FORM 10-Q

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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

For Quarterly period ended March 31, 1998

OR

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

For The transition period from ____________ to ____________

Commission file number 1-7677

LSB INDUSTRIES, INC.

Exact name of Registrant as specified in its charter

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

16 SOUTH PENNSYLVANIA, OKLAHOMA CITY, OKLAHOMA 73107

Address of principal executive offices (Zip Code)

(405) 235-4546

Registrant's telephone number, including area code

NONE

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

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

YES x NO

The number of shares outstanding of the Registrant's voting Common Stock, as of April 30, 1998 was 12,596,826 shares excluding 2,508,790 shares held as treasury stock.

PART I

FINANCIAL INFORMATION

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

The accompanying condensed consolidated balance sheet of LSB Industries, Inc. at March 31, 1998, the condensed consolidated statements of operations and cash flows for the three month periods ended March 31, 1998 and 1997 have been subjected to a review, in accordance with standards established by the American Institute of Certified Public Accountants, by Ernst & Young LLP, independent auditors, whose report with respect thereto appears elsewhere in this Form 10-Q. The financial statements mentioned above are unaudited and reflect all adjustments, consisting only of adjustments of a normal recurring nature, which are, in the opinion of management, necessary for a fair presentation of the interim periods. The results of operations for the three months ended March 31, 1998 are not necessarily indicative of the results to be expected for the full year. The condensed consolidated balance sheet at December 31, 1997, was derived from audited financial statements as of that date.

LSB INDUSTRIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Information at March 31, 1998 is unaudited)
(Dollars in thousands)

ASSETS	March 31, 1998	December 31, 1997
Current assets:		
Cash and cash equivalents	$ 5,905	$ 4,934
Trade accounts receivable, net of allowance	58,164	52,191
Inventories:		
Finished goods	34,877	36,429
Work in process	9,049	8,582
Raw materials	20,616	23,189
Total inventory	64,542	68,200
Supplies and prepaid items	7,546	7,595
Total current assets	136,157	132,920
Property, plant and equipment, net (Note 4)	101,552	118,331
Investments and other assets, net of allowance	21,276	19,402
	$ 258,985	$ 270,653

(Continued on following page)

LSB INDUSTRIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Information at March 31, 1998 is unaudited)
(Dollars in thousands)

LIABILITIES AND STOCKHOLDERS' EQUITY	March 31, 1998	December 31, 1997
Current liabilities:		
Drafts payable	$ 332	$ 737
Accounts payable	27,704	28,137
Accrued liabilities	17,725	16,196
Current portion of long-term debt	15,412	15,874
Total current liabilities	61,173	60,944
Long-term debt (Notes 4 and 6)	145,446	165,067
Contingencies (Note 5)		
Redeemable, noncumulative convertible preferred stock, $100 par value; 1,539 shares issued and outstanding (1,539 in 1997)	146	146
Stockholders' equity (Notes 3 and 8):		
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, 15,105,616 shares issued (14,914,476 in 1997)	1,511	1,504
Capital in excess of par value	38,322	38,257
Accumulated other comprehensive income (loss)	(993)	(1,003)
Accumulated deficit	(21,311)	(29,773)
	65,529	56,985
Less treasury stock, at cost:		
Series 2 Preferred, 5,000 shares	200	200
Common stock, 2,482,590 shares (1,982,620 in 1997)	13,107	12,289
Total stockholders' equity	52,222	44,496
	$ 258,985	$ 270,653

(See accompanying notes)

LSB INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
Three Months Ended March 31, 1998 and 1997
(Dollars in thousands, except per share amounts)

	1998	1997
Revenues:		
Net sales	$ 78,036	$ 73,234
Other income	1,110	1,630
Gain on sale of the Tower (Note 4)	12,993	-
	92,139	74,864
Costs and expenses:		
Cost of sales	62,119	62,312
Selling, general and administrative	15,604	14,872
Interest	4,858	3,056
	82,581	80,240
Income (loss) before provision for income taxes	9,558	(5,376)
Provision for income taxes	280	62
Net income (loss)	$ 9,278	$ (5,438)
Net income (loss) applicable to common stock (Note 2)	$ 8,462	$ (6,241)
Weighted average common shares outstanding (Note 2):		
Basic	12,746,178	12,974,824
Diluted	17,539,194	12,974,824
Income (loss) per common share (Note 2):		
Basic	$ .66	$ (.48)
Diluted	$ .53	$ (.48)

(See accompanying notes)

LSB INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
Three Months Ended March 31, 1998 and 1997
(Dollars in thousands, except per share amounts)

	1998	1997
Cash flows from operations:		
Net income (loss)	$ 9,278	$ (5,438)
Adjustments to reconcile net loss to cash flows used by operations:		
Depreciation, depletion and amortization:		
Property, plant and equipment	3,119	2,439
Other	262	283
Provision for possible losses on receivables and other assets	399	152
Gain on sale of assets	(12,993)	(65)
Recapture of prior period provisions for loss on loans receivable secured by real estate	-	(1,383)
Cash provided (used) by changes in assets and liabilities:		
Trade accounts receivable	(5,968)	(4,841)
Inventories	3,798	678
Supplies and prepaid items	(335)	(791)
Accounts payable	(563)	(4,947)
Accrued liabilities	1,644	169
Net cash used by operations	(1,359)	(13,744)
Cash flows from investing activities:		
Capital expenditures	(2,290)	(2,819)
Principal payments on notes receivable	23	183

Proceeds from sales of equipment and real estate properties	18	160
Proceeds from sale of the Tower (Note 4)	29,266	
Increase in other assets	(2,511)	(721)
Net cash provided (used) in investing activities	24,506	(3,197)
Cash flows from financing activities:		
Payments on long-term debt	(14,649)	(21,172)
Long-term and other borrowings	-	54,451
Net change in revolving debt	(5,558)	(12,408)
Net change in drafts payable	(405)	(96)
Dividends paid on preferred stocks (Note 3)	(816)	(803)
Purchases of treasury stock (Note 3)	(819)	(327)
Net proceeds from issuance of common stock	71	81
Net cash provided (used) by financing activities	(22,176)	19,918
Net increase in cash	971	2,977
Cash and cash equivalents at beginning of period	4,934	1,620
Cash and cash equivalents at end of period	$ 5,905	$ 4,597

(See accompanying notes)

Note 1: Income Taxes

At December 31, 1997, the Company had regular-tax net operating loss ("NOL") carryforwards for tax purposes of approximately $65 million (approximately $18 million alternative minimum tax NOLs). Certain amounts of regular-tax NOL expire beginning in 1999.

The Company's provision for income taxes for the three months ended March 31, 1998 of $280,000 is for current state income taxes and federal alternative minimum tax.

Note 2: Earnings Per Share

In 1997, the Financial Accounting Standards Board issued Statement No. 128, Earnings Per Share. Statement 128 replaced the calculation of primary and fully diluted earnings per share with basic and diluted earnings per share. Unlike primary earnings per share, basic earnings per share excludes any dilutive 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 income or loss applicable to common stock is computed by adjusting net income or loss by the amount of preferred stock dividends. Basic income or loss per common share is based upon the weighted average number of common shares outstanding during each period after giving appropriate effect to preferred stock dividends. Diluted income or loss per share is based on the weighted average number of common shares and dilutive common equivalent shares outstanding and the assumed conversion of dilutive convertible securities outstanding, if any, after appropriate adjustment for interest, net of related income tax effects on convertible notes payable, as applicable. All potentially dilutive securities were antidilutive for the first quarter of 1997 and have thus, been excluded from the computation of diluted loss per share for that period.

Note 2: Earnings Per Share (continued)

The following table sets forth the computation of basic and diluted earnings per share: (dollars in thousands, except per share amounts)

	March 31, 1998	March 31, 1997
Numerator:		
Numerator for 1998 diluted earnings per share - net income (loss)	$ 9,278	$ (5,438)
Preferred stock dividends	(816)	(803)
Numerator for 1998 and 1997 basic and 1997 diluted earnings per share - income (loss) available to common stockholders	$ 8,462	$ (6,241)
Denominator:		
Denominator for basic earnings per share - weighted-average shares	12,746,178	12,974,824
Effect of dilutive securities:		
Employee stock options	126,290	-
Convertible preferred stock	4,662,726	-
Convertible note payable	4,000	-
Dilutive potential common shares	4,793,016	-
Denominator for diluted earnings per share - adjusted weighted-average shares and assumed conversions	17,539,194	12,974,824
Basic earnings per share	$ .66	$ (.48)
Diluted earnings per share	$ .53	$ (.48)

Note 3: Stockholders' Equity

The table below provides detail of activity in the stockholders' equity accounts for the three months ended March 31, 1998:

	Common Stock Shares	Common Stock Par Value	Non-redeemable Preferred Stock	Capital in excess of par Value	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated deficit)	Treasury Stock-Common	Treasury Stock Preferred	Total
	(In thousands)								
Balance at December 31, 1997	15,042	$ 1,504	$ 48,000	$ 38,257	$(1,003)	$(29,773)	$(12,289)	$ (200)	$44,496
Net income						9,278			9,278
Foreign currency translation adjustment					10				10
Comprehensive income (Note 8)									9,288
Exercise of stock options	64	7		65					72
Dividends declared:									
Series B 12% preferred stock ($3.00 per share)						(60)			(60)
Series 2 preferred stock ($.81 per share)						(741)			(741)
Redeemable preferred stock ($10.00 per share)						(15)			(15)
Purchase of treasury stock							(818)		(818)
Balance at March 31, 1998	(1) 15,106	$ 1,511	$ 48,000	$ 38,322	$ (993)	$(21,311)	$(13,107)	$ (200)	$52,222

(1) Includes 2,482,590 shares of the Company's Common Stock held in treasury. Excluding the 2,482,590 shares held in treasury, the outstanding shares of the Company's Common Stock at March 31, 1998 were 12,623,026.

Note 4: Sale of the Tower

In March 1998, a subsidiary of the Company closed the sale of the Tower office building. The Company realized net proceeds of approximately $29.3 million from the sale ($1.0 million of which is held in escrow until September 1998, pending expiration of representations and warranties associated with the sale). Proceeds from the sale were used to retire the outstanding indebtedness of approximately $12.6 million in March 1998, for which this property served as collateral. Approximately $15.5 million of the remaining proceeds were used to reduce indebtedness outstanding under the Company's Revolving Credit Facility. The Company recognized a gain on the sale of the property of approximately $13 million in the first quarter of 1998.

Note 5: Commitments and Contingencies

Nitric Acid Project

In June 1997, two wholly owned subsidiaries of the Company, El Dorado Chemical Company ("EDC"), and El Dorado Nitrogen Company ("EDNC"), entered into a series of agreements with Bayer Corporation ("Bayer") (collectively, the "Bayer Agreement"). Under the Bayer Agreement, EDNC 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 being provided by an unaffiliated lender. Neither the Company nor EDC has guaranteed any of the lending obligations for the EDNC Baytown Plant. In connection with the leveraged lease, the Company entered into an interest rate forward agreement to fix the effective rate of interest implicit in such lease. As of March 31, 1998, the fair value of such agreement represented a liability of $4.1 million for which the Company has posted margin and letters of credit totaling $4.1 million. Bayer has agreed to reimburse the Company for 50% of the ultimate cost of the hedging contract associated with the interest rate forward agreement.

Debt Guarantee

The Company has guaranteed approximately $2.6 million of indebtedness of a start-up aviation company, Kestrel Aircraft

Company, in exchange for an ownership interest, to which no value has been assigned as of March 31, 1998. The Company has made investments in and advances to the aviation company totaling $628,000 as of March 31, 1998 and is accruing losses of the

aviation company based on its ownership percentage (35.9% as of March 31, 1998). The Company has recorded losses of $2,496,500 ($187,500 during the first quarter of 1998) related to the debt guarantee and advances. The debt guarantee relates to a $2 million term note and up to $600,000 of a $2 million revolving credit facility. The $2 million term note requires interest only payments through September 1998; thereafter, it requires monthly principal payments of $11,111 plus interest beginning in October 1998 until it matures on August 8, 1999, at which time all outstanding principal and unpaid interest are due. In the event of default of this note, the Company is required to assume payments on the note with the term extended until August 2004. The $2 million revolving credit facility, on which a subsidiary of the Company has guaranteed up to $600,000 of indebtedness, has an outstanding balance of $2.0 million at March 31, 1998. At March 31, 1998 principal and interest payments on such notes were current.

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 March 31,1998, the Company has accrued an amount based on a preliminary settlement proposal by the alleged potential responsible parties; however, there is no assurance such proposal will be accepted. The amount accrued is not material to the Company's financial position or results of operations. This estimate is subject to material change in the near term as additional information is obtained.

B. A subsidiary of the Company submitted to the State of Arkansas a "Groundwater Monitoring Work Plan" which was approved by the State of Arkansas. Pursuant to the Groundwater Monitoring Work Plan, the subsidiary has performed phase I and II groundwater investigations, and submitted a risk assessment report to the State of Arkansas. The risk assessment report is currently being 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 Arkansas Department of Pollution Control and Ecology ("ADPC&E") for violations of certain provisions of the 1997 Amendment. The Chemical Business believes that the El Dorado Plant has made progress in controlling certain off-site emissions; however, such off-site emissions have occurred and continue to occur from time to time, which could result in the assessment of additional penalties against the Chemical Business by the ADPC&E for violation of the 1997 Amendment.

During May 1997, approximately 2,300 gallons of caustic material spilled when a valve in a storage vessel failed, which was released to a storm water drain, and according to ADPC&E records, resulted in a minor fish kill in a drainage ditch near EDC's El Dorado, Arkansas, facility ("El Dorado Facility"). ADPC&E has proposed a Consent Administrative Agreement ("CAA") to resolve the event. The proposed CAA 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. EDC has proposed to the ADPC&E that it be

allowed to pay the $125,000 in the form of environmental improvements at the El Dorado Facility. The Company believes the remainder of the proposed civil penalty is excessive and intends to seek reduction of such amount. The draft of the proposed Consent Administrative Agreement also requires EDC to install and operate equipment to recover and treat contaminated groundwater. EDC has proposed a long term monitoring program as the groundwater remedy, and will vigorously oppose the remedy proposed in this suggested order. The draft of the proposed CAA also requires the Chemical Business to undertake certain additional compliance measures and equipment improvements related to the El Dorado Plant's wastewater treatment system.

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. During the first quarter of 1998 the Company's Chemical Business has entered into a Consent Decree in settlement of the citizen suit. The Consent Decree is subject to approval by the court. Under the terms of the Consent Decree, which is subject to court approval, the Company's Chemical Business has agreed to, among other things, (i) the granting of an injunctive relief requiring its El Dorado Facility to (a) comply with certain discharge, monitoring and reporting requirements of its waste water discharge permit, the emission limitations of its air permit and the notification requirements under certain sections of certain environmental laws and the statutory penalties for failure to comply with such notification requirements, (b) perform air and water tests to determine if the El Dorado Facility is meeting certain compliance levels and, if the tests do not meet the required compliance levels, to make the necessary corrections thereto so that such compliance levels are met, and (c) limitations relating to the El Dorado Facility's use of its older concentrated nitric acid plant, (ii) to provide the plaintiffs with copies of certain documents forwarded to, or received by, appropriate environmental regulatory agencies by the El Dorado Facility and summaries of certain test results at the El Dorado Facility, (d) pay to the U.S. Treasury $50,000 as a penalty, and (e) pay certain stipulated penalties under certain conditions in the event the El Dorado Facility fails to comply with the terms of the Consent Decree. All actions to be performed by the Company's Chemical Business under the Consent Decree and payment of penalties required by the

Consent Decree are to be paid by the Company's Chemical Business.

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 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 remediaton expenses, with the maximum limit of liability for all claims under the EIL Insurance not to exceed $10.0 million for each loss or remediaton expense and $10.0 million for all losses and remediaton expenses. The EIL Insurance also provides a retention of the first $500,000 per loss or remediaton expense that is to be paid by the Company. The Company's Chemical Business has spent approximately $1.2 million in legal, expert and other costs in connection with the toxic tort and citizen lawsuits described above. The Company has been reimbursed under its EIL Insurance approximately $405,000 of the $1.2 million. 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 entered into an agreement to settle the class action toxic tort lawsuit and completed a settlement of the other toxic tort lawsuit. Settlement of the class action toxic tort lawsuit has been preliminarily approved by the court, but such settelment is subject to final approval by the court. Settlement of the class action toxic tort lawsuit, if completed, will require, and settlement of the other toxic tort lawsuit did require, cash payments to the plaintiffs. Substantially all of such cash settlement payments are to be or were funded directly by the Company's EIL Insurance carrier.

The amount of the settlements of the toxic tort cases as discussed above paid by the EIL Insurance and the amount paid under the EIL Insurance for legal and other expenses relating to the defense of the toxic tort cases and the citizen suit case 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 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. 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.

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.

Note 6: Long-Term Debt

In November 1997, the Company's wholly owned subsidiary, ClimaChem, Inc. ("CCI") completed the sale of $105 million principal amount of 10 3/4% Senior Notes due 2007 (the "Notes").

Interest on the Notes is payable semiannually in arrears on June 1 and December 1 of each year, and the principal is payable in the year 2007. The Notes are senior unsecured obligations of 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.

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; provided, however, that at least $65 million in aggregate principal amount of the Notes remain outstanding following such redemption.
In the event of a change of control of the Company or 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 owns substantially all of the companies comprising the Company's Chemical and Climate Control Businesses. 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, by CCI. 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 currently inconsequential to CCI. Separate financial statements and other disclosures concerning the guarantors are not presented herein because management has determined they are not material to investors. Summarized consolidated balance sheet information of CCI and its subsidiaries as of December 31, 1997 and March 31, 1998 and the results of operations for the three month periods ended March 31, 1998 and March 31, 1997, is as follows: (In thousands)

	March 31, 1998	December 31, 1997
	(unaudited)	
Balance sheet data:		
Current assets	$ 93,805	$ 88,442

Property, plant and equipment	83,964	84,329
Notes receivable from LSB and affiliates	12,432	13,443
Other assets	11,294	14,661
Total assets	$ 201,495	$ 200,875
Current liabilities	$ 39,449	$ 38,004
Long-term debt	125,445	126,346
Other	9,347	9,236
Stockholder's equity	27,254	27,289
Total liabilities and stockholder's equity	$ 201,495	$ 200,875

	Three Months Ended March 31,	
	1998	1997
	(unaudited)	
Operations data:		
Total revenues	$ 63,428	$ 62,295
Costs and expenses:		
Costs of sales	50,411	52,852
Selling, general and administrative	9,780	9,050
Interest	3,313	2,036
	63,504	63,938
Loss before benefit for income taxes	(76)	(1,643)
Benefit for income taxes	(30)	(710)
Net income (loss)	$ (46)	$ (933)

Note 7: Change in Accounting

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

Note 8: Comprehensive Income

Effective January 1, 1998, the Company adopted Financial Accounting Standard No. 130 "Reporting Comprehensive Income" ("SFAS 130"). The provisions of SFAS 130 require the Company to classify items of other comprehensive income in the financial statements and display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of the balance sheet. The Company has also made similar reclassifications for all prior periods for comparative purposes. Other comprehensive income for the quarterly period ended March 31, 1997, was approximately $43,000. After consideration of the $43,000 other comprehensive income item, the comprehensive loss for the

quarterly period ended March 31, 1997 was approximately $5,395,000.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with a review of the Company's March 31, 1998 Condensed Consolidated Financial Statements.

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

OVERVIEW

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 has come to the conclusion that its Automotive and Industrial Products Businesses are non-core to the Company and the Company is exploring various alternatives to maximize shareholder value from these assets. This evaluation includes the possibility of spinning-off the Automotive and Industrial Products Businesses to its shareholders to form a new entity with a separate focus. Any action to be taken in this regard will require approval of the Company's Board of Directors.

Information about the Company's operations in different industry segments for the three months ended March 31, 1998 and 1997 is detailed below.

	Three Months Ended March 31, 1998	1997
	(In thousands) (Unaudited)	
Sales:		
Chemical	$ 33,425	$ 40,599
Climate Control	29,936	21,623
Automotive Products	10,490	7,992
Industrial Products	4,185	3,020
	$ 78,036	$ 73,234
Gross profit (1):		
Chemical	$ 4,592	$ 3,384
Climate Control	8,336	6,008
Automotive Products	2,139	1,109
Industrial Products	849	421
	$ 15,916	$ 10,922
Operating profit (loss) (2):		
Chemical	$ 1,151	$ (645)
Climate Control	2,812	1,551
Automotive Products	(407)	(1,226)
Industrial Products	(304)	(665)
	3,252	(985)
General corporate expenses	(1,829)	(1,335)
Interest expense	(4,858)	(3,056)
Gain on sale of the Tower	12,993	-
Income (loss) before provision for income taxes	$ 9,558	$ (5,376)

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

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

Chemical Business
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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 Chemical Business has not been able to offset the entire cost increase with price increases for its products 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 annual 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 future market price of anhydrous ammonia.

During July 1997, a subsidiary of the Company entered into an agreement with Bayer Corporation ("Bayer") 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 based on current market conditions, the plant should generate approximately $50 million in annual gross revenues. It is anticipated that the construction of the nitric acid plant at Bayer's facility in Baytown, Texas, will cost approximately $60 million and construction is scheduled to be completed by the end of 1998. The Company's subsidiary is to lease the nitric acid plant pursuant to a leverage lease from an unrelated third party for an initial term of ten (10) years from the date that the plant becomes fully operational, and the construction financing of this plant is being provided by an unaffiliated lender.

In addition, in May 1998, the Company entered into a letter of intent with Bayer to purchase Bayer's concentrated nitric acid production unit (the "Unit") located at Bayer's plant in West Virginia. Under the terms of the letter of intent, the Company would, if the purchase is completed, pay to Bayer $8.0 million for the Unit, payable $2.0 million at closing and $1.0 million per year for six years. If the purchase is completed, the Company would grant to Bayer a purchase money mortgage on the Unit and would lease from Bayer the land on which the Unit is located for a nominal amount. The purchase is subject to, among other things; completion by the Company of its due diligence,

completion of a final purchase agreement and approval by the Board of Directors of both parties. Completion of this transaction, if completed, is to occur on or before December 31, 1999.

The results of operation of the Chemical Business' Australian subsidiary have been adversely affected due to the recent economic developments in certain countries in Asia. These economic developments in Asia have had a negative impact on the mining industry in Australia which the Company's Chemical Business services. 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

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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 38.4%) and improved operating profit for the first three months of 1998 as compared to the first three months of 1997.

Automotive and Industrial Products Businesses
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As indicated in the above table, during the three months ended March 31, 1998 and 1997, respectively, the Automotive and Industrial Products Businesses recorded combined sales of $14.7 million and $11.0 million, respectively, and reported operating losses (as defined above) of $.7 million and $1.9 million respectively. The net investment in assets of these Businesses has decreased consistently during the last three years and the Company expects to realize further reductions in future periods.

RESULTS OF OPERATIONS

Three months ended March 31, 1998 vs. Three months ended March 31, 1997.
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Revenues

Total revenues for the three months ended March 31, 1998 and 1997 were $92.1 million and $74.9 million, respectively (an increase of $17.2 million). Sales increased $4.8 million and other income decreased $.5 million. Additionally, in March 1998,

a subsidiary of the Company closed the sale of an Oklahoma City office building, ("the Tower"). The Company recognized a pre-tax gain on the sale of the Tower of approximately $13.0 million in the first quarter of 1998.

Net Sales

Consolidated net sales included in total revenues for the three months ended March 31, 1998 were $78.0 million, compared to $73.2 million for the first three months of 1997, an increase of $4.8 million. This increase in sales resulted principally from: (I) increased sales in the Climate Control Business of $8.3 million due to increased sales in this Business' Heat Pump and Fan Coil product lines, (ii) increased sales in the Automotive Products Business of $2.5 million due to increased sales to original equipment manufacturers and new customers, and (iii) increased sales in the Industrial Products Business of $1.2 million due to increased sales of machine tools, offset by (iv) decreased sales in the Chemical Business of $7.2 million primarily due to lower sales in the U.S. of agricultural and blasting products and decreased business volume of its Australian subsidiary.

Gross Profit

Gross profit was 20.4% for the first three months of 1998, compared to 14.9% for the first three months of 1997. The increase in the gross profit percentage was due primarily to (I) increased absorption of costs due to higher production volumes in the Automotive Products Business, and (ii) lower production costs in the Chemical Business due to the effect of lower prices of anhydrous ammonia in 1998, and (iii) lower unabsorbed overhead costs caused by excessive downtime related to problems associated with mechanical failures at the Chemical Business' primary manufacturing plant in the first quarter of 1997.

Selling, General and Administrative Expense

Selling, general and administrative ("SG&A") expenses as a percent of net sales were 20.0% in the three month period ended March 31, 1998, compared to 20.3% for the first three months of

1997. This decrease is primarily the result of decreased professional fees related to environmental matters in the Chemical Business and increased sales volume in the Climate Control and Automotive Products Businesses without an equivalent corresponding increase in SG&A, offset by increased SG&A of $.4 million on the operations of the Tower prior to the Tower being sold in March 1998.

Interest Expense

Interest expense for the Company was $4.9 million during the first quarter of 1998, compared to $3.8 million, before deducting

capitalized interest, during the first quarter of 1997. During the first quarter of 1997, $.7 million of interest expense was capitalized in connection with construction of the DSN Plant. The increase of $1.1 million before the effect of capitalization primarily resulted from increased borrowings.

Income (Loss) Before Taxes

The Company had income before income taxes of $9.6 million in the first quarter of 1998 compared to a loss before income taxes of $5.4 million in the three months ended March 31, 1997. The increased profitability of $15.0 million was primarily due to the gain on the sale of the Tower and increased sales and gross profits as previously discussed.

Provision for Income Taxes

As a result of the Company's net operating loss carryforward for income tax purposes as discussed elsewhere herein and in Note 1 of Notes to Condensed Consolidated Financial Statements, the Company's provisions for income taxes for the three months ended March 31, 1998 and the three months ended March 31, 1997 are for current state income taxes and federal alternative minimum taxes.

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 and the sale of the Tower.

Net cash used by operations for the quarter ended March 31, 1998 was $1.4 million, after $3.4 million for noncash depreciation and amortization, $.4 million in provisions for possible losses on accounts receivable, notes receivable and a loan guarantee and the $13.0 million gain from the sale of the Tower and including the following changes in assets and liabilities: (i) accounts receivable increases of $6.0 million; (ii) inventory decreases of $3.8 million; (iii) increases in supplies and prepaid items of $.3 million; and (iv) increases in accounts payable and accrued liabilities of $1.1 million. The increase in accounts receivable is due to increased sales primarily in the Climate Control and Automotive Products Businesses (see "Results of Operations" for discussion of increase in sales) and seasonal sales of agricultural products in the Chemical Business. The decrease in inventory was due primarily to a decrease at the Chemical Business due to seasonal sales of agricultural products and 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 $29.4 million at December 31, 1997 to $27.9 million at March 31, 1998. The increase in accounts payable and accrued liabilities resulted primarily from an increase in accrued interest expense related to senior unsecured notes which is payable semi-annually.

Cash Flow From Investing And Financing Activities

Cash provided by investing activities for the quarter ended March 31, 1998 included cash proceeds of $29.3 million received on the sale of the Tower (see Note 4 of Notes to Condensed Consolidated Financial Statements) offset by $2.3 million in capital expenditures and $2.5 million used to increase other assets. The capital expenditures took place primarily in the Chemical and Climate Control Businesses to enhance production and product delivery capabilities. The increase in other assets included (i) a $1.0 million escrow account relating to the sale of the Tower, (ii) $.5 million of deposits made in connection with an interest rate hedge contract related to the agreement with Bayer.

Net cash used by financing activities included (i) payments on long-term debt of $14.6 million, including the $12.6 million payoff of the mortgage on the Tower, (ii) net decreases in revolving debt of $5.6 million, after application of net proceeds of $15.5 million from the sale of the Tower, (iii) decreases in drafts payable of $.4 million (iv) dividends of $.8 million, and (v) treasury stock purchases of $.8 million.

During the first quarter of 1998, the Company declared and paid the following aggregate dividends: (i) $3.00 per share on each of the outstanding shares of its Series B 12% Cumulative Convertible Preferred Stock; (ii) $.81 per share on each outstanding share of its $3.25 Convertible Exchangeable Class C Preferred Stock, Series 2; and (iii) $10.00 per share on each outstanding share of its Convertible Noncumulative Preferred Stock.

Source of Funds

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

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 senior unsecured notes (the "Notes") in the aggregate amount of $105 million pursuant to the terms of an indenture (the "Indenture"). The Notes are jointly and severally and fully and unconditionally guaranteed on a senior basis by all, except for one

inconsequential subsidiary, of the existing and all of the future subsidiaries of ClimaChem. 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.

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.

Under the terms of the Indenture, ClimaChem and its subsidiaries 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.

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 March 31, 1998 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 March 31, 1998, the availability for additional borrowings, based on eligible collateral, approximated $42.9 million. Borrowings under the Revolver outstanding at March 31, 1998, were $13.6 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. The annual interest on the outstanding debt under the Revolver at March 31, 1998 at the rates then in effect would approximate $1.4 million. The Revolving Credit Agreements also require the payment of an annual facility fee of 0.5% of the unused revolver.

In addition to the Revolving Credit Agreements discussed above, as of March 31, 1998, the Company's wholly-owned subsidiary, DSN Corporation ("DSN"), is a party to several loan agreements with a financial company (the "Financing Company") for three projects. At March 31, 1998, DSN had outstanding borrowings of $12.9 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 March 31, 1998, at the agreed to interest rates would approximate $1.1 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.

The Company's Australian subsidiary has a revolving credit working capital facility (the "TES Revolving Facility"). The TES Revolving Facility is approximately AUS$10.5 million (approximately US$6.9 million). The TES Revolving Facility allows for borrowings based on specific percentages of qualified eligible assets. At March 31, 1998,based on the effective exchange rate, the availability under the TES Revolving Facility was approximately US $6.2 million (AUS$9.3 million, with approximately US$4.7 million (AUS$7.1 million approximately) being borrowed at March 31, 1998. 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 6.5% at March 31, 1998. 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 this facility. The outstanding borrowing under the TES Revolving Facility at March 31, 1998, has been classified as due within one year in the accompanying consolidated financial statements.

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 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 letter of intent with Bayer Corporation to purchase a nitric acid unit. In addition, the Company's subsidiary has agreed to act as agent to construct a nitric acid plant as discussed under

"Overview - Chemical Business" of this "Management's Discussion and Analysis of Financial Condition and Results of Operations".

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 March 31, 1998 the balance of the loan remained $3.8 million. As of the date of this report, the decision has not been made to exercise such option and the $3.8 million loan, less a $1.5 million valuation reserve, is carried on the books as a note receivable in other assets.

In 1995, a subsidiary of the Company invested approximately $2.8 million to purchase a fifty percent (50%) 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 $1.0 million 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 $2.0 million as of March 31, 1998. The other note in the amount of $2.0 million requires monthly principal payments of $11,111 plus interest beginning in October 1998 through August 8, 1999, at which time all outstanding principal and accrued interest are due. In the event of default of the $2.0 million note, the Company is required to assume payments on the note with the term extended until August 2004. Both notes are current as to principal and interest as of March 31, 1998.

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 March 31, 1998. As of December 31, 1997, the Company had available NOL carry-overs of approximately $65 million. These NOL carry-overs will expire beginning in the year 1999. Due to its recent history of reporting net losses, the Company has established a valuation allowance on a portion of its NOLs and thus has not recognized the full benefit of its NOLs in the accompanying Condensed Consolidated Financial Statements.

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

Contingencies

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

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements contained within this report may be deemed "Forward-Looking Statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements in this report other than statements of historical fact are Forward-Looking Statements that are subject to known and unknown risks, uncertainties and other factors which could cause actual results and performance of the Company to differ materially from such statements. The words "believe", "expect", "anticipate", "intend", "will", and similar expressions identify Forward-Looking Statements. Forward-Looking Statements contained herein relate to, among other things, (i) ability to improve operations and become profitable on an annualized basis (ii) establish a plan to dispose of non-core assets, including the possible spin-off of such non-core assets (iii) the EDNC Baytown Plant will cost approximately $60 million, will be completed by late 1998 and, when the EDNC Baytown Plant is fully operational, the annual sales volume from such plant will be approximately $50.0 million, (iv) ability to meet presently anticipated capital expenditures, working capital, debt service and dividend requirements,(v) amount to be spent in 1998 relating to compliance with federal, state and local Environmental laws at the El Dorado Facility, (vi) improve liquidity and profits through liquidation of assets, (vii) anticipated financial performance, (viii) ability to comply with the Company's general working capital requirements, (ix) ability to be able to continue to borrow under the Company's revolving line of credit, (x) ability to use NOL carry-overs from

prior years, (xi) contingencies should not have a material adverse impact on the Company's liquidity, and (xii) ability to complete certain settlements. While the Company believes the expectations reflected in such Forward-Looking Statements are reasonable, it can give no assurance such expectations will prove to have been correct. There are a variety of factors which could cause future outcomes to differ materially from those described in this report, including, but not limited to, (i) decline in general economic conditions, both domestic and foreign, (ii) material reduction in revenues, (iii) inability to collect in a timely manner a material amount of receivables, (iv) increased competitive pressures, (v) costs cannot be reduced or cost reduction projects are not completed on schedule, (vi) contracts are not obtained or projects are not finalized within a reasonable period of time or on schedule, (vii) inability to dispose of or spin-off non-core businesses or assets in a reasonable manner or on reasonable terms due to the inability to dispose of such on prices or terms satisfactory to the Company or inability to spin-off such businesses due to legal impediments, (viii) changes in federal, state and local laws and regulations, especially environmental regulations, or in interpretation of such, (ix) additional releases (particularly air emissions into the environment), (x) potential increases in equipment,

maintenance, operating or labor costs not presently anticipated by the Company, (xi) inability to retain management or to develop new management, (xii) the requirement to use internally generated funds for purposes not presently anticipated, (xiii) inability to become profitable, or if unable to become profitable, the inability to secure additional liquidity in the form of additional equity or debt, (xiv) the effect of additional production capacity of anhydrous ammonia in the western hemisphere, (xv) the cost for the purchase of anhydrous ammonia not reducing or continuing to increase or the cost for natural gas increases, (xvi) changes in operating strategy or development plans, (xvii) inability to fund the expansion of the Company's businesses, (xviii) adverse results in any of the Company's pending litigation,(xix) inability to finalize the settlements of the pending environmental litigation or the Company's insurance does not cover a substantial portion of such settlements, (xx) NOL carry-overs are limited or reduced as a result of future audits by the IRS or being limited or reduced by limitations applicable to corporate taxpayers, including, without limitation, limitations imposed by code Section 382 and the consolidated return limitations, and (xxi) other factors described in "Management's Discussion and Analysis of Financial Condition and Results of Operation" contained in this report. Given these uncertainties, all parties are cautioned not to place undue reliance on such Forward-Looking Statements. The Company disclaims any obligation to update any such factors or to publicly announce the result of any revisions to any of the Forward-Looking Statements contained herein to reflect future events or developments.

Independent Accountants' Review Report

Board of Directors
LSB Industries, Inc.

We have reviewed the accompanying condensed consolidated balance sheet of LSB Industries, Inc. and subsidiaries as of March 31, 1998, and the related condensed consolidated statements of operations and cash flows for the three month periods ended March 31, 1998 and 1997. These financial statements are the responsibility of the Company's management.

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

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying condensed consolidated financial statements referred to above for them to

be in conformity with generally accepted accounting principles.

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

ERNST & YOUNG LLP

Oklahoma City, Oklahoma
May 12, 1998

PART II
OTHER INFORMATION

Item 1. Legal Proceedings

There are no additional material legal proceedings pending against the Company and/or its subsidiaries not previously reported by the Company in Item 3 of its Form 10-K for the fiscal period ended December 31, 1997, which Item 3 is incorporated by reference herein. During the quarter ended March 31, 1998, the following settlements or material developments did occur regarding certain litigation reported in Item 3 of the Company's Form 10-K for the year ended December 31, 1997:

Roy Carr, et. al v. El Dorado Chemical Company ("Carr Case"); Richard Detrez, et. al v. El Dorado Chemical Company ("Detrez Case"); Roy A. Carr, Sr., et. al v. El Dorado Chemical Company ("Citizen Suit"), which are or were pending against El Dorado Chemical Company ("EDC"), a subsidiary of the Company within the Company's Chemical Business, in the United States District Court, Western District of Arkansas. During the first quarter of 1998, EDC (i) settled the Carr Case, (ii) entered into a Consent Decree, subject to court approval, in settlement of the Citizen Suit, and (iii) entered into an agreement to settle the Detrez Case. The settlement of the Detrez Case has been preliminarily approved by the court, but such settlement is subject to final approval by the court.

Under the terms of the Consent Decree in settlement of the Citizen Suit, which is subject to court approval, EDC has agreed to, among other things, (i) the granting of injunctive relief requiring its El Dorado, Arkansas facility("El Dorado Facility") to (a) comply with certain discharge, monitoring and reporting requirements of its waste water discharge permit, the emission limitations of its air permit and the notification requirements under certain sections of certain environmental laws and the statutory penalties for failure to comply with such notification requirements, (b) perform air and water tests to determine if the El Dorado Facility is meeting certain compliance levels and, if the tests do not meet the required compliance levels, to make the necessary corrections so that such compliance levels can be met, and (c) limitations relating to the El Dorado Facility's use of its older concentrated nitric acid plant, (ii) provide the plaintiffs with copies of certain documents forwarded to, or received by, appropriate environmental regulatory agencies by the El Dorado Facility and summaries of certain test results at the El Dorado Facility, (iii) pay to the U.S. Treasury $50,000 as a penalty, and (iv) pay certain stipulated penalties under certain conditions in the event the El Dorado Facility fails to comply with the terms of the Consent Decree. All Actions to be performed by the Company's Chemical Business under the Consent Decree and payment of penalties required by the Consent Decree are to be paid by the Company's Chemical Business.

Under the Carr Case settlement and the agreement to settle the Detrez Case, certain cash payments will be or are to be made to the plaintiffs as a result of such settlements. Substantially

all such cash settlement payments made in the Carr Case and to be made in the Detrez Case, if the Detrez Case settlement is completed pursuant to the terms of the agreement are to be funded directly by the Company's EIL Insurance. See Note 5 to Notes to Condensed Consolidated Financial Statements and "Special Note Regarding Forward - Looking Statements."

Item 2. Changes in Securities

Not applicable.

Item 3. Defaults upon Senior Securities

Not applicable.

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

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits and Reports on Form 8-K

(A) Exhibits.

The Company has included the following exhibits in this report:

15.1 Letter Re: Unaudited Interim Financial Information.

27.1 Financial Data Schedule

(B) Reports of Form 8-K.

The Company did not file any reports on Form 8-K during the quarter ended March 31, 1998.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Company has caused the undersigned, duly-authorized, to sign this report on its behalf on this 19th day of May 1998.

LSB INDUSTRIES, INC.

By: /s/ Tony M. Shelby

Tony M. Shelby,
Senior Vice President of Finance
(Principal Financial Officer)

By: /s/ Jim D. Jones

Jim D. Jones
Vice President, Controller and
Treasurer(Principal Accounting
Officer)

Exhibit 15.1

Letter of Acknowledgment Re: Unaudited Financial Information

The Board of Directors
LSB Industries, Inc.

We are aware of the incorporation by reference in the Registration Statement (Form S-8 No. 33-8302) and the Registration Statement (Form S-3 No. 33-69800) of LSB Industries, Inc. and in the related Prospectus of our report dated May 12, 1998 relating to the unaudited condensed consolidated interim financial statements of LSB Industries, Inc. which are included in its Form 10-Q for the quarter ended March 31, 1998.

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

Ernst & Young LLP

Oklahoma City, Oklahoma
May 12, 1998

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MAR-31-1998
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3,160
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