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

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A
Amendment No. 1

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

For Quarterly period ended

June 30, 2005

OR

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

For the transition period from _____________to______________

Commission file number 1-7677

LSB Industries, Inc.

Exact name of Registrant as specified in its charter

Delaware	73-1015226
State or other jurisdiction of incorporation or organization	I.R.S. Employer Identification No.

16 South Pennsylvania Avenue, Oklahoma City, Oklahoma 73107

Address of principal executive offices (Zip Code)

(405) 235-4546

Registrant's telephone number, including area code

None

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES _X_ NO___

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

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

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

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Explanatory Introduction Note:

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

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

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

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

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

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

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

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

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

<u>Item 1.</u>

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

(Continued on following page)

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

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

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

(See accompanying notes)

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

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

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

(See accompanying notes)

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

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

(Continued on following page)

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

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

Supplemental cash flow information includes:

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

(See accompanying notes)

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

Note 1: Basis of Presentation

The accompanying Condensed Consolidated Financial Statements include the accounts of LSB Industries, Inc. (the "Company", "We", "Us" or "Our") and its subsidiaries. We are a diversified holding company which is engaged, through our wholly-owned subsidiary ThermaClime, Inc. ("ThermaClime") and its subsidiaries, in the manufacture and sale of a broad range of air handling and heat pump products (the "Climate Control Business") and the manufacture and sale of chemical products (the "Chemical Business"). See Note 14 - Segment Information. ThermaClime is a holding company with no significant assets or operations other than its investments in its subsidiaries. Entities that are 20% to 50% owned and for which we have significant influence are accounted for on the equity method. See Note 4 - Investment in Affiliate. All material intercompany accounts and transactions have been eliminated.

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

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

<u>Note 2: Restatement of Financial Statements</u>

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

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

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

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

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

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

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

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

- Change our classification of certain debt issuance costs previously classified as a current asset in our condensed consolidated balance sheet at December 31, 2004 since it related to long-term debt. At December 31, 2004, this change resulted in a decrease to current assets of $540,000 and an increase to non-current assets of $540,000. In addition, change

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

- Change our classification of the elimination of certain intercompany transactions (primarily relating to leases and corporate management fees) used in our consolidation process to prepare our condensed consolidated statements of income for the six and three months ended June 30, 2004. This change resulted in a decrease to cost of sales and an increase to SG&A of $637,000 and $319,000 for the six and three-month periods ended June 30, 2004, respectively.

- Change our classification of certain shipping costs previously classified as SG&A in our condensed consolidated statements of income for the six and three months ended June 30, 2004 to be consistent with the classification of other shipping cost that relate to amounts billed to our customers. This change resulted in a decrease to net sales and SG&A of $327,000 and $204,000 for the six and three-month periods ended June 30, 2004, respectively.

- Change our classification of proceeds from property insurance recoveries and their related gains previously included in net cash provided by operating activities in our condensed consolidated statement of cash flows for the six months ended June 30, 2005 to be in accordance with SFAS No. 95. This change resulted in a decrease in net cash provided by operating activities and a decrease in net cash used by investing activities of $1.1 million.

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

Condensed Consolidated Statements of Income.

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

Condensed Consolidated Balance Sheet - At June 30, 2005:

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

Condensed Consolidated Balance Sheet - At December 31, 2004:

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

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

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

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

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

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

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

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

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

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

Net income	1,608	-	(250)	1,358
Preferred stock dividend requirement	(1,134)			(1,134)
Net income applicable to common stock	$ 474	$ -	$ (250)	$ 224
Income per common share				
Basic:				
Income before cumulative effect of accounting change	$ .08	$ -	$ (.02)	$ .06
Cumulative effect of accounting change	(.04)	-	-	(.04)
Net income	$ .04	$ -	$ (.02)(A)	$ .02
Income per common share				
Diluted:				
Income before cumulative effect of accounting change	$ .06	$ -	$ (.01)	$ .05
Cumulative effect of accounting change	(.03)	-	(.01)	(.04)
Net income	$ .03	$ -	$ (.02)(A)	$ .01

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

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

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

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

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

Net cash provided by financing activities	$ 2,523	$ (2,017)	$ -	$ 506

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

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

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

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

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

Note 3: Change in Method of Accounting for Certain Inventories

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

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

Note 4: Investment in Affiliate

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

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

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

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

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

Note 5: Life Insurance Policies

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

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

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

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

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

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

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

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

Note 7: Long-Term Debt

Long-term debt consists of the following:

	June 30, 2005	December 31, 2004

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

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

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

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

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

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

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

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

(B) In April 2001, ThermaClime and its subsidiaries ("the Borrowers") entered into a $50 million revolving credit facility (the "Working Capital Revolver Loan") that provides for advances based on specified percentages of eligible accounts receivable and inventories for ThermaClime and its subsidiaries. Effective February 28, 2005 the Working Capital Revolver Loan was amended which, among other things, extended the maturity date to April 2009 and removed language considered as a subjective acceleration provision. The Working Capital Revolver Loan, as amended, accrues interest at a base rate (generally equivalent to the prime rate) plus .75% or LIBOR plus 2% (formerly base rate plus 2% or LIBOR plus 4.50%). The annual interest rate at June 30, 2005 was 5.51%. The facility provides for up to $8.5 million of letters of credit. Under the Working Capital Revolver Loan, as amended, the lender also requires the borrowers to pay a letter of credit fee equal to 1% (formerly 2.75%) per annum of the undrawn amount of all outstanding letters of credit, an unused line fee equal to .5% per annum for the excess amount available under the facility not drawn and

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

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

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

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

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

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

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

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

Note 7: Long-Term Debt (continued)

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

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

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Note 7: Long-Term Debt (continued)

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

	Combined Guarantor Subsidiaries	Consolidated Non-Guarantor Subsidiaries	ThermaClime, Inc. (Parent)	Eliminations	Consolidated
Assets					
Current assets:					
Cash	$ 174	$ -	$ 676		$ 850
Restricted cash	-	-	158		158
Accounts receivable, net	36,075	4,716	17		40,808
Inventories	27,345	195	-		27,540
Supplies, prepaid items and other	4,349	887	4,467		9,703
Deferred rent expense	-	938	-		938
Deferred income taxes	-	-	4,675		4,675
Total current assets	67,943	6,736	9,993		84,672
Property, plant and equipment, net	62,482	2,393	32		64,907
Investment in and advances to affiliates	-	-	96,127	$ (96,127)	-
Receivable fro					