

FORM 10-K  
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

(Mark One)

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

For the fiscal year ended: December 31, 1997

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934 (NO FEE REQUIRED)

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

Commission File Number: 1-7677

LSB INDUSTRIES, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware  
(State of Incorporation)

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

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

73107  
(Zip Code)

Registrant's Telephone Number, Including Area Code:

(405) 235-4546

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

Title of Each Class	Name of Each Exchange On Which Registered
Common Stock, Par Value \$.10	New York Stock Exchange
\$3.25 Convertible Exchangeable Class C Preferred Stock, Series 2	New York Stock Exchange
Preferred Share Purchase Rights	New York Stock Exchange

(Facing Sheet Continued)

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

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

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

As of February 28, 1998, the aggregate market value of the 8,543,152 shares of voting stock of the Registrant held by non-affiliates of the Company equaled approximately \$35,240,502 based on the closing sales price for the Company's common stock as reported for that date on the New York Stock Exchange. That amount does not include (1) the 1,539 shares of Convertible Non-Cumulative Preferred Stock (the "Non-Cumulative Preferred Stock") held by non-affiliates of the Company, (2) the 20,000 shares of Series B 12% Convertible, Cumulative Preferred Stock (the "Series B Preferred Stock"), and (3) the 915,000 shares of \$3.25 Convertible Exchangeable Class C Preferred Stock, Series 2, excluding 5,000 shares held in treasury (the "Series 2 Preferred Stock"). An active trading market does not exist for the shares of Non-Cumulative Preferred Stock or the Series B Preferred Stock. The shares of Series 2 Preferred Stock do not have voting rights except under limited circumstances.

As of February 28, 1998, the Registrant had 12,759,226 shares of common

stock outstanding (excluding 2,346,390 shares of common stock held as treasury stock).

FORM 10-K OF LSB INDUSTRIES, INC.

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PART I

ITEM 1. BUSINESS

GENERAL

LSB Industries, Inc. (the "Company") was formed in 1968 as an Oklahoma corporation, and in 1977 became a Delaware corporation. The Company is a

diversified holding company which is engaged, through its subsidiaries, in (i) the manufacture and sale of chemical products for the explosives, agricultural and industrial acids markets (the "Chemical Business"), (ii) the manufacture and sale of a broad range of hydronic fan coils and water source heat pumps as well as other products used in commercial and residential air conditioning systems (the "Climate Control Business"), and (iii) the manufacture or purchase and sale of certain automotive and industrial products, including automotive bearings and other automotive replacement parts (the "Automotive Products Business") and the purchase and sale of machine tools (the "Industrial Products Business").

#### SEGMENT INFORMATION AND FOREIGN AND DOMESTIC OPERATIONS AND EXPORT SALES

Schedules of the amounts of sales, operating profit and loss, and identifiable assets attributable to each of the Company's lines of business and of the amount of export sales of the Company in the aggregate and by major geographic area for each of the Company's last three fiscal years appear in Note 13 of the Notes to Consolidated Financial Statements included elsewhere in this report.

A discussion of any risks attendant as a result of a foreign operation or the importing of products from foreign countries appears below in the discussion of each of the Company's business segments.

#### CHEMICAL BUSINESS

##### GENERAL

The Company's Chemical Business manufactures three principal product lines that are derived from anhydrous ammonia: (1) fertilizer grade ammonium nitrate for the agricultural industry, (2) explosive grade ammonium nitrate for the mining industry and (3) concentrated, blended and mixed nitric acid for industrial applications. In addition, the Company also produces sulfuric acid for commercial applications primarily in the paper industry. The Chemical Business' products are sold in niche markets where the Company believes it can establish a position as a market leader. See "Special Note Regarding Forward-Looking Statements".

The Chemical Business' principal manufacturing facility is located in El Dorado, Arkansas ("El Dorado Facility") and its other manufacturing facilities are located in Hallowell, Kansas, Wilmington, North Carolina, four locations in Australia, and one location in New Zealand.

For 1997, approximately 26% of the sales of the Chemical Business consisted of sales of fertilizer and related chemical products for agricultural purposes, which represented approximately 13% of the Company's

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1997 consolidated sales, and approximately 61% consisted of sales of ammonium nitrate and other chemical-based blasting products for the mining industry, which represented approximately 30.5% of the Company's 1997 consolidated sales. The Chemical Business accounted for approximately 50% and 54% of the Company's 1997 and 1996 consolidated sales, respectively.

##### AGRICULTURAL PRODUCTS

The Chemical Business produces ammonium nitrate, a nitrogen-based fertilizer, at the El Dorado Facility. In 1997, the Company sold approximately 184,000 tons of ammonium nitrate fertilizer to farmers, fertilizer dealers and distributors located primarily in the south central United States.

Ammonium nitrate is one of several forms of nitrogen-based fertilizers which include anhydrous ammonia and urea. Although, to some extent, the various forms of nitrogen-based fertilizers are interchangeable, each has its own characteristics which produce agronomic preferences among end users. Farmers decide which type of nitrogen-based fertilizer to apply based on the crop planted, soil and weather conditions, regional farming practices and relative nitrogen fertilizer prices.

The Chemical Business is a major manufacturer of fertilizer grade ammonium nitrate, which it markets primarily in Texas, Arkansas and the surrounding regions. This market, which is in close proximity to its El Dorado Facility, includes a high concentration of pasture land and row crops which favor ammonium nitrate over other nitrogen-based fertilizers. The Company has developed the leading market position in Texas by emphasizing high quality products, customer service and technical advice. Using a proprietary prilling process, the Company produces a high performance ammonium nitrate fertilizer that, because of its uniform size, is easier to apply than many competing nitrogen-based fertilizer products. The Company believes that its "E-2" brand ammonium nitrate fertilizer is recognized as a premium product

within its primary market. In addition, the Company has developed long term relationships with end users through its network of 21 owned and operated wholesale and retail distribution centers.

#### EXPLOSIVES

The Chemical Business manufactures low density ammonium nitrate-based explosives including bulk explosives used in surface mining. In addition, the Company manufactures and sells a branded line of packaged explosives used in construction, quarrying and other applications, particularly where controlled explosive charges are required. The Company's bulk explosives are marketed primarily through five Company-owned distribution centers, three of which are located in close proximity to the customers' surface mines in the coal producing states of Kentucky, Missouri, and West Virginia. Additionally, the Company, through its Australian subsidiary, manufactures and distributes bulk and packaged explosives in Australia and New Zealand. The Company emphasizes value-added customer services and specialized product applications for its bulk explosives. Most of the sales of bulk explosives are to customers who work closely with the Company's technical representatives in meeting their specific product needs. In addition, the Company sells bulk explosives to independent wholesalers and to other explosive companies. Packaged explosives are used for application requiring controlled explosive charges and typically command a premium price and produce higher margins. The Company

believes its Slurry packaged explosive products are among the most widely recognized in the industry. Slurry packaged explosive products are sold nationally and internationally to other explosive companies and end-users.

#### INDUSTRIAL ACIDS

The Chemical Business manufactures and sells industrial acids, primarily to the food, paper, chemical and electronics industries. The Company is the leading supplier to third parties of concentrated nitric acid which is a special grade of nitric acid used in the manufacture of plastics, pharmaceuticals, herbicides, explosives, and other chemical products. In addition, the Company produces and sells regular, blended and mixed nitric acid and a variety of grades of sulfuric acid. The Company competes on the basis of price and service, including on-time reliability and distribution capabilities. The Company operates the largest fleet of tankcars in the concentrated nitric acid industry which provides it with a significant competitive advantage in terms of distribution costs and capabilities. In addition, the company provides inventory management as part of the value-added services it offers to its customers.

The Company has identified concentrated nitric acid as a strategic product line for its Chemical Business due to attractive levels of profitability, increased diversity of end markets and the ability to compete on a value added service basis. To support further growth in its nitric acid business, the Company undertook the construction of the DSN Plant located at the El Dorado Facility. The DSN Plant uses a newer and more efficient process to produce concentrated nitric acid directly from anhydrous ammonia, in contrast to the conventional process which requires the input of regular nitric acid, an intermediate step to produce concentrated nitric acid.

#### DSN PLANT

Since January 1, 1994, the Chemical Business has spent approximately \$32.0 million to install the DSN Plant. The DSN Plant began limited operations in 1995, and such limited operations continued due to certain mechanical and design problems associated with the plant's construction and installation. As a result of such problems, production at the DSN Plant was limited to approximately 170 tons per day (60% of its stated capacity of 285 tons per day assuming 338 days of annual production) during the twelve months ended December 31, 1997. In October 1997, management completed certain corrective actions at the DSN Plant. As a result of these corrective actions, the DSN Plant has the capacity to operate at approximately 285 tons per day, depending upon customer specifications. Due to customer specifications and inventory constraints, among other things, the DSN Plant has been operating at approximately 260 tons per day since the corrective actions were completed. Based on normalized production (assuming 338 days of annual production), at 260 tons per day, the Company believes that it will be able to produce concentrated nitric acid at a cost per ton approximately at \$65 per ton lower than at the production levels of 170 tons per day in the prior period. While the Company will seek to market the additional capacity of concentrated nitric acid output to commercial markets, there can be no assurance that the Company will be able to sell all of the additional capacity in this market. However, to the extent that there is insufficient demand for concentrated nitric acid, the Company believes it can profitably use the concentrated nitric acid in the production of mixed and blended acids and ammonium nitrate based fertilizer and explosives (although at lower margins than if the production were sold as concentrated nitric acid). See "Special Note Regarding

#### EDNC BAYTOWN PLANT

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 will act 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 an operating 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. Bayer will purchase from EDNC all of its requirements for nitric acid to be used by Bayer at its Baytown, Texas facility for ten years from the date on which the EDNC Baytown Plant becomes fully operational. EDNC will purchase from Bayer its requirements for anhydrous ammonia for the manufacture of nitric acid as well as utilities and other services. Subject to certain conditions, EDNC will be entitled to sell the amount of nitric acid manufactured at the EDNC Baytown Plant which is in excess of Bayer's requirements to third parties. The Bayer Agreement provides that Bayer will make certain net monthly payments to EDNC which will be sufficient for EDNC to recover all of its costs plus a profit. 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.

If operations at the EDNC Baytown Plant are not commenced by February 1, 1999, or upon a change in control of LSB, EDC or EDNC, Bayer has an option to terminate the Bayer Agreement. EDNC has an option to terminate the Bayer Agreement upon the failure of Bayer to complete the construction of certain delivery systems prior to January 1, 1999, and upon the occurrence of certain events of default which remain uncured. Bayer retains the right of first refusal with respect to any bona fide third-party offer to purchase any voting stock of EDNC or any portion of the EDNC Baytown Plant. It is anticipated that construction of the EDNC Baytown Plant will cost approximately \$60 million and will be completed by late 1998. Construction financing of the EDNC Baytown Plant is to be provided by an unaffiliated lender. Neither the Company nor EDC has guaranteed any of the lending obligations for the EDNC Baytown Plant. See "Special Note Regarding Forward-Looking Statements".

#### RAW MATERIALS

Anhydrous ammonia represents the primary component in the production of most of the products of the Chemical Business. See "Management's Discussion and Analysis of Financial Condition and Results of Operations." The Chemical business currently purchases approximately 220,000 tons of anhydrous ammonia per year for use in its manufacture of its products. The Company has contracts with two suppliers of anhydrous ammonia. One contract expires in December 1998 and the other expires in April 2000. The Chemical Business is required to buy 120,000 tons of its annual requirements of anhydrous ammonia under the contract expiring in 2000 and the balance under the other contract.

During 1995, 1996, and 1997, there were substantial increases in the price for anhydrous ammonia. During each of these periods, the Chemical Business was unable to increase its sales prices to cover all of the higher anhydrous ammonia costs incurred by the Company, and in the future the Chemical Business may not be able to pass along to its customers the full amount of increases in anhydrous ammonia costs. Accordingly, the Company's results of operations and financial condition have in the past been, and may in the future be, adversely affected by cost increases of raw materials, including anhydrous ammonia. The Company is not able to predict, as of the date of this report, what impact, if any, will result to the Company and the Company's earnings if the price of anhydrous ammonia continues at or near current levels, which are high on a historical basis, or if the price of anhydrous ammonia continues to increase further. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Special Note Regarding Forward-Looking Statements".

The Company believes that it could obtain anhydrous ammonia from other sources in the event of a termination of the above-referenced contracts, but such may not be obtainable on as favorable terms.

#### SEASONALITY

The Company believes that the only seasonal products of the Chemical Business are fertilizer and related chemical products sold to the agricultural

industry. The selling seasons for those products are primarily during the spring and fall planting seasons, which typically extend from February through May and from September through November in the geographical markets in which the majority of the Company's agricultural products are distributed. As a result, the Chemical Business increases its inventory of ammonium nitrate prior to the beginning of each planting season. Sales to the agricultural markets depend upon weather conditions and other circumstances beyond the control of the Company.

#### PATENTS

The Company believes that the Chemical Business does not depend upon any patent or license; however, the Chemical Business does own certain patents that it considers important in connection with the manufacture of certain blasting agents and high explosives. These patents began expiring in 1997 and will expire through 1999.

#### REGULATORY MATTERS

Each of the Chemical Business' domestic blasting product distribution centers are licensed by the Bureau of Alcohol, Tobacco and Firearms in order to manufacture and distribute blasting products. The Australian and New Zealand distribution centers are subject to comparable licensing requirements imposed by their respective controlling government authorities. The Chemical Business is also subject to extensive federal, state and local environmental laws, rules and regulations. See "Environmental Compliance", "Environmental Matters" and "Legal Proceedings".

#### COMPETITION

The Chemical business competes with other chemical companies in its markets, many of whom have greater financial and other resources than the Company. The Company believes that competition within the markets served by the Chemical Business is primarily based upon price, service, warranty and product performance. The Company believes that the Chemical Business is the leader in the Texas ammonium nitrate market and is the leading producer of concentrated nitric acid in the United States for third party sales. See "Special Note Regarding Forward-Looking Statements".

#### DEVELOPMENTS IN ASIA

The Chemical Business' Australian subsidiaries' results of operations have been adversely affected during 1997 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 Chemical Business services.

#### CLIMATE CONTROL BUSINESS

##### BUSINESS STRATEGY

The Climate Control Business seeks to establish leadership positions in niche markets by offering extensive product lines, custom tailored products and proprietary new technologies. Under this focused strategy, the Company has developed an extensive line of hydronic fan coils and water source heat pumps. The Company has developed flexible production to allow it to custom design units for the growing retrofit and replacement markets. The Company believes that the Climate Control Business is one of the leaders in commercializing new technology to satisfy increasingly stringent indoor air quality standards. Products recently developed by the Company include heat pipe technology for dehumidification, specialty filters for the removal of airborne particles and gases, ultraviolet light units for bacteria removal and highly energy efficient dual path heat pump products. The Climate Control Business is a pioneer in the use of geothermal water source heat pumps in residential applications. See "Special Note Regarding Forward-Looking Statements".

#### GENERAL

The Company's Climate Control Business manufactures and sells a broad range of standard and custom designed hydronic fan coils and water source heat pumps as well as other products for use in commercial and residential HVAC systems. Demand for the Climate Control Business' products is driven by the construction of commercial, institutional and residential buildings, the renovation of existing buildings and the replacement of existing systems. The Climate Control Business' commercial products are used in a wide variety of buildings, such as: hotels, motels, office buildings, schools, universities, apartments, condominiums, hospitals, nursing homes, extended care facilities, supermarkets and superstores. Many of the Company's products are targeted to meet increasingly stringent indoor air quality and energy efficiency standards. The Climate Control Business accounted for approximately 34% and

29% of the Company's 1997 and 1996 consolidated sales, respectively.

#### HYDRONIC FAN COILS

The Climate Control Business is the leading provider of hydronic fan coils targeted to the commercial and institutional markets in the U.S. Hydronic fan coils use heated or chilled water, provided by a centralized chiller and boiler through a water pipe system, to condition the air and allow individual room control. Hydronic fan coil systems are quieter and have longer lives and lower maintenance costs than comparable systems used where individual room control is required. The Company believes that its product line of hydronic fan coils is the most extensive offered by any domestic producer. The breadth of this product line coupled with customization capability provided by a flexible manufacturing process are important components of the Company's strategy for competing in the commercial and institutional renovation and replacement markets. See "Special Note Regarding Forward-Looking Statements".

#### WATER SOURCE HEAT PUMPS

The Company is a leading U.S. provider of water source heat pumps to the commercial construction and renovation markets. These are highly efficient heating and cooling units which enable individual room climate control through the transfer of heat through a water pipe system which is connected to a centralized cooling tower or heat injector. Water source heat pumps enjoy a broad range of commercial applications, particularly in medium to large sized buildings with many small, individually controlled spaces. The company believes the market for commercial water source heat pumps will continue to grow due to the relative efficiency and long life of such systems as compared to other air conditioning and heating systems, as well as to the emergence of the replacement market for those systems. See "Special Note Regarding Forward-Looking Statements".

#### GEOTHERMAL PRODUCTS

The Climate Control Business is a pioneer in the use of geothermal water source heat pumps in residential and commercial applications. Geothermal systems, which circulate water or antifreeze through an underground heat exchanger, are among the most energy efficient systems available. The Company believes that an aging installed base of residential HVAC systems, coupled with the longer life, lower cost to operate, and relatively short payback periods of geothermal systems will continue to increase demand for its geothermal products, particularly in the residential replacement market. See "Special Note Regarding Forward-Looking Statements".

#### HYDRONIC FAN COIL AND WATER SOURCE HEAT PUMP MARKET

The Company has pursued a strategy of specializing in hydronic fan coils and water source heat pump products. The annual U.S. market for hydronic fan coils and water source heat pumps is approximately \$225 million. Demand in these markets is generally driven by levels of repair, replacement, and new construction activity. The U.S. market for fan coils and water source heat pump products has grown on average 6% per year over the last 5 years. This growth has been fueled by the aging of the installed base of units, the introduction of new energy efficient systems, upgrades to central air conditioning and increased governmental regulations restricting the use of ozone depleting refrigerants in HVAC systems.

#### PRODUCTION AND BACKLOG

Most of the Climate Control Business' production of the above-described products occurs on a specific order basis. The Company manufactures the units in many sizes and configurations, as required by the purchaser, to fit the space and capacity requirements of hotels, motels, school, hospitals, apartment buildings, office buildings and other commercial or residential structures. As of December 31, 1997, the backlog of confirmed orders for the Climate Control Business was approximately \$28.8 million as compared to approximately \$14.9 million at December 31, 1996. A customer generally has the right to cancel an order prior to the order being released to production. Past experience indicates that customers generally do not cancel orders after the Company receives them. As of March 31, 1998, the Climate Control Business had released substantially all of the December 31, 1997 backlog to production. All of the December 31, 1997 backlog is expected to be filled by December 31, 1998. See "Special Note Regarding Forward-Looking Statements".

#### MARKETING AND DISTRIBUTION

##### DISTRIBUTION

The Climate Control Business sells its products to mechanical contractors, original equipment manufacturers and distributors. The Company's

sales to mechanical contractors primarily occur through independent manufacturer's representatives, who also represent complementary product lines not manufactured by the Company. Original equipment manufacturers generally consist of other air conditioning and heating equipment manufacturers who resell under their own brand name the products purchased from the Climate Control Business in competition with the Company. Sales to original equipment manufacturers accounted for approximately 25% of the sales of the Climate Control Business in 1997 and approximately 8.4% of the Company's 1997 consolidated sales.

#### MARKET

The Climate Control Business depends primarily on the commercial construction industry, including new construction and the remodeling and renovation of older buildings. In recent years this Business has introduced geothermal products designed for residential markets for both new and replacement markets.

#### RAW MATERIALS

Numerous domestic and foreign sources exist for the materials used by the Climate Control Business, which materials include aluminum, copper, steel, electric motors and compressors. The Company does not expect to have any difficulties in obtaining any necessary materials for the Climate Control Business.

#### COMPETITION

The Climate Control Business competes with approximately eight companies, some of whom are also customers of the Company. Some of the competitors have greater financial and other resources than the Company. The Climate Control Business manufactures a broader line of fan coil and water source heat pump products than any other manufacturer in the United States, and the Company believes that it is competitive as to price, service, warranty and product performance.

#### JOINT VENTURES AND OPTIONS TO PURCHASE

The Company has obtained an option to acquire 80% of the issued and outstanding stock of an Entity ("Entity") that performs energy savings contracts, primarily on US government facilities (the "Option"). For the Option, the Company has paid \$1.2 million as of the date of this report. The term of the Option expires May 4, 1998, but the Company may extend such for one (1) additional year until May 4, 1999 upon payment of \$100,000. As of the date of this report, the Company has not decided whether it will exercise the Option. If the Company decides to exercise the Option, the Company has agreed to pay an exercise price of \$4.0 million, less the amount already paid toward the Option ("Option Price"), with a portion of the unpaid exercise price being payable in cash and the balance over a certain period of time. The grantors of the Option have entered into an employment agreement with the Entity. Under the terms of the employment agreements, each of the three grantors will receive, among other things, 12 1/2% of the net profits of the Entity for a period of three to five years following the date of exercise of the Option. If the Company decides not to exercise the Option, the grantors of the Option have agreed to repay to the Company the amounts paid by the Company in connection with the Option up to a total of \$1.0 million, which obligation is secured by the stock of the Entity and other affiliates of the Entity. If the Company decides not to exercise the Option, there is no assurance that the grantors of the Option will have funds necessary to repay to the Company the amount paid for the Option. The grantors of the Option may, under certain conditions, require the Company to accelerate its decision as to when it exercises the Option. See "Management's Discussion and Analysis of Financial Condition and Results of Operations". Through the date of this report, the Company has loaned the Entity approximately \$1.4 million. The Company has recorded reserves of \$926,000 against the loans and option payments. For the year ended June 30, 1997, the Entity reported an unaudited net loss of approximately \$0.5 million.

During 1994, a subsidiary of the Company obtained an option to acquire all of the stock of a French manufacturer of air conditioning and heating equipment. The Company's subsidiary was granted the option as a result of the subsidiary loaning to the parent company of the French manufacturer approximately \$2.1 million. Subsequent to the loan of \$2.1 million, the Company's subsidiary has loaned to the parent of the French manufacturer an additional \$1.7 million. The amount loaned is secured by the stock and assets of the French manufacturer. The Company's subsidiary may exercise its option to acquire the French manufacturer by converting approximately \$150,000 of the amount loaned into equity. The option is currently exercisable and will expire June 15, 1999. As of the date of this report, the Company has not decided whether it will exercise the option.

For 1997 and 1996, the French manufacturer had revenues of \$14.3 million and \$16.0 million, respectively, and reported an approximate breakeven level of operations in 1996 and a net income of approximately \$300,000 in 1997. As a result of cumulative losses by the French manufacturer, the Company has established reserves against the loans aggregating approximately \$1.5 million through December 31, 1997. See "Management's Discussion and Analysis of Financial Condition and Results of Operations".

## AUTOMOTIVE PRODUCTS BUSINESS

### GENERAL

The Automotive Products Business is primarily engaged in the manufacture and sale of a line of anti-friction bearings, which includes straight-thrust and radial-thrust ball bearings, angular contact ball bearings, and certain other automotive replacement parts (including universal joints, motor mounts, and clutches). This Business also manufactures power train and drive line parts for original equipment manufacturers. These products are used in automobiles, trucks, trailers, tractors, farm and industrial machinery, and other equipment. The Automotive Products Business accounted for approximately 11% and 12% of the Company's 1997 and 1996 sales respectively. In 1997, the Automotive Products Business manufactured approximately 40% of the products it sold and approximately 39% in 1996, and purchased the balance of its products from other sources, including foreign sources.

### DISTRIBUTION AND MARKET

The automotive, truck and agricultural equipment replacement markets serve as the principal markets for the Automotive Products Business. This Business sells its products domestically and for export, principally through independent manufacturers' representatives who also sell other automotive products. Those manufacturers' representatives sell to retailers (including major chain stores), wholesalers, distributors and jobbers. The Automotive Products Business also sells its products directly to original equipment manufacturers and certain major chain stores.

### INVENTORY

The Company generally produces or purchases the products sold by the Automotive Products Business in quantities based on a general sales forecast, rather than on specific orders from customers. The Company fills most orders for the automotive replacement market from inventory. The Company generally produces products for original equipment manufacturers after receiving an order from the manufacturer.

### RAW MATERIALS

The principal materials that the Automotive Products Business needs to produce its products consist of high alloy steel tubing, steel bars, flat strip coil steel and bearing components produced to specifications. The Company acquires those materials from a variety of domestic and foreign suppliers at competitive prices. The Company does not anticipate having any difficulty in obtaining those materials in the near future.

### FOREIGN RISK

By purchasing a significant portion of the bearings and other automotive replacement parts that it sells from foreign manufacturers, the Automotive Products Business must bear certain import duties and international economic risks, such as currency fluctuations and exchange controls, and other risks from political upheavals and changes in United States or other countries' trade policies. Contracts for the purchase of foreign-made bearings and other automotive replacement parts provide for payment in United States dollars. Circumstances beyond the control of the Company could eliminate or seriously curtail the supply of bearings or other automotive replacement parts from any one or all of the foreign countries involved.

### COMPETITION

The Automotive Products Business engages in a highly competitive business. Competitors include other domestic and foreign bearing manufacturers, which sell in the original equipment and replacement markets. Many of those manufacturers have greater financial and other resources than the Company.

## INDUSTRIAL PRODUCTS BUSINESS

### GENERAL

The Industrial Products Business purchases and markets a proprietary line of machine tools. The current line of machine tools distributed by the

Industrial Products Business includes milling, drilling, turning and fabricating machines. The Industrial Products Business purchases most of the machine tools marketed by it from foreign companies, which manufacture the machine tools to the Company's specifications. This Business manufactures CNC bed mills and electrical control panels for machine tools. The Industrial Products Business accounted for approximately 5% of the Company's consolidated sales in each of the years 1997 and 1996.

#### DISTRIBUTION AND MARKET

The Industrial Products Business distributes its machine tools in the United States, Mexico, Canada and certain other foreign markets. The Industrial Products Business also sells its machine tools through independent machine tool dealers throughout the United States and Canada, who purchase the machine tools for resale to end users. The principal markets for machine tools, other than machine tool dealers, consist of manufacturing and metal working companies, maintenance facilities, and utilities.

#### FOREIGN RISK

By purchasing a majority of the machine tools from foreign manufacturers, the Industrial Products Business must bear certain import duties and international economic risks, such as currency fluctuations and exchange controls, and other risks from political upheavals and changes in United States or other countries' trade policies. Contracts for the purchase of foreign-made machine tools provide for payment in United States dollars. Circumstances beyond the control of the Company could eliminate or seriously curtail the supply of machine tools from any one or all of the foreign countries involved.

#### COMPETITION

The Industrial Products Business competes with manufacturers, importers, and other distributors of machine tools many of whom have greater financial resources than the Company. The Company's machine tool business generally is competitive as to price, warranty and service, and maintains personnel to install and service machine tools.

#### EMPLOYEES

As of December 31, 1997, the Company employed 1,685 persons. As of that date, (a) the Chemical Business employed 563 persons, with 135 represented by unions under agreements expiring in August 1998 and February 1999, (b) the Climate Control Business employed 669 persons, none of whom are represented by a union, and (c) the Automotive Products Business employed 315 persons, with 27 represented by unions under an agreement expiring in July 2000.

#### RESEARCH AND DEVELOPMENT

The Company incurred approximately \$394,000 in 1997, \$532,000 in 1996, and \$501,000 in 1995 on research and development relating to the development of new products or the improvement of existing products. All expenditures for research and development related to the development of new products and improvements are sponsored by the Company.

#### ENVIRONMENTAL MATTERS

The Company and its operations are subject to numerous Environmental Laws and to other federal, state and local laws regarding health and safety matters ("Health Laws"). In particular, the manufacture and distribution of chemical products are activities which entail environmental risks and impose obligations under the Environmental Laws and the Health Laws, many of which provide for substantial fines and criminal sanctions for violations, and there can be no assurance that material costs or liabilities will not be incurred by the Company in complying with such laws or in paying fines or penalties for violation of such laws. The Environmental Laws and Health Laws and enforcement policies thereunder relating to the Chemical Business have in the past resulted, and could in the future result, in penalties, cleanup costs, or other liabilities relating to the handling, manufacture, use, emission, discharge or disposal of pollutants or other substances at or from the Company's facilities or the use or disposal of certain of its chemical products. Significant expenditures have been incurred by the Chemical Business at the El Dorado Facility in order to comply with the Environmental Laws and Health Laws. The Chemical Business may be required to make additional significant site or operational modifications at the El Dorado Facility, potentially involving substantial expenditures and reduction, suspension or cessation of certain operations. See "Special Note Regarding Forward-Looking Statements;" "Management's Discussion and Analysis of Financial Condition and Results of Operations-Chemical Business" and "Legal Proceedings."

The Arkansas Department of Pollution Control & Ecology ("ADPC&E") performed an environmental inspection at the Chemical Business' El Dorado Facility in 1994, which included a review of the plant's compliance with Environmental Laws relating to wastewater and stormwater discharges, air emissions, and solid and hazardous waste practices. The reports prepared by the ADPC&E in connection with the inspection noted, in part, that releases of contaminants to groundwater were suspected to have occurred at the El Dorado Facility. In 1995, the Chemical Business and the ADPC&E entered into an administrative consent order which provided for penalties of \$150,000 (including \$125,000 to be spent on environmental improvements at the El Dorado Facility), and required the Chemical Business to investigate the nature and extent of the existing groundwater contamination, to take steps to reduce future groundwater contamination, and to address certain other environmental compliance issues at the El Dorado Facility (the "Inspection Consent Order"). Pursuant to the Inspection Consent Order, the Chemical Business installed additional monitoring wells at the El Dorado Facility in accordance with a workplan approved by the ADPC&E, and submitted the test results to ADPC&E. The results indicated that a risk assessment should be conducted on nitrates present in the shallow groundwater. The Chemical Business' consultant has completed this risk assessment, and has forwarded it to the ADPC&E for approval. The risk assessment concludes that, although there are contaminants at the El Dorado Facility and in the groundwater, the levels of such contaminants at the El Dorado Facility and in the groundwater do not present an unacceptable risk to human health and the environment. Based on this conclusion, the Chemical Business' consultant has recommended continued monitoring at the site for five years. The ADPC&E has not yet responded to the Chemical Business' proposal. There can be no assurance that the risk assessment will be approved by the ADPC&E, or that further work will not be required.

In addition, in accordance with the Inspection Consent Order, the Chemical Business currently plans to upgrade the El Dorado Facility's wastewater treatment plant, and anticipates that significant related capital expenditures will be incurred to complete this project. Because the Company is still investigating this matter, the Company cannot predict the amount of such expenditures. Furthermore, the El Dorado Facility's new wastewater permit currently is being reviewed for renewal by the ADPC&E. The new permit may impose additional or more stringent limitations on the plant's wastewater discharges. The Company believes, although there can be no assurance, that any such new limitations would not have a material adverse effect on the Company. See "Special Note Regarding Forward-Looking Statements."

During May 1997, approximately 2,300 gallons of caustic material spilled when a valve in a storage vessel located at the El Dorado Facility failed, resulting in a release of such material to a stormwater drain, and according to ADPC&E records, a minor fish kill in a creek near the El Dorado Facility. The Chemical Business and the ADPC&E are currently negotiating a proposed civil consent administrative order to resolve this matter, which would require the payment of a civil penalty. The Company has received a draft of a proposed consent administrative order from the ADPC&E that, as part of the settlement of claims by the ADPC&E resulting from the spill, includes a proposed \$201,700 civil penalty to be paid by the Chemical Business. The proposed penalty of \$201,700 includes \$125,000 which previously was agreed could be paid under the Inspection Consent Order in the form of environmental improvements at the El Dorado Facility. The proposed consent administrative order is attempting to require the Chemical Business to pay, in cash, the \$125,000 in lieu of allowing the \$125,000 to be paid in the form of improvements at the El Dorado Facility as provided in the Inspection Consent Order. The Company believes that the proposed civil penalty is excessive and intends to seek a reduction to such and to allow the Chemical Business to use the \$125,000 of the proposed \$201,700 penalty in the manner originally provided for in the Inspection Consent Order. The draft of the proposed consent administrative order also requires the Chemical Business to undertake certain additional compliance measures and equipment improvements related to the El Dorado Facility's wastewater treatment system over the next four years. However, in a letter dated March 5, 1998, the U. S. Environmental Protection Agency ("EPA") advised the ADPC&E that the four year time period allowed in the proposed consent administrative order for completion of the additional compliance measures and modifications to the El Dorado Facility's wastewater treatment system may be excessive and has requested further information from the ADPC&E regarding the compliance and modifications. The proposed consent administrative order provides for penalties to be paid by the Chemical Business if it fails to meet any requirements of the proposed order, with such penalties ranging from \$500 per day to \$2,500 per day depending on the number of days that the Chemical Business is not in compliance with such order. Although the Company does not believe the proposed consent administrative order, if completed, will have a material adverse effect on the Company's business, there can be no assurance that penalties and required expenditures related to the order will not have such an effect. See "Special Note Regarding Forward-Looking Statements." The proposed consent administrative order purports to supersede the Inspection Consent Order. If the proposed

consent administrative order is completed in its present form, then, to the extent that the requirements of the proposed consent administrative order have been previously satisfied by the Company (under the Inspection Consent Order or otherwise), the requirements of the proposed consent administrative order will be deemed satisfied upon approval by the ADPC&E. Any consent administrative order settling the spill of nitric acid is subject to final negotiations and finalization of a definitive order.

The El Dorado Facility's air permit required it to cease operation of certain older nitric acid concentrators (the "Older Nitric Acid Concentrators") within a certain period of time after the initiation of operations of the DSN Plant. Due to certain start-up problems with the DSN Plant, including excess emissions from various emission sources, the Chemical Business and the ADPC&E entered into certain agreements, including an administrative consent order (the "Air Consent Order") in 1995 to resolve certain of the Chemical Business' past violations and to permit the Chemical Business to operate the Older Nitric Acid Concentrators until the ADPC&E has made a final decision regarding the El Dorado Facility's air permit, including whether the Older Nitric Acid Concentrators may continue to operate. Although the Company expects that the Chemical Business will be able to continue to operate the Older Nitric Acid Concentrators, there can be no assurance that the ADPC&E will allow it to continue to do so. The Air Consent Order also provides for payment of a civil penalty of \$50,000, which the Chemical Business has paid, and requires installation of certain pollution control equipment and completion of certain maintenance activities at the El Dorado Facility to eliminate certain off-site hazing problems. The Air Consent Order was amended in 1996 and 1997. The second amendment to the Air Consent Order (the "1997 Amendment") provided for certain stipulated penalties of \$1,000 per hour to \$10,000 per day for continued off-site emission events and deferred enforcement for other alleged air permit violations. The 1997 Amendment acknowledges that the Chemical Business has completed the installation of the pollution control equipment and maintenance activities required under the Air Consent Order. Nonetheless, the Chemical Business was assessed an additional penalty of \$150,000, as well as a payment of an additional \$50,000 to fund certain environmental projects, with respect to a number of alleged permit violations relating to off-site emissions and other air permit conditions. The Chemical Business has paid both the penalty and the additional sums required by the 1997 Amendment. Since the 1997 Amendment and as of the date of this Prospectus, the Chemical Business has been assessed stipulated penalties of approximately \$67,000 by the ADPC&E for violations of certain provisions of the 1997 Amendment. The Chemical Business believes that the El Dorado Facility 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 and could have a material adverse effect on the Company. In addition, the El Dorado Facility was identified as one of 33 significant violators of the federal Clean Air Act in a recent review of Arkansas air programs by the EPA Office of Inspector General. The Company is unable to predict the impact, if any, of such designation. See "Special Note Regarding Forward-Looking Statements."

During 1996, the Chemical Business expended approximately \$6.8 million in connection with capital expenditures relating to compliance with federal, state and local Environmental Laws at its El Dorado Facility, including, but not limited to, compliance with the Air Consent Order, as amended. During 1997, the Chemical Business spent approximately \$1.1 million for capital expenditures relating to environmental control facilities at its El Dorado Facility to comply with Environmental Laws, including, but not limited to, the Air Consent Order, as amended, and it is anticipated that such expenditures will total approximately \$0.9 million for 1998 (excluding the implementation of any recommendations made in the Audit Report, as defined under "Legal Proceedings"). No assurance can be made that the actual expenditures of the Chemical Business for such matters will not exceed the estimated amounts by a substantial margin, which could have a material adverse effect on the Company and its financial condition. The amount to be spent during 1998 for capital expenditures related to compliance with Environmental Laws is dependent upon a variety of factors, including, but not limited to, the occurrence of additional releases or threatened releases (particularly air emissions) into the environment, or changes in the Environmental Laws (or in the enforcement or interpretation by any federal or state agency or court of competent jurisdiction). See "Special Note Regarding Forward-Looking Statements." Failure to satisfactorily resolve the pending noncompliance issues with the ADPC&E, or additional orders from the ADPC&E imposing penalties, or requiring the Chemical Business to spend more for environmental improvements or curtail production activities at the El Dorado Facility, could have a material adverse effect on the Company.

The Chemical Business is also involved in various lawsuits pending in federal court relating to environmental issues at the El Dorado Facility similar to the environmental issues discussed above and covered by the Air Consent Order, as amended, with the ADPC&E. The amounts to be spent during

1998, as discussed herein, for compliance with applicable federal, state and local Environmental Laws at the El Dorado Facility do not include expenditures, if any, that may be required to comply with any court order resulting from such lawsuits. See "Business - Legal Proceedings."

## YEAR 2000 ISSUES

Historically, most computer programs have been written using two digits rather than four to define the applicable year. Any of the Company's programs that have time-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. This, in turn, could result in major system failures or miscalculations and is generally referred to as the "Year 2000" problem.

The Company recognizes the need to ensure its operations will not be adversely impacted by the Year 2000 software problem. Starting in 1996 the Company began the process of identifying the changes required to their computer systems to make them Year 2000 compliant. The Company conducted a comprehensive review to identify the systems that could be affected by the Year 2000 problem and developed an implementation plan to address the problem. The Company expects its Year 2000 date implementation plan to be completed by the end of 1998. During the execution of its implementation plan the Company will incur internal staff costs as well as consulting and other expenses related to modifications necessary to prepare the systems for the year 2000. The Company does not anticipate that the Year 2000 problem will pose any significant operational problems or that the expenses incurred will have a material impact on its financial position or results of operation. However, if the modifications and conversions are not completed timely by the Company or its major material and service providers, the Year 2000 problem may have a material impact on the operations of the Company. In addition, the Company has sent to their major material and service providers questionnaires as to whether they are making, or have made, the necessary changes to their computer programs as to the Year 2000 issues. The Company has not received responses to these questionnaires from all of their major material and service providers as of the date of this report. As a result, the Company is unable to determine whether its major material and service providers will have made the necessary modifications in order to comply with the Year 2000 issues or whether such failure to make such modifications will have a material adverse effect on the Company. See "Special Note Regarding Forward-Looking Statements".

## ITEM 2. PROPERTIES

### CHEMICAL BUSINESS

The Chemical Business primarily conducts manufacturing operations (i) on 150 acres of a 1,400 acre tract of land located in El Dorado, Arkansas (the "El Dorado Facility"), (ii) in a facility of approximately 60,000 square feet located on ten acres of land in Hallowell, Kansas ("Kansas Facility") and (iii) in a mixed acid plant in Wilmington, North Carolina ("Wilmington Plant"). The Chemical Business owns all of its manufacturing facilities, with the El Dorado Facility and the Wilmington Plant subject to mortgages. In addition, the Chemical Business has four manufacturing facilities in Australia and one in New Zealand that produce bulk and packaged explosives.

As of December 31, 1997, the El Dorado Facility was utilized at approximately 78% of capacity, based on continuous operation.

The Chemical Business operates its Kansas Facility from buildings located on an approximate ten acre site in southeastern Kansas, and a research and testing facility comprising approximately ten acres, including buildings and equipment thereon, located in southeastern Kansas, which it owns.

In addition, the Chemical Business distributes its products through 31 agricultural and explosive distribution centers. The Chemical Business currently operates 21 agricultural distribution centers, with 15 of the centers located in Texas (12 of which the Company owns and three of which it leases); one center located in Oklahoma which the Company owns; two centers located in Missouri (one of which the Company owns and one of which it leases); and three centers located in Tennessee (all of which the company owns). The Chemical Business currently operates six domestic explosives distribution centers located in Hallowell, Kansas (owned); Bonne Terre, Missouri (owned); Poca, West Virginia (leased); Owensboro and Combs, Kentucky (leased); and Pryor, Oklahoma (leased). The Chemical Business also has four explosives distribution centers in Australia, all of which are leased, and one explosives distribution center located in New Zealand, which is leased.

### CLIMATE CONTROL BUSINESS

The Climate Control Business conducts its fan coil manufacturing operations in a facility located in Oklahoma City, Oklahoma, consisting of

approximately 265,000 square feet. The Company owns this facility subject to a mortgage. As of December 31, 1997, the Climate Control Business was using the productive capacity of the above referenced facilities to the extent of approximately 92%, based on three, eight-hour shifts per day and a five-day week in one department and one and one half eight-hour shifts per day and a five-day week in all other departments.

The Climate Control Business manufactures most of its heat pump products in a leased 270,000 square foot facility in Oklahoma City, Oklahoma, which it leases from an unrelated party. The lease term began March 1, 1988, after renewal in October 1997, and expires February 28, 2003, with options to renew for additional five-year periods, and currently provides for the payment of rent in the amount of \$52,389 per month. The Company also has an option to acquire the facility at any time in return for the assumption of the then outstanding balance of the lessor's mortgage. As of December 31, 1997, the productive capacity of this manufacturing operation was being utilized to the extent of approximately 75%, based on two twelve-hour shifts per day and a seven-day week in one department and one eight-hour shift per day and a five-day week in all other departments.

All of the properties utilized by the Climate Control Business are considered by the Company management to be suitable and adequate to meet the current needs of that Business.

#### AUTOMOTIVE PRODUCTS BUSINESS

The Automotive Products Business conducts its operations in plant facilities principally located in Oklahoma City, Oklahoma which are considered by Company management to be suitable and adequate to meet its needs. One of the manufacturing facilities occupies a building owned by the Company, subject to mortgages, totaling approximately 178,000 square feet. The Automotive Products Business also uses additional manufacturing facilities located in Oklahoma City, Oklahoma, owned and leased by the Company totaling approximately 158,000 square feet. During 1997, the Automotive Products Business under utilized the productive capacity of its facilities.

International Bearings, Inc. ("IBI"), a subsidiary of the Company operating as a separate entity within the Automotive Products Division, operates from a Company owned warehouse of approximately 45,000 square feet in an industrial park section of Memphis, Tennessee.

#### INDUSTRIAL PRODUCTS BUSINESS

The Company owns several buildings, some of which are subject to mortgages, totaling approximately 360,000 square feet located in Oklahoma City and Tulsa, Oklahoma, which the Industrial Products Business uses for showrooms, offices, warehouse and manufacturing facilities. The Company also owns real property located near or adjacent to the above-referenced buildings in Oklahoma City, Oklahoma, which the Industrial Products Business uses for parking and storage. The Company also leases facilities in Middletown, New York containing approximately 25,000 square feet for manufacturing operations.

The Industrial Products Business also leases a facility from an entity owned by the immediate family of the Company's President, which facility occupies approximately seven acres in Oklahoma City, Oklahoma, with buildings having approximately 44,000 square feet. The Industrial Products Business also leases an office in Europe to coordinate its European activities.

All of the properties utilized by the Industrial Products Business are considered by Company management to be suitable and adequate to meet the needs of the Industrial Products Business.

#### ITEM 3. LEGAL PROCEEDINGS

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 the subsidiaries of \$47,000. The site owner rejected this offer and proposed a counteroffer of \$245,000 plus a reopener for costs over \$12.5 million. The EPA rejected the Company's 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 cleanup of the site is unknown due to continuing changes in the estimated total cost of cleanup 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 December 31, 1997, the Company has accrued an amount based on a recent preliminary settlement proposal by the alleged potential responsible parties; however, there is no assurance such proposal will be accepted. Such amount 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. The subsidiary's insurance carriers have been notified of this matter; however, the amount of possible coverage, if any, is not yet determinable.

Roy Carr, et al. v. El Dorado Chemical Company ("Carr Case"); Richard Detraz, et al. v. El Dorado Chemical Company ("Detraz Case"); Roy A. Carr, Sr., et al. v. El Dorado Chemical Company ("Citizen Suit"). The Carr Case, which was filed against EDC on June 26, 1996, the Detraz Case, which was filed against EDC on October 14, 1996, and the Citizen Suit, which was filed against EDC on October 17, 1996, are pending in the United States District Court, Western District of Arkansas, El Dorado Division. The plaintiffs in the Carr Case and the Citizen Suit reside in the area surrounding EDC's El Dorado Facility, while the plaintiffs in the Detraz Case reside in various locations throughout the El Dorado, Arkansas, metropolitan area. Because the parties to the Carr Case and the Citizen Suit are substantially the same, and the cases allege similar facts, the court consolidated these two cases, although they are based on different legal theories. The plaintiffs in the Citizen Suit allege violations of the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), as amended by the Emergency Planning Community Right-To-Know Act ("EPCRA"), the Clean Air Act and the Clean Water Act, and permits issued to EDC under certain of these laws. Under the terms of such laws, the plaintiffs in the Citizen Suit are seeking penalties of up to \$25,000 for each day in which EDC violated such acts, if any, and injunctive relief requiring EDC to remediate any such alleged violations and relating to future violations. The plaintiffs in the Carr Case seek an unspecified amount of damages under various toxic tort theories for alleged bodily injury and property damage resulting from alleged releases of toxic substances into the environment from the El Dorado Facility, as well as punitive damages and damages for any diminution in the value of plaintiffs' property resulting from the alleged releases. The Detraz Case, like the Carr Case, is based on various toxic tort theories. The plaintiffs in the Detraz Case are seeking to have the case certified as a class action for persons who allegedly have been affected by emissions from the El Dorado Facility, which certification EDC is contesting. During the first quarter of 1998, the Company's Chemical Business agreed in principal to settle the Carr Case, Detraz Case and Citizen Suit. The settlements of the Carr Case and the Detraz Case, if completed, will require certain payments to be made to the plaintiffs, which payments will be funded primarily by the Company's EIL Insurance (as defined below). The settlement of the Citizen Suit, if completed, will require the Company's Chemical Business to implement at the El Dorado Facility and at the Company's expense the reasonable and necessary environmentally related recommendations made in the Audit Report discussed and defined below in connection with the Carr Case. Based on what the Company has been orally advised by the environmental engineering firm performing the evaluation, the Company does not believe that the implementation of such recommendations, if any, will have a material adverse effect on the Company. See "Special Note Regarding Forward-Looking Statements." The settlement in the Carr Case, Detraz Case and Citizen Suit are subject to finalization of definitive settlement agreements. The settlement of the Detraz Case will be subject, among other things, to court approval, while the settlement of the Citizen Suit will be subject, among other things, to approval by the court or the United States Environmental Protection Agency.

In January 1997, EDC entered into an agreed order (the "Carr Order") in the Carr Case pursuant to which EDC agreed (i) not to emit substances from the El Dorado Facility which create a nuisance on the plaintiffs' property (as defined in the Carr Order to include any off-site haze that reaches the plaintiffs' property), (ii) to operate in compliance with emission limitations and certain other requirements established by EDC's permit for the El Dorado Facility, (iii) to establish a system for monitoring and reporting (including to the plaintiffs) permit exceedences and releases of reportable quantities of hazardous substances. The Carr Order further provides that the court shall retain jurisdiction of the issues covered by the Carr Order for the purposes of enabling the parties in the Carr Case to apply to the court for any order that may be necessary to interpret, carry out, modify or enforce the Carr Order. In connection with the Carr Order, the plaintiffs have filed two motions for contempt against EDC for violations, or alleged violations, of the Carr Order. On one occasion, the court held that EDC had created a nuisance at the property of one of the plaintiffs as a result of certain emissions from the El Dorado Facility and assessed a \$500 penalty against EDC and ordered EDC

to pay plaintiffs' attorneys' fees in connection with bringing such motion. The plaintiffs in the Carr Case withdrew the other motion for contempt pending an audit of the operation of the El Dorado Facility. The parties to the Carr Case entered into an audit agreement to evaluate facility operations and emissions by an environmental engineering firm, which environmental engineering firm has issued an audit report as to its findings ("Audit Report"). Other incidents have occurred or may occur in the future which could, if the Carr Case is not settled as discussed above, give rise to the filing of additional motions for contempt alleging violations of the Carr Order, and, if the Company is found to have violated the Carr Order, it could result in the possible assessment of additional fines, penalties and costs against EDC that could have a material adverse effect on the Company and/or the Chemical Business. See "Special Note Regarding Forward-Looking Statements." If the Carr Case is settled as discussed above, then the Carr Order would be terminated as part of such settlement.

The Chemical Business maintains an Environmental Impairment Insurance Policy ("EIL Insurance") that provides coverage to the Chemical Business for certain discharges, dispersal, releases, or escapes of certain contaminants and pollutants into or upon land, the atmosphere or any water course or body of water from the El Dorado Facility, which has caused bodily injury, property damage or contamination to others or to other property not located on the El Dorado Facility site. The EIL Insurance provides limits of liability for each loss up to \$10 million, except \$5 million for all remediation expenses, with the maximum limit of liability for all claims under the EIL Insurance not to exceed \$10 million for all losses and remediation expenses. The EIL Insurance also provides for a retention of the first \$500,000 per loss or remediation expense to be paid by the Chemical Business. The Chemical Business has given notice of the pending legal actions in the Carr Case, the Detraz Case and the Citizen Suit to the EIL Insurance carrier ("EIL Carrier"), and the EIL Carrier has agreed to provide a defense for the Company in each case. The defense regarding the Citizen Suit has been undertaken by the EIL Carrier subject to a reservation of rights, indicating that the EIL Carrier may make a determination that it does not believe that any liability in the Citizen Suit is covered by the EIL Insurance, and, on that basis, deny coverage regarding the Citizens Suit and seek reimbursement of its related legal expenditures paid in connection with the Citizen Suit. The Company believes that the EIL Insurance will provide coverage for actual damages, if any, sustained by the plaintiffs in the Carr Case and the Detraz Case up to the limits of the policy in excess of the \$500,000 retention, but will not provide coverage for punitive damages, and may not provide coverage for the costs of injunctive relief and penalties resulting from the litigation. As of January 26, 1998, the Company had submitted claims to the EIL Carrier of approximately \$1.2 million for legal and consulting fees and expenses, or approximately \$700,000 in excess of the self-insured retention. The EIL Carrier has reimbursed the Chemical Business for \$405,000 of such fees and expenses (after taking into account the amount of the retention under the EIL Insurance) and has agreed to pay such future fees and expenses, subject to reservation of rights relating to the Citizen Suit. The amount of the settlements of the Carr Case and the Detraz Case, if completed, and the amount paid under the EIL Insurance for legal and other expenses relating to the defense of the Carr Case, Detraz Case and Citizen Suit reduce the amount that may be paid under the EIL Insurance.

Arch Mineral Corporation, et al. v. ICI Explosives USA, Inc., et al. On May 24, 1996, the plaintiffs filed this civil cause of action against EDC and five 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. This cause of action is pending in the United States District Court, Southern District of Indiana. The plaintiffs are suing for an unspecified amount of damages, which, pursuant to statute, plaintiffs are seeking be trebled, together with costs. Plaintiffs are also seeking a permanent injunction enjoining defendants from further alleged anti-competitive activities. Based on the information presently available to EDC, EDC does not believe that EDC conspired with any party, including, but not limited to, the five other defendants, to fix prices in connection with the sale of commercial explosives. Discovery has only recently commenced in this matter. EDC intends to vigorously defend itself in this matter. See "Special Note Regarding Forward-Looking Statements."

ASARCO v. ICI, et al. The U. S. District Court for the Eastern District of Missouri has granted ASARCO and other plaintiffs in a lawsuit originally brought against various commercial explosives manufacturers in Missouri, and consolidated with other lawsuits in Utah, leave to add EDC as a defendant in that lawsuit. This lawsuit alleges a national conspiracy, as well as a regional conspiracy, directed against explosive customers in Missouri and seeks unspecified damages. EDC 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 Arch case discussed above. Based on the information presently available to EDC, EDC does not believe that EDC

conspired with any party, to fix prices in connection with the sale of commercial explosives. EDC intends to vigorously defend itself in this matter. See "Special Note Regarding Forward-Looking Statements."

Department of Justice Investigation of Explosives Industry. For several years, certain members of the explosives industry have been the focus of grand jury investigations being conducted by the DOJ in connection with criminal antitrust allegations involving price fixing. Certain explosives companies, other than the Company, including all the Company's major competitors, and individuals employed by certain of those competitors, were indicted and have pled guilty to criminal antitrust violations. The guilty pleas have resulted in a total of nearly \$40 million in criminal fines. In connection with the grand jury investigation, the Company's Chemical Business received and has complied with two document subpoenas, certain of the Company's Chemical Business employees have been interviewed by the DOJ under grants of immunity from prosecution, and certain of the Company's Chemical Business employees have testified under subpoena before a grand jury under grants of immunity in connection with the investigation. The Company believes that it has cooperated fully with the government's investigation. Recently, the Company had been informed by an official of the DOJ that it was not currently a target of the above investigation or of any grand jury investigating criminal antitrust activity in the explosives or ammonium nitrate industries. See "Special Note Regarding Forward-Looking Statements."

Eugene Lowe, et al. v. Teresa Trucking, Inc., pending in the Circuit Court of Lincoln County, West Virginia. During the third quarter of 1997, EDC was served with this lawsuit in which approximately 27 plaintiffs have sued approximately 13 defendants, including EDC, 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 EDC to provide blasting materials and personnel to load and shoot holes drilled by employees of Heartland. Down hole blasting services were provided by EDC at Heartland's premises from approximately August 1991, until approximately August 1994. Subsequent to August 1994, EDC supplied blasting materials to the reclamation contractor at Heartland's mine. In connection with EDC's activities at Heartland, EDC has entered into a contractual indemnity to Heartland to indemnify Heartland under certain conditions for acts or actions taken by EDC or for which EDC failed to take, and Heartland is alleging that EDC 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. EDC has provided notification of this lawsuit to its three insurance carriers providing primary insurance coverage to EDC during the period covered by the plaintiff's allegations. The one insurance carrier whose policy provides for defense has indicated it will share in the defense of this lawsuit. The remaining two insurance carriers have indicated that they will be defending this lawsuit under a reservation of rights. Based on information provided to EDC by its counsel handling this matter, the Company does not believe that this matter will have a material adverse effect on the Company.

#### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

#### ITEM 4A. EXECUTIVE OFFICERS OF THE COMPANY

##### IDENTIFICATION OF EXECUTIVE OFFICERS

The following table identifies the executive officers of the Company.

Name	Age	Position and Offices with the Company	Served as an Officer from
Jack E. Golsen	69	Board Chairman and President	December, 1968
Barry H. Golsen	47	Board Vice Chairman and President of the Environmental Control Business	August, 1981
David R. Goss	57	Senior Vice President of	March, 1969

		Operations and Director	
Tony M. Shelby	56	Senior Vice President - Chief Financial Officer, and Director	March, 1969
Jim D. Jones	56	Vice President - Treasurer and Corporate Controller	April, 1977
David M. Shear	38	Vice President and General Counsel	March, 1990

The Company's officers serve one-year terms, renewable on an annual basis by the Board of Directors. All of the individuals listed above have served in substantially the same capacity with the Company and/or its subsidiaries for the last five years. In March 1996, the Company executed an employment agreement (the "Agreement") with Jack E. Golsen for an initial term of three years followed by two additional three year terms. The Agreement automatically renews for each successive three year term unless terminated by either the Company or Jack E. Golsen giving written notice at least one year prior to the expiration of the then three year term.

#### FAMILY RELATIONSHIPS

The only family relationship that exists among the executive officers of the Company is that Jack E. Golsen is the father of Barry H. Golsen.

### PART II

#### ITEM 5. MARKET FOR THE COMPANY'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

##### MARKET INFORMATION

The Company's Common Stock trades on the New York Stock Exchange, Inc. ("NYSE"). The following table shows, for the periods indicated, the high and low closing sales prices for the Company's Common Stock.

	Fiscal Year Ended December 31,			
	1997		1996	
Quarter	High	Low	High	Low
First	5 1/4	4 1/8	6 3/8	3 1/2
Second	5	4	6 1/4	4 5/8
Third	5	3 5/8	5 1/8	3 1/2
Fourth	5 13/16	3 5/8	5	3 1/2

##### STOCKHOLDERS

As of February 28, 1998, the Company had 1,058 record holders of its Common Stock.

##### DIVIDENDS

Holders of the Company's Common Stock are entitled to receive dividends only when, as, and if declared by the Board of Directors. No dividends may be paid on the Company's Common Stock until all required dividends are paid on the outstanding shares of the Company's Preferred Stock, or declared and amounts set apart for the current period, and, if cumulative, prior periods. The Company has issued and outstanding as of December 31, 1997, 915,000 shares of \$3.25 Convertible Exchangeable Class C Preferred Stock, Series 2 ("Series 2 Preferred"), 1,539 shares of a series of Convertible Non Cumulative Preferred Stock ("Non Cumulative Preferred Stock") and 20,000 shares of Series B 12% Convertible, Cumulative Preferred Stock ("Series B Preferred"). Each share of Preferred Stock is entitled to receive an annual dividend, if, as and when declared by the Board of Directors, payable as follows: (i) Series 2 Preferred at the rate of \$3.25 a share payable quarterly in arrears on March 15, June 15, September 15 and December 15, which dividend is cumulative, (ii) Non Cumulative Preferred Stock at the rate of \$10.00 a share payable April 1, and (iii) Series B Preferred at the rate of \$12.00 a share payable January 1, which dividend is cumulative. The Company has a policy as to the payment of

annual cash dividends on its outstanding Common Stock of \$.06 per share, payable at \$.03 per share semiannually, subject to change or termination by the Board of Directors at any time. The Company paid a cash dividend of \$.03 a share on its outstanding Common Stock on July 1, 1997, and January 1, 1998; however, there are no assurances that this policy will not be terminated or changed by the Board of Directors. See Notes 8, 9 and 10 of Notes to Consolidated Financial Statements.

Under the terms of a loan agreement between the Company and its lender, the Company may, so long as no event of default has occurred and is continuing under the loan agreement, make currently scheduled dividends and pay dividends on its outstanding Preferred Stock and pay annual dividends on its Common Stock equal to \$.06 per share. See Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" for a discussion of the financial covenants which the Company's failure to maintain could result in an event of default. In addition, the loan agreement with the lender includes as an event of default an ownership change if any Person (except Jack E. Golsen or members of his Immediate Family and any entity controlled by Jack E. Golsen or members of his Immediate Family together with such Person's affiliates and associates), is or becomes the beneficial owner, directly or indirectly, of more than fifty percent (50%) of the outstanding Common Stock of the Company. The term "Immediate Family" of any Person means the spouse, siblings, children, mothers and mothers-in-law, fathers and fathers-in-law, sons and daughters-in-law, daughters and sons-in-law, nieces, nephews, brothers and sisters-in-law, and sisters and brothers-in-law.

The Company is a holding company and, accordingly, its ability to pay dividends on its Preferred Stock and its Common Stock is dependent in large part on its ability to obtain funds from its subsidiaries. The ability of ClimaChem and its wholly owned subsidiaries to pay dividends to the Company, to fund the payment of dividends by the Company, or for other purposes, is restricted by certain covenants contained in the Indenture to which they are parties.

Under the terms of the Indenture, ClimaChem cannot transfer funds to the Company in the form of cash dividends or other distributions or advances, except 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. See Note 5 of Notes to Consolidated Financial Statements and Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations".

On February 17, 1989, the Company's Board of Directors declared a dividend to its stockholders of record on February 27, 1989, of one Preferred Stock purchase right on each of the Company's outstanding shares of Common Stock. The rights expire on February 27, 1999. The Company issued the rights, among other reasons, in order to assure that all of the Company's stockholders receive fair and equal treatment in the event of any proposed takeover of the Company and to guard against partial tender abusive tactics to gain control of the Company. The rights will become exercisable only if a person or group acquires beneficial ownership of 30% or more of the Company's Common Stock or announces a tender or exchange offer the consummation of which would result in the ownership by a person or group of 30% or more of the Common Stock, except any acquisition by Jack E. Golsen, Chairman of the Board and President of the Company, and certain other related persons or entities.

Each right (other than the rights, owned by the acquiring person or members of a group that causes the rights to become exercisable, which become void) will entitle the stockholder to buy one one-hundredth of a share of a new series of participating Preferred Stock at an exercise price of \$14.00 per share. Each one one-hundredth of a share of the new Preferred Stock purchasable upon the exercise of a right has economic terms designed to approximate the value of one share of the Company's Common Stock. If another person or group acquires the Company in a merger or other business combination transaction, each right will entitle its holder (other than rights owned by that person or group, which become void) to purchase at the right's then current exercise price, a number of the acquiring company's common shares which at the time of such transaction would have a market value two times the exercise price of the right. In addition, if a person or group (with certain exceptions) acquires 30% or more of the Company's outstanding Common Stock, each right will entitle its holder, (other than the rights owned by the acquiring person or members of the group that results in the rights becoming exercisable, which become void), to purchase at the right's then current exercise price, a number of shares of the Company's Common Stock having a market value of twice the right's exercise price in lieu of the new Preferred Stock.

Following the acquisition by a person or group of beneficial ownership of 30% or more of the Company's outstanding Common Stock (with certain exceptions) and prior to an acquisition of 50% or more of the Company's Common Stock by the person or group, the Board of Directors may exchange the rights (other than rights owned by the acquiring person or members of the group that results in the rights becoming exercisable, which become void), in whole or in part, for shares of the Company's Common Stock. That exchange would occur at an exchange ratio of one share of Common Stock, or one one-hundredth of a share of the new series of participating Preferred Stock, per right.

Prior to the acquisition by a person or group of beneficial ownership of 30% or more of the Company's Common Stock (with certain exceptions) the Company may redeem the rights for one cent per right at the option of the Company's Board of Directors. The Company's Board of Directors also has the authority to reduce the 30% thresholds to not less than 10%.

During 1997, the following securities were sold by the Company in transactions not registered under the Securities Act of 1933, as amended ("Securities Act"):

1. Common Stock sold pursuant to the exercise of Non-Qualified Stock Options;
  - (a) On May 29, 1997, 15,000 shares of Common Stock were sold by the Company to Dr. Robert C. Brown, a director of the Company, in connection with the exercise of a Non-Qualified Stock Option Agreement granted to Dr. Brown on June 1, 1992. The exercise price paid by Dr. Brown was \$3.125 per share, being the fair market value of such stock on the date of grant of the Non-Qualified Stock Option.
  - (b) On May 29, 1997, 15,000 shares of Common Stock were sold by the Company to Bernard Ille, a director of the Company, upon the exercise of a Non-Qualified Stock Option Agreement granted to Mr. Ille on June 1, 1992. The exercise price paid by Mr. Ille was \$3.125 per share, being the fair market value of such stock on the date of grant of the Non-Qualified Option.
  - (c) On May 29, 1997, 5,000 shares of Common Stock were sold by the Company to Dr. Jerome Shaffer, a director of the Company, upon the exercise of a Non-Qualified Stock Option Agreement, granted to Dr. Shaffer on June 1, 1992. The exercise price paid by Dr. Shaffer was \$3.125 per share, being the fair market value of such stock on the date of grant of the Non-Qualified Option.
  - (d) The shares of Common Stock sold to Drs. Brown and Shaffer and Mr. Ille described in (a), (b), and (c) above exempt from registration under Section 4(2) of the Securities Act since Drs. Brown and Shaffer and Mr. Ille are members of the Board of Directors of the Company.
2. On November 26, 1997, the Company's wholly owned subsidiary, ClimaChem, Inc., ("ClimaChem"), sold \$105 million of senior notes due 2007 (the "Notes") in a transaction exempt from registration under Section 4(2) of the Securities Act. The Notes were sold by ClimaChem to Wasserstein Perella Securities, Inc., (the "initial Purchaser"), and the Initial Purchaser resold the Notes to qualified institutional buyers in reliance on Rule 144A under the Securities Act. The \$105 million in Notes were sold by ClimaChem to the Initial Purchaser at a discount or commission of 3.000% or an aggregate discount or commission of \$3,150,000.

ITEM 6. SELECTED FINANCIAL DATA

Years ended December 31,				
1997	1996	1995	1994	1993
-----	-----	-----	-----	-----

(Dollars in Thousands,  
except per share data)

Selected Statement of  
Operations Data:

Net sales	\$313,929	\$307,160	\$267,391	\$245,025	\$232,616
	=====	=====	=====	=====	=====
Total Revenues	\$320,189	\$314,051	\$274,115	\$249,969	\$237,529
	=====	=====	=====	=====	=====
Interest expense	\$ 14,740	\$ 10,017	\$ 10,131	\$ 6,949	\$ 7,507
	=====	=====	=====	=====	=====
Income (loss) from continuing operations before extraordinary charge	\$(18,446)	\$(3,845)	\$(3,732)	\$ 983	\$ 11,235
	=====	=====	=====	=====	=====
Net income (loss)	\$(23,065)	\$(3,845)	\$(3,732)	\$ 24,467	\$ 12,399
	=====	=====	=====	=====	=====
Net income (loss) applicable to common stock	\$(26,294)	\$(7,074)	\$(6,961)	\$ 21,232	\$10,357
	=====	=====	=====	=====	=====
Basic earnings (loss) per common share (1):					
Income (loss) from continuing operations before extraordinary charge	\$ (1.68)	\$ (.55)	\$ (.53)	\$ (.17)	\$ .77
	=====	=====	=====	=====	=====
Net income (loss)	\$ (2.04)	\$ (.55)	\$ (.53)	\$ 1.57	\$ .87
	=====	=====	=====	=====	=====

(1) Diluted earnings per common share related to income from continuing operations and net income were \$.66 and \$.74 in 1993, respectively.

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ITEM 6. SELECTED FINANCIAL DATA (CONTINUED)

	Years ended December 31,				
	1997	1996	1995	1994	1993
	-----				
	(Dollars in Thousands, except per share data)				
Selected Balance Sheet Data:					
Total Assets	\$270,653	\$261,560	\$238,176	\$221,281	\$196,038
	=====	=====	=====	=====	=====
Long-term debt, including current portion	\$180,941	\$132,284	\$118,280	\$ 91,681	\$ 90,395
	=====	=====	=====	=====	=====
Redeemable preferred stock	\$ 146	\$ 146	\$ 149	\$ 152	\$ 155
	=====	=====	=====	=====	=====
Stockholders' Equity	\$ 44,496	\$ 74,018	\$ 81,576	\$ 90,599	\$74,871
	=====	=====	=====	=====	=====
Selected other Data:					
Cash dividends declared per common share	\$ .06	\$ .06	\$ .06	\$ .06	\$ .06
	=====	=====	=====	=====	=====

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with a review of the Company's December 31, 1997 Consolidated Financial Statements, Item 6 "SELECTED FINANCIAL DATA" and Item 1 "BUSINESS" included elsewhere in this report.

Certain Statements contained in this "Management's Discussion and

Analysis of Financial Conditions and Results of Operations" may be deemed forward-looking statements. See "Special Note Regarding Forward-Looking Statements".

## OVERVIEW

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 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 nor does it have the potential to do so. In this connection, the Company is developing a plan, subject to the approval of the Board of Directors, to dispose of all non-core and/or non-earning assets. The Company has been concentrating on reshaping the Automotive Products Business by the liquidation of certain of their assets that don't have the potential to earn an acceptable return and focusing on product lines that management believes have strategic advantages within select niche markets. The Company continues to explore its alternatives to accomplish these goals.

In addition, the Company has been liquidating certain slow moving inventory in the Industrial Products Business in the ordinary course of business. It is the present intention of the Company to limit this Business to lines of machine tools which should result in an acceptable return on capital employed.

Certain statements contained in this Overview are forward-looking statements, and the results thereof could differ materially from such statements if the Company is unable to liquidate such assets in a reasonable period or on reasonable terms, and if able to liquidate such assets, it may not be able to improve profits in the Automotive Products Business or have an acceptable return on capital employed in these Businesses if general economic conditions deteriorate drastically from the environment these Businesses currently operate in or these Businesses are unable to meet competitive pressures in the market place which restrict these Businesses from manufacturing or purchasing and selling their products at acceptable prices.

The following table contains certain of the information from Note 13 of Notes to the Company's Consolidated Financial Statements about the Company's operations in different industry segments for each of the three years in the period ended December 31, 1997.

	1997	1996	1995
----- (In Thousands) -----			
Sales:			
Chemical	\$ 156,949	\$ 166,163	\$ 136,903
Climate Control	105,909	89,275	83,843
Industrial Products	15,572	13,776	13,375
Automotive Products	35,499	37,946	33,270
	-----	-----	-----
	\$ 313,929	\$ 307,160	\$ 267,391
	=====	=====	=====
Gross profit: (1)			
Chemical	\$ 19,320	\$ 25,885	\$ 26,050
Climate Control	29,552	21,961	21,694
Industrial Products	3,776	3,058	2,953
Automotive Products	3,299	5,868	6,366
	-----	-----	-----
	\$ 55,947	\$ 56,772	\$ 57,063
	=====	=====	=====
Operating profit (loss): (2)			
Chemical	\$ 5,479	\$ 10,971	\$ 13,393
Climate Control	8,895	5,362	4,630
Industrial Products	(993)	(2,685)	(1,199)
Automotive Products	(7,251)	(4,134)	(3,704)
	-----	-----	-----
	6,130	9,514	13,120
General corporate expenses, net	(9,786)	(3,192)	(6,571)
Interest Expense	(14,740)	(10,017)	(10,131)
	-----	-----	-----

Loss from continuing operations before provision for income taxes and extraordinary charge	\$(18,396)	\$ (3,695)	\$ (3,582)
	=====	=====	=====

Identifiable assets:

Chemical	\$ 137,570	\$ 132,718	\$ 111,890
Climate Control	49,274	50,623	41,331
Industrial Products	9,929	13,614	17,328
Automotive Products	42,718	43,212	43,872
	-----	-----	-----
	239,491	240,167	214,421
Corporate assets	31,162	21,393	23,755
	-----	-----	-----
Total assets	\$ 270,653	\$ 261,560	\$ 238,176
	=====	=====	=====

- (1) Gross profit by industry segment represents net sales less cost of sales.
- (2) Operating profit by industry segment represents revenues less operating expenses before deducting general corporate expenses, interest expense and income taxes.

CHEMICAL BUSINESS

The Company has grown the Chemical Business through the expansion of its El Dorado Facility and the acquisition of new agricultural distribution centers in key geographical markets that are freight logical to the El Dorado Facility. During the period from December 31, 1995 through December 31, 1997, the net investment in assets of the Chemical Business was increased from \$111.9 million to \$137.6 million primarily due to the construction of additional capacity to benefit future periods.

Beginning in 1994, the results of operations of the Chemical Business have been adversely impacted by the high cost of anhydrous ammonia. From its most recent cyclical low in 1986 through 1993, the average Gulf Coast price (the "Spot Price") of anhydrous ammonia was approximately \$100 per ton. During 1994 and in each of the years since, a tightness in supply developed which resulted in an increase in the Spot Price of anhydrous ammonia to an average of approximately \$195 per ton. The Company believes that the tightness in supply of anhydrous ammonia that emerged in 1994 was a result of increased industrial usage as the U.S. economy grew, a net consolidation of the domestic capacity and a disruption in supply coming from the former Soviet Union. Although prices for anhydrous ammonia vary considerably from month to month, the annual average price has remained high for each of the last three years. The Company currently 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 Spot Price of anhydrous ammonia. The higher prices have been partially passed on to customers; however, the entire cost increase could not be offset resulting in lower gross profit margins during each of the periods since the increase. The company believes there is approximately 2 million tons of additional capacity being constructed in the western hemisphere scheduled for completion in 1998 and 1999. The Company believes this additional capacity may contribute to a decline in the market price of anhydrous ammonia.

During 1994, the Company undertook construction of the DSN Plant. The DSN Plant began operations in 1995, but due to certain mechanical and design problems, production of concentrated nitric acid during the twelve months ended December 31, 1997 was limited to an average of 170 tons per day, assuming 338 days of annual production or 60% of the stated capacity of 285 tons per day. The limitations on production resulted in significant fixed costs being expended as period costs during the second half of 1996, and the first half of 1997, 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 DSN Plant up to the stated capacity. During the annual maintenance turnaround in September 1997, management implemented corrective actions which it believes allow the DSN Plant to operate at its stated capacity, depending upon customer specifications, and to fully absorb the costs and produce a quality product. In early October 1997, the DSN Plant was restarted and is currently operating at approximately 260 tons per day due to inventory constraints and customer specifications.

During July 1997, a subsidiary of the Company entered into an agreement with Bayer Corporation whereby the Company's subsidiaries would act 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 units 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 on current market conditions, the plant should generate approximately \$50 million in annual revenues. Construction is scheduled to be completed by the end of 1998.

The Chemical Business' Australian subsidiary, TES, results of operations 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 TES services. If these adverse economic conditions in Asia continue for an extended period of time, such could have an adverse effect on the Company's consolidated results of operations for 1998.

#### CLIMATE CONTROL

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

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

As indicated in the above table, the Climate Control Business reported improved sales (an increase of 18.6%) and improved operating profit for 1997 as compared to 1996. From December 1995 through December 1997 the net investment in assets of the Climate Control Business was increased from \$41.3 million to \$49.3 million. During this two year period, additions to property, plant and equipment were \$2.7 million and depreciation was approximately \$3.1 million.

#### AUTOMOTIVE AND INDUSTRIAL PRODUCTS BUSINESSES

As indicated in the above table, during 1997, 1996 and 1995, respectively, the Automotive and Industrial Products Businesses recorded combined sales of \$51.1 million, \$51.7 million and \$ 46.6 million, respectively, and reported operating losses (as defined above) of \$8.2 million, \$6.8 million, and \$4.9 million in 1997 and 1996, and 1995 respectively. The net investment in assets of these Businesses was \$52.6 million, \$56.8 million and \$61.2 million at year end 1997, 1996 and 1995, respectively. While the Company's investment in these businesses has declined from \$61.2 million in 1995 to \$52.6 million in 1997, the Company expects to realize further reductions in future periods as it implements its proposed plan to dispose of non-core and non-earning assets.

#### RESULTS OF OPERATIONS

YEAR ENDED DECEMBER 31, 1997 COMPARED TO YEAR ENDED DECEMBER 31, 1996

##### REVENUES

Total revenues for 1997 and 1996 were \$320.2 million and \$314.1 million, respectively (an increase of \$6.1 million or 1.9%). Sales increased \$6.8 million or 2.2%.

##### NET SALES

Consolidated net sales for 1997 were \$313.9 million, compared to \$307.2 million for 1996, an increase of \$6.8 million or 2.2%. This sales increase resulted principally from: (i) increased sales in the Climate Control Business of \$16.6 million, primarily due to increased sales of heat pumps; and (ii) increased sales of \$1.8 million in the Industrial Products Business due to increased machine tool sales; partially offset by (iii) decreased sales of \$2.4 million in the Automotive Products Business due to less units being shipped and product mix; and (iv) decreased sales in the Chemical Business of \$9.2 million primarily due to reduced sales of the Company's wholly-owned Australian subsidiary, because of the expiration of certain customer contracts and recent economic developments in Asia.

##### GROSS PROFIT

Gross profit decreased \$.8 million and was 17.8% of net sales for 1997, compared to 18.5% of net sales for 1996. The gross profit percentage declined in the Automotive Products and Chemical Businesses, but improved in the

## Climate Control and Industrial Products Businesses.

The gross profit of the Chemical Business was adversely affected by higher production costs due to (i) the higher cost of anhydrous ammonia which was only partially passed on in the form of higher selling prices, (ii) unabsorbed overhead costs caused by down time related to modifications made to resolve problems associated with mechanical failures, and (iii) environmental matters at the Chemical Business' primary manufacturing plant. These increased costs in 1997 were partially offset by a reduction in cost of sales of \$2.1 million through recapture of manufacturing variances of the Chemical Business in the form of business interruption insurance settlements.

The primary reasons for the decline in gross profit percentage in the Automotive Products Business were (i) less favorable customer mix i.e. decreased sales to higher margin retail customers, and increased sales to Original Equipment Manufacturer (OEM) customers which are lower margin customers, and (ii) increases in manufacturing expenses in excess of increases in production cost absorption attributable to new product lines that have been developed.

These gross profit declines have been partially offset by gross profit percentage increases due to sales of machine tools carrying a higher gross profit percentage in the Industrial Products Business and increased absorption of costs due to higher production volumes and focus on sales of more profitable product lines in the Climate Control Business.

## SELLING, GENERAL AND ADMINISTRATIVE EXPENSE

Selling, general and administrative expenses ("SG&A"), as a percent of net sales, were 21.0% in 1997 and 18.7% in 1996. SG&A, as a percent of sales, was approximately 9.8% in 1997 compared to 9.3% in 1996 for the Chemical Business; 21.0% in 1997 compared to 19.8% in 1996 for the Climate Control Business; 32.1% in 1997 compared to 29.5% in 1996 for the Automotive Products Business; and 33.4 % in 1997 compared to 44.4% in 1996 for the Industrial Products Business.

The increase in the Chemical Business was the result of lower sales in 1997 with relatively constant SG&A expenses. Within SG&A of the Chemical Business, lower provisions for uncollectible accounts receivable in 1997 were offset by increased expenses at the Company's Australian subsidiary in anticipation of sustaining a higher level of business activity. The increase in the Climate Control Business' SG&A was the result of increases in sales personnel costs to support higher sales in future periods, additional information technology personnel to support management information systems changes and higher freight costs due to a change in sales mix toward greater domestic sales which carry a higher SG&A percent. The increase in the Automotive Products Business was due to lower sales and increased advertising expenses expected to benefit future periods. The decrease in the Industrial Products Business resulted from lower bad debt expenses and lower advertising expenses compounded by higher sales.

In addition to the variances described above, approximately \$2.2 million of the total SG&A increase of \$8.5 million is due to the operations of the Tower in 1997 as discussed elsewhere in this report and approximately \$2.8 million is due to increased legal fees, settlement accruals and loss reserves in 1997 over 1996 to assert the Company's position in various legal proceedings, joint ventures and debt guarantees as discussed more completely elsewhere in this Management's Discussion and Analysis of Financial Condition and Results of Operations.

## INTEREST EXPENSE

Interest expense for the Company, before deducting capitalized interest, was \$15.9 million during 1997, compared to \$12.4 million during 1996. During 1997, \$1.1 million of interest expense was capitalized in connection with construction of the DSN Plant, compared to \$2.4 million in 1996. The increase of \$3.5 million before the effect of capitalization primarily resulted from increased borrowings and higher interest rates. The increased borrowings were necessary to support capital expenditures, higher accounts receivable balances and to meet the operational requirements of the Company. See "Liquidity and Capital Resources" of this Management's Discussion and Analysis.

## EXTRAORDINARY CHARGE

In 1997, in connection with the issuance of the 10 3/4% unsecured senior notes due 2007 by a subsidiary of the Company, a subsidiary of the Company retired the outstanding principal associated with a certain financing arrangement and incurred a prepayment fee. The prepayment fee and loan origination costs expensed in 1997 related to the financing arrangement aggregated approximately \$4.6 million.

## NET LOSS

The Company had a net loss of \$23.1 million in 1997 compared to a net loss of \$3.8 million in 1996. The increased loss of \$19.3 million was primarily due to decreased gross profit, increased SG&A, increased interest expense and the extraordinary charge as discussed above.

YEAR ENDED DECEMBER 31, 1996 COMPARED TO YEAR ENDED DECEMBER 31, 1995

## REVENUES

Total revenues for 1996 and 1995 were \$314.1 million and \$274.1 million, respectively (an increase of \$40.0 million or 14.6%). Sales increased \$39.8 million or 14.9%.

## NET SALES

Consolidated net sales for 1996 were \$307.2 million, compared to \$267.4 million for 1995, an increase of \$39.8 million or 14.9%. This sales increase resulted principally from: (i) increased sales in the Climate Control Business of \$5.4 million, primarily due to improved market conditions; (ii) increased sales in the Chemical Business, of \$29.3 million which were primarily attributable to increased sales of \$16.0 million at Total Energy Systems ("TES"), the Company's subsidiary located in Australia and New Zealand, which resulted from an expanded customer base, to higher costs being passed through to customers and higher sales of agricultural products; (iii) increased sales of \$4.4 million in the Industrial Products Business; and (iv) increased sales of \$4.7 million in the Automotive Products Business due to the addition of certain new product lines that the Company believes the Automotive Products Business has a strategic advantage in.

## GROSS PROFIT

Gross profit decreased \$.3 million and was 18.5% of net sales for 1996, compared to 21.3% of net sales for 1995. The gross profit percentage declined in the Automotive Products, Chemical, and Climate Control Businesses. The gross profit of the Chemical Business, was adversely affected due to the continued high cost of anhydrous ammonia as discussed above and higher production costs due to unabsorbed overhead costs resulting from excessive downtime at the Chemical Business' El Dorado, Arkansas plant complex related to modifications made to install air emissions abatement equipment and resolve problems associated with mechanical failures at the DSN Plant. The Climate Control Business' gross profit percentage decreased due to production inefficiencies and decreased absorption of costs due to lower production volumes in certain product lines of this Business. The primary reason for the decline in gross profit percentage in the Automotive Products Business was a less favorable customer mix.

## SELLING, GENERAL AND ADMINISTRATIVE EXPENSE

Selling, general and administrative expenses ("SG&A"), as a percent of net sales, were 18.7% in 1996 and 21.4% in 1995. Consolidated SG&A expenses were approximately the same in 1996 as 1995 and consolidated net sales increased by 14.9% resulting in a lower percentage of SG&A to sales. Increased SG&A of the Chemical Business, consistent with sales increases were offset by reductions in SG&A in the Climate Control Business and general corporate expenses.

## INTEREST EXPENSE

Interest expense for the Company, excluding capitalized interest, was \$10.0 million during 1996, compared to \$10.1 million during 1995. During 1996, \$2.4 million of interest expense was capitalized in connection with construction of the DSN Plant, compared to \$1.4 million in 1995. The increase of \$.9 million before the effect of capitalization primarily resulted from increased borrowings and higher interest rates. The increased borrowings were necessary to support capital expenditures, higher accounts receivable balances and to meet the operational requirements of the Company.

## NET LOSS

The Company had a net loss of \$3.8 million in 1996 compared to a net loss of \$3.7 million in 1995. Although 1996 consolidated net sales increased, the consolidated gross profit did not increase and the net loss was approximately the same in 1996 as 1995.

## 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 issuance of senior unsecured notes by a wholly owned subsidiary.

Net cash used by operations for the year ended December 31, 1997 was \$20.5 million, after \$12.5 million for noncash depreciation and amortization, \$4.0 million in provisions for possible losses on accounts receivable, notes receivable, environmental matters and a loan guarantee and \$1.3 million in gains from real estate and other assets and including the following changes in assets and liabilities: (i) accounts receivable increases of \$3.8 million; (ii) inventory increases of \$1.9 million; (iii) increases in supplies and prepaid items of \$.5 million; and (iv) decreases in accounts payable and accrued liabilities of \$11.0 million. The increase in accounts receivable is due to increased sales primarily in the Climate Control Business (see "Results of Operations" for discussion of increase in sales). The increase in inventory was due primarily to an increase at the Chemical Business to support anticipated sales increases. These increases were offset by inventory reductions in the Automotive and Industrial Products Businesses resulting from liquidation of excessive inventories. Inventory in the Automotive and Industrial Products Businesses decreased from \$30.6 million at December 31, 1996 to \$29.4 million at December 31, 1997. The decrease in accounts payable and accrued liabilities resulted primarily from cash flow from financing activities becoming available to reduce accounts payable.

#### CASH FLOW FROM INVESTING AND FINANCING ACTIVITIES

Cash used by investing activities for the year ended December 31, 1997 included \$12.6 million in capital expenditures. These took place primarily in the Chemical Business to enhance production, quality and environmental safety standards. Also, included in investing activities was cash used to increase other assets \$5.3 million offset by cash proceeds received on sales of equipment and real estate properties of \$2.0 million. The increase in other assets consisted primarily of (i) a \$1.0 million advance to a French manufacturer of HVAC equipment as discussed further under "Joint Ventures and Options to Purchase", \$1.7 million of deposits made in connection with an interest rate hedge contract related to the agreement with Bayer and \$3.5 million of capitalized loan origination costs associated with the initial offering of the Notes.

Net cash provided by financing activities included (i) long-term and other borrowings of \$162.5 million, including proceeds from the \$105 million initial offering of the 10 3/4% unsecured senior notes due 2007 (the "Notes") and the \$50 million John Hancock financing discussed under "Sources of Funds", (ii) payments on long-term and other debt of \$75.8 million, including \$19.1 million in prepayments of debt with proceeds from the \$50 million John Hancock financing and \$48.3 million in prepayments of the John Hancock financing with proceeds from the \$105 million initial offering of the Notes, (iii) decreases in revolving debt of \$37.5 million, (iv) dividends of \$4.0 million, (v) treasury stock purchases of \$1.4 million, and (vi) a debt prepayment charge of \$4.6 million in connection with the prepayment of the John Hancock financing.

During 1997, the Company declared and paid the following aggregate dividends: (i) \$12.00 per share on each of the outstanding shares of its Series B 12% Cumulative Convertible Preferred Stock; (ii) \$3.25 per share on each outstanding share of its \$3.25 Convertible Exchangeable Class C Preferred Stock, Series 2; (iii) \$10.00 per share on each outstanding share of its Convertible Noncumulative Preferred Stock; and (iv) \$.06 per share on its outstanding shares of Common Stock. The Company expects to continue the payment of such dividends in the future in accordance with the policy adopted by the Board of Directors and the terms inherent to the Company's various Preferred Stocks.

#### 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.

In October 1997, the Company organized a new wholly owned subsidiary, ClimaChem, Inc. ("ClimaChem"). ClimaChem owns substantially all of the Company's Chemical and Climate Control Businesses. On November 26, 1997, ClimaChem issued the Notes in the aggregate amount of \$105 million. The Notes are jointly and severally and fully and unconditionally guaranteed on a senior basis by all, but one, of the existing and all of the future subsidiaries of ClimaChem. One current subsidiary of ClimaChem, which is currently inconsequential to ClimaChem, is not a guarantor of the Notes. The Company is neither an issuer of, nor a guarantor under, the Notes. See Note 5 of Notes to Consolidated Financial Statements.

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 the Company 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.

The proceeds from the issuance of the Notes were approximately \$105 million before deducting commissions and initial purchaser's discounts and estimated expenses thereof. After deducting discounts and commissions to the initial purchaser, but before deducting other expenses, the net proceeds to the Company from the issuance of the Notes were \$101.85 million. The net proceeds from the issuance of the Notes were used to (i) repay approximately \$53.2 million of borrowings, interest and prepayment fees to retire the loans associated with the financing agreement discussed in the next paragraph; and (ii) reduce by approximately \$48.6 million amounts outstanding under the Company's revolving credit facilities.

On February 13, 1997 certain of the Company's wholly-owned subsidiaries completed a \$50.0 million long-term financing agreement ("Financing") with an institutional lender. Approximately \$19.3 million in proceeds from the Financing were used to repay other outstanding term debt including accrued interest, and the remaining \$30.7 million in proceeds was used to pay down the Company's revolving credit facilities and thereby create additional borrowing availability for future working capital and other corporate needs. This financing agreement was prepaid in full and terminated in November, 1997 with proceeds from the initial offering of the Notes. In connection with such prepayment, ClimaChem was required to pay a prepayment charge of \$4.6 million.

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 1.5% per annum or, at the Company's option, on the Lender's LIBOR rate plus 3.875% per annum (which rates are subject to increase or reduction based upon achieving specified availability and adjusted tangible net worth levels. At December 31, 1997 the effective interest rate was 10.0%. The term of the Revolving Credit Agreements is through December 31, 2000, and is renewable thereafter for successive thirteen month terms. At December 31, 1997, the availability for additional borrowings, based on eligible collateral approximated \$33.8 million. Borrowings under the Revolver outstanding at December 31, 1997, were \$19.3 million. 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 December 31, 1997, the Company was not in compliance with certain of these financial covenants. Subsequent to December 31, 1997, the Company obtained waivers of such noncompliance and amendments to reset the financial covenants through maturity. The annual interest on the outstanding debt under the Revolver at December 31, 1997 at the rates then in effect would approximate \$1.9 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, the Company had the following term loans in place as of December 31, 1997:

- (1) As of December 31, 1997, 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 December 31, 1997, DSN had outstanding borrowings of \$13.5 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 December 31, 1997, at the agreed to interest rates would approximate \$1.2 million. The loans are secured by the various DSN property and equipment. The loan agreements require the Company to maintain certain financial ratios, including tangible net worth requirements.
- (2) As of December 31, 1997, a subsidiary of the Company ("Prime") was a party to an agreement ("Agreement") with Nations Bank ("Bank"). The Agreement, as modified, requires interest per annum at a rate equal to three quarters of one percent (.75%) above the prime rate in effect from

day to day as published in the Wall Street Journal. The outstanding principal balance of the note was payable in sixty (60) monthly payments of principal and interest commencing on June 30, 1996. Payment of the note was secured by a first and priority lien and security interest in and to Prime's right, title, and interest in the loan receivable relating to the real property and office building located in Oklahoma City, Oklahoma (the "Tower"), and the Management Agreement relating to the Tower. In February 1997, a subsidiary of the Company exercised its option to purchase the Tower by foreclosing against the loan receivable and paying approximately \$140,000 in related costs. In March 1998, a subsidiary of the Company sold the Tower. The note associated with this Agreement was paid off with part of the proceeds from this sale. The Company realized proceeds of approximately \$29 million from the sale, net of transaction costs. Proceeds from the sale were used to retire the outstanding indebtedness on the Agreement of approximately \$13 million in March 1998. Approximately \$15 million of the remaining proceeds were used to reduce indebtedness outstanding under the Company's Revolving Credit Agreements. See Note 15 of Notes to Consolidated Financial Statements concerning this subsequent event.

Future cash requirements include working capital requirements for anticipated sales increases in all Businesses and funding for future capital expenditures. Funding for the higher accounts receivable resulting from anticipated sales increases will be provided by cash flow generated by the Company and the revolving credit facilities discussed elsewhere in this report. Inventory requirements for the higher anticipated sales activity should be met by scheduled reductions in the inventories of the Industrial Products Business and in the inventories of the Automotive Products Business. In 1998, the Company has planned capital expenditures of approximately \$9.0 million, primarily in the Chemical and Climate Control Businesses.

Management believes that following the issuance of the Notes, cash flows from operations, the Company's revolving credit facilities, and other sources, including proceeds from the sale of the Tower in March 1998, will be adequate to meet its presently anticipated capital expenditure, working capital, debt service, and dividend requirements. The Company currently has no material commitment for capital expenditures, except as discussed under "Overview", "Chemical Business," of this "Management's Discussion and Analysis of Financial Condition and Results of Operations" regarding the agreement with Bayer Corporation to build a new nitric acid plant.

#### FOREIGN SUBSIDIARY

The Company's wholly-owned Australian subsidiary, TES, has a revolving credit working capital facility (the "TES Revolving Facility") with Bank of New Zealand, Australia. In February 1998, the TES Revolving Facility was increased from AUS\$8.5 million (approximately US\$5.5 million) to approximately AUS\$10.5 million (approximately US\$7.0 million). The TES Revolving Facility allows for borrowings based on specific percentages of qualified eligible assets. Based on the effective exchange rate at December 31, 1997 approximately US\$4.6 million (AUS\$7.1 million approximately) was borrowed at December 31, 1997. Based on the effective exchange rate at March 18, 1998, approximately US\$3.0 million (approximately AUS\$4.5 million) was borrowed at March 18, 1998, under the TES Revolving Credit Facility. 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 6.9% at December 31, 1997. TES is in technical noncompliance with a certain financial covenant contained in the loan agreement involving the TES Revolving Facility. However, this covenant was not met at the time of closing of this loan and the Bank of New Zealand, Australia has continued to extend credit under the Facility. The outstanding borrowing under the TES Revolving Facility at December 31, 1997, has been classified as due within one year in the accompanying consolidated financial statements.

#### 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 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%) equity 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 completed contract was for installation of energy-efficient equipment (including air conditioning and heating equipment), which would reduce utility consumption. For the installation and management, the Project will receive 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 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 \$1.2 million and has loaned the Optioned Company approximately \$1.4 million. The Company has recorded reserves of \$926,000 against the loans and option payments. 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 \$1.9 million as of December 31, 1997. 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. Both notes are current as to principal and interest.

During 1996 and 1997, the aviation company received cash infusions of \$5.0 million from an unrelated third party investor for a 41.6% ownership interest in the aviation company. During 1997, the investor exercised an option to purchase additional stock of the aviation company in exchange for \$4.0 million in scheduled payments. At December 31, 1997, \$2.5 million of payments under this option had been received. Accordingly, additional shares of stock were issued pursuant to the option exercise increasing the investor's ownership interest to 46.3%. In February 1998, the aviation company made a capital call on its shareholders. In contemplation of a sale of the aviation company to an additional investor and pursuant to such capital call, the Company invested an additional \$241,545 which increased the Company's ownership interest to 35.9%. The unrelated third party investor did not participate in such capital call and their investment was diluted to 23.1%. On March 20, 1998 the Company loaned an additional net amount of \$32,000 to the aviation company in exchange for additional stock. This transaction increased the Company's ownership interest to approximately 37.2%

#### 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 \$18 million at December 31, 1997. As of December 31, 1997, the Company had available NOL carry-overs of approximately \$65 million based on its federal income tax returns as filed with the Internal Revenue Service for taxable years through 1997. These NOL carry-overs will expire beginning in the year 1999. As of December 31, 1997 and 1996, 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 Consolidated Financial Statements.

The amount of these carry-overs has not been audited or approved by the Internal Revenue Service 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.

#### 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. The preceding sentence is a forward-looking statement that involves a number of risks and uncertainties that could cause actual results to differ materially, such as, among other factors, the following: the EIL Insurance does not provide coverage to the Company and the Chemical Business for any material claims made by the claimants, the claimants alleged damages are not covered by the EIL Policy which a court may find the Company and/or the Chemical Business liable for, such as punitive damages or penalties, a court finds the Company and/or the Chemical Business liable for damages to such claimants for a material amount in excess of the limits of coverage of the EIL Insurance or a court finds the Chemical Business liable for a material amount of damages in the antitrust lawsuits pending against the Chemical Business in a manner not presently anticipated by the Company. See "Business", "Legal Proceedings" and Note 10 of Notes to Consolidated Financial Statements.

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

The Company has included the financial statements and supplementary financial information required by this item immediately following Part IV of this report and hereby incorporates by reference the relevant portions of those statements and information into this Item 8.

#### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

No disagreements between the Company and its accountants have occurred within the 24-month period prior to the date of the Company's most recent financial statements.

#### 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) ability to improve operations and become profitable on an annualized basis (ii) establish a position as a market lender, (iii) the EDNC Baytown Plant will cost approximately \$60 million and will be completed by late 1998, (iv) ability to continue to operate the DSN Plant at the rate of approximately 260 tons per day, and at such rate can produce at a cost per ton of approximately \$65 lower than at production levels of \$170 tons per day, (v) increase demand for, and growth relating to, the Company's products, (vi) certain of the Company's product lines may be the most extensive offered, (vii) production of backlog, (viii) amount to be spent in 1998 relating to compliance with federal, state and local Environmental laws at the El Dorado Facility, (ix) Year 2000 issues, (x) improve liquidity and profits through liquidation of assets, (xi) the Company's ability to develop or adopt new and existing technologies in the conduct of its operations, (xii) anticipated financial performance, (xiii) ability to comply with the Company's general working capital requirements, and (xiv) ability to be able to continue to borrow under the Company's revolving line of credit. 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) inability to meet the

"Year 2000" compliance of the computer system by the Company, its key suppliers, customers, creditors, and financial service organization, (vi) changes in federal, state and local laws and regulations, especially environmental regulations, or in interpretation of such, pending (vii) additional releases (particularly air emissions into the environment), (viii) potential increases in equipment, maintenance, operating or labor costs not presently anticipated by the Company, (ix) inability to retain management or to develop new management, (x) the requirement to use internally generated funds for purposes not presently anticipated, (xi) inability to become profitable, or if unable to become profitable, the inability to secure additional liquidity in the form of additional equity or debt, (xii) the effect of additional production capacity of anhydrous ammonia in the western hemisphere, (xiii) the cost for the purchase of anhydrous ammonia not reducing or continuing to increase, (xiv) changes in competition, (xv) the loss of any significant customer, (xvi) changes in operating strategy or development plans, (xvii) inability to implement on a permanent basis the corrective actions necessary for the DSN Plant to operate at its stated capacity or inability to produce at the DSN Plant in an efficient manner, (xviii) inability to fund the expansion of the Company's businesses, (xix) adverse results in any of the Company's pending litigation, on claims described under "Legal Proceedings", (xx) inability to finalize the settlements of the environmental litigation in terms described in "Legal Proceedings", and (xxi) other factors described in "Business", "Legal Proceedings" or "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.

### PART III

The Company hereby incorporates by reference the information required by Part III of this report except for the information on the Company's executive officers included under Part 4A of Part I of this report, from the definitive proxy statement which the Company intends to file with the Securities and Exchange Commission on or before April 30, 1998, in connection with the Company's 1998 annual meeting of stockholders.

### PART IV

#### ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

##### (a)(1) FINANCIAL STATEMENTS

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

	Pages
Report of Independent Auditors	F-1
Consolidated Balance Sheets at December 31, 1997 and 1996	F-2 to F-3
Consolidated Statements of Operations for each of the three years in the period ended December 31, 1997	F-4
Consolidated Statements of Stockholders' Equity for each of the three years in the period ended December 31, 1997	F-5 to F-7
Consolidated Statements of Cash Flows for each of the three years in the period ended December 31, 1997	F-8 to F-9
Notes to Consolidated Financial Statements	F-10 to F-56
Quarterly Financial Data (Unaudited)	F-57

##### (a)(2) FINANCIAL STATEMENT SCHEDULE

The Company has included the following schedule in this report:

II - Valuation and Qualifying Accounts	F-59
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The Company has omitted all other schedules because the conditions requiring their filing do not exist or because the required information appears in the Company's Consolidated Financial Statements, including the notes to those statements.

(a)(3) EXHIBITS

2.1. Stock Option Agreement dated as of May 4, 1995, between optionee, LSB Holdings, Inc., an Oklahoma Corporation and the shareholders of a specialty sales organization, an option which the Company hereby incorporates hereby by reference from Exhibit 2.1 to the Company's Form 10-K for fiscal year ended December 31, 1995.

2.2. Stock Purchase Agreement and Stock Pledge Agreement between Dr. Hauri AG, a Swiss Corporation, and LSB Chemical Corp., which the Company hereby incorporates by reference from Exhibit 2.2 to the Company's Form 10-K for fiscal year ended December 31, 1994.

3.1. Restated Certificate of Incorporation, the Certificate of Designation dated February 17, 1989, and certificate of Elimination dated April 30, 1993, which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Registration Statement, No. 33-61640; Certificate of Designation for the Company's \$3.25 Convertible Exchangeable Class C Preferred Stock, Series 2, which the Company hereby incorporates by reference from Exhibit 4.6 to the Company's Registration Statement, No. 33-61640.

3.2. Bylaws, as amended, which the Company hereby incorporates by reference from Exhibit 3.02 to the Company's Form 10-K for fiscal year ended December 31, 1990.

4.1. Specimen Certificate for the Company's Non-cumulative Preferred Stock, having a par value of \$100 per share, which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 10-Q for the quarter ended June 30, 1983.

4.2. Specimen Certificate for the Company's Series B Preferred Stock, having a par value of \$100 per share, which the Company hereby incorporates by reference from Exhibit 4.27 to the Company's Registration Statement No. 33-9848.

4.3. Specimen Certificate for the Company's Series 2 Preferred, which the Company hereby incorporates by reference from Exhibit 4.5 to the Company's Registration Statement No. 33-61640.

4.4. Specimen Certificate for the Company's Common Stock, which the Company incorporates by reference from Exhibit 4.4 to the Company's Registration Statement No. 33-61640.

4.5. Rights Agreement, dated as of February 17, 1989, between the Company and The Liberty National Bank and Trust Company of Oklahoma City, which the Company hereby incorporates by reference from Exhibit 2.1 to the Company's Form 8-A Registration Statement dated February 22, 1989.

4.6. First Amendment to Preferred Share Purchase Rights Plan, dated as of May 24, 1994, between the Company and Liberty National Bank and Trust Company of Oklahoma City, which the Company hereby incorporates by reference from Exhibit 4.2 to the Company's Form 10-Q for the fiscal quarter ended March 31, 1995.

4.7. Indenture, dated as of November 26, 1997, by and among ClimaChem, Inc., the Subsidiary Guarantors and Bank One, NA, as trustee, which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 8-K, dated November 26, 1997.

4.8. Registration Rights Agreement, dated as of November 26, 1997, by and among ClimaChem, Inc., the Guarantors, and the Initial Purchaser, which the Company hereby incorporates by reference from Exhibit 4.2 to the Company's Form 8-K, dated November 26, 1997.

4.9. Form of 10 3/4% Senior Notes due 2007 and 10 3/4% Series B Senior Notes due 2007 which the Company hereby incorporates by reference from Exhibit 4.3 to the ClimaChem Registration Statement, No. 333-44905.

4.10. Amended and Restated Loan and Security Agreement, dated November 21, 1997, by and between BankAmerica Business Credit, Inc., and Climate Master, Inc., International Environmental Corporation, El Dorado Chemical Company and Slurry Explosive Corporation which the Company hereby incorporates by reference from Exhibit 10.2 to the ClimaChem Form S-4 Registration Statement, No. 333-44905.

4.11. Amended and Restated Loan and Security Agreement, dated November 21, 1997, by and between BankAmerica Business Credit, Inc., and the Company. Substantially identical Amended and Restated Loan and

Security Agreements dated November 21, 1997, were entered into by each of L&S Bearing Co., and Summit Machine Tool Manufacturing Corp., with BankAmerica Business Credit, Inc., and are hereby omitted and such will be provided upon the Commission's request.

4.12. First Amendment to Amended and Restated Loan and Security Agreement, dated March 12, 1998, between BankAmerica Business Credit, Inc., and Climate Master, Inc., International Environmental Corporation, El Dorado Chemical Company and Slurry Explosive Corporation which the Company hereby incorporates by reference from Exhibit 10.53 to the ClimaChem Form S-4 Registration Statement, No. 333-44905.

4.13. First Amendment to Amended and Restated Loan and Security Agreement, dated March 12, 1998, between BankAmerica Business Credit, Inc., and the Company. Substantially identical First Amendments to Amended and Restated Loan and Security Agreements, dated March 12, 1998, were entered into by each of L&S Bearing Co. and Summit Machine Tool Manufacturing Corp. with BankAmerica Business Credit, Inc., and are hereby omitted and such will be provided upon the Commission's request.

4.14. Waiver Letter, dated March 16, 1998, from BankAmerica Business Credit, Inc. which the Company hereby incorporates by reference from Exhibit 10.55 to the ClimaChem Form S-4 Registration Statement, No. 333-44905.

10.1. Form of Death Benefit Plan Agreement between the Company and the employees covered under the plan, which the Company hereby incorporates by reference from Exhibit 10(c)(1) to the Company's Form 10-K for the year ended December 31, 1980.

10.2. The Company's 1981 Incentive Stock Option Plan, as amended, and 1986 Incentive Stock Option Plan, which the Company hereby incorporates by reference from Exhibits 10.1 and 10.2 to the Company's Registration Statement No. 33-8302.

10.3. Form of Incentive Stock Option Agreement between the Company and employees as to the Company's 1981 Incentive Stock Option Plan, which the Company hereby incorporates by reference from Exhibit 10.10 to the Company's Form 10-K for the fiscal year ended December 31, 1984.

10.4. Form of Incentive Stock Option Agreement between the Company and employees as to the Company's 1986 Incentive Stock Option Plan, which the Company hereby incorporates by reference from Exhibit 10.6 to the Company's Registration Statement No. 33-9848.

10.5. The 1987 Amendments to the Company's 1981 Incentive Stock Option Plan and 1986 Incentive Stock Option Plan, which the Company hereby incorporates by reference from Exhibit 10.7 to the Company's Form 10-K for the fiscal year ended December 31, 1986.

10.6. The Company's 1993 Stock Option and Incentive Plan which the Company hereby incorporates by reference from Exhibit 10.6 to the Company's Form 10-K for the fiscal year ended December 31, 1993.

10.7. The Company's 1993 Non-employee Director Stock Option Plan which the Company hereby incorporates by reference from Exhibit 10.7 to the Company's Form 10-K for the fiscal year ended December 31, 1993.

10.8. Union Contracts, dated August 5, 1995, between EDC and the Oil, Chemical and Atomic Workers, the International Association of Machinists and Aerospace Workers, and the United Steel Workers of America, dated November 1, 1995 which the Company hereby incorporates by reference from Exhibit 10.7 to the Company's Form 10-K for the fiscal year ended December 31, 1995.

10.9. Lease Agreement, dated March 26, 1982, between Mac Venture, Ltd. and Hercules Energy Mfg. Corporation, which the Company hereby incorporates by reference from Exhibit 10.32 to the Company's Form 10-K for the fiscal year ended December 31, 1981.

10.10. Agreement for Purchase and Sale of Anhydrous Ammonia, dated as of January 1, 1997, between El Dorado Chemical Company and Farmland Industries, Inc. which the Company hereby incorporates by reference from Exhibit 10.10 to the Company's Form 10-K for the fiscal year ended December 31, 1996.

10.11. Limited Partnership Agreement dated as of May 4, 1995, between the general partner, and LSB Holdings, Inc., an Oklahoma Corporation, as limited partner which the Company hereby incorporates by reference from Exhibit 10.11 to the Company's Form 10-K for the fiscal

year ended December 31, 1995.

10.12. Lease Agreement dated November 12, 1987, between Climate Master, Inc. and West Point Company and amendments thereto, which the Company hereby incorporates by reference from Exhibits 10.32, 10.36, and 10.37, to the Company's Form 10-K for fiscal year ended December 31, 1988.

10.13. Severance Agreement, dated January 17, 1989, between the Company and Jack E. Golsen, which the Company hereby incorporates by reference from Exhibit 10.48 to the Company's Form 10-K for fiscal year ended December 31, 1988. The Company also entered into identical agreements with Tony M. Shelby, David R. Goss, Barry H. Golsen, David M. Shear, and Jim D. Jones and the Company will provide copies thereof to the Commission upon request.

10.14. Third Amendment to Lease Agreement, dated as of December 31, 1987, between Mac Venture, Ltd. and Hercules Energy Mfg. Corporation, which the Company hereby incorporates by reference from Exhibit 10.49 to the Company's Form 10-K for fiscal year ended December 31, 1988.

10.15. Employment Agreement and Amendment to Severance Agreement dated January 12, 1989 between the Company and Jack E. Golsen, dated March 21, 1996 which the Company hereby incorporates by reference from Exhibit 10.15 to the Company's Form 10-K for fiscal year ended December 31, 1995.

10.16. Purchase Agreement, dated November 25, 1997, between ClimaChem, Inc., and certain subsidiaries of ClimaChem, and Wasserstein Perella Securities, Inc. which the Company hereby incorporates by reference from Exhibit 1 to the ClimaChem Form S-4 Registration Statement, No. 333-44905.

10.17. Non-Qualified Stock Option Agreement, dated June 1, 1992, between the Company and Robert C. Brown, M.D. which the Company hereby incorporates by reference from Exhibit 10.38 to the Company's Form 10-K for fiscal year ended December 31, 1992. The Company entered into substantially identical agreements with Bernard G. Ille, Jerome D. Shaffer and C.L.Thurman, and the Company will provide copies thereof to the Commission upon request.

10.18. Loan and Security Agreement (DSN Plant) dated October 31, 1994 between DSN Corporation and the CIT Group which the Company hereby incorporates by reference from Exhibit 10.1 to the Company's Form 10-Q for the fiscal quarter ended September 30, 1994.

10.19. Loan and Security Agreement (Mixed Acid Plant) dated April 5, 1995 between DSN Corporation and the CIT Group, which the Company hereby incorporates by reference from Exhibit 10.25 to the Company's Form 10-K for the fiscal year ended December 31, 1994.

10.20. First Amendment to Loan and Security Agreement (DSN Plant), dated June 1, 1995, between DSN Corporation and The CIT Group/Equipment Financing, Inc. which the Company hereby incorporates by reference from Exhibit 10.13 to the ClimaChem Form S-4 Registration Statement, No. 333-44905.

10.21. First Amendment to Loan and Security Agreement (Mixed Acid Plant), dated November 15, 1995, between DSN Corporation and The CIT Group/Equipment Financing, Inc. which the Company hereby incorporates by reference from Exhibit 10.15 to the ClimaChem Form S-4 Registration Statement, No. 333-44905.

10.22. Loan and Security Agreement (Rail Tank Cars), dated November 15, 1995, between DSN Corporation and The CIT Group/Equipment Financing, Inc. which the Company hereby incorporates by reference from Exhibit 10.16 to the ClimaChem Form S-4 Registration Statement, No. 333-44905.

10.23. First Amendment to Loan and Security Agreement (Rail Tank Cars), dated November 15, 1995, between DSN Corporation and The CIT Group/Equipment Financing, Inc. which the Company hereby incorporates by reference from Exhibit 10.17 to the ClimaChem Form S-4 Registration Statement, No. 333-44905.

10.24. Letter amendment, dated May 14, 1997, to Loan and Security Agreement between DSN Corporation and The CIT Group/Equipment Financing, Inc. which the Company hereby incorporates by reference from Exhibit 10.1 to the Company's Form 10-Q for the fiscal quarter ended March 31, 1997.

10.25. Amendment to Loan and Security Agreement, dated November 21, 1997, between DSN Corporation and The CIT Group/Equipment Financing, Inc. which the Company hereby incorporates by reference from Exhibit 10.19 to the ClimaChem Form S-4 Registration Statement, No. 333-44905.

10.26. First Amendment to Non-Qualified Stock Option Agreement, dated March 2, 1994, and Second Amendment to Stock Option Agreement, dated April 3, 1995, each between the Company and Jack E. Golsen, which the Company hereby incorporates by reference from Exhibit 10.1 to the Company's Form 10-Q for the fiscal quarter ended March 31, 1995.

10.27. Facility Letter, dated August 20, 1997, between Bank of New Zealand, Australia, and Total Energy Systems Limited which the Company hereby incorporates by reference from Exhibit 10.38 to the ClimaChem Form S-4 Registration Statement, No. 333-44905.

10.28 Variation Letter, dated February 10, 1998, between Bank of New Zealand, Australia, and Total Energy Systems Limited which the Company hereby incorporates by reference from Exhibit 10.39 to the ClimaChem Form S-4 Registration Statement, No. 333-44905.

10.29. Debenture Charge, dated March 7, 1995, between Total Energy Systems Limited and Bank of New Zealand which the Company hereby incorporates by reference from Exhibit 10.40 to the ClimaChem Form S-4 Registration Statement, No. 333-44905. T.E.S. Mining Services Pty. Ltd. and Total Energy Systems (NZ) Limited are each parties to substantially identical Debentures, copies of which will be provided to the Commission upon request.

10.30. Anhydrous Ammonia Sales Agreement, dated May 28, 1997, to be effective January 1, 1997, between Koch Nitrogen Company and El Dorado Chemical Company which the Company hereby incorporates by reference from Exhibit 10.1 to the Companies Form 10-Q for the fiscal quarter ended June 30, 1997. CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #5551, DATED SEPTEMBER 25, 1997, GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.

10.31. Baytown Nitric Acid Project and Supply Agreement dated June 27, 1997, by and among El Dorado Nitrogen Company, El Dorado Chemical Company and Bayer Corporation which the Company hereby incorporates by reference from Exhibit 10.2 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #5551, DATED SEPTEMBER 25, 1997, GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.

10.32. Service Agreement, dated June 27, 1997, between Bayer Corporation and El Dorado Nitrogen Company which the Company hereby incorporates by reference from Exhibit 10.3 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #5551, DATED SEPTEMBER 25, 1997, GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.

10.33. Ground Lease dated June 27, 1997, between Bayer Corporation and El Dorado Nitrogen Company which the Company hereby incorporates by reference from Exhibit 10.4 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #5551, DATED SEPTEMBER 25, 1997, GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.

10.34. Participation Agreement, dated as of June 27, 1997, among El Dorado Nitrogen Company, Boatmen's Trust Company of Texas as Owner Trustee, Security Pacific Leasing Corporation, as Owner Participant and a Construction Lender, Wilmington Trust Company, Bayerische Landesbank, New York Branch, as a Construction Lender and the Note Purchaser, and Bank of America National Trust and Savings Association, as Construction Loan Agent which the Company hereby incorporates by reference from Exhibit 10.5 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #5551, DATED SEPTEMBER 25, 1997, GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.

10.35. Lease Agreement, dated as of June 27, 1997, between Boatmen's Trust Company of Texas as Owner Trustee and El Dorado Nitrogen Company which the Company hereby incorporates by reference from Exhibit 10.6 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997.

10.36. Security Agreement and Collateral Assignment of Construction Documents, dated as of June 27, 1997, made by El Dorado Nitrogen Company which the Company hereby incorporates by reference from Exhibit 10.7 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997.

10.37. Security Agreement and Collateral Assignment of Facility Documents, dated as of June 27, 1997, made by El Dorado Nitrogen Company and consented to by Bayer Corporation which the Company hereby incorporates by reference from Exhibit 10.8 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997.

10.38. Union Contracts, dated August 5, 1995, by and between EDC and the Oil, Chemical and Atomic Workers, the International Association of Machinists and Aerospace Workers, and the United Steel Workers of America, dated November 1, 1995, which the Company hereby incorporates by reference from Exhibit 10.7 to the Company's Form 10-K for the fiscal year ended December 31, 1995.

10.39. Amendment to Loan and Security Agreement, dated March 15, 1998, between The CIT Group/Equipment Financing, Inc., and DSN Corporation which the Company hereby incorporates by reference from Exhibit 10.54 to the ClimaChem Form S-4 Registration Statement, No. 333-44905.

21.1. Subsidiaries of the Company

23.1. Consent of Independent Auditors

27.1. Financial Data Schedule

(b) REPORTS ON FORM 8-K. The Company filed a report on Form 8-K, date of event reported November 26, 1997, in connection with the issuance of the \$105 million 10 3/4% Senior Notes due 2007 by its wholly owned subsidiary, ClimaChem, Inc.

#### SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Company has caused the undersigned, duly-authorized, to sign this report on its behalf of this 13th day of April, 1998.

LSB INDUSTRIES, INC.

By:

/s/ Jack E. Golsen  
Jack E. Golsen  
Chairman of the Board and  
President  
(Principal Executive Officer)

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)

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the undersigned have signed this report on behalf of the Company, in the capacities and on the dates indicated.

Dated: April 13, 1998

By:  
/s/ Jack E. Golsen  
Jack E. Golsen, Director

Dated: April 13, 1998

By:  
/s/ Tony M. Shelby  
Tony M. Shelby, Director

Dated: April 13, 1998 By:  
/s/ David R. Goss  
David R. Goss, Director

Dated: April 13, 1998 By:  
/s/ Barry H. Golsen  
Barry H. Golsen, Director

Dated: April 13, 1998 By:  
/s/ Robert C. Brown  
Robert C. Brown, Director

Dated: April 13, 1998 By:  
/s/ Bernard G. Ille  
Bernard G. Ille, Director

Dated: April 13, 1998 By:  
/s/ Jerome D. Shaffer  
Jerome D. Shaffer, Director

Dated: April 13, 1998 By:  
/s/ Raymond B. Ackerman  
Raymond B. Ackerman, Director

Dated: April 13, 1998 By:  
/s/ Horace Rhodes  
Horace Rhodes, Director

Dated: April 13, 1998 By:  
Gerald J. Gagner, Director

Dated: April 13, 1998 By:  
/s/ Donald W. Munson  
Donald W. Munson, Director

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#### Report of Independent Auditors

The Board of Directors and Stockholders  
LSB Industries, Inc.

We have audited the accompanying consolidated balance sheets of LSB Industries, Inc. as of December 31, 1997 and 1996, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1997. Our audits also included the financial statement schedule listed in the Index at Item 14(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of LSB Industries, Inc. at December 31, 1997 and 1996, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1997, in conformity with generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

ERNST & YOUNG LLP

Oklahoma City, Oklahoma  
March 16, 1998,  
except for the fourth paragraph of Note 5(A), as to which the date is  
April 8, 1998

LSB Industries, Inc.  
Consolidated Balance Sheets

	DECEMBER 31, 1997	1996
-----		
(In Thousands)		
ASSETS		
Current assets (Note 5):		
Cash and cash equivalents	\$ 4,934	\$ 1,620
Trade accounts receivable, net	52,191	50,791
Inventories (Note 3)	68,200	67,982
Supplies and prepaid items	7,595	7,217
-----		
Total current assets	132,920	127,610
Property, plant and equipment, net (Notes 4, 5 and 15)	118,331	103,143
Loans receivable, secured by real estate	664	15,010
Other assets, net	18,738	15,797
-----		
	\$ 270,653	\$ 261,560
=====		

(continued on following page)

LSB Industries, Inc.  
Consolidated Balance Sheets (continued)

	DECEMBER 31, 1997	1996
-----		
(In Thousands)		
(s)		
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Drafts payable	\$ 737	\$ 536
Accounts payable	28,137	41,796
Accrued liabilities	16,196	12,780
Current portion of long-term debt (Note 5)	15,874	13,007
-----		
Total current liabilities	60,944	68,119
Long-term debt (Note 5)	165,067	119,277
Commitments and contingencies (Note 10)		
Redeemable, noncumulative, convertible preferred stock, \$100 par value; 1,539 shares issued and outstanding (Note 8)	146	146
Stockholders' equity (Notes 5, 7 and 9):		
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, 15,042,356 shares issued (14,888,476 in 1996)	1,504	1,489
Capital in excess of par value	38,257	37,843
Cumulative foreign currency translation		

adjustment	(1,003)	276
Accumulated deficit	(29,773)	(2,706)
	-----	-----
	56,985	84,902
LESS TREASURY STOCK, AT COST:		
Series 2 preferred, 5,000 shares	200	200
Common stock, 2,293,390 shares (1,913,120 in 1996)	12,289	10,684
	-----	-----
Total stockholders' equity	44,496	74,018
	-----	-----
	\$270,653	\$261,560
	=====	=====

See accompanying notes.

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LSB Industries, Inc.  
Consolidated Statements of Operations

	YEAR ENDED DECEMBER 31,		
	1997	1996	1995
	-----	-----	-----
	(In Thousands, Except Per Share Amounts)		
Revenues			
Net sales	\$ 313,929	\$307,160	\$267,391
Other income	6,260	6,891	6,724
	-----	-----	-----
	320,189	314,051	274,115
Costs and expenses:			
Cost of sales	257,982	250,388	210,328
Selling, general and administrative	65,863	57,341	57,238
Interest	14,740	10,017	10,131
	-----	-----	-----
	338,585	317,746	277,697
Loss before provision for income taxes and extraordinary charge	(18,396)	(3,695)	(3,582)
Provision for income taxes (Note 6)	50	150	150
	-----	-----	-----
Loss before extraordinary charge	(18,446)	(3,845)	(3,732)
Extraordinary charge (Note 14)	4,619	-----	-----
	-----	-----	-----
Net loss	(23,065)	(3,845)	(3,732)
Preferred stock dividends	3,229	3,229	3,229
	-----	-----	-----



(\$10.00 per share)						(16)		(16)	
Common stock (\$.06 per share)						(774)		(774)	
Series 2 preferred stock(\$3.25 per share)						(2,973)		(2,973)	
Purchase of treasury stock						(1,445)		(1,445)	
Balance at December 31,1995									
-----									
	14,757	1,476	48,000	37,567	278	5,148	(10,415)	(200)	81,854

(Continued on following page)

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LSB Industries, Inc.

Consolidated Statements of Stockholders' Equity (continued)

COMMON SHARES TOTAL	NON- PAR VALUE	REDEEMABLE PREFERRED STOCK	CAPITAL EXCESS OF PAR Value in	CUMULATIVE FOREIGN CURRENCY TRANSLATION ADJUSTMENT	RETAINED EARNINGS (ACCUMULATED DEFICIT)	TREASURY STOCK COMMON	TREASURY STOCK PREFERRED	TREASURY STOCK PREFERRED	
-----									
(In Thousands)									
Net loss	\$	\$	\$		\$ (3,845)	\$	\$	\$ (3,845)	
Translation adjustment				(2)				(2)	
Conversion of 27 shares of redeemable preferred stock to common stock	1		2					2	
Exercise of stock options:									
Cash received	85	8	185					193	
Stock tendered and added to treasury at market value	45	5	89			(94)			
Dividends declared:									
Series B 12% preferred stock (\$12.00 per share)					(240)			(240)	
Redeemable preferred stock (\$10.00 per share)					(16)			(16)	
Common stock (\$.06 per share)					(780)			(780)	
Series 2 preferred stock(\$3.25 per share)					(2,973)			(2,973)	
Purchase of treasury stock						(175)		(175)	
-----									
Balance at December 31,1996	14,888	1,489	48,000	37,843	276	(2,706)	(10,684)	(200)	74,018

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Net loss					(23,065)			(23,065)
Translation adjustment					(1,279)			(1,279)
Exercise of stock								

options:				
Cash received	67	6	190	196
Stock tendered and added to treasury at market value	87	9	224	(233)
Dividends declared:				
Series B 12% preferred stock (\$12.00 per share)			(240)	(240)
Redeemable preferred stock (\$10.00 per share)			(16)	(16)
Common stock (\$.06 per share)			(773)	(773)
Series 2 preferred stock (\$3.25 per share)			(2,973)	(2,973)
Purchase of treasury stock			(1,372)	(1,372)
-----				
Balance at December 31, 1997	15,042	\$1,504	\$48,000	\$38,257
	\$(1,003)	\$(29,773)	\$(12,289)	\$(200)
	\$44,496			
	=====			

See accompanying notes.

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LSB Industries, Inc.  
Consolidated Statements of Cash Flows

	YEAR ENDED DECEMBER 31,		
	1997	1996	1995
	-----		
	(In Thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES			
Net loss	\$(23,065)	\$ (3,845)	\$ (3,732)
Adjustments to reconcile net loss to net cash provided (used) by operations			
Extraordinary charge related to financing activities	4,619	-	-
Depreciation of property, plant and equipment	11,142	8,655	7,909
Amortization	1,308	1,124	1,150
Provision for possible losses			
Trade accounts receivable	1,544	1,450	1,696
Notes receivable	1,093	1,565	1,350
Environmental matters	300	100	-
Loan guarantee	1,093	626	590
Recapture of prior period provisions for loss on loans receivable secured by real estate	(1,383)	-	-
(Gain) loss on sales of assets	57	(1,574)	(203)
Cash provided (used) by changes in assets and liabilities:			
Trade accounts receivable	(3,805)	(8,267)	(4,092)
Inventories	(1,892)	(1,717)	(6,091)
Supplies and prepaid items	(476)	(1,533)	725
Accounts payable	(13,549)	13,288	(902)
Accrued liabilities	2,530	3,441	1,256
	-----	-----	-----
Net cash provided (used) by operating activities	(20,484)	13,313	(344)
CASH FLOWS FROM INVESTING ACTIVITIES			
Capital expenditures	(12,633)	(19,950)	(17,810)
Principal payments on loans receivable	283	742	1,586
Proceeds from sales of equipment and real estate properties	1,957	417	1,345

Proceeds from the sale of investment securities	-	1,524	-
Other assets	(5,293)	(3,745)	(3,872)
Net cash used by investing activities	(15,686)	(21,012)	(18,751)

(Continued on following page)

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LSB Industries, Inc.

Consolidated Statements of Cash Flows (continued)

	YEAR ENDED DECEMBER 31,		
	1997	1996	1995
	-----		
	(In Thousands)		
CASH FLOWS FROM FINANCING ACTIVITIES			
Payments on long-term and other debt	\$(75,846)	\$(11,985)	\$ (9,476)
Long-term and other borrowings	162,451	25,029	18,471
Debt prepayment charge	(4,619)	-	-
Net change in revolving debt facilities	(37,525)	(1,266)	15,070
Net change in drafts payable	201	112	(867)
Dividends paid:			
Preferred stocks	(3,229)	(3,229)	(3,229)
Common stock	(773)	(780)	(774)
Purchase of treasury stock	(1,372)	(175)	(1,445)
Net proceeds from issuance of common stock	196	193	155
Net cash provided by financing activities	39,484	7,899	17,905
	-----		
Net increase (decrease) in cash and cash equivalents from all activities	3,314	200	(1,190)
Cash and cash equivalents at beginning of year	1,620	1,420	2,610
	-----		
Cash and cash equivalents at end of year	\$ 4,934	\$ 1,620	\$ 1,420
	=====		

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See accompanying notes.

LSB Industries, Inc.

Notes to Consolidated Financial Statements

December 31, 1997, 1996 and 1995

1. BASIS OF PRESENTATION

The accompanying consolidated financial statements include the accounts of LSB Industries, Inc. (the "Company") and its subsidiaries. The Company is a diversified holding company which is engaged in, through its subsidiaries, the manufacture and sale of chemical products (the "Chemical Business"), the manufacture and sale of a broad range of air handling and heat pump products (the "Climate Control Business"), the manufacture or purchase and sale of certain automotive products (the "Automotive Business") and the purchase and sale of machine tools (the "Industrial Products Business"). See Note 13 - Segment Information

## 2. ACCOUNTING POLICIES

### USE OF ESTIMATES

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

### INVENTORIES

Purchased machinery and equipment are carried at specific cost plus duty, freight and other charges, not in excess of net realizable value. All other inventory is priced at the lower of cost or market, with cost being determined using the first-in, first-out (FIFO) basis, except for certain heat pump products with a value of \$8,151,000 at December 31, 1997 (\$8,595,000 at December 31, 1996), which are priced at the lower of cost or market, with cost being determined using the last-in, first-out (LIFO) basis. The difference between the LIFO basis and current cost was \$1,223,000 and \$1,013,000 at December 31, 1997 and 1996, respectively.

### DEPRECIATION

For financial reporting purposes, depreciation, depletion and amortization is primarily computed using the straight-line method over the estimated useful lives of the assets.

### CAPITALIZATION OF INTEREST

Interest costs of \$1,113,000, \$2,405,000 and \$1,357,000 related to the construction of a nitric acid plant were capitalized in 1997, 1996 and 1995, respectively, and are amortized over the plant's estimated useful life.

### LOANS RECEIVABLE

Loans receivable are stated at unpaid principal balances, less allowances for loan losses, if any (none in 1997, 1996 or 1995). Management's periodic evaluation of the adequacy of the allowance is based on past loan loss

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 2. ACCOUNTING POLICIES (CONTINUED)

experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of the underlying collateral, and current economic conditions.

In February 1997, the Company foreclosed on a loan receivable with a carrying amount of \$14.0 million and exercised its option to acquire the related office building located in Oklahoma City, known as "The Tower." The estimated fair value of The Tower at the date of acquisition exceeds the Company's carrying amount at December 31, 1997 plus the exercise payment. See Note 15 - Subsequent Event.

### EXCESS OF PURCHASE PRICE OVER NET ASSETS ACQUIRED

The excess of purchase price over net assets acquired, which is included in other assets in the accompanying balance sheets, were \$3,287,000 and \$3,941,000, net of accumulated amortization, of \$3,641,000 and \$3,400,000 at December 31, 1997 and 1996, respectively, and is amortized by the straight-line method over periods of 10 to 22 years. The carrying value of the excess of purchase price over net assets acquired is reviewed (using estimated future net cash flows, including proceeds from disposal) if the facts and circumstances indicate that it may be impaired. No significant impairment provisions were required in 1997, 1996 or 1995.

### DEBT ISSUANCE COST

Debt issuance costs are amortized over the term of the associated debt instrument using the straight-line method. Such costs, which are included in other assets in the accompanying balance sheet, were \$4,272,000 and \$1,224,000 net of accumulated amortization of \$683,000 and \$1,257,000 as of December 31, 1997 and 1996, respectively.

## RESEARCH AND DEVELOPMENT COSTS

Costs incurred in connection with product research and development are expensed as incurred. Such costs amounted to \$394,000 in 1997, \$532,000 in 1996 and \$501,000 in 1995.

## ADVERTISING COSTS

Costs incurred in connection with advertising and promotion of the Company's products are expensed as incurred. Such costs amounted to \$2,430,000 in 1997, \$1,814,000 in 1996 and \$1,658,000 in 1995.

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 2. ACCOUNTING POLICIES (CONTINUED)

### TRANSLATION OF FOREIGN CURRENCY

Assets and liabilities of foreign operations, where the functional currency is the local currency, are translated into U.S. dollars at the fiscal year end exchange rate. The related translation adjustments are recorded as cumulative translation adjustments, a separate component of shareholders' equity. Revenues and expenses are translated using average exchange rates prevailing during the year.

### HEDGING

In 1997, the Company entered into an interest rate forward agreement to effectively fix the interest rate on a long-term lease commitment to become effective August 1998 (not for trading purposes). The Company accounts for this agreement under the deferral method, whereby the net gain or loss upon settlement will adjust the item being hedged, the minimum lease rentals in periods commencing with the lease execution. If the necessary correlation (generally a correlation coefficient of between 80% and 125%) ceases, the differential between the market value and the carrying value will be recognized in operations as a gain or loss. Under the interest rate forward agreement, the Company is the fixed rate payor on notional amounts aggregating \$50 million with a weighted average interest rate of 7.12%. The agreement requires a net settlement on maturity in August 1998, of which an unrelated third party is contractually obligated for 50%. The Company is required to post margin in the form of bank letters of credit or treasury bills under this interest rate hedge agreement. At December 31, 1997, the Company had issued margin in the form of letters of credit and treasury bills of approximately \$3.6 million. See Note 10 - Commitments and Contingencies and Note - 12 - Fair Value of Financial Instruments.

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 2.ACCOUNTING POLICIES (CONTINUED)

In November 1997, the Company entered into a three month natural gas swap agreement at a price of \$2.94 per MMBtu for the months of December 1997 through February 1998 to hedge the price volatility of ammonia(not for trading purposes). Under these swap agreements, the Company is the fixed-price payor. Monthly payments are made or received based on the differential between the fixed price and the specified index price of natural gas on the settlement date. Gains or losses resulting from the settlement of the swap transactions are recognized in cost of sales when the inventory is sold. At December 31,1997, commodity contracts involving notional amounts of 236,000 MMBtu were outstanding and are not reflected in the accompanying balance sheet. These notional amounts do not represent amounts exchanged by the parties; rather, they are used as the basis to calculate the amounts due under the agreements.

### LOSS 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 effects 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 loss applicable to common stock is computed by adjusting net loss by the amount of preferred stock dividends. Basic 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 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

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

2. ACCOUNTING POLICIES (CONTINUED)

convertible securities outstanding, if any, after appropriate adjustment for interest, net of related income tax effects on convertible notes payable, as applicable. All potentially dilutive securities were antidilutive for all periods presented and have thus, been excluded from diluted loss per share. See Note 7- Stockholder's Equity, Notes 8 - Redeemable Preferred Stock, and Note 9 Nonredeemable Preferred Stock for a full description of securities which may have a dilutive effect in future periods.

Average common shares outstanding used in computing loss per share are as follows:

	1997	1996	1995
	-----		
Basic and diluted	12,876,064	12,925,649	13,020,677

RECENTLY ISSUED PRONOUNCEMENTS

In June 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 130, Reporting Comprehensive Income ("Statement 130"), which is effective for fiscal years beginning after December 15, 1997. Reclassifications of financial statements for earlier periods presented for comparative purposes will be required when adopted by the Company in 1998. The Statement establishes standards for reporting and displaying comprehensive income. Comprehensive income is defined as the change in equity of an enterprise during a period from transactions and other events and circumstances from nonowner sources. It includes all changes in equity during a period except those resulting from investment by owners and distributions to owners. The primary impact of the new Statement will be related to the inclusion of foreign currency translation gains or losses in determining "Comprehensive Income" as compared with the current statement of operations which does not give effect to this item.

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

2.ACCOUNTING POLICIES (CONTINUED)

In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information ("Statement 131"), which is effective for

years beginning after December 15, 1997. Statement 131 establishes standards for the way that public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports. It also establishes standards for related disclosures about products and services, geographic areas, and major customers. Statement 131 is effective for financial statements for fiscal years beginning after December 15, 1997 and, therefore, the Company will adopt the new requirements retroactively in 1998. Management has not completed its review of Statement 131, but does not anticipate that the adoption of this Statement will have a significant effect on the Company's reported segments.

#### STATEMENTS OF CASH FLOWS

For purposes of reporting cash flows, cash and cash equivalents include cash, overnight funds and interest bearing deposits with maturities when purchased by the Company of 90 days or less.

Supplemental cash flow information includes:

	1997	1996	1995
-----			
(In Thousands)			
Cash payments for:			
Interest on long-term debt and other	\$ 14,804	\$ 12,038	\$10,613
Income taxes, net of refunds	86	345	191
Noncash financing and investing activities			
Long-term debt issued for property, plant and equipment	1,108	2,226	2,534

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LSB Industries, Inc.  
Notes to Consolidated Financial Statements (continued)

#### 3. INVENTORIES

Inventories at December 31, 1997 and 1996 consist of:

	FINISHED (OR PURCHASED) GOODS	WORK-IN- PROCESS	RAW MATERIALS	TOTAL
-----				
(In Thousands)				
1997:				
Chemical products	\$ 10,314	\$ 4,556	\$ 11,020	\$ 25,890
Climate Control products	2,941	3,246	6,748	12,935
Automotive products	16,478	780	5,421	22,679
Machinery and industrial supplies	6,696	-	-	6,696
	-----			
Total	\$ 36,429	\$ 8,582	\$ 23,189	\$ 68,200
	=====			
1996 total	\$ 37,646	\$ 10,742	\$ 19,594	\$ 67,982
	=====			

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LSB Industries, Inc.  
Notes to Consolidated Financial Statements (continued)

4. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment, at cost, consist of:

	DECEMBER 31,	
	1997	1996
	-----	
	(In Thousands)	
Land and improvements	\$ 5,425	\$ 4,860
Buildings and improvements (A)	34,648	21,540
Machinery, equipment and automotive	154,727	141,972
Furniture, fixtures and store equipment	7,159	6,399
Producing oil and gas properties	3,246	3,279
	-----	-----
	205,205	178,050
Less accumulated depreciation, depletion and amortization	86,874	74,907
	-----	-----
	\$ 118,331	\$ 103,143
	=====	=====

(A) Includes The Tower in 1997 acquired through foreclosure in February 1997 as discussed in Note 2 - Accounting Policies, Loans Receivable. See Note 15 - Subsequent Event.

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

5. LONG - TERM DEBT

Long - term debt consists of the following:

	DECEMBER 31,	
	1997	1996
	-----	
	(In Thousands)	
Secured revolving credit facility with interest at a base rate plus a specified percentage (10.0% aggregate rate at December 31, 1997) (A)	\$ 19,275	\$ 57,248
10-3/4% Senior Notes due 2007 (B)	105,000	
Secured loan with interest payable monthly (C)	11,806	13,855
Note payable to bank, due in monthly installments of principal and interest through May 2001, interest at a rate equal to the Wall Street Journal prime rate plus .75% (aggregate rate of 9.25% at December 31, 1997) (D)	12,622	12,866
Secured loan due in monthly installments Of principal and interest through July 31, 2003, interest at a rate equal to the "Three-month adjusted Libor rate plus 4.25%" (E)	-	11,820
Secured loans with institutional lender (F):		
10.415% TO 12.72% term loans	-	5,542
Revolving credit facility	-	1,944
Other, with interest at rates of 7.5% to 12.25%, most of which is secured by machinery and equipment (G)	32,238	29,009
	-----	-----
	180,941	132,284
LESS CURRENT PORTION OF LONG-TERM DEBT	15,874	13,007
	-----	-----

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 5. LONG - TERM DEBT (CONTINUED)

- (A) In December 1994, the Company, certain subsidiaries of the Company (the "Borrowing Group") and a bank entered into a series of six asset-based revolving credit facilities which provided for an initial term of three years. In November 1997, the Company amended the agreement. The amended agreement provides for a \$65 million revolving credit facility (the "Revolving Credit Facility") with four separate loan agreements (the "Credit Facility Agreement"), for the Company and its subsidiaries. Under the Revolving Credit Facility, certain conditions exist which restrict intercompany transfers of amounts borrowed between subsidiaries. Borrowings under the Revolving Credit Facility bear an annual rate of interest at a floating rate based on the lender's prime rate plus 1.5% per annum or, at the Company's option, on the lender's LIBOR rate plus 3.875% per annum (which rates are subject to increase or reduction based upon specified availability and adjusted tangible net worth levels). The agreement will terminate on December 31, 2000, subject to automatic renewal for terms of 13 months each, unless terminated by either party. The Credit Facility Agreement also requires the payment of an annual facility fee equal to 0.5% of the unused Revolving Credit Facility. The Company may terminate the Revolving Credit Facility prior to maturity; however, should the Company do so, it would be required to pay a termination fee equal to 1% of the average daily balance of loans and letters of credit outstanding during the 180 day period immediately prior to termination.

Each of the Credit Facility Agreements specify a number of events of default and requires the Company to maintain certain financial ratios (including adjusted tangible net worth and debt ratios), limits the amount of capital expenditures, and contains other covenants which restrict, among other things, (i) the incurrence of additional debt; (ii) the payment of dividends and other distributions; (iii) the making of certain investments; (iv) certain mergers, acquisitions and dispositions; (v) the issuance of secured guarantees; and (vi) the granting of certain liens.

Events of default under the Revolving Credit Facility include, among other things, (i) the failure to make payments of principal, interest, and fees, when due; (ii) the failure to perform covenants contained therein; (iii) the occurrence of a change in control if any party is or becomes the beneficial owner of more than 50% of the total voting securities of the Company, except for Jack E. Golsen or members of his immediate family; (iv) default under any material agreement or instrument (other than an agreement or instrument evidencing the lending

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 5. LONG - TERM DEBT (CONTINUED)

of money) which would have a material adverse effect on the Company and its subsidiaries which are borrowers under the Revolving Credit Facility, taken as a whole, and which is not cured within the grace period; (v) a default under any other agreement relating to borrowed money exceeding certain limits; and (vi) customary bankruptcy or insolvency defaults.

At December 31, 1997, the Company and its subsidiaries were not in compliance with certain of its financial covenants of the Revolving Credit Facility. In April 1998, the Company obtained a waiver of noncompliance and an amendment to reset the financial covenants through

maturity.

The Revolving Credit Facility is secured by the accounts receivable, inventory, proprietary rights, general intangibles, books and records, and proceeds thereof of the Company. See Note 15 - Subsequent Event.

- (B) On November 26, 1997, a subsidiary of the Company (ClimaChem, Inc., "CCI") completed the sale of \$105 million principal amount of 10 3/4% Senior Notes due 2007 (the "Notes"). The proceeds of the Notes of \$101.8 million, net of underwriter's fees, were used to (a) fully repay the principal and prepayment fees of a \$50 million John Hancock Mutual Life Insurance Company ("John Hancock") financing arrangement described in Note 14-Extraordinary Charge, (b) reduce amount outstanding under

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

#### 5. LONG TERM DEBT (CONTINUED)

various revolving credit facilities with respect to the chemical business and the Climate Control Business, and (c) fund a loan to the Company of \$10 million. The Notes bear interest at an annual rate of 10 3/4% payable semiannually in arrears on June 1 and December 1 of each year. The Notes are Senior unsecured obligations of CCI and rank pari passu in right of payment to all existing senior unsecured indebtedness of CCI and its subsidiaries. The Notes are effectively subordinated to all existing and future senior secured indebtedness of CCI.

The Notes were issued pursuant to an Indenture, which contains certain covenants that, among other things, limit the ability of CCI and its subsidiaries to: (i) incur additional indebtedness; (ii) incur certain liens; (iii) engage in certain transactions with affiliates; (iv) make certain restricted payments; (v) agree to payment restrictions affecting subsidiaries; (vi) engage in unrelated lines of business; or (vii) engage in mergers, consolidations or the transfer of all or substantially all of the assets of CCI to another person. In addition, in the event of certain asset sales, CCI will be required to use the proceeds to reinvest in the Company's business, to repay certain debt or to offer to purchase Notes at 100% of the principal amount thereof, plus accrued and unpaid interest, if any, thereon, plus liquidated damages, if any, to the date of purchase.

Except as described below, the Notes are not redeemable at CCI's option prior to December 1, 2002. After December 1, 2002, the Notes will be subject to redemption at the option of CCI, in whole or in part, at the redemption prices set forth in the 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 Notes are redeemable, at the option of CCI, 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, if any, to the date of the redemption, with the net cash proceeds of a public equity offering; provided, however, that at least \$65 million in aggregate principal amount of the Notes remain outstanding following such redemption.

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

#### 5. LONG TERM DEBT (CONTINUED)

In the event of a change of control of the Company or CCI, holders of

the Notes will have the right to require CCI 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.

CCI 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. CCI's payment obligations under the Notes are fully, unconditionally and joint and severally guaranteed by all of the existing subsidiaries of CCI, except for El Dorado Nitrogen Company ("EDNC"). The assets, equity, and earnings of EDNC are inconsequential for all periods presented. Separate financial statements and other disclosures concerning the guarantors are not presented herein because management has determined they are not material to investors. Summarized financial information of CCI and its subsidiaries as of December 31, 1997 and 1996 and the results of operations for each of the three years ended December 31, 1997 is as follows:

	DECEMBER 31,	
	1997	1996
-----		
(In Thousands)		
BALANCE SHEET DATA:		
Current assets	\$ 88,442	\$ 84,492
Property, plant and equipment	84,329	82,676
Notes receivable from LSB and affiliates	13,443	-
Other assets	14,661	6,586
	-----	-----
Total assets	\$ 200,875	\$ 173,754
	=====	=====
Current liabilities	\$ 38,004	\$ 52,342
Long-term debt	126,346	71,763
Other	9,236	16,806
Stockholders' equity	27,289	32,843
	-----	-----
Total liabilities and stockholders' equity	\$ 200,875	\$ 173,754
	=====	=====

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

#### 5. LONG-TERM DEBT (CONTINUED)

	DECEMBER 31,		
	1997	1996	1995
-----			
(In Thousands)			
OPERATIONS DATA:			
Total revenues	\$ 263,321	\$ 255,618	\$ 221,541
Costs and expenses:			
Costs of sales	213,772	207,828	172,858
Selling, general and administrative	37,854	33,122	30,344
Interest	9,369	6,247	7,185
	-----	-----	-----
	260,995	247,197	210,387
	-----	-----	-----
Income before provision for income taxes and extraordinary charge	2,326	8,421	11,154

Provision for income taxes	1,429	2,668	5,255
	-----	-----	-----
Income before extraordinary charge	897	5,753	5,899
Extraordinary charge, net of income tax benefit of \$1,750,000	2,869	-	-
	-----	-----	-----
Net income (loss)	\$ (1,972)	\$ 5,753	\$ 5,899
	=====	=====	=====

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

5. LONG TERM DEBT (CONTINUED)

(C) This agreement, as amended, between a subsidiary of the Company and an institutional lender provided for a loan, the proceeds of which were used in the construction of a nitric acid plant, in the aggregate amount of \$16.5 million requiring 84 equal monthly payments of principal plus interest, with interest at a fixed rate of 8.86% through maturity in 2002. This agreement is secured by the plant, equipment and machinery, and proprietary rights associated with the plant which has an approximate carrying value of \$30.3 million at December 31, 1997.

In November 1997, the Company amended this agreement to restate the financial and restrictive covenants to be applicable to the subsidiary of the Company. This agreement, as amended, contains covenants (i) requiring maintenance of an escalating tangible net worth, (ii) restricting distributions and dividends, (iii) restricting a change of control of the subsidiary and the Company and (iv) requiring maintenance of a reducing debt to

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

5. LONG TERM DEBT (CONTINUED)

tangible net worth ratio. At December 31, 1997, the subsidiary of the Company was not in compliance with certain of the financial covenants of the agreement. In March 1998, the subsidiary of the Company obtained a waiver of the noncompliance and an amendment to reset the financial covenants through maturity.

(D) In May 1995, a subsidiary of the Company entered into a term loan agreement with a bank in the amount of \$9 million. The agreement was amended in May 1996 to increase the loan to \$13 million. The loan, which matured in May 2001, was payable in 60 monthly payments of principal and interest, commencing on June 30, 1996. The monthly principal and interest payment was based on a 240-month period ("Amortization Period") at a rate of interest equal to .75% in excess of the prime rate of a certain bank. The loan was secured by The Tower, subsequent to its acquisition in February 1997. See Note 15-Subsequent Event.

(E) This agreement between a subsidiary of the Company and a subsidiary of a bank required monthly installments of principal and interest through July 31, 2003 at the three-month adjusted LIBOR rate plus 4.25%. The outstanding balance was paid in February 1997 in connection with the John Hancock financing arrangement. See Note 14-Extraordinary Charge.

(F) This agreement between a subsidiary of the Company and two institutional lenders provided for two series of term loans and a revolving credit facility. The outstanding balance was paid in February 1997 in connection with the John Hancock financing arrangement. See Note 14-Extraordinary Charge.

(G) Includes a \$3.0 million note payable to SBL Corporation, a related party owned by the Golsen family. The note bears interest at 10.75% per annum, is unsecured and due on demand.

Maturities of long-term debt for each of the five years after December 31, 1997 are: 1998 - \$15,874; 1999 - \$8,167; 2000 - \$27,498; 2001 - \$19,296; 2002

- - \$2,912 and thereafter - \$107,194.

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

6. INCOME TAXES

The provision for income taxes before extraordinary charge consists of the following for the year indicated:

1997	1996	1995
------	------	------

-----  
(In Thousands)

Current:

Federal	\$ -	\$ 54	\$ -
State	50	96	150
	-----	-----	-----
	\$50	\$150	\$150
	=====	=====	=====

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

6. INCOME TAXES (CONTINUED)

The approximate tax effects of each type of temporary difference and carryforward that are used in computing deferred tax assets and liabilities and the valuation allowance related to deferred tax assets at December 31, 1997 and 1996 are as follows:

1997	1996
------	------

-----  
(IN THOUSANDS)

DEFERRED TAX ASSETS

Allowances for doubtful accounts and other asset impairments not deductible for tax purpose	\$ 5,361	\$ 4,896
Capitalization of certain costs as inventory for tax purposes	2,835	3,415
Net operating loss carryforward	26,334	17,642
Investment tax and alternative minimum tax credit carryforwards	1,397	1,397
Other	956	1,079
	-----	-----
Total deferred tax assets	36,884	28,429
Less valuation allowance on deferred tax assets	26,455	17,363

Net deferred tax assets	\$ 10,429	\$ 11,066
	=====	=====
DEFERRED TAX LIABILITIES		
Accelerated depreciation used for tax purposes	\$ 8,288	\$ 8,918
Inventory basis difference resulting from a business combination	2,139	2,139
Other	2	9
	-----	-----
Total deferred tax liabilities	\$ 10,429	\$ 11,066
	=====	=====

The Company is able to realize deferred tax assets up to an amount equal to the future reversals of existing taxable temporary differences. The taxable temporary differences will turn around in the loss carryforward period as the differences are depreciated or amortized. Other differences will turn

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

#### 6. INCOME TAXES (CONTINUED)

around as the assets are disposed in the normal course of business.

The differences between the amount of the provision for income taxes and the amount which would result from the application of the federal statutory rate to "Loss before provision for income taxes and extraordinary charge" for each of the three years in the period ended December 31, 1997 are detailed below:

	1997	1996	1995
	-----	-----	-----
	(In Thousands)		
(s>			
Benefit for income taxes at federal statutory rate	\$ (8,055)	\$ (1,293)	\$ (1,254)
Changes in the valuation allowance related to deferred tax assets, net of rate differential	7,313	1,591	409
State income taxes, net of federal benefit	33	62	99
Permanent differences	534	364	283
Foreign subsidiary loss (income)	191	(635)	615
Alternate minimum tax	-	54	-
Other	34	7	(2)
	-----	-----	-----
Provision for income taxes	\$ 50	\$ 150	\$ 150
	=====	=====	=====

At december 31, 1997, the company has regular-tax net operating loss ("NOL") carryforwards of approximately \$65 million (approximately \$18 Million alternative minimum tax NOLs). Certain amounts of regular-tax NOL Expire beginning in 1999.

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

#### 7. STOCKHOLDERS' EQUITY

##### STOCK OPTIONS

The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and related interpretations in accounting for its employee stock options because, as discussed below, the alternative fair value accounting provided for under FASB Statement No. 123, "Accounting for Stock-Based Compensation," requires use of option valuation models that were not developed for use in valuing employee stock options. Under APB 25, because the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is generally recognized.

Pro forma information regarding net income and earnings per share is required by Statement 123, which also requires that the information be determined as if the Company has accounted for its employee stock options granted subsequent to December 31, 1994 under the fair value method of that Statement. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions for 1997, 1996 and 1995, respectively: risk-free interest rates of 6.2%, 6.0% and 6.4%; a dividend yield of 1.43%, 1.38% and 1.04%; volatility factors of the expected market price of the Company's common stock of .42, .41 and .41; and a weighted average expected life of the option of 8.0, 6.8 and 7.3 years.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

#### 7. STOCKHOLDERS' EQUITY (CONTINUED)

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

	YEAR ENDED DECEMBER 31,		
	1997	1996	1995
	-----		
	(In Thousands, Except Per Share Data)		
Net loss applicable to common stock	\$(26,715)	\$(7,184)	\$(7,036)
Loss per common share	(2.07)	(.56)	(.54)

Because Statement 123 is applicable only to options granted subsequent to December 31, 1994, its pro forma effect will not be fully reflected until 1998.

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

7.STOCKHOLDERS' EQUITY (CONTINUED)

QUALIFIED STOCK OPTION PLANS

In November 1981, the Company adopted the 1981 Incentive Stock Option Plan (1,350,000 shares), in March 1986, the Company adopted the 1986 Incentive Stock Option Plan (1,500,000 shares) and, in September 1993, the Company adopted the 1993 Stock Option and Incentive Plan (850,000 shares). Under these plans, the Company is authorized to grant options to purchase up to 3,700,000 shares of the Company's common stock to key employees of the Company and its subsidiaries. The 1981 and 1986 Incentive Stock Option Plans have expired and, accordingly, no additional options may be granted from these plans. Options granted prior to the expiration of these plans continue to remain valid thereafter in accordance with their terms. At December 31, 1997, there are 212,260 of options outstanding related to these two plans. At December 31, 1997, there are 836,500 options outstanding related to the 1993 Incentive Stock Option Plan which continues to be effective. These options become exercisable 20% after one year from date of grant, 40% after two years, 70% after three years, 100% after four years and lapse at the end of ten years. The exercise price of options to be granted under this plan is equal to the fair market value of the Company's common stock at the date of grant. For participants who own 10% or more of the Company's common stock at the date of grant, the option price is 110% of the fair market value at the date of grant and the options lapse after five years from the date of grant.

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

7.STOCKHOLDERS' EQUITY (CONTINUED)

Activity in the Company's qualified stock option plans during each of the three years in the period ended December 31, 1997 is as follows:

	1997		1996		1995	
Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	
Outstanding at beginning of year	1,176,640	\$4.08	611,140	\$3.40	581,140	\$ 2.84
Granted	-	-	720,500	4.33	91,000	5.88
Exercised	(118,880)	2.81	(120,000)	2.13	(61,000)	1.74
Surrendered, Forfeited or expired	(9,000)	6.05	(35,000)	4.21	-	-
Outstanding at End of year	<u>1,048,760</u>	<u>4.25</u>	<u>1,176,640</u>	<u>4.08</u>	<u>611,140</u>	<u>3.40</u>
Exercisable at end of year	<u>414,960</u>	<u>3.81</u>	<u>354,540</u>	<u>3.76</u>	<u>390,540</u>	<u>2.39</u>
Weighted average Fair value of options Granted during year	-	-	2.00	2.00	3.01	3.01

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LSB Industries, Inc.

## 7. STOCKHOLDERS' EQUITY (CONTINUED)

Outstanding options to acquire 868,260 shares of stock at December 31, 1997 had exercise prices ranging from \$1.13 to \$4.13 per share (337,660 of which are exercisable at a weighted average price of \$3.15 per share) and had a weighted average exercise price of \$3.86 and remaining contractual life of 5.4 years. The balance of options outstanding at December 31, 1997 had exercise prices ranging from \$5.36 to \$9.00 per share (77,300 of which are exercisable at a weighted average price of \$6.69 per share) and had a weighted average exercise price of \$6.15 and remaining contractual life of 7.0 years.

## NON-QUALIFIED STOCK OPTION PLANS

The Company's Board of Directors approved the grant of non-qualified stock options to the Company's outside directors, President and certain key employees, as detailed below. The option price was based on the market value of the Company's common stock at the date of grant. These options have vesting terms and lives specific to each grant but generally vest over 48 months and expire five or ten years from the grant date (except for the 1994 extension discussed below). In June 1994, the Board of Directors extended the expiration date on the grant of options for 165,000 shares to the Company's Chairman for an additional five years. The option price and terms of the option were unchanged except that, in consideration of the extension of time to exercise, the Chairman agreed to a revised vesting schedule for exercise of 20% of the option shares in each of the years 1995, 1996 and 1997 and 40% of the option shares in 1998.

In September 1993, the Company adopted the 1993 Nonemployee Director Stock Option Plan (the "Outside Director Plan"). The Outside Director Plan authorizes the grant of non-qualified stock options to each member of the Company's Board of Directors who is not an officer or employee of the Company or its subsidiaries. The maximum number of shares of common stock of the Company that may be issued under the Outside Director Plan is 150,000 shares (subject to adjustment as provided in the Outside Director Plan).

The Company shall automatically grant to each outside director an option to acquire 5,000 shares of the Company's common stock on April 30 following the end of each of the Company's fiscal years in which the Company realizes net income of \$9.2 million or more for such fiscal year. The exercise price for an option granted under this plan shall be the fair market value of the shares of common stock at the time the option is granted. Each option granted under this plan to the extent not exercised shall terminate upon the earlier of the

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LSB Industries, Inc.

## Notes to Consolidated Financial Statements (continued)

## 7. STOCKHOLDERS' EQUITY (CONTINUED)

termination as a member of the Company's Board of Directors or the fifth anniversary of the date such option was granted. During 1997 and 1995, the Company granted 50,000 options and 25,000 options, respectively, under the Outside Director Plan.

Activity in the Company's non-qualified stock option plans during each of the three years in the period ended December 31, 1997 is as follows:

	1997		1996		1995	
Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	
Outstanding at beginning of year	265,000	\$3.31	285,000	\$3.44	335,000	\$ 2.83
Granted	50,000	4.19			25,000	5.38
Exercised	(35,000)	3.13	(10,000)	3.13	(75,000)	1.38
Surrendered,						

forfeited, or expired	-	-	(10,000)	7.19	-	-
-----	-----	-----	-----	-----	-----	-----
Outstanding at end of year	280,000	3.44	265,000	3.31	285,000	3.44
=====	=====	=====	=====	=====	=====	=====
Exercisable at end of year	164,000	3.55	166,000	3.64	153,000	4.06
=====	=====	=====	=====	=====	=====	=====
Weighted average fair value of options granted during year		2.00				2.14

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

#### 7. STOCKHOLDERS' EQUITY (CONTINUED)

Outstanding options to acquire 240,000 shares of stock at December 31, 1997 had exercise prices ranging from \$1.38 to \$4.25 per share (124,000 of which are exercisable at a weighted average price of \$2.97 per share) and had a weighted average exercise price of \$2.82 and remaining contractual life of 3.2 years. The balance of options outstanding at December 31, 1997 had exercise prices ranging from \$5.38 to \$9.00 per share (40,000 of which are exercisable at a weighted average price of \$7.19 per share) and a weighted average exercise price of \$7.19 and remaining contractual life of 1.8 years.

#### PREFERRED SHARE PURCHASE RIGHTS

In February 1989, the Company's Board of Directors declared a dividend distribution of one Preferred Share Purchase Right (the "Preferred Right") for each outstanding share of the Company's common stock. The Preferred Rights are designed to ensure that all of the Company's stockholders receive fair and equal treatment in the event of a proposed takeover or abusive tender offer.

The Preferred Rights are generally exercisable when a person or group, other than the Company's Chairman and his affiliates, acquire beneficial ownership of 30% or more of the Company's common stock (such a person or group will be referred to as the "Acquirer"). Each Preferred Right (excluding Preferred Rights owned by the Acquirer) entitles stockholders to buy one one-hundredth (1/100) of a share of a new series of participating preferred stock at an exercise price of \$14. Following the acquisition by the Acquirer of beneficial ownership of 30% or more of the Company's common stock, and prior to the acquisition of 50% or more of the Company's common stock by the Acquirer, the Company's Board of Directors may exchange all or a portion of the Preferred Rights (other than Preferred Rights owned by the Acquirer) for the Company's common stock at the rate of one share of common stock per Preferred Right. Following acquisition by the Acquirer of 30% or more of the Company's common stock, each Preferred Right (other than the Preferred Rights owned by the Acquirer) will entitle its holder to purchase a number of the Company's common shares having a market value of two times the Preferred Right's exercise price.

If the Company is acquired, each Preferred Right (other than the Preferred Rights owned by the Acquirer) will entitle its holder to purchase a number of the Acquirer's common shares having a market value at the time of two times the Preferred Right's exercise price.

Prior to the acquisition by the Acquirer of beneficial ownership of 30% or

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LSB Industries, Inc.

## 7. STOCKHOLDERS' EQUITY (CONTINUED)

more of the Company's stock, the Company's Board of Directors may redeem the Preferred Rights for \$.01 per Preferred Right.

## 8. REDEEMABLE PREFERRED STOCK

Each share of the noncumulative redeemable preferred stock, \$100 par value, is convertible into 40 shares of the Company's common stock at any time at the option of the holder; entitles the holder to one vote and is redeemable at par. The redeemable preferred stock provides for a noncumulative annual dividend of 10%, payable when and as declared. Dividend payments were current at December 31, 1997 and 1996.

## 9. NON-REDEEMABLE PREFERRED STOCK

The 20,000 shares of Series B cumulative, convertible preferred stock, \$100 par value, are convertible, in whole or in part, into 666,666 shares of the Company's common stock (33.3333 shares of common stock for each share of preferred stock) at any time at the option of the holder and entitles the holder to one vote per share. The Series B preferred stock provides for annual cumulative dividends of 12% from date of issue, payable when and as declared. Dividend payments were current at December 31, 1997 and 1996.

The Class C preferred stock, designated as a \$3.25 convertible exchangeable Class C preferred stock, Series 2, has no par value ("Series 2 Preferred"). The Series 2 Preferred has a liquidation preference of \$50.00 per share plus accrued and unpaid dividends and is convertible at the option of the holder at any time, unless previously redeemed, into common stock of the Company at an initial conversion price of \$11.55 per share (equivalent to a conversion rate of approximately 4.3 shares of common stock for each share of Series 2 Preferred), subject to adjustment under certain conditions. Upon the mailing of notice of certain corporate actions, holders will have special conversion rights for a 45-day period.

The Series 2 Preferred is redeemable subsequent to June 15, 1996. The Series 2 Preferred is redeemable at the option of the Company, in whole or in part, at \$52.28 per share if redeemed on or after June 15, 1996, and thereafter at prices decreasing ratably annually to \$50.00 per share on or after June 15, 2003, plus accrued and unpaid dividends to the redemption date. Dividends on the Series 2 Preferred are cumulative and are payable quarterly in arrears. Dividend payments were current at December 31, 1997 and 1996.

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 9. NON-REDEEMABLE PREFERRED STOCK (CONTINUED)

The Series 2 Preferred also is exchangeable in whole, but not in part, at the option of the Company on any dividend payment date beginning June 15, 1996, for the Company's 6.50% Convertible Subordinated Debentures due 2018 (the "Debentures") at the rate of \$50.00 principal amount of Debentures for each share of Series 2 Preferred. Interest on the Debentures, if issued, will be payable semiannually in arrears. The Debentures will, if issued, contain conversion and optional redemption provisions similar to those of the Series 2 Preferred and will be subject to a mandatory annual sinking fund redemption of five percent of the amount of Debentures initially issued, commencing June 15, 2003 (or the June 15 following their issuance, if later).

At December 31, 1997, the Company is authorized to issue an additional 248,461 shares of \$100 par value preferred stock and an additional 5,000,000 shares of no par value preferred stock. Upon issuance, the Board of Directors of the Company is to determine the specific terms and conditions of such preferred stock.

## 10. COMMITMENTS AND CONTINGENCIES

### OPERATING LEASES

The Company leases certain property, plant and equipment under noncancelable operating leases. Future minimum payments on operating leases with initial or remaining terms of one year or more at December 31, 1997 are as follows:

(In  
Thousands)

1998	\$ 2,323
1999	1,930
2000	1,667
2001	1,604
2002	1,544
After 2002	5,751
	-----
	\$ 14,819
	=====

Rent expense under all operating lease agreements, including month-to-month leases, was \$4,085,000 in 1997, \$4,337,000 in 1996 and \$3,400,000 in 1995.

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

#### 10. COMMITMENTS AND CONTINGENCIES (CONTINUED)

Renewal options are available under certain of the lease agreements for various periods at approximately the existing annual rental amounts. Rent expense paid to related parties was \$90,000 in 1997, 1996 and 1995.

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 will act 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 \$60 million and will be completed by the end of 1998. Construction financing of the EDNC Baytown Plant is to be provided by an unaffiliated lender. Neither the Company nor EDC has guaranteed any of the lending obligations for the EDNC Baytown Plant.

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

#### 10.COMMITMENTS AND CONTINGENCIES (CONTINUED)

##### PURCHASE COMMITMENTS

A subsidiary of the Company purchases substantial quantities of anhydrous ammonia for use in manufacturing its products. A subsidiary of the Company has contracts with two suppliers of ammonia. One contract requires a subsidiary of the Company to purchase not less than 75,000 tons nor more than 140,000 tons of anhydrous ammonia each contract year and is for a term expiring in December 1998. The other requires a subsidiary of the Company to take or pay for an average of 10,000 tons of anhydrous ammonia per month and expires April 2000. These contracts are at floating prices. Purchases of anhydrous ammonia under these two contracts aggregated \$40.1 million in 1997 (\$30.4 million and \$23.8

million for the one contract effective in 1996 and 1995, respectively). The pricing volatility of such raw material directly affects the operating profitability of a subsidiary of the Company. A subsidiary of the Company also enters into agreements with suppliers of raw materials which require a subsidiary of the Company to provide finished goods in exchange therefore. At December 31, 1997, the subsidiary of the Company had received quantities of anhydrous ammonia in exchange for which the subsidiary of the Company has a commitment to provide 12,020 tons of ammonium nitrate and 20,250 tons of nitric acid. The Company believes these agreements are generally favorable to the subsidiary of the Company and the delivery commitments will be met in the ordinary course of business. At December 31, 1997, the Company has a standby letter of credit outstanding related to its Chemical Business of \$3.5 million.

A subsidiary of the Company leases certain precious metals for use in the subsidiary's manufacturing process under 90 day agreements. The agreement at December 31, 1997 requires rentals generally based on 17% of the leased metals' market values from January 1998 through March 1998, contract expiration. The agreements also require the subsidiary to purchase 900 ounces of platinum at \$450 per ounce if the spot price for platinum is \$450 per ounce or lower at the end of the lease term.

In January 1996, a subsidiary negotiated an amendment to an agreement with a foreign customer, modifying the subsidiary's firm commitment to purchase \$30 million of bearing products over a five-year period in exchange for waiver of the foreign customer's commitment to provide bearing products without charge to the subsidiary at a future date. Under this amendment the Company is not required to purchase more bearing products each year than it can sell in its normal course of business. During 1995, the subsidiary purchased approximately

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

#### 10.COMMITMENTS AND CONTINGENCIES (CONTINUED)

\$3.1 million of product in connection with such requirement. As a result of the elimination of the subsidiary's future bearing product commitment, the Company recognized the remaining \$1.8 million of contract revenue in 1995 which had been previously deferred pending completion of the subsidiary's firm purchase commitment.

In July 1995, a subsidiary of the Company entered into a product supply agreement with a third party whereby the subsidiary is required to make monthly facility fee and other payments which aggregate \$71,965. In return for this payment, the subsidiary is entitled to certain quantities of compressed oxygen produced by the third party. Except in circumstances as defined by the agreement, the monthly payment is payable regardless of the quantity of compressed oxygen used by the subsidiary. The term of this agreement, which has been included in the above minimum operating lease commitments, is for a term of 15 years; however, after the agreement has been in effect for 60 months, the subsidiary can terminate the agreement without cause at a cost of approximately \$4.5 million. Based on the subsidiary's estimate of compressed oxygen demands of the plant, the cost of the oxygen under this agreement is expected to be favorable compared to floating market prices.

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

#### DEBT GUARANTEE

The Company has guaranteed approximately \$2.6 million of indebtedness of a start-up aviation company, Kestrel Aircraft Company, in exchange for a 25.6% ownership interest, to which no value has been assigned as of December 31, 1997. The Company has advanced the aviation company \$341,000 as of December 31, 1997 and 1996 and is accruing losses of the aviation company based on its ownership percentage. In February and March 1998, the Company purchased an additional 11.6% ownership interest in the aviation company in exchange for approximately \$287,000. The Company has recorded losses of \$2,309,000

(\$1,093,000 in 1997, \$626,000 in 1996 and \$590,000 in 1995) related to the debt guarantee. The debt guarantee relates to a \$2 million term note and 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 \$1.9 million at December 31, 1997.

The aviation company expects to complete the Federal Aviation Authority certification process in the second half of 1998, at which time commercial production may begin, subject to successfully obtaining additional financing required to complete the certification process and to establish commercial production facilities. At December 31, 1997, the aviation company is in technical violation of certain of its debt covenants; however, no demand has been made on the aviation company nor the guarantors. In March 1998, the aviation company is in negotiations with two potential inventors, both of which have indicated they have adequate resources to complete the certification process and begin commercial production; however, there are no assurances that the aviation company will close with either potential investor. If the aviation company is not successful in completing the certification process and obtaining additional external funding, the Company is likely to become responsible for the \$2.6 million indebtedness guarantee and may not be able to recover amounts advanced.

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

#### 10. COMMITMENTS AND CONTINGENCIES (CONTINUED)

##### 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 the subsidiaries of \$47,000. The site owner rejected this offer and proposed a counteroffer of \$245,000 plus a reopener for costs over \$12.5 million. The EPA rejected the Company's 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 December 31, 1997, the Company has accrued an amount based on a recent preliminary settlement proposal by the alleged potential responsible parties; however, there is no assurance such proposal will be accepted. Such amount 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. The subsidiary's insurance carriers have been notified of this matter; however, the amount of possible coverage, if any, is not yet determinable.

## LSB Industries, Inc.

## Notes to Consolidated Financial Statements (continued)

## 10.COMMITMENTS AND CONTINGENCIES (CONTINUED)

- 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 reviewed by the State of Arkansas.

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 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 stormwater drain, and according to ADPC&E records, resulted in a minor fish kill in a drainage ditch near the El Dorado Plant. ADPC&E has proposed a Consent Administrative Order to resolve the event. The proposed CAO is currently being drafted by ADPC&E, and EDC has been advised that it will include a civil penalty in the amount of \$201,700 which includes \$125,000 which was previously agreed to be paid in the form of environmental improvements at the El Dorado Plant. The Company believes the proposed civil penalty is excessive and intends to seek reduction of such amount to allow the Chemical Business to use the \$125,000 as originally proposed. The draft of the proposed consent administrative order also requires the Chemical Business to undertake certain additional compliance measures and equipment improvements related to the El Dorado Plant's wastewater treatment system.

## LSB Industries, Inc.

## Notes to Consolidated Financial Statements (continued)

## 10.COMMITMENTS AND CONTINGENCIES (CONTINUED)

- C. In 1996, a lawsuit was filed against the Company's Chemical Business by a group of residents of El Dorado, Arkansas, asserting a citizens' suit against the Chemical Business as a result of certain alleged violations of the Clean Air Act, the Clean Water Act, the Chemical Business' air and water permits and certain other environmental laws, rules and regulations. The citizens' suit requests the court to order the Chemical Business to cure such alleged violations, if any, plus penalties as provided under the applicable statutes. The Company's Chemical Business will assert all defenses available to it and will vigorously defend itself.

In July 1996, several of the same individuals who are plaintiffs in the citizens' suit referenced above filed a toxic tort lawsuit against the Company's Chemical Business alleging that they suffered certain injuries

and damages as a result of alleged releases of toxic substances from the Chemical Business' El Dorado, Arkansas manufacturing facility. In October 1996, another toxic tort lawsuit was filed against the Company's Chemical Business. This subsequent action asserts similar damage theories as the previously discussed lawsuit, except this action attempts to have a class certified to represent substantially all allegedly affected persons. The plaintiffs are suing for an unspecified amount of actual and punitive damages.

The Company's insurance carriers have been notified of these matters. The Company and the Chemical Business maintain an Environmental Impairment Insurance Policy ("EIL Insurance") that provides coverage to the Company and the Chemical Business for certain discharges, dispersals, releases, or escapes of certain contaminants and pollutants into or upon land, the atmosphere or any water course or body of water from the Site, which has caused bodily injury, property damage or contamination to others or to other property not on the Site. The EIL Insurance provides limits of liability for each loss up to \$10.0 million and a similar \$10.0 million limit for all losses due to bodily injury or property damage, except \$5.0 million for all remediation expenses, with the maximum limit of liability for all claims under the EIL Insurance not to exceed \$10.0 million for each loss or remediation expense and \$10.0 million for all losses and remediation expenses. The EIL Insurance also provides a retention of the first \$500,000 per loss or remediation expense that is to be paid by the Company. The Company's Chemical Business has spent an amount in excess of \$500,000 in legal, expert and

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

#### 10.COMMITMENTS AND CONTINGENCIES (CONTINUED)

other costs in connection with the toxic tort and citizen lawsuits described above, which the Company expensed. The EIL Insurance carrier has assumed responsibility for all subsequent legal, expert and other costs of defense and is paying such legal, expert and other costs on an on-going basis, subject to a reservation of rights relating to the citizens' suit. During the first quarter of 1998, the Company's Chemical Business agreed in principle to settle the toxic tort lawsuits discussed above. Settlement of the class action toxic tort lawsuits and the citizens' suit are subject to definitive settlement agreements. Settlement of the toxic tort lawsuit filed in October 1996 is subject, among other things, to court approval, while settlement of the citizens' suit is subject, among other things, to approval by the court or the United States Environmental Protection Agency. Substantially all of such settlement payments, upon satisfaction of the conditions, are to be funded directly by the Company's EIL Insurance carrier. The settlement of the citizens' suit, if completed, will require the Company's Chemical Business to implement at the El Dorado Facility and at the Company's expense reasonable and necessary environmentally related recommendations, if any, to be made in an environmental audit report to be issued by an independent third party retained by the Company to evaluate facility operations and emissions. The audit report has not yet been completed and, as a result, the costs, if any, to implement such recommendations, if any, are not known to the Company. However, the Company does not believe that the implementation of such recommendations, if any, that might be contained in the audit report will have a material adverse effect on the Company.

The amount of the settlements of these cases, if completed, and the amount paid under the EIL Insurance for legal and other expenses relating to the defense of these matters reduce the coverage amount available under the EIL insurance.

- D. 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

## LSB Industries, Inc.

## Notes to Consolidated Financial Statements (continued)

## 10.COMMITMENTS AND CONTINGENCIES (CONTINUED)

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.

For several years, certain members of the explosives industry have been the focus of a grand jury investigation being supervised by the U.S. Department of Justice ("DOJ") in connection with criminal antitrust allegations involving price fixing. Certain explosives companies, other than the Company, including all the Company's major competitors, and individuals employed by certain of those competitors, were indicted and have pled guilty to antitrust violations. The guilty pleas have resulted in nearly \$40 million in criminal fines. In connection with the grand jury investigation, the Company's Chemical Business received and has complied with two document subpoenas, certain of the Company's Chemical Business' employees have been interviewed by the DOJ under grants of immunity from prosecution, and certain of the Company's Chemical Business employees have testified under subpoena before the grand jury under grants of immunity in connection with the investigation. The Company believes that it has cooperated fully with the government's investigation. Recently, the Company has been informed by an official of the DOJ that it is not currently a target of the above investigation or of any grand jury investigating criminal antitrust activity in the explosives or ammonium nitrate industries.

## LSB Industries, Inc.

## Notes to Consolidated Financial Statements (continued)

## 10.COMMITMENTS AND CONTINGENCIES (CONTINUED)

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 to the net loss of a particular quarter or year, if resolved unfavorably.

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

#### 10.COMMITMENTS AND CONTINGENCIES (CONTINUED)

##### OTHER

In 1989 and 1991, the Company entered into severance agreements with certain of its executive officers that become effective after the occurrence of a change in control, as defined, if the Company terminates the officer's employment or if the officer terminates employment with the Company for good reason, as defined. These agreements require the Company to pay the executive officers an amount equal to 2.9 times their average annual base compensation, as defined, upon such termination.

The Company has retained certain risks associated with its operations, choosing to self-insure up to various specified amounts under its automobile, workers' compensation, health and general liability programs. The Company reviews such programs on at least an annual basis to balance the cost/benefit between its coverage and retained exposure.

#### 11.EMPLOYEE BENEFIT PLAN

The Company sponsors a retirement plan under Section 401(k) of the Internal Revenue Code under which participation is available to substantially all full-time employees. The Company does not presently contribute to this plan.

#### 12.FAIR VALUE OF FINANCIAL INSTRUMENTS

The following discussion of fair values is not indicative of the overall fair value of the Company's balance sheet since the provisions of the SFAS No. 107, "Disclosures About Fair Value of Financial Instruments," do not apply to all assets, including intangibles.

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

#### 12.FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

The following methods and assumptions were used by the Company in estimating its fair value of financial instruments:

LOANS RECEIVABLE: For variable-rate loans with no significant change in credit risk since loan origination, fair values approximate carrying amounts. Fair values for fixed-rate loans are estimated using discounted cash flow analyses, using interest rates which would currently be offered for loans with similar terms to borrowers of similar credit quality and for the same remaining maturities (interest rates range from 7% to 11% at December 31, 1997). In 1996, the fair values of loans which are collateral dependent for realization are estimated using the fair value of the underlying collateral.

As of December 31, 1997 and 1996, the net book value of loans receivable was \$.7 million and \$15.0 million and fair values of loans receivable were approximately \$.7 million and \$18.9 million, respectively (assuming an estimated fair value of the underlying collateral for collateral dependent loans of \$18.0 million in 1996).

BORROWED FUNDS: Fair values for fixed rate borrowings are estimated using a discounted cash flow analysis that applies interest rates currently being offered on borrowings of similar amounts and terms to those currently outstanding. Carrying values for variable rate borrowings approximate their fair value. As of December 31, 1997 and 1996, carrying values of variable rate and fixed-rate long-term debt which aggregated \$180.9 million and \$132.3 million, respectively, approximated their estimated fair value.

HEDGING AGREEMENTS: The fair value of the interest rate forward agreement is estimated based on quoted market prices of instruments with similar terms. As of December 31, 1997, the financial instruments' fair value (which is not reflected on the accompanying balance sheet), net to the Company's 50% interest, represented a liability of approximately \$1.8 million. A change in the settlement index (the seven year U.S. Treasury bond) of .25% will change the fair value of the hedge agreement by approximately \$350,000, net to the Company's interest. The fair value of the natural gas swap agreement was estimated based on market prices of natural gas for the periods covered by the agreement. At December 31, 1997, the fair values of such agreement represented a liability of approximately \$165,000.

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 12. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

As of December 31, 1997, the carrying values of cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities approximated their estimated fair value.

## 13. SEGMENT INFORMATION

The Company and its subsidiaries operate principally in four industries.

### CHEMICAL

This segment manufactures and sells chemical products for mining, agricultural, electronic, paper and other industries. Production from the Company's primary manufacturing facility in El Dorado, Arkansas, for the year ended December 31, 1997 comprises approximately 76% of the chemical segment's sales. Sales to customers of this segment primarily include coal mining companies in Kentucky, Missouri and West Virginia and farmers in Texas and Arkansas.

The Chemical Business is subject to various federal, state and local environmental regulations. Although the Company has designed policies and procedures to help reduce or minimize the likelihood of significant chemical accidents and/or environmental contamination, there can be no assurances that the Company will not sustain a significant future operating loss related thereto.

In May 1997, the Chemical Business completed constructing a concentrated nitric acid plant (carrying value of \$30.3 million at December 31, 1997); which has a stated production capacity of 285 tons per day. The Company incurred significant delays and costs in attempting to achieve the plant's stated capacity. The Company anticipates maintaining an economically feasible rate of production. If such rate of production is

not maintained, the Company may sustain significant future operating losses and possible impairment related thereto.

The Chemical Business' Australian subsidiary's results of operations 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 this subsidiary services. If these adverse economic conditions in Asia continue for an extended period of time, such could have an adverse

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

### 13. SEGMENT INFORMATION (CONTINUED)

effect on the Company's consolidated results of operations for future periods resulting in possible impairment of its long-lived assets.

Further, the Company purchases substantial quantities of anhydrous ammonia for use in manufacturing its products. The pricing volatility of such raw material directly affects the operating profitability of the chemical segment.

#### CLIMATE CONTROL

This business segment manufactures and sells, primarily from its various facilities in Oklahoma City, a variety of hydronic fan coil, water source heat pump products as well as other HVAC products for use in commercial and residential air conditioning and heating systems. The Company's various facilities in Oklahoma City comprise substantially all of the environment control operations. Sales to customers of this segment primarily include original equipment manufacturers, contractors and independent sales representatives located throughout the world, are generally secured by a mechanic's lien, except for sales to original equipment manufacturers.

#### AUTOMOTIVE PRODUCTS

This segment manufactures and sells anti-friction bearings and other products for automotive applications to wholesalers, retailers and original equipment manufacturers located throughout the world. Net sales from the Company's primary facility in Oklahoma City comprises approximately 90% of the automotive products segment sales.

At December 31, 1997, the automotive segment has \$22.7 million of inventory, a portion of which is in excess of current requirements based on recent sales levels. Management has developed a program to reduce this inventory to desired levels over the near term and believes no significant loss will be incurred on disposition.

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

### 13. SEGMENT INFORMATION (CONTINUED)

#### INDUSTRIAL PRODUCTS

This segment manufactures and purchases machine tools and purchases industrial supplies for sale to machine tool dealers and end users throughout the world. Sales of industrial supplies are generally unsecured, whereas the Company generally retains a security interest in machine tools sold until payment is received.

The industrial products segment attempts to maintain a full line of certain product lines, which necessitates maintaining certain products in excess of management's successive year expected sales levels. Inasmuch as these products are not susceptible to rapid technological changes, management believes no loss will be incurred on disposition.

Credit, which is generally unsecured, is extended to customers based on an evaluation of the customer's financial condition and other factors. Credit losses are provided for in the financial statements based on historical experience and periodic assessment of outstanding accounts receivable, particularly those accounts which are past due. The Company's periodic assessment of accounts and credit loss provisions are based on the Company's best estimate of amounts which are not recoverable. Concentrations of credit risk with respect to trade receivables are limited due to the large number of customers comprising the Company's customer bases, and their dispersion across many different industries and geographic areas. As of December 31, 1997 and 1996, the Company's accounts and notes receivable are shown net of allowance for doubtful accounts of \$9.2 million and \$7.4 million, respectively.

Information about the Company's operations in different industry segments for each of the three years in the period ended December 31, 1997 is detailed below.

	1997	1996	1995
----- (In Thousands) -----			
Sales:			
Chemical	\$ 156,949	\$ 166,163	\$ 136,903
Climate Control	105,909	89,275	83,843
Automotive Products	35,499	37,946	33,270
Industrial Products	15,572	13,776	13,375
	-----	-----	-----
	\$ 313,929	\$ 307,160	\$ 267,391
	=====	=====	=====

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

### 13.SEGMENT INFORMATION (CONTINUED)

Gross profit:			
Chemical	\$ 19,320	\$ 25,885	\$ 26,050
Climate Control	29,552	21,961	21,694
Automotive Products	3,299	5,868	6,366
Industrial Products	3,776	3,058	2,953
	-----	-----	-----
	\$ 55,947	\$ 56,772	\$ 57,063
	=====	=====	=====
Operating profit (loss):			
Chemical	\$ 5,479	\$ 10,971	\$ 13,393
Climate Control	8,895	5,362	4,630
Automotive Products	(7,251)	(4,134)	(3,704)
Industrial Products	(993)	(2,685)	(1,199)
	-----	-----	-----
	6,130	9,514	13,120
General corporate expenses, net	(9,786)	(3,192)	(6,571)
Interest expense	(14,740)	(10,017)	(10,131)
	-----	-----	-----
Loss before provision for income taxes and extraordinary charge	\$ (18,396)	\$ (3,695)	\$ (3,582)

## LSB Industries, Inc.

## Notes to Consolidated Financial Statements (continued)

## 13. SEGMENT INFORMATION (CONTINUED)

	1997	1996	1995
----- (In Thousands)			
Depreciation of property, plant and equipment:			
Chemical	\$ 6,436 =====	\$ 5,504 =====	\$ 4,532 =====
Climate Control	\$ 1,544 =====	\$ 1,552 =====	\$ 1,582 =====
Automotive Products	\$ 1,568 =====	\$ 1,050 =====	\$ 986 =====
Industrial Products	\$ 190 =====	\$ 126 =====	\$ 124 =====
Additions to property, plant and equipment:			
Chemical	\$ 8,390 =====	\$ 19,137 =====	\$ 17,979 =====
Climate Control	\$ 1,127 =====	\$ 1,551 =====	\$ 447 =====
Automotive Products	\$ 936 =====	\$ 1,306 =====	\$ 1,341 =====
Industrial Products	\$ 109 =====	\$ 37 =====	\$ 265 =====
Identifiable assets:			
Chemical	\$ 137,570	\$ 132,718	111,890
Climate Control	49,274	50,623	41,331
Automotive Products	42,718	43,212	43,872
Industrial Products	9,929	13,614	17,328
	-----	-----	-----
	239,491	240,167	214,421
Corporate assets and other	31,162 -----	21,393 -----	23,755 -----
Total assets	\$ 270,653 =====	\$ 261,560 =====	\$ 238,176 =====

Revenues by industry segment include revenues from unaffiliated customers, as reported in the consolidated financial statements. Intersegment revenues, which are accounted for at transfer prices ranging from the cost of producing or acquiring the product or service to normal prices to unaffiliated customers, are not significant.

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

## Notes to Consolidated Financial Statements (continued)

## 13.SEGMENT INFORMATION (CONTINUED)

expenses. In computing operating profit, none of the following items have been added or deducted: general corporate expenses, income taxes or interest expense.

Identifiable assets by industry segment are those assets used in the operations of each industry. Corporate assets are those principally owned by the parent company or by subsidiaries not involved in the four identified industries.

Information about the Company's domestic and foreign operations for each of the three years in the period ended December 31, 1997 is detailed below:

GEOGRAPHIC REGION	1997	1996	1995
----- (In Thousands) -----			
Sales:			
Domestic	\$ 265,320	\$ 270,675	\$ 250,028
Foreign:			
Australia/New Zealand	26,482	32,917	16,884
Others	22,127	3,568	479
	-----	-----	-----
	\$ 313,929	\$ 307,160	\$ 267,391
	=====	=====	=====
Income (loss) before provision for income taxes and extraordinary charge:			
Domestic	\$ (17,270)	\$ (5,174)	\$ (693)
Foreign:			
Australia/New Zealand	(772)	1,705	(1,871)
Others	(354)	(226)	(1,018)
	-----	-----	-----
	\$ (18,396)	\$ (3,695)	\$ (3,582)
Identifiable assets:			
Domestic	\$ 248,205	\$ 237,833	\$ 221,656
Foreign:			
Australia/New Zealand	19,899	19,740	13,757
Others	2,549	3,987	2,763
	-----	-----	-----
	\$ 270,653	\$ 261,560	\$ 238,176
	=====	=====	=====

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 13.SEGMENT INFORMATION (CONTINUED)

Revenues by geographic region include revenues from unaffiliated customers, as reported in the consolidated financial statements. Revenues earned from sales or transfers between affiliates in different geographic regions are shown as revenues of the transferring region and are eliminated in consolidation.

Revenues from unaffiliated customers include foreign export sales as follows:

GEOGRAPHIC AREA	1997	1996	1995
----- (In Thousands) -----			
Mexico and Central and South America	\$ 8,604	\$ 9,084	\$ 5,955
Canada	5,609	9,703	10,311
Other	7,913	14,517	18,447
	-----	-----	-----
	\$ 22,126	\$ 33,304	\$ 34,713
	=====	=====	=====

#### 14. EXTRAORDINARY CHARGE

In February 1997, certain subsidiaries of the Company entered into a \$50 million financing arrangement with John Hancock. The financing arrangement consisted of \$25 million of fixed rate notes and \$25 million of floating rate notes. In November 1997, in connection with the issuance of the Notes described in Note 5(B)-Term Debt, a subsidiary of the Company retired the outstanding principal associated with the John Hancock financing arrangement and incurred a prepayment fee. The prepayment fee paid and loan origination costs expensed in 1997 related to the John Hancock financing arrangement aggregated approximately \$4.6 million.

#### 15. SUBSEQUENT EVENT

In March 1998, a subsidiary of the Company closed the sale of The Tower acquired through foreclosure in February 1997. The Company realized proceeds of approximately \$29 million from the sale, net of transaction costs. Proceeds from the sale were used to retire the outstanding indebtedness of approximately \$13 million in March 1998, for which this property served as collateral. Approximately \$15 million of the remaining proceeds were used to reduce indebtedness outstanding under the Company's Revolving Credit Facility. The Company will recognize a gain on the sale of the property of approximately \$13 million in the first quarter of 1998.

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LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

#### 13. SEGMENT INFORMATION (CONTINUED)

The Company will recognize a gain on the sale of the property of approximately \$13 million in the first quarter of 1998.

LSB Industries, Inc.  
Supplementary Financial Data  
Quarterly Financial Data (Unaudited)

(In Thousands, Except Per Share Amounts)

THREE MONTHS ENDED			
MARCH 31	JUNE 30	SEPTEMBER 30	DECEMBER 31
-----			

1997				
Total revenues	\$ 74,864	\$ 91,437	\$ 77,927	\$ 75,961
Gross profit on net sales	\$ 10,922	\$ 19,380	\$ 14,541	\$ 11,104
Income (loss) before extraordinary charge	\$ (5,438)	\$ 1,467	\$ (4,779)	\$ (9,696)
Net income (loss)	\$ (5,438)	\$ 1,467	\$ (4,779)	\$ (14,315)
Net income (loss) applicable to common stock	\$ (6,241)	\$ 648	\$ (5,582)	\$ (15,119)
Basic and diluted earnings(loss) per common share:				
Earnings (loss) before extraordinary charge	\$ (0.48)	\$ 0.05	\$ (0.43)	\$ (0.82)
Extraordinary charge				(0.36)
Net income (loss)	\$ (0.48)	\$ 0.05	\$ (0.43)	\$ (1.18)
1996				
Total revenues	\$ 70,906	\$ 91,460	\$ 76,841	\$ 74,844
Gross profit on net sales	\$ 14,807	\$ 17,233	\$ 13,529	\$ 11,203
Net income (loss)	\$ (531)	\$ 2,372	\$ (3,218)	\$ (2,468)

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LSB Industries, Inc.

Supplementary Financial Data

Quarterly Financial Data (Unaudited)

(In Thousands, Except Per Share Amounts)

Net income (loss) applicable to common stock	\$ (1,350)	\$ 1,568	\$ (4,021)	\$ (3,271)
Basic and diluted earnings(loss) per common share	\$ (.10)	\$ .12	\$ (.31)	\$ (.25)

In the fourth quarter of 1997, in connection with the issuance of \$105 million, 10 3/4% Senior Notes due in 2007, a subsidiary of the Company retired the outstanding principal associated with a \$50 million financing arrangement and incurred a prepayment fee. The prepayment fee paid and loan origination costs expensed in 1997 relating to the financing arrangement aggregated approximately \$4.6 million.

In the fourth quarter of 1996, the Company recorded adjustments to the cost of the DSN plant for depreciation, interest capitalization, excess cost accruals and advances on an insurance settlement. These adjustments increased gross profit on net sales by approximately \$3.7 million for the three months ended December 31, 1996.

In the fourth quarter of 1996, the Company also sustained a loss of \$1.0

million related to writing-off a note receivable from a customer in the Chemical Business.

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LSB Industries, Inc.

Schedule II - Valuation and Qualifying Accounts  
 Years ended December 31, 1997, 1996 and 1995  
 (Dollars in Thousands)

DESCRIPTION	ADDITIONS DEDUCTIONS			
	BALANCE AT BEGINNING of Year	CHARGED TO Costs and Expenses	WRITE-OFFS/ COSTS INCURRED	BALANCE AT END OF YEAR
-----				
Accounts receivable-allowance for doubtful accounts (1):				
1997	\$ 3,291	\$ 1,544	\$ 828	\$ 4,007
1996	\$ 2,584	\$ 1,451	\$ 744	\$ 3,291
1995	\$ 2,000	\$ 1,696	\$ 1,112	\$ 2,584
Inventory-reserve for slow-moving items:				
1997	\$ 1,709	\$ 68	\$ 246	\$ 1,531
1996	\$ 1,318	\$ 578	\$ 187	\$ 1,709
1995	\$ 915	\$ 437	\$ 34	\$ 1,318
Notes receivable-allowance for doubtful accounts:				
1997	\$ 4,065	\$ 1,093		\$ 5,158
1996	\$ 2,500	\$ 1,565		\$ 4,065
1995	\$ 1,150	\$ 1,350		\$ 2,500

(1) Deducted in the balance sheet from the related assets to which the reserve applies.

Other valuation and qualifying accounts are detailed in the Company's notes to consolidated financial statements.

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AMENDED AND RESTATED  
LOAN AND SECURITY AGREEMENT

by and between

BANKAMERICA BUSINESS CREDIT, INC.  
as Lender

and

LSB INDUSTRIES, INC.  
as Borrower

Dated: November 21, 1997

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AMENDED AND RESTATED LOAN AND SECURITY AGREEMENT

This AMENDED AND RESTATED LOAN AND SECURITY AGREEMENT is dated November 21, 1997, and is entered into by and between BANKAMERICA BUSINESS CREDIT, INC., a Delaware corporation, with offices at 55 South Lake Avenue, Suite 900, Pasadena, California 91101 (the "Lender"), and LSB INDUSTRIES, INC., a Delaware corporation, with offices at 16 South Pennsylvania, Oklahoma City, Oklahoma 73107 (the "Borrower" or "LSB").

W I T N E S S E T H

WHEREAS, Lender and Borrower have entered into that certain Loan and Security Agreement dated December 12, 1994, as amended by (i) that certain First Amendment to Loan and Security Agreement dated as of August 17, 1995, (ii) that certain Second Amendment to Loan and Security Agreement dated as of December 1, 1995, (iii) that certain Third Amendment to Loan and Security Agreement dated as of April 1, 1996, (iv) that certain Fourth Amendment to Loan and Security Agreement dated as of July 1, 1996, (v) that certain Fifth Amendment to Loan and Security Agreement dated as of November 18, 1996, (vi) that certain Sixth Amendment to Loan and Security Agreement dated as of February 13, 1997, (vii) that certain Seventh Amendment to Loan and Security Agreement dated as of April 11, 1997, (viii) that certain Eighth Amendment to Loan and Security Agreement dated as of May 19, 1997, (ix) that certain Ninth Amendment to Loan and Security Agreement dated as of June 30, 1997, (x) that certain Tenth Amendment to Loan and Security Agreement dated as of September 10, 1997, and (xi) that certain Eleventh Amendment to Loan and Security Agreement dated as of October 23, 1997 (as so amended, collectively referred to as the "Original Loan Agreement"); and

WHEREAS, of even date herewith, Lender has entered into three (3) related amended and restated loan transactions with L&S Bearing Co., Climate Master, Inc., International Environmental Corporation, El Dorado Chemical Company, Slurry Explosive Corporation and Summit Machine Tool Manufacturing Corp. (which, along with Borrower, are referred to as the "Borrower Subsidiaries"); and

WHEREAS, Lender has agreed to make loans and letters of credit available to Borrower based on certain assets of the Borrower and six (6) of Borrower's other Subsidiaries (the "LSB Guarantor Subsidiaries"), which loans and letters of credit are secured by guaranties of the LSB Guarantor Subsidiaries, and Borrower has represented to Lender that Borrower will, in turn, make such loans and letters of credit available to the LSB Guarantor Subsidiaries; and

WHEREAS, the aggregate amount of all loans and letters of credit to be made by Lender to the Borrower Subsidiaries will not exceed Sixty-Five Million and No/100 Dollars (\$65,000,000) in the aggregate at any time outstanding;

NOW, THEREFORE, in consideration of the mutual conditions and agreements set forth in this Agreement, and for good and valuable consideration, the receipt of which is hereby acknowledged, the Borrower and the Lender hereby agree as follows:

1. DEFINITIONS.

1.1 As used herein:

"Account" means the Borrower's or any LSB Guarantor Subsidiary's right to payment for a sale or lease and delivery of goods or rendition of services.

"Account Debtor" means each Person obligated to the Borrower or any LSB Guarantor Subsidiary on an Account.

"Affiliate" means: a Person who, directly or indirectly, controls, is controlled by or is under common control with LSB, which includes the LSB Consolidated Borrowing Group. The term "control" (including the terms "controlled by" and "under common control with") means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the Person in question.

"Applicable Interest Rate" has the meaning given to such term in Section 3.1(a).

"Acquisition" means the investment in or purchase of a corporation, association, business, entity, partnership or limited liability company by Borrower by means of the purchase of stock, assets, memberships, partnership interests or otherwise.

"Availability" means at any time the lesser of:

A. The Maximum Revolving Credit Line; or

B. The lesser of \$5,000,000 less the Availability Reductions; or

C. The sum of:

(1) eighty-five percent (85%) of the value of Eligible Accounts other than Eligible Accounts of Morey Machinery Manufacturing Corporation, plus eighty percent (80%) of the Eligible Accounts of Morey Machinery Manufacturing Corporation ("Accounts Availability"), plus

(2) the lesser of (a) the Maximum Inventory Advance Amount or (b) sixty percent (60%) of the value of Eligible Inventory; less

(3) the Availability Reductions.

"Availability Reductions" means the sum of the following amounts:

(i) the unpaid balance of outstanding Revolving Loans at such time;

(ii) one hundred percent (100%) of the aggregate undrawn face amount of all outstanding Letters of Credit at such time which the Lender has, or has caused to be, issued or obtained for the account of Borrower or any LSB Guarantor Subsidiary;

(iii) reserves for accrued interest on the Revolving Loans which is past due;

(iv) the Environmental Compliance Reserve (Note: There is no Environmental Compliance Reserve as of the Closing Date); and

(v) all other reasonable reserves which the Lender in its reasonable discretion deems necessary or desirable to maintain with respect to Borrower's account, including, without limitation, any amounts which the Lender could reasonably be obligated to pay within a six-month period for the account of Borrower.

"Bank" means Bank of America N.T. & S.A.

"Bearings" means International Bearings, Inc., an Oklahoma corporation.

"Bearings Availability" means at any time the lesser of:

A. Availability; or

B. \$3,000,000 less the Bearings Availability Reductions; or

C. The sum of:

(1) eighty-five percent (85%) of the value of Eligible Accounts of Bearings, plus

(2) the lesser of (x) \$1,000,000 or (y) (i) sixty percent (60%) of the value of Eligible Inventory of Bearings less (ii) the Bearings Availability Reduction Reserve; less

(3) the Bearings Availability Reductions.

"Bearings Availability Reduction Reserve" means a permanent inventory reserve of \$1,000,000 which reduces the Availability of Bearings based on Eligible Inventory under this Agreement until such time as this Agreement is terminated, whereupon this inventory reserve reduces the availability of L&S Bearing Co. under the L&S Bearing Loan Agreement until such time as the L&S Bearing Loan Agreement is terminated, whereafter this inventory reserve reduces the availability of Summit Machine Tool Manufacturing Corp. under the Summit Loan Agreement.

"Bearings Availability Reductions" means the Availability Reductions that pertain solely to Bearings.

"Bond Debt" means Debt owed by any member of the CCI Consolidated Group on Senior Notes due 2007 (the "Notes") in the principal amount not to exceed \$125,000,000 issued pursuant to the Bond Indenture.

"Bond Indenture" means that certain Indenture dated as of November 26, 1997 by and among CCI and other members of the CCI Consolidated Group and Bank One, NA relating to the Bond Debt.

"Borrower Subsidiaries" means LSB, L&S Bearing Co., El Dorado Chemical Company, Slurry Explosive Corporation, Climate Master, Inc., International Environmental Corporation and Summit Machine Tool Manufacturing Corp.

"Business Day" means any day that is not a Saturday, Sunday, or day on which banks in Los Angeles, California are required or permitted to close.

"Capital Expenditures" means all costs incurred, whether payable in the Fiscal Year incurred or thereafter, (including financing costs required to be capitalized under GAAP) for purchases made during a Fiscal Year for any fixed asset or improvement, or replacement, substitution, or addition thereto, which has a useful life of more than one year, including, without limitation, those costs arising in connection with the direct or indirect acquisition of such assets by way of increased product or service charges or offset items or in connection with Capital Leases.

"Capital Lease" means any lease of Property that, in accordance with GAAP, should be reflected as a liability on a Person's balance sheet.

"CCI" means ClimaChem, Inc., an Oklahoma corporation, and a wholly-owned Subsidiary of LSB.

"CCI Borrower Subsidiaries" means Climate Master, Inc., International Environmental Corporation, El Dorado Chemical Company, and Slurry Explosive Corporation.

"CCI Consolidated Borrowing Group" means the CCI Borrower Subsidiaries and the CCI Guarantor Subsidiaries.

"CCI Consolidated Group" means CCI and all of its Subsidiaries, including the CCI Borrower Subsidiaries and the CCI Guarantor Subsidiaries.

"CCI Guarantor Subsidiaries" means Climate Mate, Inc., LSB Chemical Corp., Universal Tech Corporation, The Environmental Group, Inc., CHP Corporation, Koax Corp. and APR Corporation.

"Closing Date" means the date of this Agreement, being the date first above written.

"Code" means the Internal Revenue Code of 1986, as amended.

"Collateral" has the meaning given to such term in Section 6.1.

"Debt" means all liabilities, obligations and indebtedness of the Borrower to any Person, of any kind or nature, now or hereafter owing, arising, due or payable, howsoever evidenced, created, incurred, acquired or owing, as would be shown on the balance sheet of the Borrower prepared in accordance with GAAP.

"Distribution" means, in respect of any corporation: (a) the payment or making of any dividend or other distribution of Property in respect of capital stock of such corporation, other than distributions in capital stock; and (b) the redemption or other acquisition of any capital stock of such corporation

"Dollars" and "\$" means lawful money of the United States of America.

"EDC" means Eldorado Chemical Company, a CCI Borrower Subsidiary.

"Eligible Accounts" means all Accounts of Borrower and each LSB Guarantor Subsidiary which are not ineligible. Accounts shall be ineligible as the basis for Revolving Loans based on the following criteria. Eligible Accounts shall not include any Account:

(i) where such Account is "Past Due". For the purposes of this provision, "Past Due" means: (a) where the Account has terms of payment of less than ninety-one (91) days from the invoice date, the payment thereof is more than 90 days past due; and (b) where the Account has terms of payment of ninety-one to three hundred sixty (91 to 360) days from the Invoice Date, the payment thereof is more than 30 days past due; notwithstanding the foregoing all advances to Borrower and the other Borrower Subsidiaries with respect to "eligible accounts" under the LSB-Related Loan Agreements that have terms of payment of more than one hundred eighty (180) days (the "180-Day Accounts") shall not exceed in the aggregate at any time the lesser of (i) \$1,500,000 or (ii) five percent (5%) of the Gross LSB Accounts Availability (without taking into account the 180-Day Accounts);

(ii) where, with respect to such Account, any of the representations, warranties, covenants and agreements contained in Sections 6.9 and 8.2 of this Agreement are not or have ceased to be complete and correct or have been breached;

(iii) where such Account represents a progress billing or as to which the Borrower or a LSB Guarantor Subsidiary has extended the time for payment after issuance of the invoice relating to such Account. For the purpose hereof, "progress billing" means any invoice for goods sold or leased or services rendered under a contract or agreement pursuant to which the Account Debtor's obligation to pay such invoice is expressly conditioned upon the completion by Borrower or the applicable LSB Guarantor Subsidiary of any

further performance under the contract or agreement, provided, however, that performance required under a warranty claim or provision shall not make such Account a "progress billing";

(iv) where Borrower or a LSB Guarantor Subsidiary has become aware that any one or more of the following events has occurred with respect to an Account Debtor on such Account: death or judicial declaration of incompetency of an Account Debtor who is an individual; the filing by or against the Account Debtor of a request or petition for liquidation, reorganization, arrangement, adjustment of debts, adjudication as a bankrupt, winding-up, or other relief under the bankruptcy, insolvency, or similar laws of the United States, any state or territory thereof, or any foreign jurisdiction, now or hereafter in effect; the making of any general assignment by the Account Debtor for the benefit of creditors; the appointment of a receiver or trustee for the Account Debtor or for any of the assets of the Account Debtor; the institution by or against the Account Debtor of any other type of insolvency proceeding (under the bankruptcy laws of the United States or otherwise) or of any formal or informal proceeding for the dissolution or liquidation of, or winding up of affairs of, the Account Debtor; the sale, assignment, or transfer of all or any material part of the assets of the Account Debtor; or the cessation of the business of the Account Debtor as a going concern;

(v) where an Account is not a valid, legally enforceable obligation of the Account Debtor thereunder or is subject to offset, counterclaim or other defenses on the part of such Account Debtor denying liability thereunder in whole or in part;

(vi) where the Borrower or a LSB Guarantor Subsidiary does not have good and marketable title to such Account, free and clear of all Liens, other than Liens arising under this Agreement and the documents delivered in connection herewith;

(vii) which is owed by an Account Debtor which: (i) does not maintain its chief executive office in the United States or territory thereof or Canada; or (ii) is not organized under the laws of the United States or any state or territory thereof or Canada; or (iii) is the government of any foreign country or any state, province, municipality or other political subdivision thereof (all of the foregoing being referred to as "Foreign Accounts"); except that, to the extent that such Foreign Accounts are secured or payable by letters of credit or bank guarantees reasonably acceptable to Lender, such Foreign Accounts shall be considered Eligible Accounts. Notwithstanding the foregoing, Lender has agreed that Foreign Accounts, if they otherwise meet all eligibility requirements, will be Eligible Accounts even though such Foreign Accounts are not secured or payable by letters of credit or bank guarantees reasonably acceptable to Lender up to an amount not to exceed at any one time more than five percent (5%) of the Gross LSB Accounts Availability (without taking into account such Foreign Accounts);

(viii) which is owed by an Account Debtor which is an Affiliate;

(ix) which is owed by the government of the United States of America, or any department, agency, or other instrumentality thereof, unless the Federal Assignment of Claims Act of 1940, as amended, or any other steps necessary to perfect the Lender's Security Interest therein, have been complied with to the Lender's reasonable satisfaction with respect to such Account;

(x) which is owed by any state or municipality, or any department, agency, or other instrumentality thereof, and as to which the Lender's Security Interest therein is not or cannot be perfected;

(xi) which arises out of a sale to an Account Debtor on a bill and hold, guaranteed sale, sale and return, sale on approval, consignment, or other repurchase or return basis;

(xii) which is evidenced by a promissory note or other instrument (unless such note or instrument is part of chattel paper in which Lender has a first priority perfected Security Interest) or by chattel paper (unless Lender has a first priority perfected Security Interest therein);

(xiii) where the goods giving rise to such Account have not been shipped and delivered to and accepted by the Account Debtor (provided, however, that where the Account Debtor has agreed in writing to accept billings for such goods, with a copy of such writing being provided to Lender, then such Account shall be an Eligible Account if it otherwise qualifies) or the services giving rise to such Account have not been performed by the Borrower or the LSB Guarantor Subsidiary and accepted by the Account Debtor; or

(xiv) if Lender believes in its reasonable credit judgment that the prospect of collection of such Account is impaired; or

(xv) which Account is owing from an Account Debtor in which fifty percent (50%) or more of the Accounts owing from whom are Past Due as set forth in subsection (i) of this definition of Eligible Accounts; or

(xvi) as to which either the perfection, enforceability, or validity of the Security Interest in such Account, or the Lender's right or ability to obtain direct payment to the Lender of the Proceeds of such Account, is governed by any federal, state, or local statutory requirements other than those of the UCC; or

(xvii) with respect to which the Account Debtor is located in any state requiring the filing of a Business Activity Report or similar document in order to permit the Borrower or the LSB Guarantor Subsidiary to seek judicial enforcement in such state of payment of such Account, unless Borrower or the LSB Guarantor Subsidiary has qualified to do business in such state, or has filed a Notice of Business Activities Report or equivalent report with the applicable state office for the then current year.

"Eligible Inventory" means Inventory valued at the lower of cost or market on a "first in-first out" ("FIFO") basis that constitutes (i) raw materials (including raw materials stored or held by the Borrower or any LSB Guarantor Subsidiary in the work-in-progress area and fifty percent (50%) of Inventory classified as components) and (ii) first quality finished goods and that (a) is not obsolete or unmerchantable, (b) upon which the Lender has a first priority perfected Security Interest, and (c) the Lender otherwise deems eligible as the basis for Revolving Loans based on such other credit and collateral considerations as the Lender may from time to time establish in its reasonable discretion. Without intending to limit the Lender's discretion to establish other reasonable criteria of eligibility, no work-in-progress, service or spare parts, packaging, used parts, shipping materials, supplies, containers, defective Inventory, Inventory consisting of machines being rebuilt, Inventory acquired in trade in connection with the sale of other Inventory, slow-moving Inventory, Inventory in transit (except for Inventory in transit owned by Borrower or any LSB Guarantor Subsidiary, covered by insurance, and in which Lender has a Security Interest), fifty percent (50%) of Inventory classified as components, or Inventory delivered to Borrower or any LSB Guarantor Subsidiary on consignment shall constitute Eligible Inventory. Eligible Inventory shall not include Inventory stored at locations other than those locations either owned by the Borrower or a LSB Guarantor Subsidiary or locations for which a landlord's waiver acceptable to Lender or a consignment agreement (with appropriate UCC filings) has been signed by the owner of such location and delivered to Lender. In addition, the amount of all finished goods reserves (excluding reserves for "last-in-first-out" valuation) shown on the books of Borrower or any of the LSB Guarantor Subsidiaries shall be deducted from the value of the Eligible Inventory as used in computing Availability, except to the extent that any such reserve has already been taken into account in connection with any of the above criteria.

"Environmental Compliance Reserve" means all reserves which the Lender from time to time establishes for amounts that are liabilities required to be paid by the Borrower or any LSB Guarantor Subsidiary within 180 days in order to correct any violation by the Borrower or such LSB Guarantor Subsidiary or the operations or Property of Borrower or any LSB Guarantor Subsidiary with respect to Environmental Laws.

"Environmental Laws" means all federal, state and local laws, rules, regulations, ordinances, and consent decrees relating to hazardous substances, and environmental matters applicable to the business and facilities of Borrower or any LSB Guarantor Subsidiary (whether or not owned by it). Such laws and regulations include but are not limited to the Resource Conservation and Recovery Act, 42 U.S.C. § 6901 et seq., as amended; the Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. § 9601 et seq., as amended; the Toxic Substances Control Act, 15 U.S.C. § 2601 et seq., as amended; the Clean Water Act, 33 U.S.C. § 466 et seq., as amended; the Clean Air Act, 42 U.S.C. § 7401 et seq., as amended; state and federal superlien and environmental cleanup programs; and U.S. Department of Transportation regulations.

"Equipment" means, with respect to the Borrower and each LSB Guarantor Subsidiary, all of the now owned and hereafter acquired machinery, equipment, furniture, furnishings, fixtures, and other tangible personal property (except Inventory), including, without limitation, data processing hardware and software, motor vehicles, aircraft, dies, tools, jigs, and office equipment, as well as all of such types of property which are leased and all of the rights and interests with respect thereto under such leases (including, without limitation, options to purchase); together with all present and future additions and accessions thereto, replacements therefor, component and auxiliary parts and supplies used or to be used in connection therewith, and all substitutes for any of the foregoing, and all manuals, drawings, instructions, warranties and rights with respect thereto wherever any of the foregoing is located.

"ERISA" means the Employee Retirement Income Security Act of 1974, as amended.

"Eurocurrency Liabilities" has the meaning assigned to that term in Regulation D of the Board of Governors of the Federal Reserve System, as in effect from time to time.

"Eurodollar Business Day" means any Business Day in which commercial banks are open for international business (including dealings in dollar deposits) in London, England and Los Angeles, California.

"Eurodollar Base Rate" means, for any Interest Period, an interest rate determined by the Lender to be the rate per annum at which deposits in Dollars are offered to Bank in the London interbank market at 11:00 a.m. (London time) two (2) Business Days before the first day of such Interest Period for delivery on the first day of such Interest Period in an amount substantially equal to the Eurodollar Rate Loans requested for such Interest Period and for a period equal to such Interest Period.

"Eurodollar Interest Payment Date" means the first day of each month during any Interest Period and the last day of such Interest Period.

"Eurodollar Interest Rate Determination Date" means each date of calculating the Eurodollar Rate for purposes of determining the interest rate with respect to an Interest Period. The Eurodollar Interest Rate Determination Date for any Eurodollar Rate Loan shall be the second Business Day prior to the first day of the related Interest Period for such Eurodollar Rate Loan.

"Eurodollar Rate" means, for any Interest Period, a per annum interest rate (rounded upward to the next 1/1000th of 1%) equal to the quotient of (a) the Eurodollar Base Rate for such Interest Period, divided by (b) one hundred percent (100%) minus the Eurodollar Rate Reserve Percentage for such Interest Period.

"Eurodollar Rate Loan" means a Revolving Loan during any period in which it bears interest at the rate provided in Section 3.1(a)(ii), as such amount may be adjusted pursuant to Section 3.1(b).

"Eurodollar Rate Reserve Percentage" for any Interest Period means the reserve percentage applicable during such Interest Period (or if more than one such percentage shall be so applicable, the daily average of such percentages for those days in such Interest Period during which any such percentage shall be so applicable) under regulations issued from time to time by the Board of Governors of the Federal Reserve System (or any successor) for determining the maximum reserve requirement (including, without limitation, any emergency, supplemental or other marginal reserve requirement) for Bank with respect to liabilities or assets consisting of or including Eurocurrency Liabilities having a term equal to such Interest Period.

"Event" means any event or condition which, with notice, the passage of time, the happening of any other condition or event, or any combination thereof, would constitute an Event of Default.

"Event of Default" has the meaning given to such term in Section 11.1.

"Financial Statements" means, according to the context in which it is used, the financial statements attached hereto as Exhibit G-1, and the Latest Forecasts attached hereto as Exhibit G-2, and any other financial statements required to be given by the Borrower to the Lender under this Agreement.

"Fiscal Quarter" means any three-month period ending March 31, June 30, September 30 or December 31.

"Fiscal Year" means LSB's fiscal year for financial accounting purposes. The current Fiscal Year of LSB will end on December 31, 1997.

"GAAP" means at any particular time generally accepted accounting principles as in effect at such time.

"Gross Availability Reductions" means the sum of all "Availability Reductions" as such term is defined in and calculated under the LSB-Related Loan Agreements.

"Gross LSB Accounts Availability" means the sum of the amounts calculated as "Accounts Availability" as such term is defined in and as calculated under all of the LSB-Related Loan Agreements.

"Guaranty" by any Person means all obligations of such Person which in any manner directly or indirectly guarantee the payment or performance of any

indebtedness or other obligation of any other Person (the "guaranteed obligations"), or assure or in effect assure the holder of the guaranteed obligations against the loss in respect thereof, including, without limitation, any such obligations incurred through an agreement, (a) to purchase the guaranteed obligations or any Property constituting security therefor or (b) to advance or supply funds for the purchase or payment of the guaranteed obligations or to maintain a working capital or other balance sheet condition.

"Intercompany Accounts" means all assets and liabilities, however arising, which are due to the Borrower from, which are due from the Borrower to, or which otherwise arise from any transaction by the Borrower with, any Affiliate.

"Interest Period" means, with respect to each Eurodollar Rate Loan the 90-day interest period applicable to such Eurodollar Rate Loan as determined pursuant to Section 3.3(b).

"Inventory" means all of the Borrower's and each LSB Guarantor Subsidiary's now owned and hereafter acquired inventory, wherever located, to be held for sale or lease, all raw materials, work-in-process, finished goods, returned and repossessed goods, and materials and supplies of any kind, nature or description which are or might be used in connection with the manufacture, packing, shipping, advertising, selling or finishing of such inventory, and all documents of title or other documents representing them.

"IRS" means the Internal Revenue Service or any successor agency.

"Latest Forecasts" means, (a) on the Closing Date and thereafter until the Lender receives new forecasts pursuant to Section 8.6, the forecasts of the Borrower's monthly financial condition, results of operations, and cash flows through the year ending December 31, 1997, attached hereto as Exhibit G-2; and (b) thereafter, the forecasts most recently received by the Lender pursuant to Section 7.2.

"Letter of Credit" has the meaning specified in Section 2.3.

"Letter of Credit Agreement" has the meaning specified in Section 2.3.

"Letter of Credit Fee" means the commissions charged under the Letter of Credit Agreement on the outstanding amount of each Letter of Credit.

"Lien" means: any interest in Property securing an obligation owed to, or a claim by, a Person other than the owner of the Property, whether such interest is based on the common law, statute, or contract, and including without limitation, a security interest, charge, claim, or lien arising from a mortgage, deed of trust, encumbrance, pledge, hypothecation, assignment, deposit arrangement, agreement, or conditional sale, or a lease, consignment or bailment for security purposes.

"Loans" means, collectively, all loans and advances by the Lender to or on behalf of the Borrower provided for in Article 2.

"Loan Documents" means all documents executed by Borrower and/or any LSB Guarantor Subsidiary, including this Agreement, the Letter of Credit Agreement, the Patent and Trademark Assignments, the Guaranties, the Collateral Assignment of Notes and Liens, and all other agreements, instruments, and documents heretofore, now or hereafter evidencing, securing or guaranteeing the Obligations under this Agreement, the Collateral or the Security Interest, as the same may hereafter be amended, modified, restated and/or extended.

"LSB" means LSB Industries, Inc., a Delaware corporation, the Borrower under this Agreement.

"LSB Adjusted Tangible Assets" means all of the assets of the LSB Consolidated Group, on a consolidated basis, except: (a) goodwill; (b) unamortized debt discount and expense; (c) assets constituting Intercompany Accounts; (d) fixed assets to the extent of any write-up in the book value thereof resulting from a revaluation effective after the Closing Date; and (e) any intangibles, as determined in accordance with GAAP.

"LSB Adjusted Tangible Net Worth" means, at any date: (a) the book value (after deducting related depreciation, obsolescence, amortization, valuation, and other proper reserves as determined in accordance with GAAP) at which the LSB Adjusted Tangible Assets would be shown on a consolidated balance sheet of the LSB Consolidated Group at such date prepared in accordance with GAAP less (b) (i) the amount at which the LSB Consolidated Group's liabilities would be shown on such balance sheet prepared in accordance with GAAP, and (ii) LSB's redeemable preferred stock which is valued at \$146,000 as of the Closing Date.

"LSB Borrower Subsidiaries" means LSB, L&S Bearing Co. and Summit Machine

Tool Manufacturing Corp.

"LSB Borrowing Group" means the LSB Borrower Subsidiaries and the LSB Guarantor Subsidiaries.

"LSB Consolidated Borrowing Group" means the LSB Borrowing Group and the CCI Consolidated Borrowing Group.

"LSB Guarantor Subsidiaries" means International Bearings, Inc., LSB Extrusion Co., Rotex Corporation, Tribonetics Corporation ("Tribonetics"), Morey Machinery Manufacturing Corporation, and L&S Automotive Products Co.

"LSB-Related Loan Agreements" means all of the following loan agreements: (i) this Agreement; (ii) the Loan and Security Agreement dated of even date herewith between Lender and L & S Bearing Co. (the "L&S Bearing Loan Agreement"); (iii) the Loan and Security Agreement dated of even date herewith between Lender, El Dorado Chemical Company, Slurry Explosive Corporation, Climate Master, Inc., and International Environmental Corporation; and (iv) the Loan and Security Agreement dated of even date herewith between Lender and Summit Machine Tool Manufacturing Corp. (the "Summit Loan Agreement").

"Maximum Inventory Advance Amount" means the lesser of (a) \$32,500,000 less all then outstanding revolving loans, advances, and outstanding letters of credit based on the "Eligible Inventory" (as defined in each of the LSB-Related Loan Agreements) of the LSB Consolidated Borrowing Group under the LSB-Related Loan Agreements, or (b) \$1,500,000 less all then outstanding Revolving Loans, advances, and outstanding Letters of Credit based on the Eligible Inventory.

"Maximum Revolving Credit Line" means Sixty-Five Million Dollars (\$65,000,000) less the Gross Availability Reductions.

"Multi-employer Plan" means a Plan which is described in Section 3(37) of ERISA.

"Obligations" means all present and future loans, advances, liabilities, obligations, covenants, duties and Debts owing by the Borrower to the Lender, arising under this Agreement or any other Loan Document, whether or not evidenced by any note, or other instrument or document, whether arising from an extension of credit, opening of a letter of credit, loan, guaranty, indemnification (including any indemnity to Bank by Lender in connection with the Swap Transactions or otherwise for the benefit of the Borrower), whether direct or indirect (including, without limitation, those acquired by assignment from others relating to Swap Transactions), absolute or contingent, due or to become due, primary or secondary, as principal or guarantor, and including, without limitation, all interest, charges, expenses, fees, attorneys' fees, filing fees and any other sums chargeable to the Borrower hereunder or under another Loan Document, or under any other agreement or instrument with Lender relating to the Swap Transactions. "Obligations" includes, without limitation, (a) all debts, liabilities, and obligations now or hereafter owing from Borrower to Lender under or in connection with the Letters of Credit and the Letter of Credit Agreement, (b) all debts, liabilities, and obligations now or hereafter owing from any Borrower to the Lender arising from or related to the Swap Transactions, and (c) all debts, liabilities, and obligations owing by the Borrower to the Lender under the Continuing Guaranty executed by the Borrower dated of even date herewith.

"Offering Memorandum" means that certain Offering Memorandum dated November 21, 1997, as amended or supplemented, issued by CCI describing CCI and the CCI Consolidated Group, the Bond Debt, and the Bond Indenture.

"Original Loan Agreement" has the meaning set forth in the recital clauses of this Agreement.

"Participating Lender" means any Person who shall have been granted the right by the Lender to participate in the Revolving Loans and who shall have entered into a participation agreement in form and substance satisfactory to the Lender.

"Patent and Trademark Assignments" means the Patent Security Agreement and the Trademark and Trade Names Security Agreement dated as of December 12, 1994, executed and delivered by the Borrower to the Lender to evidence and perfect the Lender's Security Interest in the Borrower's present and future patents, trademarks, trade names and related licenses and rights, each as amended and modified from time to time.

"Payment Account" means each blocked bank account, established pursuant to Section 6.10, to which Proceeds of Accounts and other Collateral are deposited or credited, and which is maintained in the name of the Borrower on terms acceptable to the Lender.

"PBGC" means the Pension Benefit Guaranty Corporation or any Person succeeding to the functions thereof.

"Pension Plan" means any employee benefit plan, including a Multiemployer Plan, which is subject to Title IV of ERISA, where either (a) the Plan is maintained by the Borrower or any Related Company; or (b) Borrower or any Related Company contributes or is required to contribute to it; or (c) Borrower or any Related Company has incurred or may incur liability, including contingent liability, under Title IV of ERISA, either to it, or to the PBGC with respect to it.

"Permitted Debt" means: (i) the Obligations; (ii) Debt set forth in the most recent Financial Statements delivered to the Lender, or the notes thereto; (iii) Debt incurred since the date of such Financial Statements to finance Capital Expenditures permitted hereby; (iv) Debt issued or assumed by any Borrower in connection with an Acquisition permitted under Section 9.14 hereof; (v) Debt resulting from a judgment having been rendered against the Borrower that is being appealed by the Borrower in good faith and in a timely manner, for which an adequate reserve has been recorded on Borrower's books, and which is not fully covered by insurance; (vi) Subordinated Debt; (vii) Debt resulting from the refinancing of any other Permitted Debt as long as (a) such Debt does not exceed the amount of the refinanced Debt, and (b) such Debt does not result in payment acceleration of the refinanced Debt; (viii) Debt resulting from trade payables and other obligations arising in the ordinary course of business, (ix) other Debt not otherwise permitted by this definition in an amount not to exceed \$5,000,000 at any one time; (x) Debt of the Borrower (a) to CCI, or (b) to a member of the LSB Consolidated Borrowing Group, or (c) to a member of the CCI Consolidated Borrowing Group, or (d) to an Affiliate in accordance with Section 9.9 hereof, or (e) to any other Subsidiary of LSB that is not CCI, a member of the CCI Consolidated Borrowing Group or the LSB Consolidated Borrowing Group, provided however that the aggregate amount of Debt outstanding to all such other Subsidiaries under (e) shall at no time exceed \$200,000 in the aggregate; (xi) the Bond Debt; (xii) the SBL Debt; and (xiii) Debt of Tribonetics to the Stillwater National Bank & Trust Company in the original principal sum of \$2,000,000 (the "Tribonetics Loan"). Notwithstanding the foregoing, Permitted Debt described in subsection (ix) of this definition, when combined with Permitted Debt allowed under subsection (ix) of the definition of Permitted Debt under all of the other LSB-Related Loan Agreements, shall not exceed \$5,000,000 at any one time.

"Permitted Liens" means: (a) Liens for taxes not yet payable or Liens for taxes being contested in good faith and by proper proceedings diligently pursued, provided that a reserve or other appropriate provision, if any, as shall be required by GAAP shall have been made therefor on the applicable Financial Statements, and further provided that, with respect to the Collateral, a stay of enforcement of any such Lien is in effect; (b) Liens in favor of the Lender; (c) reservations, exceptions, encroachments, easements, rights of way, covenants, conditions, restrictions, leases and other similar title exceptions or encumbrances affecting the Real Property; (d) Liens or deposits under workmen's compensation, unemployment insurance, social security and other similar laws, (e) Liens relating to obligations with respect to surety, appeal bonds, performance bonds, bids, tenders and other obligations of a like nature, (f) Liens existing as of the Closing Date and granted after the date hereof in connection with the Equipment, Real Property or other fixed assets, provided that such Liens attach only to such Property and the proceeds thereof, and so long as the indebtedness secured thereby does not exceed 100% of the fair market value of such Property at the time of acquisition; (g) Liens on goods consigned to the Borrower or a LSB Guarantor Subsidiary or not owned by Borrower or a LSB Guarantor Subsidiary so long as such Lien attaches only to such goods and so long as Lender has been given notice of such Lien, (h) mechanic, materialmen and other like Liens arising in the ordinary course of business securing obligations which are not overdue or are being contested in good faith by appropriate proceedings and adequately reserved against, (i) statutory Liens in favor of landlords, (j) Liens against any life insurance policy or the cash surrender value thereof which relate to borrowings incurred to finance the premiums made under such policy; (k) Liens not to exceed \$1,000,000 at any one time in amounts secured, which are junior in priority to the Security Interest and which arise or are placed inadvertently against the assets of Borrower or any LSB Guarantor Subsidiary and are removed within ten (10) days from receipt of notice by the Borrower or such LSB Guarantor Subsidiary of such Lien; and (l) Liens reflected on Exhibit A hereto.

"Person" means any individual, sole proprietorship, partnership, joint venture, trust, unincorporated organization, association, corporation, Public Authority, or any other entity.

"Plan" means, individually and collectively, all Pension Plans, all additional employee benefit plans as defined in Section 3(3) of ERISA, and all other plans, programs, agreements, arrangements, and methods of contribution or compensation providing any material remuneration or benefits, other than the cash payment of wages or salary, to any current or former employee(s) of

the Borrower.

"Proceeds" means all products and proceeds of any Collateral, and all proceeds of such proceeds and products, including, without limitation, all cash and credit balances, all payments under any indemnity, warranty, or guaranty payable with respect to any Collateral, all proceeds of fire or other insurance, and all money and other Property obtained as a result of any claims against third parties or any legal action or proceeding with respect to Collateral.

"Property" means any interest in any kind of property or asset, whether real, personal or mixed, or tangible or intangible.

"Proprietary Rights" means all of the Borrower's and each LSB Guarantor Subsidiary's now owned and hereafter arising or acquired: licenses, franchises, permits, patents, patent rights, copyrights, works which are the subject matter of copyrights, trademarks, trade names, trade styles, patent and trademark applications and licenses and rights thereunder, including without limitation those patents, trademarks and copyrights set forth on Exhibit B hereto, and all other rights under any of the foregoing, all extensions, renewals, reissues, divisions, continuations, and continuations-in-part of any of the foregoing, and all rights to sue for past, present, and future infringement of any of the foregoing; inventions, trade secrets, formulae, processes, compounds, drawings, designs, blueprints, surveys, reports, manuals, and operating standards, goodwill, customer and other lists in whatever form maintained, and trade secret rights, copyright rights, right in works of authorship, and contract rights relating to computer software programs, in whatever form created or maintained.

"Public Authority" means the government of any country or sovereign state, or of any state, province, municipality, or other political subdivision thereof, or any department, agency, public corporation or other instrumentality of any of the foregoing.

"Real Property" means all of Borrower's and LSB Guarantor Subsidiaries' rights, title, and interest in real property now owned or hereafter acquired by Borrower or any of the LSB Guarantor Subsidiaries, including, without limitation, the real property more particularly described in Exhibit H attached hereto, including all rights and easements in connection therewith and all buildings and improvements now or hereafter constructed thereon.

"Receivables" means all of the Borrower's and each LSB Guarantor Subsidiary's now owned or hereafter arising or acquired: Accounts (whether or not earned by performance), including Accounts owed to the Borrower by any of its Subsidiaries or Affiliates (but excluding Accounts arising solely from the sale of Equipment, Real Property or other fixed assets), together with all interest, late charges, penalties, collection fees, and other sums which shall be due and payable in connection with any Account; proceeds of any letters of credit naming the Borrower or any LSB Guarantor Subsidiary as beneficiary; contract rights, chattel paper, instruments, documents, general intangibles (including, without limitation, choses in action, causes of action, tax refunds, tax refund claims, Reversions and other amounts payable to the Borrower from or with respect to any Plan, rights and claims against shippers and carriers, rights to indemnification and business interruption insurance), and all forms of obligations owing to Borrower (including, without limitation, obligations owing to the Borrower by its Subsidiaries and Affiliates); guarantees and other security for any of the foregoing; and rights of stoppage in transit, replevin, and reclamation; and other rights or remedies of an unpaid vendor, lienor, or secured party.

"Reference Rate" means the per annum rate of interest publicly announced from time to time by the Bank at its San Francisco, California main office as its reference rate. It is a rate set by Bank based upon various factors including Bank's costs and desired return, general economic conditions, and other factors, and is used as a reference point for pricing some loans; however, Bank may price loans at, above or below the Reference Rate. Any change in the Reference Rate shall take effect on the day specified in the public announcement of such change.

"Reference Rate Loan" means a Revolving Loan during any period in which it bears interest at the rate provided in Section 3.1(a)(i).

"Reference Rate Margin" has the meaning specified in Section 3.1(a)(i).

"Related Company" means any member of any controlled group of corporations including, or under common control with, Borrower (as defined in Section 414(b) or (c) of the Code or Section 4001(a)(14) of ERISA).

"Reportable Event" means, with respect to a Pension Plan, a reportable event described in Section 4043 of ERISA or the regulations thereunder, a withdrawal from a Plan described in Section 4063 of ERISA, or a cessation of operations described in Section 4062(e) of ERISA.

"Restricted Investment" means any acquisition of Property by the Borrower in exchange for cash or other Property, whether in the form of an acquisition of stock, indebtedness or other obligation, or by loan, advance, capital contribution, or otherwise, except the following: (a) Property to be used in the business of Borrower or any of the LSB Guarantor Subsidiaries; (b) assets arising from the sale or lease of goods or rendition of services in the ordinary course of business of the Borrower or any of the LSB Guarantor Subsidiaries; (c) direct obligations of the United States of America, or any agency thereof, or obligations guaranteed by the United States of America, provided that such obligations mature within one year from the date of acquisition thereof; (d) certificates of deposit maturing within one year from the date of acquisition, bankers acceptances, Eurodollar bank deposits, or overnight bank deposits, in each case issued by, created by, or with a bank or trust company organized under the laws of the United States or any state thereof having capital and surplus aggregating at least \$100,000,000; and (e) commercial paper given the highest rating by a national credit rating agency and maturing not more than 270 days from the date of creation thereof.

"Reversions" means any funds which may become due to the Borrower in connection with the termination of any Plan.

"Revolving Loans" has the meaning specified in Section 2.1.

"SBL Debt" means the \$3 Million Dollar loan made by SBL Corporation to LSB and/or the other Subsidiaries of LSB during the month of October, 1997.

"Security Interest" means collectively the Liens granted by Borrower and the LSB Guarantor Subsidiaries to the Lender in the Collateral pursuant to this Agreement or the other Loan Documents.

"Subordinated Debt" shall mean Debt that is unsecured and is subordinated to the payment of the Obligations.

"Subsidiary" or "Subsidiaries" means any present or future corporation or corporations of which LSB owns, directly or indirectly, more than 50% of the voting stock.

"Subsidiary Guaranties" means the continuous guaranties of the Obligations made by the LSB Guarantor Subsidiaries in favor of the Lender.

"Swap Transaction Fee" has the meaning specified in Section 2.4.

"Swap Transaction Reserves" means all reserves which the Lender from time to time establishes for amounts that are liabilities owed by EDC to the Bank and for which Lender has agreed to indemnify the Bank. As of the Closing Date, the amount of the Swap Transaction Reserves is \$1,850,000.

"Swap Transactions" means interest rate swaps, treasury locks, and all other forward rate agreements entered into by the Bank for the account of or otherwise for the benefit of EDC.

"Termination Event" means: (a) a Reportable Event (other than a Reportable Event described in Section 4043 of ERISA which is not subject to the provision for 30-day notice to the PBGC under applicable regulations); or (b) the withdrawal of the Borrower or any Related Company from a Pension Plan during a plan year in which it was a "substantial employer" as defined in Section 4001(a)(2) of ERISA with respect to such Pension Plan; or (c) the filing of a notice of intent to terminate a Pension Plan or the treatment of a Pension Plan amendment as a termination under Section 4041 of ERISA; or (d) the institution of proceedings by the PBGC to terminate or have a trustee appointed to administer a Pension Plan; or (e) any other event or condition which might constitute grounds under Section 4042 of ERISA for the termination of, or the appointment of a trustee to administer, any Pension Plan, or (f) the partial or complete withdrawal of Borrower or any Related Company from a Multi-employer Plan, or (g) the withdrawal of Borrower from any state workers' compensation system.

"UCC" means the Uniform Commercial Code (or any successor statute) of the State of Oklahoma or of any other state the laws of which are required by Section 9-103 thereof to be applied in connection with the issue of perfection of security interests.

1.2 Accounting Terms. Any accounting term used in this Agreement shall have, unless otherwise specifically provided herein, the meaning customarily given in accordance with GAAP, and all financial computations hereunder shall be computed, unless otherwise specifically provided herein, in accordance with GAAP as consistently applied and using the same method for inventory valuation as used in the preparation of the Financial Statements.

1.3 Other Terms. All other undefined terms contained in this Agreement shall, unless the context indicates otherwise, have the meanings provided for by the UCC to the extent the same are used or defined therein. Wherever appropriate in the context, terms used herein in the singular also include the plural, and vice versa, and each masculine, feminine, or neuter pronoun shall also include the other genders.

1.4 Exhibits. All references in this Agreement to Exhibits are, unless otherwise specified, references to exhibits attached hereto, and all such exhibits are hereby deemed incorporated herein by this reference.

## 2. LOANS AND LETTERS OF CREDIT.

2.1 Revolving Loans. The Lender shall, subject to the terms and conditions set forth in this Agreement, and upon the Borrower's request from time to time, make revolving loans (the "Revolving Loans") to the Borrower up to the limits of the Availability. The Lender, in its discretion, may elect to exceed the limits of the Availability on one or more occasions, but if it does so, the Lender shall not be deemed thereby to have changed the limits of the Availability or to be obligated to exceed the limits of the Availability on any other occasion. If the unpaid balance of the Revolving Loans exceeds the Availability (with Availability for this purpose determined as if the amount of the Revolving Loans were zero), then the Lender may refuse to make or otherwise restrict Revolving Loans on such terms as the Lender determines until such excess has been eliminated. The Borrower may request Revolving Loans either orally or in writing, provided, however, that each such request with respect to Reference Rate Loans shall be made no later than 1:00 p.m. (Los Angeles, California time). Each oral request for a Revolving Loan shall be conclusively presumed to be made by a person authorized by the Borrower to do so and the crediting of a Revolving Loan to the Borrower's deposit account, or transmittal to such Person as the Borrower shall direct, shall conclusively establish the obligation of the Borrower to repay such Revolving Loan. The Lender will charge all Revolving Loans and other Obligations to a loan account of the Borrower maintained with the Lender. All fees, commissions, costs, expenses, and other charges due from the Borrower pursuant to the Loan Documents, and all payments made and out-of-pocket expenses incurred by Lender and authorized to be charged to the Borrower pursuant to the Loan Documents, will be charged as Revolving Loans to the Borrower's loan account as of the date due from the Borrower or the date paid or incurred by the Lender, as the case may be.

2.2 Availability Determination. Availability will be determined by the Lender in accordance with the terms of this Agreement, each day on the basis of such relevant information as the Lender deems appropriate to consider, including the collateral summary reports and such other information regarding the Accounts and the Inventory as the Lender shall obtain from the Borrower.

2.3 Letters of Credit. The Lender will, subject to the terms and conditions of this Agreement and the Letter of Credit Agreement as hereafter defined, and upon the Borrower's request from time to time, cause merchandise letters of credit (the "Merchandise L/C's") or standby letters of credit (the "Standby L/C's") to be issued for the Borrower's account (the Merchandise L/C's and the Standby L/C's being referred to collectively as the "Letters of Credit"). The Lender will not cause to be opened any Letter of Credit if: (a) the maximum face amount of the requested Letter of Credit, plus the aggregate undrawn face amount of all outstanding Letters of Credit under this Agreement and the other LSB-Related Loan Agreements, would exceed Eleven Million and No/100 Dollars (\$11,000,000); or (b) the maximum face amount of the requested Letter of Credit, and all commissions, fees, and charges due from Borrower to Lender in connection with the opening thereof, would cause the Availability to be exceeded at such time. In addition, with respect to any Merchandise L/C, the requested term of such Letter of Credit may not exceed 180 days, and no Merchandise L/C may by its terms be scheduled to be outstanding on the Termination Date. Standby L/C's may have terms that extend beyond the Termination Date but upon termination of this Agreement, all Letters of Credit must be either terminated with the consent of the beneficiary thereof, replaced with a letter of credit provided by a financial institution acceptable to Lender, collateralized by cash or cash equivalent, or otherwise satisfied in a manner acceptable to Lender. The Letters of Credit shall be governed by a Letter of Credit Financing Agreement - Supplement to Loan and Security Agreement between the Lender and the Borrower ("Letter of Credit Agreement"), in the form attached hereto as Exhibit "0" and made a part hereof, in addition to the terms and conditions hereof. All payments made and expenses incurred by the Lender pursuant to or in connection with the Letters of Credit and the Letter of Credit Agreement will be charged to the Borrower's loan account as Revolving Loans.

2.4 Swap Transactions. EDC has requested and the Lender has, in its sole and absolute discretion, arranged for EDC to obtain Swap Transactions from the Bank in amounts to be agreed to between EDC and Bank. Borrower

agrees to indemnify and hold the Lender harmless from any and all obligations now or hereafter owing by the Lender to the Bank arising from or related to such Swap Transactions pursuant to the indemnity referred to in clause (c) below. EDC has agreed to pay the Bank all amounts owing to the Bank pursuant to the Swap Transactions. In the event EDC shall not have paid to the Bank such amounts, the Lender shall pay the Bank and such amounts when paid by the Lender shall constitute a Revolving Loan of EDC which shall be deemed to have been requested by EDC. Borrower acknowledges and agrees that the obtaining of Swap Transactions from the Bank (a) is in the sole and absolute discretion of the Bank, (b) is subject to all rules and regulations of the Bank, and (c) is due to the Bank relying on the indemnity of the Lender to the Bank with respect to the obligations of EDC to the Bank in connection with the Swap Transactions.

### 3. INTEREST AND OTHER CHARGES

#### 3.1 Interest.

(a) Interest Rates. All amounts charged as Revolving Loans shall bear interest on the unpaid principal amount thereof from the date made until paid in full in cash at the Applicable Interest Rate as described in Sections 3.1(a)(i) and (ii) but not to exceed the maximum rate permitted by applicable law. Subject to the provisions of Section 3.2, any of the Revolving Loans may be converted into, or continued as, Reference Rate Loans or Eurodollar Rate Loans in the manner provided in Section 3.2. If at any time Revolving Loans are outstanding with respect to which notice has not been delivered to Lender in accordance with the terms of this Agreement specifying the basis for determining the interest rate applicable thereto, then those Revolving Loans shall be Reference Rate Loans and shall bear interest at a rate determined by reference to the Reference Rate until notice to the contrary has been given to the Lender and such notice has become effective. Except as otherwise provided herein, the amounts charged as Revolving Loans shall bear interest at the following rates (the "Applicable Interest Rate"):

(i) For all amounts charged as Revolving Loans other than Eurodollar Rate Loans, including all Revolving Loans which are Reference Rate Loans, then at a fluctuating per annum rate equal to one and one-half percent (1.50%) per annum (the "Reference Rate Margin") plus the Reference Rate; and

(ii) If the Revolving Loans are Eurodollar Rate Loans, then at a per annum rate equal to: three and seven-eighths percent (3.875%) per annum (the "Eurodollar Margin") plus the Eurodollar Rate determined for the applicable Interest Period.

Notwithstanding the foregoing, if, during any month, the sum of the average "Availability" (as defined in each of the LSB-Related Loan Agreements) of the LSB Consolidated Borrowing Group under the LSB-Related Loan Agreements is less than \$6,300,000, then, during the following month, the Reference Rate Margin will be increased to two percent (2%) and the Eurodollar Margin will be increased to four and three-eighths percent (4.375%).

In addition, if the LSB Adjusted Tangible Net Worth equals or exceeds \$72,500,000, as reflected on LSB's most current quarterly Financial Statements, provided no Event of Default has occurred and is continuing, then for so long as the LSB Adjusted Tangible Net Worth is at least \$72,500,000, the Reference Rate Margin will be reduced to one percent (1%) and the Eurodollar Margin will be reduced to three and three-eighths percent (3.375%), and the reduction will be effective as of the first day of the month following receipt by Lender of the applicable quarterly Financial Statements.

Finally, if the LSB Adjusted Tangible Net Worth equals or exceeds \$84,000,000, as reflected on LSB's most current quarterly Financial Statements, provided no Event of Default has occurred and is continuing, then for so long as the LSB Adjusted Tangible Net Worth is at least \$84,000,000, the Reference Rate Margin will be reduced to one-half of one percent (.50%) and the Eurodollar Margin will be reduced to two and seven-eighths percent (2.875%), and the reduction will be effective as of the first day of the month following receipt by Lender of the applicable quarterly Financial Statements.

Each change in the Reference Rate shall be reflected in the interest rate described in (i) above as of the effective date of such change. All interest charges shall be computed on the basis of a year of three hundred sixty (360) days and actual days elapsed. Except as otherwise provided herein, (1) interest accrued on each Eurodollar Rate Loan shall be payable in arrears on each Eurodollar Interest Payment Date applicable to such Eurodollar Rate Loan, and (2) interest accrued on the Reference Rate Loans will be payable in arrears on the first day of each month hereafter.

(b) Default Rate. If any Event of Default occurs, then, while any such Event of Default is continuing, all Loans shall bear interest at an increased rate of interest equal to the Applicable Interest Rate thereto plus

two percent (2.0%) per annum, and the Letter of Credit Fee shall be increased to three percent (3%) per annum.

### 3.2 Eurodollar Borrowings: Conversion or Continuation.

(a) Subject to the provisions of Section 3.3, the Borrower shall have the option: (i) to request the Lender to make a Revolving Loan as a Eurodollar Rate Loan; (ii) to convert all or any part of the outstanding Revolving Loans from Reference Rate Loans to Eurodollar Rate Loans, (iii) to convert all or any part of the outstanding Revolving Loans from Eurodollar Rate Loans to Reference Rate Loans on the expiration of the Interest Period applicable thereto; (iv) upon the expiration of any Interest Period applicable to any outstanding Eurodollar Rate Loan, to continue all or any portion of such Eurodollar Rate Loan as a Eurodollar Rate Loan; provided, however, that no outstanding Loans may be converted into or continued as, Eurodollar Rate Loans when any Event or Event of Default has occurred and is continuing.

(b) Whenever the Borrower elects to borrow, convert into or continue Eurodollar Rate Loans under this Section 3.2, the Borrower shall notify the Lender in writing or telephonically no later than 11:00 a.m. (Los Angeles, California time) two (2) Business Days in advance of the requested borrowing/conversion/continuation date. The Borrower shall specify (1) the borrowing/conversion/continuation date (which shall be a Business Day), (2) the amount and type of the Revolving Loans to be borrowed/converted/continued, and (3) the nature of the requested borrowing/ conversion/continuation. In the event that the Borrower should fail to timely notify the Lender to continue to convert any existing Eurodollar Rate Loan, such Loan shall, on the last day of the Interest Period with respect to such Revolving Loan, convert to a Reference Rate Loan.

(c) The officer of the Borrower authorized by the Borrower to request Revolving Loans on behalf of the Borrower shall also be authorized to request a conversion/continuation on behalf of the Borrower. The Lender shall be entitled to rely on such officer's authority until the Lender is notified to the contrary in writing. The Lender shall have no duty to verify the authenticity of the signature appearing on any written notification or request and, with respect to an oral notification or request, the Lender shall have no duty to verify the identity of any individual representing himself as one of the officers authorized to make such notification or request on behalf of the Borrower. The Lender shall incur no liability to the Borrower in acting upon any telephonic notice or request referred to in this Section 3.2, which the Lender believes in good faith to have been given by an officer authorized to do so on behalf of the Borrower, or for otherwise acting in good faith under this Section 3.2 and, upon lending/conversion/continuation by the Lender in accordance with this Agreement pursuant to any such telephonic notice, the Borrower shall have effected the borrowing/conversion/continuation of the applicable Loans hereunder.

(d) Any written or telephonic notice of conversion to, or borrowing or continuation of, Revolving Loans made pursuant to this Section 3.2 shall be irrevocable and the Borrower shall be bound to borrow, convert or continue in accordance therewith.

3.3 Special Provisions Governing Eurodollar Rate Loans. Notwithstanding any other provisions to the contrary contained in this Agreement, the following provisions shall govern with respect to Eurodollar Rate Loans as to the matters covered:

(a) Amount of Eurodollar Rate Loans. Each election of, continuation of, or conversion to a Eurodollar Rate Loan, shall be in a minimum amount of Five Million Dollars (\$5,000,000) and in integral multiples of One Million Dollars (\$1,000,000) in excess of that amount.

(b) Determination of Interest Period. The Interest Period for each Eurodollar Rate Loan shall be for a three (3) month period. The determination of Interest Periods shall be subject to the following provisions:

(i) In the case of immediately successive Interest Periods, each successive Interest Period shall commence on the day on which the next preceding Interest Period expires.

(ii) If any Interest Period would otherwise expire on a day which is not a Business Day, the Interest Period shall be extended to expire on the next succeeding Business Day; provided, however, that if the next succeeding Business Day occurs in the following calendar month, then such Interest Period shall expire on the immediately preceding Business Day.

(iii) The Borrower may not select an Interest Period for any Eurodollar Rate Loan, which Interest Period expires later than the Stated Termination Date.

(iv) There shall be not more than two (2) Interest Periods in effect at any one time, and no more than two (2) Interest Periods may begin during any calendar month.

(v) If an Interest Period starts on a date for which no numerical correspondent exists in the month in which such Interest Period ends, such Interest Period will end on the last Business Day of such month.

(c) Determination of Interest Rate. As soon as practicable after 11:00 a.m. (Los Angeles, California time) on the Eurodollar Interest Rate Determination Date, the Lender shall determine (which determination shall, absent manifest error, be presumptively correct) the Interest Rate for the Eurodollar Rate Loans for which an Interest Rate is then being determined and shall promptly give notice thereof (in writing or by telephone confirmed in writing) to the Borrower.

(d) Substituted Rate of Borrowing. In the event that on any Eurodollar Interest Rate Determination Date the Lender shall have determined (which determination shall, absent manifest error, be presumptively correct and binding upon all parties) that:

(i) by reason of any changes arising after the date of this Agreement affecting the interbank Eurodollar market or affecting the position of Bank or Lender in such market, adequate and fair means do not exist for ascertaining the applicable interest rates by reference to which the Eurodollar Rate then being determined is to be fixed; or

(ii) by reason of (1) any change after the date of this Agreement in any applicable law or governmental rule, regulation or order (or any interpretation thereof and including the introduction of any new law or governmental rule, regulation or order) or (2) any other circumstances affecting Bank or Lender or the interbank Eurodollar market or the position of Bank or Lender in such market (such as, for example, but not limited to, official reserve requirements required by Regulation D of the Board of Governors of the Federal Reserve System to the extent not given effect in the Eurodollar Rate), the Eurodollar Rate shall not represent the effective pricing to Lender for Dollar deposits of comparable amounts for the relevant period;

then, and in any such event, the right of the Borrower to request application of the Eurodollar Rate to some or all of the Loans shall be suspended until the Lender shall notify the Borrower that the circumstances causing such suspension no longer exist, and such Loans shall be Reference Rate Loans.

(e) Illegality. In the event that on any date Lender shall have reasonably determined (which determination shall, absent manifest error, be final and conclusive and binding upon all parties) that the making of, conversion into, or the continuation of, Lender's Eurodollar Rate Loans has become unlawful as the result of compliance by Lender or Bank in good faith with any law, governmental rule, regulation or order (whether or not having the force of law and whether or not failure to comply therewith would be unlawful), then, and in any such event, Lender shall promptly give notice (by telephone confirmed in writing) to the Borrower of such determination. In such case and except as provided in Section 3.3(f), the obligation of Lender to make or maintain any Eurodollar Rate Loans during any such period shall be terminated at the earlier of the termination of the Interest Period then in effect or when required by law, and the Borrower shall, no later than the earlier of the termination of the Interest Period in effect at the time any such determination pursuant to this Section 3.3(e) is made, or when required by law, repay the Eurodollar Rate Loans, together with all interest accrued thereon.

(f) Options of the Borrower. In lieu of prepaying the Eurodollar Rate Loans as required by Section 3.3(e), the Borrower may exercise either of the following options:

(i) Upon written notice to the Lender, the Borrower may release Lender from its obligations to make or maintain Loans as Eurodollar Rate Loans and in such event, the Borrower shall, at the end of the then current Interest Period (or at such earlier time as prepayment is otherwise required), convert all of the Eurodollar Rate Loans into Reference Rate Loans in the manner contemplated by Section 3.2, but without satisfying the advance notice requirements therein; or

(ii) The Borrower may, by giving notice (by telephone confirmed immediately by telecopy) to Lender require Lender to continue to maintain its outstanding Reference Rate Loans as Reference Rate Loans, but without satisfying the advance notice requirements set forth in such Section 3.2.

(g) Compensation. In addition to such amounts as are required to be paid by the Borrower pursuant to the other Sections of this Article 3,

the Borrower agrees to compensate the Lender for all expenses and liabilities, including, without limitation, any loss or expense incurred by Lender by reason of the liquidation or reemployment of deposits or other funds acquired by Lender to fund or maintain the Lender's Eurodollar Rate Loans to the Borrower, which Lender sustains (i) if due to the fault of the Borrower a funding of any Eurodollar Rate Loans does not occur on a date specified therefor by Borrower in a telephonic or written request for borrowing or conversion/continuation, or a successive Interest Period does not commence after notice therefor is given pursuant to Section 3.2, (ii) if any voluntary or mandatory prepayment of any Eurodollar Rate Loans occurs for any reason on a date which is not the last scheduled day of an Interest Period, or (iii) as a consequence of any other failure by the Borrower to repay Eurodollar Rate Loans when required by the terms of this Agreement.

(h) Quotation of Eurodollar Rate. Anything herein to the contrary notwithstanding, if on any Eurodollar Interest Rate Determination Date no Eurodollar Rate is available by reason of the failure of Bank to be offered quotations in accordance with the definition of "Eurodollar Base Rate," the Lender shall give the Borrower prompt notice thereof and (i) any Eurodollar Rate Loan requested to be made at the Eurodollar Rate to be determined on any Eurodollar Interest Rate Determination Date shall be made as a Reference Rate Revolving Loan, and (ii) any notice given by the Borrower to convert any Loans into or to continue any Loans as Eurodollar Rate Loans at the Eurodollar Rate to be determined on any such Eurodollar Interest Rate Determination Date shall be ineffective.

(i) Eurodollar Rate Taxes. The Borrower agrees that it will pay, prior to the date on which penalties attach thereto, all present and future income, stamp and other taxes, levies, or costs and charges whatsoever imposed, assessed, levied or collected on or from the Lender on or in respect of the Borrower's Loans from the Lender solely as a result of the interest rate being determined by reference to the Eurodollar Rate and/or the provisions of this Agreement relating to the Eurodollar Rate and/or the recording, registration, notarization or other formalization of any of the foregoing and/or any payments of principal, interest or other amounts made on or in respect of the Loans from the Lender when the interest rate is determined by reference to the Eurodollar Rate (all such taxes, levies, cost and charges being herein collectively called "Eurodollar Rate Taxes"); provided, however, that Eurodollar Rate Taxes shall not include taxes imposed on or measured by the overall net income of the Lender by the United States of America or any political subdivision or taxing authority thereof or therein, or taxes on or measured by the overall net income by any foreign branch or subsidiary of the Lender by any foreign country or subdivision thereof in which that branch or subsidiary is doing business. Promptly after the date on which payment of any such Eurodollar Rate Tax is due pursuant to applicable law, the Borrower will, at the request of the Lender, furnish to the Lender evidence, in form and substance satisfactory to the Lender, that the Borrower has met its obligation under this Section 3.3(i), in addition, the Borrower will indemnify the Lender against, and reimburse Lender on demand for, any Eurodollar Rate Taxes for which the Lender is or may be liable by reason of the making or maintenance of any Eurodollar Rate Loans hereunder, as determined by the Lender in its discretion exercised in good faith and pursuant to standards of commercial reasonableness. The Lender shall provide Borrower with appropriate receipts for any payments or reimbursements made by Borrower pursuant to this Section 3.3(i).

(j) Booking of Eurodollar Rate Loans. The Lender may make, carry or transfer Eurodollar Rate Loans at, to, or for the account of, any of its branch offices or the office of any of its Affiliates.

(k) Increased Costs. If, due to either (i) the introduction of or any change (other than any change by way of imposition or increase of reserve requirements included in the Eurodollar Reserve Percentage) in or in the interpretation of any law or regulation or (ii) the compliance with any guideline or request from any central bank or other Public Authority (whether or not having the force of law), there shall be any increase in the cost to the Lender of agreeing to make or making, funding or maintaining Eurodollar Rate Loans, then the Borrower agrees that it shall, from time to time, upon demand by the Lender in writing to the Borrower, within sixty (60) days from the date of such increased cost, pay to the Lender additional amounts sufficient to compensate the Lender for such increased cost relating to the outstanding Eurodollar Rate Loans made to the Borrower. A certificate as to the amount of such increased cost and the method of determination thereof, submitted to the Borrower by the Lender, shall be rebuttably presumptive evidence of the correctness of such amount. Notwithstanding the above, the Lender shall promptly advise Borrower of any increased costs covered by this paragraph (k) of which Lender is aware that have been made or which are proposed to be made which may require the Borrower to be required to pay the increased cost under this paragraph (k) prior to or at the time that Borrower requests additional Eurodollar Rate Loans.

### 3.4 Maximum Interest Rate.

(a) Notwithstanding the foregoing provisions of Sections 3.1 through 3.3 regarding the rates of interest applicable to the Loans, if at any time the amount of such interest computed on the basis of the Applicable Interest Rate would exceed the amount of such interest computed upon the basis of the maximum rate of interest permitted by applicable state or federal law in effect from time to time hereafter, after taking into account, to the extent required by applicable law, any and all fees, payments, charges and calculations provided for in this Agreement or in any other agreement between Borrower and Lender (the "Maximum Legal Rate"), the interest payable under this Agreement shall be computed upon the basis of the Maximum Legal Rate, but any subsequent reduction in the Reference Rate or the Eurodollar Rate shall not reduce such interest thereafter payable hereunder below the amount computed on the basis of the Maximum Legal Rate until the aggregate amount of such interest accrued and payable under this Agreement equals the total amount of interest which would have accrued if such interest had been at all times computed solely on the basis of the Applicable Interest Rate.

(b) No agreements, conditions, provisions or stipulations contained in this Agreement or any other instrument, document or agreement between the Borrower and the Lender or default of the Borrower, or the exercise by the Lender of the right to accelerate the payment of the maturity of principal and interest, or to exercise any option whatsoever contained in this Agreement or any other agreement between the Borrower and the Lender, or the arising of any contingency whatsoever, shall entitle the Lender to collect, in any event, interest exceeding the Maximum Legal Rate and in no event shall the Borrower be obligated to pay interest exceeding such Maximum Legal Rate and all agreements, conditions or stipulations, if any, which may in any event or contingency whatsoever operate to bind, obligate or compel the Borrower to pay a rate of interest exceeding the Maximum Legal Rate, shall be without binding force or effect, at law or in equity, to the extent only of the excess of interest over such Maximum Legal Rate. In the event any interest is charged in excess of the Maximum Legal Rate ("Excess"), the Borrower acknowledges and stipulates that any such charge shall be the result of an accidental and bona fide error, and such Excess shall be, first, applied to reduce the principal then unpaid hereunder; second, applied to reduce the Obligations; and third, returned to the Borrower, it being the intention of the parties hereto not to enter at any time into a usurious or otherwise illegal relationship. The Borrower recognizes that, with fluctuations in the Applicable Interest Rate and the Maximum Legal Rate, such an unintentional result could inadvertently occur. By the execution of this Agreement, the Borrower covenants that (i) the credit or return of any Excess shall constitute the acceptance by the Borrower of such Excess, and (ii) the Borrower shall not seek or pursue any other remedy, legal or equitable, against Lender, based in whole or in part upon the charging or receiving of any interest in excess of the maximum authorized by applicable law. For the purpose of determining whether or not any Excess has been contracted for, charged or received by Lender, all interest at any time contracted for, charged or received by the Lender in connection with this Agreement shall be amortized, prorated, allocated and spread in equal parts during the entire term of this Agreement.

(c) The provisions of Section 3.4 shall be deemed to be incorporated into every document or communication relating to the Obligations which sets forth or prescribes any account, right or claim or alleged account, right or claim of the Lender with respect to the Borrower (or any other obligor in respect of Obligations), whether or not any provision of Section 3.4 is referred to therein. All such documents and communications and all figures set forth therein shall, for the sole purpose of computing the extent of the liabilities and obligations of the Borrower (or other obligor) asserted by the Lender thereunder, be automatically recomputed by any Borrower or obligor, and by any court considering the same, to give effect to the adjustments or credits required by Section 3.4.

(d) If the applicable state or federal law is amended in the future to allow a greater rate of interest to be charged under this Agreement or any other Loan Documents than is presently allowed by applicable state or federal law, then the limitation of interest under Section 3.4 shall be increased to the maximum rate of interest allowed by applicable state or federal law as amended, which increase shall be effective hereunder on the effective date of such amendment, and all interest charges owing to the Lender by reason thereof shall be payable upon demand.

3.5 Capital Adequacy. If as a result of any regulatory change directly or indirectly affecting Lender or any of Lender's affiliated companies there shall be imposed, modified or deemed applicable any tax, reserve, special deposit, minimum capital, capital ratio, or similar requirement against or with respect to or measured by reference to loans made or to be made to Borrower hereunder, or to Letters of Credit issued on behalf of Borrower pursuant to the Letter of Credit Agreement, and the result shall

be to increase the cost to Lender or to any of Lender's affiliated companies of making or maintaining any Revolving Loan or Letter of Credit hereunder, or reduce any amount receivable in respect of any such Revolving Loan and which increase in cost, or reduction in amount receivable, shall be the result of Lender's or Lender's affiliated company's reasonable allocation among all affected customers of the aggregate of such increases or reductions resulting from such event, then, within ten (10) days after receipt by Borrower of a certificate from Lender containing the information described in this Section 3.5 which shall be delivered to Borrower, Borrower agrees from time to time to pay Lender such additional amounts as shall be sufficient to compensate Lender or any of Lender's affiliated companies for such increased costs or reductions in amounts which Lender determines in Lender's reasonable discretion are material. Notwithstanding the foregoing, all such amounts shall be subject to the provisions of Section 3.4. The certificate requesting compensation under this Section 3.5 shall identify the regulatory change which has occurred, the requirements which have been imposed, modified or deemed applicable, the amount of such additional cost or reduction in the amount receivable and the way in which such amount has been calculated.

#### 4. PAYMENTS AND PREPAYMENTS.

4.1 Revolving Loans. The Borrower shall repay the outstanding principal balance of the Revolving Loans, plus all accrued but unpaid interest thereon, upon the termination of this Agreement. In addition, the Borrower shall pay to the Lender, on demand, the amount by which the unpaid principal balance of the Revolving Loans at any time exceeds the Availability at such time (with Availability for this purpose determined as if the amount of the Revolving Loans were zero).

4.2 Place and Form of Payments: Extension of Time. All payments of principal, interest, and other sums due to the Lender shall be made at the Lender's address set forth in Section 13.10. Except for Proceeds received directly by the Lender, all such payments shall be made in immediately available funds. If any payment of principal, interest, or other sum to be made hereunder becomes due and payable on a day other than a Business Day, the due date of such payment shall be extended to the next succeeding Business Day and interest thereon shall be payable at the applicable interest rate during such extension.

4.3 Apportionment, Application and Reversal of Payments. Except as otherwise expressly provided hereunder, the Lender shall determine in its discretion the order and manner in which proceeds and other payments that the Lender receives are applied to the Revolving Loans, interest thereon, and the other Obligations, and the Borrower hereby irrevocably waives the right to direct the application of any payment or proceeds; provided, however, unless so directed by the Borrower, the Lender shall not apply any such payments which it receives to any Eurodollar Rate Loan, except: (a) on the expiration date of the Interest Period applicable to any such Eurodollar Rate Loan; or (b) in the event, and only to the extent, that there are not outstanding Reference Rate Loans. Following an Event of Default that is continuing, the Lender shall have the continuing and exclusive right to apply and reverse and reapply any and all such proceeds and payments to any portion of the Obligations subject to the terms of this Section 4.3 and the Borrower's right to direct prepayments of Eurodollar Rate Loans.

4.4 INDEMNITY FOR RETURNED PAYMENTS. IF AFTER RECEIPT OF ANY PAYMENT OF, OR PROCEEDS APPLIED TO THE PAYMENT OF, ALL OR ANY PART OF THE OBLIGATIONS, THE LENDER IS FOR ANY REASON REQUIRED TO SURRENDER SUCH PAYMENT OR PROCEEDS TO ANY PERSON, BECAUSE SUCH PAYMENT OR PROCEEDS IS INVALIDATED, DECLARED FRAUDULENT, SET ASIDE, DETERMINED TO BE VOID OR VOIDABLE AS A PREFERENCE, OR A DIVERSION OF TRUST FUNDS, OR FOR ANY OTHER REASON, THEN: THE OBLIGATIONS OR PART THEREOF INTENDED TO BE SATISFIED SHALL BE REVIVED AND CONTINUE AND THIS AGREEMENT SHALL CONTINUE IN FULL FORCE AS IF SUCH PAYMENT OR PROCEEDS HAD NOT BEEN RECEIVED BY THE LENDER AND THE BORROWER SHALL BE LIABLE TO PAY TO THE LENDER, AND HEREBY DOES INDEMNIFY THE LENDER AND HOLD THE LENDER HARMLESS FOR THE AMOUNT OF SUCH PAYMENT OR PROCEEDS SURRENDERED. The provisions of this Section 4.4 shall be and remain effective notwithstanding any contrary action which may have been taken by the Lender in reliance upon such payment or Proceeds, and any such contrary action so taken shall be without prejudice to the Lender's rights under this Agreement and shall be deemed to have been conditioned upon such payment or Proceeds having become final and irrevocable. The provisions of this Section 4.4 shall survive the termination of this Agreement.

5. LENDER'S BOOKS AND RECORDS: MONTHLY STATEMENTS. The Borrower agrees that the Lender's books and records showing the Obligations and the transactions pursuant to this Agreement and the other Loan Documents shall be admissible in any action or proceeding arising therefrom irrespective of whether any Obligation is also evidenced by a promissory note or other instrument, and shall constitute presumptive proof thereof until such time as Borrower has reviewed the monthly statement as hereinafter provided. The

Lender will provide to the Borrower a monthly statement of Loans, payments, and other transactions pursuant to this Agreement. Such statement shall be deemed correct, accurate, and binding on the Borrower and as an account stated and shall constitute prima facie proof thereof (except for reversals and reapplications of payments made as provided in Section 4.3 and corrections of errors discovered by the Lender), unless the Borrower notifies the Lender in writing to the contrary within thirty (30) days after such statement is rendered. In the event a timely written notice of objections is given by the Borrower, only the items to which exception is expressly made will be considered to be disputed by the Borrower.

## 6. COLLATERAL.

### 6.1 Grant of Security Interest.

(a) As security for the Obligations, the Borrower and each LSB Guarantor Subsidiary hereby grants to the Lender a continuing security interest in, lien on, and assignment of: (i) all Receivables, Inventory, Proprietary Rights, and Proceeds, wherever located and whether now existing or hereafter arising or acquired; (ii) all moneys, securities and other property and the Proceeds thereof, now or hereafter held or received by, or in transit to, the Lender from or for the Borrower, whether for safekeeping, pledge, custody, transmission, collection or otherwise, including, without limitation, all of the Borrower's deposit accounts, credits and balances with the Lender and all claims of the Borrower against the Lender at any time existing; (iii) all of Borrower's deposit accounts containing Collateral with any financial institutions with which Borrower maintains deposits; and (iv) all books, records, ledger cards, data processing records, computer software and other property and general intangibles at any time evidencing or relating to the Receivables, Inventory, Proprietary Rights, Proceeds, and other property referred to above (all of the foregoing, together with all other property in which Lender may at any time be granted a Lien, being herein collectively referred to as the "Collateral"). The Lender shall have all of the rights of a secured party with respect to the Collateral under the UCC and other applicable laws.

(b) All Obligations shall constitute a single loan secured by the Collateral. The Lender may, in its sole discretion, (i) exchange, waive, or release any of the Collateral, (ii) after the occurrence of an Event of Default that is continuing, apply Collateral and direct the order or manner of sale thereof as the Lender may determine, and (iii) after the occurrence of an Event of Default that is continuing, settle, compromise, collect, or otherwise liquidate any Collateral in any manner, all without affecting the Obligations or the Lender's right to take any other action with respect to any other Collateral.

### 6.2 Perfection and Protection of Security Interest.

The Borrower and each LSB Guarantor Subsidiary shall, at its expense, perform all steps requested by the Lender at any time to perfect, maintain, protect, and enforce the Security Interest in the Collateral including, without limitation: (a) executing and recording of the Patent and Trademark Assignments and executing and filing financing or continuation statements, and amendments thereof, relating to the Collateral in form and substance satisfactory to the Lender; (b) delivering to the Lender, upon Lender's request therefor, the originals of all instruments, documents, and chattel paper, and all other Collateral of which the Lender determines it should have physical possession in order to perfect and protect the Security Interest therein, duly endorsed or assigned to the Lender without restriction; (c) delivering to the Lender warehouse receipts covering any portion of the Collateral located in warehouses and for which warehouse receipts are issued; (d) after an Event of Default that is continuing, causing notations to be placed on the Borrower's and each LSB Guarantor Subsidiary's books of account to disclose the Security Interest; (e) delivering to the Lender, upon Lender's request therefor, all letters of credit on which the Borrower or any LSB Guarantor Subsidiary is a named beneficiary; (f) after an Event of Default that is continuing transferring Inventory to warehouses designated by the Lender; and (g) taking such other steps as are deemed necessary by the Lender to maintain the Security Interest. The Lender may file, without the Borrower's signature or that of any LSB Guarantor Subsidiary, one or more financing statements disclosing the Security Interest. The Borrower agrees that a carbon, photographic, photostatic, or other reproduction of this Agreement or of a financing statement is sufficient as a financing statement. If any Collateral is at any time in the possession or control of any warehouseman, bailee or any of the agents or processors of Borrower or any LSB Guarantor Subsidiary, then the Borrower shall notify the Lender thereof and shall notify such Person of the Security Interest in such Collateral and, upon the Lender's request following an Event of Default that is continuing, instruct such Person to hold all such Collateral for the Lender's account subject to the Lender's instructions. If at any time any Collateral is located on any premises that are not owned by the Borrower or a LSB Guarantor Subsidiary, then the Borrower shall obtain written waivers, in form and substance reasonably satisfactory to

the Lender, of all present and future Liens to which the owner or lessor of such premises may be entitled to assert against the Collateral. From time to time, the Borrower shall, upon Lender's request, cause to be executed and delivered confirmatory written instruments pledging to the Lender the Collateral, but the Borrower's failure to do so shall not affect or limit the Security Interest. So long as this Agreement is in effect and until all Obligations have been fully satisfied, the Security Interest shall continue in full force and effect in all Collateral (whether or not deemed eligible for the purpose of calculating the Availability or as the basis for any advance, loan, or other financial accommodation). Upon termination of this Agreement and payment of all Obligations, the Lender shall release all Security Interests held by the Lender.

6.3 Location of Collateral. The Borrower represents and warrants to the Lender that: (a) Exhibit D hereto is a correct and complete List of the Borrower's chief executive office, the location of its books and records as well as the books and records of the LSB Guarantor Subsidiaries, the locations of the Collateral, and the locations of all of its other places of business; and (b) Exhibit H correctly identifies any of such facilities and locations that are not owned by the Borrower or the LSB Guarantor Subsidiaries and sets forth the names of the owners and lessors of, and, to the best of the Borrower's knowledge, the holders of any mortgages on such facilities and locations. Except for Inventory that is consigned by a Borrower or a LSB Guarantor Subsidiary to a customer or warehouse, the Borrower agrees that it will not maintain, nor will it allow any LSB Guarantor Subsidiary to maintain, any Collateral at any location other than those listed on Exhibit D, and it will not otherwise change or add to any of such locations, unless it gives the Lender at least thirty (30) days prior written notice and executes or has executed, such financing statements and other documents that the Lender requests in connection therewith.

6.4 Title to, Liens on, and Sale and Use of Collateral. The Borrower represents and warrants to the Lender that: (a) all Collateral is and will continue to be owned by the Borrower or a LSB Guarantor Subsidiary free and clear of all Liens whatsoever, except for the Security Interest and other Permitted Liens; (b) the Security Interest will not be subject to any prior Lien except the Permitted Liens; (c) the Borrower and each LSB Guarantor Subsidiary will use, store, and maintain the Collateral with all reasonable care and will use the Collateral for lawful purposes only; and (d) neither the Borrower nor the LSB Guarantor Subsidiaries will, without the Lender's prior written approval, sell, or dispose of or permit the sale or disposition of any Collateral, except for (i) sales of Inventory in the ordinary course of business, and (ii) as otherwise provided or allowed by this Agreement or any of the other Loan Documents. The inclusion of Proceeds in the Collateral shall not be deemed the Lender's consent to any sale or other disposition of the Collateral except as expressly permitted herein.

6.5 Appraisals. Following the occurrence of an Event of Default that is continuing, the Borrower shall, at the request of the Lender, provide the Lender, at the Borrower's expense, with appraisals or updates thereof of any or all of the Collateral from an appraiser satisfactory to the Lender.

6.6 Access and Examination. The Lender may at all reasonable times have access to, examine, audit, make extracts from and inspect the Borrower's records, files, and books of account and those of each LSB Guarantor Subsidiary, as well as the Collateral and may discuss the Borrower's affairs and the affairs of each LSB Guarantor Subsidiary with the Borrower's officers and management and with the officers and management of each LSB Guarantor Subsidiary. The Borrower will deliver to the Lender any instrument necessary for the Lender to obtain records from any service bureau maintaining records for the Borrower or any LSB Guarantor Subsidiary. The Lender may, at any time when an Event of Default exists and at the Borrower's expense, make copies of all of the Borrower's books and records, or require the Borrower to deliver such copies to the Lender. After the occurrence of an Event of Default that is continuing, the Lender may, without expense to the Lender, use such of the Borrower's personnel, supplies, and premises as well as those of the LSB Guarantor Subsidiaries as may be reasonably necessary for maintaining or enforcing the Security Interest. Lender shall have the right, at any time, in Lender's name or in the name of a nominee of the Lender, to verify the validity, amount or any other matter relating to the Accounts, by mail, telephone, or otherwise.

6.7 Insurance. The Borrower shall insure the Collateral and Equipment against loss or damage by fire with extended coverage, theft, burglary, pilferage, loss in transit, and such other hazards as the Lender shall specify, in amounts, under policies and by insurers acceptable to the Lender. Borrower shall also maintain flood insurance, in the event of a designation of the area in which any Real Property is located as "flood prone" or a "flood risk area," as defined by the Flood Disaster Protection Act of 1973, in an amount to be reasonably determined by Lender, and shall comply with the additional requirements of the National Flood Insurance Program as

set forth therein. The Borrower shall cause the Lender to be named in each such policy as secured party of the Inventory that constitutes part of the Collateral and loss payee or additional insured, in a manner acceptable to the Lender, as to the Collateral. Each policy of insurance shall contain a clause or endorsement requiring the insurer to give not less than thirty (30) days prior written notice to the Lender in the event of cancellation of the policy for any reason whatsoever and a clause or endorsement stating that the interest of the Lender shall not be impaired or invalidated by any act or neglect of the Borrower or the owner of any premises where Collateral is located nor by the use of such premises for purposes more hazardous than are permitted by such policy. All premiums for such insurance shall be paid by the Borrower when due, and certificates of insurance and, if requested, photocopies of the policies shall be delivered to the Lender. If the Borrower fails to procure such insurance or to pay the premiums therefor when due, the Lender may (but shall not be required to) do so and charge the costs thereof to the Borrower's loan account. After becoming aware of any loss, damage or destruction to Collateral, the Borrower shall promptly notify the Lender of any such loss, damage, or destruction that exceeds \$200,000, whether or not covered by insurance. The Lender is hereby authorized to collect all insurance proceeds directly following the occurrence of an Event of Default that is continuing. After deducting from such proceeds the expenses, if any, incurred by Lender in the collection or handling thereof, if an Event of Default has occurred and is continuing, the Lender may apply such proceeds to the reduction of the Obligations, in such order as Lender determines, or at the Lender's option may permit or require the Borrower to use such money, or any part thereof, to replace, repair, restore or rebuild the Collateral in a diligent and expeditious manner with materials and workmanship of substantially the same quality as existed before the loss, damage or destruction. If no Event of Default has occurred and is continuing, Lender hereby authorizes Borrower to collect all such insurance proceeds and to use such money, or any part thereof, to replace, repair, restore or rebuild the Collateral in a diligent and expeditious manner with materials and workmanship of substantially the same quality as existed before the loss, damage or destruction.

6.8 Collateral Reporting. The Borrower will provide the Lender with the following documents at the following times in form satisfactory to the Lender: (a) on a daily basis, a schedule of Accounts created since the last such schedule, a schedule of remittance advices, credit memos and reports and a schedule of collections of Accounts since the last such schedule; (b) no later than fifteen (15) days after the last day of each month, monthly summary and detailed agings of Accounts aged by due date and by invoice date; (c) no later than twenty (20) days after the last day each month, monthly reconciliations of Accounts balances per the aging to the general ledger accounts receivable balance and to the financial statements provided to Lender under Section 7.2(c); (d) no later than twenty (20) days after the last day each month, monthly Inventory reports by category and by location; (e) no later than twenty (20) days after the last day each month, monthly reconciliations of the detailed Inventory reports to the general ledger and to the financial statements provided to Lender under Section 7.2(c); (f) upon request, copies of invoices, credit memos, shipping and delivery documents, purchase orders; (g) such other reports as to the Collateral as the Lender shall request from time to time; and (h) certificates of an officer of the Borrower certifying as to the foregoing. If any of the Borrower's records or reports of the Collateral are prepared by an accounting service or other agent, the Borrower hereby authorizes such service or agent to deliver such records, reports, and related documents to the Lender.

6.9 Accounts. (a) The Borrower hereby represents and warrants to the Lender that: (i) each existing Account represents, and each future Account will represent, a bona fide sale or lease and delivery of goods by the Borrower or a LSB Guarantor Subsidiary, or rendition of services by the Borrower or a LSB Guarantor Subsidiary, in the ordinary course of business; (ii) each existing Account is, and each future Account will be, for a liquidated amount payable by the Account Debtor thereon on the terms set forth in the invoice therefor or in the schedule thereof delivered to the Lender, without offset, deduction, defense, or counterclaim (other than claims relating to warranty issues); (iii) no payment will be received with respect to any Account, and no credit, discount, or extension, or agreement therefor will be granted to any Account, except as reported to or otherwise agreed to by the Lender in accordance with this Agreement; (iv) each copy of an invoice requested by and delivered to the Lender by the Borrower will be a genuine copy of the original invoice sent to the Account Debtor named therein; and (v) all goods described in each invoice will have been delivered to the Account Debtor and all services described in each invoice will have been performed, except where the Account Debtor has previously agreed in writing to accept billings for such goods.

(b) The Borrower shall not re-date or allow any LSB Guarantor Subsidiary to re-date any invoice or sale or make sales on extended dating beyond that customary in the business of the applicable Borrower or a LSB

Guarantor Subsidiary or extend or modify any Account which alters its eligibility status, or, with respect to ineligible Accounts, which are inconsistent with prudent business practice and industry standards. If the Borrower becomes aware of any matter adversely affecting any Account in an amount in excess of \$100,000, including information regarding the Account Debtor's creditworthiness, the Borrower will promptly so advise the Lender.

(c) The Borrower shall not accept or allow any LSB Guarantor Subsidiary to accept any note or other instrument (except a check or other instrument for the immediate payment of money) with respect to any Eligible Account without the Lender's written consent. If the Lender consents to the acceptance of any such instrument, it shall be considered as evidence of the Account and not payment thereof and the Borrower will upon Lender's request, promptly deliver such instrument to the Lender appropriately endorsed. Regardless of the form of presentment, demand, notice of dishonor, protest, and notice of protest with respect thereto, the Borrower or the appropriate LSB Guarantor Subsidiary will remain liable thereon until such instrument is paid in full.

(d) The Borrower shall notify the Lender promptly of all disputes and claims with an Account Debtor relating to an Eligible Account that exceeds \$100,000 and when no Event of Default exists hereunder, may settle or adjust them at no expense to the Lender, but no discount, credit or allowance in excess of \$100,000 shall be granted to any Account Debtor without the Lender's consent, except for discounts, credits and allowances made or given in the ordinary course of the business of the applicable Borrower or LSB Guarantor Subsidiary. The Borrower shall send the Lender a copy of each credit memorandum in excess of \$100,000 as soon as issued. The Lender may, at all times when an Event of Default exists hereunder, settle or adjust disputes and claims directly with Account Debtors for amounts and upon terms which the Lender considers advisable and, in all cases, the Lender will credit the Borrower's loan account with only the net amounts received by the Lender in payment of any Accounts.

6.10 Collection of Accounts. (a) Until the occurrence of an Event of Default that is continuing, the Borrower and each LSB Guarantor Subsidiary shall collect all Accounts, shall receive all payments relating to Accounts, and shall promptly deposit all such collections into a Payment Account established for the account of the Borrower and the LSB Guarantor Subsidiaries at a bank acceptable to the Borrower and the Lender. All collections relating to Accounts received in any such Payment Account or directly by the Borrower or any LSB Guarantor Subsidiary or the Lender, and all funds in any Payment Account or other account to which such collections are deposited, shall be the sole property of the Lender and subject to the Lender's sole control. After the occurrence of an Event of Default that is continuing, the Lender may, at any time, notify obligors that the Accounts have been assigned to the Lender and of the Security Interest therein, and may collect them directly and charge the collection costs and expenses to the Borrower's loan account. After the occurrence of an Event of Default that is continuing, the Borrower, at Lender's request, shall execute and deliver to the Lender such documents as the Lender shall require to grant the Lender access to any post office box in which collections of Accounts are received.

(a) If sales of Inventory are made for cash, the Borrower and each LSB Guarantor Subsidiary shall immediately deliver to the Lender the identical checks, cash, or other forms of payment which the Borrower or such LSB Guarantor Subsidiary receives.

(b) All payments received by the Lender on account of Accounts or as Proceeds of other Collateral will be the Lender's sole property and will be credited to the Borrower's loan account (conditional upon final collection) after allowing one (1) Business Day for collection.

(c) In the event the Borrower repays all of the Obligations upon the termination of this Agreement, other than through the Lender's receipt of payments on account of Accounts or Proceeds of other Collateral, such payment will be credited (conditional upon final collection) to the Borrower's loan account one (1) Business Day after the Lender's receipt thereof.

6.11 Inventory. The Borrower and each LSB Guarantor Subsidiary represents and warrants to the Lender that all of the Inventory is and will be held for sale or lease, or to be furnished in connection with the rendition of services, in the ordinary course of business, and is and will be fit for such purposes. The Borrower and each LSB Guarantor Subsidiary will cause the Inventory to be kept in good and marketable condition, at its own expense. The Borrower agrees that all Inventory produced by the Borrower or any LSB Guarantor Subsidiary in the United States will be produced in accordance with the Federal Fair Labor Standards Act of 1938. The Borrower will conduct a physical count of the Inventory at least once per Fiscal Year, except as otherwise agreed to between the Lender and the Borrower, and will, upon request of the Lender, supply the Lender with a copy of such count accompanied

by a report of the value of such Inventory (valued at the lower or cost, on a first-in, first-out basis, or market value). Neither the Borrower nor any LSB Guarantor Subsidiary will, without the Lender's written consent, allow any Inventory to be sold on a bill and hold basis (except as provided in subsection (xiii) of the definition of Eligible Accounts set forth in this Agreement), guaranteed sale, sale and return, sale on approval, consignment, or other repurchase or return basis.

6.12 Documents and Instruments. The Borrower and each LSB Guarantor Subsidiary represents and warrants to the Lender that: (a) all Documents and Instruments describing, evidencing, or constituting Collateral, and all signatures and endorsements thereon, are and will be complete, valid, and genuine and (b) all goods evidenced by such Documents and Instruments were, at the time of their sale, owned by the Borrower or such LSB Guarantor Subsidiary free and clear of all Liens other than Permitted Liens.

6.13 Right to Cure. The Lender may in its sole discretion pay any amount or do any act required of the Borrower or any LSB Guarantor Subsidiary hereunder in order to preserve, protect, maintain or enforce the Obligations, the Collateral or the Security Interest, and which the Borrower or such LSB Guarantor Subsidiary fails to pay or do, including, without limitation, payment of any judgment against the Borrower or such LSB Guarantor Subsidiary, any insurance premium, any warehouse charge, processing charge, any landlord's claim, and any other Lien upon the Collateral. All payments that the Lender makes under this Section 6.13 and all out-of-pocket costs and expenses that the Lender pays or incurs in connection with any action, taken by it hereunder shall be charged to the Borrower's loan account; provided that Lender will make a good faith effort to notify the Borrower and provide the Borrower with a written, itemized invoice covering such charge. Any payment made or other action taken by the Lender under this Section 6.13 shall be without prejudice to any right Lender may have to assert an Event of Default hereunder and to proceed accordingly.

6.14 Power of Attorney. The Borrower and each LSB Guarantor Subsidiary appoints the Lender and the Lender's designees as the Borrower's or such LSB Guarantor Subsidiary's attorney, with power: (a) to endorse the Borrower's or such LSB Guarantor Subsidiary's name on any checks, notes, acceptances, money orders, or other forms of payment or security that come into the Lender's possession; (b) to sign the Borrower's or such LSB Guarantor Subsidiary's name on any invoice, bill of lading, or other document of title relating to any Collateral, on drafts against customers, on assignments of Accounts, on notices of assignment, financing statements and other public records and on verifications of Accounts to Account Debtors; (c) to notify the post office authorities, when an Event of Default exists, to change the address for delivery of the Borrower's or such LSB Guarantor Subsidiary's mail to an address designated by the Lender and to receive, open and dispose of all mail addressed to the Borrower or such LSB Guarantor Subsidiary; (d) to send requests for verification of Accounts to Account Debtors; and (e) to do all things necessary to carry out this Agreement. The Borrower and each LSB Guarantor Subsidiary ratifies and approves all acts of such attorney. Neither the Lender nor the attorney will be liable for any acts or omissions or for any error of judgment or mistake of fact or law. This power, being coupled with an interest, is irrevocable until this Agreement has been terminated and the Obligations have been fully satisfied.

6.15 Lender's Rights, Duties, and Liabilities. The Borrower and each LSB Guarantor Subsidiary assumes all responsibility and liability arising from or relating to the use, sale or other disposition of the Collateral. Neither the Lender nor any of its officers, directors, employees, and agents shall be liable or responsible in any way for the safekeeping of any of the Collateral, or for any act or failure to act with respect to the Collateral, or for any loss or damage thereto, or for any diminution in the value thereof, or for any act of default by any warehouseman, carrier, forwarding agency or, other person whomsoever, all of which shall be at the Borrower's sole risk. The Obligations shall not be affected by any failure of the Lender to take any steps to perfect the Security Interest or to collect or realize upon the Collateral, nor shall loss of or damage to the Collateral release the Borrower from any of the Obligations. After the occurrence of an Event of Default that has not been cured or otherwise waived by Lender, the Lender may (but shall not be required to), without notice to or consent from the Borrower or any LSB Guarantor Subsidiary, sue upon or otherwise collect, extend the time for payment of, modify or amend the terms of, compromise or settle for cash or credit, grant other indulgences, extensions, renewals, compositions, or releases, and take or omit to take other action with respect to the Collateral, any security therefor, any agreement relating thereto, any insurance applicable thereto, or any Person liable directly or indirectly in connection with any of the foregoing, without discharging or otherwise affecting the liability of the Borrower for the Obligations.

6.16 Release of Collateral and Borrower.

(a) If LSB sells any LSB Borrower Subsidiary or LSB Guarantor Subsidiary or any LSB Borrower Subsidiary or LSB Guarantor Subsidiary sells all or substantially all of its assets, then such LSB Borrower Subsidiary or LSB Guarantor Subsidiary shall be allowed to prepay, without penalty or prepayment premium, all of the outstanding Revolving Loans applicable to such LSB Borrower Subsidiary or LSB Guarantor Subsidiary, plus the accrued interest relating to such Revolving Loans, and upon payment of such Revolving Loans, the Lender shall release and terminate its Security Interest as to the Collateral of such LSB Borrower Subsidiary or LSB Guarantor Subsidiary and release such LSB Borrower Subsidiary or LSB Guarantor Subsidiary from any further liability and responsibility under the Loan Documents.

(b) Upon payment in full of all Obligations, Lender shall immediately release its Security Interest in and to all of the Collateral.

## 7. BOOKS AND RECORDS; FINANCIAL INFORMATION; NOTICES.

7.1 Books and Records. The Borrower shall maintain, at all times, correct and complete books, records and accounts in which complete, correct and timely entries are made of its transactions in accordance with GAAP. The Borrower shall, by means of appropriate entries, reflect in such accounts and in all Financial Statements proper liabilities and reserves for all taxes and proper provision for depreciation and amortization of Property and bad debts, all in accordance with GAAP. The Borrower shall maintain at all times books and records pertaining to the Collateral in such detail, form, and scope as the Lender shall reasonably require, including without limitation records of: (a) all payments received and all credits and extensions granted with respect to the Accounts; (b) the return, repossession, stoppage in transit, loss, damage, or destruction of any Inventory; and (c) all other dealings affecting the Collateral.

7.2 Financial Information. The Borrower shall promptly furnish to the Lender all such financial information as the Lender shall reasonably request, and notify its auditors and accountants that the Lender is authorized to obtain such information directly from them. Without limiting the foregoing, Borrower will furnish to the Lender, in such detail as the Lender shall request, the following:

(a) As soon as available, but in any event not later than ninety (90) days after the close of each Fiscal Year, audited consolidated and unaudited consolidating balance sheet, statement of income and expense, retained earnings, and statement of cash flows and stockholders' equity for the LSB Consolidated Group for such Fiscal Year, and the accompanying notes thereto, setting forth in each case in comparative form figures for the previous Fiscal Year, all in reasonable detail, fairly presenting the financial position and the results of operations of the LSB Consolidated Group as at the date thereof and for the Fiscal Year then ended, and prepared in accordance with GAAP. The audited statements shall be examined in accordance with generally accepted auditing standards by, and accompanied by a report thereon unqualified as to scope of, independent certified public accountants selected by LSB and reasonably satisfactory to the Lender.

(b) As soon as available, but in any event not later than forty-five (45) days after the close of each Fiscal Quarter other than the fourth quarter of a Fiscal Year, unaudited consolidated and consolidating balance sheets of the LSB Consolidated Borrowing Group as at the end of such quarter, and consolidated and consolidating unaudited statements of income and expense and consolidated statements of cash flows for the LSB Consolidated Borrowing Group for such quarter and for the period from the beginning of the Fiscal Year to the end of such quarter, together with a report of Capital Expenditures for such Fiscal Quarter, all in reasonable detail, fairly presenting the financial position and results of operation of the LSB Consolidated Borrowing Group as at the date thereof and for such periods, prepared in accordance with GAAP consistent with the audited Financial Statements required pursuant to Section 7.2(a). Such statements shall be certified to be correct by the chief financial officer or an executive officer of LSB, subject to normal year-end adjustments.

(c) As soon as available, but in any event not later than thirty (30) days after the end of each month, unaudited consolidated balance sheets of the LSB Consolidated Group as at the end of such month, and consolidated and consolidating unaudited statements of income and expenses for the LSB Consolidated Group for such month and for the period from the beginning of the Fiscal Year to the end of such month, all in reasonable detail (although not as detailed as the reports required under Sections 7.2(a) and 7.2(b), fairly presenting the financial position and results of operation of the LSB Consolidated Group as at the date thereof and for such periods, and prepared in accordance with GAAP consistent with the audited Financial Statements required pursuant to Section 7.2(a). Such statements shall be certified to be correct by the chief financial officer, treasurer or chief accounting officer of LSB, subject to normal year end adjustments.

(d) With each of the audited Financial Statements delivered pursuant to Section 7.2(a), a certificate of the independent certified public accountants that examined such statements to the effect that they have reviewed and are familiar with the Loan Documents and that, in examining such Financial Statements, they did not become aware of any fact or condition which then constituted an Event of Default, except for those, if any, described in reasonable detail in such certificate.

(e) With each of the annual audited and quarterly unaudited Financial Statements delivered pursuant to Sections 7.2(a) and 7.2(b), a certificate of the chief financial officer, treasurer or chief accounting officer of the Borrower (i) setting forth in reasonable detail the calculations required to establish that the LSB Consolidated Group was in compliance with the covenants set forth in Sections 9.16 and 9.17 hereof as of the end of the Fiscal Year and most recent Fiscal Quarter covered in such Financial Statements; and, (ii) stating that, except as explained in reasonable detail in such certificate, (A) nothing has come to the attention of such officer that would lead such officer to believe that all of the representations, warranties and covenants of the Borrower contained in this Agreement and the other Loan Documents are not correct and complete as of the date of such certificate and (B) no Event of Default then exists or existed during the period covered by such Financial Statements. If such certificate discloses that a representation or warranty is not correct or complete, or that a covenant has not been complied with, or that an Event of Default existed or exists, such certificate shall set forth what action the Borrower has taken or proposes to take with respect thereto.

(f) No sooner than ninety (90) days and no less than thirty (30) days prior to the beginning of each Fiscal Year, projected consolidated and consolidating balance sheets, statements of income and expense, and statements of cash flow for the Borrower and Subsidiaries as at the end of and for each Fiscal Quarter of such Fiscal Year.

(g) Promptly upon their becoming available, copies of each proxy statement, financial statement and report which LSB sends to its stockholders or files with the Securities and Exchange Commission.

(h) Promptly after filing with the PBGC and the IRS a copy of each annual report or other filing filed with respect to each Plan of the Borrower or any Related Company.

(i) Such additional, reasonable information as the Lender may from time to time reasonably request regarding the financial and business affairs of the Borrower or the Subsidiaries.

7.3 Notices to Lender. The Borrower shall notify the Lender in writing of the following matters at the following times:

(a) Within two Business Days after becoming aware of the existence of any Event of Default.

(b) Within two Business Days after becoming aware that the holder of any Debt in excess of \$1,000,000 has given notice or taken any action with respect to a claimed default.

(c) Within five Business Days after a responsible officer of LSB becomes aware of any change which LSB deems to be a material adverse change in the Borrower's Property, business, operations, or condition (financial or otherwise).

(d) Within five Business Days after a responsible officer of LSB becomes aware of any pending or threatened action, proceeding, or counterclaim by any Person, or any pending or threatened investigation by a Public Authority, which, in the opinion of such officer, would materially and adversely affect the Collateral, the repayment of the Obligations, the Lender's rights under the Loan Documents, or the Borrower's Property, business, operations, or condition (financial or otherwise).

(e) Within two Business Days after becoming aware of any pending or threatened strike, work stoppage, material unfair labor practice claim, or other material labor dispute affecting the Borrower.

(f) Within five Business Days after a responsible officer of LSB becomes aware of any violation of any law, statute, regulation, or ordinance of a Public Authority applicable to Borrower, which, in the opinion of such officer, would materially and adversely affect the Collateral, the repayment of the Obligations, the Lender's rights under the Loan Documents, or the Borrower's Property, business, operations, or condition (financial or otherwise).

(g) Within five Business Days after a responsible officer of LSB becomes aware of any violation or any investigation of a violation by the Borrower of Environmental Laws which, in the opinion of such officer, would materially and adversely affect the Borrower's Property, Collateral, business, operation or condition (financial or otherwise).

(h) Within five Business Days after a responsible officer of LSB becomes aware of any Termination Event, accompanied by any materials required to be filed with the PBGC with respect thereto; immediately after the Borrower's receipt of any notice concerning the imposition of any withdrawal liability under Section 4042 of ERISA with respect to a Plan; immediately upon the establishment of any Pension Plan not existing at the Closing Date or the commencement of contributions by the Borrower to any Pension Plan to which the Borrower was not contributing at the Closing Date; and immediately upon becoming aware of any other event or condition regarding a Plan or the Borrower's or a Related Company's compliance with ERISA, which, in the opinion of such officer, would materially and adversely affect the Borrower's Property, business, operation or condition (financial or otherwise).

(i) Thirty (30) days prior to the Borrower changing its name.

Each notice given under this Section 7.3 shall describe the subject matter thereof in reasonable detail and shall set forth the action that the Borrower has taken or proposes to take with respect thereto.

## 8. GENERAL WARRANTIES AND REPRESENTATIONS.

The Borrower continuously warrants and represents to the Lender, at all times during the term of this Agreement and until all Obligations have been satisfied, that, except as hereafter disclosed to and accepted by the Lender in writing in the exercise of its reasonable discretion:

8.1 Authorization, Validity, and Enforceability of this Agreement and the Loan Documents. The Borrower has the corporate power and authority to execute, deliver and perform this Agreement and the other Loan Documents, to incur the Obligations, and to grant the Security Interest. The Borrower has taken all necessary corporate action to authorize its execution, delivery, and performance of this Agreement and the other Loan Documents. No consent, approval, or authorization of, or filing with, any Public Authority, and no consent of, any other Person, is required in connection with the Borrower's execution, delivery, and performance of this Agreement and the other Loan Documents, except for (a) those already duly obtained, (b) those required to perfect the Lender's Security Interest, and (c) the compliance with any of the conditions precedent set forth in Sections 10.4 and 10.10 hereof. This Agreement and the other Loan Documents have been duly executed and delivered by the Borrower and constitute the legal, valid and binding obligation of the Borrower, enforceable against it in accordance with its terms without defense, setoff, or counterclaim. The Borrower's execution, delivery, and performance of this Agreement and the other Loan Documents do not and will not conflict with, or constitute a violation or breach of, or constitute a default under, or result in the creation or imposition of any Lien upon the Property of the Borrower (except as contemplated by this Agreement and the other Loan Documents) by reason of the terms of (a) any material mortgage, lease, agreement, or instrument to which the Borrower is a party or which is binding upon it, (b) any judgment, law, statute, rule or governmental regulation applicable to the Borrower, or (c) the Certificate or Articles of Incorporation or By-Laws of the Borrower.

8.2 Validity and Priority of Security Interest. The provisions of this Agreement and the other Loan Documents create legal and valid Liens on all the Collateral in the Lender's favor and when all proper filings, recordings, and other actions necessary to perfect such Liens have been made or taken such Liens will constitute perfected and continuing Liens on all the Collateral, having priority over all other Liens on the Collateral, except for Permitted Liens, securing all the Obligations and enforceable against the Borrower and all third parties.

8.3 Organization and Qualification. Borrower is duly incorporated and organized and validly existing in good standing under the laws of the State of Delaware; (ii) is qualified to do business as a foreign corporation and is in good standing in each state where, because of the nature of its activities or properties, such qualification is required, except where the failure to so qualify would not have a material adverse effect on the Borrower; and (iii) has all requisite corporate power and authority to conduct its business and to own its Property.

8.4 Corporate Name; Prior Transactions. The Borrower has not, during the past five years, been known by or used any other corporate or fictitious name, or been a party to any merger or consolidation, or acquired all or substantially all of the assets of any Person, or acquired any of its Property out of the ordinary course of business, except as set forth on

8.5 Subsidiaries and Affiliates. Exhibit F is a correct and complete list of the name and relationship to the Borrower of each and all of the Borrower's Subsidiaries and other Affiliates, which list may be amended by Borrower from time to time as LSB adds new or additional Subsidiaries or Affiliates. Each Subsidiary is (a) duly incorporated and organized and validly existing in good standing under the laws of its state of incorporation set forth on Exhibit F and (b) qualified to do business as a foreign corporation and in good standing in the states set forth opposite its name on Exhibit F, which are the only states in which such qualification is necessary in order for it to own or lease its Property and conduct its business, except where the failure to so qualify would not have a material adverse effect on the LSB Borrowing Group taken as a whole.

8.6 Financial Statements and Projections.

(a) LSB has delivered to the Lender the audited consolidated balance sheet and related statements of income, retained earnings, statements of cash flows, and changes in stockholders' equity for LSB, as of December 31, 1996 and for the Fiscal Year then ended, accompanied by the report thereon of LSB's independent certified public accountants. LSB has also delivered to the Lender the unaudited consolidated balance sheets and related statements of income and cash flows for LSB, as at September 30, 1997 and for the nine months and three months then ended. Such financial statements are attached hereto as Exhibit G-1. All such financial statements have been prepared in accordance with GAAP and present accurately and fairly the Borrower's financial position as at the dates thereof and its results of operations for the periods then ended.

(b) The Latest Forecasts, attached hereto as Exhibit G-2, represent the Borrower's best estimate of the Borrower's future financial performance for the periods set forth therein. The Latest Forecasts have been or will be prepared on the basis of certain assumptions, which the Borrower believes are fair and reasonable in light of current and reasonably foreseeable business conditions; provided, however, that although such forecasts represent the Borrower's best estimate, the Borrower makes no representation that it will achieve such forecasts.

8.7 Capitalization. LSB's authorized capital stock consists of (i) 75,000,000 shares of Common Stock, par value \$.10 per share; (ii) 250,000 shares of Preferred Stock, par value \$100 per share; and (iii) 5,000,000 shares of Class C Preferred Stock, no par value. The authorized Capital Stock of each of the LSB Guarantor Subsidiaries is described on Schedule 8.7.

8.8 Solvency. The Borrower is solvent prior to and after giving effect to the making of the Revolving Loans, and after taking into account Intercompany Accounts.

8.9 Title to Property. Except for Permitted Liens, and except for Property which the Borrower or any LSB Guarantor Subsidiary leases, the Borrower and each LSB Guarantor Subsidiary has, to its knowledge, good and marketable title in fee simple to the real property listed in Exhibit H and good, indefeasible, and merchantable title to all of its other Property free of all Liens except Permitted Liens.

8.10 Real Property; Leases. Exhibit H hereto is a correct and complete list of all real property owned by the Borrower or any LSB Guarantor Subsidiary, and all leases and subleases of real property by the Borrower or any LSB Guarantor Subsidiary as lessee or sublessee where Collateral is located. Each of such leases and subleases is valid and enforceable in accordance with its terms and is in full force and effect and no material default by any party to any such lease or sublease exists.

8.11 Proprietary Rights. Exhibit B hereto is a correct and complete list of all of the Proprietary Rights owned by Borrower or any LSB Guarantor Subsidiary. None of the Proprietary Rights is subject to any licensing agreement or similar arrangement except as set forth on Exhibit B. To the Borrower's knowledge, none of the Proprietary Rights infringes on or conflicts with any other Person's Property. The Proprietary Rights described on Exhibit B constitute all of the Property of such type necessary to the current and anticipated future conduct of the Borrower's business.

8.12 Trade Names and Terms of Sale. All trade names or styles under which the Borrower or any LSB Guarantor Subsidiary will sell Inventory or create Accounts, or to which instruments in payment of Accounts may be made payable, are listed on Exhibit I hereto. The terms of sale on which such sales of Inventory will be made are set forth on Exhibit I.

8.13 Litigation. Except as set forth on Exhibit J or as described in the reports filed by LSB prior to the Closing Date with the

Securities and Exchange Commission or in the Offering Memorandum, there is no pending or, to the Borrower's knowledge, threatened suit, proceeding, or counterclaim by any Person, or investigation by any Public Authority, or any basis for any of the foregoing, which would have a material adverse effect on the LSB Consolidated Group, taken as a whole, or (ii) involve damages or a claim for damages in excess of \$1,000,000 and not fully covered by insurance.

8.14 Labor Disputes. Except as set forth on Exhibit K or as described in reports filed by LSB prior to the Closing Date with the Securities and Exchange Commission: (a) there is no collective bargaining agreement or other labor contract covering employees of the Borrower or any LSB Guarantor Subsidiary; (b) no such collective bargaining agreement or other labor contract is scheduled to expire during the term of this Agreement; (c) no union or other labor organization is seeking to organize, or to be recognized as, a collective bargaining unit of employees of the Borrower or any LSB Guarantor Subsidiary; and (d) there is no pending or, to the Borrower's knowledge, threatened strike, work stoppage, material unfair labor practice claims, or other material labor dispute which would have a material adverse effect on the LSB Consolidated Group, taken as a whole.

8.15 Environmental Laws. Except as disclosed on Exhibit M hereto, and or as described in reports filed by LSB prior to the Closing Date with the Securities and Exchange Commission or in the Offering Memorandum, and as hereafter disclosed by Borrower to Lender in writing, and to the Borrower's knowledge:

(a) All environmental permits, certificates, licenses, approvals, registrations and authorizations ("Permits") required under all Environmental Laws in connection with the business of the Borrower and each LSB Guarantor Subsidiary have been obtained, unless the failure to obtain such Permits would not have a material adverse effect on the LSB Borrowing Group, taken as a whole;

(b) No notice, citation, summons or order has been issued, no complaint has been filed, no penalty has been assessed and no investigation or review is pending or threatened by any governmental entity with respect to any generation, treatment, storage, recycling, transportation or disposal of any hazardous or toxic waste (including petroleum products and radioactive materials) generated or used ("Hazardous Substances") by the Borrower or any LSB Guarantor Subsidiary, which would have a material adverse effect on the LSB Borrowing Group, taken as a whole;

(c) Neither Borrower nor any LSB Guarantor Subsidiary has received any request for information that is likely to lead to a claim, any notice of claim, demand or other notification that the Borrower or any LSB Guarantor Subsidiary is or may be potentially responsible with respect to any clean up of any threatened or actual release of any Hazardous Substance;

(d) There are no underground storage tanks, active or abandoned, at any property now owned, operated or leased by the Borrower or any LSB Guarantor Subsidiary.

(e) Neither Borrower nor any LSB Guarantor Subsidiary has knowingly transported any Hazardous Substances to any location which is listed on the National Priority List under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended ("CERCLA"), which is the subject of any federal or state enforcement actions which may lead to claims against Borrower or any LSB Guarantor Subsidiary for clean up costs, remedial work, damages to natural resources or for personal injury claims, including, but not limited to, claims under CERCLA which would have a material adverse effect on the LSB Borrowing Group, taken as a whole.

(f) No written notification of a release of Hazardous Substance has been filed by or on behalf of the Borrower or any LSB Guarantor Subsidiary or in relation to any Property now owned, operated or leased by the Borrower or any LSB Guarantor Subsidiary or previously owned, operated or leased by the Borrower or any LSB Guarantor Subsidiary at the time such property was so owned, operated or leased. No such Property is listed or proposed for listing on the National Priority List promulgated pursuant to CERCLA, or on any similar state list of sites requiring investigation or clean up.

(g) There are no environmental Liens on any material properties owned or leased by the Borrower or any LSB Guarantor Subsidiary and no governmental actions have been taken or are in process or pending which could subject any of such Properties to such Liens.

(h) The Borrower shall promptly forward a copy to Lender of any environmental written inspections, investigations or studies prepared by or to be prepared by the Borrower or any LSB Guarantor Subsidiary relating to Properties now owned, operated or leased by the Borrower or any LSB Guarantor Subsidiary; provided, however, that Borrower makes no representation or

warranty with respect to environmental inspections, investigations, studies, audits, tests, reviews or other analyses conducted by or on behalf of Lender.

8.16 No Violation of Law. Except as disclosed in Exhibit J or in reports filed by LSB prior to the Closing Date with the Securities and Exchange Commission or in the Offering Memorandum, to the Borrower's knowledge, neither the Borrower nor any LSB Guarantor Subsidiary is in violation of any law, statute, regulation, ordinance, judgment, order, or decree applicable to it which violation would have a material adverse effect on the LSB Borrowing Group, taken as a whole.

8.17 No Default. Neither the Borrower nor any LSB Guarantor Subsidiary is in default with respect to any note, loan agreement, mortgage, lease, or other agreement to which the Borrower or any LSB Guarantor Subsidiary is a party or bound, where the amount owed by Borrower or any LSB Guarantor Subsidiary under such note, loan agreement, mortgage, lease, or other agreement exceeds \$750,000.

8.18 Plans. Each Plan has been maintained at all times in compliance, in all material respects, with its provisions and applicable law, including, without limitation, compliance with the applicable provisions of ERISA and the Code. All Pension Plans are listed on Exhibit L, and those, if any, which are a Multi-employer Plan are designated as such, and a copy of each such Pension Plan which has been requested in writing by Lender has been furnished to Lender. Except as set forth on Exhibit L, no Pension Plan has incurred any accumulated funding deficiency, as defined in Section 302(a)(2) of ERISA and Section 412(a) of the Code, whether or not waived, which would have a material adverse effect on the LSB Borrowing Group, taken as a whole. Except as set forth on Exhibit L, each Pension Plan, which is intended to be a qualified Pension Plan under Section 401(a) of the Code, as currently in effect has received a favorable determination letter from the Internal Revenue Service finding that the current form of the Plan is qualified under Section 401(a) of the Code and the trust related thereto is exempt from federal income tax under Section 501(a) of the Code. The Borrower has not incurred any liability to the PBGC other than the payment of premiums, and there are no premium payments which have become due, are unpaid, and the non-payment of which would have a material adverse effect on the LSB Borrowing Group, taken as a whole. Neither LSB nor any of its Subsidiaries, nor any fiduciary or trustee to any Plan has breached any of the responsibilities, obligations or duties imposed on it under the terms of the Plan or by ERISA with respect to any Plan the breach of which would have a material adverse effect on the LSB Borrowing Group, taken as a whole. LSB has established reserves on its books to provide for the benefits earned and other liabilities accrued under each such Plan in amounts sufficient to substantially provide for such benefits and liabilities which have not been funded through the trust, if any, established for such Plan.

8.19 Taxes. The Borrower and each LSB Guarantor Subsidiary has filed all tax returns and other reports which it was required by law to file on or prior to the date hereof and has paid all taxes, assessments, fees, and other governmental charges, and penalties and interest, if any, against it or its Property, income, or franchise, that are due and payable, except such Taxes which are being contested in good faith and for which appropriate reserves have been established in connection therewith, or for which an extension as to the date of filing has been authorized.

8.20 Use of Proceeds. None of the transactions contemplated in this Agreement (including, without limitation, the use of certain proceeds from such loans) will violate or result in the violation of Section 7 of the Securities Exchange Act of 1934, as amended, or any regulations issued pursuant thereto, including, without limitation, Regulations G, T, U and X of the Board of Governors of the Federal Reserve System ("Federal Reserve Board"), 12 C.F.R., Chapter II. Borrower does not own or intend to carry or purchase any "margin stock" within the meaning of said Regulation G. None of the proceeds of the loans will be used, directly or indirectly, to purchase or carry (or refinance any borrowing, the proceeds of which were used to purchase or carry) any "security" within the meaning of the Securities Exchange Act of 1934, as amended.

8.21 Private Offerings. Borrower has not, directly or indirectly, offered the Revolving Loans for sale to, or solicited offers to buy part thereof from, or otherwise approached or negotiated with respect thereto with, any prospective purchaser other than Lender. Borrower hereby agrees that neither it nor anyone acting on its behalf has offered or will offer the Revolving Loan or any part thereof or any similar securities for issue or sale to or solicit any offer to acquire any of the same from anyone so as to bring the issuance thereof within the provisions of Section 5 of the Securities Act of 1933, as amended.

8.22 Broker's Fees. Borrower represents and warrants to Lender that, with respect to the financing transaction herein contemplated, no Person

is entitled to any brokerage fee or other commission as a result of acts by the Borrower and Borrower agrees to indemnify and hold Lender harmless against any and all such claims if such claim is due to the acts of the Borrower.

8.23 No Material Adverse Change. Except as disclosed in the Offering Memorandum or in the written materials delivered to Lender at a meeting held with Borrower on October 7, 1997, no material adverse change has occurred in the Property, business, operations, or conditions (financial or otherwise) of the LSB Consolidated Group, taken as a whole, since the date of the Financial Statements delivered to the Lender, except as otherwise disclosed to Lender in the written materials delivered to Lender at a meeting held with Borrower on October 7, 1997, and in the reports filed by LSB with the Securities and Exchange Commission, if any.

8.24 Debt. After giving effect to the making of each Revolving Loan, the Borrower has no Debt except Permitted Debt.

9. AFFIRMATIVE AND NEGATIVE COVENANTS. The Borrower and, where applicable, each LSB Guarantor Subsidiary covenants that, so long as any of the Obligations remain outstanding or this Agreement is in effect:

9.1 Taxes and Other Obligations. The Borrower and each LSB Guarantor Subsidiary, no later than ten days after such payments become due, shall: (a) file when due (including extensions) all tax returns and other reports which it is required to file, pay when due all taxes, fees, assessments and other governmental charges against it or upon its Property, income, and franchises, make all required withholding and other tax deposits, and establish adequate reserves for the payment of all such items, and shall provide to the Lender, upon request, satisfactory evidence of its timely compliance with the foregoing; and (b) pay all Debt owed by it within normal business terms and consistent with past practices; provided, however, that neither the Borrower nor any LSB Guarantor Subsidiary need pay any tax, fee, assessment, governmental charge, or Debt, or perform or discharge any other obligation, that it is contesting in good faith by appropriate proceedings diligently pursued.

9.2 Corporate Existence and Good Standing. The Borrower and each LSB Guarantor Subsidiary shall maintain its corporate existence and its qualification and good standing in all states necessary to conduct its business and own its Property, except where the failure to so qualify would not have a material adverse effect on the Borrower or such LSB Guarantor Subsidiary, and shall obtain and maintain all licenses, permits, franchises and governmental authorizations necessary to conduct its business and own its Property.

9.3 Maintenance of Property and Insurance. The Borrower and each LSB Guarantor Subsidiary shall: (a) maintain all of its Property necessary and material in its business in good operating condition and repair, ordinary wear and tear excepted, provided, however, that Borrower shall have a period of ten (10) days after learning that repair is necessary within which to repair any Property which has not been so maintained before an Event of Default shall be deemed to have occurred; and (b) in addition to the insurance required by Section 6.7, maintain with financially sound and reputable insurers such other insurance with respect to its Property and business against casualties and contingencies of such types (including, without limitation, business interruption, public liability, product liability, and larceny, embezzlement or other criminal misappropriation), and in such amounts as is customary for Persons of established reputation engaged in the same or a similar business and similarly situated, naming the Lender, at its request, as additional insured under each such policy as to the Collateral.

9.4 Environmental Laws. Except as disclosed to Lender in writing prior to the Closing Date in connection with Section 8.15, the Borrower and each LSB Guarantor Subsidiary will use all reasonable efforts to conduct its business in substantial compliance with all Environmental Laws applicable to it, including, without limitation, those relating to the generation, handling, use, storage, and disposal of hazardous and toxic wastes and substances. The Borrower shall take prompt and appropriate action to respond to any noncompliance with Environmental Laws and shall regularly report to the Lender on such response. Without limiting the generality of the foregoing, whenever there is potential noncompliance with any Environmental Laws, the Borrower shall, at the Lender's request and the Borrower's expense: (a) cause an independent environmental engineer acceptable to the Lender to conduct such tests of the site where the Borrower's or any LSB Guarantor Subsidiary's noncompliance or alleged noncompliance with Environmental Laws has occurred and prepare and deliver to the Lender a report setting forth the results of such tests, a proposed plan for responding to any environmental problems described therein, and an estimate of the costs thereof; and (b) provide to the Lender a Supplemental report of such engineer whenever the scope of the environmental problems, or the Borrower's response thereto or the

estimated costs thereof, shall materially change.

9.5 Mergers, Consolidations, Acquisitions, or Sales. Neither the Borrower nor any LSB Guarantor Subsidiary shall enter into any transaction of merger, reorganization, or consolidation in which Borrower or, in the case of the LSB Guarantor Subsidiaries, another LSB Guarantor Subsidiary, is not the survivor or transfer, sell, assign, lease, or otherwise dispose of all or substantially all of its Property, or wind up, liquidate or dissolve, or agree to do any of the foregoing, except (i) sales of Inventory in the ordinary course of its business, or (ii) after thirty (30) days prior written notice to Lender, mergers or consolidations of the Borrower into any of the Borrower Subsidiaries or a merger of a Borrower Subsidiary or LSB Guarantor Subsidiary into the Borrower or the sale of all or substantially all of the assets of the Borrower to any of the Borrower Subsidiaries or the sale of all or substantially all of the assets of a Borrower Subsidiary or LSB Guarantor Subsidiary to the Borrower.

9.6 Guaranties. Neither the Borrower nor any LSB Guarantor Subsidiary shall make, issue, or become liable on any secured Guaranty, except Guaranties in favor of the Lender and endorsements of instruments for deposit.

9.7 Debt. Neither Borrower nor any LSB Guarantor Subsidiary shall incur or maintain any Debt other than Permitted Debt.

9.8 Prepayment. Neither the Borrower nor any LSB Guarantor Subsidiary shall voluntarily prepay any Debt, except the Obligations in accordance with the terms of this Agreement and as provided in Section 10.8 hereof.

9.9 Transactions with Affiliates. Except (a) as set forth below, or (b) as set forth in Section 9.14 hereof, or (c) transactions described in the "Certain Relationships and Related Transactions" section of the Offering Memorandum, or (d) as otherwise provided in this Agreement, the Borrower or any LSB Guarantor Subsidiary shall not sell, transfer, distribute, or pay any money or Property to any Affiliate, or lend or advance money or Property to any Affiliate, or invest in (by capital contribution or otherwise) or purchase or repurchase any stock or indebtedness, or any Property, of any Affiliate, or become liable on any secured Guaranty of the indebtedness, dividends, or other obligations of any Affiliate, except nothing contained herein shall limit or restrict the Borrower from (i) performing any agreements entered into with an Affiliate prior to the date hereof, or (ii) engaging in other transactions with Affiliates in the normal course of business, in amounts and upon terms disclosed to the Lender, and which are no less favorable to the Borrower than would be obtainable in a comparable arm's length transaction with a third party who is not an Affiliate. Subject to applicable law, Borrower and the LSB Guarantor Subsidiaries may borrow any amounts from each other and repay such amounts on terms agreed to between them without limitations.

9.10 Plans and Compensation. Neither the Borrower nor any LSB Guarantor Subsidiary shall take any action, or shall fail to take any action, that will cause or be reasonably expected to cause any representation or warranty contained in Section 8.18 (other than the listing of Pension Plans on Exhibit L), if made on and again as of any date on or after the date of this Agreement, to not be true and, without limitation and without excusing such violation, if such a prohibited action or inaction occurs or fails to occur, Borrower and the LSB Guarantor Subsidiaries shall notify Lender in writing of the nature of the resulting consequences or expected consequences, and a description of the action Borrower or any LSB Guarantor Subsidiary is taking or proposing to take with respect thereto and, when known, any action taken by the Internal Revenue Service of the Department of Labor, or the PBGC, with respect thereto.

9.11 Reserved.

9.12 Liens. The Borrower shall not create, incur, assume, or permit to exist any Lien on any Property now owned or hereafter acquired by the Borrower or any LSB Guarantor Subsidiary, except Permitted Liens.

9.13 New Subsidiaries. The Borrower shall not, directly or indirectly, organize or acquire any new subsidiary which would have an interest in the Collateral.

9.14 Distributions and Restricted Investments. Borrower and the LSB Guarantor Subsidiaries shall not (a) directly or indirectly declare or make, or incur any liability to make, any Distribution, or (b) make any Restricted Investments, except: (i) Borrower and the LSB Guarantor Subsidiaries may make Distributions and Restricted Investments to CCI and the other members of the LSB Consolidated Borrowing Group; (ii) so long as no Event of Default has occurred and is continuing, currently scheduled Dividends by LSB and performance of all of the terms, provisions and conditions by LSB,

relating to or in connection with or arising out of any and all series of LSB's preferred stock issued and outstanding as of the date hereof and the payments of an annual cash dividend on its Common Stock in an amount equal to \$.06 a share payable on a semi-annual basis; (iii) in addition to (i) above, each Borrower may make Restricted Investments to any Subsidiary of LSB other than to CCI and the members of the LSB Borrowing Group, provided, however, that the sum of all such Restricted Investments from each such Borrower and all other members of the LSB Consolidated Borrowing Group shall not exceed \$200,000 in the aggregate per annum; (iv) each Borrower may make Restricted Investments in Affiliates outstanding as of the date hereof; and (v) each Borrower may make other Restricted Investments constituting Acquisitions not otherwise permitted above in this Section as long as such Restricted Investments when aggregated with all other Restricted Investments for the same Acquisition from all members of the LSB Consolidated Borrowing Group do not exceed \$2,000,000 in cash investments and issued and/or assumed interest-bearing debt per Acquisition and \$10,000,000 in cash investments and issued and/or assumed interest-bearing debt in the aggregate for all such Acquisitions per annum; provided, however, that interest-bearing debt of the acquired company which Lender in its sole and absolute discretion agrees to refinance as a working capital facility shall not be included in the \$2,000,000 and the \$10,000,000 limitations; and further provided that nothing in this subsection (iv) shall be construed to imply Lender's willingness in advance to provide any such refinancing; and (v) CCI may make the Distributions described on Schedule 10.8. Notwithstanding any provision to the contrary contained herein, the Account currently owing to EDC by its Affiliate, TES, may be converted to preferred stock to be owned and controlled by EDC.

9.15 Capital Expenditures. Neither Borrower nor any LSB Guarantor Subsidiary shall not make or incur any Capital Expenditure if, after giving effect thereto, the aggregate amount of all Capital Expenditures by the LSB Consolidated Borrowing Group during the Fiscal Year ending December 31, 1997 and during each Fiscal Year ending thereafter would exceed \$6,000,000.

9.16 LSB Adjusted Tangible Net Worth. The LSB Adjusted Tangible Net Worth (without taking into account any purchases of treasury stock) 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 Quarter	1st Quarter	2nd Quarter	3rd Quarter	4th
Fiscal Year Ending December 31, 1997			\$40,000,000	
Fiscal Year Ending December 31, 1998 \$28,800,000	\$36,900,000	\$36,700,000	\$33,000,000	
Fiscal Year Ending December 31, 1999 \$28,800,000	\$28,800,000	\$28,800,000	\$28,800,000	

Each Fiscal Quarter during each Fiscal Year ending thereafter: \$28,800,000

9.17 Debt Ratio. The ratio of Debt of the LSB Consolidated Group to the LSB 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 Quarter	1st Quarter	2nd Quarter	3rd Quarter	4th
Fiscal Year Ending December 31, 1997			4.10:1	
Fiscal Year Ending December 31, 1998	4.73:1	4.73:1	5.13:1	6.15:1
Fiscal Year Ending				

Each Fiscal Quarter during each Fiscal Year ending thereafter: 6.15:1

9.18 Further Assurances. The Borrower and each LSB Guarantor Subsidiary shall execute and deliver, or cause to be executed and delivered, to the Lender such documents and agreements, and shall take or cause to be taken such actions, as the Lender may, from time to time, reasonably request to carry out the terms and conditions of this Agreement and the other Loan Documents.

10. CLOSING; CONDITIONS TO CLOSING. The Lender will not be obligated to make any Loans or issue any Letters of Credit at the Closing unless the following conditions precedent have been satisfied as reasonably determined by the Lender:

10.1 Representations and Warranties; Covenants; Events. The Borrower's representations and warranties contained in this Agreement and the other Loan Documents shall be correct and complete as of the Closing Date; the Borrower shall have performed and complied with all covenants, agreements, and conditions contained herein and in the other Loan Documents which are required to have been performed or complied with on or before the Closing Date; and there shall exist no Event of Default on the Closing Date.

10.2 Delivery of Documents. The Borrower shall have delivered, or cause to be delivered, to the Lender the documents listed on Exhibit N hereto and such other documents, instruments and agreements as the Lender shall request in connection herewith, duly executed by all parties thereto other than the Lender, and in form and substance satisfactory to the Lender and its counsel.

10.3 Required Approvals. The Lender shall have received certified copies of all consents or approvals of any Public Authority or other Person which the Lender reasonably determines is required in connection with the transactions contemplated by this Agreement.

10.4 No Material Adverse Change. Except as disclosed to Lender in the written materials delivered to Lender at a meeting held with Borrower on October 7, 1997, there shall have occurred no material adverse change in the Borrower's and the Subsidiaries' business or financial condition or in the Collateral taken as a whole, since September 30, 1997, and the Lender shall have received a certificate of Borrower's chief executive officer to such effect.

10.4 Proceedings. All proceedings to be taken in connection with the transactions contemplated by this Agreement, and all documents contemplated in connection herewith, shall be satisfactory in form and substance to the Lender and its counsel.

10.5 Legal Opinions. The Lender shall have received from counsel to the Borrower such legal opinions as the Lender may reasonably require with respect to the Loan Documents.

10.6 September 30, 1997 Quarterly Financial Statements. The Lender shall have received LSB's and the Subsidiaries' consolidated September 30, 1997, unaudited quarterly financial statements.

10.7 CCI Bond Offering. CCI will have raised at least \$100,000,000 in Bond Debt, part of the proceeds of which will have been used to repay all Debt owed to John Hancock, and the remainder of the proceeds shall have been distributed in accordance with Schedule 10.8.

10.8 Conditions Precedent to Each Loan. The obligation of the Lender to make each Revolving Loan or to provide for the issuance of any Letter of Credit after the Closing and after the initial Revolving Loans on the Closing Date are made, shall be subject to the further conditions precedent that on the date of any such extension of credit, the following statements shall be true, and the acceptance by the Borrower of any extension of credit shall be deemed to be a statement to the effect set forth in clauses (i) and (ii), with the same effect as the delivery to the Lender of a certificate signed by the chief executive officer and chief financial officer of the Borrower, dated the date of such extension of credit, stating that:

(i) The representations and warranties contained in this Agreement and the other Loan Documents are correct in all material respects on and as of the date of such extension of credit as though made on and as of such date, except to the extent the Lender has been notified by the Borrower that any representation or warranty is no longer correct and the reason therefor and the Lender has explicitly accepted in writing such disclosure in the exercise of its reasonable discretion; and

(ii) No Event has occurred and is continuing, or would result from such extension of credit, which constitutes an Event of Default.

#### 11. DEFAULT; REMEDIES.

11.1 Events of Default. It shall constitute an event of default ("Event of Default") if any one or more of the following shall occur for any reason:

(a) any failure by Borrower to make payment of principal, interest, fees or premium on any of the Obligations when due;

(b) any representation or warranty made by the Borrower or any LSB Guarantor Subsidiary in this Agreement, any of the other Loan Documents, any Financial Statement, or any certificate furnished by the Borrower at any time to the Lender shall prove to be untrue in any material respect as of the date when made or furnished;

(c) default shall occur in the observance or performance of any of the covenants and agreements contained in this Agreement, or in any of the other Loan Documents, or if any such agreement or document shall terminate (other than in accordance with its terms or the terms hereof or with the written consent of the Lender) or become void or unenforceable without the written consent of the Lender other than as a direct result of any conduct solely on the part of the Lender;

(d) any default by Borrower or any LSB Guarantor Subsidiary under any material agreement or instrument (other than an agreement or instrument evidencing the lending of money), which default would have a material adverse effect on the LSB Borrowing Group, taken as a whole, and such default continues for thirty (30) days after such breach first occurs; provided, however, that such grace period shall not apply, and an Event of Default shall exist, promptly upon such breach, if such breach may not, in Lender's reasonable determination, be cured by Borrower during such thirty (30) day grace period;

(e) any default by Borrower or any LSB Guarantor Subsidiary in any payment of principal of or interest on any indebtedness (other than the Obligations) for borrowed money where the then outstanding amount exceeds \$500,000 beyond any period of grace provided with respect thereto or in the performance of any other agreement, term or condition contained in any agreement under which any such obligation is created if (i) the effect of such default is to cause or permit the holder or holders of such obligation to cause, such obligation to become due prior to its stated maturity, and (ii) the effect of such default would have a material adverse effect on the Borrower.

(f) Borrower or any LSB Guarantor Subsidiary shall make a general assignment for benefit of creditors; or any proceeding shall be instituted by Borrower seeking to adjudicate it a bankrupt or insolvent, or seeking liquidation, winding up, reorganization, arrangement, adjustment, protection, relief, or composition of it or its debts under any law relating to bankruptcy, insolvency or reorganization or relief of debtors or seeking entry of an order for relief or the appointment of a receiver, trustee or other similar official for it or for any substantial part of its property or Borrower shall take any corporate action to authorize any of the actions set forth above in this Subsection 11.1(f).

(g) an involuntary petition shall be filed or an action or proceeding otherwise commenced against the Borrower or any LSB Guarantor Subsidiary seeking reorganization, arrangement or readjustment of the Borrower's debts or for any other relief under the Federal Bankruptcy Code, as amended, or under any other bankruptcy or insolvency act or law, state or federal, now or hereafter existing and remain undismissed or unvacated for a period of sixty (60) days;

(h) a receiver, assignee, liquidator, trustee or similar officer for the Borrower or any LSB Guarantor Subsidiary for all or substantially all of its Property shall be appointed involuntarily;

(i) the Borrower or any LSB Guarantor Subsidiary shall file a certificate of dissolution under applicable state law or shall be liquidated, dissolved or wound-up or shall commence or have commenced against it any action or proceeding for dissolution, winding-up or liquidation, or shall take any corporate action in furtherance thereof, except if one Borrower merges or consolidates with another Borrower;

(j) any guaranty of the Obligations shall be terminated, revoked or declared void or invalid other than by an action undertaken by Lender;

(k) one or more final judgments for the payment of money

aggregating in excess of \$1,000,000 (not covered by insurance) shall be rendered against any members of the LSB Borrowing Group, and LSB or such other member of the LSB Borrowing Group shall fail to discharge the same within thirty (30) days from the date of notice of entry thereof or to appeal therefrom or reach a negotiated settlement in connection therewith;

(l) any loss, theft, damage or destruction of any item or items of Collateral occurs which: (i) materially and adversely affects the operation of the Borrower's and the LSB Guarantor Subsidiaries' business taken as a whole; or (ii) is material in amount and is not adequately covered by insurance;

(m) any event or condition shall occur, or exist with respect to a Plan that would, in the Lender's reasonable judgment, subject the Borrower or any Subsidiary to any tax, penalty or other liabilities under the terms of the Plan, under ERISA or under the Code which in the aggregate are material in relation to the business, operations, Property or financial or other condition of the LSB Borrowing Group taken as a whole;

(n) there occurs after the date hereof an Ownership Change (as defined below) in LSB. For purposes of this Agreement, an "Ownership Change" in LSB is deemed to have occurred if any Person (except Jack E. Golsen, members of his Immediate Family [as defined below] and any entity controlled by Jack E. Golsen or members of his Immediate Family), together with such Person's affiliates and associates, is or becomes the beneficial owner, directly or indirectly, of more than fifty percent (50%) of the outstanding Common Stock of LSB. The term "Immediate Family" of any Person means the spouse, siblings, children, mothers and mothers-in-law, fathers and fathers-in-law, sons and daughters-in-law, daughters and sons-in-law, nieces, nephews, brothers and sisters-in-law, sisters and brothers -in-law;

(o) an event of default exists under any of the other LSB-Related Loan Agreements or under any of the Loan Documents;

(p) any "event of default" (as such term is defined in the Bond Indenture) occurs under the Bond Indenture or any of the Notes issued in connection therewith; and

(q) if any one or more of the LSB-Related Loan Agreements terminates prior to the termination of the other LSB-Related Loan Agreements without the Lender's prior consent thereto, unless as otherwise provided in Section 6.16(a).

## 11.2 Remedies.

(a) If an Event of Default exists, the Lender may, without notice to or demand on the Borrower, do one or more of the following at any time or times and in any order: (i) reduce the amount of or refuse to make Revolving Loans and restrict or refuse to arrange for Letters of Credit; (ii) terminate this Agreement; (iii) declare any or all Obligations to be immediately due and payable (provided however that upon the occurrence of any Event of Default described in Sections 11.1(f), 11.1(g), or 11.1(h), all Obligations shall automatically become immediately due and payable); and (iv) pursue its other rights and remedies under the Loan Documents and applicable law. The foregoing shall not be construed to limit the Lender's discretion to take the actions described in clause (i) of this subparagraph (a) at any other time.

(b) If an Event of Default exists: (i) the Lender shall have, in addition to all other rights, the rights and remedies of a secured party under the UCC; (ii) the Lender may, at any time, take possession of the Collateral and keep it on the Borrower's or any LSB Guarantor Subsidiary's premises, at no cost to the Lender, or remove any part of it to such other place or places as the Lender may desire, or, the Borrower shall, upon the Lender's demand, at the Borrower's cost, assemble the Collateral and make it available to the Lender at a place reasonably convenient to the Lender; and (iii) the Lender may sell and deliver any Collateral at public or private sales, for cash, upon credit or otherwise, at such prices and upon such terms as the Lender deems advisable, in its sole discretion, and may, if the Lender deems it reasonable, postpone or adjourn any sale of the Collateral by an announcement at the time and place of sale or of such postponed or adjourned sale without giving a new notice of sale. Without in any way requiring notice to be given in the following manner, the Borrower and each LSB Guarantor Subsidiary agrees that any notice by the Lender of sale, disposition or other intended action hereunder or in connection herewith, whether required by the UCC or otherwise, shall constitute reasonable notice to the Borrower and such LSB Guarantor Subsidiary if such notice is mailed by registered or certified mail, return receipt requested, postage prepaid, or is delivered personally against receipt, at least five (5) days prior to such action to the Borrower's address specified in or pursuant to Section 13.10. If any Collateral is sold on terms other than payment in full at the time of sale, no credit shall be given

against the Obligations until the Lender receives payment, and if the buyer defaults in payment, the Lender may resell the Collateral without further notice to the Borrower or any LSB Guarantor Subsidiary. In the event the Lender seeks to take possession of all or any portion of the Collateral by judicial process, the Borrower and each LSB Guarantor Subsidiary irrevocably waives: (a) the posting of any bond, surety or security with respect thereto which might otherwise be required; (b) any demand for possession prior to the commencement of any suit or action to recover the Collateral; and (c) any requirement that the Lender retain possession and not dispose of any Collateral until after trial or final judgment. The Borrower and each LSB Guarantor Subsidiary agrees that the Lender has no obligation to preserve rights to the Collateral or marshal any Collateral for the benefit of any Person. Following the occurrence of an Event of Default that is continuing, the Lender is hereby granted a license or other right to use, without charge, the Borrower's and each LSB Guarantor Subsidiary's labels, patents, copyrights, name, trade secrets, trade names, trademarks, and advertising matter or any similar property, in completing production of, advertising or selling any Collateral, and the Borrower's and each LSB Guarantor Subsidiary's rights under all licenses and all franchise agreements shall inure to the Lender's benefit, as long as such does not violate in any manner such other loan agreements that may be in place at such time. The proceeds of sale shall be applied first to all expenses of sale, including attorneys' fees, and second, in whatever order the Lender elects, to all Obligations. The Lender will return any excess to the Borrower and the Borrower shall remain liable for any deficiency.

(c) If an Event of Default occurs and is continuing, the Borrower and each LSB Guarantor Subsidiary hereby waives: (i) all rights to notice and hearing prior to the exercise by the Lender of the Lender's rights to repossess the Collateral without judicial process or to replevy, attach or levy upon the Collateral without notice or hearing, and (ii) all rights of set-off and counterclaim against Lender.

(d) If the Lender terminates this Agreement upon an Event of Default that has not been cured or otherwise waived to Lender's satisfaction, the Borrower shall pay the Lender, immediately upon termination, an early termination penalty equal to the early termination fee that would have been payable under Article 12 if this Agreement had been terminated on that date pursuant to the Borrower's election.

12. TERM AND TERMINATION. The term of this Agreement shall extend until April 1, 1999 (the "Termination Date"). This Agreement shall automatically be renewed thereafter for successive terms of thirteen (13) months each, unless this Agreement is terminated as provided below. The Lender and the Borrower shall each have the right to terminate this Agreement, without premium or penalty, at the end of the initial term or at the end of any renewal term by giving the other written notice not less than sixty (60) days prior to the end of such term by registered or certified mail. The Borrower may also terminate this Agreement at any time during its initial term or any renewal periods if: (a) it gives the Lender sixty (60) days prior written notice of termination by registered or certified mail; (b) it pays all Revolving Loans and reimburses Lender for all Letter of Credit obligations under this Agreement on or prior to the effective date of termination; and (c) except as otherwise provided herein, it pays the Lender, on or prior to the effective date of termination, one percent (1%) of the average daily balance of the Revolving Loans and Letters of Credit outstanding under this Agreement for the preceding one hundred eighty (180) day period (or from the Closing Date up to and including the date of termination if less than one hundred eighty (180) days from the Closing Date) if such termination is made on or prior to the Termination Date. The Lender may also terminate this Agreement without notice upon an Event of Default that has not been cured or otherwise waived to Lender's satisfaction. Upon the effective date of termination of this Agreement for any reason whatsoever, all Obligations shall become immediately due and payable. Notwithstanding the termination of this Agreement, until all Obligations are paid and performed in full, the Lender shall retain all its rights and remedies hereunder (including, without limitation, in all then existing and after-arising Collateral).

### 13. MISCELLANEOUS.

13.1 Cumulative Remedies; No Prior Recourse to Collateral. The enumeration herein of the Lender's rights and remedies is not intended to be exclusive, and such rights and remedies are in addition to and not by way of limitation of any other rights or remedies that the Lender may have under the UCC or other applicable law. The Lender shall have the right, in its sole discretion, to determine which rights and remedies are to be exercised and in which order. The exercise of one right or remedy shall not preclude the exercise of any others, all of which shall be cumulative. The Lender may, without limitation, proceed directly against the Borrower to collect the Obligations without any prior recourse to the Collateral.

13.2 No Implied Waivers. No act, failure or delay by the Lender shall constitute a waiver of any of its rights and remedies. No single or partial waiver by the Lender of any provision of this Agreement, or any other Loan Document, or of breach or default hereunder or thereunder, or of any right or remedy which the Lender may have, shall operate as a waiver of any other provision, breach, default, right or remedy or of the same provision, breach, default, right or remedy on a future occasion. No waiver by the Lender shall affect its rights to require strict performance of this Agreement.

13.3 Severability. If any provision of this Agreement shall be prohibited or invalid, under applicable law, it shall be effective only to such extent, without invalidating the remainder of this Agreement.

13.4 Governing Law. THIS AGREEMENT SHALL BE DEEMED TO HAVE BEEN MADE IN THE STATE OF OKLAHOMA AND SHALL BE GOVERNED BY AND INTERPRETED IN ACCORDANCE WITH THE LAWS OF SUCH STATE EXCEPT THAT NO DOCTRINE OF CHOICE OF LAW SHALL BE USED TO APPLY THE LAWS OF ANY OTHER STATE OR JURISDICTION.

13.5 Consent to Jurisdiction and Venue; Service of Process. The Borrower agrees that, in addition to any other courts that may have jurisdiction under applicable laws, any action or proceeding to enforce or arising out of this Agreement or any of the other Loan Documents may be commenced in the appropriate court of the State of Oklahoma for Oklahoma County, or in the United States District Court for the Western District of Oklahoma, and each Borrower consents and submits in advance to such jurisdiction and agrees that venue will be proper in such courts on any such matter. Borrower hereby waives personal service of process and agrees that a summons and complaint commencing an action or proceeding in any such court shall be properly served and shall confer personal jurisdiction if served by registered or certified mail to the Borrower. Should the Borrower fail to appear or answer any summons, complaint, process or papers so served within thirty (30) days after the mailing or other service thereof, it shall be deemed in default and an order or judgment may be entered against it as demanded or prayed for in such summons, complaint, process or papers. The choice of forum set forth in this section shall not be deemed to preclude the enforcement of any judgment obtained in such forum, or the taking of any action under this Agreement to enforce the same, in any appropriate jurisdiction.

13.6 Survival of Representations and Warranties. All of the Borrower's representations and warranties of the Borrower and each LSB Guarantor Subsidiary contained in this Agreement shall survive the execution, delivery, and acceptance thereof by the parties, notwithstanding any investigation by the Lender or its agents, but after the Closing Date it is recognized that such representations and warranties may be amended from time to time during the term of this Agreement by written agreement between the Borrower to the Lender due to changes in circumstances.

13.7 Indemnification. BORROWER HEREBY INDEMNIFIES, DEFENDS AND HOLDS LENDER, AND ITS DIRECTORS, OFFICERS, AGENTS, EMPLOYEES AND COUNSEL, HARMLESS FROM AND AGAINST ANY AND ALL LOSSES, CLAIMS, DAMAGES, LIABILITIES, DEFICIENCIES, JUDGMENTS, PENALTIES OR EXPENSES IMPOSED ON, INCURRED BY OR ASSERTED AGAINST ANY OF THEM, WHETHER DIRECT, INDIRECT OR CONSEQUENTIAL ARISING OUT OF OR BY REASON OF ANY LITIGATION, INVESTIGATIONS, CLAIMS, OR PROCEEDINGS (WHETHER BASED ON ANY FEDERAL, STATE OR LOCAL LAWS OR OTHER STATUTES OR REGULATIONS, INCLUDING, WITHOUT LIMITATION, SECURITIES, ENVIRONMENTAL, OR COMMERCIAL LAWS AND REGULATIONS, UNDER COMMON LAW OR AT EQUITABLE CAUSE, OR ON CONTRACT OR OTHERWISE) COMMENCED OR THREATENED, WHICH ARISE OUT OF OR ARE IN ANY WAY BASED UPON THE NEGOTIATION, PREPARATION, EXECUTION, DELIVERY, ENFORCEMENT, PERFORMANCE OR ADMINISTRATION OF THIS AGREEMENT, ANY OTHER LOAN DOCUMENT, OR ANY UNDERTAKING OR PROCEEDING RELATED TO ANY OF THE TRANSACTIONS CONTEMPLATED HEREBY OR ANY ACT, OMISSION TO ACT, EVENT OR TRANSACTION RELATED OR ATTENDANT THERETO, INCLUDING, WITHOUT LIMITATION, AMOUNTS PAID IN SETTLEMENT, COURT COSTS, AND THE FEES AND EXPENSES OF COUNSEL REASONABLY INCURRED IN CONNECTION WITH ANY SUCH LITIGATION, INVESTIGATION, CLAIM OR PROCEEDING, EXCEPT THAT THIS INDEMNIFICATION SHALL NOT APPLY TO ANY LOSSES, CLAIMS, DAMAGES, LIABILITIES, JUDGMENTS, PENALTIES OR EXPENSES IMPOSED ON, INCURRED BY OR ASSERTED AGAINST THE LENDER, AND ITS DIRECTORS, OFFICERS, AGENTS, EMPLOYEES, OR COUNSEL IF SUCH IS DUE TO AND ARISES FROM OR IN CONNECTION WITH THE GROSS NEGLIGENCE OR WILLFUL MISCONDUCT OF ANY OF THEM OR THE INTENTIONAL AND WRONGFUL BREACH OF THIS AGREEMENT BY LENDER. Without limiting the foregoing, if, by reason of any suit or proceeding of any kind, nature, or description against Borrower, or by Borrower or any other party against Lender, which in Lender's sole discretion makes it advisable for Lender to seek counsel for protection and preservation of its liens and security assets, or to defend its own interest, such reasonable expenses and counsel fees shall be allowed to Lender. To the extent that the undertaking to indemnify, pay and hold harmless set forth in this Section 13.7 may be unenforceable because it is violative of any law or public policy, Borrower

shall contribute the maximum portion which it is permitted to pay and satisfy under applicable law, to the payment and satisfaction of all indemnified matters incurred by Lender. The foregoing indemnity shall survive the payment of the Obligations and the termination of this Agreement. All of the foregoing costs and expenses shall be part of the Obligations and secured by the Collateral.

13.8 Other Security and Guaranties. The Lender may, without, notice or demand and without affecting the Borrower's obligations hereunder, from time to time: (a) take from any Person and hold collateral (other than the Collateral) for the payment of all or any part of the Obligations and exchange, enforce or release such collateral or any part thereof; and (b) accept and hold any endorsement or guaranty of payment of all or any part of the Obligations and release any such endorser or guarantor, or any Person who has given any Lien in any other collateral as security for the repayment of all or any part of the Obligations, or any other Person in any way obligated to pay all or any part of the Obligations.

13.9 Fees and Expenses. The Borrower shall pay to the Lender on demand all costs and expenses that the Lender pays or incurs in connection with the negotiation, preparation, consummation, administration, enforcement, and termination of this Agreement and the other Loan Documents, including, without limitation: (a) attorneys' and paralegals' fees and disbursements of counsel to the Lender (including, without limitation, a reasonable estimate of the allocable cost of in-house counsel); (b) costs and expenses (including attorneys' and paralegals' fees and disbursements, including, without limitation, a reasonable estimate of the allocable cost of in-house counsel) for any amendment, supplement, waiver, consent, or subsequent closing in connection with the Loan Documents and the transactions contemplated thereby; (c) costs and expenses of lien and title searches and title insurance; (d) fees and other charges for recording and filing financing statements and continuations, and other actions to perfect, protect, and continue the Security Interest; (e) sums paid or incurred to pay any amount or take any action required of the Borrower under the Loan Documents that the Borrower was obligated to pay or take under the Loan Documents but failed to pay or take; (f) the expenses of \$500 per Lender's auditor per audit day plus actual costs of appraisals, inspections, and verifications of the Collateral, including, without limitation, travel, lodging, and meals, for inspections of the Collateral and the Borrower's operations by the Lender's agents up to three times per year and whenever an Event of Default exists; (g) costs and expenses of forwarding loan proceeds, collecting checks and other items of payment, and establishing and maintaining Payment Accounts and lock boxes; (h) all amounts that the Borrower is required to pay under the Letter of Credit Agreement; (i) costs and expenses of preserving and protecting the Collateral; and (j) costs and expenses (including attorneys' and paralegals' fees and disbursements and including, without limitation, a reasonable estimate of the allocable cost of in-house counsel) paid or incurred to obtain payment of the Obligations, enforce the Security Interest, sell or otherwise realize upon the Collateral, and otherwise enforce the provisions of the Loan Documents, or to defend any claims made or threatened against the Lender arising out of the transactions contemplated hereby (including without limitation, preparations for and consultations concerning any such matters). The foregoing shall not be construed to limit any other provisions of the Loan Documents regarding costs and expenses to be paid by the Borrower. All of the foregoing costs and expenses shall be charged to the Borrower's loan account as Revolving Loans.

13.10 Notices. All notices, demands and requests that either party is required or elects to give to the other shall be in writing, shall be delivered personally against receipt, or sent by recognized overnight courier service, or mailed by registered or certified mail, return receipt requested, postage prepaid, and shall be addressed to the party to be notified as follows:

If to the Lender: BankAmerica Business Credit, Inc.  
55 South Lake Avenue, Suite 900  
Pasadena, California 91101  
Attn: Ms. Joyce White  
Executive Vice President, West Division Manager

with a copy to: Bank of America - Business Credit Legal Dept.  
10124 Old Grove Road  
San Diego, California 92131  
Attn: Thomas G. Montgomery, Esq.  
Assistant General Counsel

and with a copy to:Jenkins & Gilchrist, A Professional Corporation  
1445 Ross Avenue, Suite 3200  
Dallas, Texas 75201  
Attn: Linda D. Sartin, Esq.

If to the Borrower:LSB Industries, Inc.

Post Office Box 754  
Oklahoma City, Oklahoma 73101  
Attn: Mr. Jack E. Golsen  
President

with a copy to: LSB Industries, Inc.  
Post Office Box 754  
Oklahoma City, Oklahoma 73101  
Attn: Mr. Tony M. Shelby  
Senior Vice President

with a copy to: LSB Industries, Inc.  
Post Office Box 754  
Oklahoma City, Oklahoma 73101  
Attn: David M. Shear, Esq.  
General Counsel

and with a copy to: Conner & Winters  
One Leadership Square  
211 North Robinson, Suite 1700  
Oklahoma City, Oklahoma 73102-7101  
Attn: Irwin H. Steinhorn, Esq.

or to such other address as each party may designate for itself by like notice. Any such notice, demand, or request shall be deemed given when received if personally delivered or sent by overnight courier, or when deposited in the United States mails, postage paid, if sent by registered or certified mail.

13.11 Waiver of Notices. Unless otherwise expressly provided herein, the Borrower waives presentment, protest and notice of demand or dishonor and protest as to any instrument, notice of intent to accelerate and notice of acceleration, as well as any and all other notices to which it might otherwise be entitled. No notice to or demand on the Borrower which the Lender may elect to give shall entitle the Borrower to any further notice or demand in the same, similar or other circumstances.

13.12 Binding Effect; Assignment; Disclosure. The provisions of this Agreement shall be binding upon and inure to the benefit of the respective representatives, successors and assigns of the parties hereto: provided, however, that no interest herein may be assigned by the Borrower without the prior written consent of the Lender. The rights and benefits of the Lender hereunder shall, if the Lender so agrees, inure to any party acquiring any interest in the Obligations or any part thereof. The Borrower agrees that the Lender may use the Borrower's name in advertising and promotional materials and in conjunction therewith disclose the general terms of this Agreement.

13.13 Modification. THIS AGREEMENT IS INTENDED BY THE BORROWER AND THE LENDER TO BE THE FINAL, COMPLETE, AND EXCLUSIVE EXPRESSION OF THE AGREEMENT BETWEEN THEM. THIS AGREEMENT SUPERSEDES ANY AND ALL PRIOR ORAL OR WRITTEN AGREEMENTS RELATING TO THE SUBJECT MATTER HEREOF AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS, OR SUBSEQUENT ORAL AGREEMENTS OF THE PARTIES. THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN THE PARTIES. NO MODIFICATION, RESCISSION, WAIVER, RELEASE, OR AMENDMENT OF ANY PROVISION OF THIS AGREEMENT SHALL BE MADE, EXCEPT BY A WRITTEN AGREEMENT SIGNED BY THE BORROWER AND A DULY AUTHORIZED OFFICER OF THE LENDER.

13.14 Counterparts. This Agreement may be executed in any number of counterparts, and by the Lender and the Borrower in separate counterparts, each of which shall be an original, but all of which shall together constitute one and the same agreement.

13.15 Captions. The captions contained in this Agreement are for convenience only, are without substantive meaning and should not be construed to modify, enlarge, or restrict any provision.

13.16 Right of Set-Off. Whenever an Event of Default exists the Lender is hereby authorized at any time and from time to time, to set-off and apply any and all deposits (general or special, time or demand, provisional or final) at any time held by Lender or any affiliate of the Lender and other indebtedness at any time owing by the Lender or any affiliate of the Lender to or for the credit or the account of the Borrower against any and all of the Obligations, whether or not then due and payable. Lender agrees promptly to notify Borrower after any such set-off and application made by Lender, provided that the failure to give such notice shall not affect the validity of such set-off and application.

13.17 Participating Lender's Security Interests. If a Participating Lender shall at any time with the Borrower's knowledge participate with the Lender in the Loans, the Borrower hereby grants to such Participating Lender, and the Lender and such Participating Lender shall have

and are hereby given, a continuing lien on and security interest in any money, securities and other property of the Borrower in the custody or possession of the Participating Lender, including, the right of set-off, to the extent of the Participating Lender's participation in the Obligations, and such Participating Lender shall be deemed to have the, same right of set-off, to the extent of the Participating Lender's participation in the Obligations under this Agreement, as it would have if it were a direct lender.

13.18 WAIVER OF JURY TRIAL. LENDER AND BORROWER ACKNOWLEDGE AND AGREE THAT ANY CONTROVERSY WHICH MAY ARISE UNDER THIS AGREEMENT OR THE RELATIONSHIP ESTABLISHED HEREBY WOULD BE BASED UPON DIFFICULT AND COMPLEX ISSUES, AND THEREFORE, THE PARTIES AGREE THAT ANY LAWSUIT GROWING OUT OF ANY SUCH CONTROVERSY WILL BE TRIED IN A COURT OF COMPETENT JURISDICTION BY A JUDGE SITTING WITHOUT JURY. TRIAL BY A JUDGE SITTING WITHOUT A JURY WILL FURTHER

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LT IN THE AVOIDANCE OF DELAYS, A STREAMLINING OF THE PROCEEDINGS INVOLVED AND, AS A RESULT, WILL MINIMIZE THE EXPENSE OF ANY SUCH LAWSUIT FOR THE BENEFIT OF BORROWER AND LENDER. BORROWER HEREBY WAIVES TRIAL BY JURY, RIGHTS OF SET-OFF, AND THE RIGHT TO IMPOSE COUNTERCLAIMS (EXCEPT FOR COMPULSORY UNTERCLAIMS) IN ANY LITIGATION IN ANY COURT WITH RESPECT TO, IN CONNECTION WITH, OR ARISING OUT OF THIS AGREEMENT, THE OTHER LOAN DOCUMENTS, THE OBLIGATIONS OR THE COLLATERAL, OR ANY INSTRUMENT OR DOCUMENT DELIVERED PURSUANT HERETO OR THERETO, OR ANY OTHER CLAIM OR DISPUTE HOWSOEVER ARISING, BETWEEN THE BORROWER, AND THE LENDER. BORROWER HEREBY CONFIRMS THAT THE FOREGOING WAIVERS ARE INFORMED AND FREELY MADE.

13.19 AMENDMENT AND RESTATEMENT; LIMITATIONS OF SUBSIDIARY LIABILITY; WAIVERS OF CLAIMS. THIS AGREEMENT AMENDS, EXTENDS AND RESTATES IN ITS ENTIRETY THE ORIGINAL LOAN AGREEMENT. THE EXECUTION OF THIS AGREEMENT AND THE OTHER LOAN DOCUMENTS EXECUTED IN CONNECTION HEREWITH DOES NOT EXTINGUISH THE INDEBTEDNESS OUTSTANDING IN CONNECTION THEREWITH NOR DOES IT CONSTITUTE A NOVATION WITH RESPECT TO THE INDEBTEDNESS OUTSTANDING IN CONNECTION WITH THE ORIGINAL LOAN AGREEMENT. BORROWER REPRESENTS AND WARRANTS THAT AS OF THE CLOSING DATE THERE ARE NO CLAIMS OR OFFSETS AGAINST OR DEFENSES OR COUNTERCLAIMS TO ITS OBLIGATIONS UNDER THE ORIGINAL LOAN AGREEMENTS OR ANY OTHER LOAN DOCUMENTS. BORROWER WAIVES ANY AND ALL SUCH CLAIMS, OFFSETS, DEFENSES OR COUNTERCLAIMS, WHETHER KNOWN OR UNKNOWN, ARISING PRIOR TO THE CLOSING DATE.

IN WITNESS WHEREOF, the parties have entered into this Agreement on the date first above written.

"BORROWER":

LSB INDUSTRIES, INC.

By:

Jimmie D. Jones

Vice President

"LENDER":

BANKAMERICA BUSINESS CREDIT, INC.

By:  
Daniel J. Ujfalusy Senior Vice President

ACKNOWLEDGED AND AGREED TO:

Each of the following "LSB Guarantor Subsidiaries" hereby grants to the Lender a Security Interest in and to the Collateral now owned and hereafter acquired by such LSB Guarantor Subsidiary pursuant to Section 6.1 hereof and has executed this Agreement to acknowledge its agreement to comply with and be bound by all those particular warranties, representations, covenants and agreements set forth herein that are expressly applicable to the LSB Guarantor Subsidiaries by the terms of this Agreement. In addition to its grant to Lender of a Security Interest in the Collateral, L&S Automotive Products Co., LSB Extrusion Co., International Bearings, Inc., Rotex Corporation, and Tribonetics Corporation (referred to collectively as the "Automotive Subsidiaries" and individually as an "Automotive Subsidiary") each hereby grants to the Lender a Security Interest in its now owned and hereafter acquired Equipment and Real Property except the Equipment listed on Exhibit A, as well as all Proceeds thereof, and agrees to execute all documents required by Lender in order to perfect Lender's Security Interest therein. With respect to the Equipment and Real Property only, if at any time any or all of the Equipment or Real Property of the Automotive Subsidiary is either sold, financed or refinanced at a future date, then Lender agrees to either subordinate its Lien in such financed or refinanced Collateral or release its Lien upon the sale of such Collateral as required, provided however, that the net proceeds of such sale or refinancing shall be delivered to Lender to be applied to reduce the then outstanding Loans of such Automotive Subsidiary.

L&S AUTOMOTIVE PRODUCTS, CO.

By:  
David R. Goss  
Vice President

INTERNATIONAL BEARINGS, INC.

By:  
David R. Goss  
Vice President

LSB EXTRUSION CO.

By:  
David R. Goss  
Vice President

ROTEX CORPORATION

By:  
David R. Goss  
Vice President

TRIBONETICS CORPORATION

By:  
David R. Goss  
Vice President

MOREY MACHINE TOOL  
MANUFACTURING CORPORATION

By:  
David R. Goss  
Vice President

ACKNOWLEDGED AND AGREED TO:

BANKAMERICA BUSINESS CREDIT, INC.

By:  
Name:  
Title:

- EXHIBIT A - Permitted Liens
- EXHIBIT B - Proprietary Rights
- EXHIBIT C - LSB Guarantor Subsidiaries
- EXHIBIT D - List of Borrower's Locations
- EXHIBIT E - Corporate History
- EXHIBIT F - Subsidiaries and Affiliates
- EXHIBIT G-1 - Financial Statements
- EXHIBIT G-2 - Pro Forma Financial Statements
- EXHIBIT H - Real Property Descriptions: Premises
- EXHIBIT I - Trade Names, Trade Styles, Terms of Sale
- EXHIBIT J - Pending Litigation
- EXHIBIT K - Labor Matters
- EXHIBIT L - ERISA Matters
- EXHIBIT M - Schedule of Environmental Matters
- EXHIBIT N - Closing Documents
- EXHIBIT O - Letter of Credit Financing Agreement - Supplement to Amended and Restated Loan and Security Agreement
- EXHIBIT P - Notice of Borrowing
  
- SCHEDULE 8.7 Capitalization of LSB Guarantor Subsidiaries
- SCHEDULE 10.8 Use of Bond Proceeds

Exhibit 4.13

FIRST AMENDMENT  
TO AMENDED AND RESTATED  
LOAN AND SECURITY AGREEMENT

THIS FIRST AMENDMENT TO AMENDED AND RESTATED LOAN AND SECURITY AGREEMENT (the "Amendment") is dated as of March 12, 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 (the "Agreement");

WHEREAS, certain 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 to 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.

ARTICLE II

Amendments

Section 2.01. Amendment to Definition of "Swap Transaction Reserves". The definition of "Swap Transaction Reserves" contained in Section 1.1 of the Agreement is hereby amended in its entirety to read as follows:

"Swap Transaction Reserves" means all reserves which the Lender from time to time establishes for amounts that are liabilities owed by EDC to the Bank and for which Lender has agreed to indemnify the Bank. As of March 12, 1998, the amount of the Swap Transaction Reserves is \$5,000,000."

Section 2.02. Amendment to Section 9.14. Section 9.14 of the Agreement is hereby amended to read in its entirety as follows:

9.14 Distributions and Restricted Investments. Borrower and the LSB Guarantor Subsidiaries shall not (a) directly or indirectly declare or make, or incur any liability to make, any Distribution, or (b) make any Restricted Investments, except: (i) Borrower and the LSB Guarantor Subsidiaries may make Distributions and Restricted Investments to CCI and the other members of the LSB Consolidated Borrowing Group; (ii) so long as no Event of Default has occurred and is continuing, currently scheduled Dividends by LSB and performance of all of the terms, provisions and conditions by LSB, relating to or in connection with or arising out of any and all series of LSB's preferred stock issued and outstanding as of the date hereof and the payments of an annual cash dividend on its Common Stock in an amount equal to \$.06 a share payable on a semi-annual basis; (iii) in addition to (i) above, each Borrower may make Restricted Investments to any Subsidiary of LSB other than to CCI and the members of the LSB Consolidated Borrowing Group, provided, however, that the sum of all such Restricted Investments from each such Borrower and all other members of the LSB Consolidated Borrowing Group shall not exceed \$200,000 in the aggregate per annum; (iv) each Borrower may make Restricted Investments in Affiliates outstanding as of the date hereof; (v) each Borrower may make other Restricted Investments constituting Acquisitions not otherwise permitted above in this Section as long as such Restricted Investments when aggregated with all other Restricted Investments for the same Acquisition from all members of the LSB Consolidated Borrowing Group do not exceed \$2,000,000 in cash investments and issued and/or assumed interest-bearing debt per Acquisition and \$10,000,000 in cash investments and issued and/or assumed interest-bearing debt in the aggregate for all such Acquisitions per annum; provided, however, that interest-bearing debt of the acquired company which Lender in its sole and absolute discretion agrees to refinance as a working capital facility shall not be included in the \$2,000,000 and the \$10,000,000 limitations; and further provided that nothing in this subsection (iv) shall be construed to imply Lender's willingness in advance to provide any such refinancing; (vi) CCI may make the Distributions described on Schedule 10.8; and (vii) Borrower may purchase up to \$6,000,000 in the aggregate of its treasury stock from January 1, 1998 through the termination of this Agreement provided that, at the time of and immediately following any such purchase thereof Borrower Subsidiaries' aggregate Availability is at least \$3,000,000. Notwithstanding any provision to the contrary contained herein, the Account currently owing to EDC by its Affiliate, TES, may be converted to preferred stock to be owned and controlled by EDC."

Section 2.03. Amendment to Section 9.16. Section 9.16 of the Agreement is hereby amended to read in its entirety as follows:

"9.16 LSB Adjusted Tangible Net Worth. The LSB Adjusted Tangible Net Worth (without taking into account any purchases of treasury stock) 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	\$44,000,000	\$45,000,000	\$46,000,000	\$45,000,000

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

"9.17 LSB Debt Ratio. The ratio of Debt of the LSB Consolidated Group to the LSB Adjusted Tangible Net Worth (without taking into account any purchase of treasury stock) 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	3.80 to 1	3.70 to 1	3.50 to 1	3.50 to 1
Fiscal Year Ending December 31, 1999	3.50 to 1	3.50 to 1	3.50 to 1	3.50 to 1
Each Fiscal Quarter during each Fiscal Year ending thereafter:				3.50 to 1."

Section 2.05. Amendment to Section 12. The first sentence of Section 12 is hereby amended to read as follows:

"The initial term of this Agreement shall be from the Closing Date until December 31, 2000 (the "Termination Date")."

All other provisions of Section 12 remain unchanged.

### ARTICLE III

#### Waivers

Section 3.01. Waiver of Events of Default.

(a) The Lender hereby waives the following Events of Default: (i) the LSB Adjusted Tangible Net Worth for the Fiscal Quarter ending December 31, 1997 was less than \$40,000,000, in breach of Section 9.16 of the Loan Agreement; and (ii) the LSB Debt Ratio for the Fiscal Quarter ending December 31, 1997 was greater than 4.10 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 December 31, 1997, 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, *Jenkins & 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:  
Tony M. Shelby, Vice President

"LENDER"

BANKAMERICA BUSINESS CREDIT, INC.

By:

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 First Amendment to Amended and Restated Loan and Security Agreement dated as of March 12, 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:

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 First Amendment to Amended and Restated Loan and Security Agreement dated as of March 12, 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 March 12, 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:

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

LSB INDUSTRIES, INC.  
Aerobit Industries, Limited  
APR Corporation  
CHP Corporation  
ClimaChem, Inc.  
Climate Master, Inc.  
Climate Master International Limited  
Climate Mate, Inc.  
Climatex, Inc.  
Clipmate Corporation  
DSN Corporation  
El Dorado Chemical Company  
El Dorado Nitrogen Company  
Equipos Climatec S.A. de C.V.  
Explosives Equipment Corp.  
Hercules Energy Mfg. Corporation  
International Bearings, Inc.  
International Environmental Corporation  
Koax Corp.  
L&S Automotive Products Co.  
L&S Automotive Technologies, Inc.  
L&S Bearing Co.  
LSB Chemical Corp.  
LSB Extrusion Co.  
LSB Financial Corp.  
LSB Holdings, Inc.  
LSB Indonesia Corporation  
LSB International Corp.  
LSB South America Corporation  
LSB-Europa Limited  
Morey Machinery Manufacturing Corporation  
Northwest Capital Corporation  
Northwest Energy Enterprises, Inc.  
Northwest Financial Corporation  
Prime Financial Corporation  
ROL-BIT Ltd.  
Rotex Corporation  
Saffron Corporation  
Slurry Explosive Corporation  
Summit Machine Tool Systems, Inc.  
Summit Machine Tool Manufacturing Corp.  
Summit Machine Tool Inc. Corp.  
T.E.S. Mining Services Pty. Ltd.  
The Environmental Group, Inc.  
The Environmental Group International Limited  
Total Energy Systems (NZ) Ltd.  
Total Energy Systems Limited  
Tower IV Corporation  
Tower Land Development Corp.  
Tribonetics Corporation  
Universal Tech Corporation

Consent of Independent Auditors

We consent to the incorporation by reference in the Registration Statement (Form S-8, No.33-8302) pertaining to the 1981 and 1986 Incentive Stock Option Plans of LSB Industries, Inc. and the Registration Statement (Form S-3, No. 33-69800) and related Prospectus of LSB Industries, Inc. of our report dated March 16, 1998, except for the fourth paragraph of Note 5(A), as to which the date is April 8, 1998 with respect to the consolidated financial statements and schedule of LSB Industries, Inc. included in the Annual Report (Form 10-K) for the year ended December 31, 1997.

ERNST & YOUNG LLP

Oklahoma City, Oklahoma  
April 8, 1998

	Year DEC-31-1997	Year DEC-31-1996
	DEC-31-1997	DEC-31-1996
	4,934	1,620
	0	0
	52,191	50,791
	4,007	3,291
	68,200	67,982
	132,920	127,610
	205,205	178,050
	86,874	74,907
	270,653	261,560
60,944	68,119	
	165,067	119,277
146	146	
	48,000	48,000
	1,504	1,489
	5,008	24,529
270,653	261,560	
	313,929	307,160
	320,189	314,051
	257,982	250,388
	323,845	307,729
	0	0
	0	0
	14,740	10,017
	(18,396)	(3,695)
	50	150
(18,446)	(3,845)	
	0	0
(4,619)	0	0
	0	0
	(23,065)	(3,845)
	(2.04)	(.55)
	(2.04)	(.55)