

LSB INDUSTRIES INC
Form 10-Q
August 09, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 10-Q

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

For the quarterly period ended June 30, 2013

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

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Delaware
State or other jurisdiction of

73-1015226
I.R.S. Employer

incorporation or organization

Identification No.

16 South Pennsylvania Avenue, Oklahoma City, Oklahoma
Address of principal executive offices

73107
Zip Code

(405) 235-4546

Registrant's telephone number, including area code

None

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

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

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

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

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

Smaller reporting company ☐

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

The number of shares outstanding of the Registrant's voting common stock, as of July 31, 2013 was 22,441,528 shares, excluding 4,320,462 shares held as treasury stock.

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FORM 10-Q OF LSB INDUSTRIES, INC.

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Table of Contents**PART I****FINANCIAL INFORMATION****Item 1. Financial Statements****LSB INDUSTRIES, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(Information at June 30, 2013 is unaudited)**

	June 30, 2013	December 31, 2012
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 65,572	\$ 98,020
Restricted cash	780	31
Accounts receivable, net	96,480	82,801
Inventories:		
Finished goods	31,138	36,851
Work in progress	2,582	3,576
Raw materials	25,003	24,546
Total inventories	58,723	64,973
Supplies, prepaid items and other:		
Prepaid insurance	4,508	10,049
Precious metals	11,901	13,528
Supplies	11,450	9,855
Fair value of derivatives and other	625	170
Prepaid income taxes	10,120	
Other	2,102	2,096
Total supplies, prepaid items and other	40,706	35,698
Deferred income taxes	3,396	3,224
Total current assets	265,657	284,747
Property, plant and equipment, net	346,328	281,871
Other assets:		
Investment in affiliate	1,294	1,809
Goodwill	1,724	1,724
Other, net	7,286	6,461
Total other assets	10,304	9,994
	\$ 622,289	\$ 576,612

(Continued on following page)

Table of Contents**LSB INDUSTRIES, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS (continued)****(Information at June 30, 2013 is unaudited)**

	June 30, 2013	December 31, 2012
	(In Thousands)	
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	\$ 59,279	\$ 68,333
Short-term financing	3,677	9,254
Accrued and other liabilities	27,912	34,698
Deferred gain on insurance recoveries	20,707	
Current portion of long-term debt	11,718	4,798
Total current liabilities	123,293	117,083
Long-term debt	96,147	67,643
Noncurrent accrued and other liabilities	16,359	16,369
Deferred income taxes	23,733	21,020
Commitments and contingencies (Note 9)		
Stockholders equity:		
Series B 12% cumulative, convertible preferred stock, \$100 par value; 20,000 shares issued and outstanding	2,000	2,000
Series D 6% cumulative, convertible Class C preferred stock, no par value; 1,000,000 shares issued and outstanding	1,000	1,000
Common stock, \$.10 par value; 75,000,000 shares authorized, 26,761,990 shares issued (26,731,360 at December 31, 2012)	2,676	2,673
Capital in excess of par value	166,204	165,006
Retained earnings	219,251	212,192
	391,131	382,871
Less treasury stock, at cost:		
Common stock, 4,320,462 shares	28,374	28,374
Total stockholders equity	362,757	354,497
	\$ 622,289	\$ 576,612

See accompanying notes.

Table of Contents**LSB INDUSTRIES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)****Six and Three Months Ended June 30, 2013 and 2012**

	Six Months		Three Months	
	2013	2012	2013	2012
	(In Thousands, Except Per Share Amounts)			
Net sales	\$ 352,902	\$ 399,520	\$ 202,223	\$ 209,275
Cost of sales	288,821	289,341	163,564	143,540
Gross profit	64,081	110,179	38,659	65,735
Selling, general and administrative expense	49,616	44,277	25,125	22,886
Provisions for losses on accounts receivable	266	123	166	83
Other expense	3,756	722	1,726	555
Other income	(1,545)	(348)	(583)	(112)
Operating income	11,988	65,405	12,225	42,323
Interest expense	1,267	2,311	536	1,179
Non-operating other expense (income), net	24	(272)	8	(267)
Income from continuing operations before provisions for income taxes and equity in earnings of affiliate	10,697	63,366	11,681	41,411
Provisions for income taxes	3,622	23,253	4,367	15,451
Equity in earnings of affiliate	(343)	(341)	(172)	(170)
Income from continuing operations	7,418	40,454	7,486	26,130
Net loss from discontinued operations	59	118	59	97
Net income	7,359	40,336	7,427	26,033
Dividends on preferred stocks	300	300		
Net income applicable to common stock	\$ 7,059	\$ 40,036	\$ 7,427	\$ 26,033
Weighted-average common shares:				
Basic	22,431	22,332	22,437	22,341
Diluted	22,915	23,516	23,577	23,509
Income per common share:				
Basic	\$ 0.31	\$ 1.79	\$ 0.33	\$ 1.17
Diluted	\$ 0.31	\$ 1.72	\$ 0.31	\$ 1.11

See accompanying notes.

Table of Contents**LSB INDUSTRIES, INC.****CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY****(Unaudited)****Six Months Ended June 30, 2013**

	Common Stock Shares	Non- Redeemable Preferred Stock	Common Stock Par Value	Capital in Excess of Par Value (In Thousands)	Retained Earnings	Treasury Stock- Common	Total
Balance at December 31, 2012	26,731	\$ 3,000	\$ 2,673	\$ 165,006	\$ 212,192	\$ (28,374)	\$ 354,497
Net income					7,359		7,359
Dividends paid on preferred stocks					(300)		(300)
Stock-based compensation				787			787
Exercise of stock options	31		3	301			304
Excess income tax benefit associated with stock-based compensation				110			110
Balance at June 30, 2013	26,762	\$ 3,000	\$ 2,676	\$ 166,204	\$ 219,251	\$ (28,374)	\$ 362,757

See accompanying notes.

Table of Contents**LSB INDUSTRIES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)****Six Months Ended June 30, 2013 and 2012**

	2013	2012
	(In Thousands)	
Cash flows from continuing operating activities		
Net income	\$ 7,359	\$ 40,336
Adjustments to reconcile net income to net cash provided by continuing operating activities:		
Net loss from discontinued operations	59	118
Deferred income taxes	2,541	2,539
Depreciation, depletion and amortization of property, plant and equipment	13,060	10,079
Other	1,369	2,213
Cash provided (used) by changes in assets and liabilities (net of effects of discontinued operations):		
Accounts receivable	(13,696)	2,305
Inventories	6,015	1,262
Prepaid and accrued income taxes	(10,853)	7,375
Other supplies, prepaid items and other	5,646	3,087
Accounts payable	(5,393)	(10,476)
Customer deposits	(6,529)	(3,162)
Other current and noncurrent liabilities	615	846
Deferred gain on insurance recoveries	6,685	
Net cash provided by continuing operating activities	6,878	56,522
Cash flows from continuing investing activities		
Capital expenditures	(82,608)	(32,455)
Proceeds from property insurance recovery associated with property, plant and equipment	14,022	
Proceeds from sales of property and equipment	1,224	203
Proceeds from short-term investments		10,022
Purchase of short-term investments		(10,021)
Deposits of restricted cash	(749)	(208)
Payments on contractual obligations carbon credits		(180)
Other assets	(812)	(221)
Net cash used by continuing investing activities	(68,923)	(32,860)

(Continued on following page)

Table of Contents**LSB INDUSTRIES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)****(Unaudited)****Six Months Ended June 30, 2013 and 2012**

	2013	2012
	(In Thousands)	
Cash flows from continuing financing activities		
Proceeds from other long-term debt, net of fees	\$ 39,825	\$
Payments on other long-term debt	(4,661)	(4,645)
Payments of debt issuance costs		(88)
Payments on short-term financing	(5,577)	(3,376)
Proceeds from revolving debt facility		209,238
Payments on revolving debt facility		(209,238)
Payments on loans secured by cash value of life insurance policies		(1,918)
Proceeds from exercise of stock options	304	333
Excess income tax benefit associated with stock-based compensation	110	223
Acquisition of redeemable preferred stock		(39)
Dividends paid on preferred stocks	(300)	(300)
Net cash provided (used) by continuing financing activities	29,701	(9,810)
Cash flows of discontinued operations:		
Operating cash flows	(104)	(82)
Net increase (decrease) in cash and cash equivalents	(32,448)	13,770
Cash and cash equivalents at beginning of period	98,020	124,929
Cash and cash equivalents at end of period	\$ 65,572	\$ 138,699
Supplemental cash flow information:		
Cash payments for income taxes, net of refunds	\$ 11,865	\$ 13,057
Noncash investing and financing activities:		
Insurance claims receivable associated with property, plant and equipment	\$ 250	\$ 10,364
Other assets, accounts payable and long-term debt associated with additions of property, plant and equipment	\$ 11,486	\$ 9,418

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LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1: Summary of Significant Accounting Policies

For a complete discussion of our significant accounting policies, refer to the notes to our audited consolidated financial statements included in our Form 10-K for the year ended December 31, 2012 (2012 Form 10-K), filed with the Securities and Exchange Commission (SEC) on February 28, 2013.

Basis of Consolidation and Presentation LSB Industries, Inc. (LSB) and its subsidiaries (the Company , We , Us , or Our) are consolidated accompanying condensed consolidated financial statements. We are involved in manufacturing and marketing operations. We are primarily engaged in the manufacture and sale of chemical products (the Chemical Business) and the manufacture and sale of geothermal and water source heat pumps and air handling products (the Climate Control Business). LSB is a holding company with no significant operations or assets other than cash, cash equivalents, and investments in its subsidiaries. Our Chemical Business ownership of working interests in natural gas properties is accounted for as an undivided interest, whereby we reflect our proportionate share of the underlying assets, liabilities, revenues and expenses. Entities that are 20% to 50% owned and for which we have significant influence are accounted for on the equity method. All material intercompany accounts and transactions have been eliminated.

In the opinion of management, the unaudited condensed consolidated financial statements of the Company as of June 30, 2013 and for the six and three-month periods ended June 30, 2013 and 2012 include all adjustments and accruals, consisting of normal, recurring accrual adjustments which are necessary for a fair presentation of the results for the interim periods. These interim results are not necessarily indicative of results for a full year due, in part, to the seasonality of our sales of agricultural products, certain downtime events associated with our chemical facilities, and the timing of performing our major plant maintenance activities. Our selling seasons for agricultural products are primarily during the spring and fall planting seasons, which typically extend from March through June and from September through November.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with United States (U.S.) generally accepted accounting principles (GAAP) have been condensed or omitted in this Form 10-Q pursuant to the rules and regulations of the SEC. These condensed consolidated financial statements should be read in connection with our audited consolidated financial statements and notes thereto included in our 2012 Form 10-K.

Reclassifications Reclassifications have been made in our condensed consolidated statement of cash flows for the six months ended June 30, 2012 to conform to our condensed consolidated statement of cash flows for the six months ended June 30, 2013, which reclassifications combined various operating activities line items. These reclassifications did not impact the total amount of net cash provided by continuing operating activities for the six months ended June 30, 2012.

Use of Estimates The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Restricted Cash Restricted cash consists of cash balances that are legally restricted or designated by us for specific purposes.

Recognition of Insurance Recoveries If an insurance claim relates to a recovery of our losses, we recognize the recovery when it is probable and reasonably estimable. If our insurance claim relates to a contingent gain, we recognize the recovery when it is realized or realizable and earned. Amounts recoverable from our insurance carriers, if any, are included in accounts receivable.

Table of Contents**LSB INDUSTRIES, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(Unaudited)****Note 2: Income Per Common Share**

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

(Dollars in Thousands, Except Per Share Amounts)

	Six Months Ended		Three Months Ended	
	June 30,		June 30,	
	2013	2012	2013	2012
Numerator:				
Net income	\$ 7,359	\$ 40,336	\$ 7,427	\$ 26,033
Dividends on Series B Preferred	(240)	(240)		
Dividends on Series D Preferred	(60)	(60)		
Total dividends on preferred stocks	(300)	(300)		
 Numerator for basic net income per common share net income applicable to common stock	 7,059	 40,036	 7,427	 26,033
Dividends on preferred stocks assumed to be converted, if dilutive	60	300		
 Numerator for diluted net income per common share	 \$ 7,119	 \$ 40,336	 \$ 7,427	 \$ 26,033
Denominator:				
Denominator for basic net income per common share weighted-average shares	22,430,589	22,332,303	22,437,485	22,340,826
Effect of dilutive securities:				
Convertible preferred stocks	250,000	917,346	916,666	916,666
Stock options	234,071	266,776	223,232	251,838
 Dilutive potential common shares	 484,071	 1,184,122	 1,139,898	 1,168,504
 Denominator for diluted net income per common share adjusted weighted-average shares and assumed conversions	 22,914,660	 23,516,425	 23,577,383	 23,509,330
 Basic net income per common share	 \$ 0.31	 \$ 1.79	 \$ 0.33	 \$ 1.17
 Diluted net income per common share	 \$ 0.31	 \$ 1.72	 \$ 0.31	 \$ 1.11

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

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	Six Months Ended June 30,		Three Months Ended June 30,	
	2013	2012	2013	2012
Convertible preferred stocks	666,666			
Stock options	251,683	254,000	250,016	254,000
	918,349	254,000	250,016	254,000

Table of Contents**LSB INDUSTRIES, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(Unaudited)****Note 3: Accounts Receivable, net**

Our accounts receivables, net, consists of the following:

	June 30, 2013	December 31, 2012
	(In Thousands)	
Trade receivables	\$ 94,200	\$ 72,505
Insurance claims	1,907	10,059
Other	1,046	873
	97,153	83,437
Allowance for doubtful accounts	(673)	(636)
	\$ 96,480	\$ 82,801

During August 2012, El Dorado Chemical Company (EDC) entered into an agreement with Bank of America, N.A. (the Bank) to sell our accounts receivables generated from product sales to a certain customer. We agreed to enter into this agreement as a courtesy to this customer. The initial term of this agreement is for one year, with renewal options, but either party has an option to terminate the agreement pursuant to the terms of the agreement. In addition, we amended our sales agreement with the customer to offer extended payment terms under the condition that they pay an extended payment terms premium equal to the discount taken by the Bank when the accounts receivables are sold. Thus, there is no gain or loss from the sale of these receivables to the Bank. We have no continuing involvement or risks associated with the transferred accounts receivable. Pursuant to the terms of the agreement, EDC is to receive payment from the Bank no later than one business day after the Bank's acceptance of EDC's offer to sell the accounts receivables. As of June 30, 2013, EDC has been paid by the Bank for the accounts receivables sold to the Bank. We account for these transfers as sales under ASC 860 Transfers and Servicing.

Note 4: Inventories

At June 30, 2013 and December 31, 2012, inventory reserves for certain slow-moving inventory items (Climate Control products) were \$1,453,000 and \$1,818,000, respectively. In addition, because cost exceeded the net realizable value, inventory reserves for certain nitrogen-based inventories provided by our Chemical Business were \$1,056,000 and \$975,000 at June 30, 2013 and December 31, 2012, respectively.

Changes in our inventory reserves are as follows:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2013	2012	2013	2012
	(In Thousands)			
Balance at beginning of period	\$ 2,793	\$ 1,783	\$ 2,506	\$ 1,705
Provisions for losses	235	44	519	39
Write-offs and disposals	(519)	(90)	(516)	(7)

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Balance at end of period	\$ 2,509	\$ 1,737	\$ 2,509	\$ 1,737
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The provision for losses is included in cost of sales in the accompanying condensed consolidated statements of income.

Table of Contents**LSB INDUSTRIES, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(Unaudited)****Note 5: Current and Noncurrent Accrued and Other Liabilities**

Our current and noncurrent accrued and other liabilities consist of the following:

	June 30, 2013	December 31, 2012
	(In Thousands)	
Deferred revenue on extended warranty contracts	\$ 7,177	\$ 7,007
Accrued warranty costs	6,944	6,172
Accrued payroll and benefits	6,842	6,612
Customer deposits	1,660	8,189
Other	21,648	23,087
	44,271	51,067
Less noncurrent portion	16,359	16,369
Current portion of accrued and other liabilities	\$ 27,912	\$ 34,698

Note 6: Accrued Warranty Costs

Our Climate Control Business sells equipment that has an expected life, under normal circumstances and use, that extends over several years. As such, we provide warranties after equipment shipment/start-up covering defects in materials and workmanship. Generally for commercial/institutional products, the base warranty coverage for most of the manufactured equipment in the Climate Control Business is limited to eighteen months from the date of shipment or twelve months from the date of start-up, whichever is shorter, and to ninety days for spare parts. For residential products, the base warranty coverage for manufactured equipment in the Climate Control Business is limited to ten years from the date of shipment for material and to five years from the date of shipment for labor associated with the repair. The warranty provides that most equipment is required to be returned to the factory or an authorized representative and the warranty is limited to the repair and replacement of the defective product, with a maximum warranty of the refund of the purchase price. Furthermore, companies within the Climate Control Business generally disclaim and exclude warranties related to merchantability or fitness for any particular purpose and disclaim and exclude any liability for consequential or incidental damages. In some cases, the customer may purchase a specific product may be sold with an extended warranty. The above discussion is generally applicable to such extended warranties, but variations do occur depending upon specific contractual obligations, certain system components, and local laws.

Changes in our product warranty obligation (accrued warranty costs) are as follows:

	Six Months Ended		Three Months Ended	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
	(In Thousands)			
Balance at beginning of period	\$ 6,172	\$ 5,370	\$ 6,486	\$ 5,616
Amounts charged to costs and expenses	4,011	3,344	2,021	1,776
Costs incurred	(3,239)	(2,636)	(1,563)	(1,314)

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Balance at end of period	\$ 6,944	\$ 6,078	\$ 6,944	\$ 6,078
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Note 7: Asset Retirement Obligations

Currently, we have an obligation to plug and abandon a wastewater injection well at one of our Chemical Business facilities when the permit expires. Additionally, we have certain facilities in our Chemical Business that contain asbestos insulation around certain piping and heated surfaces, which we plan to maintain or replace, as needed, with non-asbestos insulation through our standard repair and maintenance activities to prevent deterioration. Currently, there is insufficient information to estimate the fair value for most of our asset retirement obligations (ARO). In addition, we currently have no plans to discontinue the use of these facilities, and the remaining life of the facilities is indeterminable. As a result, a liability for only a minimal amount relating to AROs associated with these facilities has been established. However, we will continue to review these obligations and record a liability when a reasonable estimate of the fair value can be made. In addition, our Chemical Business owns working interests in certain natural gas properties. We recognized AROs associated with the obligation to plug and abandon wells when the natural gas reserves in the wells are depleted. At June 30, 2013 and December 31, 2012, our accrued liability for AROs was \$162,000 and \$154,000, respectively.

Table of Contents**LSB INDUSTRIES, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(Unaudited)****Note 8: Long-Term Debt**

Our long-term debt consists of the following:

	June 30, 2013	December 31, 2012
	(In Thousands)	
Working Capital Revolver Loan (A)	\$	\$
Secured Term Loan (B)	66,563	68,438
Secured Promissory Note (C)	32,837	
Other, with a current weighted-average interest rate of 5.48%, most of which is secured by machinery, equipment and real estate	8,465	4,003
	107,865	72,441
Less current portion of long-term debt	11,718	4,798
Long-term debt due after one year	\$ 96,147	\$ 67,643

(A) As of June 30, 2013, our wholly owned subsidiary, ThermaClime, LLC (ThermaClime) and its subsidiaries are parties to a \$50 million revolving credit facility (the Working Capital Revolver Loan). See additional discussion under Note 16 Subsequent Events.

(B) As of June 30, 2013, ThermaClime and certain of its subsidiaries are parties to a term loan agreement (the Secured Term Loan). The stated interest rate on the Secured Term Loan includes a variable interest rate (based on three-month LIBOR plus 300 basis points, a rate that is adjusted quarterly) and a fixed interest rate. At June 30, 2013, the weighted-average interest rate was 3.90%. The Secured Term Loan borrowers are also subject to numerous covenants under the agreement. As defined in the agreement, the Secured Term Loan borrowers are also subject to a minimum fixed charge coverage ratio of not less than 1.10 to 1 and a maximum leverage ratio of not greater than 4.50 to 1. Both of these requirements are measured quarterly on a trailing twelve-month basis. The Secured Term Loan borrowers were in compliance with these financial covenants for the twelve-month period ended June 30, 2013. A prepayment premium equal to 1.0% of the principal amount prepaid is due to the lenders should the borrowers elect to prepay on or prior to March 29, 2014; however, this premium is eliminated thereafter. See additional discussion under Note 16 Subsequent Events.

(C) On February 1, 2013, Zena Energy LLC (Zena), a subsidiary within our Chemical Business, entered into a loan (the Secured Promissory Note) with a lender in the original principal amount of \$35 million. The Secured Promissory Note follows the acquisition by Zena of working interests (Working Interests) in certain natural gas properties during October 2012. The proceeds of the Secured Promissory Note effectively financed \$35 million of the approximately \$50 million purchase price of the Working Interests previously paid out of LSB's working capital. The proceeds of the Secured Promissory Note are being used for general working capital purposes. The Secured Promissory Note matures on February 1, 2016. Principal and interest are payable monthly based on a five-year amortization at a defined LIBOR rate plus 300 basis points (but not below 3.00% per annum) with a final balloon payment of \$15.3 million. The interest rate at June 30, 2013 was 3.27%. The loan is secured by the Working Interests and related properties and proceeds.

Note 9: Commitments and Contingencies

Purchase and Sales Commitments During the six months ended June 30, 2013, amendments were made to the following significant purchase and sales commitments.

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Ammonium nitrate supply agreement Pursuant to a long-term cost-plus supply agreement, EDC sells to a customer a significant annual volume of industrial grade ammonium nitrate ("AN") produced at our chemical production facility located in El Dorado, Arkansas (the "El Dorado Facility"). In April 2013, this agreement was amended to update and correct the specification of AN solution to be manufactured by EDC. The amendment also modified the required notice of termination from two years to one year.

Bayer Agreement Subsidiaries within our Chemical Business, El Dorado Nitric Company and its subsidiaries ("EDN") and EDC, are party to an agreement (the "Bayer Agreement") with Bayer Material Science LLC ("Bayer"). EDN operates Bayer's nitric acid plant (the "Baytown Facility") located within Bayer's chemical manufacturing complex. Under the terms of the Bayer Agreement, Bayer purchases from EDN all of Bayer's requirements for nitric acid for use in Bayer's chemical manufacturing complex located in Baytown, Texas that provides a pass-through of certain costs plus a profit. In addition, EDN is responsible for the maintenance and operation of the Baytown Facility. If there is a change in control of EDN, Bayer has the right to terminate the Bayer Agreement upon payment of certain fees to EDN. In June 2013, the Bayer Agreement was amended, dated effective July 1, 2014, to extend the term of the agreement for an additional seven years, beginning July 1, 2014. The amendment also provides incentives to EDN for meeting certain safety, environmental, and reliability thresholds.

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LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Note 9: Commitments and Contingencies (continued)

Capital Project Commitments During November 2012, EDC entered into an agreement with Weatherly Inc. for the licensing, engineering, and procurement of major manufacturing equipment for a new 65% strength nitric acid plant to be constructed at the El Dorado Facility. In addition, EDC plans to construct a separate nitric acid concentrator. The estimated cost for this project is approximately \$120 million, of which \$25.2 million has been incurred and capitalized at June 30, 2013. See additional discussion under Note 16 Subsequent Events.

Legal Matters Following is a summary of certain legal matters involving the Company:

A. Environmental Matters

Our operations are subject to numerous environmental laws (Environmental Laws) and to other federal, state and local laws regarding health and safety matters (Health Laws). In particular, the manufacture, production and distribution of products by our Chemical Business are activities that entail environmental and safety risks and impose obligations under the Environmental Laws and the Health Laws, many of which provide for certain performance obligations, substantial fines and criminal sanctions for violations. There can be no assurance that we will not incur material costs or liabilities in complying with such laws or in paying fines or penalties for violation of such laws. The Environmental Laws and Health Laws and enforcement policies thereunder relating to our Chemical Business have in the past resulted, and could in the future result, in compliance expenses, cleanup costs, penalties or other liabilities relating to the handling, manufacture, use, emission, discharge or disposal of effluents at or from our facilities or the use or disposal of certain of its chemical products. Historically, significant expenditures have been incurred by subsidiaries within our Chemical Business in order to comply with the Environmental Laws and Health Laws and are reasonably expected to be incurred in the future. We will also be obligated to manage certain discharge water outlets and monitor groundwater contaminants at our Chemical Business facilities should we discontinue the operations of a facility. We do not operate the natural gas wells where we own an interest and compliance with Environmental and Health Laws is controlled by others, with our Chemical Business being responsible for its proportionate share of the costs involved. As of June 30, 2013, our accrued liabilities for environmental matters totaled \$1,074,000 relating primarily to matters discussed below. It is reasonably possible that a change in the estimate of our liability could occur in the near term. Also see discussion in Note 7 Asset Retirement Obligations.

1. Discharge Water Matters

Each of our chemical manufacturing facilities generates process wastewater, which may include cooling tower and boiler water quality control streams, contact storm water (rain water inside the facility area that picks up contaminants) and miscellaneous spills and leaks from process equipment. The process water discharge, storm-water runoff and miscellaneous spills and leaks are governed by various permits generally issued by the respective state environmental agencies as authorized by the United States Environmental Protection Agency (EPA), subject to oversight by the EPA. These permits limit the type and amount of effluents that can be discharged and controls the method of such discharge. The following are discharge water matters in relation to the respective permits.

The El Dorado Facility is subject to a state National Pollutant Discharge Elimination System (NPDES) discharge water permit issued by the Arkansas Department of Environmental Quality (ADEQ). The El Dorado Facility is currently operating under an NPDES discharge water permit, which became effective in 2004 (2004 NPDES permit). In November 2010, a preliminary draft of a discharge water permit renewal for the El Dorado Facility, which contains more restrictive limits, was issued by the ADEQ.

EDC believes that the El Dorado Facility has generally demonstrated its ability to comply with applicable ammonia and nitrate permit limits, but has, from time to time, had difficulty demonstrating consistent compliance with the more restrictive dissolved minerals permit levels. As part of the El Dorado Facility's long-term compliance plan, EDC has pursued a rulemaking and permit modification with the ADEQ as to the discharge requirements relating to its dissolved minerals. The ADEQ approved a rule change, but the EPA formally disapproved the rule change. In October 2011, EDC filed a lawsuit against the EPA in the United States District Court, El Dorado, Arkansas, appealing the EPA's decision

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disapproving the rule change. In March 2013, the District Court affirmed the EPA's decision. EDC has appealed the District Court's decision. We do not believe this matter regarding the dissolved minerals will be an issue once the pipeline discussed below is operational.

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LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Note 9: Commitments and Contingencies (continued)

During 2012, EDC settled an Administrative Complaint issued by the EPA, and thereafter handled by the United States Department of Justice (DOJ), relating to certain alleged violations of EDC's 2004 NPDES permit. Initially the Administrative Complaint sought a penalty of \$124,000 for alleged violations through December 31, 2010, but was settled by EDC for \$100,000 and the EPA/DOJ indicated that any alleged violations from and after January 1, 2011, would be addressed at a later date. Thereafter, the DOJ advised that some action would be taken for alleged violations occurring after December 31, 2010. As of the date of this report, no action has been filed by the DOJ. The cost (or range of costs) cannot currently be reasonably estimated regarding this matter. Therefore, no liability has been established at June 30, 2013.

The City of El Dorado, Arkansas (the City) is constructing a pipeline for disposal of wastewater generated by the City and by certain companies in the El Dorado area. EDC and other companies in the El Dorado area have entered into a funding agreement and operating agreement with the City, pursuant to which each party has agreed to contribute to the cost of construction and the annual operating costs of the pipeline for the right to use the pipeline to dispose its wastewater. EDC is funding a portion of the construction of the pipeline that will be owned by the City because it believes that it will enable EDC to comply with water discharge permit limits under current and foreseeable regulations. EDC anticipates its share of the funding for the capital cost in connection with the construction of the pipeline will be approximately \$3.7 million, of which most of these costs have been incurred and capitalized as of June 30, 2013. The City plans to complete the construction of the pipeline in 2013. Once the pipeline is completed, EDC is contractually obligated to pay a portion of the operating costs of the pipeline, which portion is estimated to be \$100,000 to \$150,000 annually. The initial term of the operating agreement is through December 2053.

In addition, the El Dorado Facility is currently operating under a consent administrative order (2006 CAO) that recognizes the presence of nitrate contamination in the shallow groundwater. The 2006 CAO required EDC to continue semiannual groundwater monitoring, to continue operation of a groundwater recovery system and to submit a human health and ecological risk assessment to the ADEQ relating to the El Dorado Facility. The final remedy for shallow groundwater contamination, should any remediation be required, will be selected pursuant to a new consent administrative order and based upon the risk assessment. The cost of any additional remediation that may be required will be determined based on the results of the investigation and risk assessment, of which cost (or range of costs) cannot currently be reasonably estimated. Therefore, no liability has been established at June 30, 2013, in connection with this matter.

2. Air Matters

In connection with a national enforcement initiative, the EPA has sent information requests to most, if not all, of the operators of nitric acid plants in the United States, including our El Dorado and Cherokee Facilities and the Baytown Facility operated by our subsidiary, EDN, under Section 114 of the Clean Air Act as to construction and modification activities at each of these facilities over a period of years. These information requests were to enable the EPA to determine whether these facilities are in compliance with certain provisions of the Clean Air Act. If the EPA were successful in establishing that any of our chemical facilities were in violation of the Clean Air Act, the EPA could assess civil penalties of up to \$27,500 per day and require the facility to retrofit with the best available control technology.

After a review by our Chemical Business of these facilities in obtaining information for the EPA pursuant to the EPA's request, our Chemical Business management believes that certain facilities within our Chemical Business will be required to make capital improvements to emission equipment in order to comply with the requirements of the Clean Air Act. During the second quarter of 2013, we negotiated an oral global agreement in principle with the EPA/DOJ to settle this matter. Settlement of this matter is subject to the parties entering into definitive settlement agreements and consent decrees and such being finalized after the notice and comment period. The proposed oral agreement in principle provides, among other things, the following:

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LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Note 9: Commitments and Contingencies (continued)

all of our Chemical Business nitric acid plants are to achieve certain emission rates within a certain time period for each plant. In order to achieve these emission rates, six of our Chemical Business eight nitric acid plants will require additional pollution control technology equipment to achieve the emission rates agreed upon. We have already completed necessary modifications at two of our Chemical Business existing nitric acid plants. The cost of the necessary pollution control equipment is estimated to range from \$2.0 million to \$3.0 million for each of the remaining six nitric acid plants;

our Chemical Business will provide a reforestation mitigation project that is unrelated to our emissions or activities and will not be located at one of our plant sites, which we estimate will cost approximately \$150,000 and is included in our accrued liabilities for environmental matters discussed above; and

a civil penalty to be paid by our Chemical Business in the amount of \$725,000 (which includes the \$100,000 civil penalty to the ODEQ discussed below), which amount is included in our accrued liabilities for environmental matters discussed above.

One of our subsidiaries, Pryor Chemical Company (PCC), within our Chemical Business, has been advised that the Oklahoma Department of Environmental Quality (ODEQ) is conducting an investigation into whether the chemical production facility located in Pryor, Oklahoma (the Pryor Facility) was in compliance with certain rules and regulations of the ODEQ and whether the Pryor Facility s reports of certain air emissions relating primarily to 2011 were intentionally reported incorrectly to the ODEQ. Pursuant to the request of the ODEQ, PCC has submitted information and a report to the ODEQ as to the reports filed by the Pryor Facility relating to the air emissions in question and has and continues to cooperate with the ODEQ in connection with this investigation. However, on February 20, 2013, investigators with the ODEQ obtained documents from the Pryor Facility in connection with this investigation pursuant to a search warrant and interviewed several employees at the facility. As of June 30, 2013, we are not aware of any recommendations made or to be made by the ODEQ with respect to formal legal action to be taken or recommended as a result of this ongoing investigation.

By letter dated April 19, 2013 (the letter), ODEQ, based on its inspection of our Pryor Facility conducted in December 2012, identified fourteen issues of alleged non-compliance and concern from the evaluation relating to federal and state air quality regulations, some of which were the subject of the ongoing investigation by ODEQ described above. ODEQ requested that PCC submit to ODEQ certain additional records regarding air emissions, calculations demonstrating compliance with certain air emissions, and a compliance plan providing for remedial measures for certain alleged noncompliance matters. ODEQ has advised PCC that compliance with such requests may allow PCC to avoid receipt of a notice of violation. PCC engaged in discussions with ODEQ to resolve all matters identified in the letter. Subsequently, a settlement was reached to resolve the allegations identified in the letter. Three of the violations were already resolved through the global settlement with the EPA/DOJ discussed above, and ODEQ agreed to resolve the remaining eleven violations by PCC paying a civil penalty for \$100,000 (which amount is included in the \$725,000 civil penalty discussed above) with the settlement being addressed as an addition to the global settlement discussed above. This settlement is unrelated to the pending ODEQ investigation at the Pryor Facility described above, which remains ongoing to our knowledge.

3. Other Environmental Matters

In 2002, two subsidiaries within our Chemical Business sold substantially all of their operating assets relating to a Kansas chemical facility (Hallowell Facility) but retained ownership of the real property. Even though we continued to own the real property, we did not assess our continuing involvement with our former Hallowell Facility to be significant and therefore accounted for the sale as discontinued operations. Our subsidiary retained the obligation to be responsible for, and perform the activities under, a previously executed consent order to investigate the surface and subsurface contamination at the real property and a corrective action strategy based on the investigation. In addition, certain of our subsidiaries agreed to indemnify the buyer of such assets for these environmental matters. Based on the assessment discussed above, we account

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for transactions associated with the Hallowell Facility as discontinued operations.

The successor (Chevron) of a prior owner of the Hallowell Facility has agreed in writing, on a nonbinding basis and within certain other limitations, to pay and has been paying one-half of the costs of the interim measures relating to this matter as approved by the Kansas Department of Environmental Quality, subject to reallocation.

Our subsidiary and Chevron are pursuing with the state of Kansas a course of long-term surface and groundwater monitoring to track the natural decline in contamination. Currently, our subsidiary and Chevron are in the process of performing additional surface and groundwater testing. We have accrued for our allocable portion of costs for the additional testing, monitoring and risk assessments that could be reasonably estimated.

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LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Note 9: Commitments and Contingencies (continued)

In addition during 2010, the Kansas Department of Health and Environment (KDHE) notified our subsidiary and Chevron that the Hallowell Facility has been referred to the KDHE s Natural Resources Trustee, who is to consider and recommend restoration, replacement and/or whether to seek compensation. KDHE will consider the recommendations in its evaluation. Currently, it is unknown what damages the KDHE would claim, if any. The ultimate required remediation, if any, is unknown.

The nature and extent of a portion of the requirements are not currently defined, and the associated costs (or range of costs) are not currently reasonably estimable.

Our allocable portion of the total estimated liability related to the Hallowell Facility has been established in connection with this matter and is included in our accrued liabilities for environmental matters discussed above. The estimated amount is not discounted to its present value.

B. Other Pending, Threatened or Settled Litigation

During April 2013, an explosion and fire occurred at the West Fertilizer Co. (West Fertilizer), located in West, Texas, causing death, bodily injury and substantial property damage. West Fertilizer is not owned or controlled by us, but West Fertilizer had been a customer of EDC, purchasing ammonium nitrate (AN) from EDC from time to time. LSB and EDC have received letters from counsel purporting to represent subrogated insurance carriers, personal injury claimants and persons who suffered property damages informing them that their clients are conducting investigations into the cause of the explosion and fire to determine, among other things, whether AN manufactured by EDC and supplied to West Fertilizer was stored at West Fertilizer at the time of the explosion and, if so, whether such AN may have been one of the contributing factors of the explosion. Other manufacturers of AN also supplied AN to West Fertilizer. The lawsuits that have been filed name West Fertilizer and another supplier of AN as defendants, but neither EDC nor LSB have been named in any of these suits. EDC does not believe that its product was in storage at West Fertilizer at the time of the explosion. Furthermore, EDC does not believe that its product would have been a contributing factor in the explosion even if it had been stored at West Fertilizer at the time of the explosion. EDC has retained a firm specializing in cause and origin investigations, with particular experience with fertilizer facilities, to assist EDC in its own investigation. LSB and EDC have placed its liability insurance carrier on notice of this matter, which policies have aggregate limits of general liability totaling \$100 million, with a self-insured retention of \$250,000. As of June 30, 2013, no liability has been established in connection with this matter.

Other Claims and Legal Actions

We are also involved in various other claims and legal actions including claims for damages resulting from water leaks related to our Climate Control products and other product liability occurrences. Most of the product liability claims are covered by our general liability insurance, which generally includes a deductible of \$250,000 per claim. For any claims or legal actions that we have assessed the likelihood of our liability as probable, we have recognized our estimated liability up to the applicable deductible. At June 30, 2013, our accrued general liability insurance claims were \$489,000 and are included in accrued and other liabilities. It is possible that the actual future development of claims could be different from our estimates but, after consultation with legal counsel, we believe that changes in our estimates will not have a material effect on our business, financial condition, results of operations or cash flows.

Note 10: Derivatives, Hedges, Financial Instruments and Carbon Credits

We have two classes of contracts that are accounted for on a fair value basis, which are commodities futures/forward contracts (commodities contracts) and interest rate contracts as discussed below. All of these contracts are used as economic hedges for risk management purposes but are not designated as hedging instruments. In addition, as discussed below, we are issued climate reserve tonnes (carbon credits), of which a certain portion of the carbon credits are to be sold and the proceeds given to Bayer. The carbon credits are accounted for on a fair value basis as discussed below. Also the contractual obligations associated with these carbon credits are accounted for on a fair value basis (as discussed

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below) unless we enter into a firm sales commitment to sell the carbon credits. The valuations of these assets and liabilities were determined based on quoted market prices or, in instances where market quotes are not available, other valuation techniques or models used to estimate fair values.

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LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Note 10: Derivatives, Hedges, Financial Instruments and Carbon Credits (continued)

The valuations of contracts classified as Level 1 are based on quoted prices in active markets for identical contracts, when applicable. The valuations of contracts classified as Level 2 are based on quoted prices for similar contracts and valuation inputs other than quoted prices that are observable for these contracts. At June 30, 2013 and December 31, 2012, the valuations of contracts classified as Level 2 related to interest rate swap contracts. For interest rate swap contracts, we utilize valuation software and market data from a third-party provider. These contracts are valued using a discounted cash flow model that calculates the present value of future cash flows pursuant to the terms of the contracts and using market information for forward interest-rate yield curves. At June 30, 2013, the valuation inputs included the contractual weighted-average pay rate of 3.23% and the estimated market weighted-average receive rate of 0.69%. No valuation input adjustments were considered necessary relating to nonperformance risk for the contracts.

The valuations of assets and liabilities classified as Level 3 are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. At June 30, 2013 and December 31, 2012, the valuations (\$1.00 and \$0.50 per carbon credit, respectively) of the carbon credits and the contractual obligations associated with these carbon credits are classified as Level 3 and are based on the range of ask/bid prices obtained from a broker adjusted downward due to minimal market volume activity. The valuations are using undiscounted cash flows based on management's assumption that the carbon credits would be sold and the associated contractual obligations would be extinguished in the near term. In addition, no valuation input adjustments were considered necessary relating to nonperformance risk for the carbon credits and associated contractual obligations.

Commodities Contracts

Raw materials for use in our manufacturing processes include copper used by our Climate Control Business and anhydrous ammonia and natural gas used by our Chemical Business. As part of our raw material price risk management, we periodically enter into futures/forward contracts for these materials, which contracts may be required to be accounted for on a mark-to-market basis. At June 30, 2013, we did not have any futures/forward copper contracts requiring mark-to-market accounting. At December 31, 2012, our futures/forward copper contracts were for 625,000 pounds of copper through May 2013 at a weighted-average cost of \$3.53 per pound. At June 30, 2013 and December 31, 2012, we did not have any futures/forward natural gas contracts requiring mark-to-market accounting. The cash flows relating to these contracts are included in cash flows from continuing operating activities, when applicable.

Interest Rate Contracts

As part of our interest rate risk management, we periodically purchase and/or enter into various interest rate contracts. In February 2011, we entered into an interest rate swap at no cost, which sets a fixed three-month LIBOR rate of 3.23% on a declining balance (from \$23.8 million to \$18.8 million) for the period beginning in April 2012 through March 2016. This contract is a free-standing derivative and is accounted for on a mark-to-market basis. During the six months ended June 30, 2013 and 2012, no cash flows occurred relating to the purchase or sale of interest rate contracts. The cash flows associated with the interest rate swap payments are included in cash flows from continuing operating activities.

Carbon Credits and Associated Contractual Obligation

Periodically, we are issued carbon credits by the Climate Action Reserve in relation to a greenhouse gas reduction project ("Project ") performed at the Baytown Facility. Pursuant to the terms of the agreement with Bayer, a certain portion of the carbon credits are to be used to recover the costs of the Project, and any balance thereafter to be allocated between Bayer and EDN. We have no obligation to reimburse Bayer for its costs associated with the Project, except through the transfer or sale of the carbon credits when such credits are issued to us. The carbon credits are accounted for on a fair value basis, and the contractual obligations associated with these carbon credits are also accounted for on a fair value basis (unless we enter into a firm sales commitment to sell the carbon credits). At June 30, 2013, we had approximately 625,000 carbon credits (a minimal amount at December 31, 2012), all of which were subject to contractual obligations. The cash flows associated with the carbon

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credits and the associated contractual obligations are included in cash flows from continuing investing activities, when applicable.

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The following details our assets and liabilities that are measured at fair value on a recurring basis at June 30, 2013 and December 31, 2012:

Description	Total Fair Value At June 30, 2013	Fair Value Measurements at June 30, 2013 Using				Total Fair Value at December 31, 2012
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2) (In Thousands)	Significant Unobservable Inputs (Level 3)		
Assets Supplies, prepaid items and other:						
Commodities contracts	\$	\$	\$	\$		\$ 79
Carbon credits	625			625		91
Total	\$ 625	\$	\$	\$ 625		\$ 170
Liabilities Current and noncurrent accrued and other liabilities:						
Contractual obligations -carbon credits	\$ 625	\$	\$	\$ 625		\$ 91
Interest rate contracts	1,449		1,449			1,874
Total	\$ 2,074	\$	\$ 1,449	\$ 625		\$ 1,965

None of our assets or liabilities measured at fair value on a recurring basis transferred between Level 1 and Level 2 classifications for the periods presented below. In addition, the following is a reconciliation of the beginning and ending balances for assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

	Assets		Liabilities		Assets		Liabilities	
	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012
	(In Thousands)							
Beginning balance	\$ 91	\$ 42	\$ (91)	\$ (42)	\$ 312	\$ 42	\$ (312)	\$ (42)
Transfers into Level 3								
Transfers out of Level 3								
Total realized and unrealized gains (losses) included in earnings	546		(546)		313		(313)	
Purchases								
Issuances								

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Sales	(12)								
Settlements		12							
Ending balance	\$ 625	\$ 42	\$ (625)	\$ (42)	\$ 625	\$ 42	\$ (625)	\$ (42)	

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

	Six Months Ended June 30,		Three Months Ended June 30,	
	2013	2012	2013	2012
	(In Thousands)			
Total net gains (losses) included in earnings:				
Cost of sales Commodities contracts	\$ (275)	\$ (72)	\$ (113)	\$ (214)
Cost of sales Foreign exchange contracts		(8)		(8)
Other income Carbon credits	546		313	
Other expense Contractual obligations relating to carbon credits	(546)		(313)	
Interest expense Interest rate contracts	89	(329)	88	(233)
	\$ (186)	\$ (409)	\$ (25)	\$ (455)

	Six Months Ended June 30,		Three Months Ended June 30,	
	2013	2012	2013	2012
	(In Thousands)			
Change in unrealized gains (losses) relating to contracts still held at period end:				
Cost of sales Commodities contracts	\$	\$ (208)	\$	\$ (209)
Cost of sales Foreign exchange contracts		(2)		(2)
Other income Carbon credits	534		313	
Other expense Contractual obligations relating to carbon credits	(534)		(313)	
Interest expense Interest rate contracts	425	226	257	(44)
	\$ 425	\$ 16	\$ 257	\$ (255)

At June 30, 2013 and December 31, 2012, we did not have any financial instruments with fair values significantly different from their carrying amounts. These financial instruments include our long-term debt agreements, which valuations are classified as Level 3 and are based on valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. The fair value measurement of our long-term debt agreements are valued using a discounted cash flow model that calculates the present value of future cash flows pursuant to the terms of the debt agreements and applies estimated current market interest rates. The estimated current market interest rates are based primarily on interest rates currently being offered on borrowings of similar amounts and terms. In addition, no valuation input adjustments were considered necessary relating to nonperformance risk for the debt agreements. The fair value of financial instruments is not indicative of the overall fair value of our assets and liabilities since financial instruments do not include all assets, including intangibles, and all liabilities.

Table of Contents**LSB INDUSTRIES, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(Unaudited)****Note 11: Income Taxes**

Provisions for income taxes are as follows:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2013	2012	2013	2012
	(In Thousands)			
Current:				
Federal	\$ 784	\$ 17,441	\$ 1,754	\$ 12,051
State	297	3,273	412	2,198
Total Current	1,081	20,714	2,166	14,249
Deferred:				
Federal	2,280	2,220	1,971	1,049
State	261	319	230	153
Total Deferred	2,541	2,539	2,201	1,202
Provisions for income taxes	\$ 3,622	\$ 23,253	\$ 4,367	\$ 15,451

For the six and three months ended June 30, 2013 and 2012, the current provisions for federal income taxes shown above includes regular federal income tax after the consideration of permanent and temporary differences between income for GAAP and tax purposes, including the benefit related to the retroactive tax relief for certain tax provisions that expired in 2012 as discussed below. For the six and three months ended June 30, 2013 and 2012, the current provisions for state income taxes shown above includes regular state income tax and provisions for uncertain state income tax positions.

Our annual estimated effective tax rate for 2013 includes the impact of permanent tax differences, such as the domestic manufacturer's deduction, the advanced energy credit and other permanent items. In connection with the American Taxpayer Relief Act of 2012 that was signed into law in January 2013, we recorded a one-time benefit of approximately \$0.5 million related to the retroactive tax relief for certain tax provisions that expired in 2012. Because the legislation was signed into law after December 31, 2012, the retroactive effects of the law reduced the current provision for the six months ended June 30, 2013 and impacted the estimated effective tax rate for 2013.

The tax provision for the six months ended June 30, 2013 and 2012 was \$3.6 million (37% of pre-tax income, excluding the impact of the 2012 retroactive tax benefits) and \$23.3 million (36% of pre-tax income), respectively.

LSB and certain of its subsidiaries file income tax returns in the U.S. federal jurisdiction and various state jurisdictions. With few exceptions, the 2009-2011 years remain open for all purposes of examination by the U.S. Internal Revenue Service (IRS) and other major tax jurisdictions. We are under examination by the IRS for the tax years 2008-2010. As of June 30, 2013, the IRS has proposed certain adjustments, which we are protesting. We anticipate that the adjustments, if any, will not result in a material change to our financial position, results of operations and cash flows.

Note 12: Property and Business Interruption Insurance Claims and Recoveries

El Dorado Facility

On May 15, 2012, the El Dorado Facility suffered significant damage when a reactor in its 98% strength nitric acid plant (DSN plant) exploded. No employees or individuals in the surrounding area were seriously injured as a result of the explosion. In addition, several other plants and infrastructure within the El Dorado Facility sustained various degrees of damage. Our insurance policy provides, for the policy period covering this claim, for repair or replacement cost coverage relating to property damage with a \$1.0 million deductible and provides for business interruption coverage for certain lost profits and extra expense with a 30-day waiting period. As a result of this event, a notice of insurance claims for property damage and business interruption was filed with the insurance carriers. The engineering firm representing our insurance carriers has determined that the DSN plant was not destroyed by the explosion and was repairable. However, we have concluded that due to the extensive damage, the DSN plant should not be repaired but should be replaced with a new 65% strength nitric acid plant and a separate nitric acid concentrator.

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LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Note 12: Property and Business Interruption Insurance Claims and Recoveries (continued)

Based upon our assessment that it was probable that the amount of coverage for property damages would exceed our property loss deductible, the net book value of the damaged property and other recoverable costs incurred through June 30, 2013, we recorded an insurance claim receivable relating to this event, which offset the loss on disposal of the damaged property and certain repairs and clean-up costs incurred (recoverable costs).

As of June 30, 2013, our insurance carriers approved unallocated payments totaling \$50 million. We received correspondence associated with the \$30 million received in 2013, which stated that our insurance carriers are still investigating the circumstances surrounding this event (including the cause of this event, scope of our losses and support for our claim) under a reservation of rights. For financial reporting purposes, we allocated \$37.5 million to our property insurance claim and \$12.5 million to our business interruption claim primarily based on the claims information provided to our insurance carriers as of that time in relation to our requests for insurance proceeds.

The \$37.5 million allocated to the property insurance claim was partially applied against the recoverable costs totaling \$22.8 million. The insurance recovery in excess of the recoverable costs of \$14.7 million was deferred (included in current liabilities at June 30, 2013) since it is considered a gain contingency. The deferred portion of this recovery, and any additional recoveries, will be recognized if, and when, realized or realizable and earned.

The insurance recovery of \$12.5 million allocated to the business interruption claim was applied against recoverable costs (primarily relating to additional expenses associated with purchased product sold to our customers while certain of our nitric and sulfuric acid plants were being repaired) totaling \$8.5 million as a reduction to cost of sales (\$7.3 million during the fourth quarter of 2012, \$0.7 million during the first quarter of 2013, and \$0.5 million during the second quarter of 2013). The insurance recovery in excess of recoverable costs of \$4.0 million was deferred (included in current liabilities at June 30, 2013) since a portion of this amount relates to recoverable costs, which we were unable to conclude that it was at least probable (for financial reporting purposes) that these costs would be approved and a portion of this amount relates to lost profits, which is considered a gain contingency. The deferred portion of this recovery, and any additional recoveries, will be recognized if, and when, realized or realizable and earned.

As of June 30, 2013, there was no insurance claim receivable balance included in accounts receivable relating to this event.

Cherokee Facility

On November 13, 2012, a pipe ruptured within our chemical production facility located in Cherokee, Alabama (the Cherokee Facility) causing damage primarily to the heat exchanger portion of its ammonia plant. No serious injuries or environmental impact resulted from the pipe rupture. As a result of the damage, the Cherokee Facility could only produce, on a limited basis, nitric acid and AN solution from purchased ammonia until the repairs were completed. Our insurance policy provides, for the policy period covering this claim, for repair or replacement cost coverage relating to property damage with a \$2.5 million deductible and provides for business interruption coverage for certain lost profits and extra expense with a 30-day waiting period. As a result of this event, a notice of insurance claims for property damage and business interruption was filed with the insurance carriers.

Based upon our assessment that it was probable that the amount of coverage for property damages would exceed our property loss deductible, the net book value of the damaged property and other recoverable costs incurred, we recorded an insurance claim receivable relating to this event, which offset the loss on the disposal of the damaged property and other recoverable costs incurred.

As of June 30, 2013, our insurance carriers approved payments relating to our business interruption claim totaling \$15 million. We received correspondence associated with the approval of these payments, which stated that our insurance carriers are still investigating the circumstances surrounding this event (including the cause of this event, scope of our losses and support for our claim) under a reservation of rights.

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The business interruption insurance recovery of \$15 million was applied against recoverable costs (primarily relating to additional expenses associated with purchased product sold or used in products sold to our customers while our facility was being repaired) totaling \$13 million as a reduction to cost of sales (\$10.1 million during the first quarter of 2013 and \$2.9 million during the second quarter of 2013). The insurance recovery in excess of recoverable costs of \$2.0 million was deferred (included in current liabilities at June 30, 2013) since a portion of this amount relates to recoverable costs, which we were unable to conclude that it was at least probable (for financial reporting purposes) that these costs would be approved and a portion of this amount relates to lost profits, which is considered a gain contingency. The deferred portion of this recovery, and any additional recoveries, will be recognized if, and when, realized or realizable and earned.

Table of Contents**LSB INDUSTRIES, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****(Unaudited)****Note 12: Property and Business Interruption Insurance Claims and Recoveries (continued)**

As of June 30, 2013, the balance of the insurance claim receivable, included in accounts receivable, relating to this event was \$1.9 million, consisting of recoverable costs associated with our property insurance claim.

It is possible that the actual future development of the insurance claims discussed above could be different from our current allocations and estimates.

Note 13: Other Expense, Other Income and Non-Operating Other Expense (Income), net

	Six Months Ended June 30,		Three Months Ended June 30,	
	2013	2012	2013	2012
	(In Thousands)			
Other expense:				
Dismantle and demolition expense (1)	\$ 2,100	\$	\$ 912	\$
Miscellaneous penalties	796		484	
Realized and unrealized losses on contractual obligations associated with carbon credits	546		313	
Impairment on long-lived assets	210			
Losses on sales and disposals of property and equipment		551	(50)	536
Miscellaneous expense (2)	104	171	67	19
Total other expense	\$ 3,756	\$ 722	\$ 1,726	\$ 555
Other income:				
Realized and unrealized gains on carbon credits	\$ 546	\$	\$ 313	\$
Settlements of litigation and potential litigation (3)	545			
Gains on sales and disposals of property and equipment	179		179	
Miscellaneous income (2)	275	348	91	112
Total other income	\$ 1,545	\$ 348	\$ 583	\$ 112
Non-operating other expense (income), net:				
Interest income	\$ (12)	\$ (48)	\$ (4)	\$ (24)
Miscellaneous income (2)		(263)		(263)
Miscellaneous expense (2)	36	39	12	20
Total non-operating other expense (income), net	\$ 24	\$ (272)	\$ 8	\$ (267)

(1) Amount relates to the dismantling and demolition of certain plant and equipment at our chemical facilities.

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- (2) Amounts represent numerous unrelated transactions, none of which are individually significant requiring separate disclosure.
- (3) Amount relates primarily to a settlement reached associated with a class action insurance brokerage antitrust litigation.

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LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Note 14: Segment Information

	Six Months Ended June 30,		Three Months Ended June 30,	
	2013	2012	2013	2012
	(In Thousands)			
Net sales:				
Chemical (1)	\$ 198,818	\$ 262,339	\$ 121,328	\$ 138,134
Climate Control	147,627	130,304	77,357	67,546
Other	6,457	6,877	3,538	3,595
	\$ 352,902	\$ 399,520	\$ 202,223	\$ 209,275
Gross profit: (2)				
Chemical (1)	\$			