

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 Quarterly period ended September 30, 2001

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

The number of shares outstanding of the Registrant's voting Common Stock, as of October 31, 2001 was 11,933,563 shares excluding 3,272,426 shares held as treasury stock.

PART I

FINANCIAL INFORMATION

Company or group of companies for which report is filed: LSB Industries, Inc. and all of its subsidiaries.

The accompanying condensed consolidated balance sheet of LSB Industries, Inc., at September 30, 2001, the condensed consolidated statements of operations for the nine-month and three-month periods ended September 30, 2001 and 2000 and the condensed consolidated statements of cash flows for the nine-month periods ended September 30, 2001 and 2000 have been subjected to a review, in accordance with standards established by the American Institute of Certified Public Accountants, by Ernst & Young LLP, independent auditors, whose report with respect thereto appears elsewhere in this Form 10-Q. The financial statements mentioned above are unaudited and reflect all adjustments, consisting only of adjustments of a normal recurring nature, except for the extraordinary gain recognized in the third quarter of 2001 and the second and third quarters of 2000 on the extinguishment of certain Senior Unsecured Notes as discussed in Note 7 of the Notes to the Condensed Consolidated Financial Statements, the gain on termination of the former firm purchase commitments recognized in the second quarter of 2001, and the loss provision recognized in the first and second quarters of 2000 on firm purchase commitments which are, in the opinion of management, necessary for a fair presentation of the interim periods. The results of operations for the nine months ended September 30, 2001, are not necessarily indicative of the results to be expected for the full year. The condensed consolidated balance sheet at December 31, 2000 was derived from audited financial statements as of that date. Reference is made to the Company's Annual Report on Form 10-K for the year ended December 31, 2000, for an expanded discussion of the Company's financial disclosures and accounting policies.

LSB INDUSTRIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Information at September 30, 2001 is unaudited)
(Dollars in thousands)

<u>ASSETS</u>	<u>September 30,</u> <u>2001</u>	<u>December 31,</u> <u>2000</u>
Current assets:		
Cash and cash equivalents	\$ 1,832	\$ 3,063
Restricted cash	1,117	-
Trade accounts receivable, net	48,921	48,333
Inventories:		
Finished goods	20,010	18,990
Work in process	3,502	2,962
Raw materials	8,586	9,687
Total inventory	<u>32,098</u>	<u>31,639</u>

Supplies and prepaid items:		
Precious metals	2,747	1,621
Other	4,601	4,356
	<u>7,348</u>	<u>5,977</u>
Total current assets	91,316	89,012
Property, plant and equipment, net	78,338	80,884
Other assets, net	19,979	22,999
	<u>189,633</u>	<u>192,895</u>

(Continued on following page)

LSB INDUSTRIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Information at September 30, 2001 is unaudited)
(Dollars in thousands)

<u>LIABILITIES AND STOCKHOLDERS' DEFICIT</u>	September 30, 2001	December 31, 2000
Current liabilities:		
Drafts payable	\$ 42	\$ 224
Accounts payable	25,752	26,765
Accrued liabilities	23,533	25,847
Accrued losses on firm purchase commitments	-	3,465
Current portion of long-term debt	48,821	42,101
	<u>98,148</u>	<u>98,402</u>
Total current liabilities		
Long-term debt	89,537	93,904
Other non-current liabilities:		
Accrued losses on firm purchase commitments	-	3,450
Negative goodwill	1,983	1,329
Other	6,562	5,113
	<u>8,545</u>	<u>9,892</u>
Commitments and Contingencies (Note 6)	-	-
Redeemable, noncumulative convertible preferred stock, \$100 par value; 1,295 shares issued and outstanding (1,462 shares in 2000)	123	139
Stockholders' deficit:		
Series B 12% cumulative, convertible preferred stock \$100 par value; 20,000 shares issued and outstanding	2,000	2,000
Series 2 \$3.25 convertible, exchangeable Class C preferred stock, \$50 stated value; 628,550 shares issued	31,427	31,427
Common stock, \$.10 per value 75,000,000 shares authorized, 15,204,989 shares issued (15,163,909 shares in 2000)	1,521	1,516
Capital in excess of par value	52,429	52,376
Accumulated other comprehensive loss	(2,222)	-
Accumulated deficit	(75,607)	(80,480)
	<u>9,548</u>	<u>6,839</u>
Less treasury stock at cost:		
Series 2 Preferred, 5,000 shares	200	200
Common stock, 3,272,426 shares in 2001 (3,285,957 shares in 2000)	16,068	16,081
	<u>(6,720)</u>	<u>(9,442)</u>
	<u>\$ 189,633</u>	<u>\$ 192,895</u>

(See accompanying notes)

LSB INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
Nine Months Ended September 30, 2001 and 2000
(Dollars in thousands, except per share amounts)

	2001	2000
Revenues:		
Net sales	\$ 261,428	\$ 214,290
Gain on sale of property and equipment (Note 9)	3,939	-

Other income	1,157	4,027
	<u>266,524</u>	<u>218,317</u>
Costs and expenses:		
Cost of sales	217,376	172,075
Selling, general and administrative	36,798	35,332
Interest	11,010	11,720
Provision for loss on (benefit from termination of) firm purchase commitments	(2,338)	2,485
Other expenses	1,185	2,084
	<u>264,031</u>	<u>223,696</u>
Income (loss) from continuing operations before provision for income taxes and extraordinary gain	2,493	(5,379)
Provision for income taxes	216	-
	<u>2,277</u>	<u>(5,379)</u>
Income (loss) from continuing operations before extraordinary gain	2,277	(5,379)
Net loss from discontinued operations	-	(579)
Extraordinary gain, net of income taxes of \$35 (\$225 in 2000) (Note 7)	2,596	17,196
	<u>2,596</u>	<u>17,196</u>
Net income	\$ 4,873	\$ 11,238
	<u>\$ 4,873</u>	<u>\$ 11,238</u>
Net income applicable to common stock (Note 3)	\$ 3,173	\$ 9,033
	<u>\$ 3,173</u>	<u>\$ 9,033</u>
Weighted average common shares (Note 3):		
Basic	11,906,249	11,868,963
	<u>11,906,249</u>	<u>11,868,963</u>
Diluted	12,329,937	11,868,963
	<u>12,329,937</u>	<u>11,868,963</u>
Income (loss) per common share (Note 3):		
Basic:		
Net income (loss) from continuing operations	\$.05	\$ (.66)
Net loss from discontinued operations	-	(.05)
Extraordinary gain	.22	1.47
	<u>.27</u>	<u>.76</u>
Net income applicable to common stock	\$.27	\$.76
	<u>\$.27</u>	<u>\$.76</u>
Diluted:		
Net income (loss) from continuing operations	\$.05	\$ (.66)
Net loss from discontinued operations	-	(.05)
Extraordinary gain	.21	1.47
	<u>.26</u>	<u>.76</u>
Net income applicable to common stock	\$.26	\$.76
	<u>\$.26</u>	<u>\$.76</u>

(See accompanying notes)

LSB INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
Three Months Ended September 30, 2001 and 2000
(Dollars in thousands, except per share amounts)

	2001	2000
	<u>2001</u>	<u>2000</u>
Revenues:		
Net sales	\$ 76,841	\$ 68,106
Gain on sale of property and equipment (Note 9)	3,555	-
Other income	265	1,845
	<u>80,661</u>	<u>69,951</u>
Costs and expenses:		
Cost of sales	66,351	56,860
Selling, general and administrative	12,400	11,984
Interest	3,476	3,636
Other expenses	302	423
	<u>82,529</u>	<u>72,903</u>
Loss from continuing operations before benefit for income taxes and extraordinary gain	(1,868)	(2,952)
Benefit for income taxes	(35)	-
	<u>(1,833)</u>	<u>(2,952)</u>
Loss from continuing operations before extraordinary gain	(1,833)	(2,952)
Net loss from discontinued operations	-	(579)
Extraordinary gain, net of income taxes of \$35 in 2001 (Note 7)	2,566	3,952
	<u>2,566</u>	<u>3,952</u>

Net income	\$	733	\$	421
		<hr/>		<hr/>
Net income (loss) applicable to common stock (Note 3)	\$	166	\$	(195)
		<hr/>		<hr/>
Weighted average common shares (Note 3):				
Basic and diluted		11,928,610		11,877,518
		<hr/>		<hr/>
Income (loss) per common share (Note 3):				
Basic and diluted:				
Net loss from continuing operations	\$	(.21)	\$	(.32)
Net loss from discontinued operations		-		(.05)
Extraordinary gain		.22		.35
		<hr/>		<hr/>
Net income (loss) applicable to common stock	\$.01	\$	(.02)
		<hr/>		<hr/>

(See accompanying notes)

LSB INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
Nine Months Ended September 30, 2001 and 2000
(Dollars in thousands)

	2001	2000
	<hr/>	<hr/>
Cash flows from operating activities:		
Net income	\$ 4,873	\$ 11,238
Adjustments to reconcile net income to cash flows provided by (used in) continuing operations:		
Net loss from discontinued operations	-	579
Extraordinary gain on extinguishment of debt	(2,631)	(17,421)
Gain on sale of property and equipment	(3,939)	-
Depreciation, depletion and amortization:		
Property, plant and equipment	7,337	6,354
Other	533	1,057
Provision for (recovery and reversal of) possible losses on receivables	(107)	1,011
Provision for (realization of) losses on firm sales and purchase commitments, net of inventory write-down	(7,160)	211
Cash provided (used) by changes in assets and liability:		
Trade accounts receivable	(351)	(5,050)
Inventories	(1,124)	3,019
Supplies and prepaid items	154	(527)
Accounts payable	(1,013)	8,554
Accrued liabilities	2,612	4,248
	<hr/>	<hr/>
Net cash provided by (used in) continuing operating activities	(816)	13,273
Cash flows from investing activities:		
Capital expenditures	(5,685)	(4,908)
Proceeds from sale of property and equipment	4,730	76
Restricted cash held in escrow	(1,117)	-
Increase in other assets	(618)	(261)
	<hr/>	<hr/>
Net cash used in investing activities	(2,690)	(5,093)
Cash flows from financing activities:		
Proceeds from long-term and other debt	3,891	2,718
Payments on long-term and other debt	(6,005)	(3,957)
Acquisition of 10 3/4% Senior Notes	(2,066)	(7,002)
Net change in revolving debt facilities	6,607	1,264
Net change in drafts payable	(182)	(25)
Net proceeds from issuance of common stock	30	-
Purchases of preferred stock	-	(1,153)
	<hr/>	<hr/>
Net cash provided by (used in) financing activities	2,275	(8,155)
Net cash used in discontinued operations	-	(579)
	<hr/>	<hr/>
Net decrease in cash and cash equivalents	(1,231)	(554)
Cash and cash equivalents at beginning of period	3,063	3,130
	<hr/>	<hr/>
Cash and cash equivalents at end of period	\$ 1,832	\$ 2,576
	<hr/>	<hr/>

(See accompanying notes)

Note 1: Basis of Presentation The accompanying Condensed Consolidated Financial Statements include the accounts of LSB Industries, Inc. (the "Company") and its subsidiaries. The Company is a diversified holding company which is engaged, through its subsidiaries, in the manufacture and sale of chemical products (the "Chemical Business"), the manufacture and sale of a broad range of air handling and heat pump products (the "Climate Control Business"), and the purchase and sale of machine tools (the "Industrial Products Business"). See Note 5 - Segment Information. All material intercompany accounts and transactions have been eliminated. Certain reclassifications have been made to the prior year Condensed Consolidated

Financial Statements to conform to the current year presentation.

Note 2: Income Taxes At December 31, 2000, the Company had regular- tax net operating loss ("NOL") carryforwards for tax purposes of approximately \$69.8 million (approximately \$42.5 million alternative minimum tax NOLs), exclusive of NOL carryforwards attributable to certain entities sold in March 2001. See Note 6-Commitments and Contingencies. Certain amounts of regular-tax NOL carryforwards expire beginning in 2001. There was approximately \$2 million of income tax expense for the nine-month period of 2001 associated with operations (none in 2000) representing current state income taxes and federal alternative minimum income taxes.

Note 3: Income (Loss) Per Share Net income (loss) applicable to common stock is computed by adjusting the net income by the amount of preferred stock dividend requirements. Basic income (loss) per common share is based upon the net income (loss) applicable to common stock and the weighted average number of common shares outstanding during each period. Diluted income (loss) per share is based on the weighted average number of common shares and dilutive common equivalent shares outstanding and the assumed conversion of dilutive convertible securities outstanding, if any, after appropriate adjustment for interest, net of related income tax effects on convertible notes payable, as applicable.

For the nine months ended September 30, 2001, the Company's Board of Directors did not declare and pay the regular quarterly dividends of \$.8125 on the Company's Series 2 \$3.25 Convertible Class C preferred stock. Dividends in arrears at September 30, 2001, relating to the Company's Series 2 \$3.25 Convertible Class C preferred stock, amounted to approximately \$4.6 million. In addition, the Company's Board of Directors did not declare and pay the January 1, 2001 regular dividend on the Company's Series B 12% Convertible, Cumulative Preferred Stock. Dividends in arrears at September 30, 2001, related to the Company's Series B 12% Convertible, Cumulative Preferred Stock, amounted to approximately \$5 million.

Note 3: Income (Loss) Per Share (continued).

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

(Dollars in thousands, except per share amounts)

	Nine Months Ended		Three Months Ended	
	September 30,		September 30,	
	2001	2000	2001	2000
Numerator:				
Net income	\$ 4,873	\$ 11,238	\$ 733	\$ 421
Preferred stock dividend requirements	(1,700)	(2,205)	(567)	(616)
Numerator for basic earnings (loss) per share - net income (loss) applicable to common stock	3,173	9,033	166	(195)
Preferred stock dividend requirements on preferred stock assumed to be converted, if dilutive	-	-	-	-
Numerator for diluted earnings (loss) per share	\$ 3,173	\$ 9,033	\$ 166	\$ (195)
Denominator:				
Denominator for basic earnings (loss) per share - weighted - average shares	11,906,249	11,868,963	11,928,610	11,877,518
Effect of dilutive securities:				
Employee stock options	362,935	-	-	-
Convertible preferred stock	56,753	-	-	-
Convertible note payable	4,000	-	-	-
Dilutive potential common shares	423,688	-	-	-
Denominator for dilutive earnings (loss) per share - adjusted weighted-average shares and assumed conversions	12,329,937	11,868,963	11,928,610	11,877,518
Basic earnings (loss) per share	\$.27	\$.76	\$.01	\$ (.02)
Diluted earnings (loss) per share	\$.26	\$.76	\$.01	\$ (.02)

Note 4: Stockholders' Deficit

The table below provides detail of activity in the stockholders' deficit accounts for the nine months ended September 30, 2001:

	Common Stock		Non-redeemable Preferred Stock	Capital in excess of par value	Accumulated Other Comprehensive Loss	Accumulated deficit	Treasury Stock - Common	Treasury Stock - Preferred	Total
	Shares	Value							
Balance at	(in thousands)								
December 31, 2000	15,164	\$ 1,516	\$ 33,427	\$ 52,376	\$ -	\$ (80,480)	\$ (16,081)	\$ (200)	\$ (9,442)
Net income				4,873					4,873
Cumulative effect of change in accounting for derivative financial instruments, net of taxes				(2,439)					(2,439)
Reclassification to operations, net of taxes				217					217
Comprehensive income									2,651
Exercise of stock options	34	3	38						41
Conversion of 167 shares of redeemable	7	2	15						17

preferred stock
to
common stock

Net change in treasury stock - common						13				13
Balance at	(1)									
September 30, 2001		15,205	\$ 1,521	\$ 33,427	\$ 52,429	\$ (2,222)	\$ (75,607)	\$ (16,068)	\$ (200)	\$ (6,720)

(1) Includes 3,272 shares of the Company's Common Stock held in treasury. Excluding the 3,272 shares held in treasury, the outstanding shares of the Company's Common Stock at September 30, 2001 were 11,933.

Note 5: Segment Information

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2001	2000	2001	2000
(in thousands)				
Net sales:				
Chemical (1)	\$ 150,423	\$ 107,156	\$ 40,522	\$ 30,848
Climate Control	105,733	98,978	34,920	34,709
Industrial Products (2)	5,272	8,156	1,399	2,549
	<u>\$ 261,428</u>	<u>\$ 214,290</u>	<u>\$ 76,841</u>	<u>\$ 68,106</u>
Gross profit: (3)				
Chemical	\$ 13,647	\$ 14,088	\$ 271	\$ 2,062
Climate Control	28,618	25,840	9,753	8,484
Industrial Products	1,787	2,287	466	700
	<u>\$ 44,052</u>	<u>\$ 42,215</u>	<u>\$ 10,490</u>	<u>\$ 11,246</u>
Operating profit (loss): (4)				
Chemical	\$ 7,884	\$ 5,439	\$ 670	\$ (411)
Climate Control	8,799	8,587	2,977	2,874
Industrial Products	36	245	(210)	39
	<u>16,719</u>	<u>14,271</u>	<u>3,437</u>	<u>2,502</u>
General corporate expenses and other, net	(5,554)	(5,445)	(1,829)	(1,818)
Interest expense	(11,010)	(11,720)	(3,476)	(3,636)
Benefit from termination of (provision for loss on) firm purchase commitments-Chemical	2,338	(2,485)	-	-
Income (loss) from continuing operations before provision (benefit) for income taxes and extraordinary gain	<u>\$ 2,493</u>	<u>\$ (5,379)</u>	<u>\$ (1,868)</u>	<u>\$ (2,952)</u>

(1) Chemical net sales for the nine and three months ended September 30, 2001, include approximately \$27.4 million and \$6.5 million, respectively associated with a subsidiary's operation of the Cherokee Plant acquired on October 31, 2000.

(2) Excludes intersegment sales to Climate Control of \$409,000 for the nine months ended September 30, 2001. Only minimal intersegment sales were recognized during the three months ended September 30, 2001. For the nine and three months ended September 30, 2000, \$676,000 and \$85,000 were excluded, respectively.

(3) Gross profit by industry segment represents net sales less cost of sales. Chemical gross profit for the nine months ended September 30, 2001, includes a gross profit of approximately \$2 million and a gross loss of \$2.1 million for the three months ended September 30, 2001 associated with the Cherokee Plant as discussed above.

(4) Operating profit (loss) by industry segment represents revenues less operating expenses before deducting general corporate expense, interest expense, income taxes, benefit from termination of (provision for loss on) firm purchase commitments and before extraordinary gain. Chemical operating profit for the nine and three months ended September 30, 2001, includes an operating loss of approximately \$0.7 million and \$2.4 million, respectively associated with the Cherokee Plant as discussed above. Certain reclassifications have been made to the prior year segment information to conform to the current year presentation.

Note 6: Contingencies

Legal Matters

Following is a summary of certain legal actions involving the Company:

A. In 1987, the U.S. Environmental Protection Agency ("EPA") notified one of the Company's former subsidiaries, along with numerous other companies, of potential responsibility for clean-up of a waste disposal site in Oklahoma. In 1990, the EPA added the site to the National Priorities List. Following the remedial investigation and feasibility study, in 1992 the Regional Administrator of the EPA signed the Record of Decision ("ROD") for the site. The ROD detailed EPA's selected remedial action for the site and estimated the cost of the remedy at \$3.6 million. In 1992, the Company's subsidiary made settlement proposals which would have entailed a collective payment by the subsidiaries of \$47,000. The site owner rejected this offer and proposed a counteroffer of \$245,000 plus a reopener for costs over \$12.5 million. The EPA rejected the Company's subsidiary's offer, allocating 60% of the cleanup costs to the potentially responsible parties and 40% to the site operator. The EPA estimated the total cleanup costs at \$10.1 million as of February 1993. The site owner rejected all settlements with the EPA, after which the EPA issued an order to the site owner to conduct the remedial design/remedial action approved for the site. In August 1997, the site owner issued an "invitation to settle" to various parties, alleging the total cleanup costs at the site may exceed \$22 million. No legal action has yet been filed. The amount of the cost associated with the clean-up of the site is unknown due to continuing changes in the estimated total cost of clean-up of the site and the percentage of the total waste which was alleged to have been contributed to the site by the former subsidiary of the Company. This liability was assumed as of May 4, 2000, by the purchaser of the Automotive Business, and certain of the Company's subsidiaries received an indemnification by the purchaser of the Automotive Business. In March, 2001, the Company sold to the purchaser of the Automotive Business all of the stock of the corporate entity that formerly comprised the Automotive Business. Due to the deteriorating financial condition of the purchaser of the Automotive Business, the Company does not believe that the purchaser of the Automotive Business can perform its obligations under the referenced indemnification. In May 2001, the buyer of the Automotive Business agreed to allow its lenders to complete a peaceful repossession of its collateral.

B. The Company and its 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 the Company 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 the Chemical Business have in the past resulted, and could in the future result, in penalties, cleanup costs, or other liabilities relating to the handling, manufacture, use, emission, discharge or disposal of pollutants or other substances at or from the Company's facilities or the use or disposal of certain of its chemical products. Significant expenditures have been incurred by the Chemical Business at the El Dorado Facility in order to comply with the Environmental Laws and Health Laws. The Chemical Business could be required to make additional significant site or operational modifications at the El Dorado Facility, involving substantial expenditures.

The Chemical Business entered into a consent administrative order with the Arkansas Department of Environmental Quality ("ADEQ") in August, 1998 (the "Wastewater Consent Order"). The Wastewater Consent Order recognized the presence of nitrate contamination in the shallow groundwater and required installation of an interim groundwater bioremediation treatment system. The bioremediation was not successful in achieving denitrification. The Chemical Business prepared a report to the ADEQ regarding field testing of the shallow groundwater with a plan for quarterly sampling of the monitor wells for the remainder of 2001. Upon completion of the waste minimization activities referenced below, a final remedy for groundwater contamination will be selected, based on an evaluation of risk. There are no known users of groundwater in the area, and preliminary risk assessments have not identified any risk that would require additional remediation. There can be no assurance that the risk assessment will be approved by the ADEQ, or that further work will not be required. The Wastewater Consent Order included a \$183,700 penalty assessment, of which \$125,000 is being satisfied over five years at expenditures of \$25,000 per year for waste minimization activities.

The Wastewater Consent Order also required certain improvements in the wastewater collection and treatment system to be completed by a specified deadline. In September 2001, ADEQ proposed and the Company's subsidiary agreed that in lieu of the Wastewater Consent Order, ADEQ will issue a renewal permit establishing new, more restrictive effluent limits. The Company believes that the new permit will establish new deadlines, which the Company's subsidiary believes will allow a minimum of three years for the El Dorado plant to come into compliance with the new limits. Alternative methods for meeting these requirements are continuing to be examined by the Chemical Business. The Company believes, although there can be no assurance, that any such new effluent limits would not have a material adverse effect on the Company; however, should the facility be unable to operate in compliance with the new limits, such would have a material adverse effect upon the financial position and operating results of the Company and may result in the recognition of impairment of certain long-lived assets.

The wastewater program is not yet finally determined but is currently expected to require future capital expenditures of approximately \$2 to \$3 million. Discussions for securing financing are currently underway.

C. In connection with the sale of the Automotive Business in May 2000, the buyer assumed over \$5 million of vendor liabilities. In March 2001, the Company sold to the buyer all of the stock of the corporate entity that formerly comprised the Automotive Business. As of September 30, 2001, a majority of these liabilities existing prior to the sale had not yet been paid. In May 2001, the buyer of the Automotive Business agreed to allow its lenders to complete a peaceful repossession of its collateral.

The Company has several contingencies, including those set forth above, that could impact its liquidity in the event that the Company is unsuccessful in defending against the claimants or possible claimants. Although management does not anticipate that these claims or possible claims will result in substantial adverse impacts on its liquidity, it is not possible to determine the outcome.

Note 7: Long-Term Debt In November 1997, the Company's wholly owned subsidiary, ClimaChem, Inc. ("ClimaChem"), completed the sale of 10 3/4% Senior Notes due 2007, (the "Notes"). Interest on the Notes is payable semiannually in arrears on June 1 and December 1 of each year, and the principal is payable in the year 2007. The Notes are senior unsecured obligations of ClimaChem and rank *pari passu* in right of payment to all existing senior unsecured indebtedness of ClimaChem and its subsidiaries. The Notes are effectively subordinated to all existing and future senior secured indebtedness of ClimaChem. The outstanding principal balance of the Notes is approximately \$70.6 million at September 30, 2001.

During the nine months ended September 30, 2001 and 2000, the Company repurchased Notes having a face value of approximately \$4.7 million and \$25.2 million, respectively, and recognized a gain of approximately \$2.6 million and \$17.4 million before income taxes, respectively.

ClimaChem owns substantially all of the companies comprising the Company's Chemical and Climate Control Businesses. ClimaChem is a holding company with no significant assets, other than the notes and accounts receivable from the Company, or material operations other than its investments in its subsidiaries, and each of its subsidiaries is wholly owned, directly or indirectly, by ClimaChem. ClimaChem's payment obligations under the Notes are fully, unconditionally and joint and severally guaranteed by all of the existing subsidiaries of ClimaChem (the "Guarantors"), except for one subsidiary, El Dorado Nitric Company ("EDNC") (formerly known as El Dorado Nitrogen Company) and its subsidiaries.

Summarized consolidated unaudited balance sheet information of ClimaChem and its subsidiaries as of September 30, 2001 and December 31, 2000 and the results of operations for the nine-month and three-month periods ended September 30, 2001 and 2000 are detailed below.

ClimaChem, Inc.	September 30, 2001	December 31, 2000
	_____	_____
	(in thousands)	
Balance sheet data:		
Cash	\$ 1,365	\$ 2,838
Trade accounts receivable, net	46,724	45,981
Inventories:		
Finished goods	18,374	16,371
Work in process	3,502	2,962
Raw material	8,586	9,687
	_____	_____
Total inventory	30,462	29,020
Supplies and prepaid items:		
Precious Metals	1,989	1,621
Other	4,203	4,368
	_____	_____
	6,192	5,989
Due from LSB and affiliates, net (1)	-	1,103
	_____	_____
Total current assets	84,743	84,931
Property, plant and equipment, net	71,578	72,825
Notes and interest receivable from LSB and affiliates (1)	14,347	14,166
Other assets, net	14,510	17,245
	_____	_____
Total assets	\$ 185,178	\$189,167
	_____	_____
Accounts payable	\$ 24,683	\$ 25,865
Accrued liabilities	19,884	18,182

Accrued losses on firm purchase commitments	-	3,465
Due to LSB and affiliates, net (1)	1,425	-
Current portion of long-term debt (2)	43,037	37,092
	<hr/>	<hr/>
Total current liabilities	89,029	84,604
Long-term debt (3)	82,674	89,064
Other non-current liabilities:		
Accrued losses on firm purchase commitments	-	3,450
Other	4,928	2,666
	<hr/>	<hr/>
	4,928	6,116
Stockholders' equity	8,547	9,383
	<hr/>	<hr/>
Total liabilities and stockholders' equity	\$ 185,178	\$189,167
	<hr/>	<hr/>

ClimaChem, Inc.	Nine Months Ended		Three Months Ended	
	September 30,		September 30,	
	2001	2000	2001	2000
	<hr/>	<hr/>	<hr/>	<hr/>
	(in thousands)			
Operations data:				
Revenues:				
Net Sales	\$ 256,157	\$ 205,894	\$ 75,443	\$ 65,317
Other income, net	1,291	1,121	511	1,066
	<hr/>	<hr/>	<hr/>	<hr/>
	257,448	207,015	75,954	66,383
Costs and expenses:				
Cost of sales	216,229	166,828	66,270	55,099
Selling, general and administrative	34,362	33,208	10,469	11,270
Interest	10,240	10,573	3,247	3,266
Provision for loss on (benefit from termination of) firm purchase commitments	(2,338)	2,485	- -	- -
	<hr/>	<hr/>	<hr/>	<hr/>
	258,493	213,094	79,986	69,635
Loss before benefit for income taxes and extraordinary gain	(1,045)	(6,079)	(4,032)	(3,252)
Benefit for income taxes	-	-	(1,255)	-
	<hr/>	<hr/>	<hr/>	<hr/>
Loss before extraordinary gain	(1,045)	(6,079)	(2,777)	(3,252)
Extraordinary gain, net of income taxes	2,431	14,521	2,401	1,952
	<hr/>	<hr/>	<hr/>	<hr/>
Net income (loss)	\$ 1,386	\$ 8,442	\$ (376)	\$ (1,300)
	<hr/>	<hr/>	<hr/>	<hr/>

1. Notes and other receivables from LSB and affiliates are eliminated when consolidated with LSB.

2. In April 2001, the Company replaced the existing Revolving Credit Facility ("Revolver") for ClimaChem and its subsidiaries. ClimaChem and its subsidiaries, ("the borrowers"), entered into a new \$50 million credit facility with a new lender (the "Working Capital Revolver Loan"). The Working Capital Revolver Loan provides for advances based on specified percentages of eligible accounts receivable and inventory of ClimaChem and its subsidiaries and accrues interest at a base rate (generally equivalent to the prime rate) plus 2% or the LIBOR rate plus 4.5%. The effective interest rate was 8% at September 30, 2001. The Working Capital Revolver Loan matures in April 2005 and is secured by receivables, inventory and intangibles of all the ClimaChem entities other than El Dorado Nitric Co., ("EDNC"). EDNC is neither a borrower or guarantor of the Working Capital Revolver Loan. The Working Capital Revolver Loan requires ClimaChem to meet certain financial covenants on a quarterly and/or annual basis. As of September 30, 2001, ClimaChem and its subsidiaries had \$39.1 million outstanding on the Working Capital Revolver Loan (\$32.7 million was outstanding as of December 31, 2000 under the Revolver).

3. In September 2001, ClimaChem purchased Notes having a face value of approximately \$4.7 million from a subsidiary of the Company which is not a subsidiary of ClimaChem at the subsidiary's cost and recognized a gain of approximately \$2.6 million before income taxes.

Note 8: Comprehensive Income The Company presents comprehensive income (loss) in accordance with Financial Accounting Standard No. 130 "Reporting Comprehensive Income" ("SFAS 130"). The provisions of SFAS 130 require the Company to classify items of other comprehensive income (loss) in the financial statements and display the accumulated balance of other comprehensive income (loss) separately from retained earnings and additional paid in capital in the equity section of the balance sheet.

Other comprehensive income (loss) for the nine-month and three-month periods ended September 30, 2001 and 2000 is detailed below.

	Nine Months		Three Months	
	Ended September 30,		Ended September 30,	
	2001	2000	2001	2001
	<hr/>	<hr/>	<hr/>	<hr/>
	(in thousands)			
Net income	\$ 4,873	\$ 11,238	\$ 733	\$ 421

Cumulative effect of change in accounting for derivative financial instruments (Note 10)	(2,439)	-	-	-
Reclassification to operations	217	-	73	-
Total comprehensive income	\$ 2,651	\$ 11,238	\$ 806	\$ 421

Note 9: Gain on the Sale of Property and Equipment On October 31, 2000 subsidiaries of the Company, which are not subsidiaries of ClimaChem acquired a chemical plant. This plant is located at Crystal City, Missouri ("Crystal City Plant") and was shut down concurrent with the purchase thereof. In July 2001, the Crystal City Plant was sold for approximately \$4 million. Approximately \$1.8 million of the proceeds will be used by the Company and its subsidiaries which are not subsidiaries of ClimaChem to retire obligations assumed in connection with the Company's former automotive business of which approximately \$1.1 million is classified as restricted cash held in escrow at September 30, 2001. The remainder, by agreement with ClimaChem's lender, has been applied against the outstanding balance on the Working Capital Revolver Loan. The Company recognized a gain on the sale of the Crystal City Plant of approximately \$3.5 million in the third quarter of 2001.

Note 10: Change in Accounting In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement No. 133 ("SFAS 133"), "Accounting for Derivative Instruments and Hedging Activities." The Company adopted this new Statement effective January 1, 2001. The Statement required the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that do not qualify or are not designated as hedges must be adjusted to fair value through operations. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value will be immediately recognized in earnings.

In 1997, the Company 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, the Company executed the long-term lease agreement and terminated the forward at a net cost of \$2.8 million. The Company historically accounted for this hedge under the deferral method (as an adjustment of the initial term lease rentals). At December 31, 2000, the remaining deferred cost included in other assets approximated \$2.4 million. The deferred cost recognized in operations amounted to \$217,000 and \$73,000 for the nine months and three months ended September 30, 2000, respectively. Upon adoption of SFAS 133 on January 1, 2001, the deferred cost was reclassified into accumulated other comprehensive loss and will be amortized to operations over the term of the lease arrangement. The amount amortized to operations for the nine months and three months ended September 30, 2001 was \$217,000 and \$73,000, respectively. The Company also periodically enters into exchange-traded futures contracts for copper and aluminum (as such products are used in the Company's Climate Control Business), which contracts are currently accounted for on a mark to market basis.

In July 2001, the FASB issued Statements No. 141 ("SFAS 141"), "Business Combinations," and No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets". SFAS 141 is effective for all business combinations initiated after June 30, 2001 and SFAS 142, that will require that goodwill and intangible assets with indefinite lives no longer be amortized but be tested for impairment at least annually, will become effective for the Company on January 1, 2002. Also in July 2001, the FASB issued Statement No. 143 ("SFAS 143"), "Accounting for Asset Retirement Obligation" which will require liability recognition for legal or contractual retirement obligations associated with tangible long-lived assets. The Company will adopt SFAS 143 effective January 1, 2003. In August 2001, the FASB issued Statement No. 144 ("SFAS 144") "Accounting for the Impairment of Disposal of Long-Lived Assets" which will modify the accounting for and potentially the financial statement presentation of assets held for disposal. The Company expects to adopt SFAS 144 no later than effective January 1, 2002. The Company is currently analyzing the effect, if any, the adoption of these standards will have on its financial statements.

Note 11: Liquidity and Management's Plan The Company is a diversified holding company and, as a result, it is dependent on credit agreements and its ability to obtain funds from its subsidiaries in order to pay its debts and obligations.

The Company's wholly-owned subsidiary, ClimaChem, Inc. ("ClimaChem"), through its subsidiaries, owns substantially all of the Company's Chemical and Climate Control Businesses. ClimaChem and its subsidiaries are dependent on credit agreements with lenders and internally generated cash flow in order to fund their operations and pay their debts and obligations.

In April, 2001, the Company replaced the existing revolving credit facility for ClimaChem and its subsidiaries with a new lender. ClimaChem and its subsidiaries, entered into a new \$50 million credit facility ("Working Capital Revolver Loan") with a new lender which matures in April 2005. An LSB subsidiary which is not a subsidiary of ClimaChem, Summit Machine Tool Manufacturing Corp., also executed the third amended and restated revolving credit agreement with the prior lender (the "Agreement") in April 2001. The Agreement provides a revolving line of credit of up to \$2.5 million through March 2002. The Company is currently in negotiations concerning the replacement of the Agreement.

ClimaChem is restricted as to the funds that it may transfer to the Company under the terms contained in an Indenture ("Indenture") covering the Senior Unsecured Notes issued by ClimaChem and the Working Capital Revolver Loan. Although no management fees under the Management Agreement were paid by ClimaChem to LSB for the nine months ended September 30, 2001 due to the operating results, it is possible that ClimaChem could pay up to \$1.8 million of management fees to the Company (if ClimaChem has earnings before interest, income taxes, depreciation and amortization ("EBITDA") in excess of \$26 million for the year).

The Company has limited capital expenditures for the remainder of 2001 and has planned capital expenditures for 2002 of approximately \$5 million, primarily in the Chemical and Climate Control Businesses, but such capital expenditures are dependent upon obtaining acceptable financing. The Company will make these expenditures if there is sufficient working capital or available financing.

On November 1, 2001, the Company's subsidiary, El Dorado Chemical Company ("EDC") concluded a long term industrial grade ammonium nitrate supply agreement ("Supply Agreement") with Orica USA Inc. ("Orica"). Under the Supply Agreement, EDC will supply from its El Dorado, Arkansas plant approximately 200,000 tons of industrial grade ammonium nitrate per year, which is the plant's manufacturing capacity for that product, for a term of no less than five (5) years. As part of the Supply Agreement, EDC will implement certain of Orica's proprietary ammonium nitrate manufacturing technology at EDC's Arkansas plant. In addition to the industrial grade ammonium nitrate products, EDC's Arkansas plant has manufacturing capacity for approximately 250,000 tons per year of agricultural grade ammonium nitrate products, 90,000 tons per year of concentrated nitric acid, and 100,000 tons per year of sulfuric acid.

Also on November 1, 2001, EDC concluded the sale of its explosives distribution business to Orica and to Nelson Brothers, LLC ("Site Agreement"). The total sales price for the distribution sites was \$3.5 million, \$2 million of which was paid to EDC in the first quarter of 2001, which amount was applied to the total sales price. The Company will recognize a gain on the sale of these assets of approximately \$2.8 million in the fourth quarter of 2001.

Effective October 1, 2001, the Company's subsidiary, Cherokee Nitrogen Company ("CNC") concluded a long term 83% ammonium nitrate solution supply agreement with Nelson Brothers, LLC ("Solution Agreement"). Under the Solution Agreement, CNC will supply to Nelson Brothers, LLC its requirements of 83% ammonium nitrate solution from CNC's Cherokee, Alabama manufacturing plant for a term of no less than five (5) years.

Assuming the plan is executed as discussed above, management of the Company believes the Company will have adequate resources to meet its obligations as they come due. This expectation could change in the near term if there are unforeseen adverse events.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the Company's September 30, 2001 Condensed Consolidated Financial Statements.

Certain statements contained in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" may be deemed forward-looking statements. See "Special Note Regarding Forward-Looking Statements".

Overview

General

The Company continues to focus on its core businesses relating to its Chemical and Climate Control Businesses. In addition, the Company is seeking to reduce its outstanding indebtedness and improve its liquidity and operating results through liquidation of selected assets.

Chemical Business

The Company's Chemical Business manufactures three principal product lines that are derived from anhydrous ammonia: (1) fertilizer grade ammonium nitrate and urea ammonia nitrate for the agricultural industry, (2) explosive grade ammonium nitrate for the mining industry and (3)

concentrated, blended and mixed nitric acid for industrial applications. In addition the Company also produces sulfuric acid for industrial applications.

On October 31, 2000 subsidiaries of the Company, which are not subsidiaries of ClimaChem acquired two chemical plants. One plant is in Cherokee, Alabama ("Cherokee Plant"). This plant is being leased to and operated by a subsidiary of ClimaChem. The other plant is in Crystal City, Missouri ("Crystal City Plant"). This plant was shut down concurrent with the purchase thereof. In July 2001, the Crystal City Plant was sold for approximately \$4 million. Approximately \$1.8 million of the proceeds will be used by the Company and its subsidiaries which are not subsidiaries of ClimaChem to retire obligations assumed in connection with the Company's former automotive business of which approximately \$1.1 million is classified as restricted cash held in escrow at September 30, 2001. The remainder, by agreement with ClimaChem's lender, has been applied against the outstanding balance on the Working Capital Revolver Loan.

Net sales in the Chemical Business were \$150.4 million for the nine months ended September 30, 2001 and \$107.2 million for the nine months ended September 30, 2000. The gross profit decreased to \$13.6 million (or 9.1% of net sales) in 2001 from \$14.1 million (or 13.1% of net sales) in 2000. The net sales include approximately \$27.4 million and gross profit includes approximately \$.2 million in 2001 associated with the Cherokee Plant as discussed above.

On November 1, 2001, the Company's subsidiary, El Dorado Chemical Company ("EDC") concluded a long term industrial grade ammonium nitrate supply agreement ("Supply Agreement") with Orica USA Inc. ("Orica"). Under the Supply Agreement, EDC will supply from its El Dorado, Arkansas plant approximately 200,000 tons of industrial grade ammonium nitrate per year, which is the plant's manufacturing capacity for that product, for a term of no less than five (5) years. As part of the Supply Agreement, EDC will implement certain of Orica's proprietary ammonium nitrate manufacturing technology at EDC's Arkansas plant. In addition to the industrial grade ammonium nitrate products, EDC's Arkansas plant has manufacturing capacity for approximately 250,000 tons per year of agricultural grade ammonium nitrate products, 90,000 tons per year of concentrated nitric acid, and 100,000 tons per year of sulfuric acid.

Also on November 1, 2001, EDC concluded the sale of its explosives distribution business to Orica and to Nelson Brothers, LLC ("Site Agreement"). The total sales price for the distribution sites was \$3.5 million, \$2 million of which was paid to EDC in the first quarter of 2001, which amount was applied to the total sales price. The Company will recognize a gain on the sale of these assets of approximately \$2.8 million in the fourth quarter of 2001.

Effective October 1, 2001, the Company's subsidiary, Cherokee Nitrogen Company ("CNC") concluded a long term 83% ammonium nitrate solution supply agreement with Nelson Brothers, LLC ("Solution Agreement"). Under the Solution Agreement, CNC will supply to Nelson Brothers, LLC its requirements of 83% ammonium nitrate solution from CNC's Cherokee, Alabama manufacturing plant for a term of no less than five (5) years.

Climate Control

The Climate Control Business manufactures and sells a broad range of hydronic fan coil, air handling, air conditioning, heating, water source heat pumps, and dehumidification products targeted to both commercial and residential new building construction and renovation.

The Climate Control Business focuses on product lines in the specific niche markets of hydronic fan coils and water source heat pumps and has established a significant market share in these specific markets.

Sales of \$105.7 million for the nine months ended September 30, 2001, in the Climate Control Business were approximately 6.8% greater than sales of \$99 million for the nine months ended September 30, 2000. The gross profit was approximately \$28.6 million in the 2001 period and \$25.8 million in the 2000 period. The gross profit percentage increased to 27.1% for 2001 from 26.1% for 2000.

RESULTS OF OPERATIONS

Nine months ended September 30, 2001 vs. Nine months ended September 30, 2000.

Revenues

Total revenues for the nine months ended September 30, 2001 and 2000 were \$266.5 million and \$218.3 million, respectively, an increase of \$48.2 million. Sales increased \$47.1 million. The gain on sale of property and equipment of approximately \$3.9 million for the nine months ended September 30, 2001 includes the sale of the Crystal City Plant as previously discussed.

Net Sales

Consolidated net sales included in total revenues for the nine months ended September 30, 2001, were \$261.4 million, compared to \$214.3 million for the first nine months of 2000, an increase of \$47.1 million. During the first nine months of 2001, the newly acquired Cherokee Plant contributed \$27.4 million to the Company's net sales. The remaining increase in sales resulted principally from: (i) increased sales relating to the Chemical Business of \$15.9 million from increased customer demand and higher sales prices of explosive products and (ii) increased sales of \$6.8 million in the Climate Control Business due primarily from an increase in customer demand and higher sales prices relating to heat pump products and the increase in sales of new products and services introduced in the second and third quarters of 2000. This increase in sales was partially offset by a decrease in sales of certain products in the Climate Control Business and a decrease in sales of machine tools in the Industrial Products Business.

Gross Profit

Gross profit as a percent of sales was 16.9% for the first nine months of 2001, compared to 19.7% for the first nine months of 2000. The decrease in the gross profit percentage was the result of lower profit margins in the Chemical Business due primarily to increased raw material costs resulting, in part, from the extremely high cost of natural gas in late 2000 and the first two quarters of 2001 and competitive pressures on sales prices of agricultural products. This decrease was partially offset by (i) improved margins of the explosive products in the Chemical Business and (ii) improved margins of certain products in the Climate Control Business.

Selling, General and Administrative Expense

Selling, general and administrative ("SG&A") expenses as a percent of net sales were 14.1% in the nine-month period ended September 30, 2001, compared to 16.5% for the first nine months of 2000. This decrease is primarily the result of higher sales without a comparable increase in expense. This decrease was partially offset by an increase relating to new products and services introduced in the third quarter of 2000 in the Climate Control Business.

Interest Expense

Interest expense was \$11 million in the first nine months of 2001, compared to \$11.7 million for the first nine months of 2000. The decrease of \$0.7 million primarily resulted from the reduced debt outstanding resulting from the repurchase of the Senior Unsecured Notes during 2001 and 2000 and decreased lenders' prime rates offset, in part, by the increase in borrowings from the Working Capital Revolver Loan.

Benefit from Termination (Provision for Loss)

The Company had a gain of approximately \$2.3 million from the termination of firm purchase commitments for the nine months ended September 30, 2001 compared to a provision for loss on firm purchase commitments of approximately \$2.5 million for the same period in 2000. Effective in June 2001, the Company renegotiated its contract to purchase anhydrous ammonia. In connection with the termination of the above-market take-or-pay provisions of the firm purchase commitments, the Chemical Business recognized a gain of \$2.3 million in the second quarter of 2001.

Other Expense

Other expense for the nine months ended September 30, 2001 included expenses incurred due to mark-to-market adjustments relating to various metals used in the Chemical and Climate Control Businesses of approximately \$.4 million and financing fees of approximately \$.2 million relating to extending the maturity of the former revolving credit facility.

Income (Loss) from Continuing Operations before Income Taxes and Extraordinary Gain

The Company had income from continuing operations before income taxes and extraordinary gain of \$2.5 million in the first nine months of 2001 compared to a loss of \$5.4 million in the nine months ended September 30, 2000. The increase in profitability of \$7.9 million was due to the increased gross profit of the Climate Control Business, the gain on the sale of the Crystal City Plant, decrease in interest expense, the benefit from termination of the firm purchase commitments recognized in 2001 compared to a loss incurred in 2000 as discussed above and the decrease in other expenses. This increase was partially offset by the decrease in other income, the decrease in gross profit of the Chemical and Industrial Products Businesses and the increase in SG&A expenses as discussed above.

Provision for Income Taxes

As a result of the Company's net operating loss carry-forward for income tax purposes as discussed elsewhere herein and in Note 2 of Notes to Condensed Consolidated Financial Statements, a provision for income taxes associated with operations was recognized for the nine months ended September 30, 2001 relating only to current state income taxes and federal alternative minimum taxes (none in 2000).

Discontinued Operations

For the nine months ended September 30, 2000, the Company charged approximately \$.6 million to net loss from discontinued operations relating to the Company's former automotive business which was sold in May 2000.

Extraordinary Gain

During the nine months ended September 30, 2001 and 2000, the Company repurchased Senior Unsecured Notes having a face value of approximately \$4.7 million and \$25.2 million, respectively, and recognized a gain of approximately \$2.6 million and \$17.4 million, before income taxes, respectively.

Three months ended September 30, 2001 vs. Three months ended September 30, 2000.

Revenues

Total revenues for the three months ended September 30, 2001 and 2000 were \$80.7 million and \$70 million, respectively, an increase of \$10.7 million. Sales increased \$8.7 million. The gain on sale of property and equipment of approximately \$3.6 million for the three months ended September 30, 2001 includes the sale of the Crystal City Plant as previously discussed.

Net Sales

Consolidated net sales included in total revenues for the three months ended September 30, 2001, were \$76.8 million, compared to \$68.1 million for the same three months of 2000, an increase of \$8.7 million. During the three months ended September 30, 2001, the newly acquired Cherokee Plant contributed \$6.5 million to the Company's net sales. The remaining increase in sales resulted principally from increased sales relating to the Chemical Business of \$3.2 million from increased customer demand and improved sales prices of explosive products. This increase in sales was partially offset by a decrease in sales in the Industrial Products Business due, in part, to the discontinuance of an industrial supply product line.

Gross Profit

Gross profit as a percent of sales was 13.7% for the three months ended September 30, 2001, compared to 16.5% for the same period in 2000. The decrease in the gross profit percentage was primarily the result of lower profit margins in the Chemical Business due primarily to increased raw material costs and competitive pressures on sales prices of agricultural products. This decrease was partially offset by improved margins of certain products in the Climate Control Business and improved margins of machine tools in the Industrial Products Business.

Selling, General and Administrative Expense

Selling, general and administrative ("SG&A") expenses as a percent of net sales were 16.1% in the three-month period ended September 30, 2001, compared to 17.6% for the three months ended September 30, 2000. This decrease is primarily the result of higher sales without a comparable increase in expense.

Interest Expense

Interest expense was \$3.5 million in the three months ended September 30, 2001, compared to \$3.6 million for the same period in 2000. The decrease of \$.1 million primarily resulted from the reduced debt resulting from the repurchase of the Senior Unsecured Notes during 2001 and 2000 and decreased lenders' prime rates offset, in part, by the increase in borrowings from the Working Capital Revolver Loan.

Other Expense

Other expense for the three months ended September 30, 2001 and 2000 was \$.3 million and \$.4 million, respectively.

Loss from Continuing Operations before Income Taxes and Extraordinary Gain

The Company had a loss of \$1.9 million from continuing operations before income taxes and extraordinary gain for the three months ended September 30, 2001 compared to a loss of \$3 million for the three months ended September 30, 2000. The decrease in loss of \$1.1 million was due, in part, to the net increase in other revenues relating to the gain on sale of property and equipment as discussed above. This decrease in loss was partially offset by the decrease in gross profit and increase in SG&A as discussed above.

Benefit for Income Taxes

As a result of the Company's net operating loss carry-forward for income tax purposes as discussed elsewhere herein and in Note 2 of Notes to Condensed Consolidated Financial Statements, a benefit for income taxes associated with operations was recognized for the three months ended September 30, 2001 (none in 2000).

Discontinued Operations

For the three months ended September 30, 2000, the Company charged approximately \$.6 million to net loss from discontinued operations relating to the Company's former automotive business which was sold in May 2000.

Extraordinary Gain

During the three months ended September 30, 2001 and 2000, the Company repurchased Senior Unsecured Notes having a face value of approximately \$4.7 million and \$6 million, respectively, and recognized a gain of approximately \$2.6 million and \$4 million, before income taxes, respectively.

Liquidity and Capital Resources

Cash Flow From Operations

Historically, the Company's primary cash needs have been for operating expenses, working capital and capital expenditures. The Company has financed its cash requirements primarily through internally generated cash flow, borrowings under its revolving credit facilities and secured equipment financing. Net cash used in operating activities for the nine months ended September 30, 2001 was \$.8 million, after certain non-cash and working capital adjustments. The increase in inventories relates primarily to (i) the acquisition of the Cherokee plant in October 2000 and (ii) the introduction of new products in 2000, offset in part, by the elimination of certain products in the Climate Control Business and the reduction of products in the Industrial Products Business. The decrease in accounts payable is primarily due to the timing of payments and a decrease in production of industrial acid products in the Chemical Business and elimination of certain products in the Climate Control Business. The decrease was offset, in part, due to the acquisition of the Cherokee plant and the introduction of new products and services in the Climate Control Business. The increase in accrued liabilities includes an increase in deferred revenue relating to the exercise of an option and related sale of the building in which Climate Master, Inc., builds its products, an increase in a deferred lease payment due in December 2001, increase in accrued interest on the Senior Unsecured Notes due in December 2001 and the prepayment received on the sale of the Company's explosives distribution outlets. This increase was partially offset by a decrease in the amount of deposits held by the Chemical Business and the reduction in accrued shut-down costs relating to the Crystal City Plant that was sold in July 2001.

Cash Flow From Investing and Financing Activities

Net cash used in investing activities for the nine months ended September 30, 2001 included \$5.7 million for capital expenditures, restricted cash held in escrow of \$1.1 million and an increase in other assets of \$.6 million offset by proceeds from sale of property and equipment of \$4.7 million. The capital expenditures were primarily for the benefit of the Chemical Business. The restricted cash held in escrow relates to a portion of the proceeds from the sale of the Crystal City Plant to be used to retire obligations assumed in connection with the Company's former automotive business. The increase in other assets is primarily due to an increase in deferred loan costs relating to the new credit facility partially offset by the sale of certain non-current inventory in the Industrial Products Business.

Net cash provided by financing activities included proceeds from long-term debt and other debt issuances of \$3.9 million and a net increase in revolving working capital debt of \$6.6 million to fund the increase in accounts receivable and inventories and the decrease in accounts payable, offset in part, by payments on long-term debt of \$6 million and the acquisition of Senior Notes of \$2.1 million.

Source of Funds

The Company is a diversified holding company and, as a result, it is dependent on credit agreements and its ability to obtain funds from its subsidiaries in order to pay its debts and obligations.

The Company's wholly-owned subsidiary, ClimaChem, Inc. ("ClimaChem"), through its subsidiaries, owns substantially all of the Company's Chemical and Climate Control Businesses. ClimaChem and its subsidiaries are dependent on credit agreements with lenders and internally generated cash flow in order to fund their operations and pay their debts and obligations.

In April, 2001, the Company replaced the existing Revolving Credit Facility ("Revolver") for ClimaChem and its subsidiaries. ClimaChem and its subsidiaries, ("the borrowers"), entered into a new \$50 million credit facility with a new lender (the "Working Capital Revolver Loan"). The Working Capital Revolver Loan provides for advances based on specified percentages of eligible accounts receivable and inventory of ClimaChem and its subsidiaries and accrues interest at a base rate (generally equivalent to the prime rate) plus 2% or the LIBOR rate plus 4.5%. Interest is due monthly. The Working Capital Revolver Loan matures in April 2005 and is secured by receivables, inventory and intangibles of all the ClimaChem entities other than El Dorado Nitric Co., ("EDNC"). EDNC is neither a borrower or guarantor of the Working Capital Revolver Loan. The Working Capital Revolver Loan requires ClimaChem to meet certain financial covenants on a quarterly and/or annual basis. The Working Capital Revolver Loan requires that ClimaChem's excess availability, as defined, equal an amount not less than \$3.8 million, on each interest payment date, after giving effect to the interest payment due under ClimaChem's 10 3/4% Senior Notes. The terms of the Working Capital Revolver require that the \$3.8 million reserve and the interest amount to be reserved against borrowing availability periodically during the six months between semi-annual interest payment dates. A subsidiary of the Company which is not a subsidiary of ClimaChem, Summit Machine Tool Manufacturing Corp. ("Summit"), executed the third amended and restated revolving credit agreement with the prior lender (the "Agreement") in April 2001. The Agreement provides a revolving line of credit of up to \$2.5 million through March 2002. The Agreement is guaranteed by the Company. The Agreement requires monthly payments of interest which accrue based on the lender's prime rate plus the applicable margin (2.5% in April 2001). Effective July 1, 2001, the applicable margin increased fifty basis points and increases fifty basis points monthly thereafter until the Agreement is terminated. The Agreement may be terminated by Summit with proper notice without premium or penalty. The Company is currently in negotiations concerning the replacement of the Agreement.

As of September 30, 2001, the Company had a borrowing availability under the Agreement of \$2 million and ClimaChem had borrowing availability under the Working Capital Revolver Loan of \$8.2 million prior to the required reserves which were \$4.5 million at September 30, 2001. The effective interest rates under the Agreement and the Working Capital Revolver Loan were 10% and 8%, respectively. Borrowings under the Working Capital Revolver Loan outstanding at September 30, 2001, were \$39.1 million. The annual interest on the outstanding debt under the Working Capital Revolver Loan at September 30, 2001, at the rates then in effect would approximate \$3.1 million annually.

As of September 30, 2001, the Company has outstanding \$70.6 million in Senior Unsecured Notes which require that a semi-annual interest payment of \$3.8 million be paid on December 1, 2001.

ClimaChem is restricted as to the funds that it may transfer to the Company under the terms contained in an Indenture ("Indenture") covering the Senior Unsecured Notes issued by ClimaChem and the Working Capital Revolver Loan. Under the terms of an Indenture between ClimaChem, the guarantors and the trustee relating to the Senior Notes, ClimaChem is permitted to distribute or pay in the form of dividends and other distributions to the Company in connection with ClimaChem's outstanding equity securities or loans, (a) advances or investments to any person (including the Company), up to 50% of ClimaChem's consolidated net income for the period (taken as one accounting period), commencing on the first day of the first full fiscal quarter commencing after the Issue Date of the Senior Notes to and including the last day of the fiscal quarter ended immediately prior to the date of said calculation (or, in the event consolidated net income for such period is a deficit, then minus 100% of such deficit), plus (b) the aggregate net cash proceeds received by ClimaChem from the sale of its capital stock. This limitation will not prohibit (i) payment to the Company under a Services Agreement, Management Agreement and a Tax Sharing Agreement, or (ii) the payment of any dividend within 60 days after the date of its declaration if such dividend could have been made on the date of such declaration. ClimaChem did not declare and pay to the Company a dividend during the nine months ended September 30, 2001.

Although no management fees under the Management Agreement were paid by ClimaChem to LSB for the nine months ended September 30, 2001 due to the operating results, it is possible that ClimaChem could pay up to \$1.8 million of management fees to the Company (if ClimaChem has earnings before interest, income taxes, depreciation and amortization ("EBITDA") in excess of \$26 million for the year).

Due to the Company's and ClimaChem previous operating losses and limited borrowing ability under the credit facility then in effect, the Company discontinued payment of cash dividends on its Common Stock for periods subsequent to January 1, 1999, until the Board of Directors determines otherwise. As of the date of this report, the Company has not paid the regular quarterly dividend of \$.8125 on its outstanding \$3.25 Convertible Exchangeable Class C Preferred Stock Series 2 ("Series 2 Preferred") since September 15, 1999, totaling approximately \$4.6 million. In addition, the Company did not declare and pay the January 1, 2000 and 2001 regular dividend on the Series B Preferred totaling approximately \$5.5 million. The Company does not anticipate having funds available to pay dividends on its stock for the foreseeable future.

The Company has limited capital expenditures for the remainder of 2001 and has planned capital expenditures for 2002 of approximately \$5 million, primarily in the Chemical and Climate Control Businesses, but such capital expenditures are dependent upon obtaining acceptable financing. The Company will make these expenditures if there is sufficient working capital or available financing. As discussed in Note 6 of Notes to Condensed Consolidated Financial Statements, the wastewater program is not yet finally determined but is currently expected to require future capital expenditures of approximately \$2 to \$3 million. Discussions for securing financing are currently underway.

On November 1, 2001, the Company's subsidiary, El Dorado Chemical Company ("EDC") concluded a long term industrial grade ammonium nitrate supply agreement ("Supply Agreement") with Orica USA Inc. ("Orica"). Under the Supply Agreement, EDC will supply from its El Dorado, Arkansas plant approximately 200,000 tons of industrial grade ammonium nitrate per year, which is the plant's manufacturing capacity for that product, for a term of no less than five (5) years. As part of the Supply Agreement, EDC will implement certain of Orica's proprietary ammonium nitrate manufacturing technology at EDC's Arkansas plant. In addition to the industrial grade ammonium nitrate products, EDC's Arkansas plant has manufacturing capacity for approximately 250,000 tons per year of agricultural grade ammonium nitrate products, 90,000 tons per year of concentrated nitric acid, and 100,000 tons per year of sulfuric acid.

Also on November 1, 2001, EDC concluded the sale of its explosives distribution business to Orica and to Nelson Brothers, LLC ("Site Agreement"). The total sales price for the distribution sites was \$3.5 million, \$2 million of which was paid to EDC in the first quarter of 2001, which amount was applied to the total sales price. The Company will recognize a gain on the sale of these assets of approximately \$2.8 million in the fourth quarter of 2001.

Effective October 1, 2001, the Company's subsidiary, Cherokee Nitrogen Company ("CNC") concluded a long term 83% ammonium nitrate solution supply agreement with Nelson Brothers, LLC ("Solution Agreement"). Under the Solution Agreement, CNC will supply to Nelson Brothers, LLC its requirements of 83% ammonium nitrate solution from CNC's Cherokee, Alabama manufacturing plant for a term of no less than five (5) years.

Assuming, that the Company is successful in completing the matters discussed under the "Source of Funds", management of the Company believes the Company will have adequate resources to meet its obligations as they come due. This expectation could change in the near term if there are unforeseen adverse events.

Debt Conversion

As of October 15, 2001, Prime Financial Corporation ("Prime"), a subsidiary of the Company, had an outstanding principal balance of \$1,350,000 (the "Note") owed to SBL Corporation ("SBL"), a corporation wholly owned by the spouse and children of Jack E. Golsen, Chairman of the Board and President of the Company. The Company guaranteed payment of the Note under a limited guarantee and the pledged number of shares of the Company's common stock pledged by Prime to the Lender to secure its guarantee has been reduced to 973,461 shares.

On October 18, 2001, the Company and Prime entered into an agreement (the "Agreement") to take in payment of \$1 million of the unpaid balance of the debt under the Note, 1,000,000 shares of a newly created series of Series D Convertible Preferred Stock in the Company ("Series D Preferred Stock"), with each share of Series D Preferred Stock having, among other things, .875 votes and voting as a class with the Company's common stock, a liquidation preference of \$1.00 per share, cumulative dividends at the rate of six percent (6%) per annum, and convertibility into LSB common stock on the basis of four shares of Preferred Stock into one share of common stock. Dividends on the Series D Preferred Stock will be paid only after accrued and unpaid dividends are paid on the Company's Series 2 \$3.25 Preferred Stock. As of the date of the report, there is \$4.6 million in accrued but unpaid dividends due on the Series 2 \$3.25 Preferred Stock. As of the date of this report, \$350,000 remains outstanding under the Note which is payable on demand. The Company also reduced its limited guarantee to such lender to \$350,000. See discussion in Item 2 of Part II "Changes in Securities".

Contingencies

The Company has several contingencies that could impact its liquidity in the event that the Company is unsuccessful in defending against the claimants. Although management does not anticipate that these claims will result in substantial adverse impacts on its liquidity, it is not possible to determine the outcome. See Notes 6A and C of the Notes to Condensed Consolidated Financial Statements for a discussion as to certain possible contingencies involving the sale of the Automotive Business. The preceding sentence is a forward looking statement that involves a number of risks and uncertainties that could cause actual results to differ materially. See Note 6 of Notes to Condensed Consolidated Financial Statements.

Quantitative and Qualitative Disclosure about Market Risk

General

The Company's results of operations and operating cash flows are impacted by changes in market interest rates. Reference is made to the Company's Annual Report on Form 10-K for the year ended December 31, 2000, for an expanded analysis of expected maturities of long term debt and its weighted average interest rates.

Interest Rate Risk

The Company's interest rate risk exposure results from its debt portfolio which is impacted by short-term rates, primarily prime rate-based borrowings from commercial banks, and long-term rates, primarily fixed-rate notes, some of which prohibit prepayment or require substantial prepayment penalties.

As of September 30, 2001, the Company's variable rate and fixed rate debt, which aggregated \$138.4 million, exceeded the debt's fair market value by approximately \$38.8 million (\$49.4 million at December 31, 2000). The fair value of the Senior Unsecured Notes of a subsidiary of the Company was determined based on a market quotation for such securities.

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,

- availability of net operating loss carryovers,
- amount to be spent relating to compliance with federal, state and local environmental laws at the El Dorado Facility,
- liquidity and availability of funds,
- anticipated financial performance,
- adequate cash flows to meet its presently anticipated working capital requirements,
- management believes that the Company has adequate resources to meet its obligations as they come due,

- ability to make planned capital improvements,
- ability to obtain financing for wastewater disposal project and

- management does not anticipate that these contingent claims will result in substantial adverse impact on the Company's liquidity.

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

- decline in general economic conditions, both domestic and foreign,
- material reduction in revenues,
- material increase in interest rates,
- ability to collect in a timely manner a material amount of receivables,
- increased competitive pressures,
- changes in federal, state and local laws and regulations, especially environmental regulations, or in interpretation of such, pending,
- additional releases (particularly air emissions) into the environment,
- material increases in equipment, maintenance, operating or labor costs not presently anticipated by the Company,
- 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 the Company's businesses,
- adverse results in any of the Company's pending litigation,
- 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. The Company disclaims any obligation to update any such factors or to publicly announce the result of any revisions to any of the Forward-Looking Statements contained herein to reflect future events or developments.

We have reviewed the accompanying condensed consolidated balance sheet of LSB Industries, Inc. and subsidiaries as of September 30, 2001, and the related condensed consolidated statements of operations for the nine-month and three-month periods ended September 30, 2001 and 2000 and the condensed consolidated statements of cash flows for the nine-month periods ended September 30, 2001 and 2000. These financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States, which will be performed for the full year with the objective of expressing an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying condensed consolidated financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States.

We have previously audited, in accordance with auditing standards generally accepted in the United States, the consolidated balance sheet of LSB Industries, Inc. and subsidiaries as of December 31, 2000, and the related consolidated statements of operations, stockholders' deficit and cash flows for the year then ended (not presented herein); and in our report dated April 16, 2001, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2000, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

ERNST & YOUNG LLP

Oklahoma City, Oklahoma

November 9, 2001

PART II OTHER INFORMATION

Item 1. Legal Proceedings

There are no additional material legal proceedings pending against the Company and/or its subsidiaries not previously reported by the Company in Item 3 of its Form 10-K for the fiscal period ended December 31, 2000, which Item 3 is incorporated by reference herein.

Item 2. Changes in Securities

On October 17, 1997, Prime Financial Corporation ("Prime"), a subsidiary of the Company, borrowed from SBL Corporation ("SBL"), a corporation wholly owned by the spouse and children of Jack E. Golsen, Chairman of the Board and President of the Company, the principal amount of \$3,000,000 (the "Prime Loan") on an unsecured basis and payable on demand, with interest payable monthly in arrears at a variable interest rate equal to the Wall Street Journal Prime Rate plus 2% per annum. The purpose of the loan was to assist the Company by providing additional liquidity. As of October 15, 2001, the unpaid principal balance on the Prime Loan was \$1,350,000.

In order to make the Prime Loan to Prime, SBL and certain of its affiliates borrowed the \$3,000,000 from a bank (collectively, "SBL Borrowings"), and as part of the collateral pledged by SBL to the bank in connection with such loan, SBL pledged, among other things, its note from Prime. Effective April 21, 2000, Prime guaranteed on a limited basis the obligations of SBL and its affiliates relating to the unpaid principal amount due to the bank in connection with the SBL borrowings, and, in order to secure its obligations under the guarantees, it pledged to the bank 1,973,461 shares of the Company's Common Stock that it holds as treasury stock.

On October 18, 2001, the Company and Prime entered into an agreement (the "Agreement") to take in payment of \$1 million of the unpaid balance of the debt under the Note, 1,000,000 shares of a newly created series of its Class C Preferred Stock designated as "Series D Cumulative Convertible Class C Preferred Stock", no par value ("Preferred Stock"), with each share of such new series of Preferred Stock having, among other things, .875 votes and voting as a class with the Company's common stock, a liquidation preference of \$1.00 per share, cumulative dividends at the rate of six percent (6%) per annum, and convertibility into LSB common stock on the basis of four shares of Preferred Stock into one share of common stock. Dividends will be paid only after accrued and unpaid dividends are paid on the Company's Series 2 \$3.25 Preferred Stock. As of the date of this report, \$350,000 remains outstanding from Prime to SBL, which is payable on demand. In connection with the Agreement, the Company limited guaranty to the bank has been reduced to \$350,000, and the number of shares of Company common stock pledged by Prime to the lender to secure its guaranty has been reduced to 973,461 shares.

The transaction represented by the Agreement was reviewed, negotiated and approved by a Special Committee of the Board of Directors of the Company comprised of three outside and independent directors. The Special Committee retained its own counsel and investment banker.

The Preferred Stock issued to SBL under the Agreement was issued in a transaction exempt from registration under the Securities Act of 1933 (the "Act"), as amended, pursuant to Section 4(2) of the Act, in that the owners of SBL are accredited investors consisting of the spouse and adult children of Jack E. Golsen, Chairman of the Board and President of the Company and mother and siblings of Barry H. Golsen, Vice Chairman of the Board of the Company.

Item 3. Defaults upon Senior Securities

(b) The Company's Board of Directors did not declare and pay the September 15, 2001 dividends on the Company's outstanding \$3.25 Convertible Exchangeable Class C Preferred Stock, Series 2 ("Series 2 Preferred"). Accrued and unpaid dividends on the Series 2 Preferred are cumulative. The amount of the total arrearage of unpaid dividends on the outstanding Series 2 Preferred is approximately \$4.6 million as of the date of this report. In addition, management of the Company has decided not to recommend the Company's Board of Directors to approve the December 15, 2001 dividend payment on its outstanding Series 2 Preferred. If the December 15 dividend on the Series 2 Preferred is not paid, the amount of the total arrearage of unpaid dividends payable on the outstanding Series 2 Preferred will be approximately \$5.1 million and the Company will have exceeded six quarters without paying the quarterly dividend on its Series 2 Preferred.

Whenever dividends on the Series 2 Preferred shall be in arrears and unpaid, whether or not declared, in amount equal to at least six quarterly dividends (whether or not consecutive), the holders of the Series 2 Preferred (voting separately as a class) will have the exclusive right to vote for and elect two additional directors of the Company's Board of Directors during the period that dividends on the Series 2 Preferred remain in arrears. The right of the holders of the Series 2 Preferred to vote for such two additional directors shall terminate, subject to re-vesting in the event of a subsequent similar arrearage, when all cumulative and unpaid dividends on the Series 2 Preferred have been declared and set apart for payment. The term of office of all directors so elected by the holders of the Series 2 Preferred shall terminate immediately upon the termination of the right of the holders of the Series 2 Preferred to vote for such two additional directors, subject to the requirements of Delaware law.

Also the Company's Board of Directors did not declare and pay the January 1, 2000 and 2001 regular dividend on the Company's Series B 12% Convertible, Cumulative Preferred Stock ("Series B"). Dividends in arrears at September 30, 2001, related to the Company's Series B amounted to approximately \$.5 million.

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

Not applicable

9;9;9; Item 5. Other Information

On November 1, 2001, the Company's subsidiary, El Dorado Chemical Company ("EDC") concluded a long term industrial grade ammonium nitrate supply agreement ("Supply Agreement") with Orica USA Inc. ("Orica"). Under the Supply Agreement, EDC will

supply from its El Dorado, Arkansas plant approximately 200,000 tons of industrial grade ammonium nitrate per year, which is the plant's manufacturing capacity for that product, for a term of no less than five (5) years. As part of the Supply Agreement, EDC will implement certain of Orica's proprietary ammonium nitrate manufacturing technology at EDC's Arkansas plant. In addition to the industrial grade ammonium nitrate products, EDC's Arkansas plant has manufacturing capacity for approximately 250,000 tons per year of agricultural grade ammonium nitrate products, 90,000 tons per year of concentrated nitric acid, and 100,000 tons per year of sulfuric acid.

Also on November 1, 2001, EDC concluded the sale of its explosives distribution business to Orica and to Nelson Brothers, LLC ("Site Agreement"). The total sales price for the distribution sites was \$3.5 million, \$2 million of which was paid to EDC in the first quarter of 2001, which amount was applied to the total sales price. The Company will recognize a gain on the sale of these assets of approximately \$2.8 million in the fourth quarter of 2001.

Effective October 1, 2001, the Company's subsidiary, Cherokee Nitrogen Company ("CNC") concluded a long term 83% ammonium nitrate solution supply agreement with Nelson Brothers, LLC ("Solution Agreement"). Under the Solution Agreement, CNC will supply to Nelson Brothers, LLC its requirements of 83% ammonium nitrate solution from CNC's Cherokee, Alabama manufacturing plant for a term of no less than five (5) years.

The Company has made a decision to attempt to dispose of its non-core assets. The non-core assets include certain small fractional oil properties owned by the Company. A committee of outside independent directors was established to attempt to sell the Company's oil properties. In soliciting offers in connection with this proposed transaction, the Committee received two bids, one of which was from Golsen Petroleum Company ("GPC") to purchase the Company's oil properties for \$350,000, plus the assumption of liabilities associated with the assets. GPC, a subsidiary of SBL, is owned, directly and indirectly, by Jack E. Golsen's immediate family, including Barry H. Golsen. The amount of the GPC offer was superior to the other bid. The Committee retained an independent certified petroleum engineer to assist the Committee. GPC's offer exceeded the appraised value of the oil properties. The Committee also considered the cash flow effect on the Company of the sale of the oil properties and determined that a cash sale was in the Company's best interest. After approval of the transaction by the Committee, on September 30, 2001, the Company entered into an agreement to sell to GPC the oil properties for \$350,000 cash and the assumption of approximately \$113,000 in liabilities.

Item 6. Exhibits and Reports on Form 8-K

- (A) Exhibits. The Company has included the following exhibits in this report:
- 4.1 Specimen of Certificate of Series D 6% Cumulative, Convertible Class C Preferred Stock.
 - 10.1 Stock Purchase Agreement, dated September 30, 2001, by and between Summit Machinery Company and SBL Corporation.
 - 10.2 Agreement, dated October 18, 2001, by and between LSB Industries, Inc., Prime Financial Corporation, and SBL Corporation.
 - 10.3 Certificate of Designations of LSB Industries, Inc., relating to the issuance of a new series of Class C Preferred Stock.
 - 15.1 Letter Re: Unaudited Interim Financial Information
- (B) Reports of Form 8-K. The Company did not file any reports on Form 8-K during the quarter ended September 30, 2001.

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 12th day of November 2001.

LSB INDUSTRIES, INC.

By: /s/ Tony M. Shelby

Tony M. Shelby,

Senior Vice President of Finance
(Principal Financial Officer)

By: /s/ Jim D. Jones

Jim D. Jones

Vice President, Controller and
Treasurer (Principal Accounting Officer)

LSB INDUSTRIES, INC.

The shares represented by this Certificate are subject to certain restrictions as described on the reverse side of this Certificate.

No Par Value

THIS CERTIFIES THAT SBL Corporation is the owner of

One Million Shares of a Series of Class C Preferred Stock each of the Capital Stock of

LSB Industries, Inc. designated as Series D 6% Cumulative, Convertible Class C Preferred Stock

Transferable only on the books of the Corporation by the holder

hereof in person or by Attorney upon surrender of this Certificate

properly endorsed.

IN WITNESS WHEREOF, the said Corporation has caused this Certificate to be

signed by its duly authorized officers and to be sealed with the Seal of the

Corporation this 18th October 2001

____ Secretary _____ President

SHARES 1,000,000 ; EACH

NEITHER THIS PREFERRED STOCK NOR ANY SHARES OF COMMON STOCK ISSUABLE UPON THE CONVERSION OF THIS PREFERRED STOCK HAVE BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE SECURITIES ACT) OR QUALIFIED UNDER APPLICABLE STATE SECURITIES LAWS. THIS PREFERRED STOCK AND THE COMMON STOCK ISSUABLE UPON CONVERSION OF THIS PREFERRED STOCK MAY NOT BE OFFERED, SOLD, PLEDGED, HYPOTHECATED OR OTHERWISE TRANSFERRED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION STATEMENT AND QUALIFICATION IN EFFECT WITH RESPECT THERETO UNDER THE SECURITIES ACT AND UNDER ANY APPLICABLE STATE SECURITIES LAW OR WITHOUT THE PRIOR WRITTEN CONSENT OF LSB INDUSTRIES, INC. AND AN OPINION OF LSB INDUSTRIES, INC.'S COUNSEL, OR AN OPINION FROM COUNSEL FOR THE HOLDER HEREOF, WHICH OPINION IS SATISFACTORY TO THE COMPANY, THAT SUCH REGISTRATION AND QUALIFICATION IS NOT REQUIRED UNDER APPLICABLE FEDERAL AND STATE SECURITIES LAWS OR AN EXEMPTION THEREFROM.

LSB INDUSTRIES, INC. WILL FURNISH WITHOUT CHARGE TO EACH STOCKHOLDER WHO SO REQUESTS THE POWERS, DESIGNATIONS, PREFERENCES AND RELATIVE, PARTICIPATING, OPTIONAL OR OTHER SPECIAL RIGHTS OF EACH CLASS OF STOCK OR SERIES THEREOF AND THE QUALIFICATIONS, LIMITATIONS OR RESTRICTIONS OF SUCH PREFERENCES AND/OR RIGHTS.

STOCK PURCHASE AGREEMENT

THIS AGREEMENT ("Agreement") has been made and entered into effective the ____ day of September, 2001, by and between Summit Machinery Company, an Oklahoma corporation ("Seller"), and SBL Corporation, an Oklahoma corporation ("Buyer"), with reference to the following:

WHEREAS: Seller owns 1000 shares of common stock of Northwest Energy Enterprises, Inc. ("NEE"), which shares together represent all of the issued and outstanding stock of NEE.

WHEREAS: Buyer desires to acquire all of the issued and outstanding shares of NEE (the "Shares"), and the Seller desires to sell the Shares to Buyer upon and subject to the terms and conditions set forth in this Agreement.

NOW, THEREFORE, in consideration of the foregoing and for other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties agree as follows:

1. Sale of the Shares

1.1 Sale and Delivery of the Shares. Subject to the terms and conditions herein set forth, at the Closing (hereafter defined) Seller shall sell, assign, transfer and deliver to Buyer the Shares, and Buyer agrees to purchase, receive, and accept delivery of and to pay Seller for the Shares.

1.2 Purchase Price and Payment. The purchase price for the Shares is \$350,000.00 ("Purchase Price"). The Purchase Price shall be paid by the Buyer to Seller at the Closing in immediately available U.S. funds.

2. The Closing. The purchase and sale of the Shares (the "Closing") shall be held at 16 South Pennsylvania, Oklahoma City, Oklahoma 73107, on or about October 15, 2001, or such other time and place as shall be determined by Seller.

3. Representations and Warranties of Seller. The Seller represents and warrants to Buyer, as follows:

3.1 The Shares. The Seller owns and has full and valid rights and title to the Shares, free and clear of all liens, security interests, claims and encumbrances, and the Seller has good right and authority to sell the same. The Shares have been validly authorized and issued, fully paid and nonassessable and are not subject to any outstanding rights, options, warrants or claims issued or executed by the Seller.

3.2 Authority for Agreement. The Seller has full and requisite power and authority to execute and deliver this Agreement and to perform its obligations hereunder. This Agreement constitutes the valid and legally binding obligation of the Seller, enforceable against the Seller in accordance with its terms.

3.3 Corporate Status. NEE is an Oklahoma corporation duly organized and existing and in good standing under the laws of the State of Oklahoma.

3.4 Capitalization. NEE's authorized capitalization consists of 10,000 shares of common stock, par value of \$1.00 each.

3.5 Subsidiaries. NEE has no subsidiaries.

4. Representations and Warranties of Buyer. Buyer represents and warrants to Seller as follows:

4.1 Organization. Buyer is an Oklahoma corporation duly organized, validly existing and in good standing under the laws of the Oklahoma and has corporate power to enter into and to carry out the terms and provisions of this Agreement.

4.2 Agreement Authorized. The execution, delivery and performance of this Agreement by Buyer has been authorized by all requisite corporation action on the part of Buyer and will not conflict with or result in any breach in the terms, conditions or provisions of Buyer's corporate charter, by-laws or any other instrument to which Buyer is a party.

4.3 Securities Law Restrictions. Buyer shall, within the meaning of the Securities Act of 1933, acquire the Shares for investment and not with a view to the sale or distribution thereof.

4.4 Knowledgeable Buyer. Prior to the Closing, Buyer managed the business of NEE. Buyer confirms and acknowledges that it has performed unrestricted due diligence into the assets and liabilities of NEE. Buyer is fully aware of the nature and extent of all liabilities and assets in NEE and is not relying on any representations or warranties, express or implied, of Seller except as may be expressly provided in this Agreement.

5. Additional Agreements of Parties.

5.1 Transfer of Shares. On the Closing, Seller will cooperate with Buyer in arranging to have available immediately after the Closing the transfer books of NEE and to cause such action to be taken by the officers and directors of NEE as may be required in order that all of the Shares delivered hereunder may forthwith be transferred of record to Buyer and in order that Buyer may cause such changes to be effected in the Board of Directors and officers of NEE as Buyer may desire.

5.2 Conduct of Business. Buyer shall promptly perform and undertake all liabilities that are part of NEE. Buyer hereby indemnifies Seller from and against any claim associated with the liabilities that are a part of NEE and any assets of NEE.

6. Conditions Precedent to Obligations of Buyer. The obligations of Buyer hereunder at the Closing shall be subject at its option, to the condition that all representations and warranties and other statements of Seller herein are true and correct and the condition that Seller perform all of its obligations hereunder to be performed at or prior to the Closing, and the following conditions:

6.1 Delivery of Stock. Certificates evidencing the Shares, duly executed for transfer to Buyer, and duly transferred to Buyer on the books of NEE.

6.2 Officers and Board of Directors. The Officers and members of the Board of Directors of NEE shall resign their office and/or directorships effective as of the Closing.

6.3 Consents. All consents from third parties required to consummate the transactions provided for in this Agreement shall have been obtained.

6.4 No Change. There shall have been no material adverse change in the condition or obligations of NEE (financial or otherwise).

7. Conditions Precedent to Obligations of Seller. The obligations of Seller at the Closing shall be subject, at its option, to the conditions that:

7.1 Representations and Warranties. All representations and warranties and other statements of Buyer herein are at and as of the Closing true and correct.

7.2 Performance of Obligations. Buyer shall have performed all of its obligations hereunder to be performed at or prior to the Closing.

8. Expenses. Except as otherwise herein provided, each party hereto will bear and pay its own expenses of negotiating and consummating the transactions contemplated hereby.

9. Notices.

9.1 All notices, requests or other communications called hereunder or contemplated hereby, shall be in writing, shall be deemed to have been given if personally delivered in return for a receipt, or if mailed, by registered or certified mail, return receipt requested, or by overnight courier service, to the parties at the addresses set forth below. The date of delivery shall be the date of giving notice or if any notice, given or made by mail in the manner prescribed above shall be deemed to have been given five (5) days after the date of mailing. Any party may change the address to which notices are given, by giving notice in the manner herein provided:

Notices to Seller shall be addressed as follows:

Summit Machinery Company
16 South Pennsylvania Avenue
Oklahoma City, OK 73107
Attn: President

Notices to Buyer shall be addressed as follows:

SBL Corporation
16 South Pennsylvania Avenue
Oklahoma City, OK 73107
Attn: President

10. Miscellaneous.

10.1 Whole Agreement - No Oral Modification. This Agreement embodies all representations, warranties and agreements of the parties hereto, and may not be altered or modified except by an instrument in writing signed by the parties.

10.2 Benefit of Agreement. This Agreement shall be binding upon and inure to the benefit of the parties and their respective successors and assigns.

10.3 Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Oklahoma applicable contracts made and performed entirely therein.

10.4 Counterparts. This Agreement may be executed in any number of counterparts, which taken together shall constitute one and the same instrument, and each of which shall be considered an original for all purposes.

10.5 Section Headings. The section headings contained in this Agreement are for convenience and reference only and shall not in any way affect the meaning or interpretation of this Agreement.

10.6 Severability. All agreements and covenants contained herein are severable, and in the event any of them should be held to be invalid by a court of competent jurisdiction, this Agreement shall be interpreted and enforced as if such invalid agreements or covenants were not contained herein.

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed as of the day and year first above written.

"SELLER"

SUMMIT MACHINERY COMPANY

By:

"BUYER"

SBL CORPORATION

By:

Jack E. Golsen, President

AGREEMENT

THIS AGREEMENT is entered into this 18th day of October, 2001, by and between LSB INDUSTRIES, INC., a Delaware corporation (the ACompany@); PRIME FINANCIAL CORPORATION, an Oklahoma corporation (APrime@) and a wholly owned subsidiary of the Company; and SBL CORPORATION, an Oklahoma corporation (ASBL@).

WITNESSETH

WHEREAS, all of the issued and outstanding stock of SBL is owned, directly or indirectly, by the following members of the immediate family of Jack E. Golsen (AJ. Golsen@), Chairman of the Board of Directors and President of the Company: Sylvia H. Golsen (wife of J. Golsen); Barry H. Golsen (son of J. Golsen and Vice Chairman of the Board of Directors of the Company and President of the Company's Climate Control Business; Steven J. Golsen (son of J. Golsen and an executive officer within the Company's Climate Control Business); and Linda Golsen Rappaport (a daughter of J. Golsen) (collectively, the AGolsen Family@);

WHEREAS, Prime is a wholly owned subsidiary of the Company;

WHEREAS, on or about October 16, 1997, SBL and affiliates borrowed from the Stillwater National Bank and Trust Company (ASStillwater Bank@) the sum of \$3,000,000 (ASBL Loan@);

WHEREAS, on or about October 17, 1997, SBL loaned to Prime the \$3,000,000 that SBL borrowed from Stillwater Bank, on an unsecured basis and payable on demand, with the annual interest rate payable monthly in arrears at a variable interest rate equal to the Wall Street Journal Prime Rate plus 2% per annum (the APrime Loan@);

WHEREAS, the Prime Loan was evidenced by a Promissory Note, dated October 17, 1997, which Promissory Note was amended and restated by that certain Promissory Note, dated March 5, 1998, bearing a fixed interest rate per annum of 10.75%, with Prime as the maker and payable to the order of SBL (the APrime Note@);

WHEREAS, SBL pledged to the Stillwater Bank certain of its assets, including, but not limited to, the Prime Note, to secure its payment obligations under the SBL Loan;

WHEREAS, in April, 2000, SBL and Prime agreed to modify the Prime Note from a demand note to a note with a payment date of April 1, 2001, except under limited circumstances (AExtension Agreement@);

WHEREAS, in order to obtain the Extension Agreement from SBL, Prime was required to guarantee SBL's Loan to Stillwater Bank on a limited basis pursuant to the terms of a Guaranty Agreement, dated as of April 21, 2000 (AGuaranty Agreement@), as amended and modified by that certain Agreement, dated April 21, 2000, by and between Stillwater Bank, Prime and SBL (ASStillwater Agreement@), and pledged to the Stillwater Bank 1,973,461 shares of the Company's common stock, par value \$.10 per share (the APrime Stock@), owned by Prime pursuant to the terms of that certain Security Agreement, effective as of April 21, 2000, between Prime and the Stillwater Bank (APrime Security Agreement@);

WHEREAS, during 2001, Prime and SBL agreed to extend the payment date of the Prime Note until April 1, 2002;

WHEREAS, as of the date of this Agreement, the outstanding principal balance due under the Prime Note is \$1,350,000, and all accrued interest through October 15, 2001, has been paid in full;

WHEREAS, SBL has proposed to the Company and Prime to take in payment of \$1,000,000 of the unpaid balance due under the Prime Note, one million (1,000,000) shares of a newly created series of Class C Preferred Stock of the Company (APreferred Stock@), with each share of such new series of Preferred Stock having, among other things, .875 votes and voting as a class with the Company's common stock, par value \$.10 per share (ACompany's Common Stock@), a liquidation preference of \$1.00 per share and cumulative dividends at the rate of six percent (6%) of the liquidation preference per annum;

WHEREAS, the Company's Board of Directors (the ABoard@) established a Special Committee (ASpecial Committee@) of the Board comprised of three outside and independent members of the Board, none (i) of whom are related to J. Golsen or any members of the Golsen Family, (ii) have any business dealings with the Company or any of its subsidiaries (other than serving as a director of the Company and a subsidiary thereof) or any of the Golsen Family or entities controlled by the Golsen Family or persons related to any member of the Golsen Family;

WHEREAS, the Special Committee, with the advice of its own counsel and investment bankers, none of whom have had any previous dealings with the Company, any subsidiaries of the Company, the Golsen Family or any entities controlled by the Golsen Family, have negotiated with SBL an agreement, whereby SBL has agreed to accept in payment of \$1,000,000 of the Prime Loan one million shares of a new created series of the Company's Class C Preferred Stock, no par value (ANew Series of Preferred@), with such shares of the New Series of Preferred having a designation of ASeries D 6% Cumulative, Convertible Class C Preferred Stock, no par value, a liquidation preference of \$1.00 per share and containing such designations, preferences, voting, dividend and relative, participating, optional or other special rights and qualifications, limitations or restrictions as stated and expressed in the Certificate of Designations attached hereto as Exhibit AA@ (ANew Series Preferred Certificate of Designations@), subject to the terms and conditions of this Agreement;

WHEREAS, upon completion of the transaction contemplated by this Agreement, Prime will owe to SBL under the Prime Note the remaining principal sum of \$350,000;

WHEREAS, the New Series of Preferred is not, and will not in the future be, publicly traded and there is no, and there will not be in the future, any market for such stock;

WHEREAS, the Company's Common Stock is listed for trading on the Over-The-Counter Bulletin Board (AOTC-BB@), and the Company is subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended (the AExchange Act@), and has been subject to such filing requirements for the past ninety (90) days;

WHEREAS, SBL is an Accredited investor@ and all of the equity owners of SBL are Accredited investors@, as such term is defined in Rule 501 of Regulation D promulgated under the Securities Act of 1933, as amended (the ASecurities Act@);

WHEREAS, in reliance upon the representations made by SBL in this Agreement, the transactions contemplated by this Agreement are such that the offer and issuance of securities by the Company hereunder will be exempt from registration under the applicable U.S. federal securities laws since this is a private placement and intended to be a nonpublic offering pursuant to Section 4(2) of the Securities Act and/or Regulation D promulgated under the Securities Act; and

WHEREAS, the New Series of Preferred is not, and will not be in the future, quoted or listed for trading on any securities exchange, organized market or quotation system.

NOW THEREFORE, for and in consideration of the premises and mutual agreements contained herein, the parties hereto agree as follows:

1. **Payment of \$1 million of Prime Note.** Subject to the terms and conditions of this Agreement, at the Closing (as defined below) Prime shall pay, and SBL shall accept, \$1,000,000 as partial payment of the outstanding principal amount due under the Prime Note, with such payment not in cash but in the form of the issuance by the Company of one million shares of the New Series of Preferred, designated as Series D 6% Cumulative, Convertible Class C Preferred Stock, no par value, having a liquidation preference of \$1.00 per share, with all such shares of the New Series of Preferred containing such other preferences and relative, voting, dividend, participating, optional or other special rights and qualifications, limitations or restrictions as expressed in the New Series Preferred Certificate of Designations.

2. **Outstanding Principal Balance.** Upon issuance by the Company of the one million shares of New Series of Preferred to SBL, the outstanding unpaid principal balance due under the Prime Note shall be \$350,000. At the Closing, SBL shall deliver to Prime the original of the Prime Note and the original of any amended and restated Prime Note, all of which shall be marked ACanceled@ by SBL and so executed by SBL, and Prime shall, at the Closing, execute a new amended and restated promissory note (ANew Note@) replacing in all respects the Prime Note, with the terms and provisions of the New Note to be substantially similar to the Prime Note, except that the principal amount of the New Note shall be \$350,000, bear an annual rate of interest of 10 3/4%, be unsecured and shall provide that the principal of the New Note shall be payable on demand. A copy of the New Note to be executed by Prime at the Closing is attached hereto as Exhibit AB@.

3. **Conditions Precedent.** The Company's and Prime's obligations under this Agreement is subject to all of the following conditions precedent being complied with:

3.1 The Stillwater Bank shall have delivered to SBL the original and all copies thereof of the Prime Note, so that SBL can mark ACanceled@ and deliver such to Prime at the Closing, all in a manner satisfactory to the Company; and

3.2 The Stillwater Bank and Prime shall have amended the Prime Guaranty limiting Prime's obligations under the Prime Guaranty to an amount not to exceed \$350,000. In addition, Stillwater Bank shall have returned to Prime 1,000,000 shares of Prime Stock pledged by Prime to the Stillwater Bank, and Prime and Stillwater Bank shall have amended the Prime Security Agreement so that the only collateral pledged or to be pledged by Prime under the Prime Security Agreement or any other security agreement relating to the Prime Guaranty or any loans by the Stillwater Bank to SBL is 973,461 shares of the Company Common Stock. Further, Stillwater Bank shall amend the UCC-1 Financing Statement that may have been filed of record by the Stillwater Bank covering any and all collateral, including the Prime Stock, pledged by Prime to Stillwater Bank, to limit the collateral pledged by Prime to only 973,461 shares of the Prime Stock and terminating its lien in and to any and all other collateral. All of the above are to be in a manner satisfactory to the Company.

4. **Closing.** The consummation of this Agreement (the AClosing@) will occur simultaneously with the conditions precedent set forth in Section 3 being met (the AClosing Date@).

5. **Representations, Warranties and Covenants of SBL.** SBL hereby represents, warrants and covenants to the Company as follows:

5.1 **Investment Intent.** SBL represents and warrants that the shares of New Series of Preferred are being, and any underlying shares of Company Common Stock issuable upon conversion of the New Series of Preferred (AConversion Shares@) will be, purchased or acquired solely for SBL's own account, for investment purposes only and not with a view toward the distribution or resale to others. SBL acknowledges, understands and appreciates that the shares of New Series of Preferred and the Conversion Shares have not been registered under the Securities Act by reason of a claimed exemption under the provisions of the Securities Act which depends, in large part, upon SBL's representations as to investment intent, investor status, and related and other matters set forth herein. SBL understands that, in the view of the Securities Exchange Commission (ASEC@), among other things, a purchase now with an intent to distribute or resell would represent a purchase and acquisition with an intent inconsistent with its representation to the Company, and the SEC might regard such a transfer as a deferred sale for which the registration exemption is not available.

5.2 **Certain Risk.** SBL recognizes that the acquisition of the New Series of Preferred involves a high degree of risk, and while the Conversion Shares are presently quoted and traded on the Over-The-Counter Bulletin Board, such (i) are not registered under applicable federal (U.S.) or state securities laws, and thus may not be sold, conveyed, assigned or transferred unless registered under such laws or unless an exemption from registration is available under such laws, as more fully described herein and (ii) the New Series of Preferred subscribed for and that are to be acquired under this Agreement are not quoted, traded or listed for trading or quotation on any organized market or quotation system, and there is therefore no present public or other market for the New Series of Preferred, nor can there be any assurance that the Conversion Shares will continue to be quoted, traded or listed for trading or quotation on the Over-The-Counter Bulletin Board or on any other organized market or quotation system.

5.3 **Prior Investment Experience.** SBL acknowledges that it and/or the owners of its stock have prior investment experience, including investment in non-listed and non-registered securities, or has employed the services of an investment advisor, attorney or accountant to read all of the documents furnished or made available by the Company to it and to evaluate the merits and risks of such an investment on its behalf and that it recognizes the highly speculative nature of this investment.

5.4 **No Review by the SEC.** SBL hereby acknowledges that this offering of the New Series of Preferred has not been reviewed by the SEC because this private placement is intended to be a nonpublic offering pursuant to Section 4(2) of the Securities Act and/or Regulation D promulgated under the Securities Act.

5.5 **Not Registered.** SBL understands that the New Series of Preferred and the Conversion Shares have not been registered under the Securities Act by reason of a claimed exemption under the provisions of the Securities Act which depends, in part, upon SBL's investment intention. In this connection, SBL understands that it is the position of the SEC that the statutory basis for such exemption would not be present if its representation merely meant that its present intention was to hold such securities for a short period, such as the capital gains period of tax statutes, for a deferred sale, or for any other reason or fixed period.

5.6 **No Public Market.** SBL understands that there is no public market for the New Series of Preferred. SBL understands that although there is presently a public market for the Company's Common Stock, including the Conversion Shares, Rule 144 (the ARule@) promulgated under the Securities Act requires, among other conditions, a one-year holding period following full payment of the consideration therefor prior to the resale (in limited amounts) of securities acquired in a nonpublic offering without having to satisfy the registration requirements under the Securities Act. SBL understands that the Company makes no representation or warranty regarding its fulfillment in the future of any reporting requirements under the Exchange Act, or its dissemination to the public of any current financial or other information concerning the Company, as is required by the Rule as one of the conditions of its availability. SBL understands and hereby acknowledges that the Company is under no obligation to register the New Series of Preferred or the Conversion Shares under the Securities Act.

5.7 **Sophisticated Investor.** That (a) SBL has adequate means of providing for its current financial needs and possible contingencies; (b) SBL is able to bear the economic risks inherent in an investment in the New Series of Preferred and that an important consideration bearing on its ability to bear the economic risk is whether SBL can afford a complete loss of its investment in the New Series of Preferred and SBL represents and warrants that SBL can afford such a complete loss; and (c) SBL has such knowledge and experience in business, financial, investment and banking matters (including, but not limited to, investments in restricted, non-listed and non-registered securities) that SBL is capable of evaluating the merits, risks and advisability of an investment in the New Series of Preferred.

5.8 **Tax Consequences.** SBL acknowledges that the Company has made no representation regarding the potential or actual tax consequences for SBL which will result from entering into the Agreement and from consummation of the transaction contemplated hereunder. SBL acknowledges that it bears complete responsibility for obtaining adequate tax advice regarding this Agreement.

5.9 **SEC Filing.** SBL acknowledges that it and its equity owners have been previously furnished with true and complete copies of the following documents which have been filed with the SEC pursuant to Sections 13(a), 14(a), 14(c) or 15(d) of the Exchange Act.

(i) Annual Report on Form 10-K for the year ended December 31, 2000 (the AForm 10-K@); (ii) Current Reports on Form 8-K, filed during 2001; (iii) Quarterly Reports on Form 10-Q for the quarter ended March 31, 2001 and June 30, 2001; (iv) the Company's Proxy Statement for the 2001 Annual Meeting of Shareholders; and (v) the information contained in any reports or documents required to be filed by the Company under Sections 13(a), 14(a), 14(c) or 15(d) of the Exchange Act since the distribution of the Form 10-K.

5.10 **Documents, Information and Access.** SBL's decision to acquire the New Series of Preferred in payment of \$1,000,000 of the Prime Note is not based on any promotional, marketing or sales materials, and SBL and its representatives have been afforded, prior to purchase thereof, the opportunity to ask questions of, and to receive answers from, the Company and its management, and has had access to all documents and information which SBL deems material to an investment decision with respect to the purchase of New Series of Preferred hereunder.

5.11 **No Registration, Review or Approval.** SBL acknowledges and understands that the private offering and sale of securities pursuant to this Agreement has not been reviewed or approved by the SEC or by any state securities commission, authority or agency, and is not registered under the Securities Laws. SBL acknowledges, understands and agrees that the shares of New Series of Preferred are being offered and exchanged hereunder pursuant to (x) a private placement exemption to the registration provisions of the Securities Act pursuant to Section 4(2) of such Securities Act and/or Regulation D promulgated under the Securities Act and (y) a similar exemption to the registration provisions of applicable state securities law.

5.12 **Transfer Restrictions.** SBL will not transfer any New Series of Preferred purchased until this Agreement or any Conversion Shares required unless such are registered under the Securities Laws, or unless an exemption is available under such Securities Laws, and the Company may, if it chooses, where an exemption from registration is claimed by such Subscriber, condition any transfer of New Series of Preferred or Conversion Shares out of SBL's name on receipt of an opinion of the Company's counsel, to the effect that the proposed transfer is being effected in accordance with, and does not violate, an applicable exemption from registration under the Securities Laws, or an opinion of counsel to SBL, which opinion is satisfactory to the Company, to the effect that registration under the Securities Act is not required in connection with such sale or transfer and the reasons therefor.

5.13 **No Commission.** SBL agrees and acknowledges that no commissions or other remuneration is being paid or given directly or indirectly for soliciting the Exchange.

5.14 **Reliance.** SBL understands and acknowledges that the Company is relying upon all of the representations, warranties, covenants, understandings, acknowledgments and agreements contained in this Agreement in determining whether to accept this subscription and to issue the New Series of Preferred to SBL.

5.15 **Accuracy or Representations and Warrants.** All of the representations, warranties, understandings and acknowledgments that SBL has made herein are true and correct in all material respects as of the date of execution hereof. SBL will perform and comply fully in all material respects with all covenants and agreements set forth herein, and SBL covenants and agrees that until the acceptance of this Agreement by the Company, SBL shall inform the Company immediately in writing of any changes in any of the representations or warranties provided or contained herein.

5.16 **Indemnity.** SBL hereby agrees to indemnify, defend and hold harmless the Company, Prime and their respective successors and assigns, from and against any demands, claims, actions or causes of action, assessments, liabilities, losses, costs, damages, penalties, charges, fines or expenses (including, without limitation, interest, and attorney and accountants' fees, disbursements and expenses), arising out of or relating to or in connection with (i) any breach by SBL of any representation, warranty, covenant or agreement made by SBL in this Agreement or (ii) the \$1,000,000 of the Prime Note being paid with the New Series of Preferred or (iii) any sale or distribution by SBL of the New Series of Preferred or Conversion Shares in violation of the Securities Act or any applicable state securities or blue sky laws (collectively, the ASecurities Laws@). Such right to indemnification shall be in addition to any and all other rights of the Company or Prime under this Agreement or otherwise, at law or in equity.

5.17 **Survival.** SBL expressly acknowledges and agrees that all of its representations, warranties, agreements and covenants set forth in this Agreement shall be of the essence hereof and shall survive the execution, delivery and Closing of this Agreement, the sale, purchase, and conversion, if any, of the New Series of Preferred, and the sale of the Conversion Shares.

6. **Representations, Warranties and Covenants of the Company.** In order to induce SBL to enter into this Agreement and to consummate the transactions contemplated by this Agreement, the Company and Prime hereby represent, warrant, and covenant to SBL as follows:

6.1 **Organization, Authority, Qualification.** The Company is a corporation duly incorporated and in good standing under the laws of the State of Delaware. Prime is a corporation duly incorporated and in good standing under the laws of the State of Oklahoma.

6.2 **Authorization.** The Company and Prime have full power and authority to execute and deliver this Agreement and to perform its obligations under and consummate the transactions contemplated by this Agreement.

6.3 **No Commission.** The Company and Prime agree and acknowledge that no commission is being paid or given directly or indirectly for soliciting this Agreement.

6.4 **Ownership of, and Title to, Securities.** The New Series of Preferred to be issued hereunder are, and all Conversion Shares, when issued, will be, duly authorized, validly issued, fully paid and nonassessable shares of the capital stock of the Company, free of personal liability.

7. **Securities, Legends and Notices.** SBL represents and warrants that it has read, considered and understood the following legends, and agrees that such legends, substantially in the form and substance set forth below, shall be placed on all of the certificates representing the New Series of Preferred:

New Series of Preferred Legends

NEITHER THIS PREFERRED STOCK NOR ANY SHARES OF COMMON STOCK ISSUABLE UPON THE CONVERSION OF THIS PREFERRED STOCK HAVE BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE ASECURITIES ACT@) OR QUALIFIED UNDER APPLICABLE STATE SECURITIES LAWS. THIS PREFERRED STOCK AND THE COMMON STOCK ISSUABLE UPON CONVERSION OF THIS PREFERRED STOCK MAY NOT BE OFFERED, SOLD, PLEDGED, HYPOTHECATED OR OTHERWISE TRANSFERRED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION STATEMENT AND QUALIFICATION IN EFFECT WITH RESPECT THERETO UNDER THE SECURITIES ACT AND UNDER ANY APPLICABLE STATE SECURITIES LAW OR WITHOUT THE PRIOR WRITTEN CONSENT OF LSB INDUSTRIES, INC. AND AN OPINION OF LSB INDUSTRIES, INC.'S COUNSEL, OR AN OPINION FROM COUNSEL FOR THE HOLDER HEREOF, WHICH OPINION IS SATISFACTORY TO THE COMPANY, THAT SUCH REGISTRATION AND QUALIFICATION IS NOT REQUIRED UNDER APPLICABLE FEDERAL AND STATE SECURITIES LAWS OR AN EXEMPTION THEREFROM.

Conversion Shares Legends.

THE SHARES OF COMMON STOCK REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE ASECURITIES ACT@) OR QUALIFIED UNDER APPLICABLE STATE SECURITIES LAWS. THIS COMMON STOCK MAY NOT BE OFFERED, SOLD, PLEDGED, HYPOTHECATED OR OTHERWISE TRANSFERRED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION STATEMENT AND QUALIFICATION IN EFFECT WITH RESPECT THERETO UNDER THE SECURITIES ACT AND UNDER ANY APPLICABLE STATE SECURITIES LAW OR WITHOUT THE PRIOR WRITTEN CONSENT OF LSB INDUSTRIES, INC. AND AN OPINION OF LSB INDUSTRIES, INC.'S COUNSEL, OR AN OPINION FROM COUNSEL FOR THE HOLDER HEREOF, WHICH OPINION IS SATISFACTORY TO THE COMPANY, THAT SUCH REGISTRATION AND QUALIFICATION IS NOT REQUIRED UNDER APPLICABLE FEDERAL AND STATE SECURITIES LAWS OR AN EXEMPTION THEREFROM.

8. Miscellaneous.

8.1 **Amendment; Waiver.** This Agreement shall not be changed, modified or amended in any respect except by the mutual written agreement of the parties hereto. Any provision of this Agreement may be waived in writing by the party which is entitled to the benefits thereof. No waiver of any provision of this Agreement shall be deemed to, or shall constitute a waiver of, any other provision hereof or thereof (whether or not similar), nor shall any such waiver constitute a continuing waiver.

8.2 **Binding Effect; Assignment.** Neither this Agreement, nor any rights or obligations hereunder are assignable by SBL.

8.3 **Governing Law; Litigation Costs.** This Agreement and its validity, construction and performance shall be governed in all respects by the internal laws of the State of Oklahoma, except with respect to corporate law issues as to the Company relating to the authorization, issuance and validity of the New Series of Preferred and the Conversion Shares which shall be governed by the Delaware General Corporation Laws, without giving effect to such states' conflicts of laws provisions.

8.4 **Headings** The captions, headings and titles preceding the text of each or any Section, subsection or paragraph hereof are for convenience of reference only and shall not affect the construction, meaning or interpretation of this Agreement or the Warrants or any term or provisions hereof or thereof.

8.5 **Counterparts** This Agreement may be executed in one or more original or facsimile counterparts, each of which shall be deemed an original and all of which shall be considered one and the same agreement, binding on all of the parties hereto, notwithstanding that all parties are not signatories to the same counterpart.

8.6 **Transfer Taxes.** Each party hereto shall pay all such sales, transfer, use, gross receipts, registration and similar taxes arising out of, or in connection with, the transactions contemplated by this Agreement (collectively, the ATransfer Taxes@) as are payable by such party under applicable law.

8.7 **Entire Agreement.** This Agreement, along with the New Series Preferred Certificate of Designations, merges and supersedes any and all prior agreements, understandings, discussions, assurances, promises, representations or warranties among the parties with respect to the subject matter hereof, and contains the entire agreement among the parties with respect to the subject matter set forth herein and therein.

8.8 **Notices.** Except as otherwise specified herein to the contrary, all notices, requests, demands and other communications required or desired to be given hereunder shall only be effective if given in writing, by hand or by fax, by certified or registered mail, return receipt requested, postage prepaid, or by U.S. Express Mail service, or by private overnight mail service (e.g., Federal Express). Any such notice shall be deemed to have been given (i) on the business day actually received if given by hand or by fax, (ii) on the business day immediately subsequent to mailing, if sent by U.S. Express Mail service or private overnight mail service, or (iii) five (5) business days following the mailing thereof, if mailed by certified or registered mail, postage prepaid, return receipt requested, and all such notices shall be sent to the following address (or to such other address or addresses as a party may have advised the other in the manner provided in this Section 8.8):

If to the Company or Prime: Mr. Tony M. Shelby

LSB Industries, Inc.

16 South Pennsylvania

P. O. Box 754

President

SBL Corporation

16 South Pennsylvania Avenue

Oklahoma City, Oklahoma 73107

8.9 **No Third Party Beneficiaries.** This Agreement and the rights, benefits, privileges, interests, duties and obligations contained or referred to herein shall be solely for the benefit of the parties hereto and no third party shall have any rights or benefits hereunder as a third party beneficiary or otherwise hereunder.

IN WITNESS WHEREOF, the Company, Price and SBL have each duly executed this Agreement on the ____ day of October, 2001.

LSB INDUSTRIES, INC.,

a Delaware corporation

By: _____

Tony M. Shelby

Senior Vice President

PRIME FINANCIAL CORPORATION,

an Oklahoma corporation

By: _____

President

SBL CORPORATION,

an Oklahoma corporation

By: _____

Jack E. Golsen

President

CERTIFICATE OF DESIGNATIONS
OF
LSB INDUSTRIES, INC.

LSB Industries, Inc. (the ACorporation@ or ALSB@), a corporation organized and existing under the Delaware General Corporation Law, hereby certifies pursuant to Section 151(g) of the General Corporation Law of the State of Delaware, that the following resolutions relating to the issuance of a new series of Class C Preferred Stock, no par value, of the Corporation consisting of 1,000,000 shares were duly adopted by a Special Committee of the members of the Board of Directors of the Corporation at a meeting held on October 9, 2001, pursuant to resolutions of the whole Board of Directors of the Corporation.

RESOLVED, that pursuant to authority expressly granted to and vested in the Board of Directors of LSB Industries, Inc. (ALSB@ or the ACorporation@) by the provisions of the Restated Certificate of Incorporation of LSB, the Board of Directors of LSB does hereby create, and LSB may issue, pursuant to the terms of the Agreement, dated October 18, 2001, between LSB, Prime Financial Corporation, an Oklahoma corporation (APrime@) and a wholly owned subsidiary of LSB, and Stillwater National Bank and Trust Company (ASStillwater Bank@) (the AAgreement@), from LSB=s Class C Preferred Stock, no par value, a new series consisting of 1,000,000 shares designated as ASeries D 6% Cumulative, Convertible Class C Preferred Stock,@ no par value, and hereby fixes the designations, preferences, rights and privileges of such Series D 6% Cumulative, Convertible Class C Preferred Stock and the qualifications, limitations or restrictions thereof, as follows:

1. **Designation.** The shares of this series of Class C Preferred Stock shall be designated as ASeries D 6% Cumulative, Convertible Class C Preferred Stock@ (hereinafter called ASeries D Preferred Stock@), having no par value, with said Series D Preferred Stock to consist of one million (1,000,000) shares.
2. **Dividends; Cumulative.** The holders of shares of the Series D Preferred Stock shall be entitled to receive cash dividends, but only when, as and if declared by the Board of Directors of LSB, in a manner as permitted by law, at the rate of six percent (6%) per annum of the Liquidation Preference (as defined below) of such Series D Preferred Stock and no more, payable annually on such date in each year as shall be fixed by the Board of Directors of LSB (ACash Dividends@).

If Cash Dividends on the Series D Preferred Stock for any year shall not have been paid or set apart in full for the Series D Preferred Stock, the aggregate deficiency shall be cumulative and shall be paid or set apart for payment before any dividends shall be paid upon or set apart for payment for any class of common stock of LSB (other than a dividend payable in common stock of LSB).

Any accumulation of dividends on the Series D Preferred Stock shall not bear interest. The holders of Series D Preferred Stock shall not be entitled to receive any dividends thereon other than the dividends provided for in this paragraph 2.

Cash Dividends on Series D Preferred Stock shall be declared if, when and as the Board of Directors shall in their sole discretion deem advisable, and only from the net profits or surplus of the Corporation, in a manner as permitted by law as such shall be fixed and determined by the said Board of Directors. The determination of the Board of Directors at any time of the amount of net profits or surplus available for a Cash Dividend shall be binding and conclusive on the holders of all the Series D Preferred Stock of the Corporation at the time outstanding.

Except as otherwise provided in the last paragraph of this Section 2, when dividends are not paid in full upon the shares of this Series D Preferred Stock and any other preferred stock of LSB ranking on a parity as to dividends with this Series D Preferred Stock, all dividends declared upon shares of this Series D Preferred Stock and any other preferred stock of LSB ranking on a parity as to dividends with Series D Preferred Stock shall be declared pro rata so that the amount of dividends declared per share on this Series D Preferred Stock and such other preferred stock shall in all cases bear to each other the same ratio that accrued dividends per share on the shares of this Series D Preferred Stock and such other preferred stock bear to each other; provided, however, that dividends on preferred stock that provides for non-cumulative dividends shall be entitled to participate, and shall rank on a parity, to the extent of dividends due in the then current period for which such dividends are paid. Holders of share of Series D Preferred Stock shall not be entitled to any dividends, whether payable in cash, property or stock, in excess of the full cumulative dividends, as herein provided, on this Series D Preferred Stock. No interest or sum of money in lieu of interest, shall be payable in respect of any dividend payment or payments on this Series D Preferred Stock which may be in arrears.

Notwithstanding anything herein to the contrary, if at any time any dividend on LSB=s then outstanding \$3.25 Convertible Exchangeable Class C Preferred Stock, Series 2 (\$3.25 Preferred@) shall be in default, in whole or in part, then no dividend shall be paid or declared and set apart for payment on the Series D Preferred Stock unless and until all cumulative accrued and unpaid dividends with respect to such \$3.25 Preferred shall have been paid or declared and set apart for payment.

3. **No Preemptive Rights.** No holder of the Series D Preferred Stock shall have any preemptive rights. No holder of the Series D Preferred Stock shall be entitled to purchase or subscribe for any part of the unissued stock of LSB or of any stock of LSB to be issued by reason of any increase of the authorized capital stock of LSB, or to purchase or subscribe for any bonds, certificates of indebtedness, debentures or other securities convertible into or carrying options or warrants to purchase stock or other securities of LSB or to purchase or subscribe for any stock of LSB purchased by LSB or by its nominee or nominees, or to have any other preemptive rights now or hereafter defined by the laws of the State of Delaware.

4. **Preference on Liquidation, etc.** In the event of any voluntary or involuntary liquidation, dissolution or winding up of LSB, or any reduction in its capital resulting in any distribution of assets to its stockholders, the holders of the Series D Preferred Stock shall be entitled to receive in cash out of the assets of LSB, whether from capital or from earnings, available for distribution to its stockholders, before any amount shall be paid to the holders of the common stock of LSB, the sum of One and No/100 Dollar (\$1.00), per share (ALiquidation Preference@), plus an amount equal to all accumulated and unpaid Cash Dividends thereon as of the date fixed for payment of such distributive amount. The purchase or redemption by LSB of stock of any class, in any manner permitted by law, shall not for the purpose of this paragraph be regarded as a liquidation, dissolution or winding up of LSB or as a reduction of its capital. Neither the consolidation nor merger of LSB with or into any other corporation or corporations, nor the sale or transfer by LSB of all or any part of its assets, shall be deemed to be a liquidation, dissolution or winding up of LSB for the purpose of this paragraph. A dividend or distribution to stockholders from net profits or surplus earned after the date of any reduction of capital shall not be deemed to be a distribution resulting from such reduction in capital. No holders of Series D Preferred Stock shall be entitled to receive or participate in any amounts with respect thereto upon any liquidation, dissolution or winding up of LSB other than the amounts provided for in this paragraph. If, in the event of any such liquidation, dissolution or winding up of LSB, there shall be shares of more than one class or series of preferred stock outstanding, and such other class or classes or series of preferred stock by their terms have a parity with the Series D Preferred Stock, and in such event there shall be assets distributable upon all shares of the Series D Preferred Stock and of such other classes or series of preferred stock in an amount less than the amount of which the holders thereof are entitled, then any amount available to be paid upon all such shares of preferred stock (including the Series D Preferred Stock) shall be divided among said classes or series of preferred stock in proportion to the aggregate amounts which would have been paid to the holders of the shares of each class or series had they received payment in the full amount to which they would be entitled in such event.

5. **Voting Rights.** Subject to the provisions of this paragraph 5, at every meeting of stockholders of LSB each holder of the Series D Preferred Stock shall be entitled to .875 votes for each share of Series D Preferred Stock held of record in his, her or its name on all matters submitted to a vote of the stockholders of LSB. The Series D Preferred Stock, the Common Stock (as defined below) of LSB, LSB=s Series B 12% Cumulative, Convertible Preferred Stock, par value \$100.00 per share, and LSB's Series of Convertible Non-Cumulative Preferred Stock, par value \$100.00 per share, shall vote together as one class.

6. **Conversion Privileges.** Subject to the terms of this paragraph 6, the holder of record of any share or shares of Series D Preferred Stock shall have the right at any time, at his, her or its option and election, to convert four (4) shares of Series D Preferred Stock into one (1) share of LSB common stock, par value \$0.10 per share (ACommon Stock@), (equivalent to a conversion price of \$4.00 per share of LSB Common Stock) on the following terms and conditions:

(a) LSB shall at the time of such conversion pay to the holder of record of any share or shares of Series D Preferred Stock any accrued but unpaid dividends on said Series D Preferred Stock so surrendered for conversion, except: (i) as otherwise limited by law or by any agreement or instrument to which LSB is a party or may be bound by (including, but not limited to, this Certificate of Designations), and (ii) that the amount of the dividend paid for the then current annual dividend period in which such conversion occurs shall be pro-rated for that portion of such year that has elapsed prior to the time the holder of such share or shares of Series D Preferred Stock exercises his, her or its rights of conversion. If LSB is limited by law from paying such accrued but unpaid dividends, in whole or in part, on the share or shares of Series D Preferred Stock surrendered for conversion at the time such are surrendered for conversion, then LSB shall only be required to pay that amount of such accrued but unpaid dividends as allowed by such law at the time of such conversion and no more. If LSB is limited under any agreement (including, but not limited to, this Certificate of Designations) from paying such accrued but unpaid dividends, in whole or in part, on the share or shares of Series D Preferred Stock surrendered for conversion at the time such are surrendered for conversion, then LSB

shall pay to the holder of record thereof that portion of such accrued but unpaid dividends that LSB is unable to pay on such share or shares of Series D Preferred Stock at the time such are surrendered for conversion due to said agreement (AUnpaid Dividends@) when LSB is no longer prohibited from paying such Unpaid Dividends under an agreement and prior to any dividends being paid upon or set apart for payment for any class of Common Stock of LSB (other than a dividend payable in Common Stock of LSB); and in connection therewith, LSB and such holder shall, at the time of such conversion, enter into a separate contract, the terms of which are to be satisfactory to LSB and such holder, evidencing LSB's obligation to pay to the holder thereof the Unpaid Dividends (without interest) after such conversion when LSB is no longer prohibited from paying such under an agreement and prior to any dividends being paid upon or set apart for payment for any class of Common Stock of LSB (other than a dividend payable in Common Stock of LSB).

(b) In the event that LSB shall (i) pay to the holders of its Common Stock a stock dividend payable in its Common Stock, the number of shares of Common Stock issuable upon conversion of the Series D Preferred Stock shall be proportionately adjusted, effective as of the date of payment of such stock dividend; or (ii) have a stock split, reclassification, recapitalization, combination of outstanding shares or similar corporate rearrangement (other than a stock dividend which is provided for in (i) above), without any consideration thereof being received by LSB, increasing or decreasing the number of shares of LSB's Common Stock, the number of shares of Common Stock issuable upon conversion of the Series D Preferred Stock shall be proportionately increased or decreased, effective as of the date of the payment of or happening of such event; or (iii) be consolidated with or merge into another corporation, in which LSB is the non-surviving corporation, or sell all or substantially all of LSB's assets as an entirety under one plan or arrangement to another corporation and such consolidation, merger or sale shall be effected in such a way that holders of LSB's Common Stock shall be entitled to receive stock, securities or assets with respect to or in exchange for such Common Stock, then after the effective date of such consolidation, merger or sale each share of Series D Preferred Stock shall be convertible into (in lieu of LSB Common Stock) the number of shares of stock or other securities or assets to which such holder of the Series D Preferred Stock would have been entitled to upon such consummation as if the holder of the Series D Preferred Stock had so exercised his, her or its right of conversion under such Series D Preferred Stock immediately prior to such consolidation, merger or sale, and LSB shall make lawful provision therefor as part of such consolidation, merger or sale.

(c) LSB shall not be required to issue any fraction of a share of Common Stock upon any conversion, but (i) may deliver scrip therefor, which shall not entitle the bearer thereof to vote, or to receive dividends or to any other or further right or interest, except to convert the same in amounts aggregating one or more whole shares of LSB Common Stock at any time within a period, fixed by the Board of Directors of LSB, which shall be stated in the scrip, or (ii) may pay in cash therefor an amount equal to the same fraction of the fair market value of a full share of LSB Common Stock. For such purpose of determining the fair market value of LSB Common Stock, the fair market value of a share of LSB Common Stock, shall be the last recorded sale price of such a share of LSB Common Stock on a national securities exchange on the day immediately preceding the date upon which such Series D Preferred Stock is surrendered for conversion or, if there be no recorded sale price on such day, the last quoted bid price per share of LSB Common Stock on such exchange at the close of trading on such date. If LSB Common Stock shall not be at the time dealt in on a national security exchange, such fair market value of LSB Common Stock shall be the prevailing market value of such Common Stock on any other securities exchange or in the open market, as determined by LSB, which determination shall be conclusive.

(d) Any holder of a share or shares of Series D Preferred Stock desiring to convert such Series D Preferred Stock into Common Stock of LSB shall surrender the certificate or certificate representing the share or shares of Series D Preferred Stock so to be converted, duly endorsed to LSB in blank, with the signature of said endorsement guaranteed by a national bank or investment banking firm, at the principal office of LSB (or such other place as may be designated by LSB), and shall give written notice to LSB at said office that he elects to convert the same, and setting forth the name or names (with the address or addresses) in which the shares of Common Stock are to be issued.

(e) The issuance of certificates for shares of Common Stock upon conversion of the Series D Preferred Stock shall be made without charge for tax in respect of such issuance; however, if any certificate is to be issued in any name other than that of the holder of record of the Series D Preferred Stock so converted, the person or persons requesting the issuance thereof shall pay to LSB the amount of any tax which may be payable in respect of any transfer involved in such issuance, or shall establish to the satisfaction of LSB that such tax has been paid or is not due and payable.

7. Redemption. There shall be no mandatory or optional redemption rights with respect to the Series D Preferred Stock.

8. Status of Recquired Shares. Shares of the Series D Preferred Stock which have been issued and reacquired in any manner (until LSB elects to retire them) shall (upon compliance with any applicable provisions of the laws of the State of Delaware) have the status of authorized and unissued shares of the class of Class C Preferred Stock of LSB undesignated as to series and may be redesignated and reissued.

9. Priority. (a) For purposes of this resolution, any stock of any class or series of LSB shall be deemed to rank:

(i) Prior or senior to the shares of this Series D Preferred Stock either as to dividends or upon liquidation, if the holders of such class or classes shall be entitled to the receipt of dividends or of amounts distributable upon dissolution, liquidation or winding up of LSB, whether voluntary or involuntary, as the case may be, in preference or priority to the holders of shares of this Series D Preferred Stock;

(ii) On a parity with or equal to shares of this Series D Preferred Stock, either as to dividends or upon liquidation, whether or not the dividend rates, dividend payment dates or redemption or liquidation prices per share or sinking fund provisions, if any, are different from those of this Series D Preferred Stock, if the holders of such stock are entitled to the receipt of dividends or of amounts distributable upon dissolution, liquidation or winding up of LSB, whether voluntary or involuntary, in proportion to their respective dividend rates or liquidation prices, without preference or priority, one over the other, as between the holders of such stock and the holders of shares of this Series D Preferred Stock; and

(iii) Junior to shares of this Series D Preferred Stock, either as to dividends or upon liquidation, if such class or series shall be Common Stock or if the holders of shares of this Series D Preferred Stock shall be entitled to receipt of dividends or of amounts distributable upon dissolution, liquidation or involuntary, as the case may be, in preference or priority to the holders of shares of such class or series.

10. Miscellaneous. The shares of the Series D Preferred Stock shall not be subject to the operation of or to the benefit of any retirement or sinking fund. The shares of the Series D Preferred Stock shall not have any other relative, participating, optional or other rights and powers not set forth above.

IN WITNESS WHEREOF, this Corporation has caused this Certificate of Designations to be signed and attested by its duly authorized officers this ___ day of October, 2001.

LSB INDUSTRIES, INC.

By: _____
Jack E. Golsen, President

David M. Shear, Secretary

Letter of Acknowledgment RE: Unaudited Financial Information

The Board of Directors
LSB Industries, Inc.

We are aware of the incorporation by reference in the Registration Statement (Form S-8 No. 33-8302) pertaining to the 1981 and 1986 Stock Option Plans, the Registration Statement (Form S-8 No. 333-58225) pertaining to the 1993 Stock Option and Incentive Plan, the Registration Statements (Forms S-8 No. 333-62831, No. 333-62835, No. 333-62839, No. 333-62843, and No. 333-62841) pertaining to the registration of an aggregate of 225,000 shares of common stock pursuant to the certain Non-Qualified Stock Option Agreements for various employees and the Registration Statement (Form S-3 No. 33-69800) of LSB Industries, Inc. and in the related Prospectuses of our report dated November 9, 2001, relating to the unaudited condensed consolidated interim financial statements of LSB Industries, Inc. which is included in its Form 10-Q for the quarter ended September 30, 2001.

Pursuant to Rule 436(c) of the Securities Act of 1933 our report is not a part of the registration statement prepared or certified by accountants within the meaning of Section 7 or 11 of the Securities Act of 1933.

ERNST & YOUNG LLP

Oklahoma City, Oklahoma

November 9, 2001