Preferred"). As of June 30, 2005 the aggregate amount of unpaid dividends in arrears on our Series 2 Preferred, Series B Preferred and Series D 6% Cumulative, Convertible Class C preferred stock ("Series D Preferred") totaled approximately \$11.9 million, \$1.3 million and \$.2 million respectively. During 2005, we purchased 10,000 shares of our Series 2 Preferred at \$45.10 a share. As of June 30, 2005 we or our subsidiaries own as treasury stock 15,000 shares of our Series 2 Preferred.

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LSB INDUSTRIES, INC.  
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The following table sets forth the computation of basic and diluted income per share:

(Dollars in thousands, except per share amounts)

	Six Months Ended June 30,		Three Months Ended June 30,	
	2005	2004 (As restated)	2005	2004 (As restated)
<b>Numerator:</b>				
Net income	\$ 3,491	\$ 1,358	\$ 2,077	\$ 1,601
Preferred stock dividend requirements	(1,117)	(1,134)	(555)	(567)
Numerator for basic and diluted net income per share - net income applicable to common stock	\$ 2,374	\$ 224	\$ 1,522	\$ 1,034
<b>Denominator:</b>				
Denominator for basic net income per share - weighted - average shares	13,480,781	12,729,095	13,727,053	12,802,708
Effect of dilutive securities:				
Employee stock options	1,231,586	1,520,872	1,213,812	1,413,247
Warrants	54,267	648,440	53,768	650,110
Convertible preferred stock	290,560	292,960	290,380	292,660
Convertible note payable	4,000	4,000	4,000	4,000
Dilutive potential common shares	1,580,413	2,466,272	1,561,960	2,360,017
Denominator for diluted net income per share - adjusted weighted - average shares and assumed conversions	15,061,194	15,195,367	15,289,013	15,162,725
Basic net income per share	\$ .18	\$ .02	\$ .11	\$ .08

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Diluted net income per share                    \$            .16        \$            .01        \$            .10        \$            .07

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

	Six Months Ended June 30,		Three Months Ended June 30,	
	2005	2004	2005	2004
Convertible preferred stock	3,311,547	3,347,931	3,296,662	3,347,931

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LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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Note 12: Income Taxes

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

Note 13: Other Expense and Other Income

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

	Six Months Ended June 30,		Three Months Ended June 30,	
	2005 (As restated)	2004 (As restated) (In thousands)	2005 (As restated)	2004 (As restated)
<b>Other expense:</b>				
Other miscellaneous expense (1)	\$ 177	\$ 194	\$ (39)	\$ 57
Total other expense	\$ 177	\$ 194	\$ (39)	\$ 57
<b>Other income:</b>				
Gains on sales of property and equipment	\$ 744	\$ 143	\$ 322	\$ 138
Property insurance recoveries in excess of losses incurred (Note 8)	523	-	523	-
Rental income	102	56	43	26
Other (1)	186	118	163	81
Total other income	\$ 1,555	\$ 317	\$ 1,051	\$ 245
<b>Non-operating other income:</b>				
Proceeds from certain key individual life insurance policies in excess of benefit obligations (Note 14)	\$ 1,162	\$ -	\$ 24	\$ -
Gains on sales of certain current assets, primarily precious metals	220	2,336	-	527
Miscellaneous income	137	118	75	62
Miscellaneous expense	(61)	(117)	(39)	(39)
Total non-operating other income, net	\$ 1,458	\$ 2,337	\$ 60	\$ 550

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

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Note 14: Segment Information

	Six Months Ended June 30,		Three Months Ended June 30,	
	2005 (As restated)	2004 (As restated)	2005 (As restated)	2004 (As restated)
	(In thousands)			
Net sales:				
Climate Control (1)	\$ 75,495	\$ 69,982	\$ 39,991	\$ 38,433
Chemical	117,524	114,772	67,589	63,649
Other	3,170	2,825	1,928	1,828
	<u>\$ 196,189</u>	<u>\$ 187,579</u>	<u>\$ 109,508</u>	<u>\$ 103,910</u>
Gross profit: (2)				
Climate Control	\$ 21,986	\$ 21,967	\$ 11,978	\$ 11,710
Chemical (3)	9,215	4,748	5,104	4,303
Other	1,068	800	638	471
	<u>\$ 32,269</u>	<u>\$ 27,515</u>	<u>\$ 17,720</u>	<u>\$ 16,484</u>
Operating income (loss): (4)				
Climate Control (1)	\$ 5,938	\$ 6,458	\$ 3,541	\$ 3,044
Chemical (3) (5)	4,433	(167)	2,872	1,667
General corporate expenses and other business operations, net (6)	(2,877)	(4,028)	(1,490)	(2,231)
	7,494	2,263	4,923	2,480
Interest expense	(5,828)	(3,029)	(3,091)	(1,597)
Non-operating other income, net:				
Chemical (7)	279	2,406	22	563
Corporate and other business operations (8)	1,179	(69)	38	(13)
Provision for income taxes	-	(4)	-	-
Equity in earnings of affiliate-Climate Control	367	327	185	168
Income before cumulative effect of accounting change	<u>\$ 3,491</u>	<u>\$ 1,894</u>	<u>\$ 2,077</u>	<u>\$ 1,601</u>

(1) As discussed in Note 15, effective March 31, 2004, we were required to consolidate the parent company of a French manufacturer ("MultiClima") of HVAC equipment. Therefore the operating results include net sales of \$3.8 million, gross profit of \$.8 million and an operating loss of \$.6 million relating to MultiClima (after all material intercompany transactions have been eliminated) for the six and three months ended June 30, 2004.

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

(3) We follow the practice of expensing precious metals used as a catalyst in the Chemical Business manufacturing processes as they are used, because the amount and timing of

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recovery is not predictable. Periodically, we recover a portion of the amount previously expensed. During the first quarter of 2005, a recovery of \$1 million contributed to an increase in gross profit. During the second quarter of 2004, a settlement of \$.6 million was reached with a vendor's insurance carrier relating to several mechanical problems with a boiler that had been repaired by one of our vendors at the El Dorado Facility. This amount is classified as a reduction of cost of sales.

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

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

(5) During the second quarter of 2005, we recognized a gain of \$.4 million from certain property insurance claims as discussed in Note 8-Contingencies.

(6) The amounts included are not allocated to our Climate Control and Chemical Businesses since these items are not included in the operating results reviewed by our chief operating decision makers for purposes of making decisions as discussed above. General corporate expenses and other business operations, net consist of the following:

	Six Months Ended		Three Months Ended	
	June 30,		June 30,	
	2005	2004	2005	2004
	(As restated)	(As restated)	(As restated)	(As restated)
	(In thousands)			
Gross profit-Other	\$ 1,068	\$ 800	\$ 638	\$ 471
Selling, general and administrative:				
Personnel	(2,628)	(1,935)	(1,464)	(854)
Professional fees (A)	(1,018)	(1,875)	(575)	(1,434)
Office overhead	(396)	(390)	(189)	(170)
Property, franchise and other taxes	(101)	(142)	(47)	(67)
All other	(705)	(680)	(361)	(285)
Total selling, general and administrative	(4,848)	(5,022)	(2,636)	(2,810)
Other income (B)	1,010	200	484	109
Other expense	(107)	(6)	24	(1)
Total general corporate expenses and other business operations, net	\$ (2,877)	\$ (4,028)	\$ (1,490)	\$ (2,231)

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LSB INDUSTRIES, INC.  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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(Unaudited)

Six Months Ended June 30, 2005 and 2004

(A) During the second quarter of 2004, we incurred professional fees and other costs aggregating \$1 million relating to a proposed unregistered offering of Senior Secured Notes which was terminated in June 2004.

(B) During the first and second quarters of 2005, we recognized gains of \$.4 million and \$.3 million, respectively, from sales of corporate assets (these items are classified as other income in the accompanying condensed consolidated statement of income).

(7) During the first and second quarters of 2004, we recognized gains of \$1.8 million and \$.5 million from the sales of certain current assets (primarily precious metals).

(8) We recognized \$1.1 million in proceeds receivable from certain key man life insurance policies in excess of the present value of our obligations for benefits during the first quarter of 2005 due to the untimely death of one of our executives in January 2005.

## Note 15: Recently Issued Pronouncements

On December 16, 2004 the Financial Accounting Standards Board (FASB) issued FASB Statement No. 123 (revised 2004), Share-Based Payment, which is a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation. Statement 123(R) supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and amends FASB Statement No. 95, Statement of Cash Flows. Generally, the approach in Statement 123(R) is similar to the approach described in Statement 123. However, Statement 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative.

As amended by the Securities and Exchange Commission, Statement 123(R) must be adopted at the beginning of the next fiscal year that begins after June 15, 2005. We expect to adopt Statement 123(R) on January 1, 2006. Our Board of Directors is considering a plan to accelerate the vesting schedule of both qualified and non-qualified stock options currently outstanding. At December 31, 2005 we currently estimate that there will be 45,000 shares that will not be fully vested with a remaining \$90,000 of stock-based compensation expense. If the plan is executed, at December 31, 2005 all outstanding stock options will be fully vested and no cumulative effect of accounting change adjustment will be required on our financial statements when Statements 123(R) is adopted.

In January 2003, the FASB issued Interpretation No. 46 ("FIN 46") "Consolidation of Variable Interest Entities." FIN 46 addresses the consolidation of variable interest entities which meet certain characteristics. In December 2003, the FASB revised FIN 46 that included changes to the effective dates depending on the characteristics of the variable interest entities and the date of involvement.

Prior to 2003, we, through our subsidiaries, entered into loan agreements where we loaned funds to the parent company of MultiClima, S.A. ("MultiClima") a French manufacturer of HVAC equipment, whose product line is compatible with our Climate Control Business. Under the loan agreements, one of our subsidiaries has the option ("Option") to exchange its rights under the loan agreements for 100% of the borrower's outstanding common stock. This subsidiary also

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obtained a security interest in the stock of MultiClima to secure its loans. Based on our assessment of the parent company and MultiClima in relation to FIN 46, as revised, we were required to consolidate this entity effective March 31, 2004. Prior to consolidating this entity, the outstanding notes receivable balance, net of reserve, was \$2,558,000.

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

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purchased from MultiClima by certain of our subsidiaries.

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

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Item 2.

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

#### Amendment to Item 2

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

- We have amended our 2004 audited Consolidated Statements of Income contained in our Annual Report on Form 10-K for the year ended December 31, 2004 ("2004 Form 10-K") to appropriately classify other income relating to the sale of assets and other expense relating to the impairment of certain assets and certain other items from non-operating to operating income. These restated classifications did not change or affect "net income" reflected in our Consolidated Statement of Income in our 2004 Form 10-K. As a result of these restated classifications, we have amended the Condensed Consolidated Statements of Income for the six and three months ended June 30, 2004.
- We have amended our 2005 Condensed Consolidated Statements of Income contained in our quarterly reports on Forms 10-Q ("2005 Forms 10-Q") for the quarters ended June 30, 2005 and March 31, 2005 to appropriately classify a gain resulting from the sale of certain operating assets and certain other items from non-operating to operating income. These restated classifications did not change or affect "net income" reflected in our Condensed Consolidated Statements of Income in our 2005 Forms 10-Q.
- We have restated our audited financial statements contained in our 2004 Form 10-K to appropriately reflect the change from LIFO to FIFO method of accounting for certain inventory of heat pump products within our Climate Control segment in accordance with Accounting Principles Board Opinion No. 20. The effect for each of the three years in the period ended December 31, 2004 decreased reported net income in 2004 and 2003 by \$503,000 and \$198,000, respectively, and increased 2002 net income by \$23,000. The effect of this restatement increased stockholders' equity by \$678,000 at December 31, 2001. There was no effect on the balance sheet at December 31, 2004 resulting from this restatement. We did not disclose this change in our financial statements contained in the 2004 Form 10-K since we believed that this was not a material change pursuant to Staff Accounting Bulletin 99. As a result, the effect changed the 2004 results of operations reflected in our 2005 Forms 10-Q by increasing our net loss by \$125,000 for the three months ended March 31, 2004 (from a net loss of \$.1 million to a net loss of \$.2 million) and reducing our net income by \$250,000 for the six months ended June 30, 2004 (from net income of \$1.6 million to net income of \$1.4 million).
- We have changed classifications of certain items in our condensed consolidated statements of income primarily relating to shipping costs. Also we made changes to our classifications of certain items in our condensed consolidated statement of cash flows relating to recoveries from property insurance and the financing portion of prepaid insurance.

The following MD&A should be read in conjunction with our June 30, 2005 Condensed Consolidated Financial Statements (As restated).

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

Overview

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### General

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

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

#### Climate Control Business

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

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

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

#### Chemical Business

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

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

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Our facility in Baytown, Texas ("Baytown Facility") continues to generate consistent operating profit and the operating profit from the remaining Chemical Business improved for 2005 compared to the first six months of 2004 despite the El Dorado Facility sustaining a mechanical failure of one of its four nitric acid plants adversely affecting the results of our fourth quarter of 2004 and first two quarters of 2005 as discussed below under "Liquidity and Capital Resources."

Irrespective of our strategy of developing customers that purchase substantial quantities of our products based on formulas as discussed above, our Chemical Business continues to underperform our expectations due, in part, to our inability to generate sufficient non-seasonal sales volume to operate our manufacturing facilities at optimum levels. As a result, we are reviewing alternative strategies for our Chemical Business to improve our operating results. Although we have discussed the issues with certain investment bankers we have not retained an investment banker to assist us in our review.

### 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 ThermaClima and non-ThermaClima subsidiaries.

Historically, ThermaClima's primary cash needs have been for working capital and capital expenditures. ThermaClima and its subsidiaries depend upon credit agreements, internally generated cash flows, and



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secured equipment financing in order to fund operations and pay obligations.

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

ThermaClime's ability to maintain an adequate amount of borrowing availability under its Working Capital Revolver Loan depends on its ability to comply with the terms and conditions of 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 LSB and its affiliates and certain ThermaClime subsidiaries. This limitation does not prohibit payment of amounts due under a Services Agreement, Management Agreement and a Tax Sharing Agreement. As of June 30, 2005 ThermaClime had availability under its Working Capital Revolver Loan of \$18.2 million, based on eligible collateral, plus cash on hand of \$.8 million.

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

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

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production costs of a process chemical plant, other than the raw material costs, tend to be fixed costs.

For the first six months of 2005, approximately 64% of the Chemical Business' sales are made pursuant to sales agreements that provide for the pass through of raw material costs, variable costs, and certain fixed costs, plus in most cases, a profit margin. Even though 64% of our sales are based upon the above described sales agreements, our Chemical Business has continued to sustain losses due, in part, to non-seasonal sales volume being insufficient to run the plants at optimum production levels.

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

Beginning in October 2004 and continuing into June 2005, the Chemical Business' results were adversely affected as a result of a mechanical failure of one of the four nitric acid plants at the El Dorado, Arkansas plant. The failure, which resulted in major damage, caused the plant that normally produces 10,000 tons per month of nitric acid to go down on October 7, 2004. The plant was restored to normal production in June 2005. Approximately \$5.5 million was expended to repair the plant. Our property insurance provides for replacement cost coverage subject to a \$1 million deductible. As of June 30, 2005 we recognized insurance claims of \$1.6 million relating to this property damage claim which we have received from our insurance carriers as of the date of this report. The effect of this property insurance recovery to the accompanying statements of income was \$.4 million for the six and three-month periods ended June 30, 2005, which was classified as other income. We have additional property damage claims pending. Recoveries related to pending claims will be recognized when the claim amounts are agreed to by our insurers and will impact our financial statements in the near term.

In addition, our business interruption insurance policy contains a forty-five day waiting period before covering losses resulting from business interruptions. As of June 30, 2005 we have not filed a claim for recovery of the business interruption related to this incident. As a result, we have not recognized any insurance recoveries. Since the business interruption period related to this incident has ended, we are currently compiling the information necessary to submit the claim. Preliminary indications are that the negative impact on earnings resulting from the lost production was approximately \$5 to \$5.5 million from October 7, 2004 through the restart date in June 2005 of which approximately \$1.5 million occurred in the second quarter 2005 and approximately \$1.5 to \$2 million occurred in the first quarter 2005. The above loss estimates do not include extra expenses incurred by the Company in investigating damages and commissioning the plant which is also covered by insurance. Recoveries related to this business interruption will be recognized when the claim amount is agreed to by our insurers.

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

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#### Capital Expenditures

Our Chemical Business has historically required significant investment to fund capital expenditures, while our Climate Control Business has been much less capital intensive, however, we believe we have committed capital expenditures for the remainder of 2005 of approximately \$2 million related to our Climate Control Business and approximately \$3.2 million related to our Chemical Business. The \$3.2 million includes \$2.4 million relating to operations, and \$.8 million for environmental compliance. These expenditures will be financed through internally generated cash flow and secured asset financing.

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

We currently expect to incur capital expenditures of approximately \$3 to \$4 million through June 2007 to construct a new water treatment collection and discharge facility. In addition our pro-rata portion of engineering and construction costs for the City to build a pipeline for the discharged water is approximately \$1.8 million. Certain additional expenditures will be required to bring the sulfuric acid plant's air emissions to lower limits. The ultimate cost is believed to be between \$1.5 and \$3 million, through February 2010.

#### Dividends

Due to previous operating losses and limited borrowing ability under credit facilities, we discontinued payment of cash dividends on our outstanding capital stock for periods subsequent to January 1, 1999. Although dividends on all of our outstanding series of preferred stock are payable if and when declared by the Board of Directors, the terms of each outstanding series of preferred stock provide that dividends are cumulative, except for the redeemable, non-cumulative, convertible preferred stock. As of June 30, 2005 there is approximately \$13.4 million of accrued and unpaid dividends on our outstanding preferred stocks. We do not anticipate paying dividends on our stock for the foreseeable future.

#### Purchases of Preferred Stock

During the second quarter of 2005, we purchased 10,000 shares of our Series 2 Preferred at \$45.10 a share, for a total of \$451,000. We financed these purchases of the Series 2 Preferred from our working capital. As of June 30, 2005 we or our subsidiaries own as treasury stock 15,000 shares of our Series 2 Preferred.

#### Summary

Cash flow and liquidity will continue to be managed very carefully. We believe, based upon current forecasts, that we will have adequate cash in 2005 from internal cash flows and financing sources to enable us to satisfy our cash requirements as they become due in 2005 and our lease payment of \$5.8 million due in January 2006 in connection with our lease of our Baytown Facility. Due to the volatility of the cost for major raw materials used in our Chemical Business, we have historically experienced revisions to financial forecasts on a frequent basis during the

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course of a year. As a result, actual results may be significantly different than our forecast, which could have a material impact on our liquidity and future operating results. In addition, during 2006 and 2007, we have certain obligations becoming due, including, but not limited to, approximately \$13 million of ThermaClime's 10-3/4 % Senior Unsecured Notes due in 2007. We are currently exploring alternatives for raising additional long-term liquidity to assist us in funding for these obligations and/or for general working capital purposes.

#### Loan Agreements - Terms and Conditions

##### Working Capital Revolver Loan

- ThermaClime finances its working capital requirements through borrowings under a Working Capital Revolver Loan. Under the Working Capital Revolver Loan, ThermaClime and its subsidiaries may borrow on a revolving basis up to \$50 million based on specific percentages of eligible accounts receivable and

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inventories. Effective February 28, 2005 the Working Capital Revolver Loan was amended which, among other things, extended the maturity date to April 2009 and removed language considered as a subjective acceleration provision. As of June 30, 2005 borrowings outstanding were \$30 million and the net credit available for additional borrowings was \$18.2 million. The Working Capital Revolver Loan requires that ThermaClime and its Climate Control Business meet certain financial covenants and minimum EBITDA amounts. The EBITDA requirements are measured quarterly on a trailing twelve-month basis. ThermaClime and its Climate Control Business were in compliance with the required minimum EBITDA amounts for the twelve-month period ended June 30, 2005. The trailing twelve-month EBITDA requirements for the remainder of 2005 range from \$13.7 to \$16 million for ThermaClime and is fixed at \$10 million for the Climate Control Business. The EBITDA requirements were set at amounts based upon our forecasts which are presently considered by management to be achievable. See discussion under "Liquidity and Capital Resources - Summary" as to the historical viability of our forecasts.

We have the ability to set our financial covenants under the Working Capital Revolver Loan agreement with our lenders on an annual basis each January. For 2005, we have established mutually agreeable limits that we believe are well within our ability to achieve.

### Senior Secured Loan -

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

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

The Senior Secured Loan accrues interest at the applicable LIBOR rate, as defined, plus an applicable LIBOR margin, as defined or, at the election of the Borrowers, the alternative base rate, as defined, plus an applicable base rate margin, as defined, with the annual interest rate not to exceed 11% or 11.5% depending on the leverage ratio. At June 30, 2005 the annual interest rate was 11.49%.

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

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additional indebtedness and liens, limitations on mergers, acquisitions, dissolution and sale of assets, and limitations on declaration of dividends and distributions to us, all with certain exceptions. The Borrowers are also subject to a minimum fixed charge coverage ratio, measured quarterly on a trailing twelve-month basis. The Borrowers were in compliance with the required minimum ratio for the twelve-month period ended June 30, 2005. The maturity date of the Senior Secured Loan can be accelerated by the Lender upon the occurrence of a continuing event of default, as defined.

For the remainder of 2005, it is anticipated that ThermaClime will incur interest expense of approximately \$2.9 million relating to the Senior Secured Loan.

### Cross - Default Provisions

- The Working Capital Revolver Loan agreement and the Senior Secured Loan contain cross-default provisions. If 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 the only seasonal products are fertilizer and related chemical products sold by our Chemical Business to the agricultural industry. The selling seasons for those products are primarily during the spring and fall planting seasons, which typically extend from March through June and from September through November in the geographical markets in which the majority of our agricultural products are distributed. As a result, our Chemical Business increases its inventory of ammonium nitrate and UAN

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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.

### Death Benefit Agreement

On May 12, 2005 the Company entered into a Death Benefit Agreement with Jack E. Golsen. The Death Benefit Agreement provides that, upon Mr. Golsen's death, the Company will pay to Mr. Golsen's family or designated beneficiary \$2.5 million to be funded from the net proceeds received by the Company under certain new life insurance policies on Mr. Golsen's life that have been purchased and are owned by the Company. The new life insurance policies owned by the Company provide a stated death benefit of \$7 million. The Company is obligated to keep in existence no less than \$2.5 million of the stated death benefit.

### Certain Related Party Transaction

In August 1996, Prime Financial Corporation ("Prime"), one of our subsidiaries, made a loan to John A. Shelley in the principal sum of \$50,000, bearing an annual rate of interest of 9%, payable on demand. The loan was evidenced by a demand promissory note and was made as part of his severance package as President of Equity Bank when the Company sold the bank. The note was fully reserved by Prime. Prime never demanded repayment of the principal or any accrued interest under the note. During the second quarter of 2005, Prime wrote off the note principal

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to the 2005 Annual Meeting held on June 23, 2005 during which Mr. Shelley was elected as a director of the Company for a one-year term.

### Critical Accounting Policy and Estimates

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 to those critical accounting policies discussed in our Form 10-K/A, Amendment No. 1, for the year ended December 31, 2004, during the quarter ended June 30, 2005 a significant area of financial reporting impacted by management's judgment, estimates and assumptions was the timing of the recognition of the property and business interruption insurance claims which are discussed above under "Liquidity and Capital Resources" and in Note 8 of Notes to Condensed Consolidated Financial Statements.

### RESULTS OF OPERATIONS

The following Results of Operations should be read in conjunction with the "Explanatory Introduction Note" on page 3 of this 2005 Form 10-Q/A, our June 30, 2005 Condensed Consolidated Financial Statements and accompanying notes and discussions above under "Overview".

#### Six Months Ended June 30, 2005 Compared to Six Months Ended June 30, 2004

##### Net Sales

Our Climate Control Business net sales for the first six months of 2005 were \$75.5 million compared to \$70 million for the same period in 2004, a 7.9% increase. Net sales of our heat pump products increased \$6.9 million, or 21.1%, primarily as a result of a 12% increase in the number of units sold due to stronger customer demand, an 8% 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 \$1.1 million, or 4.6%, primarily due to a 4% increase in overall average unit sales prices due to the increase in our raw material costs as well as an increase in unit volume related to an improved rate of customer orders. Net sales of our other HVAC products decreased \$2.5 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 (also see Note 13 of Notes to Condensed Consolidated Financial Statements). Excluding the effect of MultiClima, sales of other HVAC products increased \$1.3 million which includes an increase in sales of \$.9 million relating to our modular chiller systems and \$.5 million relating to a new product line as a result of improved customer order intake.

Our Chemical Business net sales for the six months ended June 30, 2005 were \$117.5 million compared to \$114.8 million for the same period in 2004 or a 2.4% increase. This overall increase of \$2.7 million

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reflects, in part, higher sales prices resulting from the increased cost of the raw material feedstocks (anhydrous ammonia and natural gas) as discussed below. Sales prices increased overall by 7% but volume of tons sold decreased 5%. The decrease in volume includes a decrease of 11% at the El Dorado Facility due primarily to the lost production as a result of the

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mechanical failure discussed above in "Liquidity and Capital Resources." The increase in net sales includes an increase of \$3.4 million relating to our agricultural products, an increase of \$.5 million relating to our mining products, offset, in part, by a decrease of \$1.2 million relating to our industrial acid and other chemical products.

Net sales classified as "Other" consists of sales of industrial machinery and related components. Net sales for the six-month period ended June 30, 2005 were \$3.2 million compared to \$2.8 million for the same period in 2004 or an increase of \$.4 million.

### Gross Profit

Gross profit by industry segment represents net sales less cost of sales.

Our Climate Control Business gross profit was \$22 million or 29.1% as a percentage of net sales for the first six months of 2005 compared to \$22 million or 31.4% for the same period in 2004. Decreases in gross profit resulted primarily by our inability to fully pass on to our customers the increases in raw material costs of steel and copper, estimated to be 13% and 20%, respectively. In addition, these decreases include \$.8 million relating to MultiClima in the second quarter of 2004 as discussed above and the disruption in production of our hydronic fan coils as discussed above. These decreases in gross profit were offset by the increase in sales of our heat pump products as discussed above.

Our Chemical Business gross profit was \$9.2 million or 7.8 % as a percentage of net sales for the six months ended June 30, 2005 compared to \$4.7 million or 4.1% for the same period in 2004. The net increase in gross profit of \$4.5 million is due primarily to improved margins on certain agricultural and industrial acid products, increased fixed-cost absorption at the Cherokee, Alabama nitrogen plant ("Cherokee Facility") in 2005 as a result of the plant being down for several weeks in the first quarter of 2004 for a planned major maintenance activity ("Turnaround") and the recovery of \$1 million of production catalyst (precious metals) in 2005. This increase was offset, in part, to the lost production at the El Dorado Facility as a result of the mechanical failure discussed above in "Liquidity and Capital Resources" and our inability to fully pass on to our customers the 13% and 12% increases in costs of our primary raw material feedstocks, anhydrous ammonia and natural gas, respectively. In addition in 2004, a settlement of \$.6 million was reached with a vendor's insurance carrier relating to several mechanical problems experienced in 2001 through 2003 with a boiler that had been repaired by one of our vendors at the El Dorado Facility.

Gross profit classified as "Other" (see discussion above) was \$1.1 million or 33.7% as a percentage of net sales for the six-month period ended June 30, 2005 compared to \$.8 million or 28.3% for the same period in 2004 or an increase of \$.3 million.

### Operating Income (Loss)

Our chief operating decision makers use operating income (loss) by industry segment for purposes of making decisions which include resource allocations and performance evaluations. Operating income (loss) by industry segment represents gross profit by industry segment less selling, general and administrative expenses ("SG&A") incurred by each industry segment plus other income and other expense earned/incurred by each industry segment before general corporate expenses and other business operations, net. General corporate expenses and other

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business operations, net consist of unallocated portions of gross profit, SG&A, other income and other expense.

Operating Income - Climate Control:

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Our Climate Control Business operating income was \$5.9 million for the first six months of 2005 compared to \$6.5 million for the same period of 2004. The net decrease in operating income of \$.6 million resulted primarily by the increase in personnel costs of \$.4 million due primarily to increased group health insurance costs, increased shipping costs of \$.4 million as a result of increased sales volume and rising fuel costs, increased commissions of \$.4 million due to increased sales volume, increased professional fees of \$.3 million primarily relating to arbitrations between one of our subsidiaries, Trison, and a customer (also see discussions in Note 8 of Notes to Condensed Consolidated Financial Statements), increased advertising costs of \$.3 million primarily to stimulate additional sales and the net decrease in gross profit as discussed above. This decrease was partially offset by the decrease in selling, general and administrative expenses of \$1.4 million relating to MultiClima in the second quarter of 2004 as discussed above.

### Operating Income (Loss) - Chemical:

Our Chemical Business operating income was \$4.4 million for the six months ended June 30, 2005 compared to an operating loss of \$.2 million for the same period in 2004. The net increase in operating income of \$4.6 million resulted primarily by the net increase in gross profit of \$4.5 million as discussed above and a gain of \$.4 million from certain property insurance claims as discussed above under "Liquidity and Capital Resources."

### General Corporate Expense and Other Business Operations, Net:

Our general corporate expense and other business operations, net were \$2.9 million for the six-month period ended June 30, 2005 compared to \$4 million for the same period of 2004. The net decrease of \$1.1 million relates primarily to professional fees of \$1 million incurred during the second quarter of 2004 relating to a proposed unregistered offering of Senior Secured Notes which was terminated and gains of \$.7 million in 2005 from the sales of corporate assets. This decrease was partially offset by an increase in personnel costs of \$.7 million which includes 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 Jack E. Golsen during the second quarter of 2005 as discussed above under "Death Benefit Agreement."

### Interest Expense

Interest expense was \$5.8 million for the first six months of 2005 compared to \$3 million for the same period in 2004. The increase of \$2.8 million relates primarily to interest expense incurred on the \$50 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.

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### Non-Operating Other Income, Net

#### Chemical:

Our Chemical Business non-operating other income, net was \$.3 million for the six months ended June 30, 2005 compared to \$2.4 million for the same period in 2004. The net decrease of \$2.1 million relates primarily to gains on sales of certain current assets (primarily precious metals) of \$.2 million in 2005 compared to \$2.3 million in 2004.

#### Corporate and Other Business Operations:

Non-operating other income, net for corporate and other business operations was \$1.2 million for the six-month period ended June 30, 2005 compared to a net expense of \$.1 million for 2004. The increase of \$1.3 million includes proceeds from certain key individual life insurance policies in excess of benefit obligations of \$1.2 million due to the untimely death of one of our executives in January 2005.

### Cumulative Effect of Accounting Change

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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 (also see Note 15 of Notes to Condensed Consolidated Financial Statements). As a result, we recorded a cumulative effect of accounting change of \$.5 million primarily relating to the elimination of embedded profit included in the cost of inventory which was purchased from MultiClima by certain of our subsidiaries.

### Three Months Ended June 30, 2005 Compared to Three Months Ended June 30, 2004

#### Net Sales

Our Climate Control Business net sales for the second quarter of 2005 were \$40 million compared to \$38.4 million for the same period in 2004, a 4.1% increase. Net sales of our heat pump products increased \$2 million, or 10.9%, as a result of a 7% increase in the number of units sold due to stronger customer demand and a 4% increase in overall sales prices due to the increase in our raw material costs as previously discussed. Net sales of our hydronic fan coils increased \$1.8 million, or 14.2%, due to an increase in overall average unit sales prices due to the increase in our raw material costs as previously discussed and an increase in sales volume as a result of an improved rate of customer orders. Net sales of our other HVAC products decreased \$2.2 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 as discussed above. Excluding the effect of MultiClima, sales of other HVAC products increased \$1.6 million which includes an increase in sales of \$.6 million relating to a construction project which began in February 2005, an increase of \$.5 million relating to our modular chiller systems and \$.3 million relating to a new product line as a result of improved customer order intake.

Our Chemical Business net sales for the three months ended June 30, 2005 were \$67.6 million compared to \$63.6 million for the same period in 2004 or a 5.9% increase. This overall increase of \$4 million reflects, in part, higher sales prices resulting from the increased cost of the raw material feedstocks (anhydrous ammonia and natural gas) as discussed below. Sales prices increased overall by 13% but volume of tons sold decreased 6%. The decrease in volume includes a decrease of 13% at the El Dorado Facility due primarily to the lost production as a result of the mechanical failure discussed above in "Liquidity and Capital Resources." The

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increase in net sales includes an increase of \$2.9 million relating to our agricultural products, an increase of \$1.6 million relating to our mining products, and an increase of \$.5 million relating to our industrial acid and other chemical products.

Net sales classified as "Other" (see discussion above) for the three-month period ended June 30, 2005 were \$1.9 million compared to \$1.8 million for the same period in 2004 or an increase of \$.1 million.

#### Gross Profit

Gross profit by industry segment represents net sales less cost of sales.

Our Climate Control Business gross profit was \$12 million or 30% as a percentage of net sales for the second quarter of 2005 compared to \$11.7 million or 30.5% for the same period in 2004. The net increase in gross profit of \$.3 million resulted primarily by the increase in sales of our hydronic fan coil products as discussed above and improved margins relating to our large custom air handler products as a result of selling price increases to cover higher material costs. This increase was offset, in part, by \$.8 million relating to MultiClima in the second quarter of 2004 as discussed above and our inability to fully pass on to our customers increases in raw material costs of steel and copper as discussed previously.

Our Chemical Business gross profit was \$5.1 million or 7.6% as a percentage of net sales for the three months ended June 30, 2005 compared to \$4.3 million or 6.8% for the same period in 2004. The net increase in gross profit of \$.8 million is due primarily to improved margins and increased fixed-cost absorption at the Cherokee Facility as the result of increased sales prices and volume of tons sold. This increase was offset, in part, by the lost production at the El Dorado Facility as a result of the mechanical failure discussed above in "Liquidity and Capital Resources" and our inability to fully pass on to our customers the 40% and 15% increases in costs of our primary raw material feedstocks, anhydrous ammonia and natural gas, respectively. In addition in 2004, a settlement of \$.6 million was reached with a vendor's insurance carrier relating to several mechanical problems experienced in 2001 through 2003 with a boiler that had been repaired by one of our vendors at the El Dorado Facility.

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Gross profit classified as "Other" (see discussion above) was \$.6 million or 33.1% as a percentage of net sales for the three-month period ended June 30, 2005 compared to \$.5 million or 25.8% for the same period in 2004 or an increase of \$.1 million.

### Operating Income

See discussion above for definition of operating income by industry segment.

#### Operating Income - Climate Control:

Our Climate Control Business operating income was \$3.5 million for the three months ended June 30, 2005 compared to \$3 million for the same period of 2004. The net increase in operating income of \$.5 million resulted primarily by the decrease in selling, general and administrative expenses of \$1.4 million relating to MultiClima in the second quarter of 2004 and the net increase in gross profit of \$.3 million discussed above. This increase was offset, in part, by the increase in commissions of \$.4 million due to increased sales volume, increased personnel costs of \$.2 million due primarily to increased group health

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insurance costs, increased shipping costs of \$.2 million as a result of increased sales volume and rising fuel costs and increased professional fees of \$.2 million primarily relating to arbitrations between one of our subsidiaries and a customer as previously discussed.

#### Operating Income - Chemical:

Our Chemical Business operating income was \$2.9 million for the second quarter of 2005 compared to \$1.7 million for the same period in 2004. The net increase in operating profit of \$1.2 million resulted primarily by the net increase in gross profit of \$.8 million discussed above and a gain of \$.4 million from certain property insurance claims as previously discussed.

#### General Corporate Expense and Other Business Operations, Net:

Our general corporate expense and other business operations, net were \$1.5 million for the three-month period ended June 30, 2005 compared to \$2.2 million for the same period of 2004. The net decrease of \$.7 million relates primarily of professional fees of \$1 million incurred relating to a proposed unregistered offering of Senior Secured Notes which was terminated during the second quarter of 2004 and gains of \$.3 million from the sales of corporate assets. This decrease was partially offset by an increase in personnel costs of \$.6 million which includes an increase in net premium costs associated with key individual life insurance policies including policies associated with a death benefit agreement entered into with Jack E. Golsen during the second quarter of 2005 as discussed above under "Death Benefit Agreement."

### Interest Expense

Interest expense was \$3.1 million for the three months ended June 30, 2005 compared to \$1.6 million for the same period in 2004. The increase of \$1.5 million relates primarily to interest expense incurred on the \$50 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.

### Non-Operating Other Income, Net - Chemical

During the second quarter of 2004, we recognized gains on sales of certain current assets (primarily precious metals) of \$.5 million.

### 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



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and Capital Resources."

For 2005, cash provided by operations from net income plus depreciation and amortization less other adjustments was \$7.7 million for the six-month period ended June 30, 2005.

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Cash used by operations included \$1.4 million as the result of an increase in accounts receivable and a decrease in customer deposits and accounts payable partially offset by an increase in other accrued liabilities, change in deferred rent expense, a decrease in prepaid insurance and inventories.

Net cash provided by operating activities was \$6.3 million.

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

- increased sales of our Climate Control products in the second quarter of 2005 compared to the fourth quarter of 2004 and
- increased sales of our agricultural products in our Chemical Business as a result of the spring planting season.

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

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

The decrease in accounts payable relates primarily to:

- payments made on outstanding payables at December 31, 2004 relating to the costs incurred as a result of a mechanical failure at one of our nitric acid plants as discussed under "Liquidity and Capital Resources."

The increase in other accrued liabilities includes:

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

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

The decrease in prepaid insurance resulted from the recognition of related insurance expense for the six months ended June 30, 2005.

The decrease in inventories relates primarily to the increased sales of our agricultural products in our Chemical Business as a result of the spring planting season offset, in part, to an increase of UAN at our Cherokee Facility as a result of one of our customers inability to provide enough railcars for transportation purposes and a planned inventory buildup due to a Turnaround scheduled during the fourth quarter of 2005.

### Cash Flow from Investing Activities

Net cash used by investing activities for the six months ended June 30, 2005 included \$6.8 million for capital expenditures of which \$5.4 million is for the benefit of our Chemical

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Business. A majority of these expenditures relating to the Chemical Business are the result of the mechanical failure of the acid plant discussed above under "Liquidity and Capital Resources."

Cash provided by investing activities included \$1.3 million of proceeds from property insurance recoveries and \$1.1 million of proceeds from sales of corporate assets.

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### Cash Flow from Financing Activities

Net cash provided by financing activities primarily consisted of a net increase in the Working Capital Revolver Loan of \$2.5 million, long-term borrowings of \$1.8 million and proceeds from short-term financing and drafts payable of \$.8 million partially offset by payments on short-term financing and drafts payable of \$2.8 million, payments on long-term debt of \$1.5 million and the purchase of 10,000 shares of our Series 2 Preferred for \$.5 million.

### Off-Balance Sheet Arrangements

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

### Aggregate Contractual Obligations

In the operation of our businesses, we enter into contracts, leases and borrowing arrangements. In connection with a series of agreements with Bayer Corporation ("Bayer"), under which we are to supply nitric acid with a provision for pass through of production costs subject to certain performance obligations on our part, a subsidiary of ThermaClima entered into a 10 year lease in June 1999 that requires minimum future net lease rentals of approximately \$34.4 million at June 30, 2005. The lease payments are includable costs in these agreements. These lease rentals are made monthly on a straight-line basis over the term of the agreements, typically with one annual payment representing a majority of the amount due for the year. The next annual lease payment of approximately \$5.8 million due in January 2006, has been considered in evaluating our liquidity. Our ability to perform on this lease commitment is contingent upon Bayer's performance under the related purchase agreement and our liquidity.

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

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

As discussed under "Cash Flow from Financing Activities" of this MD&A during the first six months of 2005, we had a net increase in borrowings under the Working Capital Revolver Loan of \$2.5 million and other long-term borrowings of \$1.8 million.

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

#### General

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

#### Forward Sales Commitments Risk

Periodically our Chemical Business enters into forward sales commitments of chemical products for deliveries in future periods. As a result, we could be exposed to embedded losses should our product costs exceed the firm sales prices. To minimize this risk, our Chemical Business enters into exchange-traded futures for natural gas as discussed below. At June 30, 2005 our sales commitments with firm sales prices were minimal.

#### Commodity Price Risk

Our Climate Control Business buys substantial quantities of copper and steel for use in manufacturing processes and our Chemical Business buys substantial quantities of anhydrous ammonia and natural gas as feedstocks generally at market prices. Periodically, our Climate Control Business enters into

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exchange-traded futures for copper and our Chemical Business enters into exchange-traded futures for natural gas, which contracts are generally accounted for on a mark-to-market basis in accordance with SFAS No. 133. At June 30, 2005 our purchase commitments under these contracts were for 875,000 pounds of copper through May 2006 at a weighted average cost of \$1.24 per pound (\$1,086,000) and a weighted average market value of \$1.36 per pound (\$1,188,000) and for 50,000 MMBtu of natural gas through August 2005 at a weighted average cost of \$6.55 per MMBtu (\$328,000) and a weighted average market value of \$6.98 per MMBtu (\$349,000).

### Interest Rate Risk

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

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

We purchased two interest rate cap contracts for a cost of \$590,000 in March 2005 to help minimize our interest rate risk exposure relating to the Working Capital Revolver Loan. These contracts set a maximum three-month LIBOR base rate of 4.59% on \$30 million. These contracts mature on March 29, 2009. These contracts are free-standing derivatives and are accounted for on a mark-to-market basis in accordance with SFAS No.133. At June 30, 2005 the market basis of these contracts was \$312,000.

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As of June 30, 2005 our variable rate and fixed rate debt, which aggregated \$109.2 million exceeded the debt's fair market value by approximately \$7 million (\$6.1 million at December 31, 2004).

### Item 4. Controls and Procedures

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

In response to comments raised by the staff of the SEC concerning the lack of disclosure relating to our change from the LIFO method of accounting to the FIFO method for inventory of heat pump products within our Climate Control segment, our management agreed with the SEC to disclose the change and restate our 2004 audited financial statements and prior years in accordance with APB No. 20. See "Explanatory Introduction Note." In connection with the restatement, under the direction of our CEO and CFO, and the benefit of hind sight, we re-evaluated our disclosure controls and procedures that were in effect as of June 30, 2005 and identified the following material weakness:

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

Solely as a result of this material weakness, we have concluded that our disclosure controls and procedures were not effective as of June 30, 2005. Our management has discussed our disclosure controls and procedures with our Audit Committee and our independent auditors. We are in the process of correcting the above described material weakness.

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

- Changed our classification of other income relating to the sale of assets and certain other items and other expense relating to certain other items from non-operating to operating income in our condensed consolidated statements of income for the six and three months ended June 30, 2005 and 2004 in response to comments raised by the staff of the SEC since these transactions were associated with our operations.
- Changed our classification of certain shipping costs previously classified as SG&A to net sales in our condensed consolidated statements of income for the six and three months ended June 30, 2004 to be consistent with the classification of other shipping cost that relate to amounts billed to our customers.

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- Changed our classification of proceeds from property insurance recoveries and their related gains and the financing portion of prepaid insurance in our condensed consolidated statements of cash flows for the six months ended June 30, 2005 and 2004 to be in accordance with Statement of Financial Accounting Standards No. 95.

In connection with the above changes in classification which did not change or affect net income in our condensed consolidated statements of income, we performed a quantitative and

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qualitative analysis of these changes and concluded that these classification changes did not result from a material weakness in our disclosure controls and procedures.

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

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

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

We corrected the material weakness during December 2005. During the quarter ended June 30, 2005, there were no significant changes to our internal controls over financial reporting. However, subsequent to June 30, 2005, we took certain steps to correct the material weakness as described above.

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### SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

the agricultural products are the only seasonal products,

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

- the amount of committed capital expenditures related to our Climate Control and Chemical Businesses,

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

- liquidity and availability of funds,

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- anticipated financial performance,
- adequate cash in 2005 from internal cash flows and financing sources to meet our presently anticipated working capital requirements,
- adequate resources to meet our obligations as they come due,
- ability to make planned capital improvements,
- amount of and ability to obtain financing for the Discharge Water disposal project,
- ThermaClime's forecasts for 2005 for ThermaClime's operating results meeting all required covenant tests for all quarters and the year ending in 2005,
- ThermaClime's actions and the result of those actions if it fails to meet debt covenants and the lender declares an event of default,
- maintain compliance with all loan covenants,
- EDC's ability to comply with the terms of the Discharge Water permit,
- the amount of additional expenditures relating to the AirCAO,
- the good likelihood that Cherokee will recover monies from Dynegey over and above any monies which may be recovered by the plaintiff or owed to Dynegey,
- property and business interruption claim amounts being agreed to by our insurer and impacting our financial statements in the near term,
- the impact on our liquidity and future operating results if actual results are significantly different than our forecast,
- the amount of interest to be incurred for the remainder of 2005 relating to the Senior Secured Loan and
- the Climate Control Business' objectives include moving new operations into an operating profit by increasing the sales levels above the breakeven point and the continued emphasis on increasing the sales and operating margins of existing products and on new product development.

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

decline in general economic conditions, both domestic and foreign,

- material reduction in revenues,

- material increase in interest rates,

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

- increased competitive pressures,

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

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additional releases (particularly air emissions) into the environment,  
material increases in equipment, maintenance, operating or labor costs not presently anticipated by us,  
•  
the requirement to use internally generated funds for purposes not presently anticipated,  
•  
the inability to secure additional financing for planned capital expenditures,  
•  
the cost for the purchase of anhydrous ammonia and natural gas,  
•  
changes in competition,  
•  
the loss of any significant customer,  
•  
changes in operating strategy or development plans,  
•  
inability to fund the working capital and expansion of our businesses,  
•  
adverse results in any of our pending litigation,  
•  
possible negative effects as to the restatements discussed in the "Explanatory Introduction Note",  
•  
inability to obtain necessary raw materials and  
•  
other factors described in "Management's Discussion and Analysis of Financial Condition and Results of Operation" contained in this report.  
•

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

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### PART II OTHER INFORMATION

#### Item 1. Legal Proceedings

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

The Company and one of our subsidiaries within the Climate Control Business, ClimaCool Corp., have been sued, together with two unrelated companies, in the United States District Court for the Northern District of Illinois, Eastern Division, in a case styled Multistack LLC v. ClimaCool Corp., et al., alleging that we, ClimaCool and others infringed on a patent in connection with certain modular air chillers that ClimaCool purchased from a French air conditioning company for resale in the United States. The Company is planning to manufacture modular air chillers similar to the design that is subject to this litigation. The complaint alleges that the defendants have infringed and continue to infringe on a certain patent and request:

- an injunction restraining the defendants from further infringement of the patent;

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- actual damages and an award of increased damages in an amount not less than three times the amount of damages assessed by the court; and
- attorney fees.

We have answered the allegations, denying infringement and raising various affirmative defenses, including the assertion of counterclaims for unfair competition, abuse of process, and declaratory judgment of non-infringement and non-enforceability. We intend to vigorously defend this action.

IEC's insurance company settled the case styled Hilton Hotels, et al. v. International Environmental Corporation, et al., without IEC's participation. The insurance company agreed to pay the plaintiff approximately \$1.1 million, subject to completion of definitive settlement agreements.

During July 2005, we received correspondence from the Purchaser ("Purchaser") of the assets of our explosive subsidiary advising that they had received a letter threatening them and others with legal action due to alleged blasting activities in Millbury, Massachusetts, that the threatening parties claimed caused ammonium perchlorate contamination in the drinking water. It has been alleged that prior to the time our explosive company sold its assets to the Purchaser, it sold certain of the blasting products to the blasting companies that performed the blasting activities at the site that caused the contamination. The initial claims were made by the landowner and owners of certain water wells in the area against the drilling and blasting companies. The drilling and blasting activities were performed on the landowner's site as part of construction of a shopping mall. These claims have been made against numerous parties, including the Purchaser and other parties that performed blasting and drilling activities at the site, alleging that the costs of remediation will be several million dollars. We are investigating this matter and intend to vigorously defend ourselves, and, if required, the Purchaser in this matter.

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

#### Purchases of Equity Securities by the Issuer and Affiliated Purchasers

The following table includes information relating to purchases of equity securities by the Company and affiliated purchasers, as defined, for the three months ended June 30, 2005

Period	(a) Total number of shares of preferred stock purchased	(b) Average price paid per share of preferred stock	(c) Total number of shares of preferred stock purchased as part of publicly announced plans or programs	(d) Maximum number (or approximate dollar value) of shares of common stock that may yet be purchased under the plans or programs
April 1, 2005 - April 30 2005	5,000	\$ 45.10	-	-
May 1, 2005 - May 31, 2005	5,000	\$ 45.10	-	-
June 1, 2005 - June 30, 2005	-	\$ -	-	-
Total	10,000	\$ 45.10	-	-

During the second quarter of 2005, we purchased 10,000 shares of Series 2 Preferred in the open market. These shares are being held as treasury stock.

### Item 3. Defaults upon Senior Securities

(b) Although dividends on our Series 2 Preferred are payable if and when declared by the Board of Directors, the terms of the Series 2 Preferred provide that dividends are cumulative. Our Board of Directors have not declared and paid dividends on our outstanding Series 2 Preferred since June 1999. The amount of the total arrearage of unpaid dividends on the outstanding Series 2 Preferred is \$11.9 million as of June 30, 2005. If the September 15 dividend on the Series 2 Preferred is not paid, the amount of the

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total arrearage of unpaid dividends payable on the outstanding Series 2 Preferred will be \$12.4 million.

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

At the request of Jayhawk Capital Management, L.L.C. ("Jayhawk"), a special meeting was held on March 11, 2002 for the purpose of electing the two additional directors to our Board of

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Directors. At this special meeting, the holders of the Series 2 Preferred elected two members of our Board of Directors, Dr. Allen Ford and Mr. Grant Donovan, as permitted pursuant to the terms of the Series 2 Preferred.

Also our Board of Directors did not declare and pay the January 1 regular dividend on our Series B Preferred since 1999. Dividends in arrears at June 30, 2005 related to the Series B Preferred was \$1.3 million.

In addition, dividends in arrears related to our Series D Preferred was \$.2 million as of June 30, 2005.

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

At the Company's 2005 Annual Meeting of Shareholders held on June 23, 2005 the following nominees to the Board of Directors were elected as directors of the Company:

Name	Number of Shares "For"	Number of Shares "Against" and to "Withhold Authority"	Number of Abstentions and Broker Non-Votes
Raymond B. Ackerman	13,763,827	19,962	-
Bernard G. Ille	13,747,526	36,263	-
Donald W. Munson	13,726,547	57,242	-
Tony M. Shelby	13,710,147	73,642	-
John A. Shelley	13,716,194	67,595	-

Messrs. Ackerman, Ille, Munson and Shelby had been serving on the Board of Directors at the time of the Annual Meeting and were reelected for a term of three years. Mr. Shelley was elected for a one-year term. The following are the directors whose terms of office continued after such Annual Meeting: Robert C. Brown, M.D., Charles A. Burtch, Grant J. Donovan, Dr. N. Allen Ford, PH.D, Jack E. Golsen, Barry H. Golsen, J.D., David R. Goss and Horace G. Rhodes.

At the Annual Meeting, Ernst & Young, LLP, Independent Registered Public Accounting Firm, was appointed as independent auditors of the Company for 2005, as follows:

Number of Shares "For"	Number of Shares "Against" and to "Withhold Authority"	Number of Abstentions and Broker Non- Votes
13,778,150	3,313	2,326

#### Item 5. Other Information

Not applicable



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Item 6. Exhibits

(a) Exhibits

The Company has included the following exhibits in this report:

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

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SIGNATURES

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

LSB INDUSTRIES, INC.

By: /s/ Tony M. Shelby

Tony M. Shelby  
Executive Vice President of Finance and Chief Financial  
Officer  
(Principal Financial Officer)

By: /s/ Jim D. Jones

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