FORM 10-Q

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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

For Quarterly period ended September 30, 1998

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, 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 x NO ______

The number of shares outstanding of the Registrant's voting Common Stock, as of October 31, 1998 was 11,999,686 shares excluding 3,108,990 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 wholly-owned subsidiaries.

The accompanying condensed consolidated balance sheet of LSB Industries, Inc. at September 30, 1998, the condensed consolidated statements of operations for the nine month and three month periods ended September 30, 1998 and 1997 and the consolidated statements of cash flows for the nine month periods ended September 30, 1998 and 1997 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, which are, in the opinion of management, necessary for a fair presentation of the interim periods. The results of operations for the nine months and three months ended September 30, 1998 are not necessarily indicative of the results to be expected for the full year. The condensed consolidated balance sheet at December 31, 1997, was derived from audited financial statements as of that date.

LSB INDUSTRIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Information at September 30, 1998 is unaudited)
(Dollars in thousands)

ASSETS	September 30, 1998	December 31, 1997
Current assets:		
Cash and cash equivalents	$ 1,322	$ 4,934
Trade accounts receivable, net of allowance	59,261	52,191
Inventories:		
Finished goods	31,956	36,429
Work in process	9,533	8,582
Raw materials	24,722	23,189
Total inventory	66,211	68,200
Supplies and prepaid items	9,410	7,595
Total current assets	136,204	132,920
Property, plant and equipment, net (Note 5)	97,849	118,331
Investments and other assets, net of allowance	19,548	19,402
	$ 253,601	$ 270,653

(Continued on following page)

LSB INDUSTRIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Information at September 30, 1998 is unaudited)
(Dollars in thousands)

LIABILITIES AND STOCKHOLDERS' EQUITY	September 30, 1998	December 31, 1997
Current liabilities:		
Drafts payable	$ 1,766	$ 737
Accounts payable	22,070	28,137
Accrued liabilities	22,172	16,196
Current portion of long-term debt	12,509	15,874
Total current liabilities	58,517	60,944
Long-term debt (Notes 5 and 7)	149,528	165,067
Contingencies (Note 6)		
Redeemable, noncumulative convertible preferred stock, $100 par value; 1,485 shares issued and outstanding (1,539 in 1997)	141	146
Stockholders' equity (Note 4):		
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; 920,000 shares issued	46,000	46,000
Common stock, $.10 par value; 75,000,000 shares authorized, 15,107,776 shares issued (15,042,356 in 1997)	1,511	1,504
Capital in excess of par value	38,327	38,257
Accumulated other comprehensive loss	(1,933)	(1,003)
Accumulated deficit	(24,820)	(29,773)
	61,085	56,985
Less treasury stock, at cost:		
Series 2 Preferred, 5,000 shares	200	200
Common stock, 3,080,190 shares (2,293,390 in 1997)	15,470	12,289
Total stockholders' equity	45,415	44,496
	$ 253,601	$ 270,653

(See accompanying notes)

LSB INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
Nine Months Ended September 30, 1998 and 1997
(Dollars in thousands)

	1998	1997 (Note 1)
Revenues:		
Net sales	$ 244,242	$ 239,037
Other income, including $3.6 million of Tower income in 1997 ($676,000 in 1998) (Note 5)	1,471	4,630
Gain on sale of the Tower (Note 5)	12,993	-
	258,706	243,667
Costs and expenses:		
Cost of sales	192,318	194,195
Selling, general and administrative	45,548	47,652
Interest	13,062	10,382
	250,928	252,229
Income (loss) before provision for income taxes	7,778	(8,562)
Provision for income taxes	275	188
Net income (loss)	$ 7,503	$ (8,750)
Net income (loss) applicable to common stock (Note 3)	$ 5,077	$ (11,176)
Weighted average common shares outstanding (Note 3):		
Basic	12,502	12,904
Diluted	13,352	12,904
Income (loss) per common share (Note 3):		
Basic	$ .41	$ (.87)
Diluted	$ .39	$ (.87)

(See accompanying notes)

LSB INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
Three Months Ended September 30, 1998 and 1997
(dollars in thousands, except per share amounts)

	1998	1997 (Note 1)
Revenues:		
Net sales	$ 78,773	$ 76,536
Other income, including Tower income of $820,000 in 1997 (none in 1998) (Note 5)	146	1,203
	78,919	77,739
Costs and expenses:		
Cost of sales	63,145	61,995
Selling, general and administrative	14,732	16,474
Interest	4,223	3,986
	82,100	82,455
Loss before provision for income taxes	(3,181)	(4,716)
Provision for income taxes	15	63
Net loss	$ (3,196)	$ (4,779)
Net loss applicable to common stock (Note 3)	$ (3,999)	$ (5,582)
Weighted average common shares outstanding (Note 3):		
Basic	12,185	12,832
Diluted	12,185	12,832
Loss per common share (Note 3):		
Basic	$ (.33)	$ (.44)
Diluted	$ (.33)	$ (.44)

(See accompanying notes)

LSB INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
Nine Months Ended September 30, 1998 and 1997
(Dollars in thousands)

	1998	1997
Cash flows from operations:		
Net income (loss)	$ 7,503	$ (8,750)
Adjustments to reconcile net income (loss) to cash flows used by operations:		
Depreciation, depletion and amortization:		
Property, plant and equipment	8,948	7,809
Other	1,226	888
Provision for possible losses on receivables and other assets	1,588	1,394
Loss (gain) on sale of assets	(13,584)	282
Recapture of prior period provisions for loss on loans receivable secured by real estate	-	(1,383)
Cash provided (used) by changes in assets and liabilities:		
Trade accounts receivable	(7,863)	(6,254)
Inventories	1,105	2,540
Supplies and prepaid items	(2,115)	(672)
Accounts payable	(5,255)	(6,616)
Accrued liabilities	6,428	(166)
Net cash used by operations	(2,019)	(10,928)
Cash flows from investing activities:		
Capital expenditures	(6,157)	(7,141)
Principal payments on notes receivable	308	263
Proceeds from sales of equipment and real estate properties	1,742	87
Proceeds from sale of the Tower (Note 5)	29,266	-
Increase in other assets	(3,096)	(3,101)
Net cash provided (used) in investing activities	22,063	(9,892)
Cash flows from financing activities:		
Payments on long-term debt	(19,878)	(26,290)
Long-term and other borrowings	150	54,451
Net change in revolving debt	1,373	(2,618)
Net change in drafts payable	358	(127)
Dividends paid (Note 4):		
Preferred Stocks	(2,426)	(2,424)
Common Stock	(124)	(389)
Purchases of treasury stock (Note 4)	(3,181)	(1,112)
Net proceeds from issuance of common stock	72	191
Net cash provided (used) by financing activities	(23,656)	21,682
Net increase (decrease) in cash	(3,612)	862
Cash and cash equivalents at beginning of period	4,934	1,620
Cash and cash equivalents at end of period	$ 1,322	$ 2,482

(See accompanying notes)

Note 1: Basis of Presentation Certain amounts in the Statements of Operations for the nine month and three month periods ended September 30, 1997 have been reclassified to conform to the 1998 presentation of certain other expense items previously included in selling, general and administrative expenses.

Note 2: Income Taxes At December 31, 1997, the Company had regular-tax net operating loss ("NOL") carryforwards for tax purposes of approximately $64 million (approximately $31 million alternative minimum tax NOLs). Certain amounts of regular-tax NOL expire beginning in 2000.

The Company's provision for income taxes for the nine months ended September 30, 1998 of $275,000 is for current state income taxes and federal alternative minimum tax.

Note 3: Earnings Per Share In 1997, the Financial Accounting Standards Board issued Statement No. 128, Earnings Per Share. Statement 128 replaced the calculation of primary and fully diluted earnings per share with basic and diluted earnings per share. Unlike primary earnings per share, basic earnings per share excludes any dilutive effect of options, warrants and convertible securities. Diluted earnings per share is very similar to the previously reported fully diluted earnings per share. All earnings per share amounts for all periods have been presented, and where appropriate, restated to conform to the Statement 128 requirements.

Net income or loss applicable to common stock is computed by adjusting net income or loss by the amount of preferred stock dividends. Basic income or loss per common share is based upon the weighted average number of common shares outstanding during each period after giving appropriate effect to preferred stock dividends. Diluted income or 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. The Company has stock options, convertible preferred stock, and a convertible note payable which are potentially dilutive. All of these potentially dilutive securities were antidilutive for the nine months ended September 30, 1997, and the three months ended September 30, 1998 and 1997. Certain convertible preferred stock and certain stock options were antidilutive for the nine month period ended September 30, 1998, and are therefore excluded from the calculation of diluted earnings (loss) per share.

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
Nine Months Ended September 30, 1998 and 1997

Note 3: Earnings Per Share (continued) The following table sets forth the computation of basic and diluted earnings per share:
(dollars in thousands, except per share amounts)

	Nine Months Ended September 30, 1998	Nine Months Ended September 30, 1997
Numerator:		
Net income (loss)	$ 7,503	$ (8,750)
Preferred stock dividends	(2,426)	(2,426)
Numerator for 1998 and 1997 basic and 1997 diluted earnings per share - income (loss) available to common stockholders	$ 5,077	$ (11,176)
Preferred stock dividends on preferred stock assumed to be converted in 1998	195	-
Numerator for 1998 diluted earnings per share	$ 5,272	$ (11,176)
Denominator:		
Denominator for basic earnings per share - weighted-average shares	12,502	12,904
Effect of dilutive securities:		
Employee stock options	119	-
Convertible preferred stock	727	-
Convertible note payable	4	-
Dilutive common shares	850	-
Denominator for diluted earnings per share - adjusted weighted-average shares and assumed conversions	13,352	12,904
Basic earnings (loss) per share	$ .41	$ (.87)
Diluted earnings (loss) per share	$ .39	$ (.87)

	Three Months Ended September 30,	
	1998	1997
	$ (3,196)	$ (4,779)
	(803)	(803)
	$ (3,999)	$ (5,582)
	-	-
	$ (3,999)	$ (5,582)
	12,185	12,832
	-	-
	-	-
	-	-
	-	-
	12,185	12,832
	$ (.33)	$ (.44)
	$ (.33)	$ (.44)

LSB INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
Nine Months Ended September 30, 1998 and 1997

Note 4: Stockholders' Equity The table below provides detail of activity in the stockholders' equity accounts for the nine months ended September 30, 1998: (in thousands)

	Common Stock Shares	Common Stock Par Value	Non-redeemable Preferred Stock	Capital in excess of par Value
			(In thousands)	
Balance at December 31, 1997	15,042	$ 1,504	$ 48,000	$ 38,257
Net income				
Foreign currency translation adjustment				
Comprehensive income (Note 9)				
Conversion of 54 shares of redeemable preferred stock to common stock	2			5
Exercise of stock options	64	7		65
Dividends declared:				
Common Stock ($.01 per share)				
Series B 12% preferred stock ($9.00 per share)				
Series 2 preferred stock ($2.44 per share)				
Redeemable preferred stock ($10.00 per share)				
Purchase of treasury stock				
Balance at September 30, 1998	(1) 15,108	$ 1,511	$ 48,000	$ 38,327

Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated deficit)	Treasury Stock-Common	Treasury Stock Preferred	Total
$(1,003)	$(29,773)	$(12,289)	$ (200)	$44,496
	7,503			7,503
(930)				(930)
				6,573
				5
				72
	(124)			(124)
	(180)			(180)
	(2,231)			(2,231)
	(15)			(15)
		(3,181)		(3,181)
$(1,933)	$(24,820)	$(15,470)	$ (200)	$45,415

(1) Includes 3,080 shares of the Company's Common Stock held in treasury. Excluding the 3,080 shares held in treasury, the outstanding shares of the Company's Common Stock at September 30, 1998 were 12,028.

Note 5: Sale of the Tower In March 1998, a subsidiary of the Company closed the sale of the Tower office building. The Company realized net proceeds of approximately $29.3 million from the sale. Proceeds from the sale were used to retire the outstanding indebtedness of approximately $12.6 million in March 1998, for which this property served as collateral. Approximately $16.5 million of the remaining proceeds were used to reduce indebtedness outstanding under the Company's Revolving Credit Facility. The Company recognized a gain on the sale of the property of approximately $13 million in the first quarter of 1998.

Note 6: Commitments and Contingencies

Nitric Acid Project

In June 1997, two wholly owned subsidiaries of the Company, El Dorado Chemical Company ("EDC"), and El Dorado Nitrogen Company ("EDNC"), entered into a series of agreements with Bayer Corporation ("Bayer") (collectively, the "Bayer Agreement"). Under the Bayer Agreement, EDNC is acting as an agent to construct, and upon completion of construction, will operate a nitric acid plant (the "EDNC Baytown Plant") at Bayer's Baytown, Texas chemical facility. EDC has guaranteed the performance of EDNC's obligations under the Bayer Agreement. Under the terms of the Bayer Agreement, EDNC is to lease the EDNC Baytown Plant pursuant to a leveraged lease from an unrelated third party with an initial lease term of ten years from the date on which the EDNC Baytown Plant becomes fully operational. Upon expiration of the initial ten-year term from the date the EDNC Baytown Plant becomes operational, the Bayer Agreement may be renewed for up to six renewal terms of five years each; however, prior to each renewal period, either party to the Bayer Agreement may opt against renewal. It is anticipated that construction of the EDNC Baytown Plant will cost approximately $65 million and will be completed in the first quarter of 1999. Construction financing of the EDNC Baytown Plant is being provided by an unaffiliated lender. Neither the Company, EDC nor EDNC has guaranteed any of the lending obligations for the EDNC Baytown Plant. In connection with the leveraged lease, the Company entered into an interest rate forward agreement to fix the effective rate of interest implicit in such lease. As of September 30, 1998, the fair value of such agreement represented a liability of $7.3 million for which the Company has posted margin and letters of credit totaling the same. Bayer has agreed to reimburse the Company for 50% of the ultimate cost of the hedging contract associated with the interest rate forward agreement. See Note 8, "Changes in Accounting", for the expected accounting upon adoption of SFAS #133.

EDNC has agreed in the Bayer Agreement that, prior to completion of EDNC's Baytown Plant, EDNC will deliver to Bayer a certain amount of Bayer's needs for nitric acid at Bayer's Baytown Plant. In 1998, EDNC began delivering nitric acid to Bayer that it has purchased from EDC and unaffiliated third party vendors.

Debt Guarantee

The Company has guaranteed approximately $2.6 million of indebtedness of a start-up aviation company, Kestrel Aircraft Company, in exchange for an ownership interest, to which no value has been assigned as of September 30, 1998. The Company has made investments in and advances to the aviation company totaling $1.2 million as of September 30, 1998 and is accruing losses of the aviation company based on its ownership percentage (44.2% as of September 30, 1998). The Company has recorded losses of $3.4 million ($1.1 million during the first nine months of 1998) related to the debt guarantee and advances. The debt guarantee relates to a $2 million term note and up to $600,000 of a $2 million revolving credit facility. The $2 million term note requires interest only payments through September 1998; thereafter, it requires monthly principal payments of $11,111 plus interest beginning in October 1998 until it matures on August 8, 1999, at which time all outstanding principal and unpaid interest are due. In the event of default of this note, the Company is required to assume payments on the note with the term extended until August, 2004. The $2 million revolving credit facility, on which a subsidiary of the Company has guaranteed up to $600,000 of indebtedness, has an outstanding balance of $2.0 million at September 30, 1998. As of the date of this report, the aviation company is in default on the required payments for both of the above-described debt instruments, subject to expiration of grace periods. In the event the aviation company does not pay the delinquent amounts within the allowed grace periods, the lenders could require the Company to honor its guarantees. Under the terms of these note instruments, upon written notice from the lenders, if the aviation company does not cure its conditions of default within a specified period of time, the guarantors become primarily responsible for the payments of the notes. The $600,000 guarantee is on a line of credit that has a maturity date of November 18, 1998; therefore, if not refinanced or otherwise cured, it may become due and payable by the Company in the fourth quarter of 1998.

As of the date of this report, no demand has been made upon the Company's guarantees for either the $2.0 million note or the line of credit. The aviation company continues to have discussions with potential investors who appear to have adequate resources to complete the certification process and begin commercial production.

Should the potential investors ultimately provide funding to the aviation company, it is expected that the Company will not be required to perform for the full amount under the $2.0 million note guarantee, and may also recover a portion of its investment in and advances to the aviation company previously written off.

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 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 made settlement proposals which would have entailed a collective payment by such subsidiaries of the Company 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 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 Company's 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 Company. As of September 30, 1998, the Company has accrued an amount based on a preliminary settlement proposal by the alleged potential responsible parties; however, there is no assurance such proposal will be accepted. The amount accrued is not material to the Company's financial position or results of operations. This estimate is subject to material change in the near term as additional information is obtained.

B. A subsidiary of the Company submitted to the State of Arkansas a "Groundwater Monitoring Work Plan" which was approved by the State of Arkansas. Pursuant to the Groundwater Monitoring Work Plan, the subsidiary has performed phase I and II groundwater investigations, and submitted a risk assessment report to the State of Arkansas. The risk assessment report is currently being held in abeyance by the State of Arkansas. On August 10, 1998, the subsidiary entered into a Consent Administrative Agreement ("CAA") with the State of Arkansas, which requires the implementation of interim measures to reduce the concentrations of nitrates in the shallow groundwater.

On February 12, 1996, the subsidiary entered into a Consent Administrative Agreement ("Administrative Agreement") with the State of Arkansas to resolve certain compliance issues associated with nitric acid concentrators. Pursuant to the Administrative Agreement, the subsidiary installed additional pollution control equipment to address the compliance issues. The subsidiary was assessed $50,000 in civil penalties associated with the Administrative Agreement. In the summer of 1996 and then on January 28, 1997, the subsidiary executed amendments to the Administrative Agreement ("Amended Agreements"). The Amended Agreements imposed a $150,000 civil penalty, which penalty has been paid. Since the 1997 amendment, the Chemical Business has been assessed stipulated penalties of approximately $67,000 by the Arkansas Department of Pollution Control and Ecology ("ADPC&E") for violations of certain provisions of the 1997 Amendment. The Chemical Business believes that the El Dorado Plant has made progress in controlling certain off-site emissions; however, such off-site emissions have occurred and continue to occur from time to time, which could result in the assessment of additional penalties against the Chemical Business by the ADPC&E for violation of the 1997 Amendment.

During May, 1997, approximately 2,300 gallons of caustic material spilled when a valve in a storage vessel failed, which was released to a storm water drain, and according to ADPC&E records, resulted in a minor fish kill in a drainage ditch near EDC's El Dorado, Arkansas, facility ("El Dorado Facility"). The referenced CAA resolves this spill by requiring EDC to implement wastewater minimization characterization, and enhanced treatment in order to meet more stringent effluent limits by February 1, 2002. The CAA includes a civil penalty in the amount of $183,700 which includes $42,000 that has already been paid by funding an environmental project in the community, and $125,000 which will be paid in the form of environmental improvements at the El Dorado Plant over a five year period. EDC paid stipulated penalties in the amount of $5,000 relating to upset conditions occurring in September, 1998.

C. A civil cause of action has been filed against the Company's Chemical Business and five (5) other unrelated commercial explosives manufacturers alleging that the defendants allegedly violated certain federal and state antitrust laws in connection with alleged price fixing of certain explosive products. The plaintiffs are suing for an unspecified amount of damages, which, pursuant to statute, plaintiffs are requesting be trebled, together with costs. Based on the information presently available to the Company, the Company does not believe that the Chemical Business conspired with any party, including but not limited to, the five (5) other defendants, to fix prices in connection with the sale of commercial explosives. Discovery has only recently commenced in this matter. The Chemical Business intends to vigorously defend itself in this matter.

The Company's Chemical Business has been added as a defendant in a separate lawsuit pending in Missouri. This lawsuit alleges a national conspiracy, as well as a regional conspiracy, directed against explosive customers in Missouri and seeks unspecified damages. The Company's Chemical Business has been included in this lawsuit because it sold products to customers in Missouri during a time in which other defendants have admitted to participating in an antitrust conspiracy, and because it has been sued in the preceding described lawsuit. Based on the information presently available to the Company, the Company does not believe that the Chemical Business conspired with any party, to fix prices in connection with the sale of commercial explosives. The Chemical Business intends to vigorously defend itself in this matter.

During the third quarter of 1997, a subsidiary of the Company was served with a lawsuit in which approximately 27 plaintiffs have sued approximately 13 defendants, including a subsidiary of the Company alleging personal injury and property damage for undifferentiated compensatory and punitive damages of approximately $7,000,000. Specifically, the plaintiffs assert blast damage claims, nuisance (road dust from coal trucks) and personal injury claims (exposure to toxic materials in blasting materials) on behalf of residents living near the Heartland Coal Company ("Heartland") strip mine in Lincoln County, West Virginia. Heartland employed the subsidiary to provide blasting materials and personnel to load and shoot holes drilled by employees of Heartland. Down hole blasting services were provided by the subsidiary at Heartland's premises from approximately August 1991, until approximately August 1994. Subsequent to August 1994, the subsidiary supplied blasting materials to the reclamation contractor at Heartland's mine. In connection with the subsidiary's activities at Heartland, the subsidiary has entered into a contractual indemnity to Heartland to indemnify Heartland under certain conditions for acts or actions taken by the subsidiary for which the subsidiary failed to take, and Heartland is alleging that the subsidiary is liable thereunder for Heartland's defense costs and any losses to or damages sustained by, the plaintiffs in this lawsuit. Discovery has only recently begun in this matter, and the Company intends to vigorously defend itself in this matter. Based on limited information available, the subsidiary's counsel believes that the exposure, if any, to the subsidiary related to this litigation is in the $100,000 range.

The Company, including its subsidiaries, is a party to various other claims, legal actions, and complaints arising in the ordinary course of business. In the opinion of management after consultation with counsel, all claims, legal actions (including those described above) and complaints are adequately covered by insurance, or if not so covered, are without merit or are of such kind, or involve such amounts that unfavorable disposition is not presently expected to have a material effect on the financial position of the Company, but could have a material impact on the results of operations for a particular quarter or year, if resolved unfavorably.

Note 7: Long-Term Debt In November, 1997, the Company's wholly owned subsidiary, ClimaChem, Inc. ("ClimaChem"), completed the sale of $105 million principal amount of 10 3/4% Senior Notes due 2007, which Senior Notes were exchanged with registered senior notes of the same amount and substantially the same terms in April, 1998 (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.

Except as described below, the Notes are not redeemable at ClimaChem's option prior to December 1, 2002. After December 1, 2002, the Notes will be subject to redemption at the option of ClimaChem, in whole or in part, at the redemption prices set forth in the indenture relating to the Notes between ClimaChem, the guarantors and the trustee ("Indenture"), plus accrued and unpaid interest thereon, plus liquidated damages, if any, to the applicable redemption date. In addition, until December 1, 2000, up to $35 million in aggregate principal amount of the Notes is redeemable, at the option of ClimaChem, at a price of 110.75% of the principal amount of the Notes, together with accrued and unpaid interest, if any, thereon, plus liquidated damages; provided, however, that at least $65 million in aggregate principal amount of the Notes remain outstanding following such redemption.

In the event of a change of control of the Company or ClimaChem, holders of the Notes will have the right to require ClimaChem to repurchase the Notes, in whole or in part, at a redemption price of 101% of the principal amount thereof, plus accrued and unpaid interest, if any, thereon, plus liquidated damages, if any, to the date of repurchase.

ClimaChem owns substantially all of the companies comprising the Company's Chemical and Climate Control Businesses. ClimaChem is a holding company with no assets or 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, except for El Dorado Nitrogen Company ("EDNC"). The assets, equity, and earnings of EDNC are currently inconsequential to ClimaChem. Separate financial statements and other disclosures concerning the guarantors are not presented herein because management has determined they are not material to investors. Summarized consolidated balance sheet information of ClimaChem and its subsidiaries as of December 31, 1997 and September 30, 1998 and the results of operations for the nine month and three month periods ended September 30, 1998 and September 30, 1997, are detailed below.

Note 7: (continued)

	September 30, 1998	December 31, 1997
	(In thousands) (unaudited)	
Balance sheet data:		
Current assets	$ 90,625	$ 92,741
Property, plant and equipment	81,057	84,329
Notes receivable from LSB and affiliates	13,443	13,443
Other assets	11,173	10,362
Total assets	$ 196,298	$ 200,875
Current liabilities	$ 38,109	$ 38,004
Long-term debt	121,782	126,346
Other	9,236	9,236
Stockholder's equity	27,171	27,289
Total liabilities and stockholder's equity	$ 196,298	$ 200,875

	Nine Months Ended September 30, 1998	Nine Months Ended September 30, 1997	Three Months Ended September 30, 1998	Three Months Ended September 30, 1997
	(In thousands) (unaudited)			
Operations data:				
Total revenues	$ 202,718	$ 200,877	$ 65,390	$ 62,541
Costs and expenses:				
Costs of sales	160,099	161,684	52,660	50,021
Selling, general and administrative	30,566	28,005	10,217	9,287
Interest	9,333	6,587	3,060	2,332
	199,998	196,276	65,937	61,640
Income (loss) before provision for income taxes	2,720	4,601	(547)	901
Income tax provision	1,908	1,821	208	320
Net income (loss)	$ 812	$ 2,780	$ (755)	$ 581

Note 7: (continued)

At September 30, 1998, the Company and ClimaChem were not in compliance with certain financial covenants related to debt instruments other than the Notes. In November, 1998, the Company and ClimaChem obtained waivers for such noncompliance and amendments to reset the covenants where applicable. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" - "Sources of Funds" for further discussion of such waivers and debt instruments.

Note 8: Changes in Accounting Effective January 1, 1998, the Company changed its method of accounting for the costs of computer software developed for internal use to capitalize costs incurred after the preliminary project stage as outlined in Statement of Position 98-1 "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" ("SOP 98-1"). These costs capitalized will be amortized over their estimated useful life. Prior to 1998, these costs were expensed as incurred. The effect of this change on net income for the nine months ended September 30, 1998 was not material.

In the second quarter of 1998, the Accounting Standards Executive Committee of the Securities and Exchange Commission released Statement of Position 98-5 "Reporting on the Costs of Start-up Activities" ("SOP 98-5"). SOP 98-5 requires that the costs of start-up activities, including organization costs, be expensed as incurred. As of September 30, 1998, the start-up costs the Company has capitalized on its balance sheet are immaterial. SOP 98-5 is effective for fiscal years ending after December 15, 1998. The Company expects to adopt SOP 98-5 no later than the first quarter of 1999.

In June, 1998, the Financial Accounting Standards Board issued Statement No. 133 ("SFAS #133"), Accounting for Derivative Instruments and Hedging Activities, which is required to be adopted in years beginning after June 15, 1999. The Statement permits early adoption as of the beginning of any fiscal quarter after its issuance. The Company has not yet determined when this new Statement will be adopted. The Statement will require the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through income. 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. The Company has not yet determined what all of the effects of SFAS #133 will be on the earnings and financial position of the Company; however, the Company expects that the Interest Rate Forward Agreement discussed in Note 6, "Nitric Acid Project", will be accounted for as a cash flow hedge upon adoption of SFAS #133, with the effective portion of the hedge being classified in equity in accumulated other comprehensive income or loss. The amount included in accumulated other comprehensive income or loss will be amortized to income over the initial term of the leveraged lease.

Note 9: Comprehensive Income Effective January 1, 1998, the Company adopted 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 in the financial statements and display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of the balance sheet. The Company has also made similar reclassifications for all prior periods for comparative purposes. Other comprehensive income for the nine month and three month periods ended September 30, 1998 and 1997 is detailed below.

	Nine Months Ended		Three Months Ended	
	9/30/98	9/30/97	9/30/98	9/30/97
	(In thousands)			
Net income (loss)	$ 7,503	$ (8,750)	$ (3,196)	$ (4,779)
Foreign currency translation loss	(930)	(859)	(324)	(309)
Comprehensive income (loss)	$ 6,573	$ (9,609)	$ (3,520)	$ (5,088)

Note 10: Proposed Transaction

During August, 1998, the Company announced its intent, subject to satisfactory completion of certain conditions, to spin-off the Automotive Products Business ("Automotive") to its shareholders as a dividend. The shares in Automotive would be distributed by the Company to the Company's shareholders on a pro-rata basis, with the exact number of shares of Automotive to be issued in connection with the spin-off to be determined. The spin-off of Automotive is subject to, among other things, receipt by the Company from the Internal Revenue Service or an opinion of counsel of confirmation of tax-free treatment, certain Securities and Exchange Commission filings, arrangement for lines of credit for Automotive, and the

Company's Board of Directors' approval. There are no assurances that the Company will spin-off Automotive.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with a review of the Company's September 30, 1998 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 is pursuing a strategy of focusing on its more profitable businesses and concentrating on businesses and product lines in niche markets where the Company has established or believes it can establish a position as a market leader. In addition, the Company is seeking to improve its liquidity and profits through liquidation of selected assets that are on its balance sheet and on which it is not realizing an acceptable return and does not reasonably expect to do so. In this connection, the Company has come to the conclusion that its Automotive and Industrial Products Businesses are non-core to the Company and the Company is exploring various alternatives to maximize shareholder value from these assets.

On August 5, 1998, the Company announced its intent, subject to satisfactory completion of certain conditions, to spin-off the Automotive Products Business ("Automotive") to its shareholders as a dividend. The shares in Automotive would be distributed to LSB shareholders on a pro-rata basis, with the exact number of shares of Automotive to be issued in connection with the spin-off to be determined. The spin-off of Automotive is subject to, among other things, receipt by the Company from the Internal Revenue Service or an opinion of counsel of confirmation of tax-free treatment, certain Securities and Exchange Commission filings, arrangement for lines of credit for Automotive, and LSB Board of Directors' approval. Subject to completion of the above conditions, management believes that the spin-off will be completed in the first quarter of 1999. There are no assurances that the Company will spin-off Automotive.

Information about the Company's operations in different industry segments for the nine months and three months ended September 30, 1998 and 1997 is detailed below.

	Nine Months Ended		Three Months Ended	
	1998	1997	1998	1997
	(In thousands) (Unaudited)			
Sales:				
Chemical	$112,218	$122,853	$ 34,695	$ 32,658
Climate Control	89,894	77,526	30,637	29,704
Automotive Products	31,274	27,245	10,076	10,208
Industrial Products	10,856	11,413	3,365	3,966
	$244,242	$239,037	$ 78,773	$ 76,536
Gross profit (1):				
Chemical	$ 15,762	$ 16,388	$ 3,453	$ 3,605
Climate Control	26,499	22,469	9,178	8,786
Automotive Products	6,985	3,311	2,019	1,085
Industrial Products	2,678	2,674	978	1,065
	$ 51,924	$ 44,842	$ 15,628	$ 14,541
Operating profit (loss) (2):				
Chemical	$ 5,702	$ 5,288	$ 91	$ 554
Climate Control	10,395	7,721	4,083	3,330
Automotive Products	(337)	(4,447)	(408)	(1,559)
Industrial Products	(780)	(880)	(262)	(170)
	14,980	7,682	3,504	2,155
General corporate expenses and other	(7,133)	(5,862)	(2,462)	(2,885)
Interest expense	(13,062)	(10,382)	(4,223)	(3,986)
Gain on sale of the Tower	12,993	-	-	-
Income (loss) before provision for income taxes	$ 7,778	$ (8,562)	$ (3,181)	$ (4,716)

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

(2) Operating profit (loss) by industry segment represents revenues less operating expenses before deducting general corporate expenses, interest expense and income taxes and, in 1998, before gain on sale of the Tower.

Chemical Business

Although sales in the Chemical Business have declined from $122.9 million in the nine months ended September 30, 1997, to $112.2 million in the nine months ended September 30, 1998 (a decrease of 8.7%), the operating profit has increased from $5.3 million in the first nine months of 1997 to $5.7 million in the first nine months of 1998 (an increase of 7.8%).

During the first nine months of 1997, limitations on production, as a result of certain mechanical and design problems relating to the construction and start-up of a concentrated nitric acid plant, resulted in significant fixed costs being expended as period costs rather than being absorbed as cost of product being produced and sold. In addition, significant amounts were expended for engineering, consulting, and other costs to bring the nitric acid plant up to its stated capacity.

Additionally, the cost of the Chemical Business' primary raw material, anhydrous ammonia, averaged approximately $186 per ton in the first nine months of 1997, compared to approximately $160 per ton in the first nine months of 1998. The Chemical Business purchases approximately 220,000 tons of anhydrous ammonia per year under two contracts, both effective as of January 1, 1997. The Company's purchase price of anhydrous ammonia under these contracts can be higher or lower than the current market spot price of anhydrous ammonia. Pricing is subject to variations due to numerous factors contained in these contracts. Based on the price calculations contained in the contracts, one contract is presently priced above the current market spot price. The Chemical Business is required to purchase approximately one half of its requirements from each of the suppliers under the terms of the contracts.

The ammonia industry has added an additional one million tons of capacity of anhydrous ammonia in the western hemisphere in 1998 and the Company believes there is approximately one million tons of additional annual capacity of anhydrous ammonia being constructed in the western hemisphere scheduled for completion in 1999. The Company believes this additional capacity may contribute to a decline in the future market price of anhydrous ammonia.

In 1998, the Chemical Business has been adversely affected by the extreme drought conditions in the mid-south market during the primary fertilizer season, followed by excess wet conditions and floods in the fall season, resulting in substantially lower volume and lower sales prices for certain of its products sold in its agricultural markets.

During July, 1997, a subsidiary of the Company entered into an agreement with Bayer Corporation ("Bayer") whereby one of the Company's subsidiaries is acting as agent to construct a nitric acid plant located within Bayer's Baytown, Texas chemical plant complex. This plant, when constructed, will be operated by the Company's subsidiary and will supply nitric acid for Bayer's polyurethane business under a long-term supply contract. Management estimates that, after the initial startup phase of operations at the plant, at full production capacity based on terms of the Bayer Agreement and dependent upon the price of anhydrous ammonia, based on the price of anhydrous ammonia as of the date of this report, the plant should generate approximately $35 million to $50 million in annual gross revenues. It is anticipated that the construction of the nitric acid plant at Bayer's facility in Baytown, Texas, will cost approximately $65 million and construction is scheduled to be completed in the first quarter of 1999. The Company's subsidiary is to lease the nitric acid plant pursuant to a leverage lease from an unrelated third party for an initial term of ten (10) years from the date that the plant becomes fully operational, and the construction financing of this plant is being provided by an unaffiliated lender.

The results of operation of the Chemical Business' Australian subsidiary have been adversely affected due to the recent economic developments in certain countries in Asia. These economic developments in Asia have had a negative impact on the mining industry in Australia which the Company's Chemical Business services. As these adverse economic conditions in Asia have continued, such have had an adverse effect on the Company's consolidated results of operations in 1998. The Company has received an offer to sell its Australian subsidiary. There are no assurances that the Company would sell the Australian subsidiary.

Climate Control

The Climate Control Business manufactures and sells a broad range of hydronic fan coil, air handling, air conditioning, heating, water source heat pump, 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.

As indicated in the above table, the Climate Control Business reported improved sales (an increase of 16.0%) and improved operating profit (an increase of 34.6%) for the first nine months of 1998 as compared to the first nine months of 1997.

Automotive and Industrial Products Businesses

As indicated in the above table, during the nine months ended September 30, 1998 and 1997, respectively, the Automotive and Industrial Products Businesses recorded combined sales of $42.1 million and $38.7 million, respectively, and reported operating losses (as defined above) of $1.1 million and $5.3 million, respectively. The net investment in assets of these Businesses has decreased consistently during the last three years and the Company expects to realize further reductions in future periods. See "Overview - General" for a discussion of the Company's intent to spin-off the Automotive Business, subject to numerous conditions precedent.

RESULTS OF OPERATIONS

Nine Months Ended September 30, 1998 vs. Nine Months Ended September 30, 1997

Revenues

Total revenues for the nine months ended September 30, 1998 and 1997 were $258.7 million and $243.7 million, respectively (an increase of $15.0 million). Sales increased $5.2 million and other income decreased $3.2 million. Additionally, in March, 1998, a subsidiary of the Company closed the sale of an Oklahoma City office building ("the Tower"). The Company recognized a pre-tax gain on the sale of the Tower of approximately $13.0 million in the first quarter of 1998. The decrease in other income of $3.2 million was primarily due to non-recurring operations of the Tower, which was sold in March, 1998.

Net Sales

Consolidated net sales included in total revenues for the nine months ended September 30, 1998 were $244.2 million, compared to $239.0 million for the first nine months of 1997, an increase of $5.2 million. This increase in sales resulted principally from: (i) increased sales in the Climate Control Business of $12.4 million, primarily due to increased volume and price increases in both the heat pump and fan coil product lines, and (ii) increased sales in the Automotive Products Business of $4.0 million primarily due to improved volume of units being shipped to original equipment manufacturers and new customers, offset by (iii) decreased sales in the Industrial Products Business of $.6 million due to decreased sales of machine tools, and (iv) decreased sales in the Chemical Business of $10.6 million primarily due to lower sales volume in the U.S. of agricultural and blasting products and decreased business volume of its Australian subsidiary. Sales were lower in the Chemical Business during the first nine months of 1998, compared to the first nine months of 1997, as a result of adverse weather conditions in its agricultural markets during the spring and fall planting seasons. Blasting sales in the Chemical Business declined as a result of elimination of certain low profit margin sales and decreased volume in the Australian subsidiary resulting from adverse economic developments in Asia.

Gross Profit

Gross profit was 21.3% for the first nine months of 1998, compared to 18.8% for the first nine months of 1997. The increase in the gross profit percentage was due primarily to (i) increased absorption of costs due to higher production volumes and improved experience with returns and allowances in the Automotive Products Business, (ii) lower production costs in the Chemical Business due to the effect of lower prices of anhydrous ammonia in 1998, (iii) lower unabsorbed overhead costs caused by excessive downtime related to problems associated with mechanical failures at the Chemical Business' primary manufacturing plant in the first half of 1997, and (iv) lower material costs as a result of improved unit cost of certain raw materials in the Climate Control Business.

Selling, General and Administrative Expense

Selling, general and administrative ("SG&A") expenses as a percent of net sales were 18.6% and 19.9% in the nine month periods ended September 30, 1998 and 1997, respectively. This decrease is primarily the result of (i) a comprehensive cost reduction program implemented by the Company, (ii) increased sales volume in the Climate Control and Automotive Products Businesses without an equivalent corresponding increase in SG&A, (iii) decreased professional fees related to general litigation, and (iv) decreased SG&A on the operations of the Tower since it was sold in March of 1998 but was included for the full nine months in 1997.

Interest Expense

Interest expense for the Company was approximately $13.1 million during the nine months ended September 30, 1998, compared to approximately $11.5 million, before deducting capitalized interest, during the nine months ended September 30, 1997. During the first nine months of 1997, $1.1 million of interest expense was capitalized in connection with construction of the DSN Plant. The 1998 increase of $1.6 million before the effect of capitalization primarily resulted from increased borrowings.

Income (Loss) Before Tax

The Company had income before income taxes of $7.8 million in the first nine months of 1998 compared to a loss before income taxes of $8.6 million in the nine months ended September 30, 1997. The increased profitability of $16.4 million was primarily due to the gain on the sale of the Tower and increased sales and gross profits as previously discussed, partially offset by increased interest expense.

Provision For Income Taxes

As a result of the Company's net operating loss carryforward for income tax purposes as discussed elsewhere herein and in Note 2 of Notes to Condensed Consolidated Financial Statements, the Company's provisions for income taxes for the nine months ended September 30, 1998 and the nine months ended September 30, 1997 are for current state income taxes and federal alternative minimum taxes.

Three Months Ended September 30, 1998 vs. Three Months Ended September 30, 1997.

Revenues

Total revenues for the three months ended September 30, 1998 and 1997 were $78.9 million and $77.7 million, respectively (an increase of $1.2 million). Sales increased $2.2 million and other income decreased $1.0 million. Other income decreased because the three month period ended September 30, 1997 included operations of the Tower, which was sold in March, 1998.

Net Sales

Consolidated net sales included in total revenues for the three months ended September 30, 1998 were $78.8 million, compared to $76.5 million for the third quarter of 1997, an increase of $2.3 million. This increase in sales resulted principally from: (i) increased sales in the Chemical Business of $2.0 million primarily due to sales of nitric acid products pursuant to the Bayer Agreement (see Note 6 of Notes to Condensed Consolidated Financial Statements), offset by reduced sales of the Australian subsidiary, and (ii) increased sales in the Climate Control Business of $.9 million due to price increases and improved demand for the heat pump products offered by this business, offset by (iii) decreased sales in the Industrial Products Business of $.6 million due to decreased sales of machine tools, and (iv) decreased sales in the Automotive Products Business of $.1 million.

Gross Profit

Gross profit was 19.8% for the third quarter of 1998, compared to 19.0% for the third quarter of 1997. The increase in the gross profit percentage was due primarily to (i) increased absorption of costs due to higher production volumes and improved experience with returns and allowances in the Automotive Products Business, and (ii) lower material costs caused by improved unit cost of certain raw materials in the Climate Control Business.

Selling, General and Administrative Expense

Selling, general and administrative ("SG&A") expenses as a percent of net sales were 18.7% in the three month period ended September 30, 1998, compared to 21.5% for the third quarter of 1997. This decrease is primarily the result of (i) a comprehensive cost reduction program implemented by the Company, (ii) increased sales volume in the Climate Control Business without an equivalent corresponding increase in SG&A, (iii) decreased professional fees related to general litigation, and (iv) decreased SG&A on the operations of the Tower since it was sold in March of 1998.

Interest Expense

Interest expense for the Company was $4.2 million during the third quarter of 1998, compared to $4.0 million during the third quarter of 1997. The increase of $.2 million primarily resulted from increased borrowings.

Loss Before Taxes

The Company had a loss before income taxes of $3.2 million in the third quarter of 1998, compared to a loss before income taxes of $4.7 million in the three months ended September 30, 1997. The difference is composed principally of improved sales and gross profit and a reduction in SG&A, offset by a reduction in other income due to the sale of the Tower.

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 and borrowings under its revolving credit facilities, and more recently, by the issuance of senior unsecured notes by a wholly owned subsidiary and the sale of the Tower. See "Sources of Funds" below.

Net cash used by operations for the nine months ended September 30, 1998 was $2.0 million, after adding back to income $10.2 million for noncash depreciation and amortization, $1.6

million in provisions for possible losses on accounts receivable, notes receivable and a loan guarantee and subtracting from income $13.6 million in gains from sales of the Tower and other real estate properties and includes the following changes in assets and liabilities: (i) accounts receivable increases of $7.9 million; (ii) inventory decreases of $1.1 million; (iii) increases in supplies and prepaid items of $2.1 million; and (iv) increases in accounts payable and accrued liabilities of $1.2 million. The increase in accounts receivable is due to increased sales and extended terms to new customers in the Automotive Products Businesses, increased sales in the Climate Control Business (see "Results of Operations" for discussion of increase in sales) and seasonal sales of agricultural products and initial sales under the Bayer Agreement in the Chemical Business. The decrease in inventory was due primarily to a decrease at the Chemical Business due to seasonal sales of agricultural products offset by inventory increases in the Climate Control Business necessary to meet increased sales demand. The increase in supplies and prepaid items resulted primarily from an increase in maintenance and manufacturing supplies in the Chemical Business. The increase in accounts payable and accrued liabilities is primarily due to accrued interest expense related to senior unsecured notes which are payable semi-annually.

Cash Flow From Investing And Financing Activities

Cash provided by investing activities for the nine months ended September 30, 1998 included cash proceeds of $29.3 million received on the sale of the Tower (see Note 5 of Notes to Condensed Consolidated Financial Statements) and proceeds from sales of other property of $1.7 million offset by $6.2 million in capital expenditures and $3.1 million used to increase other assets. The capital expenditures took place primarily in the Chemical and Climate Control Businesses to enhance production and product delivery capabilities. The increase in other assets includes approximately $900,000 of cash advances to a start-up aviation company as discussed later in this report under "Debt Guarantee" and approximately $600,000 of deposits made in connection with an interest rate hedge contract related to the agreement with Bayer. See Note 6 of Notes to Condensed Consolidated Financial Statements.

Net cash used by financing activities included (i) payments on long-term debt of $19.9 million, including the $12.6 million payoff of the mortgage on the Tower, (ii) net decreases in revolving debt of $1.4 million, after application of net proceeds of $16.5 million from the sale of the Tower, (iii) increases in drafts payable of $.4 million, (iv) dividends of $2.5 million, and (v) treasury stock purchases of $3.2 million.

During the first nine months of 1998, the Company declared and paid dividends totaling $2.5 million, as follows: (i) $9.00 per share on each of the outstanding shares of its Series B 12% Cumulative Convertible Preferred Stock; (ii) $2.44 per share on each outstanding share of its $3.25 Convertible Exchangeable Class C Preferred Stock, Series 2; (iii) $.01 per share on each outstanding share of its Common Stock; and (iv) $10.00 per share on each outstanding share of its Convertible Noncumulative Preferred Stock.

Source of Funds

The Company is a diversified holding Company and its liquidity is dependent, in large part, on the operations of its subsidiaries and credit agreements with lenders.

ClimaChem, Inc., a wholly owned subsidiary of the Company, owns substantially all of the Company's Chemical and Climate Control Businesses. ClimaChem, Inc. and its subsidiaries (collectively "ClimaChem") issued in November, 1997, senior unsecured notes which were exchanged with registered senior notes of the same amount and substantially the same terms in April, 1998 ("Notes") in the aggregate amount of $105 million pursuant to the terms of an indenture (the "Indenture"). The Notes are jointly and severally and fully and unconditionally guaranteed on a senior basis by all, except for one inconsequential subsidiary, of the existing and all of the future subsidiaries of ClimaChem. The Company is neither an issuer of, nor a guarantor under, the Notes.

Interest on the Notes is payable semiannually on June 1 and December 1 of each year, commencing June 1, 1998. The Notes will mature on December 1, 2007, unless earlier redeemed. The Notes are redeemable at the option of ClimaChem on December 1, 2002, at 105.375% of the principal amount declining to face amount at December 1, 2005 and thereafter under the terms set forth in the Indenture. The Notes are effectively subordinated to all secured indebtedness of ClimaChem and its subsidiaries.

Under the terms of the Indenture, ClimaChem can transfer funds to the Company in the form of cash dividends or other distributions for (i) the amount of taxes that ClimaChem would be required to pay if they were not consolidated with the Company and (ii) an amount not to exceed fifty percent (50%) of ClimaChem's net income for the year in question and (iii) the amount of direct and indirect costs and expenses incurred by the Company on behalf of ClimaChem pursuant to a certain services agreement and a certain management agreement to which ClimaChem and the Company are parties.

The Company and certain of its subsidiaries are parties to a working capital line of credit evidenced by four separate loan agreements ("Revolving Credit Agreements") with an unrelated lender ("Lender") collateralized by receivables, inventory, and proprietary rights of the Company and the subsidiaries that are parties to the Revolving Credit Agreements and the stock of certain of the subsidiaries that are borrowers under the Revolving Credit Agreements. The Revolving Credit Agreements, as amended, provide for revolving credit facilities ("Revolver") for total direct borrowings up to $65.0 million, including the issuance of letters of credit. The Revolver provides for advances at varying percentages of eligible inventory and trade receivables. The Revolving Credit Agreements, as amended, provide for interest at the lender's prime rate plus .5% per annum or, at the Company's option, on the Lender's LIBOR rate plus 2.875% per annum (which rates are subject to increase or reduction based upon achieving specified availability and adjusted tangible net worth levels). At September 30, 1998, the effective interest rate was 8.75%. The term of the Revolving Credit Agreements is through December 31, 2000, and is renewable thereafter for successive thirteen month terms. At September 30, 1998, the availability for borrowings, based on eligible collateral, approximated $52.2 million ($34.7 million applicable to ClimaChem). Borrowings under the Revolver outstanding at September 30, 1998, were $20.6 million ($4.3 million applicable to ClimaChem). Availability for additional borrowings under the Revolver at September 30, 1998 approximated $31.6 million ($30.4 million applicable to ClimaChem). The Revolving Credit Agreements, as amended, require the Company to maintain certain financial ratios and contain other financial covenants, including tangible net worth requirements and capital expenditure limitations. At September 30, 1998, the Company and ClimaChem were not in compliance with certain of these financial covenants. In November, 1998, the Company and ClimaChem obtained waivers for such noncompliance and amendments to reset the covenants to amounts the Company and ClimaChem expect to achieve in future periods. The annual interest on the outstanding debt under the Revolver at September 30, 1998 at the rates then in effect would approximate $1.8 million. The Revolving Credit Agreements also require the payment of an annual facility fee of 0.5% of the unused revolver.

In addition to the Revolving Credit Agreements discussed above, as of September 30, 1998, the Company's wholly-owned subsidiary, DSN Corporation ("DSN"), is a party to several loan agreements with a financial company (the "Financing Company") for three projects. At September 30, 1998, DSN had outstanding borrowings of $11.6 million under these loans. The loans have repayment schedules of 84 consecutive monthly installments of principal and interest. The interest rate on each of the loans is fixed and range from 8.2% to 8.9%. Annual interest, for the three notes as a whole, at September 30, 1998, at the agreed to interest rates would approximate $1.0 million. The loans are secured by the various DSN property and equipment. The loan agreements require ClimaChem to maintain certain financial ratios, including tangible net worth requirements. At September 30, 1998, ClimaChem was not in compliance with the tangible net worth covenant of these agreements. In November, 1998, ClimaChem obtained a waiver for such noncompliance and a waiver through September, 1999 for future noncompliance, if appropriate. The Company expects to reset covenants in the fourth quarter of 1998 as it relates to periods ending on or after December 31, 1999.

The Company's Australian subsidiary has a revolving credit working capital facility (the "TES Revolving Facility"). The TES Revolving Facility is approximately AUS$10.5 million (approximately US$6.0 million). The TES Revolving Facility allows for borrowings based on specific percentages of qualified eligible assets. At September 30, 1998, based on the effective exchange rate, the total availability under the TES Revolving Facility was approximately US$6.0 million (AUS$10.5 million), with approximately US$3.2 million (AUS$5.6 million approximately) being borrowed at September 30, 1998. Availability for additional borrowings under the TES Revolving Facility at September 30, 1998 approximated US$2.8 million (AUS$4.9 million). Such debt is secured by substantially all the assets of TES, plus an unlimited guarantee and indemnity from LSB and certain subsidiaries of TES. The interest rate on this debt is dependent upon the borrowing option elected by TES and had a weighted average rate of 7.23% at September 30, 1998. Technically, TES is not in compliance with a certain financial covenant contained in the loan agreement involving the TES Revolving Facility. However, this covenant was waived at the time of closing of this loan and the Bank of New Zealand, Australia has continued to extend credit under this facility. The outstanding borrowing under the TES Revolving Facility at September 30, 1998, has been classified as due within one year in the accompanying condensed consolidated financial statements.

LSB's cash flows are dependent on the cash flows of its subsidiaries. With the issuance of the Notes in 1997, significant limitations exist on the cash flows from the ClimaChem subsidiaries which may be distributed to LSB and its subsidiaries other than ClimaChem to meet the cash flow requirements of LSB and its subsidiaries other than ClimaChem. The cash flow requirements of LSB and its subsidiaries other than ClimaChem include those related to development and general operations of its subsidiaries other than ClimaChem, as well as treasury stock purchases and dividend payments on its preferred stock.

The primary source of funds for the Company is from its ClimaChem subsidiary. The Company can receive funds directly from ClimaChem equal to 50% of ClimaChem's net income and payments pursuant to (i) a Management Agreement, (ii) a Services Agreement, (iii) a Tax Sharing Agreement, and (iv) other affiliated transactions, all of which are provided for by the terms of the Indenture dated November 26, 1997, between ClimaChem and a trustee for the Note holders.

As discussed earlier in this report, the Company intends to spin-off the Automotive Products Business ("Automotive"). When the planned spin-off of Automotive is accomplished as presently intended, the liquidity and capital resources required by Automotive will no longer be included in the Company's financial statements and Automotive will not be a party to the Revolver. See "Overview - General" within this MD&A.

The Company, excluding ClimaChem, does not have any material commitments for capital expenditures.

Management believes that cash flows from revolving credit facilities of the Company, excluding ClimaChem, the funds from ClimaChem and other sources will be adequate to meet the anticipated requirements of the Company, excluding ClimaChem.

ClimaChem has expended approximately $6.0 million for capital expenditures up to and including September, 1998. Planned capital expenditures for the balance of 1998 are $3.0 million. ClimaChem's 1999 budget for capital expenditures has not been finalized, but expenditures will probably equal or exceed those in 1998.

Management believes that ClimaChem's cash flow from operations, ClimaChem's revolving credit facilities, and other sources will be adequate to meet the presently anticipated capital expenditure, working capital, debt service, and permitted dividend requirements of ClimaChem.

The Company's Chemical Business may be required to incur additional capital expenditures as discussed in Note 6 of Notes to Condensed Consolidated Financial Statements regarding a "Groundwater Monitoring Work Plan" and the Consent Administrative Agreement related to the Chemical Business' wastewater treatment system. At the date of this report, the cost of the expenditures for these environmental matters has not been determined.

Joint Ventures and Options to Purchase

Prior to 1997, the Company, through a subsidiary, loaned $2.8 million to a French manufacturer of HVAC equipment whose product line is compatible with that of the Company's Climate Control Business in the USA. Under the loan agreement, the Company has the option to exchange its rights under the loan for 100% of the borrower's outstanding common stock. The Company obtained a security interest in the stock of the French manufacturer to secure its loan. During 1997 the Company advanced an additional $1 million to the French manufacturer bringing the total of the loan at December 31, 1997 to $3.8 million. As of September 30, 1998 the balance of the loan remained $3.8 million. As of the date of this report, the decision has not been made to exercise such option and the $3.8 million loan, less a $1.5 million valuation reserve, is carried on the books as a note receivable in other assets.

In 1995, a subsidiary of the Company invested approximately $2.8 million to purchase a fifty percent (50%) limited partner interest in an energy conservation joint venture (the "Project"). The Project had been awarded a contract to retrofit residential housing units at a US Army base which it completed during 1996. The contract involved the installation of energy-efficient equipment (including air conditioning and heating equipment), which is expected to reduce utility consumption. For the installation and management, the Project receives an average of seventy-seven percent (77%) of all energy and maintenance savings during the twenty (20) year contract term. The Project spent approximately $17.5 million to retrofit the residential housing units at the US Army base. The Project received a non-recourse loan from a lender to finance approximately $14.0 million of the cost of the Project. The Company is not guaranteeing any of the lending obligations of the Project.

During 1995, the Company executed a stock option agreement to acquire eighty percent (80%) of the stock of a specialty sales organization ("Optioned Company"), which owns the remaining fifty percent (50%) equity interest in the Project discussed above, to enhance the marketing of the Company's air conditioning products. The stock option has a four (4) year term, and a total option granting price of $1.0 million and annual $100,000 payments for yearly extensions of the stock option thereafter for up to three (3) years. Through the date of this report the Company has made option payments aggregating $1.3 million and has loaned the Optioned Company approximately $1.4 million. The Company has recorded reserves of $1.1 million against the loans. Upon exercise of the stock option by the Company, or upon the occurrence of certain performance criteria which would give the grantors of the stock option the right to accelerate the date on which the Company must elect whether to exercise, the Company shall pay certain cash and issue promissory notes for the balance of the exercise price of the subject shares. The total exercise price of the subject shares is $4.0 million, less the amounts paid for the granting and any extensions of the stock option. As of the date of this report, no decision to exercise this option has been reached by the Company.

Debt Guarantee

The Company and one of its subsidiaries have guaranteed approximately $2.6 million of indebtedness of a startup aviation company in exchange for an ownership interest. The debt guarantee relates to two note instruments. One note for which the subsidiary had guaranteed up to $600,000 had a balance of approximately $2.0 million as of September 30, 1998. The other note in the amount of $2.0 million requires monthly principal payments of $11,111 plus interest beginning in October 1998 through August 8, 1999, at which time all outstanding principal and accrued interest are due. In the event of default of the $2.0 million note, the Company is required to assume payments on the note with the term extended until August, 2004. As of the date of this report, the aviation company is delinquent on the required payments for both of the above-described debt instruments. In the event the aviation company does not pay the delinquent amounts within the allowed grace period, the lenders may require the Company to honor its guarantees. Under the terms of these note instruments, upon written notice from the lenders, if the aviation company does not cure its conditions of default within a specified period of time, the guarantors become primarily responsible for the payments of the notes. The $600,000 guarantee is on a line of credit that has a maturity date of November 18, 1998. Therefore, if not refinanced or otherwise cured, it may become due and payable by the Company in the fourth quarter of 1998.

As of the date of this report, no demand has been made upon the Company's guarantees for either the $2.0 million note or the line of credit. The aviation company continues to have discussions with potential investors who appear to have adequate resources to complete the certification process and begin commercial production. Should the potential investors ultimately provide funding to the aviation company, it is expected that the Company will not be required to perform for the full amount under the $2.0 million note guarantee, and may also recover a portion of its investment in and advances to the aviation company previously written off.

In the first nine months of 1998, the aviation company made capital calls on its shareholders. In contemplation of a sale of the aviation company to an additional investor and pursuant to such capital calls, the Company invested an additional $860,000 and loaned an additional net amount of $33,000 to the aviation company in exchange for additional stock. These transactions increased the Company's ownership interest to approximately 44.2%. Prior to funding, if any, by third parties, the Company may be requested to make additional purchases of capital stock of the aviation company and/or make additional advances.

Availability of Company's Loss Carry-overs

The Company anticipates that its cash flow in future years will benefit from its ability to use net operating loss ("NOL") carry-overs from prior periods to reduce the federal income tax payments which it would otherwise be required to make with respect to income generated in such future years. Such benefit, if any is dependent on the Company's ability to generate taxable income in future periods, for which there is no assurance. Such benefit if any, will be limited by the Company's reduced NOL for alternative minimum tax purposes which is approximately $31 million at September 30, 1998. As of December 31, 1997, the Company had available NOL carry-overs of approximately $64 million. These NOL carry-overs will expire beginning in the year 2000. Due to its recent history of reporting net losses, the Company has established a valuation allowance on a portion of its NOLs and thus has not recognized the full benefit of its NOLs in the accompanying Condensed Consolidated Financial Statements.

The amount of these carry-overs has not been audited or approved by the Internal Revenue Service ("IRS") and, accordingly, no assurance can be given that such carry-overs will not be reduced as a result of audits in the future. In addition, the ability of the Company to utilize these carry-overs in the future will be subject to a variety of limitations applicable to corporate taxpayers generally under both the Internal Revenue Code of 1986, as amended, and the Treasury Regulations. These include, in particular, limitations imposed by Code Section 382 and the consolidated return regulations.

Year 2000 Issue

The Year 2000 Issue is the result of computer programs being written using two digits rather than four to define the applicable year. Any of the Company's computer programs or hardware that have date-sensitive software or embedded chips may recognize a date using "00" as the year 1900 rather than the Year 2000. This could result in a system failure or miscalculations causing disruptions of operations, including, among other things, a temporary inability to process transactions, create invoices, or engage in similar normal business activities.

Beginning in 1996, the Company undertook a project to enhance certain of its IT systems and install certain other technologically advanced communication systems to provide extended functionality for operational purposes. A major part of the Company's program was to implement a standardized IT system purchased from a national software distributor at all of the Company and subsidiary operations, and to install a Local Area Network ("LAN"). The IT system and the LAN necessitated the purchase of additional hardware, as well as software. The process implemented by the Company to advance its systems to be more "state-of-the-art" systems had an added benefit in that the software and hardware changes necessary to achieve the Company's goals are Year 2000 compliant.

Starting in 1996 through September 30, 1998, the Company has capitalized approximately $850,000 in costs to accomplish its enhancement program. The capitalized costs include $422,000 in external programming costs with the remainder representing hardware and software purchases. The Company anticipates that the remaining cost to complete this IT systems enhancement project will be less than $100,000 and such costs will be capitalized.

The Company's plan to identify and resolve the Year 2000 Issue involved the following phases: assessment, remediation, testing, and implementation. To date, the Company has fully completed its assessment of all systems that could be significantly affected by the Year 2000. Based on assessments, the Company determined that it was required to modify or replace certain portions of its software and hardware so that those systems will properly utilize dates beyond December 31, 1999. For its IT exposures which include financial, order management, and manufacturing systems, the Company is 100% complete on the assessment and remediation phases. As of the date of this report, the Company has completed its testing and has implemented its remediated systems for all of its businesses except a portion of the Chemical Business. The uncompleted testing and remediation procedures represent approximately 10% and 25%, respectively, of the total Year 2000 Program testing and remediation phase. Completion of the remaining testing and implementation phase is expected by December 31, 1998. The assessments also indicated that limited software and hardware (embedded chips) used in production and manufacturing systems ("operating equipment") also are at limited risk. The Company has completed its assessment and identified remedial action which will take place in the second quarter 1999. In addition, the Company has completed its assessment of its product line and determined that the products it has sold and will continue to sell do not require remediation to be Year 2000 compliant. Accordingly, based on the Company's current assessment, the Company does not believe that the Year 2000 presents a material exposure as it relates to the Company's products.

The Company has queried its significant suppliers, subcontractors, distributors and other third parties (external agents). The Company does not have any direct system interfaces with external agents. To date, the Company is not aware of any external agent with a Year 2000 Issue that would materially impact the Company's results of operations, liquidity, or capital resources. However, the Company has no means of ensuring that external agents will be Year 2000 ready. The inability of external agents to complete their Year 2000 resolution process in a timely fashion could materially impact the Company. The effect of non-compliance by external agents is not determinable at this time.

Management of the Company believes it has an effective program in place to resolve the remaining aspects of the Year 2000 Issue applicable to its businesses in a timely manner. If the Company does not complete the remaining phases of its program, the Year 2000 Issue could have a negative impact on the operations of the Company, however, management does not believe such potential impact to be material.

The Company is creating contingency plans for certain critical applications. These contingency plans will involve, among other actions, manual workarounds, increasing inventories, and adjusting staffing strategies. In addition, disruptions in the economy generally resulting from Year 2000 Issues could also materially adversely affect the Company.

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.

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, (i) establishment of a plan to dispose of non-core assets, (ii) ability to complete the spin-off of the Automotive Products Business, (iii) the EDNC Baytown Plant will cost approximately $65 million, will be completed by the first quarter of 1999 and, when the EDNC Baytown Plant is fully operational, the annual sales volume from such plant will be approximately $35 million to $50 million, (iv) ability to meet presently anticipated capital expenditures, working capital, debt service and dividend requirements,(v) amount to be spent in 1998 relating to compliance with federal, state and local Environmental laws at the El Dorado Facility, (vi) additional capacity for the production of anhydrous ammonia constructed in 1998, and being constructed in 1999, may contribute to the decline of its future market prices, (vii) improve liquidity and profits through liquidation of assets, (viii) anticipated financial performance, (ix) ability to comply with the Company's general working capital requirements, (x) ability to comply with revised financial covenants under the Revolver, (xi) ability to be able to continue to borrow under the Company's revolving line of credit, (xii) ability to use NOL carry-overs from prior years, (xiii) contingencies should not have a material adverse impact on the Company's liquidity, (xiv) ability to be in compliance with certain financial covenants contained in certain loan agreements, (xv) ability to complete resolution of the Year 2000 Issues in a timely manner, and (xvi) capital expenditures for the balance of 1998 and for 1999. 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, (i) decline in general economic conditions, both domestic and foreign, (ii) material reduction in revenues, (iii) inability to collect in a timely manner a material amount of receivables, (iv) increased competitive pressures, (v) costs cannot be reduced or cost reduction projects are not completed on schedule, (vi) contracts are not obtained or projects are not finalized within a reasonable period of time or on schedule, (vii) inability to dispose of non-core businesses or assets in a reasonable manner or on reasonable terms due to the inability to dispose of such on prices or terms satisfactory to the Company or inability to spin-off such businesses due to legal impediments, (viii) changes in federal, state and local laws and regulations, especially environmental regulations, or in interpretation of such, (ix) additional releases (particularly air emissions into the environment), (x) potential increases in equipment, maintenance, operating or labor costs not presently anticipated by the Company, (xi) inability to retain management or to develop new management, (xii) the requirement to use internally generated funds for purposes not presently anticipated, (xiii) inability to become profitable, or if unable to become profitable, the inability to secure additional liquidity in the form of additional equity or debt, (xiv) inability by others to complete construction of additional capacity for the production of anhydrous ammonia, (xv) the effect of additional production capacity of anhydrous ammonia in the western hemisphere, (xvi) the cost for the purchase of anhydrous ammonia not reducing or continuing to increase or the cost for natural gas increases, (xvii) changes in operating strategy or development plans, (xviii) inability to fund the expansion of the Company's businesses, (xix) adverse results in any of the Company's pending litigation,(xx) NOL carry-overs are limited or reduced as a result of future audits by the IRS or being limited or reduced by limitations applicable to corporate taxpayers, including, without limitation, limitations imposed by code Section 382 and the consolidated return limitations, and (xxi) 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.

Independent Accountants' Review Report

Board of Directors
LSB Industries, Inc.

We have reviewed the accompanying condensed consolidated balance sheet of LSB Industries, Inc. and subsidiaries as of September 30, 1998, and the related condensed consolidated statements of operations for the nine month and three month periods ended September 30, 1998 and 1997, and the condensed consolidated statements of cash flows for the nine month periods ended September 30, 1998 and 1997. 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 generally accepted auditing standards, 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 generally accepted accounting principles.

We have previously audited, in accordance with generally accepted auditing standards, the consolidated balance sheet of LSB Industries, Inc. as of December 31, 1997, and the related consolidated statements of operations, stockholders' equity and cash flows for the year then ended (not presented herein); and in our report dated March 16, 1998, except for the fourth paragraph of Note 5(A), as to which the date is April 8, 1998, 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, 1997, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

ERNST & YOUNG LLP

Oklahoma City, Oklahoma
November 20, 1998

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, 1997, which Item 3 is incorporated by reference herein, except as described in the Company's Forms 10-Q for the quarters ended March 31, 1998 and June 30, 1998.

Item 2. Changes in Securities and Use of Proceeds

Not applicable.

Item 3. Defaults Upon Senior Securities

Not applicable.

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

Not applicable.

Item 5. Other Information

(A) During the third quarter, the Company announced its intent, subject to satisfactory completion of certain conditions, to spin-off the Automotive Products Business ("Automotive") to its shareholders as a dividend. The shares in Automotive would be distributed to LSB shareholders on a pro-rata basis, with the exact number of shares of Automotive to be issued in connection with the spin-off to be determined. The spin-off of Automotive is subject to, among other things, receipt by the Company from the Internal Revenue Service or an opinion of counsel of confirmation of tax-free treatment, certain filings with the Commission, arrangement for lines of credit for Automotive, and LSB Board of Directors' approval. Subject to completion of the above conditions, management believes that the spin-off will be completed in the first quarter of 1999. There are no assurances that the Company will spin-off Automotive.

(B) The Company's common stock and its $3.25 Convertible Exchangeable Class C Preferred Stock, Series 2 (the "Series 2 Preferred") are currently listed for trading on the New York Stock Exchange ("NYSE"). The Company recently fell below the NYSE continued listing criteria for net tangible assets available to the holders of the Company's common stock and the three year average net income. Based on a business plan submitted to the NYSE, the NYSE has agreed to continue the listing of the Company's common stock and Series 2 Preferred subject to certain quarterly reviews. There are no assurances that the Company will be able to comply with the business plan presented to the NYSE and that the Company's common stock and Series 2 Preferred will continue to be listed on the NYSE.

Item 6. Exhibits and Reports on Form 8-K

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

4.1 Fourth Amendment to Amended and Restated Loan and Security Agreement between the Company and BankAmerica Business Credit, Inc. ("BABC"). Substantially identical amendments have been entered into by each of L & S Bearing Co. and Summit Machine Tool Manufacturing Corp. with BABC, and such are hereby omitted and will be provided upon the Commission's request.

4.2 Fourth Amendment to Amended and Restated Loan and Security Agreement between BABC and Climate Master, Inc., International Environmental Corporation, El Dorado Chemical Company and Slurry Explosive Corporation.

10.1 Waiver letter dated November 17, 1998, from The CIT Group.

15.1 Letter Re: Unaudited Interim Financial Information.

27.1 Financial Data Schedule.

(B) Reports of Form 8-K. The Company did not file any reports on Form 8-K during the quarter ended September 30, 1998.

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 23rd day of November, 1998.

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)

EXHIBIT INDEX

Exhibit No.	Description	Sequential Page No.
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10.1	Waiver letter dated November 17, 1998, from The CIT Group.	68
15.1	Letter Re: Unaudited Interim Financial Information.	69
27.1	Financial Data Schedule.	70

FOURTH AMENDMENT
TO AMENDED AND RESTATED
LOAN AND SECURITY AGREEMENT

THIS FOURTH AMENDMENT TO AMENDED AND RESTATED LOAN AND SECURITY AGREEMENT (the "Amendment") is dated as of November 19, 1998, and entered into by and between BANKAMERICA BUSINESS CREDIT, INC. ("Lender") and LSB INDUSTRIES, INC. ("Borrower").

WHEREAS, Lender and Borrower have entered into that certain Amended and Restated Loan and Security Agreement dated as of November 21, 1997 as amended by that certain First Amendment to Amended and Restated Loan and Security Agreement dated as of March 12, 1998, that certain Second Amendment to Amended and Restated Loan and Security Agreement dated as of June 30, 1998, and that certain Third Amendment to Amended and Restated Loan and Security Agreement dated as of August 14, 1998 (as so amended, the "Agreement");

WHEREAS, two Events of Default have occurred under the Agreement;

WHEREAS, the Borrower desires that the Lender waive the Events of Default and amend the Agreement in certain respects; and

WHEREAS, the Lender is willing to waive the Events of Default and amend the Agreement subject to the terms and conditions contained herein;

NOW, THEREFORE, in consideration of the mutual conditions and agreements set forth in the Agreement and this Amendment, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties, intending to be legally bound, hereby agree as follows:

ARTICLE I

Definitions

Section 1.01. Definitions. Capitalized terms used in this Amendment, to the extent not otherwise defined herein, shall have the same meanings as in the Agreement, as amended hereby.

Section 1.02. New Definitions. The following new definitions are hereby added to the Agreement and read as follows:

"Automotive Subsidiaries" means the following LSB Guarantor Subsidiaries: L&S Automotive Products Co., LSB Extrusion Co., International Bearings, Inc., Rotex Corporation, and Tribonetics Corporation.

"Automotive Termination Date" means the date that LSB obtains alternative financing for the Automotive Subsidiaries in accordance with the provisions of Section 6.16(b) and indefeasibly repays all Obligations attributable to the Automotive Subsidiaries.

"Springing Covenant Event" means three consecutive Business Days when the aggregate Availability of the LSB Consolidated Borrowing Group under all of the LSB-Related Loan Agreements is less than Fifteen Million Dollars ($15,000,000) on each such Business Day."

ARTICLE II

Amendments

Section 2.01. Amendment to Section 9.16. Section 9.16 of the

Agreement is hereby amended to read in its entirety as follows:

"9.16 At all times (i) prior to the Automotive Termination Date and (ii) after the Automotive Termination Date but only if a Springing Covenant Event has occurred whereafter such financial covenant shall remain in effect until the termination of this Agreement, the following financial covenant shall be in effect:

LSB Adjusted Tangible Net Worth. The LSB Adjusted Tangible Net Worth increased by an amount equal to the purchase price paid by Borrower for its treasury stock for purchases from January 1, 1998 through termination of this Agreement, which amount shall not exceed $6,000,000, will not be less than the following amounts at the end of each of the Fiscal Quarters during the following Fiscal Years:

Fiscal Quarters in the Following Fiscal Years	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Fiscal Year Ending December 31, 1998				$34,500,000
First Fiscal Quarter during Fiscal Year Ending December 31, 1999	The LSB Adjusted Tangible Net Worth as of December 31, 1998 less $4,500,000 and less all Dividends actually paid by LSB in cash from January 1, 1999 until the date of calculation.			
Second Fiscal Quarter during Fiscal Year Ending December 31, 1999	The LSB Adjusted Tangible Net Worth as of March 31, 1999 and less all Dividends actually paid by LSB in cash from January 1, 1999 until the date of calculation.			
Third Fiscal Quarter during Fiscal Year Ending December 31, 1999 and each Fiscal Quarter during each Fiscal Year ending thereafter:	The LSB Adjusted Tangible Net Worth as of June 30, 1999 plus fifty percent (50%) of the profits for each fiscal quarter thereafter, if any, and less all Dividends actually paid by LSB in cash from January 1, 1999 until the date of calculation."			

Section 2.02. Amendment to Section 9.17. Section 9.17 of the Agreement is hereby amended to read in its entirety as follows:

"9.17 At all times (i) prior to the Automotive Termination Date and (ii) after the Automotive Termination Date but only if a Springing Covenant Event has occurred whereafter such financial covenant shall remain in effect until the termination of this Agreement, the following financial covenant shall be in effect:

LSB Debt Ratio. The ratio of Debt of the LSB Consolidated Borrowing Group to the LSB Adjusted Tangible Net Worth increased by an amount equal to the purchase price paid by Borrower for its treasury stock for purchases from January 1, 1998 through termination of this Agreement, which amount shall not exceed $6,000,000, will not be greater than the following ratios at the end of each of the Fiscal Quarters during the following Fiscal Years:

Fiscal Quarters in the Following Fiscal Years	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Fiscal Year Ending December 31, 1998				5.00 to 1
Fiscal Year Ending December 31, 1999	5.00 to 1	5.00 to 1	5.00 to 1	5.00 to 1
Each Fiscal Quarter during each Fiscal Year ending thereafter:			5.00 to 1."	

Section 2.03. Sale of Automotive Subsidiaries. Notwithstanding any provision in the Agreement to the contrary, Borrower and Lender hereby agree that, unless the Automotive Termination Date occurs on or before January 15, 1999, Borrower will pay Lender on January 15, 1999 a fee in the amount of $250,000, which fee may be charged to Borrower's account as a Revolving Loan.

ARTICLE III

Waivers

Section 3.01. Waiver of Events of Default.

(a) The Lender hereby waives the following Events of Default: (i) the LSB Borrowing Group's Adjusted Tangible Net Worth for the Fiscal Quarter ending September 30, 1998 was less than $43,900,000, in breach of Section 9.16 of the Loan Agreement; and (ii) the LSB Borrowing Group's Debt Ratio for the Fiscal Quarter ending September 30, 1998 was greater than 3.75 to 1.0, in breach of Section 9.17 of the Loan Agreement.

(b) The foregoing waiver is only applicable to and shall only be effective to the extent described above. The waiver is limited to the facts and circumstances referred to herein and shall not operate as (i) a waiver of or consent to non-compliance with any other section or provision of the Loan Agreement, (ii) a waiver of any right, power, or remedy of the Lender under the Loan

Agreement (except as provided herein), or (iii) a waiver of any other Event of Default or Event which may exist under the Loan Agreement.

ARTICLE IV

Ratifications, Representations and Warranties

Section 4.01. Ratifications. The terms and provisions set forth in this Amendment shall modify and supersede all inconsistent terms and provisions set forth in the Agreement and, except as expressly modified and superseded by this Amendment, the terms and provisions of the Agreement, including, without limitation, all financial covenants contained therein, are ratified and confirmed and shall continue in full force and effect. Lender and Borrower agree that the Agreement as amended hereby shall continue to be legal, valid, binding and enforceable in accordance with its terms.

Section 4.02. Representations and Warranties. Borrower hereby represents and warrants to Lender that the execution, delivery and performance of this Amendment and all other loan, amendment or security documents to which Borrower is or is to be a party hereunder (hereinafter referred to collectively as the "Loan Documents") executed and/or delivered in connection herewith, have been authorized by all requisite corporate action on the part of Borrower and will not violate the Articles of Incorporation or Bylaws of Borrower.

ARTICLE V

Conditions Precedent

Section 5.01. Conditions. The effectiveness of this Amendment is subject to the satisfaction of the following conditions precedent (unless specifically waived in writing by the Lender):

(a) Lender shall have received all of the following, each dated (unless otherwise indicated) as of the date of this Amendment, in form and substance satisfactory to Lender in its sole discretion:

(i) Company Certificate. A certificate executed by the Secretary or Assistant Secretary of Borrower certifying (A) that Borrower's Board of Directors has met and adopted, approved, consented to and ratified the resolutions attached thereto which authorize the execution, delivery and performance by Borrower of the Amendment and the Loan Documents, (B) the names of the officers of Borrower authorized to sign this Amendment and each of the Loan Documents to which Borrower is to be a party hereunder, (C) the specimen signatures of such officers, and (D) that neither the Articles of Incorporation nor Bylaws of Borrower have been amended since the date of the Agreement;

(ii) No Material Adverse Change. There shall have occurred no material adverse change in the business, operations, financial condition, profits or prospects of Borrower, or in the

Collateral since September 30, 1998, and the Lender shall have received a certificate of Borrower's chief executive officer to such effect;

(iii) Other Documents. Borrower shall have executed and delivered such other documents and instruments as well as required record searches as Lender may require.

(b) All corporate proceedings taken in connection with the transactions contemplated by this Amendment and all documents, instruments and other legal matters incident thereto shall be satisfactory to Lender and its legal counsel, Jenkens & Gilchrist, a Professional Corporation.

ARTICLE VI

Miscellaneous

Section 6.01. Survival of Representations and Warranties. All representations and warranties made in the Agreement or any other document or documents relating thereto, including, without limitation, any Loan Document furnished in connection with this Amendment, shall survive the execution and delivery of this Amendment and the other Loan Documents, and no investigation by Lender or any closing shall affect the representations and warranties or the right of Lender to rely thereon.

Section 6.02. Reference to Agreement. The Agreement, each of the Loan Documents, and any and all other agreements, documents or instruments now or hereafter executed and delivered pursuant to the terms hereof or pursuant to the terms of the Agreement as amended hereby, are hereby amended so that any reference therein to the Agreement shall mean a reference to the Agreement as amended hereby.

Section 6.03. Severability. Any provision of this Amendment held by a court of competent jurisdiction to be invalid or unenforceable shall not impair or invalidate the remainder of this Amendment and the effect thereof shall be confined to the provision so held to be invalid or unenforceable.

Section 6.04. APPLICABLE LAW. THIS AMENDMENT AND ALL OTHER LOAN DOCUMENTS EXECUTED PURSUANT HERETO SHALL BE DEEMED TO HAVE BEEN MADE AND TO BE PERFORMABLE IN THE STATE OF OKLAHOMA AND SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF OKLAHOMA.

Section 6.05. Successors and Assigns. This Amendment is binding upon and shall inure to the benefit of Lender and Borrower and their respective successors and assigns; provided, however, that Borrower may not assign or transfer any of its rights or obligations hereunder without the prior written consent of Lender. Lender may assign any or all of its rights or obligations hereunder without the prior consent of Borrower.

Section 6.06. Counterparts. This Amendment may be executed in one or more counterparts, each of which when so executed shall be deemed to be an original, but all of which when taken together shall constitute one and the same instrument.

Section 6.07. Effect of Waiver. No consent or waiver, express or implied, by Lender to or of any breach of or deviation from any covenant or condition of the Agreement or duty shall be deemed a consent or waiver to or of any other breach of or deviation from the same or any other covenant, condition or duty. No failure on the part of Lender to exercise and no delay in exercising, and no course of dealing with respect to, any right, power, or privilege under this Amendment, the Agreement or any other Loan Document shall operate as a waiver thereof, nor shall any single or partial exercise of any right, power, or privilege under this Amendment, the Agreement or any other Loan Document preclude any other or further exercise thereof or the exercise of any other right, power, or privilege. The rights and remedies provided for in the Agreement and the other Loan Documents are cumulative and not exclusive of any rights and remedies provided by law.

Section 6.08. Headings. The headings, captions and arrangements used in this Amendment are for convenience only and shall not affect the interpretation of this Amendment.

Section 6.09. Releases. As a material inducement to Lender to enter into this Amendment, Borrower hereby represents and warrants that there are no claims or offsets against, or defenses or counterclaims to, the terms and provisions of and the other obligations created or evidenced by the Agreement or the other Loan Documents. Borrower hereby releases, acquits, and forever discharges Lender, and its successors, assigns, and predecessors in interest, their parents, subsidiaries and affiliated organizations, and the officers, employees, attorneys, and agents of each of the foregoing (all of whom are herein jointly and severally referred to as the "Released Parties") from any and all liability, damages, losses, obligations, costs, expenses, suits, claims, demands, causes of action for damages or any other relief, whether or not now known or suspected, of any kind, nature, or character, at law or in equity, which Borrower now has or may have ever had against any of the Released Parties, including, but not limited to, those relating to (a) usury or penalties or damages therefor, (b) allegations that a partnership existed between Borrower and the Released Parties, (c) allegations of unconscionable acts, deceptive trade practices, lack of good faith or fair dealing, lack of commercial reasonableness or special relationships, such as fiduciary, trust or confidential relationships, (d) allegations of dominion, control, alter ego, instrumentality, fraud, misrepresentation, duress, coercion, undue influence, interference or negligence, (e) allegations of tortious interference with present or prospective business relationships or of antitrust, or (f) slander, libel or damage to reputation, (hereinafter being collectively referred to as the "Claims"), all of which Claims are hereby waived.

Section 6.10. Expenses of Lender. Borrower agrees to pay on demand (i) all costs and expenses reasonably incurred by Lender in connection with the preparation, negotiation and execution of this Amendment and the other Loan Documents executed pursuant hereto and any and all subsequent amendments, modifications, and supplements hereto or thereto, including, without limitation, the costs and fees of Lender's legal counsel and the allocated cost of staff counsel and (ii) all costs and expenses reasonably incurred by Lender in connection with the enforcement or preservation of any rights under the Agreement, this Amendment and/or other Loan

Documents, including, without limitation, the costs and fees of Lender's legal counsel and the allocated cost of staff counsel.

Section 6.11. NO ORAL AGREEMENTS. THIS AMENDMENT, TOGETHER WITH THE OTHER LOAN DOCUMENTS AS WRITTEN, REPRESENT THE FINAL AGREEMENTS BETWEEN LENDER AND BORROWER AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS OR SUBSEQUENT ORAL AGREEMENTS OF THE PARTIES. THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN LENDER AND BORROWER.

IN WITNESS WHEREOF, the parties have executed this Amendment on the date first above written.

"BORROWER"

LSB INDUSTRIES, INC.

By: /s/ Tony M. Shelby

Tony M. Shelby, Vice President

"LENDER"

BANKAMERICA BUSINESS CREDIT, INC.

By: /s/ Michael J. Jasaitis

Michael J. Jasaitis,
Vice President

ACKNOWLEDGED AND AGREED TO:

Each of the following "LSB Guarantor Subsidiaries" hereby acknowledges the execution of and consents to the terms and conditions of that certain Fourth Amendment to Amended and Restated Loan and Security Agreement dated as of November 19, 1998 between LSB Industries, Inc., and BABC.

L&S AUTOMOTIVE PRODUCTS, CO.
INTERNATIONAL BEARINGS, INC.
LSB EXTRUSION CO.
ROTEX CORPORATION
TRIBONETICS CORPORATION
MOREY MACHINE TOOL MANUFACTURING CORPORATION

By: /s/ Tony M. Shelby

Tony M. Shelby,
Vice President acting on
behalf of each of the above.

CONSENTS AND REAFFIRMATIONS

Each of the undersigned hereby acknowledges the execution of, and consents to, the terms and conditions of that certain Fourth Amendment to Amended and Restated Loan and Security Agreement dated as of November 19, 1998, between LSB Industries, Inc. and BankAmerica Business Credit, Inc. ("Creditor") and reaffirms its obligations under (i) that certain Continuing Guaranty with Security Agreement (the "Guaranty") dated as of November 21, 1997, and (ii) that certain Cross-Collateralization and Cross-Guaranty Agreement (the "Cross-Collateralization Agreement") dated as of November 21, 1997, each made by the undersigned in favor of the Creditor, and acknowledges and agrees that the Guaranty and the Cross-Collateralization Agreement remain in full force and effect and the Guaranty and the Cross-Collateralization Agreement are hereby ratified and confirmed.

Dated as of November 19, 1998.

LSB INDUSTRIES, INC.
L&S BEARING CO.
SUMMIT MACHINE TOOL MANUFACTURING CORP.
L&S AUTOMOTIVE PRODUCTS CO.
INTERNATIONAL BEARINGS, INC.
LSB EXTRUSION CO.
ROTEX CORPORATION
TRIBONETICS CORPORATION
MOREY MACHINERY MANUFACTURING
CORPORATION

By: /s/ Tony M. Shelby
____
Tony M. Shelby, Vice President
acting on behalf of each of the
above

S

FOURTH AMENDMENT
TO AMENDED AND RESTATED
LOAN AND SECURITY AGREEMENT

THIS FOURTH AMENDMENT TO AMENDED AND RESTATED LOAN AND SECURITY AGREEMENT (the "Amendment") is dated as of November 19, 1998, and entered into by and between BANKAMERICA BUSINESS CREDIT, INC. ("Lender") and CLIMATE MASTER, INC. ("Climate Master"), INTERNATIONAL ENVIRONMENTAL CORPORATION ("IEC"), EL DORADO CHEMICAL COMPANY ("EDC") and SLURRY EXPLOSIVE CORPORATION ("Slurry") (Climate, IEC, EDC, and Slurry being collectively referred to herein as "Borrower").

WHEREAS, Lender and Borrower have entered into that certain Amended and Restated Loan and Security Agreement dated as of November 21, 1997 as amended by that certain First Amendment to Amended and Restated Loan and Security Agreement dated as of March 12, 1998, that certain Second Amendment to Amended and Restated Loan and Security Agreement dated as of June 30, 1998, and that certain Third Amendment to Amended and Restated Loan and Security Agreement dated as of August 14, 1998 (as so amended, the "Agreement");

WHEREAS, two Events of Default have occurred under the Agreement;

WHEREAS, the Borrower desires that the Lender waive the Events of Default and amend the Agreement in certain respects; and

WHEREAS, the Lender is willing to waive the Events of Default and amend the Agreement subject to the terms and conditions contained herein;

NOW, THEREFORE, in consideration of the mutual conditions and agreements set forth in the Agreement and this Amendment, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties, intending to be legally bound, hereby agree as follows:

ARTICLE I

Definitions

Section 1.01. Definitions. Capitalized terms used in this Amendment, to the extent not otherwise defined herein, shall have the same meanings as in the Agreement, as amended hereby.

Section 1.02. New Definitions. The following new definitions are hereby added to the Agreement and read as follows:

"Automotive Subsidiaries" means the following LSB Guarantor Subsidiaries: L&S Automotive Products Co., LSB Extrusion Co., International Bearings, Inc., Rotex Corporation, and Tribonetics Corporation.

"Automotive Termination Date" means the date that LSB obtains alternative financing for the Automotive Subsidiaries in accordance with the provisions of Section 6.16(b) of the Amended and Restated Loan and Security Agreement, dated November 21, 1997, as amended, between Lender and LSB and indefeasibly repays all Obligations attributable to the Automotive Subsidiaries.

"Springing Covenant Event" means three consecutive Business Days when the aggregate Availability of the LSB Consolidated Borrowing Group under all of the LSB-Related Loan Agreements is less than Fifteen Million Dollars ($15,000,000) on each such Business Day."

ARTICLE II

Amendments

Section 2.01 Amendment to Section 9.16. Section 9.16 of the Agreement is hereby amended to read in its entirety as follows:

"9.16 At all times (i) prior to the Automotive Termination Date and (ii) after the Automotive Termination Date but only if a Springing Covenant Event has occurred whereafter such financial covenant shall remain in effect until the termination of this Agreement, the following financial covenant shall be in effect:

CCI Adjusted Tangible Net Worth. The CCI Adjusted Tangible Net Worth will not be less than the following amounts at the end of each of the Fiscal Quarters during the following Fiscal Years:

Fiscal Quarters in the Following Fiscal Years	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Fiscal Year Ending December 31, 1998				$18,500,000
First Fiscal Quarter during Fiscal Year Ending December 31, 1999	The CCI Adjusted Tangible Net Worth as of December 31, 1998 less $1,500,000.			
Second Fiscal Quarter during Fiscal Year Ending December 31, 1999	The CCI Adjusted Tangible Net Worth as of March 31, 1999.			

Third Fiscal Quarter during Fiscal Year Ending December 31, 1999 and each Fiscal Quarter during each Fiscal Year ending there-after:	The CCI Adjusted Tangible Net Worth as of March 31, 1999 plus fifty percent (50%) of CCI's profits for the prior fiscal quarter without taking into account any losses."

Section 2.02. Amendment to Section 9.17. Section 9.17 of the Agreement is hereby amended to read in its entirety as follows:

"9.17 At all times (i) prior to the Automotive Termination Date and (ii) after the Automotive Termination Date but only if a Springing Covenant Event has occurred whereafter such financial covenant shall remain in effect until the termination of this Agreement, the following financial covenant shall be in effect:

Debt Ratio. The ratio of Debt of the CCI Consolidated Group to the CCI Adjusted Tangible Net Worth will not be greater than the following ratios at the end of each of the Fiscal Quarters during the following Fiscal Years:

Fiscal Quarters in the Following Fiscal Years	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Fiscal Year Ending December 31, 1998				7.75:1
Fiscal Year Ending December 31, 1999 and	7.75:1	7.75:1	7.75:1	7.75:1
Each Fiscal Quarter during each Fiscal Fiscal Year ending thereafter:			7.75:1"	

ARTICLE III

Waivers

Section 3.01. Waiver of Events of Default.

(a) The Lender hereby waives the following Events of Default: (i) the CCI Adjusted Tangible Net Worth for the Fiscal Quarter ending September 30, 1998 was less than $23,000,000, in breach of Section 9.16 of the Loan Agreement; and (ii) the CCI Consolidated Group's Debt Ratio for the Fiscal Quarter ending September 30, 1998 was greater than 6.35 to 1.0, in breach of Section 9.17 of the Loan Agreement.

(b) The foregoing waiver is only applicable to and shall only be effective to the extent described above. The waiver is limited to the facts and circumstances referred to herein and shall not operate as (i) a waiver of or consent to non-compliance with any other section or provision of the Loan Agreement, (ii) a waiver of any right, power, or remedy of the Lender under the Loan Agreement (except as provided herein), or (iii) a waiver of any other Event of Default or Event which may exist under the Loan Agreement.

ARTICLE IV

Ratifications, Representations and Warranties

Section 4.01. Ratifications. The terms and provisions set forth in this Amendment shall modify and supersede all inconsistent terms and provisions set forth in the Agreement and, except as expressly modified and superseded by this Amendment, the terms and provisions of the Agreement, including, without limitation, all financial covenants contained therein, are ratified and confirmed and shall continue in full force and effect. Lender and Borrower agree that the Agreement as amended hereby shall continue to be legal, valid, binding and enforceable in accordance with its terms.

Section 4.02. Representations and Warranties. Borrower hereby represents and warrants to Lender that the execution, delivery and performance of this Amendment and all other loan, amendment or security documents to which Borrower is or is to be a party hereunder (hereinafter referred to collectively as the "Loan Documents") executed and/or delivered in connection herewith, have been authorized by all requisite corporate action on the part of Borrower and will not violate the Articles of Incorporation or Bylaws of Borrower.

ARTICLE V

Conditions Precedent

Section 5.01. Conditions. The effectiveness of this Amendment is subject to the satisfaction of the following conditions precedent (unless specifically waived in writing by the Lender):

(a) Lender shall have received all of the following, each dated (unless otherwise indicated) as of the date of this Amendment, in form and substance satisfactory to Lender in its sole discretion:

(i) Company Certificate. A certificate executed by the Secretary or Assistant Secretary of Borrower certifying (A) that Borrower's Board of Directors has met and adopted, approved, consented to and ratified the resolutions attached thereto which authorize the execution, delivery and performance by Borrower of the Amendment and the Loan Documents, (B) the names of the officers of Borrower authorized to sign this Amendment and each of the Loan Documents to which Borrower is to be a party hereunder, (C) the specimen signatures of such officers, and (D) that neither the Articles of Incorporation nor Bylaws of Borrower have been amended since the date of the Agreement;

(ii) No Material Adverse Change. There shall have occurred no material adverse change in the business, operations, financial condition, profits or prospects of Borrower, or in the Collateral since September 30, 1998, and the Lender shall have received a certificate of Borrower's chief executive officer to such effect;

(iii) Other Documents. Borrower shall have executed and delivered such other documents and instruments as well as required record searches as Lender may require.

(b) All corporate proceedings taken in connection with the transactions contemplated by this Amendment and all documents, instruments and other legal matters incident thereto shall be satisfactory to Lender and its legal counsel, Jenkens & Gilchrist, a Professional Corporation.

ARTICLE VI

Miscellaneous

Section 6.01. Survival of Representations and Warranties. All representations and warranties made in the Agreement or any other document or documents relating thereto, including, without limitation, any Loan Document furnished in connection with this Amendment, shall survive the execution and delivery of this Amendment and the other Loan Documents, and no investigation by Lender or any closing shall affect the representations and warranties or the right of Lender to rely thereon.

Section 6.02. Reference to Agreement. The Agreement, each of the Loan Documents, and any and all other agreements, documents or instruments now or hereafter executed and delivered pursuant to the terms hereof or pursuant to the terms of the Agreement as amended hereby, are hereby amended so that any reference therein to the Agreement shall mean a reference to the Agreement as amended hereby.

Section 6.03. Severability. Any provision of this Amendment held by a court of competent jurisdiction to be invalid or unenforceable shall not impair or invalidate the remainder of this Amendment and the effect thereof shall be confined to the provision so held to be invalid or unenforceable.

Section 6.04. APPLICABLE LAW. THIS AMENDMENT AND ALL OTHER LOAN DOCUMENTS EXECUTED PURSUANT HERETO SHALL BE DEEMED TO HAVE BEEN MADE AND TO BE PERFORMABLE IN THE STATE OF OKLAHOMA AND SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF OKLAHOMA.

Section 6.05. Successors and Assigns. This Amendment is binding upon and shall inure to the benefit of Lender and Borrower and their respective successors and assigns; provided, however, that Borrower may not assign or transfer any of its rights or obligations hereunder without the prior written consent of Lender. Lender may assign any or all of its rights or obligations hereunder without the prior consent of Borrower.

Section 6.06. Counterparts. This Amendment may be executed in one or more counterparts, each of which when so executed shall be deemed to be an original, but all of which when taken together shall constitute one and the same instrument.

Section 6.07. Effect of Waiver. No consent or waiver, express or implied, by Lender to or of any breach of or deviation from any covenant or condition of the Agreement or duty shall be deemed a consent or waiver to or of any other breach of or deviation from the same or any other covenant, condition or duty. No failure on the part of Lender to exercise and no delay in exercising, and no course of dealing with respect to, any right, power, or privilege under this Amendment, the Agreement or any other Loan Document shall operate as a waiver thereof, nor shall any single or partial exercise of any right, power, or privilege under this Amendment, the Agreement or any other Loan Document preclude any other or further exercise thereof or the exercise of any other right, power, or privilege. The rights and remedies provided for in the Agreement and the other Loan Documents are cumulative and not exclusive of any rights and remedies provided by law.

Section 6.08. Headings. The headings, captions and arrangements used in this Amendment are for convenience only and shall not affect the interpretation of this Amendment.

Section 6.09. Releases. As a material inducement to Lender to enter into this Amendment, Borrower hereby represents and warrants that there are no claims or offsets against, or defenses or counterclaims to, the terms and provisions of and the other obligations created or evidenced by the Agreement or the other Loan Documents. Borrower hereby releases, acquits, and forever discharges Lender, and its successors, assigns, and predecessors in interest, their parents, subsidiaries and affiliated organizations, and the officers, employees, attorneys, and agents of each of the foregoing (all of whom are herein jointly and severally referred to as the "Released Parties") from any and all liability, damages, losses, obligations, costs, expenses, suits, claims, demands, causes of action for damages or any other relief, whether or not now known or suspected, of any kind, nature, or character, at law or in equity, which Borrower now has or may have ever had against any of the Released Parties, including, but not limited to, those relating to (a) usury or penalties or damages therefor, (b) allegations that a partnership existed between Borrower and the Released Parties, (c) allegations of unconscionable acts, deceptive trade practices, lack of good faith or fair dealing, lack of commercial reasonableness or special relationships, such as fiduciary, trust or confidential relationships, (d) allegations of dominion, control, alter ego, instrumentality, fraud, misrepresentation, duress, coercion, undue influence, interference or negligence, (e) allegations of tortious interference with present or prospective business relationships or of antitrust, or (f) slander, libel or damage to reputation, (hereinafter being collectively referred to as the "Claims"), all of which Claims are hereby waived.

Section 6.10. Expenses of Lender. Borrower agrees to pay on demand (i) all costs and expenses reasonably incurred by Lender in connection with the preparation, negotiation and execution of this Amendment and the other Loan Documents executed pursuant hereto and any and all subsequent amendments, modifications, and supplements hereto or thereto, including, without limitation, the costs and fees of Lender's legal counsel and the allocated cost of staff counsel and (ii) all costs and expenses reasonably incurred by Lender in connection with the enforcement or preservation of any rights under the Agreement, this Amendment and/or other Loan Documents, including, without limitation, the costs and fees of Lender's legal counsel and the allocated cost of staff counsel.

Section 6.11. NO ORAL AGREEMENTS. THIS AMENDMENT, TOGETHER WITH THE OTHER LOAN DOCUMENTS AS WRITTEN, REPRESENT THE FINAL

AGREEMENTS BETWEEN LENDER AND BORROWER AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS OR SUBSEQUENT ORAL AGREEMENTS OF THE PARTIES. THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN LENDER AND BORROWER.

IN WITNESS WHEREOF, the parties have executed this Amendment on the date first above written.

"BORROWER":

CLIMATE MASTER, INC.

By: /s/ Tony M. Shelby
____
Tony M. Shelby
Vice President

INTERNATIONAL ENVIRONMENTAL CORPORATION

By: /s/ Tony M. Shelby
____
Tony M. Shelby
Vice President

EL DORADO CHEMICAL COMPANY

By: /s/ Tony M. Shelby
____
Tony M. Shelby
Vice President

SLURRY EXPLOSIVE CORPORATION

By: /s/ Tony M. Shelby

____

Tony M. Shelby
Vice President

"LENDER"

BANKAMERICA BUSINESS CREDIT, INC.

By: /s/ Michael J. Jasaitis

Michael J. Jasaitis, Vice President

CONSENTS AND REAFFIRMATIONS

The undersigned hereby acknowledges the execution of, and consents to, the terms and conditions of that certain Fourth Amendment to Amended and Restated Loan and Security Agreement dated as of November 19, 1998, between Climate Master, Inc., International Environmental Corporation, El Dorado Chemical Corporation, Slurry Explosive Corporation and BankAmerica Business Credit, Inc. ("Creditor") and reaffirms its obligations under that certain Continuing Guaranty (the "Guaranty") dated as of November 21, 1997, made by the undersigned in favor of the Creditor, and acknowledges and agrees that the Guaranty remains in full force and effect and the Guaranty is hereby ratified and confirmed.

Dated as of November 19, 1998.

CLIMACHEM, INC.

By: /s/ Tony M. Shelby

Tony M. Shelby, Vice President

CONSENTS AND REAFFIRMATIONS

Each of the undersigned hereby acknowledges the execution of, and consents to, the terms and conditions of that certain Fourth Amendment to Amended and Restated Loan and Security Agreement dated as of November 19, 1998, between Climate Master, Inc., International Environmental Corporation, El Dorado Chemical Corporation, Slurry Explosive Corporation and BankAmerica Business Credit, Inc. ("Creditor") and each reaffirms its obligations under that certain Continuing Guaranty with Security Agreement (the "Guaranty") dated as of November 21, 1997, and acknowledges and agrees that such Guaranty remains in full force and effect and each Guaranty is hereby ratified and confirmed.

Dated as of November 19, 1998.

LSB INDUSTRIES, INC.
LSB CHEMICAL CORP.
L&S AUTOMOTIVE PRODUCTS CO.
L&S BEARING CO.
INTERNATIONAL BEARINGS, INC.
LSB EXTRUSION CO.
ROTEX CORPORATION
TRIBONETICS CORPORATION
SUMMIT MACHINE TOOL MANUFACTURING CORP.
MOREY MACHINERY MANUFACTURING CORPORATION
CHP CORPORATION
KOAX CORP.
APR CORPORATION
CLIMATE MATE, INC.
THE ENVIRONMENTAL GROUP, INC.
UNIVERSAL TECH CORPORATION

By: /s/ Tony M. Shelby

Tony M. Shelby, Vice President acting on behalf of each of the above

The CIT Group/
Equipment Financing
550 CIT Drive
P. O. Box 490
Livingston, NJ 07030-0480

November 17, 1998

THE
CIT
GROUP

Jim Jones
Vice President and Treasurer
LSB Industries
16 South Pennsylvania Avenue
Oklahoma City, OK 73107

Dear Mr. Jones:

Reference is made to that certain Loan and Security Agreement, dated as of October 31, 1994, as amended, a Loan and Security Agreement, dated as of April 5, 1995, as amended, and a Loan and Security Agreement dated as of November 15, 1995, as amended, by and between The CIT Group/Equipment Financing, Inc. ("Lender") and DSN Corporation ("Borrower").

Borrower has informed Lender that ClimaChem was not in compliance with the Tangible Net Worth covenant contained in Section 6.10, and the Leverage Ratio covenant of the above referenced Agreement for the period ended September 30, 1998, and will be unable to meet these requirements through and including the quarter ending September 30, 1999.

Borrower has requested, that notwithstanding anything to the contrary in the Agreement, that Lender waive these instances of non-compliance for these periods.

Lender hereby waives these instances of non-compliance for the periods mentioned above, provided that such waiver is subject to the following conditions:

(1) This waiver is strictly limited to the Tangible Net Worth and Leverage Ratio Covenants of the Agreement.

(2) The waiver is strictly limited to the specific periods above.

Lender also agrees to consider resetting the covenants sixty (60) days from the date of this waiver, along with a determination of the fee. However, the reset of the covenants is subject to approval by Lender's Credit Committee.

Sincerely,
THE CIT GROUP/Equipment Financing, Inc.

By /s/ Anthony Joseph
____
Anthony G. Joseph
Vice President

An affiliate of
The Dai-Ichi Kangyo Bank, Limited

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 Incentive Stock Option Plans, the Registration Statement (Form S-8 No. 333-58225) pertaining to the 1993 Stock Option and Incentive Plan, the Registration Statement (Form 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 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 20, 1998, relating to the unaudited condensed consolidated interim financial statements of LSB Industries, Inc. which are included in its Form 10-Q for the quarter ended September 30, 1998.

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.

/s/ Ernst & Young LLP

ERNST & YOUNG LLP

Oklahoma City, Oklahoma
November 20, 1998

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