

FORM 10-Q

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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

For Quarterly period ended March 31, 1999

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, 1999 was 11,835,386 shares excluding 3,273,290 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, 1999, the condensed consolidated statements of operations and cash flows for the three month periods ended March 31, 1999 and 1998 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, 1999 are not necessarily indicative of the results to be expected for the full year. The condensed consolidated balance sheet at December 31, 1998, was derived from audited financial statements as of that date. Reference is made to the Company's Annual Report on Form 10-K for the year ended December 31, 1998, for an expanded discussion of the Company's financial disclosures and accounting policies.

LSB INDUSTRIES, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Information at March 31, 1999 is unaudited)  
(dollars in thousands)

ASSETS	March 31, 1999	December 31, 1998
Current assets:		
Cash and cash equivalents	\$ 1,240	\$ 1,555
Trade accounts receivable, net	57,113	52,730
Inventories:		
Finished goods	33,322	34,236
Work in process	8,163	7,178
Raw materials	21,864	22,431
Total inventory	63,349	63,845
Supplies and prepaid items	9,503	7,809
Total current assets	131,205	125,939
Property, plant and equipment, net	99,102	99,228
Other assets, net	21,120	23,480
	\$ 251,427	\$ 248,647

(Continued on following page)

LSB INDUSTRIES, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Information at March 31, 1999 is unaudited)  
(dollars in thousands)

LIABILITIES AND STOCKHOLDERS' EQUITY	March 31, 1999	December 31, 1998
Current liabilities:		
Drafts payable	\$ 499	\$ 758
Accounts payable	20,534	24,043
Accrued liabilities	19,490	19,006
Current portion of long-term debt	14,559	13,954
Total current liabilities	55,082	57,761
Long-term debt (Note 6)	165,759	155,688
Commitments and Contingencies (Note 5)		
Redeemable, noncumulative convertible preferred stock, \$100 par value; 1,463 shares issued and outstanding	139	139
Stockholders' equity (Notes 3 and 7):		
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, 15,108,676 shares issued	1,511	1,511
Capital in excess of par value	38,329	38,329
Accumulated other comprehensive loss	(1,337)	(1,559)
Accumulated deficit	(39,794)	(35,166)
	46,709	51,115
Less treasury stock, at cost:		
Series 2 Preferred, 5,000 shares	200	200
Common stock, 3,273,290 shares (3,202,690 in 1998)	16,062	15,856
Total stockholders' equity	30,447	35,059
	\$ 251,427	\$ 248,647

(See accompanying notes)

LSB INDUSTRIES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)  
Three Months Ended March 31, 1999 and 1998  
(Amounts in thousands, except per share amounts)

	1999	1998
Businesses continuing at March 31,:		
Revenues:		
Net sales	\$ 70,189	\$ 73,290
Other income	-	889
Gain on sale of the Tower		12,993
	70,189	87,172
Costs and expenses:		
Cost of sales	54,075	57,539
Selling, general and administrative	14,327	14,811
Interest	4,367	4,701
Other expenses	210	-
	72,979	77,051
Income (loss) before subsidiary to be disposed of during 1999	(2,790)	10,121
Subsidiary to be disposed of during 1999 (Note 9):		
Revenues	2,868	4,779
Operating costs, expenses and interest	3,838	5,342
	(970)	(563)
Income (loss) before provision for income taxes	(3,760)	9,558
Provision for income taxes	50	280
Net income (loss)	\$ (3,810)	\$ 9,278
	=====	=====
Net income (loss) applicable to common stock (Note 2)	\$ (4,626)	\$ 8,462
	=====	=====
Weighted average common shares outstanding (Note 2):		
Basic	11,881	12,746
Diluted	11,881	17,539
Income (loss) per common share (Note 2):		
Basic	\$ (.39)	\$ .66
	=====	=====
Diluted	\$ (.39)	\$ .53
	=====	=====

(See accompanying notes)

LSB INDUSTRIES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)  
Three Months Ended March 31, 1999 and 1998  
(dollars in thousands)

	1999	1998
Cash flows from operations:		
Net income (loss)	\$ (3,810)	\$ 9,278
Adjustments to reconcile net income (loss) to cash flows used by operations:		
Depreciation, depletion and amortization:		
Property, plant and equipment	2,819	3,119
Other	318	262
Provision for possible losses on receivables and other assets	427	399
Loss (gain) on sale of assets	23	(12,993)
Cash provided (used) by changes in assets and liabilities:		
Trade accounts receivable	(4,633)	(5,968)
Inventories	645	3,798
Supplies and prepaid items	(1,692)	(335)
Accounts payable	(3,564)	(563)
Accrued liabilities	2,522	1,644
Net cash used by operations	(6,945)	(1,359)
Cash flows from investing activities:		
Capital expenditures	(2,328)	(2,290)
Principal payments on loans receivable	135	23
Proceeds from sales of equipment and real estate properties	-	18
Proceeds from sale of the Tower	-	29,266
Decrease (increase) in other assets	1,827	(2,511)
Net cash provided (used) by investing activities	(366)	24,506
Cash flows from financing activities:		
Payments on long-term and other debt	(2,522)	(14,649)
Net change in revolving debt facilities	10,799	(5,558)
Net change in drafts payable	(259)	(405)
Dividends paid on preferred stocks (Note 3)	(816)	(816)
Purchases of treasury stock (Note 3)	(206)	(819)
Net proceeds from issuance of common stock	-	71
Net cash provided (used) by financing activities	6,996	(22,176)
Net increase (decrease) in cash and cash equivalents from all activities	(315)	971
Cash and cash equivalents at beginning of period	1,555	4,934
Cash and cash equivalents at end of period	\$ 1,240	\$ 5,905

(See accompanying notes)

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 1999 and 1998

Note 1: Income Taxes At December 31, 1998, the Company had regular-tax net operating loss ("NOL") carryforwards for tax purposes of approximately \$63.8 million (approximately \$31.4 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, 1999 of \$50,000 is for current state income taxes and federal alternative minimum tax.

Note 2: Earnings Per Share Net income or loss applicable to common stock is computed by adjusting net income or loss by the amount of preferred stock dividends. Basic income or loss per common share is based upon the weighted average number of common shares outstanding during each period after giving appropriate effect to preferred stock dividends. Diluted income or loss per share is based on the weighted average number of common shares and dilutive common equivalent shares outstanding and the assumed conversion of dilutive convertible securities outstanding, if any, after appropriate adjustment for interest, net of related income tax effects on convertible notes payable, as applicable. The Company has stock options, convertible preferred stock, and a convertible note payable, which are potentially dilutive. All of these potentially dilutive securities were antidilutive for the first quarter of 1999 and have thus, been excluded from the computation of diluted loss per share for that period.

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 1999 and 1998

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)

	1999	March 31, 1998
	<u>                    </u>	<u>                    </u>
Numerator:		
Numerator for 1998 diluted earnings per share - net income (loss)	\$ (3,810)	\$ 9,278
Preferred stock dividends	(816)	(816)
	<u>                    </u>	<u>                    </u>
Numerator for 1999 and 1998 basic and 1999 diluted earnings per share - income (loss) available to common stockholders	\$ (4,626)	\$ 8,462
	=====	=====
Denominator:		
Denominator for basic earnings per share - weighted-average shares	11,880,625	12,746,178
Effect of dilutive securities:		
Employee stock options	-	126,290
Convertible preferred stock	-	4,662,726
Convertible note payable	-	4,000
	<u>                    </u>	<u>                    </u>
Dilutive potential common shares	-	4,793,016
	<u>                    </u>	<u>                    </u>
Denominator for diluted earnings per share - adjusted weighted-average shares and assumed conversions	11,880,625	17,539,194
	=====	=====
Basic earnings (loss) per share	(.39)	\$ .66
	=====	=====
Diluted earnings (loss) per share	(.39)	\$ .53
	=====	=====



LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months ended March 31, 1999 and 1998

Note 3: Stockholders' Equity The table below provides detail of activity in the stockholders' equity accounts for the three months ended March 31, 1999:

	Common Stock		Non- redeemable Preferred Stock	Capital in excess of par Value	Accumulated Other Com- prehensive Loss
	Shares	Par Value			
			(in thousands)		
Balance at December 31, 1998	15,109	\$ 1,511	\$ 48,000	\$ 38,329	\$(1,559)
Net loss					
Foreign currency translation adjustment					222
Total comprehensive income (Note 8)					
Dividends declared:					
Series B 12% preferred stock (\$3.00 per share)					
Series 2 preferred stock (\$.81 per share)					
Redeemable preferred stock (\$10.00 per share)					
Purchase of treasury stock					
	(1)				
Balance at March 31, 1999	15,109	\$ 1,511	\$ 48,000	\$ 38,329	\$(1,337)
	=====	=====	=====	=====	=====

Accumu lated deficit	Treasury Stock- Common	Treasury Stock Prefer- red	Total
\$(35,166) (3,810)	\$(15,856)	\$ (200)	\$35,059 (3,810)
			222
			<u>(3,588)</u>
(60)			(60)
(741)			(741)
(15)			(15)
	(206)		(206)
<u>\$(38,794)</u>	<u>\$(16,062)</u>	<u>\$ (200)</u>	<u>\$30,447</u>
=====	=====	=====	=====

(1) Includes 3,273 shares of the Company's Common Stock held in treasury. Excluding the 3,273 shares held in treasury, the outstanding shares of the Company's Common Stock at March 31, 1999 were 11,836.

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 1999 and 1998

Note 4: Segment Information

	Three Months Ended March 31,	
	1999	1998
	(in thousands) (unaudited)	
Net sales:		
Businesses continuing:		
Chemical	\$ 30,745	\$ 28,679
Climate Control	26,699	29,936
Automotive Products	10,105	10,490
Industrial Products	2,640	4,185
Subsidiary to be disposed of:		
Chemical	2,868	4,746
	\$ 73,057	\$ 78,036
	=====	=====
Operating profit (loss):		
Businesses continuing:		
Chemical	\$ 1,446	\$ 1,557
Climate Control	2,707	2,812
Automotive Products	9	(407)
Industrial Products	(411)	(304)
Subsidiary to be disposed of:		
Chemical	(845)	(406)
	2,906	3,252
General corporate expenses and other	(2,174)	(1,829)
Interest expense	(4,492)	(4,858)
Gain on sale of the Tower	-	12,993
	Income (loss) before provision	for income taxes
	\$ (3,760)	\$ 9,558
	=====	=====

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 agreed to act as an agent to construct, and upon completion of construction, operate a nitric acid plant

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(the "EDNC Baytown Plant") at Bayer's Baytown, Texas chemical facility. EDC 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, 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 cost of the EDNC Baytown Plant will approximate \$69 million and will be completed in the second quarter of 1999. Construction financing of the EDNC Baytown Plant is provided by an unaffiliated lender. Neither the Company nor EDC has guaranteed any of the repayment 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, 1999, the fair value of such agreement represented a liability of \$2.6 million for which the Company has issued a letter of credit totaling the same. See Note 7, "Changes in Accounting," for the expected accounting upon adoption of SFAS #133.

In January 1999, the contractor constructing the EDNC Baytown Plant under a turnkey agreement, informed the Company that it could not complete construction alleging a lack of financial resources. EDNC at that time demanded that the contractor's bonding company provide funds necessary for subcontractors to complete construction. A substantial portion of the costs to complete the EDNC Baytown Plant (\$12.9 million), which were to be funded by the construction contractor, have been funded by proceeds from the bonding company; however, the cost to the Company through its leveraged lease is expected to be impacted by these events. As a result of the delay in completion of the EDNC Baytown Plant, the Company's subsidiaries, EDNC and EDC, have entered into an interim supply agreement with Bayer to provide product from the manufacturing facility in El Dorado, Arkansas.

In connection with the EDNC Baytown Plant, EDNC had entered into a long-term production and supply agreement with Bayer. This agreement provided for a commencement date of no later than February 1, 1999. As mentioned above, EDNC is providing product to Bayer under an interim supply agreement until the EDNC Baytown Plant becomes operational. In connection with these agreements, EDNC and Bayer are to determine the financial impact of the delay in completing the Baytown Plant as scheduled. Based on current

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estimates, the loss associated with these agreements and contract provisions is not expected to be material.

#### Debt Guarantee

The Company previously guaranteed approximately \$2.6 million of indebtedness of a start-up aviation company, Kestrel Aircraft Company ("Kestrel"), in exchange for a 44.9% ownership interest. At December 31, 1998, the Company had accrued the full amount of its commitment under the debt guarantees and fully reserved its investments and advances to Kestrel. In the first quarter of 1999, upon demand of the Company's guarantee, the Company assumed an obligation for a \$2.0 million term note, which is due in equal monthly principal payments of \$11,111, plus interest, through August 2004 and funded its \$600,000 obligation related to a subsidiary's partial guarantee of Kestrel's obligation under a revolving credit facility. In connection with the demand of the Company to perform under its guarantees, the Company and the other guarantors formed a new company ("KAC") which acquired the assets of the aviation company through foreclosure.

The Company and the other shareholders of KAC are attempting to sell the assets acquired in foreclosure. Proceeds received by the Company, if any, from the sale of KAC assets will be recognized in the results of operations when and if realized.

#### 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

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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, 1999, 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. Such amount is not material to the Company's financial position or results of operations. This estimate is subject to material change in the near term as additional information is obtained. The subsidiary's insurance carriers have been notified of this matter; however, the amount of possible coverage, if any, is not yet determinable.

- B. On February 12, 1996, the Chemical Business 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 Chemical Business installed additional pollution control equipment to address the compliance issues. The Chemical Business 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.

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Three Months Ended March 31, 1999 and 1998

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 the El Dorado Plant. In 1998, the ADPC&E issued a Consent Administrative Order ("1998 CAO") to resolve the event. The 1998 CAO includes a civil penalty in the amount of \$183,700 which includes \$125,000 to be paid over five years in the form of environmental improvements at the El Dorado Plant. The remaining \$58,700 was paid in 1998. The 1998 CAO also requires the Chemical Business to undertake a facility-wide wastewater evaluation and pollutant source control program and wastewater facility-wide wastewater minimization program. The program requires that the subsidiary complete rainwater drain-off studies including engineering design plans for additional water treatment components to be submitted to the ADCP&E by August 2000. The construction of the additional water treatment components shall be completed by August 2001 and the El Dorado plant has been mandated to be in compliance with final effluent limits on or before February 2002. The wastewater program is currently expected to require future capital expenditures of approximately \$5.0 million.

- C. A civil cause of action has been filed against the Company's Chemical Business and five (5) other unrelated commercial explosives manufacturers alleging that the defendants allegedly violated certain federal and state antitrust laws in connection with alleged price fixing of certain explosive products. The plaintiffs are suing for an unspecified amount of damages, which, pursuant to statute, plaintiffs are requesting be trebled, together with costs. Based on the information presently available to the Company, the Company does not believe that the Chemical Business conspired with any party, including but not limited to, the five (5) other defendants, to fix prices in connection with the sale of commercial explosives. This litigation has been consolidated, for discovery purposes only, with several other actions in a multi-district litigation proceeding in Utah. Discovery in this litigation is in process. 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

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Three Months Ended March 31, 1999 and 1998

products to customers in Missouri during a time in which other defendants have admitted to participating in an antitrust conspiracy, and because it has been sued in the preceding described lawsuit. Based on the information presently available to the Company, the Company does not believe that the Chemical Business conspired with any party, to fix prices in connection with the sale of commercial explosives. The Chemical Business intends to vigorously defend itself in this matter.

During the third quarter of 1997, a subsidiary of the Company was served with a lawsuit in which approximately 27 plaintiffs have sued approximately 13 defendants, including a subsidiary of the Company alleging personal injury and property damage for undifferentiated compensatory and punitive damages of approximately \$7,000,000. Specifically, the plaintiffs assert property damage to their residence and wells, annoyance and inconvenience, and nuisance as a result of daily blasting and round-the-clock mining activities. The plaintiffs are residents living near the Heartland Coal Company ("Heartland") strip mine in Lincoln County, West Virginia, and an unrelated mining operation operated by Pen Coal Inc. During 1999, the plaintiffs withdrew all personal injury claims previously asserted in this litigation. 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 as a result of the subsidiary's operations. Discovery in this litigation in process. The Company intends to vigorously defend itself in this matter. Based on the limited information available, the subsidiary's counsel believes that the subsidiaries' possible loss, if any, related to this litigation is not presently expected to have a material adverse effect on the Company.

The Company, including its subsidiaries, is a party to various other claims, legal actions, and complaints arising in the ordinary



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(Unaudited)  
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course of business. In the opinion of management after consultation with counsel, all claims, legal actions (including those described above) and complaints are not presently probable of material loss, 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 income (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. ("ClimaChem"), 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 ClimaChem and rank pari passu in right of payment to all existing senior unsecured indebtedness of ClimaChem and its subsidiaries. The Notes are effectively subordinated to all existing and future senior secured indebtedness of ClimaChem.

ClimaChem owns substantially all of the companies comprising the Company's Chemical and Climate Control Businesses. ClimaChem is a holding company with no assets or operations other than its investments in its subsidiaries, and each of its subsidiaries is wholly owned, directly or indirectly, by ClimaChem. ClimaChem's payment obligations under the Notes are fully, unconditionally and joint and severally guaranteed by all of the existing subsidiaries of ClimaChem, except for El Dorado Nitrogen Company ("EDNC"). The assets, equity, and earnings of EDNC are currently inconsequential to ClimaChem. Separate financial statements and other disclosures concerning the guarantors are not presented herein because management has determined they are not material to investors. Summarized consolidated balance sheet information of ClimaChem and its subsidiaries as of March 31, 1999 and December 31, 1998 and the results of operations for the three month periods ended March 31, 1999 and 1998 are detailed below.

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 1999 and 1998

	March 31, 1999	December 31, 1998
Balance sheet data:		
Current assets (1) (2)	\$ 95,569	\$ 90,291
Property, plant and equipment, net	84,338	82,389
Notes receivable from LSB and affiliates, net	13,443	13,443
Other assets, net	11,267	10,480
Total assets	\$ 205,617	\$ 196,603
Current liabilities	\$ 38,482	\$ 35,794
Long-term debt	134,626	127,471
Other	9,680	9,580
Stockholders' equity	22,829	23,758
Total liabilities and stockholders' equity	\$ 205,617	\$ 196,603

	Three Months Ended March 31,	
	1999	1998
Operations data:		
Total revenues	\$ 59,951	\$ 63,428
Costs and expenses:		
Cost of sales	47,171	50,411
Selling, general and administrative	10,603	9,780
Interest	3,278	3,313
	61,052	63,504
Loss before provision (benefit) for income taxes	(1,101)	(76)
Provision (benefit) for income taxes	50	(30)
Net loss	\$ (1,151)	\$ (46)

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 1999 and 1998

- (1) Notes receivable from LSB and affiliates is eliminated when consolidated with LSB.
- (2) Current assets include income tax and other receivables due from LSB which aggregate \$4.3 million and \$5.0 million at March 31, 1999, and December 31, 1998.

Note 7: Change in Accounting In June, 1998, the Financial Accounting Standards Board issued Statement No. 133 ("SFAS #133"), Accounting for Derivative Instruments and Hedging Activities, which is required to be adopted in years beginning after June 15, 1999. The Statement permits early adoption as of the beginning of any fiscal quarter after its issuance. The Company has not yet determined when this new Statement will be adopted. The Statement will require the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value will be immediately recognized in earnings. The Company has not yet determined what all of the effects of SFAS #133 will be on the earnings and financial position of the Company; however, the Company expects that the interest rate forward agreement discussed in Note 5, "Nitric Acid Project," will be accounted for as a cash flow hedge upon adoption of SFAS #133, with the effective portion of the hedge being classified in equity in accumulated other comprehensive income or loss. The amount included in accumulated other comprehensive income or loss will be amortized to income over the initial term of the leveraged lease.

Note 8: Comprehensive Income The Company presents comprehensive income in accordance with Financial Accounting Standard No. 130 "Reporting Comprehensive Income" ("SFAS 130"). The provisions of SFAS 130 require the Company to classify items of other comprehensive income 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. Other comprehensive income for the three month periods ended March 31, 1999 and 1998 is detailed below.

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 1999 and 1998

	Three Months Ended March 31,	
	1999	1998
	(in thousands)	
Net income (loss)	\$ (3,810)	\$ 9,278
Foreign currency translation income	222	10
Total comprehensive income (loss)	\$ (3,588) =====	\$ 9,288 =====

Note 9: Subsequent Events. The Company finalized a term and revolving line of credit of a total of \$18.55 million with an asset-based lender for its Automotive Products Business which was funded on May 10, 1999. This facility replaces the Automotive Products Business' previous loan agreement under the Company's Revolver and provides for a \$2.55 million term loan and a \$16.0 million revolving credit facility (an increase of borrowing ability calculated as of March 31, 1999 of \$2.7 million compared to the Automotive Products Business' availability under the replaced facility) based on eligible amounts of accounts receivable and inventory. This facility provides for interest at a bank's prime rate plus one percent (1%) per annum, or at the Company's option, the lender's LIBOR rate plus two and three-quarters percent (2.75%) per annum. The effective interest rate at closing was 8.75%. The term of this new facility is through May 7, 2001, and is renewable thereafter for successive twelve-month terms. As a result, the terms and conditions of this facility, outstanding borrowings under the revolving credit facility of \$9.3 million at closing and \$.6 million under the term loan will be classified as long-term debt due within one year (borrowings by the Automotive Products Business under the Company's revolving credit agreement were classified as long-term debt due after one year in the accompanying condensed consolidated balance sheets as of March 31, 1999 and December 31, 1998). The Automotive Products Business was required to secure such loan with substantially all of its assets. The loan agreement contains various affirmative and negative covenants, including a requirement to maintain tangible net worth of not less than \$6.4 million. The Company was required to provide such lender with a \$1.0 million standby letter of credit to further secure such loan. In connection with this financing, the Company's Revolving Credit Facility, that is not available to the Automotive Products

LSB INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
Three Months Ended March 31, 1999 and 1998

Business, provides for the elimination of its financial covenants so long as the remaining borrowing group maintains a minimum aggregate availability under such facility of at least \$15 million.

On May 7, 1999, the Company's wholly owned subsidiary, Total Energy Systems Limited and its subsidiaries ("TES") entered into an agreement (the "Asset Sale Agreement") to sell substantially all the assets of TES ("Defined Assets"). Under the Asset Sale Agreement, TES retains its liabilities and will liquidate such liabilities from the proceeds of the sale and from the collection of its accounts receivables which were retained by TES pursuant to the Asset Sale Agreement.

The gain or loss on the closing of the Asset Sale Agreement is subject to the fluctuation in the exchange rate between Australian dollars and U. S. dollars prior to the close. At the date of this report, the gain or loss associated with this transaction is expected to be comprised primarily of disposition costs of approximately \$250,000, the recognition in earnings of the cumulative foreign currency loss at such time (\$1,337,000 at March 31, 1999) and the amount, if any, related to the resolution of certain environmental matters.

The Asset Sale Agreement is subject to certain conditions precedent, including the purchaser receiving proper authorization from specifically identified government and industry regulatory agencies in Australia, and resolution of certain environmental matters.

The Company expects to finalize the Asset Sale Agreement in the second quarter of 1999, but there are no assurances that the Company will be successful in doing so.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the Company's March 31, 1999 Condensed Consolidated Financial Statements.

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

OVERVIEW

General

The Company is pursuing a strategy of focusing on its core businesses and concentrating on product lines in niche markets where the Company has established or believes it can establish a position as a market leader. In addition, the Company is seeking to improve its liquidity and profits through liquidation of selected assets that are on its balance sheet and on which it is not realizing an acceptable return and does not reasonably expect to do so. In this connection, the Company has come to the conclusion that its Automotive and Industrial Products Businesses are non-core to the Company and the Company is exploring various alternatives to maximize shareholder value from these assets. The Company is also considering the sale of other assets that are non-core to its Chemical and Climate Control Businesses.

The Company is continuing with its evaluation of the spin-off of Automotive to its shareholders as a dividend. As part of its evaluation, the Company has finalized a new credit facility for the Automotive Products Business ("Automotive"). See "Liquidity & Capital Resources" of this MD&A for a description of the credit facility. In addition, the spin-off of Automotive will require, among other things, commitment to a formal plan, receipt by the Company of an opinion of counsel confirming tax-free treatment, certain Securities and Exchange Commission filings, resolving certain issues relating to a certain series of the Company's outstanding preferred stock and LSB Board of Directors' approval. Subject to completion and resolution of the above conditions, management believes there is a strong likelihood that the spin-off will be completed during 1999. However, there are no assurances that the Company will spin-off Automotive.

Certain statements contained in this Overview are forward-looking statements, and future results could differ materially from such statements.

Information about the Company's operations in different industry segments for the three months ended March 31, 1999 and 1998 is detailed below.

	Three Months Ended March 31,	
	1999	1998
	(in thousands) (Unaudited)	
Sales:		
Businesses continuing:		
Chemical	\$ 30,745	\$ 28,679
Climate Control	26,699	29,936
Automotive Products	10,105	10,490
Industrial Products	2,640	4,185
Subsidiary to be disposed of (1):		
Chemical	2,868	4,746
	<u>\$ 73,057</u>	<u>\$ 78,036</u>
	=====	=====
Gross profit (loss) (2):		
Businesses continuing:		
Chemical	\$ 4,957	\$ 4,426
Climate Control	8,321	8,336
Automotive Products	2,096	2,139
Industrial Products	740	849
Subsidiary to be disposed of (1):		
Chemical	(158)	166
	<u>\$ 15,956</u>	<u>\$ 15,916</u>
	=====	=====
Operating profit (loss) (3):		
Businesses continuing:		
Chemical	\$ 1,446	\$ 1,557
Climate Control	2,707	2,812
Automotive Products	9	(407)
Industrial Products	(411)	(304)
Subsidiary to be disposed of (1):		
Chemical	(845)	(406)
	<u>2,906</u>	<u>3,252</u>
General corporate expenses	(2,174)	(1,829)
Interest expense	(4,492)	(4,858)
Gain on sale of the Tower	-	12,993
	<u>Income (loss) before provision</u>	<u>Income (loss) before provision</u>
for income taxes	<u>\$ (3,760)</u>	<u>\$ 9,558</u>
	=====	=====

(1) On May 7, 1999, the Company's wholly owned Australian subsidiary, TES, entered into an agreement to sell substantially all of its assets, subject to certain conditions precedent. See Note 9 of Notes to Condensed Consolidated Financial Statements for further information. The operating results for TES have been presented separately in the above table.

- (2) Gross profit by industry segment represents net sales less cost of sales.
- (3) 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

Sales in the Chemical Business (excluding the subsidiary being disposed of) have increased from \$28.7 million in the three months ended March 31, 1998 to \$30.7 million in the three months ended March 31, 1999 (an increase of 7.0%) and the gross profit (excluding the Australian subsidiary being disposed of) has increased from \$4.4 million in 1998 to \$5.0 in 1999, the gross profit percentage (excluding the subsidiary being disposed of) has increased from 15.4% in 1998 to 16.1% in 1999.

The cost of the Chemical Business' primary raw material, anhydrous ammonia, averaged approximately \$22 per ton less in the first quarter of 1999, than in the first quarter of 1998. The Chemical Business purchases approximately 220,000 tons of anhydrous ammonia per year under three contracts expiring in April, 2000, June, 2000, and December, 2000, respectively. The Company's purchase price of anhydrous ammonia under these contracts can be higher or lower than the current market spot price of anhydrous ammonia. Pricing is subject to variations due to numerous factors contained in these contracts. Based on the price calculations contained in the contracts, the contract expiring in April, 2000 is presently priced above the current market spot price. The Chemical Business is required to purchase 120,000 tons of its requirements under a contract expiring in April, 2000, at least 24,000 tons of its requirements under a second contract expiring in June, 2000, and 60,000 tons of its requirements under a third contract expiring in December, 2000, with additional quantities of anhydrous ammonia available under each contract. Anhydrous ammonia is not being currently supplied under the contract expiring in December, 2000, due to that supplier's declaration of an event of force majeure as a result of a shut down of its plant due to mechanical problems. The Company has been able to obtain anhydrous ammonia from other sources on similar terms as provided in the contract expiring in December, 2000.

The anhydrous ammonia industry added an additional one million tons of capacity of anhydrous ammonia in the western hemisphere in 1998, and the Company believes there is approximately one million tons of additional annual capacity of anhydrous ammonia being constructed in the western hemisphere scheduled for completion in 1999. The Company believes this additional capacity may contribute to a decline in the future market price of anhydrous ammonia. See "Special Note Regarding Forward-Looking Statements".



In June, 1997, a subsidiary of the Company entered into an agreement with Bayer Corporation ("Bayer") whereby one of the Company's subsidiaries is acting as agent to construct a nitric acid plant located within Bayer's Baytown, Texas chemical plant complex. This plant will be operated by the Company's subsidiary and will supply nitric acid for Bayer's polyurethane business under a long-term supply contract. Management estimates that, after the initial startup phase of operations at the plant, at full production capacity based on terms of the Bayer Agreement and dependent upon the price of anhydrous ammonia, based on the price of anhydrous ammonia as of the date of this report, the plant should generate approximately \$35 million to \$50 million in annual gross revenues. Unlike the Chemical Business' regular sales volume, the market risk on this additional volume is much less since the contract provides for recovery of costs, as defined, plus a profit. It is anticipated that the construction of the nitric acid plant at Bayer's facility in Baytown, Texas, will cost approximately \$69 million and construction will be completed in the second quarter of 1999. The Company's subsidiary is to lease the nitric acid plant pursuant to a leverage lease from an unrelated third party for an initial term of ten (10) years from the date that the plant becomes fully operational, and the construction financing of this plant is being provided by an unaffiliated lender.

The results of operation of the Chemical Business' Australian subsidiary have been adversely affected due to the recent economic developments in certain countries in Asia. These economic developments in Asia have had a negative impact on the mining industry in Australia which the Company's Chemical Business services. As these adverse economic conditions in Asia have continued, such have had an adverse effect on the Company's consolidated results of operations. On May 7, 1999, the Company's wholly owned Australian subsidiary entered into an agreement to sell substantially all of its assets, subject to certain conditions precedent. Revenues of the Australian subsidiary for the three month periods ended March 31, 1999, and March 31, 1998, were \$2.9 million and \$4.8 million, respectively. For the year ended December 31, 1998, the Australian subsidiary had a net loss of US\$2.9 million and revenues of US\$14.2 million. See Note 9 of Notes to Condensed Consolidated Financial Statements and Item 5 "Other Information" of Part II of this report for further information concerning this transaction. There are no assurances that this sale will be successfully completed.

#### Climate Control

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

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

Although sales in the Climate Control Business were 10.8% lower in the three months ended March 31, 1999, than in the three months ended March 31, 1998, the gross profit remained \$8.3 million in both periods. The gross profit percentage of the Climate Control Business has improved from 27.8% in the first quarter of 1998 to 31.2% in the first quarter of 1999.

#### Automotive and Industrial Products Businesses

As indicated in the above table, during the three months ended March 31, 1999 and 1998, respectively, the Automotive and Industrial Products recorded combined sales of \$12.7 million and \$14.7 million, respectively, and reported operating losses (as defined above) of \$.4 million and \$.7 million, respectively. The net investment in assets of these Businesses has decreased during the last three years and the Company expects to realize further reductions in future periods. See "Overview General" for a discussion of the Company's intent to spin off the Automotive Products Business, subject to numerous conditions precedent. The Company continues to eliminate certain categories of machines from the Industrial Products product line by not replacing machines when sold.

#### RESULTS OF OPERATIONS

Three months ended March 31, 1999 vs. Three months ended March 31, 1998.

##### Revenues

Total revenues, excluding the gain on the sale of the Tower, for the three months ended March 31, 1999 and 1998 were \$73.1 million and \$79.0 million, respectively (a decrease of \$5.9 million). Sales decreased \$4.9 million and other income decreased \$1.0 million. The decrease in other income was primarily due to nonrecurring operations of the Tower, sold in March 1998. The Company recognized a pre-tax gain on the sale 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, 1999, were \$73.1 million, compared to \$78.0 million for the first three months of 1998, a decrease of \$4.9 million. This decrease in sales resulted principally from:  
(i) decreased sales in the Climate Control Business of \$3.2 million

due to decreased sales volume in this Business' Heat Pump and Fan Coil product lines, as well as production line changes and training time for new employees which slowed production temporarily, (ii) decreased sales in the Automotive Products Business of \$.4 million which is reasonably consistent with the prior year quarter, and (iii) decreased sales in the Industrial Products Business of \$1.5 million due to decreased sales of machine tools, offset by (iv) increased sales in the Chemical Business of \$4.2 million primarily due to sales of nitric acid products pursuant to the Bayer Agreement (see Note 5 of Notes to Condensed Consolidated Financial Statements), offset by reduced sales of the Australian subsidiary and reduced selling prices on the Company's nitrogen end product due to reduced raw material cost and general supply and demand.

#### Gross Profit

Gross profit was 21.8% for the first three months of 1999, compared to 20.4% for the first three months of 1998. The increase in the gross profit percentage was due primarily to ( ) improved product mix and pricing, as well as reduced costs of component parts, in the Company's heat pump product line, (ii) lower production costs in the Chemical Business due to the effect of lower prices of anhydrous ammonia in 1999, and (iii) improved product mix of machine tools sold.

#### Selling, General and Administrative Expense

Selling, general and administrative ("SG&A") expenses as a percent of net sales were 20.4% in the three-month period ended March 31, 1999, compared to 20.2% for the first three months of 1998. This increase is primarily the result of decreased sales volume in the Climate Control Business, the Industrial Products Business, and the Australian Subsidiary of the Chemical Business, without an equivalent corresponding decrease in SG&A.

#### Interest Expense

Interest expense for the Company was \$4.4 million in the first quarter of 1999, compared to \$4.7 million for the first quarter of 1998. The decrease of \$.3 million primarily resulted from decreased borrowings.

#### Income (Loss) Before Taxes

The Company had a loss before income taxes of \$3.8 million in the first quarter of 1999 compared to income before income taxes of \$9.6 million in the three months ended March 31, 1998. The decreased profitability of \$13.4 million was primarily due to the gain on the sale of the Tower in 1998, and the reduction in other income 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, 1999 and the three months ended March 31, 1998 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, borrowings under its revolving credit facilities, and the issuance of senior unsecured notes by its wholly owned subsidiary, ClimaChem, Inc. in November 1997.

Net cash used by operations for the quarter ended March 31, 1999 was \$6.9 million, after \$3.1 million for noncash depreciation and amortization, \$.4 million in provisions for possible losses on accounts receivable, and including the following changes in assets and liabilities: (i) accounts receivable increases of \$4.6 million; (ii) inventory decreases of \$.6 million; (iii) increases in supplies and prepaid items of \$1.7 million; and (iv) decreases in accounts payable and accrued liabilities of \$1.0 million. The increase in accounts receivable is primarily due to increased sales and increased days of sales outstanding in the Climate Control Business and seasonal sales of agricultural products in the Chemical Business, offset by decreased sales in the Industrial Products Business. The decrease in inventory was due primarily to a decrease at the Automotive Products Business due to liquidation of excessive inventories, offset by increases in the Climate Control Business in anticipation of higher sales volume in the heat pump product lines and increases in the Chemical Business due to reduced sales of the Australian subsidiary. Inventory in the Automotive and Industrial Products Businesses decreased from \$26.3 million at December 31, 1998 to \$24.7 million at March 31, 1999. The decrease in accounts payable and accrued liabilities resulted primarily from a decrease in trade accounts payable balances offset by an increase in accrued interest expense related to senior unsecured notes which is payable semi-annually.

### Cash Flow From Investing And Financing Activities

Cash used by investing activities for the quarter ended March 31, 1999 included \$2.3 million in capital expenditures offset by decreases in other assets of \$1.8 million. The capital expenditures took place primarily in the Chemical and Climate

Control Businesses to enhance production and product delivery capabilities. The decrease in other assets was primarily due to the reduction of deposits made in connection with an interest rate hedge contract related to the leveraged lease of the nitric acid plant in Baytown, Texas.

Net cash provided by financing activities included (i) payments on long-term debt of \$2.5 million, (ii) net increases in revolving debt of \$10.8 million, (iii) decreases in drafts payable of \$.3 million, (iv) dividends of \$.8 million, and (v) treasury stock purchases of \$.2 million.

During the first quarter of 1999, 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.

As of March 31, 1999, the Company and certain of its subsidiaries, including ClimaChem and its subsidiaries were parties to a working capital line of credit evidenced by four separate loan agreements ("Revolving Credit Agreements") with an unrelated lender ("Lender") collateralized by receivables, inventory, and proprietary rights of the Company and the subsidiaries that are parties to the Revolving Credit Agreements and the stock of certain of the subsidiaries that are borrowers under the Revolving Credit Agreements. The Revolving Credit Agreements, as amended, provide for revolving credit facilities ("Revolver") for total direct borrowings up to \$65.0 million, including the issuance of letters of credit. The Revolver provides for advances at varying percentages of eligible inventory and trade receivables. The Revolving Credit Agreements, as amended, provide for interest at the lender's prime rate plus .5% per annum or, at the Company's option, on the Lender's LIBOR rate plus 2.875% per annum. At March 31, 1999, the effective interest rate was 8.3%. The term of the Revolving Credit Agreements is through December 31, 2000, and is renewable thereafter for successive thirteen month terms. At March 31, 1999, the availability for additional borrowings, based on eligible collateral, approximated \$18.7 million. Borrowings under the Revolver outstanding at March 31, 1999, were \$34.9 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; however, with the refinancing of the Automotive Products Business loan agreement as discussed below, the Company's financial covenants are eliminated, so long as the remaining borrowing group maintains a minimum aggregate availability under the Revolving Credit Facility of \$15.0 million. If the Company is unable to maintain aggregate availability of \$15.0 million, the Company would be required to maintain certain financial ratios, including tangible net worth requirements. In April 1999, prior to finalization of the new Automotive financing, the Company obtained waivers of noncompliance and amendments to reset the financial covenants through maturity. The annual interest on the outstanding debt under the Revolver at March 31, 1999 at the rates then in effect would approximate \$2.9 million. The Revolving Credit Agreements also require the payment of an annual facility fee of 0.5% of the unused revolver and restricts the flow of funds, except under certain conditions, to subsidiaries of the Company that are not parties to the Revolving Credit Agreements.

Under the Revolving Credit Agreements discussed above, the Company and its subsidiaries, other than ClimaChem and its subsidiaries, have the right to borrow on a revolving basis up to \$24 million, based on eligible collateral. At March 31, 1999, the Company and its subsidiaries, except ClimaChem and its subsidiaries, had borrowings under the Revolver approximately equal to then eligible collateral (\$16.1 million).

On May 7, 1999, the Company's Automotive Products Business entered into a Loan and Security Agreement (the "Automotive Loan Agreement") with an unrelated lender (the "Automotive Lender") secured by substantially all assets of the Automotive Products Business to refinance the Automotive Products Business' working capital requirements that were previously financed under the Revolver. In addition, the Company was required to provide the Automotive Lender a \$1.0 million standby letter of credit to further secure the Automotive Loan Agreement. As of the funding date, the Automotive Products Business' availability for additional borrowing, based on eligible collateral, was \$3.8 million. The Automotive Loan Agreement provides a Revolving Loan Facility (the "Automotive Revolver"), Letter of Credit Accommodations and a Term Loan (the "Automotive Term Loan").

The Automotive Revolver provides for total direct borrowings up to \$16.0 million, including the issuance of letters of credit. The Automotive Revolver provides for advances at varying percentages of eligible inventory and trade receivables. The Automotive Revolver provides for interest at the rate from time to time publicly announced by First Union National Bank as its prime rate plus one percent (1%) per annum or, at the Company's option, on the Automotive Lender's LIBOR rate plus two and three-quarters percent (2.75%) per annum. The Automotive Revolver also requires the payment of a monthly servicing fee of \$3,000 and a monthly

unused line fee equal to 0.5% of the unused credit facility. At May 10, 1999, the funding date, the effective interest rate was 8.75%. The term of the Automotive Revolver is through May 7, 2001, and is renewable thereafter for successive twelve-month terms.

The Automotive Loan Agreement restricts the flow of funds, except under certain conditions, between the Automotive Products Business and the Company and its subsidiaries.

The Automotive Term Loan is in the amount of \$2,550,000. The Automotive Term Loan is evidenced by a term promissory note (the "Term Promissory Note") and is secured by all the same collateral as the Automotive Revolver. The interest rate of the Automotive Term Loan is the same as the Automotive Revolver discussed above. The terms of the Term Promissory Note require sixty (60) consecutive monthly principal installments (or earlier as provided in the Term Promissory note) of which the first thirty-six (36) installments shall each be in the amount of \$48,611, the next twenty-two (22) installments shall each be in the amount of \$33,333.33, and the last installment shall be in the amount of the entire unpaid principal balance. Interest payments are also required monthly as calculated on the outstanding principal balance. On May 10, 1999, the Automotive Revolver funded approximately \$9.3 million, and the Automotive Term Loan funded \$2,550,000, the aggregate total of approximately \$11.9 million was simultaneously transferred to the lender in payment of the Automotive Products Business' balance under the Revolver.

In addition to the credit facilities discussed above, as of March 31, 1999, 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, 1999, DSN had outstanding borrowings of \$10.3 million under these loans. The loans have repayment schedules of 84 consecutive monthly installments of principal and interest through maturity in 2002. 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, 1999, at the agreed to interest rates would approximate \$.9 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. In April 1999, DSN obtained a waiver of the covenants through June 2000.

As previously discussed, the Company is a holding company and, accordingly, its ability to pay dividends on its outstanding Common Stock and Preferred Stocks is dependent in large part on its ability to obtain funds from its subsidiaries. The ability of the Company's wholly owned subsidiary, ClimaChem (which owns all of the stock of substantially all of the Company's subsidiaries comprising the Chemical Business and the Climate Control Business) and its subsidiaries to transfer funds to the Company is restricted by

certain covenants contained in the Indenture to which they are parties. Under the terms of the Indenture, ClimaChem and its subsidiaries cannot transfer funds to the Company, except for (i) the amount of income taxes that they would be required to pay if they were not consolidated with the Company, (ii) an amount not to exceed fifty percent (50%) of ClimaChem's consolidated 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 and ClimaChem's subsidiaries pursuant to a certain services agreement and a certain management agreement to which the companies are parties. During 1998 and the first quarter of 1999, ClimaChem reported a consolidated net loss of approximately \$2.6 million and \$1.1 million, respectively. Accordingly, ClimaChem and its subsidiaries were unable to transfer funds to the Company in 1998 and the first quarter of 1999, except for reimbursement of costs and expenses incurred by the Company on their behalf or in connection with certain agreements.

Due to ClimaChem's net loss for 1998 and the Company's (other than ClimaChem and its subsidiaries) limited borrowing ability under the Revolver, management is considering, but has not made its final decision, recommending to the Board of Directors that the Company discontinue payment of cash dividends on its Common Stock for periods subsequent to January 1, 1999, until the Board of Directors determines otherwise. In addition, as of the date of this report, management has not determined whether the Company will have adequate liquidity to declare and pay the quarterly dividends on its outstanding Preferred Stock subsequent to the first quarter dividends already declared and paid.

Future cash requirements (other than cash dividends) include working capital requirements for anticipated sales increases in the Company's core 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 reductions in the inventories of the Industrial Products Business and in the inventories of the Automotive Products Business. In addition, the Company is also considering the sale of certain assets which it does not believe are critical to its Chemical and Climate Control Businesses. In 1999, the Company has planned capital expenditures of approximately \$10 million, primarily in the Chemical and Climate Control Businesses, a certain amount of which it anticipates will be financed by equipment finance contracts on a term basis and in a manner allowed under its various loan agreements. Such capital expenditures include approximately \$2.4 million (\$443,000 in the three months ended March 31, 1999), which the Chemical Business anticipates spending related to environmental control facilities at its El Dorado Facility, as previously discussed in this report.



The Company currently has no material commitments for capital expenditures.

During the latter part of March 1999, the Company's management began considering the realignment of certain of the Company's overhead to better match its focus on its core businesses. Consistent with this realignment, in April 1999, the Company's Board of Directors approved the sale of certain assets to ClimaChem in accordance with the terms of the Indenture to which ClimaChem and its subsidiaries are parties to and the loan agreement that the Company and subsidiaries of ClimaChem are borrowing under, which assets are materially related to the lines of businesses of the Chemical and Climate Control Businesses.

Management believes that, based upon the above described plans and changes, the Company will have adequate cash flow from operations, its revolving lines of credit and other sources to meet its present anticipated working capital and debt service requirements.

The spin-off being evaluated by the Company of the Automotive Products Business would be accomplished in the form of a dividend to the holders of the Company's Common Stock and the balance of the amount the Automotive Products Business owes the Company would be evidenced by a promissory note of approximately \$6.0 million. In order to declare and pay a dividend upon shares of capital stock, the Delaware General Corporation Law ("Delaware Law") requires that such either be declared and paid (1) out of "surplus", as defined under the Delaware Law, or (2) in case there is no "surplus", out of net profits of the Company for the fiscal year in which the dividend is declared or the preceding fiscal year. The Company is presently reviewing with its investment banker as to whether it has sufficient "surplus" to accomplish the spin-off of the Automotive Products Business to its holders of its Common Stock after the capital contribution by the Company to the Automotive Products Business as discussed above. The Company does not believe that it will be able to pay such dividend out of net profits. If the Company's investment banker is unable to opine that the Company has sufficient "surplus" to accomplish the spin-off, under Delaware Law the Company could reduce its "capital" (as defined under Delaware Law) represented by issued shares of its capital stock without par value and transfer the amount of such reduction to "surplus", as long as the assets of the Company remaining after such reduction shall be sufficient to pay the Company's debts for which payment has not otherwise been provided. The terms of the Company's Series B 12% Cumulative Convertible Preferred Stock ("Series B Preferred") provides, in part, that "In the event of any voluntary or involuntary liquidation, dissolution or winding up of LSB, or any reduction in its capital resulting in any distribution of assets to its stockholders, the holders of the Series B Preferred Stock shall be entitled to receive in cash out of assets of LSB, whether from capital or from earnings available for distribution to the

stockholders, before any amount shall be paid to the holder of Common Stock of LSB the sum of One Hundred & No/100 Dollars (\$100) (the par value of the Series B Preferred Stock) per share, plus an amount equal to all accumulated and unpaid cash dividends thereon to the date fixed for payment of such distributive amount". Counsel to the Company has advised the Company that a transfer from "capital" to "surplus" to distribute the stock of the Automotive Products Business to the holders of the Company's Common Stock would trigger a payment of \$100 per outstanding share of Series B Preferred. There are currently outstanding 20,000 shares of Series B Preferred, all of which are owned by Jack E. Golsen or members of his immediate family and/or entities wholly owned by members of Mr. Golsen's immediate family. Mr. Golsen has advised the Company that if the Company is required to transfer from "capital" to "surplus" an amount necessary to complete the spin-off and such triggers the payment under the Series B Preferred, he would not require the Company to pay such in cash but would be willing to receive such amount in a form other than cash, with the form to be determined based on negotiations with independent members of the Company's Board of Directors. The Series B Preferred was issued by the Company in 1987 in connection with a transaction approved by the Board of Directors and the stockholders of the Company. Accordingly, as of the date of this report, there are no assurances that the Company will ultimately commit to a formal plan to spin-off the Automotive Products Business.

During 1998 and pursuant to the Company's previously announced repurchase plan, the Company purchased 909,300 shares of Common Stock, for an aggregate purchase price of \$3,567,026. From January 1, 1999, through March 31, 1999, the Company has purchased under its repurchase plan a total of 70,600 shares of Common Stock for an aggregate amount of \$205,234. As of the date of this report, management and the Board of Directors are considering whether to continue with its repurchase plan to purchase shares of its Common Stock and if so, to what extent for the balance of 1999.

#### Foreign Subsidiary

The Company's wholly owned Australian subsidiary, TES, has a revolving credit working capital facility (the "TES Revolving Facility") with Bank of New Zealand, Australia, in the amount of AUS\$10.5 million (approximately US\$6.5 million). The TES Revolving Facility allows for borrowings based on specific percentages of qualified eligible assets. Based on the effective exchange rate at March 31, 1999, approximately US\$7.2 million (AUS\$11.6 million approximately) was borrowed at March 31, 1999. The borrowings include approximately US\$1.2 million of cash disbursements not presented to the bank for payment prior to March 31, 1999. There are no assurances that the bank would have cleared these checks if they were presented for payment; however, TES received adequate customer collection subsequent to March 31, 1999, to provide

availability under their line of credit as such checks were presented for payment. 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 6.87% at March 31, 1999. TES is in technical noncompliance with a certain financial covenant contained in the loan agreement involving the TES Revolving Facility. However, this covenant was not met at the time of closing of this loan and the Bank of New Zealand, Australia has continued to extend credit under the Facility. The outstanding borrowing under the TES Revolving Facility at March 31, 1999 has been classified as due within one year in the accompanying consolidated financial statements. As previously noted in this report, the Company has entered into an agreement to sell certain assets of TES, effectively disposing of this portion of the Chemical Business. If this transaction is finalized, the TES Revolving Facility will be paid off with proceeds from the sale. This transaction is subject to conditions precedent and is expected to be finalized in the second quarter of 1999; however, there are no assurances that the Company will finalize this transaction. Under the terms of the Indenture to which ClimaChem is bound, the net cash proceeds from the sale of TES, if completed, are required (1) within 270 days from the date of the sale to be applied to the redemption of the notes issued under the Indenture or to the repurchase of such notes, or (2) within 240 days from the date of such sale, the amount of the net cash proceeds be invested in a related business of ClimaChem or the Australian subsidiary or used to reduce indebtedness of ClimaChem. As of the date of this report, the Company expects that net proceeds from the possible sale of TES will be reinvested in related businesses of ClimaChem or be used to retire the indebtedness of ClimaChem.

#### Joint Ventures and Options to Purchase

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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. Parties to the option have agreed to extend the exercise date of the option to June 15, 2005. 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 \$1.3 million (\$1.0 million of which is refundable) and has loaned the Optioned Company approximately \$1.4 million. The Company has recorded reserves of \$1.5 million against the loans and option payments. The loans and option payments are secured by the stock and other collateral of the Optioned Company. The Company has determined to not exercise the Option and has allowed the term of the Option to lapse.

#### Debt Guarantee

At December 31, 1998, the Company and one of its subsidiaries had outstanding guarantees of approximately \$2.6 million of indebtedness of a startup aviation company in exchange for an ownership interest in the aviation company of approximately 45%.

During the first quarter of 1999, the Company was called upon to perform on both guarantees. The Company paid approximately \$600,000 to the lender in satisfaction of the guarantee and assumed the obligation for the \$2.0 million note, which is due in equal monthly principal payments, plus interest, through August, 2004. In connection with the demand on the Company to perform under its guarantee, the Company and the other guarantors formed a new company ("KAC") which acquired the assets of the aviation company through foreclosure.

The Company and the other shareholders of KAC are attempting to sell the assets acquired in foreclosure. Proceeds received by the Company, if any, from the sale of KAC assets will be recognized in the results of operations when and if realized.

#### Availability of Company's Loss Carry-overs

The Company anticipates that its cash flow in future years will benefit from its ability to use net operating loss ("NOL") carry-overs from prior periods to reduce the federal income tax payments which it would otherwise be required to make with respect to income generated in such future years. Such benefit, if any is dependent on the Company's ability to generate taxable income in future periods, for which there is no assurance. Such benefit if any, will be limited by the Company's reduced NOL for alternative minimum tax purposes which is approximately \$31.4 million at March 31, 1999. As of December 31, 1998, the Company had available regular tax NOL carry-overs of approximately \$63.8 million based on its federal income tax returns as filed with the Internal Revenue Service for taxable years through 1998. 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 and, accordingly, no assurance can be given that such carry-overs will not be reduced as a result of audits in the future. In addition, the ability of the Company to utilize these carry-overs in the future will be subject to a variety of limitations applicable to corporate taxpayers generally under both the Internal Revenue Code of 1986, as amended, and the Treasury Regulations. These include, in particular, limitations imposed by Code Section 382 and the consolidated return regulations.

#### Year 2000 Issues

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

Beginning in 1996, the Company undertook a project to enhance certain of its Information Technology ("IT") systems and install

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

Starting in 1996 through March 31, 1999, the Company has capitalized approximately \$1.0 million in costs to accomplish its enhancement program. The capitalized costs include \$425,000 in external programming costs, with the remainder representing hardware and software purchases. The Company anticipates that the remaining cost to complete this IT systems enhancement project will be less than \$100,000, and such costs will be capitalized.

The Company's plan to identify and resolve the Year 2000 Issue involved the following phases: assessment, remediation, testing, and implementation. To date, the Company has fully completed its assessment of all systems that could be significantly affected by the Year 2000. Based on assessments, the Company determined that it was required to modify or replace certain portions of its software and hardware so that those systems will properly utilize dates beyond December 31, 1999. For its IT exposures which include financial, order management, and manufacturing scheduling systems, the Company is 100% complete on the assessment and remediation phases. As of the date of this report, the Company has completed its testing and has implemented its remediated systems for all of its businesses except a portion of the Industrial Products Business. The uncompleted testing and remediation procedures represent approximately 2% and 5%, respectively, of the total Year 2000 Program testing and remediation phase. Completion of the remaining testing and implementation phase is expected by August 31, 1999. The assessments also indicated that limited software and hardware (embedded chips) used in production and manufacturing systems ("operating equipment") also are at limited risk. The Company has completed its assessment and identified remedial action which will be completed in the second quarter 1999. In addition, the Company has completed its assessment of its product line and determined that the products it has sold and will continue to sell do not require remediation to be Year 2000 compliant. Accordingly, based on the Company's current assessment, the Company does not believe that the Year 2000 presents a material exposure as it relates to the Company's products.

The Company has queried its significant suppliers, subcontractors, distributors and other third parties (external agents). The Company does not have any direct system interfaces

with external agents. To date, the Company is not aware of any external agent with a Year 2000 Issue that would materially impact the Company's results of operations, liquidity, or capital resources. However, the Company has no means of ensuring that external agents will be Year 2000 ready. The inability of external agents to complete their Year 2000 resolution process in a timely fashion could materially impact the Company. The effect of non-compliance by external agents is not determinable at this time.

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

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

#### Contingencies

The Company has several contingencies that could impact its liquidity in the event that the Company is unsuccessful in defending against the claimants. Although management does not anticipate that these claims will result in substantial adverse impacts on its liquidity, it is not possible to determine the outcome. The preceding sentence is a forward-looking statement that involves a number of risks and uncertainties that could cause actual results to differ materially, such as, among other factors, the following: the EIL Insurance does not provide coverage to the Company and the Chemical Business for any material claims made by the claimants, the claimants alleged damages are not covered by the EIL Policy which a court may find the Company and/or the Chemical Business liable for, such as punitive damages or penalties, a court finds the Company and/or the Chemical Business liable for damages to such claimants for a material amount in excess of the limits of coverage of the EIL Insurance or a court finds the Chemical Business liable for a material amount of damages in the antitrust lawsuits pending against the Chemical Business in a manner not presently anticipated by the Company. See Note 5 of Notes to Condensed Consolidated Financial Statements.

## Quantitative and Qualitative Disclosures about Market Risk

### General

The Company's results of operations and operating cash flows are impacted by changes in market interest rates and raw material prices for products used in its manufacturing processes. The Company also has a wholly owned subsidiary in Australia, for which the Company has foreign currency translation exposure. The derivative contracts used by the Company are entered into to hedge these risks and exposures and are not for trading purposes. All information is presented in U. S. dollars. See Note 9 of Notes to Consolidated Financial Statements for a discussion of the Australian subsidiary in 1999.

### Interest Rate Risk

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

Reference is made to the Company's Annual Report on Form 10-K for the year ended December 31, 1998, for an expanded analysis of expected maturities of long-term debt and its weighted average interest rates and discussion related to raw material price risk.

As of March 31, 1999, the Company's variable rate and fixed rate debt which aggregated \$180.3 million exceeded the debt's fair market value by approximately \$3.2 million. The fair value of the Company's Senior Notes was determined based on a market quotation for such securities.

The Company is also a party to a series of agreements under which, upon completion of construction, it will lease a nitric acid plant. The minimum lease payments associated therewith until execution will be directly impacted by the change in interest rates. To mitigate a portion of the Company's exposure to adverse market changes related to this leveraged lease, in 1997 the Company entered into an interest rate forward agreement whereby the Company is the fixed rate payor on notional amounts aggregating \$25 million, net to its 50% interest, with a weighted average interest rate of 7.12%. The Company accounts for this forward under the deferral method, so long as high correlation is maintained, whereby the net gain or loss upon settlement will adjust the item being hedged, the minimum lease rentals, in periods commencing with the lease execution. As of March 31, 1999, the fair value of this interest rate forward agreement represented a liability of



approximately \$2.6 million (\$3.3 million at December 31, 1998) net to the Company's 50% interest.

#### Foreign Currency Risk

The Company has a wholly owned subsidiary located in Australia, for which the functional currency is the local currency, the Australian dollar. Since the Australian subsidiary accounts are converted into U.S. dollars upon consolidation using the end of the period exchange rate, declines in value of the Australian dollar to the U.S. dollar result in translation loss to the Company. Additionally, any cumulative foreign currency translation loss will impact operating results in the period the Company sells or disposes of substantially all of its investment in the subsidiary. As of March 31, 1999, the Company's net investment in this Australian subsidiary was \$5.7 million (\$5.8 million at December 31, 1998) with the cumulative translation loss not recognized in results of operations aggregating approximately \$1.3 million (\$1.6 million at December 31, 1998).



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) establishing a position as a market leader, (iii) construction costs of the EDNC Baytown Plant will approximate \$69 million and will be completed by the second quarter of 1999, (iv) delay in completing the Baytown Plant as scheduled will not result in material losses, (v) the sale of substantially all of the assets of the Company's Australian subsidiary, (vi) payment of dividends on Common Stock and Preferred Stock, (vii) availability of net operating loss carryovers, (viii) amount to be spent in 1999 relating to compliance with federal, state and local Environmental laws at the El Dorado Facility, (ix) Year 2000 issues, (x) improving liquidity and profits through liquidation of assets or realignment of assets, (xi) the Company's ability to develop or adopt new and existing technologies in the conduct of its operations, (xii) anticipated financial performance, (xiii) ability to comply with the Company's general working capital and debt service requirements, (xiv) spin-off the Automotive Products Business, (xv) ability to be able to continue to borrow under the Company's revolving line of credit, and (xvi) ability of the EDNC Baytown Plant to generate \$35 to \$50 million in gross revenues once operational. 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) material increase in interest rates; (iv) inability to collect in a timely manner a material amount of receivables, (v) increased competitive pressures, (vi) inability to meet the "Year 2000" compliance of the computer system by the Company, its key suppliers, customers, creditors, and financial service organization, (vii) changes in federal, state and local laws and regulations, especially environmental regulations, or in interpretation of such, pending (viii) additional releases (particularly air emissions into the environment), (ix) potential increases in equipment, maintenance, operating or labor costs not

presently anticipated by the Company, (x) inability to retain management or to develop new management, (xi) the requirement to use internally generated funds for purposes not presently anticipated, (xii) inability to become profitable, or if unable to become profitable, the inability to secure additional liquidity in the form of additional equity or debt, (xiii) the effect of additional production capacity of anhydrous ammonia in the western hemisphere, (xiv) the cost for the purchase of anhydrous ammonia increasing or the Company's inability to purchase anhydrous ammonia on favorable terms when a current supply contract terminates, (xv) changes in competition, (xvi) the loss of any significant customer, (xvii) changes in operating strategy or development plans, (xviii) inability to fund the working capital and expansion of the Company's businesses, (xix) adverse results in any of the Company's pending litigation, (xx) inability to obtain necessary raw materials, (xxi) inability to satisfy the NYSE continued listing requirements, (xxii) inability to complete the spinoff due to inability to obtain (a) required tax ruling or opinion, (b) necessary approvals by the Securities and Exchange Commission ("SEC") as to certain documents required to be filed with the SEC relating to the spin-off, (c) certain opinions from financial advisors, (d) unqualified audit report from the Company's auditors as to the Automotive Products Business, and (e) satisfactory resolution of a possible distribution to an outstanding series of preferred stock in connection with the spinoff; (xxiii) inability to recover the Company's investment in the aviation company, (xxiv) inability to finalize the sale of TES due to the Australian government's failure to approve the sale or the potential buyer's inability or refusal to complete the sale; (xxv) Bayer's inability or refusal to purchase all of the Company's production at the new Baytown nitric acid plant; (xvii) material increases in equipment, maintenance, operating or labor costs not presently anticipated by the Company; and (xxiii) other factors described "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, 1999, and the related condensed consolidated statements of operations and cash flows for the three month periods ended March 31, 1999 and 1998. 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, 1998, 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 February 19, 1999, except for paragraphs (A) and (C) of Note 5 and Note 14, as to which the date is April 14, 1999, 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, 1998, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

ERNST & YOUNG LLP

Oklahoma City, Oklahoma  
May 14, 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, 1998, which Item 3 is incorporated by reference herein.

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

- (A) On May 7, 1999, the Company's wholly owned Australian subsidiary entered into an agreement (the "Asset Sale Agreement") to sell substantially all of its assets. The Asset Sale Agreement is subject to certain conditions precedent; however, the Company expects to finalize the Asset Sale Agreement in the second quarter of 1999. There are no assurances that the Company will finalize the Asset Sale Agreement. See Note 9 of Notes to Condensed Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations of this report for further information concerning the Asset Sale Agreement.
- (B) On May 7, 1999, the Company's Automotive Products Business entered into a Loan and Security Agreement (the "Automotive Loan Agreement") with an unrelated lender. The Automotive Loan Agreement consists of a Revolving Loan Facility (the "Automotive Revolver"), Letter of Credit Accommodations and a Term Loan (the "Automotive Term Loan"). The Automotive Revolver provides for total direct borrowings up to \$16.0 million consisting of advances based on varying percentages of eligible inventory and trade receivables. The Automotive Term Loan is in the amount of \$2,550,000 and requires



repayment in monthly installments of principal and interest. The Automotive Products Business has secured the Automotive Loan Agreement with substantially all of its assets, and the Company has provided the lender with a \$1.0 million standby letter of credit to secure the Automotive Loan Agreement. See Note 9 of Notes to Condensed Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations of this report for further discussion concerning the Automotive Loan Agreement.

Item 6. Exhibits and Reports on Form 8-K

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

- 4.1 Loan and Security Agreement, dated May 7, 1999, by and between Congress Financial Corporation and L&S Automotive Products Co., International Bearings, Inc., L&S Bearing Co., LSB Extrusion Co., Rotex Corporation, and Tribonetics Corporation.
- 4.2 Termination and Mutual General Release Agreement, dated as of May 10, 1999, by and among L&S Bearing Co., L&S Automotive Products Co., LSB Extrusion Co., Rotex Corporation, Tribonetics Corporation, International Bearings, Inc., and Bank of America National Trust and Savings Association (successor-in-interest to BankAmerica Business Credit, Inc.).
- 4.3 Letter Agreement, dated April 30, 1999, by and among Bank of America National Trust and Savings Association (successor-in-trust to BankAmerica Business Credit, Inc.), L&S Bearing Co., LSB Extrusion Co., Tribonetics Corporation, Rotex Corporation, L&S Automotive Products Co., International Bearings, Inc., and Congress Financial Corporation.
- 10.1 Asset Purchase Agreement, dated May 7, 1999, between Quantum Explosives Pty. Limited and Total Energy Systems Limited, Total Energy Systems (International) Pty. Ltd. and Total Energy Systems (NZ) Limited. CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST.

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, 1999.



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 21st day of May 1999.

LSB INDUSTRIES, INC.

By: /s/ Tony M. Shelby

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

By: /s/ Jim D. Jones

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

EXHIBIT INDEX

Exhibit No.	Description	Sequential Page No.
4.1	Loan and Security Agreement, dated May 7, 1993, by and between Congress Financial Corporation and L&S Automotive Products Co., International Bearings, Inc., L&S Bearing Co., LSB Extrusion Co., Rotex Corporation, and Tribonetics Corporation.	49
4.2	Termination and Mutual General Release Agreement, dated as of May 10, 1993, by and among L&S Bearing Co., L&S Automotive Products Co., LSB Extrusion Co., Rotex Corporation, Tribonetics Corporation, International Bearings, Inc., and Bank of America National Trust and Savings Association (successor-in-interest to BankAmerica Business Credit, Inc.).	111
4.3	Letter Agreement, dated April 30, 1999, by and among Bank of America National Trust and Savings Association (successor-in-trust to BankAmerica Business Credit, Inc.), L&S Bearing Co., LSB Extrusion Co., Tribonetics Corporation, Rotex Corporation, L&S Automotive Products Co., International Bearings, Inc., and Congress Financial Corporation.	116
10.1	Asset Purchase Agreement, dated May 7, 1999, between Quantum Explosives Pty. Limited and Total Energy Systems Limited, Total Energy Systems (Internation) Pty. Ltd. and Total Energy Systems (NZ) Limited. CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST.	120
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Loan and Security Agreement

by and between

CONGRESS FINANCIAL CORPORATION (SOUTHWEST)

as Lender

and

L&S AUTOMOTIVE PRODUCTS CO.  
TRIBONETICS CORPORATION  
L&S BEARING CO.  
LSB EXTRUSION CO.  
ROTEX CORPORATION

AND

INTERNATIONAL BEARINGS, INC.

as Borrowers

Dated: May 7, 1999

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LOAN AND SECURITY AGREEMENT

THIS LOAN AND SECURITY AGREEMENT dated May 7, 1999, is entered into by and between Congress Financial Corporation (Southwest), a Texas corporation ("Lender") and L&S Automotive Products Co. ("LSAP"), a Delaware corporation, International Bearings, Inc. ("IBI"), an Oklahoma corporation, L&S Bearing Co. ("L&SB"), an Oklahoma corporation, LSB Extrusion Co. ("LSBE"), an Oklahoma corporation, Rotex Corporation ("Rotex"), an Oklahoma corporation, and Tribonetics Corporation ("Tribonetics"), an Oklahoma corporation (LSAP, IBI, L&SB, LSBE, Rotex and Tribonetics are individually, collectively and jointly and severally herein referred to as "Borrower" or the "Borrowers").

W I T N E S S E T H:

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WHEREAS, Borrowers have requested that Lender enter into certain financing arrangements with Borrowers pursuant to which Lender may make loans and provide other financial accommodations to each Borrower; on the terms and conditions set forth herein; and

WHEREAS, Lender is willing to make such loans and provide such financial accommodations on the terms and conditions set forth herein;

NOW, THEREFORE, in consideration of the mutual conditions and agreements set forth herein, and for other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties hereto agree as follows:

SECTION 1. DEFINITIONS

All terms used herein which are defined in Article 1 or Article 9 of the Uniform Commercial Code shall have the meanings given therein unless otherwise defined in this Agreement. All references to the plural herein shall also mean the singular and to the singular shall also mean the plural unless the context otherwise requires. All references to Borrowers and Lender pursuant to the definitions set forth in the recitals hereto, or to any other person herein, shall include their respective successors and assigns. The words "hereof", "herein", "hereunder", "this Agreement" and words of similar import when used in this Agreement shall refer to this Agreement as a whole and not any particular provision of this Agreement. Any reference to this Agreement or any other Financing Agreement shall mean such agreement as now exists or may hereafter be amended, modified, supplemented, extended, renewed, restated or replaced. The word "including" when used in this Agreement shall mean "including, without limitation". An Event of Default shall exist or continue or be continuing until such Event of Default is waived in accordance with Section 11.3, is cured pursuant to the terms of this Agreement, or is cured in a manner satisfactory to Lender, if such Event of Default is capable of being cured as determined by Lender. Any accounting term used herein unless otherwise defined in this Agreement shall have the

meanings customarily given to such term in accordance with GAAP. For purposes of this Agreement, the following terms shall have the respective meanings given to them below:

1.1 "Accounts" shall mean all present and hereafter arising rights of each Borrower to payment for goods sold or leased or for services rendered, which are not evidenced by instruments or chattel paper, and whether or not earned by performance.

1.2 "Adjusted Eurodollar Rate" shall mean, with respect to each Interest Period for any Eurodollar Rate Loan, the rate per annum (rounded upwards, if necessary, to the next one-sixteenth (1/16) of one (1%) percent) determined by dividing (a) the Eurodollar Rate for such Interest Period by (b) a percentage equal to: (i) one (1) minus (ii) the Reserve Percentage. For purposes hereof, "Reserve Percentage" shall mean the reserve percentage, expressed as a decimal, prescribed by any United States or foreign banking authority for determining the reserve requirement which is or would be applicable to deposits of United States dollars in a non-United States or an international banking office of Reference Bank used to fund a Eurodollar Rate Loan or any Eurodollar Rate Loan made with the proceeds of such deposit, whether or not the Reference Bank actually holds or has made any such deposits or loans. The Adjusted Eurodollar Rate shall be adjusted on and as of the effective day of any change in the Reserve Percentage.

1.3 "Availability Reserves" shall mean, as of any date of determination, such amounts as Lender may from time to time establish and revise in good faith reducing the amount of Revolving Loans and Letter of Credit Accommodations which would otherwise be available to Borrowers under the lending formula(s) provided for herein: (a) to reflect events, conditions, contingencies or risks which, as determined by Lender in good faith, adversely affect or may adversely affect either (i) the Collateral or any other property which is security for the Obligations or its value, (ii) the assets or business of Borrowers or any Obligor when taken as a whole, or (iii) the security interests and other rights of Lender in the Collateral (including the enforceability, perfection and priority thereof) or (b) to reflect Lender's good faith belief that any collateral report or financial information furnished by or on behalf of Borrowers or any Obligor to Lender is or may have been incomplete, inaccurate or misleading in any material respect or (c) to reflect outstanding Letter of Credit Accommodations as provided in Section 2.2 hereof or (d) in respect of any state of facts which Lender determines in good faith constitutes an Event of Default, or may, with notice or passage of time or both, constitute an Event of Default.

1.4 "Blocked Accounts" shall have the meaning set forth in Section 6.3 hereof.

1.5 "Business Day" shall mean any day other than a Saturday, Sunday, or other day on which commercial banks are authorized or required to close under the laws of the State of New York or the State of North Carolina, and a day on which the Reference Bank and Lender are open for the transaction of business, except that if a determination of a Business Day shall relate to any Eurodollar Rate Loans, the term Business Day shall also exclude any day on which

banks are closed for dealings in dollar deposits in the London interbank market or other applicable Eurodollar Rate market.

1.6 "Code" shall mean the Internal Revenue Code of 1986, as the same now exists or may from time to time hereafter be amended, modified, recodified or supplemented, together with all rules, regulations and interpretations thereunder or related thereto.

1.7 "Collateral" shall have the meaning set forth in Section 5 hereof.

1.8 "Collateral Letter of Credit" shall mean the standby letter of credit dated on or about the date hereof issued for the account of LSB Industries, Inc. ("LSB") by Bank America Los Angeles (or another issuer acceptable to Lender) in the amount of \$1,000,000 for the benefit of Lender substantially in the form of Exhibit B.

1.9 "Distribution Agreement" shall mean (a) a fully executed Distribution Agreement substantially in the form of the draft of Distribution Agreement attached hereto as Schedule 1.9 between Guarantor and LSB, and (b) all attachments and exhibits to such agreement and all other agreements, leases and other documents, executed in connection therewith in substantially the same form as the attachments, exhibits, agreements, leases and other documents attached hereto as Schedule 1.9.

1.10 "Eligible Accounts" shall mean Accounts created by any Borrower which are and continue to be acceptable to Lender based on the criteria set forth below. In general, Accounts shall be Eligible Accounts if:

(a) such Accounts arise from the actual and bona fide sale and delivery of goods by Borrowers or rendition of services by Borrowers in the ordinary course of their business which transactions are completed in accordance with the terms and provisions contained in any documents related thereto;

(b) such Accounts (i) are Accounts of Advance Stores Co., Inc. ("Advance"), Western Auto Supply Co., Inc. ("Western"), or other account debtors approved by Lender (such Accounts being hereinafter collectively referred to as the "Advance Auto Accounts") which are not unpaid more than one-hundred eighty (180) days after the date of the original invoice for them or thirty (30) days after the due date for them, whichever is earlier, or (ii) such Accounts are not Advance Accounts and are not unpaid more than one-hundred twenty (120) days after the date of the original invoice for them or sixty (60) days after the due date for them, whichever is earlier;

(c) such Accounts do not arise from sales on consignment, guaranteed sale, sale and return, sale on approval, or other terms under which payment by the account debtor may be conditional or contingent;

(d) the chief executive office of the account debtor with respect to such Accounts is located in the United States of America, Puerto Rico or Canada; or, if the chief executive office of account debtor is located outside the United States of America, Puerto Rico or Canada either: (i) the account debtor has delivered to Borrower an irrevocable letter of credit issued or confirmed by a bank satisfactory to Lender and payable only in the United States of America and in U.S. dollars, sufficient to cover such Account, in form and substance satisfactory to Lender and, if required by Lender, the original of such letter of credit has been delivered to Lender or Lender's agent and the issuer thereof notified of the assignment of the proceeds of such letter of credit to Lender, or (ii) such Account is subject to credit insurance payable to Lender issued by an insurer and on terms and in an amount acceptable to Lender, or (iii) such Account is otherwise acceptable in all respects to Lender (subject to such lending formula with respect thereto as Lender may determine);

(e) such Accounts do not consist of progress billings, bill and hold invoices or retainage invoices, except as to bill and hold invoices, if Lender shall have received an agreement in writing from the account debtor, in form and substance satisfactory to Lender, confirming the unconditional obligation of the account debtor to take the goods related thereto and pay such invoice;

(f) the account debtor with respect to such Accounts has not asserted a counterclaim, defense or dispute and does not have any right of setoff against such Accounts (but the portion of the Accounts of such account debtor in excess of the amount at any time and from time to time owed by Borrower to such account debtor or claimed owed by such account debtor may be deemed Eligible Accounts);

(g) there are no facts, events or occurrences which would impair the validity, enforceability or collectability of such Accounts or reduce the amount payable or delay payment thereunder;

(h) such Accounts are subject to the first priority, valid and perfected security interest of Lender and any goods giving rise thereto are not, and were not at the time of the sale thereof, subject to any liens except those permitted in this Agreement;

(i) the account debtor with respect to such Accounts is not affiliated with any Borrower directly or indirectly by virtue of family membership, ownership, control, management or otherwise;

(j) the account debtors with respect to such Accounts are not any foreign government, the United States of America, any State, political subdivision, department, agency or instrumentality thereof, unless, if the account debtor is the United States of America, any State, political subdivision, department, agency or instrumentality thereof, upon Lender's request, the Federal Assignment of Claims Act of 1940, as amended or any similar State or local law, if applicable, has been complied with in a manner satisfactory to Lender;



(k) there are no proceedings or actions to the knowledge of Borrowers or Lender which are threatened or pending against the account debtors with respect to such Accounts which might result in any material adverse change in any such account debtor's financial condition;

(l) (i) for Accounts which are not Advance Auto Accounts or Accounts described in subsection (iii) hereof, such Accounts of a single account debtor or its affiliates do not constitute more than ten percent (10%) percent of all otherwise Eligible Accounts (but the portion of the Accounts not in excess of such percentage may be deemed Eligible Accounts, in Lender's discretion); (ii) for Accounts which are Advance Auto Accounts, such Accounts do not constitute more than fifty percent (50%) of all otherwise Eligible Accounts (but the portion of the Accounts not in excess of such percentage may be deemed Eligible Accounts, in Lender's discretion); and (iii) for Accounts of Dexter Axle, a division of Tomkins Industries, and FMC Corporation, the Accounts of each such account debtor do not constitute more than fifteen percent (15%) of all otherwise Eligible Accounts (but the portion of the Accounts not in excess of such percentage may be deemed Eligible Accounts, in Lender's discretion);

(m) (i) for Accounts which are not Advance Auto Accounts, such Accounts are not owed by an account debtor who has Accounts unpaid more than one hundred twenty (120) days after the date of the original invoice for them or sixty (60) days after the due date for them, whichever is earlier and which such Accounts constitute more than fifty percent (50%) of the total Accounts of such account debtor; (ii) for Advance Auto Accounts, such Accounts are not owed by an account debtor who has Accounts unpaid more than one-hundred eighty (180) days after the date of the original invoice for them or thirty (30) days after the due date for them, whichever is earlier and which such Accounts constitute more than twenty-five percent (25%) of the total Accounts of such account debtor;

(n) such Accounts are owed by account debtors whose total indebtedness to Borrower does not exceed the credit limit with respect to such account debtors as determined by Lender from time to time (but the portion of the Accounts not in excess of such credit limit may be deemed Eligible Accounts);

(o) such Accounts are owed by account debtors deemed creditworthy at all times by Lender, as determined by Lender; and

(p) the principal office, assets or place of business of the account debtors with respect to such Accounts are not outside the United States, Puerto Rico or Canada (or as otherwise provided in the Section 1.11(d)).

General criteria for Eligible Accounts may be established and revised from time to time by Lender in good faith. Any Accounts which are not Eligible Accounts shall nevertheless be part of the Collateral.

1.11 "Eligible Inventory" shall mean Inventory consisting of finished goods held for resale in the ordinary course of the business of any Borrower and raw materials for such finished goods, (including raw materials stored or held by any Borrower in the work in progress area of such Borrower but which are not characterized as work in progress for accounting purposes) which are acceptable to Lender based on the criteria set forth below. In general, Eligible Inventory shall not include (a) work-in-process; (b) components which are not part of finished goods and which are not otherwise acceptable to Lender; (c) spare parts for Equipment; (d) packaging and shipping materials; (e) supplies used or consumed in Borrower's business; (f) Inventory at premises other than those owned and controlled by any Borrower, except if Lender shall have received an agreement in writing from the person in possession of such Inventory and/or the owner or operator of such premises in form and substance satisfactory to Lender acknowledging Lender's first priority security interest in the Inventory, waiving security interests and claims by such person against the Inventory and permitting Lender access to, and the right to remain on, for a reasonable period of time, the premises so as to exercise Lender's rights and remedies and otherwise deal with the Collateral; (g) Inventory subject to a security interest or lien in favor of any person other than Lender except those permitted in this Agreement; (h) bill and hold goods; (i) unserviceable, obsolete or slow moving Inventory; (j) Inventory which is not subject to the first priority, valid and perfected security interest of Lender; (k) defective returned, damaged and/or defective Inventory; and (l) Inventory purchased or sold on consignment. General criteria for Eligible Inventory may be established and revised from time to time by Lender in good faith. Any Inventory which is not Eligible Inventory shall nevertheless be part of the Collateral.

1.12 "Environmental Laws" shall mean all foreign, Federal, State and local laws (including common law), legislation, rules, codes, licenses, permits (including any conditions imposed therein), authorizations, judicial or administrative decisions, injunctions or agreements between any Borrower and any governmental authority, (a) relating to pollution and the protection, preservation or restoration of the environment (including air, water vapor, surface water, ground water, drinking water, drinking water supply, surface land, subsurface land, plant and animal life or any other natural resource), or to human health or safety, (b) relating to the exposure to, or the use, storage, recycling, treatment, generation, manufacture, processing, distribution, transportation, handling, labeling, production, release or disposal, or threatened release, of Hazardous Materials, or (c) relating to all laws with regard to recordkeeping, notification, disclosure and reporting requirements respecting Hazardous Materials. The term "Environmental Laws" includes (i) the Federal Comprehensive Environmental Response, Compensation and Liability Act of 1980, the Federal Superfund Amendments and Reauthorization Act, the Federal Water Pollution Control Act of 1972, the Federal Clean Water Act, the Federal Clean Air Act, the Federal Resource Conservation and Recovery Act of 1976 (including the Hazardous and Solid Waste Amendments thereto), the Federal Solid Waste Disposal and the Federal Toxic Substances Control Act, the Federal Insecticide, Fungicide and Rodenticide Act, and the Federal Safe Drinking Water Act of 1974, (ii) applicable state counterparts to such laws, and (iii) any common law or equitable doctrine that may impose liability or obligations for injuries or damages due to, or threatened as a result of, the presence of or exposure to any Hazardous Materials.

1.13 "Equipment" shall mean all of each Borrower's now owned and hereafter acquired equipment, machinery, computers and computer hardware and software (whether owned or licensed), vehicles, tools, furniture, fixtures, all attachments, accessions and property now or hereafter affixed thereto or used in connection therewith, and substitutions and replacements thereof, wherever located.

1.14 "ERISA" shall mean the United States Employee Retirement Income Security Act of 1974, as the same now exists or may hereafter from time to time be amended, modified, recodified or supplemented, together with all rules, regulations and interpretations thereunder or related thereto.

1.15 "ERISA Affiliate" shall mean any person required to be aggregated with any Borrower or any of its subsidiaries under Sections 414(b), 414(c), 414(m) or 414(o) of the Code.

1.16 "Eurodollar Rate Loans" shall mean any Loans or portion thereof on which interest is payable based on the Adjusted Eurodollar Rate in accordance with the terms hereof.

1.17 "Eurodollar Rate" shall mean with respect to the Interest Period for a Eurodollar Rate Loan, the interest rate per annum equal to the arithmetic average of the rates of interest per annum (rounded upwards, if necessary, to the next one-sixteenth (1/16) of one percent (1%)) at which Reference Bank is offered deposits of United States dollars in the London interbank market (or other Eurodollar Rate market selected by Borrowers and approved by Lender) on or about 9:00 a.m. (New York time) two (2) Business Days prior to the commencement of such Interest Period in amounts substantially equal to the principal amount of the Eurodollar Rate Loans requested by and available to Borrowers in accordance with this Agreement, with a maturity of comparable duration to the Interest Period selected by Borrowers.

1.18 "Event of Default" shall mean the occurrence or existence of any event or condition described in Section 10.1 hereof.

1.19 "Excess Availability" shall mean the amount, as determined by Lender, calculated at any time, equal to: (a) the lesser of: (i) the amount of the Revolving Loans available to Borrowers as of such time based on the applicable lending formulas multiplied by the Net Amount of Eligible Accounts and the Value of Eligible Inventory, as determined hereunder, and subject to the sublimits and Availability Reserves from time to time established by Lender hereunder, and (ii) the Maximum Credit (less the then outstanding principal amount of the Term Loan), minus (b) the sum of: (i) the amount of all then outstanding and unpaid Obligations (but not including for this purpose the then outstanding principal amount of the Term Loan), plus (ii) the aggregate amount of all then outstanding and unpaid trade payables of Borrowers which are more than sixty (60) days past due as of such time, plus (iii) the amount of checks issued by Borrowers to pay trade payables, but not yet sent, plus (iv) the book overdraft of Borrowers (in the aggregate), in excess of \$750,000.

1.20 "Financing Agreements" shall mean, collectively, this Agreement and all notes, guarantees, security agreements and other agreements, documents and instruments now or at any time hereafter executed and/or delivered by Borrowers or any Obligor in connection with this Agreement, as the same now exist or may hereafter be amended, modified, supplemented, extended, renewed, restated or replaced.

1.21 "GAAP" shall mean generally accepted accounting principles in the United States of America as in effect from time to time as set forth in the opinions and pronouncements of the Accounting Principles Board and the American Institute of Certified Public Accountants and the statements and pronouncements of the Financial Accounting Standards Board which are applicable to the circumstances as of the date of determination consistently applied, except that, for purposes of Section 9.15 hereof, GAAP shall be determined on the basis of such principles in effect on the date hereof and consistent with those used in the preparation of the audited financial statements delivered to Lender prior to the date hereof.

1.22 "Guarantor" shall mean LSA Technologies Inc., a Delaware corporation.

1.23 "Guaranty" shall mean that certain Guarantee, of even date with this Agreement, from the Guarantor guaranteeing the Obligations of each and every Borrower to the Lender, as amended, modified, supplemented, extended, renewed, restated or replaced.

1.24 "Hazardous Materials" shall mean any hazardous, toxic or dangerous substances, materials and wastes, including hydrocarbons (including naturally occurring or man-made petroleum and hydrocarbons), flammable explosives, asbestos, urea formaldehyde insulation, radioactive materials, biological substances, polychlorinated biphenyls, pesticides, herbicides and any other kind and/or type of pollutants or contaminants (including materials which include hazardous constituents), sewage, sludge, industrial slag, solvents and/or any other similar substances, materials, or wastes and including any other substances, materials or wastes that are or become regulated under any Environmental Law (including any that are or become classified as hazardous or toxic under any Environmental Law).

1.25 "Information Certificate" shall mean the Information Certificate of Borrowers constituting Exhibit A hereto containing material information with respect to Borrowers, their business and assets provided by or on behalf of Borrowers to Lender in connection with the preparation of this Agreement and the other Financing Agreements and the financing arrangements provided for herein.

1.26 "Interest Period" shall mean for any Eurodollar Rate Loan, a period of approximately one (1), two (2), or three (3) months duration as Borrowers may elect, the exact duration to be determined in accordance with the customary practice in the applicable Eurodollar Rate market; provided, that, Borrowers may not elect an Interest Period which will end after the last day of the then-current term of this Agreement.

1.27 "Interest Rate" shall mean, as to Prime Rate Loans, a rate of one percent (1%) per annum in excess of the Prime Rate and, as to Eurodollar Rate Loans, a rate of two and three-quarters percent (2.75%) per annum in excess of the Adjusted Eurodollar Rate (based on the Eurodollar Rate applicable for the Interest Period selected by Borrowers as in effect three (3) Business Days after the date of receipt by Lender of the request of Borrowers for such Eurodollar Rate Loans in accordance with the terms hereof, whether such rate is higher or lower than any rate previously quoted to Borrowers); provided, that, the Interest Rate shall mean the rate of three percent (3%) per annum in excess of the Prime Rate as to Prime Rate Loans and the rate of four and three-quarters percent (4.75%) per annum in excess of the Adjusted Eurodollar Rate as to Eurodollar Rate Loans, at Lender's option, without notice, (a) for the period (i) from and after the date of termination until Lender has received full and final payment of all Obligations (notwithstanding entry of a judgment against Borrowers) and (ii) from and after the date of the occurrence of an Event of Default for so long as such Event of Default is continuing as determined by Lender, and (b) on the Revolving Loans at any time outstanding in excess of the amounts available to Borrowers under Section 2 (whether or not such excess(es), arise or are made with or without Lender's knowledge or consent and whether made before or after an Event of Default).

1.28 "Inventory" shall mean all of each Borrower's now owned and hereafter existing or acquired raw materials, work in process, finished goods and all other inventory of whatsoever kind or nature, wherever located.

1.29 "LSB" shall mean LSB Industries, Inc., a Delaware corporation.

1.30 "Letter of Credit Accommodations" shall mean the letters of credit, merchandise purchase or other guaranties which are from time to time either (a) issued or opened by Lender for the account of any Borrower or Borrowers or any Obligor or (b) with respect to which Lender has agreed to indemnify the issuer or guaranteed to the issuer the performance by any Borrower or Borrowers of its or their obligations to such issuer.

1.31 "Loans" shall mean the Revolving Loans and the Term Loan.

1.32 "Maximum Credit" shall mean the amount of \$18,550,000.

1.33 "Maximum Legal Rate" shall have the meaning set forth in Section 3.1 hereof.

1.34 "Net Amount of Eligible Accounts" shall mean the gross amount of Eligible Accounts less (a) sales, excise or similar taxes included in the amount thereof and (b) returns, discounts, claims, credits (including unissued credits) and allowances of any nature at any time issued, owing, granted, outstanding, available or claimed with respect thereto.

1.35 "Net Worth" shall mean as to any Person, at any time, in accordance with GAAP (except as otherwise specifically set forth below), on a consolidated basis for such Person and its

subsidiaries (if any), the amount equal to: (a) the difference between: (i) the aggregate net book value of all assets of such Person and its subsidiaries, calculating the book value of inventory for this purpose on a first-in-first-out basis, after deducting from such book values all appropriate reserves in accordance with GAAP (including all reserves for doubtful receivables, obsolescence, depreciation and amortization) and (ii) the aggregate amount of the indebtedness and other liabilities of such Person and its subsidiaries (including tax and other proper accruals) less (b) the value of any asset of such Person arising from the conversion of any indebtedness or other liability of such Person to equity.

1.36 "Obligations" shall mean any and all Revolving Loans, the Term Loan, Letter of Credit Accommodations and all other obligations, liabilities and indebtedness of every kind, nature and description owing by each and every Borrower to Lender and/or its affiliates, including principal, interest, charges, fees, costs and expenses, however evidenced, whether as principal, surety, endorser, guarantor or otherwise, whether arising under the Financing Agreements, whether now existing or hereafter arising, whether arising before, during or after the initial or any renewal term of this Agreement or after the commencement of any case with respect to any such Borrower under the United States Bankruptcy Code or any similar statute (including the payment of interest and other amounts which would accrue and become due but for the commencement of such case, whether or not such amounts are allowed or allowable in whole or in part in such case), whether direct or indirect, absolute or contingent, joint or several, due or not due, primary or secondary, liquidated or unliquidated, secured or unsecured.

1.37 "Obligor" shall mean any guarantor, endorser, acceptor, surety or other person liable on or with respect to the Obligations or who is the owner of any property which is security for the Obligations, other than any Borrower.

1.38 "Payment Account" shall have the meaning set forth in Section 6.3 hereof.

1.39 "Person" or "person" shall mean any individual, sole proprietorship, partnership, corporation (including any corporation which elects subchapter S status under the Internal Revenue Code of 1986, as amended), limited liability company, limited liability partnership, business trust, unincorporated association, joint stock corporation, trust, joint venture or other entity or any government or any agency or instrumentality or political subdivision thereof.

1.40 "Prime Rate" shall mean the rate from time to time publicly announced by First Union National Bank or its successors, at its office in Charlotte, North Carolina, as its prime rate, whether or not such announced rate is the best rate available at such bank.

1.41 "Prime Rate Loans" shall mean any Loans or portion thereof on which interest is payable based on the Prime Rate in accordance with the terms thereof.

1.42 "Records" shall mean all of each Borrower's present and future books of account of every kind or nature, purchase and sale agreements, invoices, ledger cards, bills of lading and other shipping evidence, statements, correspondence, memoranda, credit files and other data relating to the Collateral or any account debtor, together with the tapes, disks, diskettes and other data and software storage media and devices, file cabinets or containers in or on which the foregoing are stored (including any rights of such Borrower with respect to the foregoing maintained with or by any other person).

1.43 "Reference Bank" shall mean First Union National Bank, or such other bank as Lender may from time to time designate.

1.44 "Revolving Loans" shall mean the loans now or hereafter made by Lender to or for the benefit of each Borrower on a revolving basis (involving advances, repayments and readvances) as set forth in Section 2.1 hereof.

1.45 "Subordination Agreements" shall mean the Subordination Agreement, of even date herewith, between LSB, Guarantor and Borrowers, as amended, modified, supplemented, extended, renewed, restated or replaced, subordinating the obligations owed by and among Borrowers to Guarantor and LSB, as the same now exist or may hereafter be amended, modified, supplemented, extended, renewed, restated or replaced.

1.46 "Term Loan" shall mean the term loan made by Lender to Borrowers as provided for in Section 2.3 hereof.

1.47 "Term Promissory Note" shall have the meaning set forth in Section 2.3 hereof.

1.48 "Value" shall mean, as determined by Lender in good faith, with respect to Inventory, the lower of (a) cost computed on a first-in-first-out basis in accordance with GAAP or (b) market value.

## SECTION 2. CREDIT FACILITIES

### 2.1 Revolving Loans.

(a) Subject to and upon the terms and conditions contained herein, Lender agrees to make Revolving Loans to Borrowers from time to time in amounts requested by such Borrower or Borrowers up to the amount equal to the sum of:

(i) eighty-five percent (85%) of the Net Amount of Eligible Accounts of such Borrower or Borrowers; provided, however, the amount of Revolving Loans outstanding with respect to Advance Auto Accounts which are not fully insured by credit insurance payable to Lender issued by an insurer and on terms and in an amount acceptable to Lender shall not exceed \$3,000,000, and provided further, subject to the

provisions of Section 9.7, with respect to IBI, the amount of Revolving Loans outstanding at any time with respect to Eligible Accounts shall not exceed \$1,600,000; plus

(ii) the lesser of: (A) the sum of forty percent (40%) of the Value of Eligible Inventory consisting of finished goods plus thirty percent and (30%) of the Value of Eligible Inventory consisting of raw materials for such finished goods or (B) \$7,500,000; provided, however, subject to the provisions of Section 9.7, with respect to IBI, the amount of Revolving Loans outstanding at any time with respect to Eligible Inventory shall not exceed \$1,000,000.; less

(iii) any Availability Reserves.

The unused portion of the sublimits available to IBI may be utilized by the other Borrowers.

(b) Lender may, in its discretion, from time to time, upon not less than five (5) days prior notice to Borrowers, (i) reduce the lending formula for with respect to Eligible Accounts to the extent that Lender determines in good faith that: (A) the dilution with respect to the Accounts for any period (based on the ratio of (1) the aggregate amount of reductions in Accounts other than as a result of payments in cash to (2) the aggregate amount of total sales) has increased in any material respect or may reasonably be anticipated to increase in any material respect, above historical levels or (B) the general creditworthiness of account debtors of Borrowers has declined or (ii) adjust the lending formula(s) for Borrowers with respect to Eligible Inventory to the extent that Lender determines that: (A) the number of days of the turnover of the Inventory for any period has changed in any material respect or (B) the liquidation value of the Eligible Inventory, or any category thereof, has decreased, or (C) the nature and quality of the Inventory has deteriorated. In determining whether to reduce the lending formula(s), Lender may consider events, conditions, contingencies or risks which are also considered in determining Eligible Accounts, Eligible Inventory or in establishing Availability Reserves.

(c) Except in Lender's discretion, the aggregate amount of the Loans and the Letter of Credit Accommodations outstanding to all Borrowers at any time shall not exceed the Maximum Credit. In the event that the outstanding amount of any component of the Loans, or the aggregate amount of the outstanding Loans and Letter of Credit Accommodations, exceed the amounts available under the lending formulas, the sublimits for Letter of Credit Accommodations set forth in Section 2.2(d) or the Maximum Credit, as applicable, such event shall not limit, waive or otherwise affect any rights of Lender in that circumstance or on any future occasions and any Borrower shall, upon demand by Lender, which may be made at any time or from time to time, immediately repay to Lender the entire amount of any such excess(es) for which payment is demanded.

(d) For purposes only of applying the sublimit on Revolving Loans based on Eligible Inventory pursuant to Section 2.1(a)(ii)(B), Lender may treat the then undrawn amounts of



outstanding Letter of Credit Accommodations for the purpose of purchasing Eligible Inventory as Revolving Loans to the extent Lender is in effect basing the issuance of the Letter of Credit Accommodations on the Value of the Eligible Inventory being purchased with such Letter of Credit Accommodations. In determining the actual amounts of such Letter of Credit Accommodations to be so treated for purposes of the sublimit, the outstanding Revolving Loans and Availability Reserves shall be attributed first to any components of the lending formulas in Section 2.1(a) that are not subject to such sublimit, before being attributed to the components of the lending formulas subject to such sublimit.

## 2.2 Letter of Credit Accommodations.

(a) Subject to and upon the terms and conditions contained herein, at the request of any Borrower, Lender agrees to provide or arrange for Letter of Credit Accommodations for the account of Borrowers containing terms and conditions acceptable to Lender and the issuer thereof. Any payments made by Lender to any issuer thereof and/or related parties in connection with the Letter of Credit Accommodations shall constitute additional Revolving Loans to Borrowers pursuant to this Section 2.

(b) In addition to any charges, fees or expenses charged by any bank or issuer in connection with the Letter of Credit Accommodations, Borrowers shall pay to Lender a letter of credit fee at a rate equal to one and one-half percent (1.5%) per annum on the daily outstanding balance of the Letter of Credit Accommodations for the immediately preceding month (or part thereof), payable in arrears as of the first day of each succeeding month, except that Borrowers shall pay to Lender such letter of credit fee, at Lender's option, without notice, at a rate equal to three and one-half percent (3 1/2%) per annum on such daily outstanding balance for: (i) the period from and after the date of termination hereof until Lender has received full and final payment of all Obligations (notwithstanding entry of a judgment against any Borrower) and (ii) the period from and after the date of the occurrence of an Event of Default for so long as such Event of Default is continuing as determined by Lender. Such letter of credit fee shall be calculated on the basis of a three hundred sixty (360) day year and actual days elapsed and the obligation of Borrowers to pay such fee shall survive the termination or non-renewal of this Agreement.

(c) No Letter of Credit Accommodations shall be available unless on the date of the proposed issuance of any Letter of Credit Accommodations, the Revolving Loans available to any Borrowers (subject to the Maximum Credit and any Availability Reserves) are equal to or greater than: (i) if the proposed Letter of Credit Accommodation is for the purpose of purchasing Eligible Inventory, the sum of (A) seventy percent (70%) of the cost of such Eligible Inventory, plus (B) freight, taxes, duty and other amounts which Lender estimates must be paid in connection with such Inventory upon arrival and for delivery to one of such Borrower's locations for Eligible Inventory within the United States of America and (ii) if the proposed Letter of Credit Accommodation is for any other purpose, an amount equal to one hundred (100%) percent of the face amount thereof and all other commitments and obligations made or incurred by Lender with respect thereto.

Effective on the issuance of each Letter of Credit Accommodation, an Availability Reserve shall be established in the applicable amount set forth in Section 2.2(c)(i) or Section 2.2(c)(ii).

(d) Except in Lender's discretion, the amount of all outstanding Letter of Credit Accommodations and all other commitments and obligations made or incurred by Lender in connection therewith shall not at any time exceed \$3,000,000 with respect to all Borrowers; provided, however, that no Letter of Credit Accommodations shall be made with respect to IBI. At any time an Event of Default exists or has occurred and is continuing, upon Lender's request, Borrowers will either furnish cash collateral to secure the reimbursement obligations to the issuer in connection with any Letter of Credit Accommodations or furnish cash collateral to Lender for the Letter of Credit Accommodations, and in either case, the Revolving Loans otherwise available to Borrowers shall not be reduced as provided in Section 2.2(c) to the extent of such cash collateral.

(e) Each Borrower shall jointly and severally indemnify and hold Lender harmless from and against any and all losses, claims, damages, liabilities, costs and expenses which Lender may suffer or incur in connection with any Letter of Credit Accommodations and any documents, drafts or acceptances relating thereto, including any losses, claims, damages, liabilities, costs and expenses due to any action taken by any issuer or correspondent with respect to any Letter of Credit Accommodation. Each Borrower assumes all risks with respect to the acts or omissions of the drawer under or beneficiary of any Letter of Credit Accommodation and for such purposes the drawer or beneficiary shall be deemed such Borrower's agent. Each Borrower assumes all risks for, and agrees to pay, all foreign, Federal, State and local taxes, duties and levies relating to any goods subject to any Letter of Credit Accommodations or any documents, drafts or acceptances thereunder. Each Borrower hereby releases and holds Lender harmless from and against any acts, waivers, errors, delays or omissions, whether caused by any Borrower, by any issuer or correspondent or otherwise with respect to or relating to any Letter of Credit Accommodation. The provisions of this Section 2.2(e) shall survive the payment of Obligations and the termination of this Agreement.

(f) Nothing contained herein shall be deemed or construed to grant any Borrower any right or authority to pledge the credit of Lender in any manner. Lender shall have no liability of any kind with respect to any Letter of Credit Accommodation provided by an issuer other than Lender unless Lender has duly executed and delivered to such issuer the application or a guarantee or indemnification in writing with respect to such Letter of Credit Accommodation. Each Borrower shall be bound by any reasonable interpretation made in good faith by Lender, or any other issuer or correspondent under or in connection with any Letter of Credit Accommodation or any documents, drafts or acceptances thereunder, notwithstanding that such interpretation may be inconsistent with any instructions of such or any Borrower. Lender shall have the sole and exclusive right and authority to: (i) at any time an Event of Default exists or has occurred and is continuing, (A) approve or resolve any questions of non-compliance of documents, (B) give any instructions as to acceptance or rejection of any documents or goods or (C) execute any and all

applications for steamship or airway guaranties, indemnities or delivery orders, and (ii) at all times, (A) grant any extensions of the maturity of, time of payment for, or time of presentation of, any drafts, acceptances, or documents, and (B) agree to any amendments, renewals, extensions, modifications, changes or cancellations of any of the terms or conditions of any of the applications, Letter of Credit Accommodations, or documents, drafts or acceptances thereunder or any letters of credit included in the Collateral. Lender may take such actions either in its own name or in any Borrower's name.

(g) Any rights, remedies, duties or obligations granted or undertaken by any Borrower to any issuer or correspondent in any application for any Letter of Credit Accommodation, or any other agreement in favor of any issuer or correspondent relating to any Letter of Credit Accommodation, shall be deemed to have been granted or undertaken by any Borrower to Lender. Any duties or obligations undertaken by Lender to any issuer or correspondent in any application for any Letter of Credit Accommodation, or any other agreement by Lender in favor of any issuer or correspondent relating to any Letter of Credit Accommodation, shall be deemed to have been undertaken by any Borrower to Lender and to apply in all respects to such Borrower.

### 2.3 Term Loan.

(a) Lender is making a Term Loan to Borrowers in the original principal amount of \$2,550,000. The Term Loan is (i) evidenced by a Term Promissory Note, substantially in the form of Exhibit C attached hereto, in such original principal amount (the "Term Promissory Note") duly executed and delivered by Borrowers to Lender concurrently herewith; (ii) to be repaid, together with interest and other amounts, in accordance with this Agreement, the Term Promissory Note, and the other Financing Agreements and (a) secured by all of the Collateral; provided, however, no amount of the Term Loan shall be made available to IBI.

(b) Lender shall on at least thirty (30) days prior written request (the "Release Request") from Borrowers and at Borrowers' expense, release Lender's security interest in the Equipment upon the payment in full of the Term Loan and satisfaction of all of the following terms and conditions:

(i) Borrowers, on a consolidated basis, shall have net income (exclusive of extraordinary gains and losses) in an aggregate amount of not less than \$2,000,000 for the fiscal year of Borrowers immediately preceding the date of the Release Request as shown on the financial statements of Borrowers furnished to Lender pursuant to Section 9.6(a)(ii) hereof and there shall not have been any material adverse change since the date of such statement;

(ii) Excess Availability at the date of the Release Request and at the time of the final release agreement shall be in an amount of not less than \$5,000,000;

(iii) Borrowers shall have received a bonafide written offer from a third party financial institution with respect to such Equipment to provide secured refinancing of the Equipment;

(iv) No Event of Default or any Event which with notice or lapse of time, will constitute an Event of Default shall have occurred and be continuing at the Release Date; and

(v) Borrowers shall provide a certificate from an officer of each Borrower representing that all the foregoing conditions are satisfied on the Release Date;

(vi) Notwithstanding that Borrowers have satisfied the foregoing conditions, Lender shall have the right (but not the obligation) to exercise a right of first refusal to finance such Equipment in accordance with the provisions of Section 2.7 hereof as if such Equipment were "Option Equipment" thereunder. The Release Request shall be treated as the Option Notice for purposes of applying the provisions of Section 2.7 hereof.

2.4 Availability Reserves. All Revolving Loans otherwise available to any Borrower pursuant to the lending formulas and subject to the Maximum Credit and other applicable limits hereunder shall be subject to Lender's continuing right to establish and revise Availability Reserves as provided herein.

#### 2.5 Joint and Several Liability; Rights of Contribution.

(a) Each Borrower states and acknowledges that: (i) pursuant to this Agreement, such Borrower desires to utilize its borrowing potential on a consolidated basis to the same extent possible if it was merged into a single corporate entity with all other Borrowers and that this Agreement reflects the establishment of credit facilities which would not otherwise be available to such Borrower if such Borrower were not jointly and severally liable for payment of all of the Obligations; (ii) it has determined that it will benefit specifically and materially from the advances of credit contemplated by this Agreement; (iii) it is both a condition precedent to the obligations of Lender hereunder and a desire of the Borrowers that each Borrower execute and deliver to Lender this Agreement; and (iv) Borrowers have requested and bargained for the structure and terms of and security for the advances contemplated by this Agreement.

(b) Each Borrower hereby irrevocably and unconditionally: (i) agrees that it is jointly and severally liable to Lender for the full and prompt payment of the Obligations and the performance by each Borrower of its obligations hereunder in accordance with the terms hereof; (ii) to the extent provided herein agrees to fully and promptly perform all of its obligations hereunder with respect to each advance of credit hereunder as if such advance had been made directly to it; and (iii) agrees as a primary obligation to indemnify Lender on demand for and against any loss incurred by Lender as a result of any of the Obligations of any one or more of the Borrowers being or becoming void, voidable, unenforceable or ineffective for any reason whatsoever, whether or not known to Lender or any Person, the amount of such

loss being the amount which Lender would otherwise have been entitled to recover, without duplication, from any one or more of the Borrowers.

(c) It is the intent of each Borrower that the indebtedness, obligations and liability hereunder of no one of them be subject to challenge on any basis, including, without limitation, pursuant to any applicable fraudulent conveyance or fraudulent transfer laws. Accordingly, as of the date hereof, the liability of each Borrower under this section, together with all of its other liabilities to all Persons as of the date hereof and as of any other date on which a transfer or conveyance is deemed to occur by virtue of this Agreement, calculated in amount sufficient to pay its probable net liabilities on its existing indebtedness as the same become absolute and matured ("Dated Liabilities") is, and is to be, less than the amount of the aggregate of a fair valuation of its property as of such corresponding date ("Dated Assets"). To this end, each Borrower under this section, (i) grants to and recognizes in each other Borrower, ratably, rights of subrogation and contribution in the amount, if any, by which the Dated Assets of such Borrower, but for the aggregate of subrogation and contribution in its favor recognized herein, would exceed the Dated Liabilities of such Borrower or, as the case may be, (ii) acknowledges receipt of and recognizes its right to subrogation and contribution ratably from each of the other Borrowers in the amount, if any, by which the Dated Liabilities of such Borrower, but for the aggregate of subrogation and contribution in its favor recognized herein, would exceed the Dated Assets of such Borrower under this section. In recognizing the value of the Dated Assets and the Dated Liabilities, it is understood that Borrowers will recognize, to at least the same extent of their aggregate recognition of liabilities hereunder, their rights to subrogation and contribution hereunder. It is a material objective of this section that each Borrower recognizes rights to subrogation and contribution rather than be deemed to be insolvent (or in contemplation thereof) by reason of an arbitrary interpretation of its joint and several obligations hereunder. In addition to and not in limitation of the foregoing provisions of this section, the Borrowers and Lender hereby agree and acknowledge that it is the intent of each Borrower and of Lender that the obligations of each Borrower hereunder be in all respects in compliance with, and not be voidable pursuant to, applicable fraudulent conveyance and fraudulent transfer laws.

2.6 Structure of Credit Facility. Each Borrower agrees and acknowledges that the present structure of the credit facilities detailed in this Agreement is based in part upon the financial and other information presently known to Lender regarding each Borrower, the corporate structure of Borrowers, and the present financial condition of each Borrower. Each Borrower hereby agrees that Lender shall have the right, in Lender's good faith credit judgment, to require that any or all of the following changes be made to these credit facilities: (i) restrict loans and advances between Borrowers, (ii) establish separate lockbox and dominion accounts for each Borrower, and (iii) establish such other procedures as shall be reasonably deemed by Lender to be useful in tracking where the Revolving Loans are made under this Agreement and the source of payments received by Lender on such Revolving Loans.

2.7 Right of First Refusal. Pursuant to the provisions of Section 9.9(e), each time any Borrower proposes to refinance all or any part of its Equipment listed on Attachment I hereto (the

"Option Equipment"), Lender shall have the right (but not the obligation) to exercise a right of first refusal to finance such Option Equipment in accordance with the following provisions:

(a) Option Notice. Such Borrower shall deliver a written notice ("Option Notice") to Lender stating (i) such Borrower's bona fide intention to obtain financing for the Option Equipment from a third party (each an "Equipment Lender") (which may be a party existing and providing financing on the date hereof) with respect to such Option Equipment (each such financing by any financing party including the Lender being a "Refinancing"), (ii) the terms and conditions of the proposed financing in reasonable detail, including, without limitation, (A) the applicable interest or other pricing, including financing fees, (B) the term of the financing, and (C) and any covenants affecting such Borrower, and (iii) the name and address of the proposed Equipment Lender and other information reasonably requested by Lender (including an executed copy of a written proposal or commitment of the proposed Equipment Lender).

(b) Lender Financing Right. Within twenty (20) days after receipt of the Option Notice, Lender shall have the right, but not the obligation, to elect to provide financing for the Option Equipment upon the price and terms of the applicable Refinancing designated in the Option Notice, by providing a written term sheet in a customary form for Lender containing terms substantially identical to the terms provided to such Borrower by the Equipment Lender for such Refinancing.

(c) Closing of Transfer. If Lender elects to provide the Refinancing in place of the Equipment Lender as set forth in the Option Notice, then the closing of such purchase shall occur as soon as practicable, but in any event thirty (30) days after receipt of such notice, and such Borrower, each other Borrower, the Guarantor and other parties to the Financing Agreements which may be affected thereby and Lender shall execute such documents and instruments, provide such due diligence, take such actions and make such deliveries as may be reasonably required by Lender to close and fund such Refinancing.

(d) Equipment Lender's Refinancing Right. If Lender elects not to provide the Refinancing designated in the Option Notice, then such Borrower may complete the such proposed Refinancing within sixty (60) days after the expiration of Lender's right described in clause (b) above to provide such Refinancing with the Equipment Lender on the terms presented to Lender under this section. If such Refinancing by the Equipment Lender is not completed within such sixty (60) day period, then the procedures set forth in this section must be followed again as if any prior Option Notice had not been given with respect to such Refinancing or the Option Equipment.

## SECTION 3. INTEREST AND FEES

### 3.1 Interest.

(a) Each Borrower shall pay to Lender interest on the outstanding principal amount of the non-contingent Obligations at the Interest Rate. All interest accruing hereunder on and after the date of any Event of Default or termination hereof shall be payable on demand.

(b) Borrowers may from time to time request that Prime Rate Loans be converted to Eurodollar Rate Loans or that any existing Eurodollar Rate Loans continue for an additional Interest Period. Such request from Borrowers shall specify the amount of the Prime Rate Loans which will constitute Eurodollar Rate Loans (subject to the limits set forth below) and the Interest Period to be applicable to such Eurodollar Rate Loans. Subject to the terms and conditions contained herein, three (3) Business Days after receipt by Lender of such a request from Borrowers, such Prime Rate Loans shall be converted to Eurodollar Rate Loans or such Eurodollar Rate Loans shall continue, as the case may be, provided, that, (i) no Event of Default, or event which with notice or passage of time or both would constitute an Event of Default exists or has occurred and is continuing, (ii) no party hereto shall have sent any notice of termination or non-renewal of this Agreement, (iii) Borrowers shall have complied with such customary procedures as are established by Lender and specified by Lender to Borrowers from time to time for requests by Borrowers for Eurodollar Rate Loans, (iv) no more than four (4) Interest Periods may be in effect at any one time, (v) the aggregate amount of the Eurodollar Rate Loans must be in an amount not less than \$5,000,000 or an integral multiple of \$1,000,000 in excess thereof, (vi) the maximum amount of the Eurodollar Rate Loans at any time requested by Borrowers shall not exceed the amount equal to (A) the principal amount of the Term Loan which it is anticipated will be outstanding as of the last day of the applicable Interest Period plus (B) eighty percent (80%) of the lowest principal amount of the Revolving Loans which it is anticipated will be outstanding during the applicable Interest Period, in each case as determined by Lender (but with no obligation of Lender to make such Revolving Loans) and (vii) Lender shall have determined that the Interest Period or Adjusted Eurodollar Rate is available to Lender through the Reference Bank and can be readily determined as of the date of the request for such Eurodollar Rate Loan by Borrowers. Any request by Borrowers to convert Prime Rate Loans to Eurodollar Rate Loans or to continue any existing Eurodollar Rate Loans shall be irrevocable. Notwithstanding anything to the contrary contained herein, Lender and Reference Bank shall not be required to purchase United States Dollar deposits in the London interbank market or other applicable Eurodollar Rate market to fund any Eurodollar Rate Loans, but the provisions hereof shall be deemed to apply as if Lender and Reference Bank had purchased such deposits to fund the Eurodollar Rate Loans.

(c) Any Eurodollar Rate Loans shall automatically convert to Prime Rate Loans upon the last day of the applicable Interest Period, unless Lender has received and approved a request to continue such Eurodollar Rate Loan at least three (3) Business Days prior to such last day in accordance with the terms hereof.

Any Eurodollar Rate Loans shall, at Lender's option, upon notice by Lender to Borrowers, convert to Prime Rate Loans in the event that (i) an Event of Default or event which, with the notice or passage of time, or both, would constitute an Event of Default, shall exist, (ii) this Agreement shall terminate, or (iii) the aggregate principal amount of the Prime Rate Loans which have previously been converted to Eurodollar Rate Loans or existing Eurodollar Rate Loans continued, as the case may be, at the beginning of an Interest Period shall at any time during such Interest Period exceed either (A) the aggregate principal amount of the Loans then outstanding, or (B) the sum of the then outstanding principal amount of the Term Loan plus the Revolving Loans then available to Borrowers under Section 2 hereof. Borrowers shall pay to Lender, upon demand by Lender (or Lender may, at its option, charge any loan account of Borrowers) any amounts required to compensate Lender, the Reference Bank or any participant with Lender for any loss (including loss of anticipated profits), cost or expense incurred by such person, as a result of the conversion of Eurodollar Rate Loans to Prime Rate Loans pursuant to any of the foregoing.

(d) Interest shall be payable by Borrowers to Lender monthly in arrears not later than the first day of each calendar month and shall be calculated on the basis of a three hundred sixty (360) day year and actual days elapsed. The interest rate on non-contingent Obligations (other than Eurodollar Rate Loans) shall increase or decrease by an amount equal to each increase or decrease in the Prime Rate effective on the first day of the month after any change in such Prime Rate is announced based on the Prime Rate in effect on the last day of the month in which any such change occurs.

(e) No agreements, conditions, provisions or stipulations contained in this Agreement or any other instrument, document or agreement between one or more Borrowers and Lender or default of such Borrower(s), or the exercise by Lender of the right to accelerate the payment of the maturity of principal and interest, or to exercise any option whatsoever contained in this Agreement or any other Financing Agreement, or the arising of any contingency whatsoever, shall entitle Lender to contract for, charge, or receive, in any event, interest exceeding the maximum rate of interest permitted by applicable state or federal law in effect from time to time (hereinafter "Maximum Legal Rate"). In no event shall any Borrower be obligated to pay interest exceeding such Maximum Legal Rate and all agreements, conditions or stipulations, if any, which may in any event or contingency whatsoever operate to bind, obligate or compel such Borrower to pay a rate of interest exceeding the Maximum Legal Rate, shall be without binding force or effect, at law or in equity, to the extent only of the excess of interest over such Maximum Legal Rate. In the event any interest is contracted for, charged or received in excess of the Maximum Legal Rate ("Excess"), each Borrower acknowledges and stipulates that any such contract, charge, or receipt shall be the result of an accident and bona fide error, and that any Excess received by Lender shall be applied, first, to reduce the principal then unpaid hereunder; second, to reduce the other Obligations; and third, returned to such Borrower, it being the intention of the parties hereto not to enter at any time into a usurious or otherwise illegal relationship. Each Borrower recognizes that, with fluctuations in the Prime Rate, the LIBOR Rate and the Maximum Legal Rate, such a result could inadvertently occur. By the execution of this Agreement, each Borrower covenants



that (i) the credit or return of any Excess shall constitute the acceptance by such Borrower of such Excess, and (ii) such Borrower shall not seek or pursue any other remedy, legal or equitable, against Lender, based in whole or in part upon contracting for, charging or receiving of any interest in excess of the maximum authorized or receiving of any interest in excess of the maximum authorized by applicable law (so long as any Excess is returned to Borrower). For the purpose of determining whether or not any Excess has been contracted for, charged or received by Lender, all interest at any time contracted for, charged or received by Lender in connection with this Agreement shall be amortized, prorated, allocated and spread in equal parts during the entire term of this Agreement.

3.2 Closing Fee. Borrowers shall pay to Lender as a closing fee the amount of \$135,000, which shall be fully earned as of and payable on the date hereof.

3.3 Servicing Fee. Borrowers shall pay to Lender monthly a servicing fee in an amount equal to \$3,000 in respect of Lender's services for each month (or part thereof) while this Agreement remains in effect and for so long thereafter as any of the Obligations are outstanding, which fee shall be fully earned as of and payable in advance on the date hereof and on the first day of each month hereafter.

3.4 Unused Line Fee. Borrowers shall pay to Lender monthly an unused line fee at a rate equal to one-half percent (.5%) per annum calculated upon the amount by which \$16,000,000 exceeds the average daily principal balance of the outstanding Revolving Loans and Letter of Credit Accommodations during the immediately preceding month (or part thereof) while this Agreement is in effect and for so long thereafter as any of the Obligations are outstanding, which fee shall be payable on the first day of each month in arrears.

3.5 Changes in Laws and Increased Costs of Loans.

(a) Notwithstanding anything to the contrary contained herein, all Eurodollar Rate Loans shall, upon notice by Lender to Borrowers, convert to Prime Rate Loans in the event that (i) any change in applicable law or regulation (or the interpretation or administration thereof) shall either (A) make it unlawful for Lender, Reference Bank or any participant to make or maintain Eurodollar Rate Loans or to comply with the terms hereof in connection with the Eurodollar Rate Loans, or (B) shall result in the increase in the costs to Lender, Reference Bank or any participant of making or maintaining any Eurodollar Rate Loans by an amount deemed by Lender to be material, or (C) reduce the amounts received or receivable by Lender in respect thereof, by an amount deemed by Lender to be material or (ii) the cost to Lender, Reference Bank or any participant of making or maintaining any Eurodollar Rate Loans shall otherwise increase by an amount deemed by Lender to be material. Each Borrower shall pay to Lender, upon demand by Lender (or Lender may, at its option, charge any loan account of such Borrower) any amounts required to compensate Lender, the Reference Bank or any participant with Lender for any loss (including loss of anticipated profits), cost or expense incurred by such person as a result of the foregoing, including, without limitation, any such loss, cost or expense incurred by reason of the liquidation or reemployment of deposits or other

funds acquired by such person to make or maintain the Eurodollar Rate Loans or any portion thereof. A certificate of Lender setting forth the basis for the determination of such amount necessary to compensate Lender as aforesaid shall be delivered to Borrowers and shall be conclusive, absent manifest error.

(b) If any payments or prepayments in respect of the Eurodollar Rate Loans are received by Lender other than on the last day of the applicable Interest Period (whether pursuant to acceleration, upon maturity or otherwise), including any payments pursuant to the application of collections under Section 6.3 or any other payments made with the proceeds of Collateral, each affected Borrower shall pay to Lender upon demand by Lender (or Lender may, at its option, charge any loan account of such Borrower) any amounts required to compensate Lender, the Reference Bank or any participant with Lender for any additional loss (including loss of anticipated profits), cost or expense incurred by such person as a result of such prepayment or payment, including, without limitation, any loss, cost or expense incurred by reason of the liquidation or reemployment of deposits or other funds acquired by such person to make or maintain such Eurodollar Rate Loans or any portion thereof.

#### SECTION 4. CONDITIONS PRECEDENT

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4.1 Conditions Precedent to Initial Loans and Letter of Credit Accommodations. Each of the following is a condition precedent to Lender making the initial Loans and providing the initial Letter of Credit Accommodations hereunder:

(a) Lender shall have received evidence, in form and substance satisfactory to Lender, that Lender has valid perfected and first priority security interests in and liens upon the Collateral, subject only to the security interests and liens permitted herein or in the other Financing Agreements;

(b) all requisite corporate action and proceedings in connection with this Agreement and the other Financing Agreements shall be satisfactory in form and substance to Lender, and Lender shall have received all information and copies of all documents, including records of requisite corporate action and proceedings which Lender may have reasonably requested in connection therewith, such documents where requested by Lender or its counsel to be certified by appropriate corporate officers or governmental authorities;

(c) no material adverse change shall have occurred in the assets, business or prospects of Borrowers as taken as a whole since the date of Lender's latest field examination and no change or event shall have occurred which would materially impair the ability of the Borrowers when taken as a whole to perform their obligations hereunder or under any of the other Financing Agreements to which they are a party or of Lender to enforce the Obligations or realize upon the Collateral;

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(d) Lender shall have completed a field review of the Records and such other information with respect to the Collateral as Lender may require to determine the amount of Revolving Loans available to Borrowers, the results of which shall be satisfactory to Lender, not more than three (3) Business Days prior to the date hereof;

(e) Lender shall have received, in form and substance satisfactory to Lender, all consents, waivers, acknowledgments and other agreements from third persons which Lender may deem necessary or desirable in order to permit, protect and perfect its security interests in and liens upon the Collateral or to effectuate the provisions or purposes of this Agreement and the other Financing Agreements, including acknowledgments by lessors, mortgagees and warehousemen of Lender's security interests in the Collateral, waivers by such persons of any security interests, liens or other claims by such persons to the Collateral and agreements permitting Lender access to, and the right to remain on for a reasonable period of time, the premises to exercise its rights and remedies and otherwise deal with the Collateral;

(f) Lender shall have received evidence of insurance (including credit insurance on Advance Auto Accounts in amounts satisfactory to Lender) and loss payee endorsements required hereunder and under the other Financing Agreements, in form and substance satisfactory to Lender, and certificates of insurance policies and/or endorsements naming Lender as loss payee;

(g) Lender shall have received, in form and substance satisfactory to Lender, such opinion letters of in-house counsel to Borrowers with respect to the Financing Agreements and such other matters as Lender may request;

(h) the other Financing Agreements and all instruments and documents hereunder and thereunder shall have been duly executed and delivered to Lender, in form and substance satisfactory to Lender; and

(i) the Excess Availability as determined by Lender, as of the date hereof, shall be not less than \$3,500,000 after giving effect to the initial Loans made or to be made and Letter of Credit Accommodations issued or to be issued in connection with the initial transactions hereunder.

(j) the Lender shall have received in form and substance satisfactory to Lender, an appraisal of the Collateral;

(k) Lender shall have received the Collateral Letter of Credit;

(l) Lender shall have received, in form and substance satisfactory to Lender, the Subordination Agreement;

(m) Lender shall have received, in form and substance satisfactory to Lender, a Guaranty from Guarantor of the Obligations;

(n) Lender shall have received a payment in cash in the amount of \$550,000.00, in the form of a wire transfer from Borrower or any affiliate of Borrower for the credit of Borrower; and

(o) Lender shall have received such other agreements and documents which Lender shall requested.

4.2 Conditions Precedent to All Loans and Letter of Credit Accommodations. Each of the following is an additional condition precedent to Lender making Loans and/or providing Letter of Credit Accommodations to Borrowers, including the initial Loans and Letter of Credit Accommodations and any future Loans and Letter of Credit Accommodations:

(a) all representations and warranties contained herein and in the other Financing Agreements shall be true and correct in all material respects with the same effect as though such representations and warranties had been made on and as of the date of the making of each such Loan or providing each such Letter of Credit Accommodation and after giving effect thereto; and

(b) no Event of Default and no event or condition which, with notice or passage of time or both, would constitute an Event of Default, shall exist or have occurred and be continuing on and as of the date of the making of such Loan or providing each such Letter of Credit Accommodation and after giving effect thereto.

#### SECTION 5. GRANT OF SECURITY INTEREST

To secure payment and performance of all Obligations, each Borrower hereby grants to Lender a continuing security interest in, a lien upon, and a right of set off against, and hereby assigns to Lender as security, the following property and interests in property of any Borrower, whether now owned or hereafter acquired or existing, and wherever located (collectively, the "Collateral"):

##### 5.1 Accounts;

5.2 all present and future contract rights, general intangibles (including tax and duty refunds), registered and unregistered patents, patent rights, patent applications, trademarks, trademark registrations, trademark applications, service marks, copyrights, trade names, applications for the foregoing, trade secrets, goodwill, processes, drawings, blueprints, customer lists, licenses, whether as licensor or licensee, choses in action and other claims and existing and hereinafter arising leasehold interests in equipment, real estate and fixtures), chattel paper, documents, instruments, securities and other investment property (other than the equity shares of stock of any of the Borrowers), letters of credit, bankers' acceptances and guaranties;

5.3 all present and future monies, securities, credit balances, deposits, deposit accounts and other property of such Borrower now or hereafter held or received by or in transit to

Lender or its affiliates or at any other depository or other institution from or for the account of such Borrower, whether for safekeeping, pledge, custody, transmission, collection or otherwise, and all present and future liens, security interests, rights, remedies, title and interest in, to and in respect of Accounts and other Collateral, including (a) rights and remedies under or relating to guaranties, contracts of suretyship, letters of credit and credit and other insurance related to the Collateral, (b) rights of stoppage in transit, replevin, repossession, reclamation and other rights and remedies of an unpaid vendor, lienor or secured party, (c) goods described in invoices, documents, contracts or instruments with respect to, or otherwise representing or evidencing, Accounts or other Collateral, including returned, repossessed and reclaimed goods, and (d) rights of Borrowers in deposits by and property of account debtors or other persons securing the obligations of account debtors to Borrowers or any Borrower;

5.4 Inventory;

5.5 Equipment, excluding the Equipment identified on Attachment I attached hereto and incorporated herein by this reference if and to the extent a lien has been granted by any Borrower in respect of such Equipment and obligations remain outstanding with respect to such lien and Equipment).

5.6 Records; and

5.7 all products and proceeds of the foregoing, in any form, including insurance proceeds and all claims and proceeds of any claims against third parties for loss or damage to or destruction of any or all of the foregoing.

SECTION 6. COLLECTION AND ADMINISTRATION

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6.1 Borrowers' Loan Account. With respect to all Borrowers other than IBI, Lender shall maintain one or more loan account(s) on its books as it deems appropriate in which shall be recorded (a) all Loans, Letter of Credit Accommodations and other Obligations and the Collateral, (b) all payments made by or on behalf of Borrowers and (c) all other appropriate debits and credits as provided in this Agreement, including fees, charges, costs, expenses and interest. With respect to IBI, Lender shall use reasonable efforts to maintain one or more loan account(s) on its books in which shall be recorded (d) all Loans, Letter of Credit Accommodations and other Obligations and the Collateral of IBI reflecting sublimits imposed herein on Loans or Letter of Credit Accommodations that may be made to IBI, (e) all payments made by or on behalf of IBI, and (f) all other appropriate debits and credits as provided in this Agreement, including fees, charges, costs, expenses and interest or IBI. All entries in the loan account(s) shall be made in accordance with Lender's customary practices as in effect from time to time.

6.2 Statements. Lender shall render to Borrowers each month a statement setting forth the balance in the Borrowers' loan account(s) maintained by Lender for Borrowers pursuant to the

provisions of this Agreement, including principal, interest, fees, costs and expenses. Each such statement shall be subject to subsequent adjustment by Lender but shall, absent manifest errors or omissions, be considered correct and deemed accepted by Borrowers and conclusively binding upon any Borrower as an account stated except to the extent that Lender receives a written notice from any Borrower of any specific exceptions of any Borrower thereto within one hundred eighty (180) days after the date such statement has been mailed by Lender. Until such time as Lender shall have rendered to Borrowers a written statement as provided above, the balance in Borrowers' loan account(s) shall be presumptive evidence of the amounts due and owing to Lender by Borrowers.

### 6.3 Collection of Accounts.

(a) LSAP shall establish and maintain, at its expense, blocked accounts or lockboxes and related blocked accounts (in either case, "Blocked Accounts"), as Lender may specify, with such banks as are acceptable to Lender into which Borrowers shall promptly deposit and direct their account debtors to directly remit all payments on Accounts and all payments constituting proceeds of Inventory or other Collateral in the identical form in which such payments are made, whether by cash, check or other manner. The banks at which the Blocked Accounts are established shall enter into an agreement, in form and substance satisfactory to Lender, providing that all items received or deposited in the Blocked Accounts are the property of Lender, that the depository bank has no lien upon, or right to setoff against, the Blocked Accounts, the items received for deposit therein, or the funds from time to time on deposit therein and that the depository bank will wire, or otherwise transfer, in immediately available funds, on a daily basis, all funds received or deposited into the Blocked Accounts to such bank account of Lender as Lender may from time to time designate for such purpose ("Payment Account"). Borrowers agree that all payments made to such Blocked Accounts or other funds received and collected by Lender, whether on the Accounts or as proceeds of Inventory or other Collateral shall be the property of Lender.

(b) For purposes of calculating the amount of the Loans available to Borrowers, such payments will be applied (conditional upon final collection) to the Obligations on the Business Day of receipt by Lender of immediately available funds in the Payment Account provided such payments and notice thereof are received in accordance with Lender's usual and customary practices as in effect from time to time and within sufficient time to credit Borrower's loan account on such day, and if not, then on the next Business Day. For the purposes of calculating interest on the Obligations, such payments or other funds received will be applied (conditional upon final collection) to the Obligations one (1) Business Day following the date of receipt of immediately available funds by Lender in the Payment Account provided such payments or other funds and notice thereof are received in accordance with Lender's usual and customary practices as in effect from time to time and within sufficient time to credit Borrowers' loan account on such day, and if not, then on the next Business Day.

(c) Each Borrower and all of its affiliates, subsidiaries, shareholders, directors, employees or agents shall, acting as trustee for Lender, receive, as the property of Lender,

any monies, checks, notes, drafts or any other payment relating to and/or proceeds of Accounts or other Collateral which come into its possession or under its control and immediately upon receipt thereof, shall deposit or cause the same to be deposited in the Blocked Accounts of such Borrower, or remit the same or cause the same to be remitted, in kind, to Lender. In no event shall the same be commingled with such Borrower's own funds. Each Borrower agrees to reimburse Lender on demand for any amounts owed or paid to any bank at which a Blocked Account is established or any other bank or person involved in the transfer of funds to or from the Blocked Accounts arising out of Lender's payments to or indemnification of such bank or person. The obligation of each Borrower to reimburse Lender for such amounts pursuant to this Section 6.3 shall survive the termination or non-renewal of this Agreement.

6.4 Payments. All Obligations shall be payable to the Payment Account as provided in Section 6.3 or such other place as Lender may designate from time to time. Lender may apply payments received or collected from any Borrower or for the account of Borrowers (including the monetary proceeds of collections or of realization upon any Collateral) to such of the Obligations, whether or not then due, in such order and manner as Lender determines. At Lender's option, all principal, interest, fees, costs, expenses and other charges provided for in this Agreement or the other Financing Agreements may be charged directly to the loan account(s) of Borrowers. Each Borrower shall make all payments to Lender on the Obligations free and clear of, and without deduction or withholding for or on account of, any setoff, counterclaim, defense, duties, taxes, levies, imposts, fees, deductions, withholding, restrictions or conditions of any kind. If after receipt of any payment of, or proceeds of Collateral applied to the payment of, any of the Obligations, Lender is required to surrender or return such payment or proceeds to any Person for any reason, then the Obligations intended to be satisfied by such payment or proceeds shall be reinstated and continue and this Agreement shall continue in full force and effect as if such payment or proceeds had not been received by Lender. Each Borrower shall be liable to pay to Lender, and does hereby indemnify and hold Lender harmless for the amount of any payments or proceeds surrendered or returned. This Section 6.4 shall remain effective notwithstanding any contrary action which may be taken by Lender in reliance upon such payment or proceeds. This Section 6.4 shall survive the payment of the Obligations and the termination or non-renewal of this Agreement.

6.5 Authorization to Make Loans. Lender is authorized to make the Loans and provide the Letter of Credit Accommodations to any Borrower based upon telephonic or other instructions received from anyone purporting to be an authorized officer of such Borrower or other authorized person or, at the discretion of Lender, if such Loans are necessary to satisfy any Obligations. All requests for Loans or Letter of Credit Accommodations hereunder shall specify the date on which the requested advance is to be made or Letter of Credit Accommodations established (which day shall be a Business Day) and the amount of the requested Loan. Requests received after 11:30 a.m. Dallas, Texas time on any day shall be deemed to have been made as of the opening of business on the immediately following Business Day. All Loans and Letter of Credit Accommodations under this Agreement shall be conclusively presumed to have been made to, and at the request of and for the benefit of, Borrowers when deposited to the credit of Borrowers or otherwise

disbursed or established in accordance with the instructions of any Borrower or in accordance with the terms and conditions of this Agreement.

6.6 Use of Proceeds. Borrowers shall use the initial proceeds of the Loans provided by Lender to Borrowers hereunder only for: (a) payments to each of the persons listed in the disbursement direction letter furnished by LSAP to Lender on or about the date hereof and (b) costs, expenses and fees in connection with the preparation, negotiation, execution and delivery of this Agreement and the other Financing Agreements. All other Loans made or Letter of Credit Accommodations provided by Lender to Borrowers pursuant to the provisions hereof shall be used by any Borrower only for general operating, working capital and other proper corporate purposes of any Borrower not otherwise prohibited by the terms hereof. None of the proceeds will be used, directly or indirectly, for the purpose of purchasing or carrying any margin security or for the purposes of reducing or retiring any indebtedness which was originally incurred to purchase or carry any margin security or for any other purpose which might cause any of the Loans to be considered a "purpose credit" within the meaning of Regulation U or X of the Board of Governors of the Federal Reserve System, as amended.

#### SECTION 7. COLLATERAL REPORTING AND COVENANTS

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7.1 Collateral Reporting. LSAP shall provide Lender with the following documents in a form satisfactory to Lender: (a) on a regular basis as required by Lender, a schedule of Accounts, sales made, credits issued and cash received; (b) on a monthly basis (or after a Default or Event of Default more frequently as Lender may request), (i) perpetual inventory reports by mix, category and locations, (ii) agings of accounts receivable, and (ii) agings of accounts payable, (c) within sixty (60) days after the end of each fiscal quarter of Advance quarterly financial statements of Advance (including in each case balance sheets, statements of income and loss, statements of cash flow, and statements of shareholders' equity), all in reasonable detail, fairly presenting the financial position and the results of the operations of Advance and its subsidiaries as of the end of and through such period, the Lender acknowledging that such financial statements of Advance shall be obtained through industry sources, such as MEMA Financial Services Group, Inc. or any regular securities filings of Advance, to the extent such filings are available, (d) upon Lender's request, (i) copies of customer statements and credit memos, remittance advices and reports, and copies of deposit slips and bank statements, (ii) copies of shipping and delivery documents, and (iii) copies of purchase orders, invoices and delivery documents for Inventory and Equipment acquired by any Borrower; and (d) such other reports as to the Collateral as Lender shall reasonably request from time to time.



## 7.2 Accounts Covenants.

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(a) Each Borrower shall notify Lender promptly of (i) any material delay in such Borrower's performance of any of its obligations to any account debtor or the assertion of any claims, offsets, defenses or counterclaims by any account debtor for an amount in excess of \$100,000, or any disputes with account debtors for an amount in excess of \$100,000, or any settlement, adjustment or compromise thereof for an amount in excess of \$100,000, (ii) all material adverse information relating to the financial condition of any account debtor and (iii) any event or circumstance which, to such Borrower's knowledge would cause Lender to consider any then existing Accounts as no longer constituting Eligible Accounts. No credit, discount, allowance or extension or agreement for any of the foregoing shall be granted to any account debtor without Lender's consent, except in the ordinary course of such Borrower's business in accordance with practices and policies previously disclosed in writing to Lender (if applicable). So long as no Event of Default exists or has occurred and is continuing, Borrowers shall settle, adjust or compromise any claim, offset, counterclaim or dispute with any account debtor. At any time that an Event of Default exists or has occurred and is continuing, Lender shall, at its option, have the exclusive right to settle, adjust or compromise any claim, offset, counterclaim or dispute with account debtors or grant any credits, discounts or allowances.

(b) Without limiting the obligation of any Borrower to deliver any other information to Lender, Borrowers shall promptly report to Lender any return of Inventory by any one account debtor if either the Inventory so returned in such case has a value in excess of \$75,000 for all Borrowers in the aggregate or if the Inventory so returned is not an exchange of substantially similar and merchantable Inventory for other merchantable Inventory of a similar value. At any time that Inventory is returned, reclaimed or repossessed, the portion of the Account which arose from the sale of such returned, reclaimed or repossessed Inventory shall not be deemed an Eligible Account. In the event any account debtor returns Inventory when an Event of Default exists or has occurred and is continuing, each Borrower shall, upon Lender's request, (i) hold the returned Inventory in trust for Lender, (ii) segregate all returned Inventory from all of its other property, (iii) dispose of the returned Inventory solely according to Lender's instructions, and (iv) not issue any credits, discounts or allowances with respect thereto without Lender's prior written consent.

(c) With respect to each Account: (i) the amounts shown on any invoice delivered to Lender or schedule thereof delivered to Lender shall be true and complete, (ii) no payments shall be made thereon except payments immediately delivered to Lender pursuant to the terms of this Agreement, (iii) no credit, discount, allowance or extension or agreement for any of the foregoing shall be granted to any account debtor except as reported to Lender in accordance with this Agreement and except for credits, discounts, allowances or extensions made or given in the ordinary course of any Borrower's business in accordance with practices and policies previously disclosed to Lender, (iv) there shall be no setoffs, deductions, contra's, defenses, counterclaims or disputes existing or asserted with respect thereto except as reported to Lender or in accordance with the terms of this Agreement, (v) none of the transactions giving rise thereto will violate any applicable State

or Federal laws or regulations, all documentation relating thereto will be legally sufficient under such laws and regulations and all such documentation will be legally enforceable in accordance with its terms.

(d) Lender shall have the right at any time or times, in Lender's name or in the name of a nominee of Lender, to verify the validity, amount or any other matter relating to any Account or other Collateral of any Borrower, by mail, telephone, facsimile transmission or otherwise.

(e) To the extent that any Borrower or Borrowers have knowledge thereof, each Borrower shall deliver or cause to be delivered to Lender, within a reasonable time, with appropriate endorsement and assignment, all chattel paper and instruments which such Borrower now owns or may at any time acquire, except as Lender may otherwise agree.

(f) Lender may, at any time or times that an Event of Default exists or has occurred and is continuing, (i) notify any or all account debtors that the Accounts have been assigned to Lender and that Lender has a security interest therein and Lender may direct any or all accounts debtors to make payment of Accounts directly to Lender, (ii) extend the time of payment of, compromise, settle or adjust for cash, credit, return of merchandise or otherwise, and upon any terms or conditions, any and all Accounts or other obligations included in the Collateral and thereby discharge or release the account debtor or any other party or parties in any way liable for payment thereof without affecting any of the Obligations, (iii) demand, collect or enforce payment of any Accounts or such other obligations, but without any duty to do so, and Lender shall not be liable for its failure to collect or enforce the payment thereof nor for the negligence of its agents or attorneys with respect thereto and (iv) take whatever other action Lender may deem necessary or desirable for the protection of its interests. At any time that an Event of Default exists or has occurred and is continuing, at Lender's request, all invoices and statements sent to any account debtor shall state that the Accounts and such other obligations have been assigned to Lender and are payable directly and only to Lender and Borrower shall deliver to Lender such originals of documents evidencing the sale and delivery of goods or the performance of services giving rise to any Accounts as Lender may require.

7.3 Inventory Covenants. With respect to the Inventory: (a) Borrowers shall at all times maintain inventory records reasonably satisfactory to Lender, keeping correct and accurate records itemizing and describing the kind, type, quality and quantity of Inventory, Borrowers' cost therefor and daily withdrawals therefrom and additions thereto; (b) Borrowers shall conduct a physical count of the Inventory at least once each year, but at any time or times as Lender may request on or after an Event of Default and promptly following such physical inventory, Borrowers shall supply Lender with a report in the form and with such specificity as may be reasonably satisfactory to Lender concerning such physical count; (c) Borrowers shall not remove any Inventory from the locations set forth or permitted herein, without the prior written consent of Lender, except for sales of Inventory in the ordinary course of

Borrowers' business and except to move Inventory directly from one location set forth or permitted herein to another such location; (d) upon Lender's request, Borrowers shall, at their expense, no more than twice in any twelve (12) month period, but at any time or times as Lender may request on or after an Event of Default that is continuing; deliver or cause to be delivered to Lender written reports or appraisals as to the Inventory in form, scope and methodology acceptable to Lender and by an appraiser acceptable to Lender, addressed to Lender or upon which Lender is expressly permitted to rely; (e) Borrowers shall produce, use, store and maintain the Inventory with all reasonable care and caution and in accordance with applicable standards of any insurance and in conformity with applicable laws (including the requirements of the Federal Fair Labor Standards Act of 1938, as amended and all rules, regulations and orders related thereto); (f) each Borrower assumes all responsibility and liability arising from or relating to the production, use, sale or other disposition of the Inventory; (g) Borrower shall not sell Inventory to any customer on approval, or any other basis which entitles the customer to return or may obligate Borrower to repurchase such Inventory, except in the ordinary course of business; (h) Borrower shall keep the Inventory in good and marketable condition; and (i) Borrower shall not, without prior written notice to Lender, acquire or accept any Inventory on consignment or approval.

7.4 Equipment Covenants. With respect to the Equipment: (a) upon Lender's request, Borrowers shall, at their expense, at any time or times as Lender may request on or after an Event of Default that is continuing, deliver or cause to be delivered to Lender written reports or appraisals as to the Equipment in form, scope and methodology acceptable to Lender and by an appraiser acceptable to Lender; (b) Borrowers shall keep the Equipment in good order, repair, running and marketable condition (ordinary wear and tear excepted and excluding Equipment which is (i) obsolete and can or will no longer be used in the ordinary course of Borrowers' business; (ii) not repairable or useful for any purpose, (iii) damaged beyond repair or constitutes a total loss or constructive total loss, (iv) other than the Equipment on Attachment I hereto; (c) Borrowers shall use the Equipment with all reasonable care and caution and in accordance with applicable standards of any insurance and in conformity with all applicable laws; (d) the Equipment is and shall be used in Borrowers' business and not for personal, family, household or farming use; (e) Subject to the provisions of Section 9.7 hereof, Borrowers shall not remove any Equipment from the locations set forth or permitted herein, except to the extent necessary to have any Equipment repaired or maintained in the ordinary course of the business of any Borrower or to move Equipment directly from one location set forth or permitted herein to another such location and except for the movement of motor vehicles used by or for the benefit of any Borrower in the ordinary course of business; (f) the Equipment is now and shall remain personal property and no Borrowers shall permit any of the Equipment to be or become a part of or affixed to real property; (g) Borrowers assume all responsibility and liability arising from the use of the Equipment.

7.5 Power of Attorney. Each Borrower hereby irrevocably designates and appoints Lender (and all persons designated by Lender) as such Borrower's true and lawful attorney-in-fact, and authorizes Lender, in such Borrower's or Lender's name, to: (a) at any time an Event of Default or event which with notice or passage of time or both would constitute an Event of Default exists or has occurred and is continuing (i) demand payment on Accounts or other

proceeds of Inventory or other Collateral, (ii) enforce payment of Accounts by legal proceedings or otherwise, (iii) exercise all of such Borrower's rights and remedies to collect any Account or other Collateral, (iv) sell or assign any Account upon such terms, for such amount and at such time or times as the Lender deems advisable, (v) settle, adjust, compromise, extend or renew an Account, (vi) discharge and release any Account, (vii) prepare, file and sign such Borrower's name on any proof of claim in bankruptcy or other similar document against an account debtor, (viii) notify the post office authorities to change the address for delivery of such Borrower's mail to an address designated by Lender, and open and dispose of all mail addressed to Borrower, (ix) take control in any manner of any item of payment or proceeds thereof, (x) have access to any lockbox or postal box into which such Borrower's mail is deposited, (xi) do all acts and things which are necessary, in Lender's determination, to fulfill such Borrower's obligations under this Agreement and the other Financing Agreements, and (b) at any time to (i) endorse such Borrower's name upon any items of payment or proceeds thereof and deposit the same in the Lender's account for application to the Obligations, (ii) endorse such Borrower's name upon any chattel paper, document, instrument, invoice, or similar document or agreement relating to any Account or any goods pertaining thereto or any other Collateral, (iii) sign such Borrower's name on any verification of Accounts and notices thereof to account debtors, and (iv) execute in such Borrower's name and file any UCC financing statements or amendments thereto. Such Borrower hereby releases Lender and its officers, employees and designees from any liabilities arising from any act or acts under this power of attorney and in furtherance thereof, whether of omission or commission, except as a result of Lender's own gross negligence or willful misconduct as determined pursuant to a final non-appealable order of a court of competent jurisdiction.

7.6 Right to Cure. After the occurrence of an Event of Default, Lender may, at its option, (a) cure any default by any Borrower under any agreement with a third party or pay or bond on appeal any judgment entered against such Borrower, (b) discharge taxes, liens, security interests or other encumbrances at any time levied on or existing with respect to the Collateral and (c) pay any amount, incur any expense or perform any act which, in Lender's judgment, is necessary or appropriate to preserve, protect, insure or maintain the Collateral and the rights of Lender with respect thereto. Lender may add any amounts so expended to the Obligations and charge Borrowers' account therefor, such amounts to be repayable by Borrowers on demand. Lender shall be under no obligation to effect such cure, payment or bonding and shall not, by doing so, be deemed to have assumed any obligation or liability of such Borrower. Any payment made or other action taken by Lender under this section shall be without prejudice to any right to assert an Event of Default hereunder and to proceed accordingly.

7.7 Access to Premises. From time to time as requested by Lender, at the cost and expense of Borrowers, (a) Lender or its designee shall have complete access to all of Borrowers' premises during normal business hours and after notice to Borrowers, or at any time and without notice to Borrowers if an Event of Default exists or has occurred and is continuing, for the purposes of inspecting, verifying and auditing the Collateral and all of Borrowers' books and records, including the Records, and (b) Borrowers shall promptly furnish to Lender such copies of such books and records or extracts therefrom as Lender may request, and

(c) use during normal business hours such of any Borrower's personnel, equipment, supplies and premises as may be reasonably necessary for the foregoing and if an Event of Default exists or has occurred and is continuing for the collection of Accounts and realization of other Collateral.

## SECTION 8. REPRESENTATIONS AND WARRANTIES

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Each Borrower hereby jointly and severally represents and warrants to Lender the following (which shall survive the execution and delivery of this Agreement), the truth and accuracy of which are a continuing condition of the making of Loans and providing Letter of Credit Accommodations by Lender to any Borrower:

8.1 Corporate Existence, Power and Authority; Subsidiaries. Each Borrower is a corporation duly organized and in good standing under the laws of its state of incorporation and is duly qualified as a foreign corporation and in good standing in all states or other jurisdictions where the nature and extent of the business transacted by it or the ownership of assets makes such qualification necessary, except for those jurisdictions in which the failure to so qualify would not have a material adverse effect on such Borrower's financial condition, results of operation or business or the rights of Lender in or to any of the Collateral. The execution, delivery and performance of this Agreement, the other Financing Agreements and the transactions contemplated hereunder and thereunder are all within such Borrower's corporate powers, have been duly authorized and are not in contravention of law or the terms of such Borrower's certificate of incorporation, by-laws, or other organizational documentation, or any indenture, agreement or undertaking to which such Borrower is a party or by which such Borrower or its property is bound. This Agreement and the other Financing Agreements constitute legal, valid and binding obligations of such Borrower enforceable in accordance with their respective terms. Such Borrower does not have any subsidiaries except as set forth on the Information Certificate.

8.2 Financial Statements; No Material Adverse Change. All financial statements relating to Borrowers which have been or may hereafter be delivered by Borrowers to Lender have been prepared in accordance with GAAP and fairly present the financial condition and the results of operation of Borrowers as at the dates and for the periods set forth therein. Except as disclosed in any interim financial statements furnished by Borrowers to Lender prior to the date of this Agreement, there has been no material adverse change in the assets, liabilities, properties and condition, financial or otherwise, of Borrowers, taken as a whole since the date of the most recent audited financial statements furnished by Borrowers to Lender prior to the date of this Agreement.

8.3 Chief Executive Office; Collateral Locations. The chief executive office of each Borrower and such Borrower's Records concerning Accounts are located only at the address set forth below and its only other places of business and the only other locations of Collateral, if any, are the addresses set forth in the Information Certificate, subject to the right of such Borrower to establish new locations in accordance with Section 9.2 below. The Information Certificate correctly identifies any of such locations which are not owned by such Borrower and sets forth the owners

and/or operators thereof. The holders of any mortgages on such locations of which any Borrower is aware are identified on Schedule 8.3.

8.4 Priority of Liens; Title to Properties. The security interests and liens granted to Lender under this Agreement and the other Financing Agreements constitute valid and perfected first priority liens and security interests in and upon the Collateral when all proper filing, recordings and other actions necessary to perfect such liens have been taken subject only to the liens indicated on Schedule 8.4 hereto and the other liens permitted under Section 9.8 hereof. To the best of its knowledge, each Borrower has good and marketable title to all of its material properties and assets subject to no liens, mortgages, pledges, security interests, encumbrances or charges of any kind, except those granted to Lender and such others as are specifically listed on Schedule 8.4 hereto or permitted under Section 9.8 hereof.

8.5 Tax Returns. Borrowers have filed, or caused to be filed, in a timely manner all tax returns, reports and declarations which are required to be filed by it (without requests for extension except as previously disclosed in writing to Lender). All information in such tax returns, reports and declarations is complete and accurate in all material respects. Borrowers have paid or caused to be paid all taxes due and payable or claimed due and payable in any assessment received by it, except taxes the validity of which are being contested in good faith by appropriate proceedings diligently pursued and available to Borrowers and with respect to which adequate reserves have been set aside on their books. Adequate provision has been made for the payment of all accrued and unpaid Federal, State, county, local, foreign and other taxes whether or not yet due and payable and whether or not disputed.

8.6 Litigation. Except as set forth on the Information Certificate, there is no present investigation by any governmental agency pending, or to the best of any Borrower's knowledge threatened, against or affecting such Borrower, its assets or business and there is no action, suit, proceeding or claim by any Person pending, or to the best of such Borrower's knowledge threatened, against any Borrower or its assets or goodwill, or against or affecting any transactions contemplated by this Agreement, which if adversely determined against such Borrower would result in a material adverse change in the assets, business or prospects of Borrowers as taken as a whole or would impair the ability of Borrowers to perform their obligations hereunder or under any of the other Financing Agreements to which it is a party or of Lender to enforce any Obligations or realize upon any Collateral.

8.7 Compliance with Other Agreements and Applicable Laws. No Borrower is in default in any material respect under, or in violation in any material respect of any of the terms of, any agreement, contract, instrument, lease or other commitment to which it is a party or by which they or any of its assets are bound and each Borrower is in compliance in all material respects with all applicable provisions of laws, rules, regulations, licenses, permits, approvals and orders of any foreign, Federal, State or local governmental authority the failure to comply with which would have a material adverse effect on the Borrowers or any Borrower.

## 8.8 Employee Benefits.

(a) No Borrower has engaged in any transaction in connection with which such Borrower or any of its ERISA Affiliates could be subject to either a civil penalty assessed pursuant to Section 502(i) of ERISA or a tax imposed by Section 4975 of the Code, including any accumulated funding deficiency described in Section 8.8(c) hereof and any deficiency with respect to vested accrued benefits described in Section 8.8(d) hereof.

(b) No liability to the Pension Benefit Guaranty Corporation has been or is expected by any Borrower to be incurred with respect to any employee benefit plan of such Borrower or any of its ERISA Affiliates. There has been no reportable event (within the meaning of Section 4043(b) of ERISA) or any other event or condition with respect to any employee pension benefit plan of any Borrower or any of its ERISA Affiliates which presents a risk of termination of any such plan by the Pension Benefit Guaranty Corporation.

(c) Full payment has been made of all amounts which such Borrower or any of its ERISA Affiliates is required under Section 302 of ERISA and Section 412 of the Code to have paid under the terms of each employee benefit plan as contributions to such plan as of the last day of the most recent fiscal year of such plan ended prior to the date hereof, and no accumulated funding deficiency (as defined in Section 302 of ERISA and Section 412 of the Code), whether or not waived, exists with respect to any employee benefit plan, including any penalty or tax described in Section 8.8(a) hereof and any deficiency with respect to vested accrued benefits described in Section 8.8(d) hereof.

(d) The current value of all vested accrued benefits under all employee benefit plans maintained by any Borrower that are subject to Title IV of ERISA does not exceed the current value of the assets of such plans allocable to such vested accrued benefits, including any penalty or tax described in Section 8.8(a) hereof and any accumulated funding deficiency described in Section 8.8(c) hereof. The terms "current value" and "accrued benefit" have the meanings specified in ERISA.

(e) Neither any Borrower nor any of its ERISA Affiliates is or has ever been obligated to contribute to any "multiemployer plan" (as such term is defined in Section 4001(a)(3) of ERISA) that is subject to Title IV of ERISA.

8.9 Bank Accounts. All of the deposit accounts, investment accounts or other accounts in the name of or used by each Borrower maintained at any bank or other financial institution are set forth on Schedule 8.9 hereto, subject to the right of such Borrower to establish new accounts in accordance with Section 9.13 below.

#### 8.10 Environmental Compliance.

(a) Except as set forth on Schedule 8.10 hereto and the Information Certificate, no Borrower has not generated, used, stored, treated, transported, manufactured, handled, produced or disposed of any Hazardous Materials, on or off its premises (whether or not owned by it) in any manner which at any time violates any applicable Environmental Law or any license, permit, certificate, approval or similar authorization thereunder and the operations of Borrowers comply in all material respects with all Environmental Laws and all licenses, permits, certificates, approvals and similar authorizations thereunder.

(b) Except as set forth on Schedule 8.10 hereto and the Information Certificate, there has been no investigation, proceeding, complaint, order, directive, claim, citation or notice by any governmental authority or any other person nor is any pending or to the best of any Borrower's knowledge threatened, with respect to any non-compliance with or violation of the requirements of any Environmental Law by Borrower or the release, spill or discharge, threatened or actual, of any Hazardous Material or the generation, use, storage, treatment, transportation, manufacture, handling, production or disposal of any Hazardous Materials or any other environmental, health or safety matter, which affects any Borrower or its business, operations or assets or any properties at which any Borrower has transported, stored or disposed of any Hazardous Materials which would have a material adverse effect on any Borrower.

(c) Except as set forth on Schedule 8.10 hereto and the Information Certificate, no Borrower has any material liability (contingent or otherwise) in connection with a release, spill or discharge, threatened or actual, of any Hazardous Materials or the generation, use, storage, treatment, transportation, manufacture, handling, production or disposal of any Hazardous Materials.

(d) Each Borrower has all licenses, permits, certificates, approvals or similar authorizations ("Permits") required to be obtained or filed in connection with the operations of Borrower under any Environmental Law and all of which such Permits are valid and in full force and effect unless the failure to obtain such Permits would not have a material adverse effect on any Borrower.

8.11 Accuracy and Completeness of Information. All information furnished by or on behalf of each Borrower in writing to Lender in connection with this Agreement or any of the other Financing Agreements or any transaction contemplated hereby or thereby, including all information on the Information Certificate is true and correct in all material respects on the date as of which such information is dated or certified and does not omit any material fact necessary in order to make such information not misleading. Since the date of the last financial statements delivered to Lender, no event or circumstance has occurred which has had or could reasonably be expected to have a material adverse effect on the business, assets or prospects of Borrowers, taken as a whole, which has not been fully and accurately disclosed to Lender in writing.

8.12 Survival of Warranties; Cumulative. All representations and warranties contained in this Agreement or any of the other Financing Agreements shall survive the execution and delivery of



this Agreement and shall be deemed to have been made again to Lender on the date of each additional borrowing or other credit accommodation hereunder and shall be conclusively presumed to have been relied on by Lender regardless of any investigation made or information possessed by Lender. The representations and warranties set forth herein shall be cumulative and in addition to any other representations or warranties which any Borrower shall now or hereafter give, or cause to be given, to Lender.

8.13 Year 2000 Issues. Each Borrower shall, and shall cause any subsidiary to, take all actions which may be required so that its computer-based information systems, including, without limitation, all of its proprietary computer hardware and software and all computer hardware and software leased or licensed from third parties (and whether supplied by others) are able to operate effectively and correctly process data using dates on or after January 1, 2000. Compliance with the foregoing shall mean that the Borrower's systems will operate and correctly process data without human intervention such that (a) there is correct century recognition, (b) calculations properly accommodate same century and multi-century formulas and date values, (c) all leap years shall be calculated correctly and (d) the information systems shall otherwise comply with applicable industry standards and regulatory guidelines regarding the change of the century and year 2000 compliance. Such Borrower shall, by no later than September 30, 1999, certify to Lender in writing that its information systems have been modified, updated and reprogrammed as required by this section. On and after September 30, 1999, the computer-based information systems of such Borrower shall be, and with ordinary course upgrading and maintenance, will continue to be sufficient to permit such Borrower to conduct its business without any material adverse effect as a result of the year 2000.

#### SECTION 9. AFFIRMATIVE AND NEGATIVE COVENANTS

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9.1 Maintenance of Existence. Except as otherwise permitted pursuant to the Distribution Agreement and the provisions of this section, each Borrower shall at all times preserve, renew and keep in full, force and effect its corporate existence and rights and franchises with respect thereto and maintain in full force and effect all permits, licenses, trademarks, tradenames, approvals, authorizations, leases and contracts necessary to carry on the business as presently or proposed to be conducted. Each Borrower shall give Lender thirty (30) days prior written notice of any proposed change in its corporate name, which notice shall set forth the new name and such Borrower shall deliver to Lender a copy of the amendment to the Certificate of Incorporation of such Borrower providing for the name change certified by the Secretary of State of the jurisdiction of incorporation of such Borrower as soon as it is available.

9.2 New Collateral Locations. Any Borrower may open any new location within the continental United States provided such Borrower (a) gives Lender thirty (30) days prior written notice of the intended opening of any such new location and (b) executes and delivers, or causes to be executed and delivered, to Lender such agreements, documents, and instruments as Lender may deem

reasonably necessary or desirable to protect its interests in the Collateral at such location, including, without limitation, UCC financing statements.

### 9.3 Compliance with Laws, Regulations, Etc.

(a) Each Borrower shall, at all times, comply in all material respects with all laws, rules, regulations, licenses, permits, approvals and orders applicable to it, and duly observe all requirements of any Federal, State or local governmental authority, including the Employee Retirement Security Act of 1974, as amended, the Occupational Safety and Health Act of 1970, as amended, the Fair Labor Standards Act of 1938, as amended, and all statutes, rules, regulations, orders, permits and stipulations relating to environmental pollution and employee health and safety, including all of the Environmental Laws, (except to the extent the failure to so comply would not have a material adverse effect on any Borrower).

(b) Each Borrower shall establish and maintain, at its expense, a system to assure and monitor its continued compliance with all Environmental Laws in all of its operations, which system shall include annual reviews of such compliance by employees or agents of Borrower who are familiar with the requirements of the Environmental Laws. Copies of all environmental surveys, audits, assessments, feasibility studies and results of remedial investigations which are performed or received after the date hereof shall be promptly furnished, or caused to be furnished, by Borrower to Lender. Borrower shall take prompt and appropriate action to respond to any non-compliance with any of the Environmental Laws and shall regularly report to Lender on such response.

(c) Borrowers shall give both oral and written notice to Lender immediately upon any Borrower's receipt of any notice of, or any Borrower's otherwise obtaining knowledge of, (i) the occurrence of any event involving the release, spill or discharge, threatened or actual, of any Hazardous Material or (ii) any investigation, proceeding, complaint, order, directive, claims, citation or notice with respect to: (A) any non-compliance with or violation of any Environmental Law by Borrower or (B) the release, spill or discharge, threatened or actual, of any Hazardous Material or (C) the generation, use, storage, treatment, transportation, manufacture, handling, production or disposal of any Hazardous Materials or (D) any other environmental, health or safety matter, all which has or may be expected to have a material adverse effect on any Borrower or its businesses, operations or assets or any properties at which such Borrower transported, stored or disposed of any Hazardous Materials.

(d) Without limiting the generality of the foregoing, whenever Lender reasonably determines that there is non-compliance, or any condition which requires any action by or on behalf of Borrower in order to avoid any material non-compliance, with any Environmental Law, Borrowers shall, at Lender's request and Borrowers' expense: (i) cause an independent environmental engineer acceptable to Lender to conduct such tests of the site where any Borrower's non-compliance or alleged non-compliance with such Environmental Laws has occurred as to such non-compliance and prepare and deliver to Lender a report as to such non-compliance setting forth the results of such tests, a proposed plan for responding to any environmental problems described therein, and an

estimate of the costs thereof and (ii) provide to Lender a supplemental report of such engineer whenever the scope of such non-compliance, or Borrower's response thereto or the estimated costs thereof, shall change in any material respect.

(e) Each Borrower shall indemnify and hold harmless Lender, its directors, officers, employees, agents, invitees, representatives, successors and assigns, from and against any and all losses, claims, damages, liabilities, costs, and expenses (including attorneys' fees and legal expenses) directly or indirectly arising out of or attributable to the use, generation, manufacture, reproduction, storage, release, threatened release, spill, discharge, disposal or presence of a Hazardous Material, including the costs of any required or necessary repair, cleanup or other remedial work with respect to any property of Borrower and the preparation and implementation of any closure, remedial or other required plans. All representations, warranties, covenants and indemnifications in this Section 9.3 shall survive the payment of the Obligations and the termination or non-renewal of this Agreement.

9.4 Payment of Taxes and Claims. Borrowers shall duly pay and discharge all taxes, assessments, contributions and governmental charges upon or against them or their properties or assets, except for taxes the validity of which are being contested in good faith by appropriate proceedings diligently pursued and available to such Borrower and with respect to which adequate reserves have been set aside on its books. Borrowers shall be liable for any tax or penalties imposed on Lender as a result of the financing arrangements provided for herein and Borrowers agree to jointly and severally indemnify and hold Lender harmless with respect to the foregoing, and to repay to Lender on demand the amount thereof, and until paid by Borrowers such amount shall be added and deemed part of the Loans, provided, that, nothing contained herein shall be construed to require Borrowers to pay any income or franchise taxes attributable to the income of Lender from any amounts charged or paid hereunder to Lender. The foregoing indemnity shall survive the payment of the Obligations and the termination or non-renewal of this Agreement.

9.5 Insurance. Borrowers shall, at all times, maintain with financially sound and reputable insurers insurance with respect to the Collateral against loss or damage and all other insurance of the kinds and in the amounts customarily insured against or carried by corporations of established reputation engaged in the same or similar businesses and similarly situated. Said policies of insurance shall be satisfactory to Lender as to form, amount and insurer. Lender acknowledges that the insurance amounts, carriers and policies set forth in Schedule 9.5 are satisfactory to Lender as of the time of Closing hereof. Borrowers shall furnish certificates, policies or endorsements to Lender as Lender shall require as proof of such insurance, and, if Borrowers fail to do so, Lender is authorized, but not required, to obtain such insurance at the expense of Borrowers. All policies shall provide for at least thirty (30) days prior written notice to Lender of any cancellation or reduction of coverage and that Lender may act as attorney for any and every Borrower in obtaining, and at any time an Event of Default exists or has occurred and is continuing, adjusting, settling, amending and canceling such insurance. Borrowers shall cause Lender to be named as a loss payee and an additional insured as its interest may appear (but without any liability for any premiums) under such insurance policies and Borrowers shall obtain non-contributory lender's loss payable

endorsements to all insurance policies in form and substance satisfactory to Lender. Such lender's loss payable endorsements shall specify that the proceeds of such insurance shall be payable to Lender as its interests may appear and further specify that Lender shall be paid regardless of any act or omission by any or every Borrowers or any of its or their affiliates. At its option, Lender may apply any insurance proceeds received by Lender at any time to the cost of repairs or replacement of Collateral and/or to payment of the Obligations, whether or not then due, in any order and in such manner as Lender may determine or hold such proceeds as cash collateral for the Obligations.

#### 9.6 Financial Statements and Other Information.

(a) Borrowers shall keep proper books and records in which true and complete entries shall be made of all dealings or transactions of or in relation to the Collateral and the business of Borrowers and their subsidiaries (if any) in accordance with GAAP and LSAP and its subsidiaries shall furnish or cause to be furnished to Lender: (i) within forty-five (45) days after the end of each fiscal month, monthly unaudited consolidated financial statements (including balance sheets, statements of income and loss, statements of cash flow, and statements of shareholders' equity), all in reasonable detail, fairly presenting the financial position and the results of the operations of LSAP and its subsidiaries as of the end of and through such fiscal month; (ii) within one hundred (100) days after the end of each fiscal year, audited consolidated financial statements of LSAP and its subsidiaries (including in each case balance sheets, statements of income and loss, and statements of shareholders' equity), and the accompanying notes thereto, all in reasonable detail, fairly presenting the financial position and the results of the operations of LSAP and its subsidiaries as of the end of and for such fiscal year, together with either the unqualified opinion of independent certified public accountants or if the opinion is qualified, such qualifications are acceptable to Lender in its sole discretion, in either case, which accountants shall be an independent accounting firm selected by LSAP and reasonably acceptable to Lender, that such financial statements have been prepared in accordance with GAAP, and present fairly the results of operations and financial condition of LSAP and its subsidiaries as of the end of and for the fiscal year then ended; and (iii) as soon as available, a copy of each regular, periodic or special report, registration statement, or prospectus filed by LSA Technologies, Inc. with any securities exchange or the Securities and Exchange Commission or any successor agency.

(b) Each Borrower shall promptly notify Lender in writing of the details of (i) any loss, damage, investigation, action, suit, proceeding or claim relating to the Collateral or which would result in any material adverse change in Borrowers' business, properties, assets, goodwill or condition, financial or otherwise and (ii) the occurrence of any Event of Default or event which, with the passage of time or giving of notice or both, would constitute an Event of Default.

(c) Borrowers shall promptly after the sending or filing thereof furnish or cause to be furnished to Lender copies of all reports which Guarantor or such Borrower sends to its stockholders

generally and copies of all reports and registration statements which Guarantor or any Borrower files with the Securities and Exchange Commission, any national securities exchange or the National Association of Securities Dealers, Inc.

(d) Borrowers shall furnish or cause to be furnished to Lender such budgets, forecasts, projections and other information respecting the Collateral and the business of Borrowers, as Lender may, from time to time, reasonably request. Lender is hereby authorized to deliver a copy of any financial statement or any other information relating to the business of Borrowers to any court or other government agency or to any participant or assignee or prospective participant or assignee. If at any time, (i) an Event of Default occurs and is continuing, or (ii) for any reason, Ernst & Young LLP no longer prepares the financial statements of Borrower, Borrower hereby authorizes and directs all accountants or auditors to deliver to Lender, at Borrower's expense, copies of the financial statements of Borrower and any reports or management letters prepared by such accountants or auditors on behalf of Borrower and to disclose to Lender such information as they may have regarding the business of Borrower. Any documents, schedules, invoices or other papers delivered to Lender may be destroyed or otherwise disposed of by Lender one (1) year after the same are delivered to Lender, except as otherwise designated by any Borrower to Lender in writing.

(e) Borrowers shall furnish no later than sixty (60) days prior to the expiry date of the Collateral Letter of Credit, written confirmation of the extension, or notice of expiration, of the Collateral Letter of Credit at such expiry date. Borrowers shall cause the issuer of such Collateral Letter of Credit not later than sixty (60) days prior to such expiry date, to furnish, if applicable, a notice that such Collateral Letter of Credit will not be renewed or extended.

9.7 Sale of Assets, Consolidation, Merger, Dissolution, Etc. Except as provided in the Distribution Agreement, no Borrower will, directly or indirectly, (a) merge into or with or consolidate with any other Person or permit any other Person to merge into or with or consolidate with it except for the merger of any Borrower with any other Borrower upon the prior consent of Lender, or (b) sell, assign, lease, transfer, abandon or otherwise dispose of any stock or indebtedness to any other Person or any of its assets to any other Person except (i) as between Borrowers, in the ordinary course of and pursuant to the reasonable requirements of such Borrowers' businesses; (ii) for sales of Inventory in the ordinary course of business, or other sale, assignment, lease, transfer or other disposal in an amount not to exceed \$100,000 per calendar year; (iii) for the disposition of worn-out or obsolete Equipment or Equipment no longer used in the business of any Borrower so long as (A) if an Event of Default exists or has occurred and is continuing, any proceeds are paid to Lender and (B) for all Borrowers, in the aggregate, such sales do not involve Equipment having an aggregate fair market value in excess of \$100,000 for all such Equipment disposed of in any fiscal year; (iv) for sales of Accounts of any Borrower, the principal office, assets or place of business of the account debtors with respect to such Accounts are outside either the United States Canada or Puerto Rico provided (A) such Accounts are not Eligible Accounts; (B) the Excess Availability at the time of the sale of such Accounts is less than \$1,000,000 and (C) the sales price for such Accounts is not less than 100% of the original invoice for such Accounts); (v) sale of capital stock with respect to a Borrower to the extent such

transactions do not cause a Change of Control (as hereinafter defined) of such Borrower; or (vi) sale of Inventory of IBI pursuant to an Operating Agreement, an Inventory Purchase Agreement and other related agreements substantially in the form of the drafts of the Operating Agreement and Inventory Purchase Agreement, dated as of April 16, 1999 previously provided to Lender, provided; (A) Lender shall have received a payment equal to the amount of Revolving Loans outstanding at any time with respect to Eligible Inventory of IBI pursuant to Section 2.1(a)(ii) hereof plus undrawn amounts available to IBI pursuant to section 2.1(a)(ii) hereof and an additional amount of \$500,000, and (B) after the sale of Inventory pursuant to this subsection, no further amounts will be made available with respect to IBI pursuant to this Agreement; or (c) form or acquire any subsidiaries, or (d) wind up, liquidate or dissolve or (e) agree to do any of the foregoing. For any sale of assets of any Borrowers pursuant to subsections 9.7(b)(iii) or (iv) hereof, Lender shall upon such sale and at the expense of Borrowers, release its security interest in such assets. As used in this section, "Change of control" shall mean the acquisition by any Person or group of Persons acting together, of a direct interest in more than fifty-one percent (51%) of the voting power of the voting stock of or membership interests in, any Borrower, including by way of merger or consolidation, or otherwise.

9.8 Encumbrances. No Borrower shall create, incur, assume or suffer to exist any security interest, mortgage, pledge, lien, charge or other encumbrance of any nature whatsoever on any of its assets or properties, including the Collateral, except: (a) liens and security interests of Lender; (b) liens in favor of warehouseman, landlords, carriers, mechanics, materialmen, laborers or suppliers; (c) liens arising from deposits made in connection with obtaining workers' compensation or other unemployment insurance; (d) liens arising by reason of security for surety, appeal bonds or performance bonds; (e) liens resulting from any judgment or award that would not have a material adverse effect on the Borrowers taken as a whole; (f) liens securing the payment of taxes, either not yet overdue or the validity of which are being contested in good faith by appropriate proceedings diligently pursued and available to such Borrower and with respect to which adequate reserves have been set aside on its books; (g) non-consensual statutory liens (other than liens securing the payment of taxes) arising in the ordinary course of such Borrower's business to the extent: (i) such liens secure indebtedness which is not overdue or (ii) such liens secure indebtedness relating to claims or liabilities which are fully insured and being defended at the sole cost and expense and at the sole risk of the insurer or being contested in good faith by appropriate proceedings diligently pursued and available to such Borrower, in each case prior to the commencement of foreclosure or other similar proceedings and with respect to which adequate reserves have been set aside on its books; (h) zoning restrictions, easements, licenses, covenants and other restrictions affecting the use of real property which do not interfere in any material respect with the use of such real property or ordinary conduct of the business of such Borrower as presently conducted thereon or materially impair the value of the real property which may be subject thereto; (i) purchase money security interests in Equipment (including capital leases) arising after the date hereof and purchase money mortgages on real estate not to exceed \$1,500,000 in the aggregate at any time outstanding so long as such security interests and mortgages do not apply to any property of such Borrower other than the Equipment or real

estate so acquired, and the indebtedness secured thereby does not exceed the cost of the Equipment or real estate so acquired, as the case may be; (i) the security interests and liens set forth on Schedule 8.4 hereto; (k) security interests and liens created pursuant to the refinancing of obligations and indebtedness pursuant to Section 9.9(e) hereof; (l) liens arising from operating leases and (m) liens against any life insurance policy or the cash surrender value thereof which relate to borrowings incurred to finance the premiums made under such policy. Lender shall upon the acquisition of Equipment as provided pursuant to subsection (i) above, release its security interest in such Equipment so acquired if so required under the terms of the financing arrangements governing such acquisition.

9.9 Indebtedness. No Borrower shall incur, create, assume, become or be liable in any manner with respect to, or permit to exist, any obligations or indebtedness, except:

(a) the Obligations;

(b) trade obligations and normal accruals in the ordinary course of business not yet due and payable, or with respect to which such Borrower is contesting in good faith the amount or validity thereof by appropriate proceedings diligently pursued and available to such Borrower, and with respect to which adequate reserves have been set aside on its books;

(c) purchase money indebtedness (including capital leases) to the extent not incurred or secured by liens (including capital leases) in violation of any other provision of this Agreement;

(d) the indebtedness set forth on Schedule 9.9; or as set forth in the latest financial statements of any Borrower submitted to Lender on or prior to the date hereof, to the extent that there has been no change in or modification of terms of the indebtedness described on such financial statements provided, that, (i) such Borrower may only make regularly scheduled payments of principal and interest in respect of such indebtedness in accordance with the terms of the agreement or instrument evidencing or giving rise to such indebtedness as in effect on the date hereof, (ii) such Borrower shall not, directly or indirectly (A) amend, modify, alter or change the terms of such indebtedness or any agreement, document or instrument related thereto as in effect on the date hereof as such may (1) increase the amounts payable thereunder, (2) increase the amount or rate of interest payable thereon (3) cause any payment thereon to be due on any earlier date, or (4) provide additional collateral therefor (B) redeem, retire, defease, purchase or otherwise acquire such indebtedness, or set aside or otherwise deposit or invest any sums for such purpose, and (iii) such Borrower shall furnish to Lender all notices of default or demands in connection with such indebtedness either received by any Borrower or on its behalf, promptly after the receipt thereof, or sent by such Borrower or on its behalf, concurrently with the sending thereof, as the case may be. No Borrower is, or will be rendered, insolvent as a result of any Revolving Loan or any other advance of credit by Lender to such Borrower;

(e) indebtedness incurred as a result of the refinancing of Option Equipment pursuant to the terms of Section 2.7, provided that, (i) the terms, conditions and amount of any such refinancing shall be on terms no less favorable to any Borrower than the indebtedness being refinanced up to the original principal amount of such indebtedness, or otherwise satisfactory to Lender in its sole discretion; (ii) Excess Availability at the time of such refinancing, and after giving effect to such refinancing, is greater than \$2,000,000

(f) other indebtedness not to exceed \$1,500,000;

(g) indebtedness described in the Subordination Agreement;

(h) indebtedness resulting from a judgment having been rendered against any Borrower that is being appealed in good faith and in a timely manner for which adequate reserves acceptable to Lender have been recorded and which is not covered by insurance;

(i) Borrowings based on the cash value of life insurance policies, the proceeds of which are used to pay life insurance premiums;

(j) other indebtedness approved by Lender in its sole discretion; and

(k) indebtedness described in Section 9.10(e) and as otherwise permitted hereunder.

9.10 Loans, Investments, Guarantees, Etc. Except as set out in the Distribution Agreement and as otherwise provided herein, no Borrower shall directly or indirectly, make any loans or advance money or property to any person, or invest in (by capital contribution, dividend or otherwise) or purchase or repurchase the stock or indebtedness or all or a substantial part of the assets or property of any person, or assume, endorse, or otherwise become responsible for (directly or indirectly) the indebtedness, performance, obligations or dividends of any Person or agree to do any of the foregoing, except: (a) loans to employees of Borrowers not to exceed at any one time \$75,000, in the aggregate; (b) the endorsement of instruments for collection or deposit in the ordinary course of business; (c) investments in: (i) short-term direct obligations of the United States Government, (ii) negotiable certificates of deposit issued by any bank satisfactory to Lender, payable to the order of such Borrower or to bearer and delivered to Lender, and (iii) commercial paper rated A1 or P1; provided, that, as to any of the foregoing, unless waived in writing by Lender, such Borrower shall take such actions as are deemed necessary by Lender to perfect the security interest of Lender in such investments; (d) the loans, advances and guarantees set forth on Schedule 9.10 hereto; provided, that, as to such loans, advances and guarantees, (i) such Borrowers shall not, directly or indirectly, (A) amend, modify, alter or change the terms of such loans, advances or guarantees or any agreement, document or instrument related thereto, or (B) as to such guarantees, redeem, retire, defease, purchase or otherwise acquire the obligations arising pursuant to such guarantees, or set aside or otherwise deposit or invest any sums for such purpose, and (ii) such Borrower shall furnish to Lender all notices of default or demands in



connection with such loans, advances or guarantees or other indebtedness subject to such guarantees either received by such Borrower or on its behalf, promptly after the receipt thereof, or sent by such Borrower or on its behalf, concurrently with the sending thereof, as the case may be; and (e) loans, advances or investments in the ordinary course of each such Person's business operations, as presently existing, among LSAP, L&SB, LSBE, Rotex and Tribonetics.

9.11 Dividends and Redemptions. Except for dividends duly declared and paid by L&SB, LSBE, Rotex and Tribonetics to LSAP, Borrowers shall not, directly or indirectly, declare or pay any dividends on account of any shares of class of capital stock of such Borrower now or hereafter outstanding, or set aside or otherwise deposit or invest any sums for such purpose, or redeem, retire, defease, purchase or otherwise acquire any shares of any class of capital stock (or set aside or otherwise deposit or invest any sums for such purpose) for any consideration other than common stock or apply or set apart any sum, or make any other distribution (by reduction of capital or otherwise) in respect of any such shares or agree to do any of the foregoing other than the distribution to Guarantor of actual franchise and related taxes owing by Borrowers and otherwise, as may be permitted herein.

9.12 Transactions with Affiliates. Except as set out in Schedule 9.12 hereto, and as otherwise provided herein, no Borrower shall, directly or indirectly, (a) purchase, acquire or lease any property from, or sell, transfer or lease any property to, (i) any officer, director, agent or other person affiliated with such Borrower; (ii) any other Borrower; or (iii) any officer, director, agent or other person affiliated with any other Borrower, except in the ordinary course of and pursuant to the reasonable requirements of such Borrower's business and upon fair and reasonable terms no less favorable to such Borrower than such Borrower would obtain in a comparable arm's length transaction with an unaffiliated person or (b) make any payments of management, consulting or other fees for management or similar services, or of any indebtedness owing to (i) any officer, employee, shareholder, director or other person affiliated with such Borrower; (ii) any other Borrower; or (iii) any officer, employee, shareholder, director or other person affiliated with any other Borrower. except (w) reasonable compensation to officers, employees and directors for services rendered to such Borrower in the ordinary course of business (x) fees (i) for services and expenses actually incurred by the provider of such services, (ii) for services performed by the provider of such services in the ordinary course of business of such provider and pursuant to the reasonable requirements of any Borrower or Guarantor pursuant to either (A) the Services Agreement (in the form substantially similar to the draft Services Agreement attached to the Distribution Agreement) in an amount not to exceed \$250,000 per calendar year and (B) the Services and Consulting Agreement (in the form substantially similar to the draft Services and Consulting Agreement attached to the Distribution Agreement) for administrative services offered by LSB in an amount not to exceed \$750,000 per calendar year; (y) payments made pursuant to the Tax Sharing Agreement (in the form substantially similar to the draft Tax Sharing Agreement attached to the Distribution Agreement) in an amount not to exceed \$100,000 per calendar year, or \$250,000 in the aggregate, during the term hereof; and (z) payments made pursuant to the Indemnity Agreement (in the form substantially similar to the draft Indemnification Agreement attached to the

Distribution Agreement) in an amount not to exceed \$100,000 per calendar year, or \$500,000 in the aggregate, during the term hereof.

9.13 Additional Bank Accounts. No Borrowers shall directly or indirectly, open, establish or maintain any deposit account, investment account or any other account with any bank or other financial institution, other than the Blocked Accounts and the accounts set forth in Schedule 8.9 hereto, except: (a) as to any new or additional Blocked Accounts and other such new or additional accounts which contain any Collateral or proceeds thereof, with the prior written consent of Lender and subject to such conditions thereto as Lender may establish and (b) as to any accounts used by any Borrower to make payments of payroll, taxes or other obligations to third parties, after prior written notice to Lender.

9.14 Compliance with ERISA.

(a) No Borrower shall, with respect to any "employee benefit plans" maintained by such Borrower or any of its ERISA Affiliates: (i) terminate any of such employee benefit plans so as to incur any liability to the Pension Benefit Guaranty Corporation established pursuant to ERISA, (ii) allow or suffer to exist any prohibited transaction involving any of such employee benefit plans or any trust created thereunder which would subject such Borrower or such ERISA Affiliate to a tax or penalty or other liability on prohibited transactions imposed under Section 4975 of the Code or ERISA, (iii) fail to pay to any such employee benefit plan any contribution which it is obligated to pay under Section 302 of ERISA, Section 412 of the Code or the terms of such plan, (iv) allow or suffer to exist any accumulated funding deficiency, whether or not waived, with respect to any such employee benefit plan, (v) allow or suffer to exist any occurrence of a reportable event or any other event or condition which presents a material risk of termination by the Pension Benefit Guaranty Corporation of any such employee benefit plan that is a single employer plan, which termination could result in any liability to the Pension Benefit Guaranty Corporation or (vi) incur any withdrawal liability with respect to any multiemployer pension plan.

(b) As used in this Section 9.14, the terms "employee benefit plans", "accumulated funding deficiency" and "reportable event" shall have the respective meanings assigned to them in ERISA, and the term "prohibited transaction" shall have the meaning assigned to it in Section 4975 of the Code and ERISA.

9.15 Net Worth. LSAP shall, at all times, maintain Net Worth of not less than \$6,400,000.

9.16 Costs and Expenses. Borrowers shall pay to Lender on demand all reasonable costs, expenses, filing fees and taxes paid or payable in connection with the preparation, negotiation, execution, delivery, recording, administration, collection, liquidation, enforcement and defense of the Obligations, Lender's rights in the Collateral, this Agreement, the other Financing Agreements and all other documents related hereto or thereto, including any amendments, supplements or consents which may hereafter be contemplated (whether or not executed) or entered into

in respect hereof and thereof, including: (a) all costs and expenses of filing or recording (including Uniform Commercial Code financing statement filing taxes and fees, documentary taxes, intangibles taxes and mortgage recording taxes and fees, if applicable); (b) costs, expenses and fees for insurance premiums, environmental audits, surveys, assessments, engineering reports and inspections, appraisal fees and search fees; (c) costs and expenses of remitting loan proceeds, collecting checks and other items of payment, and establishing and maintaining the Blocked Accounts, together with Lender's customary charges and fees with respect thereto; (d) charges, fees or expenses charged by any bank or issuer in connection with the Letter of Credit Accommodations; (e) costs and expenses of preserving and protecting the Collateral; (f) costs and expenses paid or incurred in connection with obtaining payment of the Obligations, enforcing the security interests and liens of Lender, selling or otherwise realizing upon the Collateral, and otherwise enforcing the provisions of this Agreement and the other Financing Agreements or defending any claims made or threatened against Lender arising out of the transactions contemplated hereby and thereby (including preparations for and consultations concerning any such matters); (g) all out-of-pocket expenses and costs heretofore and from time to time hereafter incurred by Lender during the course of periodic field examinations of the Collateral and Borrowers' operations, plus a per diem charge at the rate of \$650.00 per person per day for Lender's examiners in the field and office; and (h) the reasonable fees and disbursements of outside counsel (including legal assistants) to Lender in connection with any of the foregoing.

9.17 Further Assurances. At the request of Lender at any time and from time to time, each Borrower shall, at its expense, duly execute and deliver, or cause to be duly executed and delivered, such further agreements, documents and instruments, and do or cause to be done such further acts as may be necessary or proper to evidence, perfect, maintain and enforce the security interests and the priority thereof in the Collateral and to otherwise effectuate the provisions or purposes of this Agreement or any of the other Financing Agreements. Within three day's after Lender's request, such Borrower shall provide a certificate from an officer of such Borrower representing that all conditions precedent to the making of Loans and providing Letter of Credit Accommodations contained herein are satisfied. Where permitted by law, each Borrower hereby authorizes Lender to execute and file one or more UCC financing statements signed only by Lender.

## SECTION 10. EVENTS OF DEFAULT AND REMEDIES

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10.1 Events of Default. The occurrence or existence of any one or more of the following events are referred to herein individually as an "Event of Default", and collectively as "Events of Default":

(a) (i) any Borrower fails to pay any of its Obligations within two (2) Business Days after the same becomes due and payable or (ii) such Borrower or any Obligor fails to perform any of the covenants contained in Sections 9.1, 9.2, 9.3, 9.4, 9.6, 9.14, 9.16 and 9.17 of this Agreement and such failure shall continue for ten (10) days; provided, that, such ten (10) day period shall not apply in the case of: (A) any failure to observe any such covenant which is not capable of being cured at all or within such ten (10) day period or which has been the subject of a prior failure within a

six (6) month period or (B) an intentional breach of such Borrower or any Obligor of any such covenant or (iii) such Borrower fails to perform any of the terms covenants, conditions or provisions contained in this Agreement or any of the other Financing Agreements other than those described in Sections 10.1(a)(i) and 10.1(a)(ii) above;

(b) any representation, warranty or statement of fact made by any Borrower to Lender in this Agreement, the other Financing Agreements or any other agreement, schedule, confirmatory assignment or otherwise shall when made or deemed made be false or misleading in any material respect;

(c) any Obligor revokes, terminates or fails to perform any of the terms, covenants, conditions or provisions of any guarantee, endorsement or other agreement of such party in favor of Lender;

(d) any final judgment for the payment of money is rendered against any Borrower or any Obligor in excess of \$100,000 in any one case or in excess of \$500,000 in the aggregate and shall remain undischarged or unvacated for a period in excess of thirty (30) days or execution shall at any time not be effectively stayed, or any judgment other than for the payment of money, or injunction, attachment, garnishment or execution is rendered against any Borrower or any Obligor or any of their assets;

(e) any Obligor (being a natural person or a general partner of an Obligor which is a partnership) dies or any Borrower or any Obligor, which is a partnership, limited liability company, limited liability partnership or a corporation, dissolves or suspends or discontinues doing business;

(f) any Borrower or any Obligor becomes insolvent (however defined or evidenced), makes an assignment for the benefit of creditors, makes or sends notice of a bulk transfer or calls a meeting of its creditors or principal creditors;

(g) a case or proceeding under the bankruptcy laws of the United States of America now or hereafter in effect or under any insolvency, reorganization, receivership, readjustment of debt, dissolution or liquidation law or statute of any jurisdiction now or hereafter in effect (whether at law or in equity) is filed against any Borrower or any Obligor or all or any part of its properties and such petition or application is not dismissed within thirty (30) days after the date of its filing or any Borrower or any Obligor shall file any answer admitting or not contesting such petition or application or indicates its consent to, acquiescence in or approval of, any such action or proceeding or the relief requested is granted sooner;

(h) a case or proceeding under the bankruptcy laws of the United States of America now or hereafter in effect or under any insolvency, reorganization, receivership, readjustment of debt,

dissolution or liquidation law or statute of any jurisdiction now or hereafter in effect (whether at a law or equity) is filed by any Borrower or any Obligor or for all or any part of its property; or

(i) any default by any Borrower or Borrowers or any Obligor under any agreement, document or instrument relating to any indebtedness for borrowed money owing to any person other than Lender, or any capitalized lease obligations, contingent indebtedness in connection with any guarantee, letter of credit, indemnity or similar type of instrument in favor of any person other than Lender, in any case in an amount, individually or in the aggregate in excess of \$250,000, which default continues for more than the applicable cure period, if any, with respect thereto, or any default by any Borrower or any Obligor under any material contract, lease, license or other obligation to any person other than Lender, which default continues for more than the applicable cure period, if any, with respect thereto;

(j) any change in the controlling ownership of any Borrower;

(k) the indictment of any Borrower or any Obligor under any criminal statute, or commencement or threatened commencement of criminal or civil proceedings against any Borrower or any Obligor, pursuant to which statute or proceedings the penalties or remedies sought or available include forfeiture of any of the property of such Borrower or such Obligor;

(l) there shall be a material adverse change in the business or assets of any Borrower or any Obligor individually or of Borrowers (in the aggregate) after the date hereof;

(m) there shall be an event of default under any of the other Financing Agreements;

(n) (i) the Collateral Letter of Credit shall not be in full force and effect at any time prior to the termination of the Financing Agreements; or (ii) any drawing or renewal of the Collateral Letter of Credit shall be subject to dispute or actual legal challenge by LSB or the issuer thereof; or (iii) Lender shall have received notice from the issuer of the Collateral Letter of Credit that such Collateral Letter of Credit will not be renewed or extended; or (iv) such Collateral Letter of Credit shall not be renewed effective on or before its expiry date; or (v) Borrower shall fail to furnish, or cause to be furnished, the notices pursuant to Section 9.6(e); provided, however, that any such Event of Default shall be deemed cured upon the indefeasible payment in full by the issuer of the Collateral Letter of Credit to Lender of the face amount of the Collateral Letter of Credit.

## 10.2 Remedies.

(a) At any time an Event of Default exists or has occurred and is continuing, Lender shall have all rights and remedies provided in this Agreement, the other Financing Agreements, the Uniform Commercial Code and other applicable law, all of which rights and remedies may be exercised without notice to or consent by any Borrower or any Obligor, except as such notice or

consent is expressly provided for hereunder or required by applicable law. All rights, remedies and powers granted to Lender hereunder, under any of the other Financing Agreements, the Uniform Commercial Code or other applicable law, are cumulative, not exclusive and enforceable, in Lender's discretion, alternatively, successively, or concurrently on any one or more occasions, and shall include, without limitation, the right to apply to a court of equity for an injunction to restrain a breach or threatened breach by any Borrower of this Agreement or any of the other Financing Agreements. Lender may, at any time or times, proceed directly against any Borrower (or any group of Borrowers) or any Obligor to collect the Obligations without prior recourse to the Collateral and without prejudice, waiver or impairment of any other rights and remedies against, or with respect to, another Borrower Obligor or other Person.

(b) Without limiting the foregoing, at any time an Event of Default exists or has occurred and is continuing, Lender may, in its discretion and without limitation, (i) accelerate the payment of all Obligations and demand immediate payment thereof to Lender (provided, that, upon the occurrence of any Event of Default described in Sections 10.1(g) and 10.1(h), all Obligations shall automatically become immediately due and payable), (ii) with or without judicial process or the aid or assistance of others, enter upon any premises on or in which any of the Collateral may be located and take possession of the Collateral or complete processing, manufacturing and repair of all or any portion of the Collateral, (iii) require one or more Borrowers, at any Borrowers' expense, to assemble and make available to Lender any part or all of the Collateral at any place and time designated by Lender, (iv) collect, foreclose, receive, appropriate, setoff and realize upon any and all Collateral, (v) remove any or all of the Collateral from any premises on or in which the same may be located for the purpose of effecting the sale, foreclosure or other disposition thereof or for any other purpose, (vi) sell, lease, transfer, assign, deliver or otherwise dispose of any and all Collateral (including entering into contracts with respect thereto, public or private sales at any exchange, broker's board, at any office of Lender or elsewhere) at such prices or terms as Lender may deem reasonable, for cash, upon credit or for future delivery, with the Lender having the right to purchase the whole or any part of the Collateral at any such public sale, all of the foregoing being free from any right or equity of redemption of any Borrower, which right or equity of redemption is hereby expressly waived and released by such Borrower and/or (vii) terminate this Agreement. If any of the Collateral is sold or leased by Lender upon credit terms or for future delivery, the Obligations shall not be reduced as a result thereof until payment therefor is finally collected by Lender. If notice of disposition of Collateral is required by law, five (5) days prior notice by Lender to such Borrower designating the time and place of any public sale or the time after which any private sale or other intended disposition of Collateral is to be made, shall be deemed to be reasonable notice thereof and such Borrower waives any other notice. In the event Lender institutes an action to recover any Collateral or seeks recovery of any Collateral by way of prejudgment remedy, such Borrower waives the posting of any bond which might otherwise be required.

(c) Lender may apply the cash proceeds of Collateral actually received by Lender from any sale, lease, foreclosure or other disposition of the Collateral to payment of the Obligations, in whole or in part and in such order as Lender may elect, whether

or not then due. Borrowers shall remain jointly and severally liable to Lender for the payment of any deficiency with interest at the highest rate provided for herein and all costs and expenses of collection or enforcement, including attorneys' fees and legal expenses.

(d) Without limiting the foregoing, upon the occurrence of an Event of Default or an event which with notice or passage of time or both would constitute an Event of Default, Lender may, at its option, without notice, (i) cease making Loans or arranging for Letter of Credit Accommodations or reduce the lending formulas or amounts of Revolving Loans and Letter of Credit Accommodations available to any Borrower or all Borrowers and/or (ii) terminate any provision of this Agreement providing for any future Loans or Letter of Credit Accommodations to be made by Lender to any Borrower.

(e) Upon the occurrence of any Event of Default that is continuing. Lenders may draw on the Collateral Letter of Credit and apply the proceeds thereof to the repayment of the Obligations.

SECTION 11. JURY TRIAL WAIVER; OTHER WAIVERS AND CONSENTS;  
GOVERNING LAW

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11.1 Governing Law; Choice of Forum; Service of Process; Jury Trial Waiver.

(a) The validity, interpretation and enforcement of this Agreement and the other Financing Agreements and any dispute arising out of the relationship between the parties hereto, whether in contract, tort, equity or otherwise, shall be governed by the internal laws of the State of Texas (without giving effect to principles of conflicts of law).

(b) Each Borrower and Lender irrevocably consent and submit to the non-exclusive jurisdiction of the State of Texas and the United States District Court for the Northern District of Texas and waive any objection based on venue or forum non conveniens with respect to any action instituted therein arising under this Agreement or any of the other Financing Agreements or in any way connected with or related or incidental to the dealings of the parties hereto in respect of this Agreement or any of the other Financing Agreements or the transactions related hereto or thereto, in each case whether now existing or hereafter arising, and whether in contract, tort, equity or otherwise, and agree that any dispute with respect to any such matters shall be heard only in the courts described above (except that Lender shall have the right to bring any action or proceeding against such Borrower or its property in the courts of any other jurisdiction which Lender deems necessary or appropriate in order to realize on the Collateral or to otherwise enforce its rights against such Borrower or its property).

(c) Each Borrower hereby waives personal service of any and all process upon it and consents that all such service of process may be made by certified mail (return receipt requested) directed to its address set forth on the signature pages hereof and

service so made shall be deemed to be completed five (5) days after the same shall have been so deposited in the U.S. mails, or, at Lender's option, by service upon Such Borrower in any other manner provided under the rules of any such courts. Within thirty (30) days after such service, Such Borrower shall appear in answer to such process, failing which Such Borrower shall be deemed in default and judgment may be entered by Lender against Such Borrower for the amount of the claim and other relief requested.

(d) EACH BORROWER AND LENDER HEREBY WAIVES ANY RIGHT TO TRIAL BY JURY OF ANY CLAIM, DEMAND, ACTION OR CAUSE OF ACTION (i) ARISING UNDER THIS AGREEMENT OR ANY OF THE OTHER FINANCING AGREEMENTS OR (ii) IN ANY WAY CONNECTED WITH OR RELATED OR INCIDENTAL TO THE DEALINGS OF THE PARTIES HERETO IN RESPECT OF THIS AGREEMENT OR ANY OF THE OTHER FINANCING AGREEMENTS OR THE TRANSACTIONS RELATED HERETO OR THERETO IN EACH CASE WHETHER NOW EXISTING OR HEREAFTER ARISING, AND WHETHER IN CONTRACT, TORT, EQUITY OR OTHERWISE. EACH BORROWER AND LENDER HEREBY AGREES AND CONSENTS THAT ANY SUCH CLAIM, DEMAND, ACTION OR CAUSE OF ACTION SHALL BE DECIDED BY COURT TRIAL WITHOUT A JURY AND THAT SUCH BORROWER OR LENDER MAY FILE AN ORIGINAL COUNTERPART OF A COPY OF THIS AGREEMENT WITH ANY COURT AS WRITTEN EVIDENCE OF THE CONSENT OF THE PARTIES HERETO TO THE WAIVER OF THEIR RIGHT TO TRIAL BY JURY.

(e) Lender shall not have any liability to any Borrower (whether in tort, contract, equity or otherwise) for losses suffered by such Borrowers in connection with, arising out of, or in any way related to the transactions or relationships contemplated by this Agreement, or any act, omission or event occurring in connection herewith, unless it is determined by a final and non-appealable judgment or court order binding on Lender, that the losses were the result of acts or omissions constituting gross negligence or willful misconduct. In any such litigation, Lender shall be entitled to the benefit of the rebuttable presumption that it acted in good faith and with the exercise of ordinary care in the performance by it of the terms of this Agreement.

11.2 Waiver of Notices. Each Borrower hereby expressly waives demand, presentment, protest and notice of protest and notice of dishonor with respect to any and all instruments and commercial paper, included in or evidencing any of the Obligations or the Collateral, and any and all other demands and notices of any kind or nature whatsoever with respect to the Obligations, the Collateral and this Agreement, except such as are expressly provided for herein. No notice to or demand on such Borrower which Lender may elect to give shall entitle such Borrower to any other or further notice or demand in the same, similar or other circumstances.

11.3 Amendments and Waivers. Neither this Agreement nor any provision hereof shall be amended, modified, waived or discharged orally or by course of conduct, but only by a written agreement signed by an authorized officer of Lender, and as to amendments, as



also signed by an authorized officer of each Borrower. Lender shall not, by any act, delay, omission or otherwise be deemed to have expressly or impliedly waived any of its rights, powers and/or remedies unless such waiver shall be in writing and signed by an authorized officer of Lender. Any such waiver shall be enforceable only to the extent specifically set forth therein. A waiver by Lender of any right, power and/or remedy on any one occasion shall not be construed as a bar to or waiver of any such right, power and/or remedy which Lender would otherwise have on any future occasion, whether similar in kind or otherwise.

11.4 Indemnification. EACH BORROWER SHALL JOINTLY AND SEVERALLY INDEMNIFY AND HOLD LENDER, AND ITS DIRECTORS, AGENTS, EMPLOYEES AND COUNSEL (THE "INDEMNIFIED PARTIES"), HARMLESS FROM AND AGAINST ANY AND ALL LOSSES, CLAIMS, DAMAGES, LIABILITIES, COSTS OR EXPENSES IMPOSED ON, INCURRED BY OR ASSERTED AGAINST ANY OF THEM IN CONNECTION WITH ANY LITIGATION, INVESTIGATION, CLAIM OR PROCEEDING COMMENCED OR THREATENED RELATED TO THE NEGOTIATION, PREPARATION, EXECUTION, DELIVERY, ENFORCEMENT, PERFORMANCE OR ADMINISTRATION OF THIS AGREEMENT, ANY OTHER FINANCING AGREEMENTS, OR ANY UNDERTAKING OR PROCEEDING RELATED TO ANY OF THE TRANSACTIONS CONTEMPLATED HEREBY OR ANY ACT, OMISSION, EVENT OR TRANSACTION (INCLUDING LENDER'S OWN NEGLIGENCE) RELATED OR ATTENDANT THERETO, INCLUDING AMOUNTS PAID IN SETTLEMENT, COURT COSTS, AND THE FEES AND EXPENSES OF COUNSEL OTHER THAN THOSE ARISING SOLELY OUT OF THE GROSS NEGLIGENCE OR WILLFUL MISCONDUCT OF ANY INDEMNIFIED PARTY. TO THE EXTENT THAT THE UNDERTAKING TO INDEMNIFY, PAY AND HOLD HARMLESS SET FORTH IN THIS SECTION MAY BE UNENFORCEABLE BECAUSE IT VIOLATES ANY LAW OR PUBLIC POLICY, EACH BORROWER SHALL PAY THE MAXIMUM PORTION WHICH IT IS PERMITTED TO PAY UNDER APPLICABLE LAW TO LENDER IN SATISFACTION OF INDEMNIFIED MATTERS UNDER THIS SECTION. THE FOREGOING INDEMNITY SHALL SURVIVE THE PAYMENT OF THE OBLIGATIONS AND THE TERMINATION OR NON-RENEWAL OF THIS AGREEMENT.

## SECTION 12. TERM OF AGREEMENT; MISCELLANEOUS

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### 12.1 Term.

(a) This Agreement and the other Financing Agreements shall become effective as of the date set forth on the first page hereof and shall continue in full force and effect for a term

ending on the date two (2) years from the date hereof (the "Renewal Date"), and from year to year thereafter, unless sooner terminated pursuant to the terms hereof. Lender or Borrowers may terminate this Agreement and the other Financing Agreements effective on the Renewal Date or on the anniversary of the Renewal Date in any year by giving to the other party at least sixty (60) days prior written notice; provided, that, this Agreement and all other Financing Agreements must be terminated simultaneously. Upon the effective date of termination of the Financing Agreements, Borrowers shall pay to Lender, in full, all outstanding and unpaid Obligations and shall furnish cash collateral to Lender in such amounts as Lender determines are reasonably necessary to secure Lender from loss, cost, damage or expense, including attorneys' fees and legal expenses, in connection with any contingent Obligations, including issued and outstanding Letter of Credit Accommodations and checks or other payments provisionally credited to the Obligations and/or as to which Lender has not yet received final and indefeasible payment. Such payments in respect of the Obligations and cash collateral shall be remitted by wire transfer in Federal funds to such bank account of Lender, as Lender may, in its discretion, designate in writing to Borrowers for such purpose. Interest shall be due until and including the next Business Day, if the amounts so paid by Borrowers to the bank account designated by Lender are received in such bank account later than 12:00 noon, Dallas, Texas time.

(b) No termination of this Agreement or the other Financing Agreements shall relieve or discharge any Borrowers of its respective duties, obligations and covenants under this Agreement or the other Financing Agreements until all Obligations have been fully and finally discharged and paid, and Lender's continuing security interest in the Collateral and the rights and remedies of Lender hereunder, under the other Financing Agreements and applicable law, shall remain in effect until all such Obligations have been fully and finally discharged and paid and Lender shall have no further obligations to make Loans or Letter of Credit Accommodations available to any Borrower.

(c) Upon the payment in full, in cash, of all Obligations and termination of the Financing Agreements, Lender shall, at Borrowers' expense, release the Collateral from the security interest granted herein and make such filings as may be reasonably necessary in connection herewith.

(d) If for any reason this Agreement is terminated prior to the end of the then current term or renewal term of this Agreement, in view of the impracticality and extreme difficulty of ascertaining actual damages and by mutual agreement of the parties as to a reasonable calculation of Lender's lost profits as a result thereof, Borrowers agree to pay to Lender, upon the effective date of such termination, an early termination fee in the amount set forth below if such termination is effective in the period indicated:

	Amount	Period
(i)	2% of Maximum Credit	From the date hereof to and including May 7, 2000.
(ii)	1% of Maximum Credit	After May 7, 2000 to and including the Renewal Date.
(iii)	.5% of Maximum Credit	From the Renewal Date and to but not including the next occurring anniversary of this Agreement after the Renewal Date.

Such early termination fee shall be presumed to be the amount of damages sustained by Lender as a result of such early termination and each Borrower agrees that it is reasonable under the circumstances currently existing. In addition, Lender shall be entitled to such early termination fee upon the occurrence of any Event of Default described in Sections 10.1(g) and 10.1(h) hereof, even if Lender does not exercise its right to terminate this Agreement, but elects, at its option, to provide financing to any Borrower or permit the use of cash collateral under the United States Bankruptcy Code. The early termination fee provided for in this Section 12.1 shall be deemed included in the Obligations.

12.2 Notices. All notices, requests and demands hereunder shall be in writing and (a) made to Lender at its address set forth below and to Borrowers at their chief executive offices set forth below, or to such other address as each party may designate by written notice to the other in accordance with this provision, and (b) deemed to have been given or made: if delivered in person, immediately upon delivery; if by telex, telegram or facsimile transmission, immediately upon sending and upon confirmation of receipt; if by nationally recognized overnight courier service with instructions to deliver the next Business Day, one (1) Business Day after sending; and if by certified mail, return receipt requested, five (5) days after mailing.

12.3 Partial Invalidity. If any provision of this Agreement is held to be invalid or unenforceable, such invalidity or unenforceability shall not invalidate this Agreement as a whole, but this Agreement shall be construed as though it did not contain the particular provision held to be invalid or unenforceable and the rights and obligations of the parties shall be construed and enforced only to such extent as shall be permitted by applicable law.

12.4 Successors. This Agreement, the other Financing Agreements and any other document referred to herein or therein shall be binding upon and inure to the benefit of and be enforceable by Lender, Borrowers and their respective successors and assigns, except that no Borrower may assign its rights under this Agreement, the other Financing Agreements and any other document referred to herein or therein without the prior written consent of Lender. Lender may, after notice to Borrowers, assign its rights and delegate its obligations under this Agreement and

the other Financing Agreements and further may assign, or sell participations in, all or any part of the Loans, the Letter of Credit Accommodations or any other interest herein to another financial institution or other person, in which event, the assignee or participant shall have, to the extent of such assignment or participation, the same rights and benefits as it would have if it were the Lender hereunder, except as otherwise provided by the terms of such assignment or participation.

12.5 Entire Agreement. This Agreement, the other Financing Agreements, any supplements hereto or thereto, and any instruments or documents delivered or to be delivered in connection herewith or therewith represents the entire agreement and understanding concerning the subject matter hereof and thereof between the parties hereto, and supersede all other prior agreements, understandings, negotiations and discussions, representations, warranties, commitments, proposals, offers and contracts concerning the subject matter hereof, whether oral or written. In the event of any inconsistency between the terms of this Agreement and any schedule or exhibit hereto, the terms of this Agreement shall govern.

12.6 NONAPPLICABILITY OF ARTICLE 5069-15.01 ET SEQ. BORROWER AND LENDER HEREBY AGREE THAT, EXCEPT FOR SECTION 15.10(B) THEREOF, THE PROVISIONS OF TEX. REV. CIV. STAT. ANN. ART. 5069-15.01 ET SEQ. (VERNON 1987) (REGULATING CERTAIN REVOLVING CREDIT LOANS AND REVOLVING TRI-PARTY ACCOUNTS) SHALL NOT APPLY TO THIS AGREEMENT OR ANY OF THE OTHER FINANCING AGREEMENTS.

12.7 WAIVER OF CONSUMER RIGHTS. BORROWERS HEREBY WAIVE THEIR RIGHTS UNDER THE DECEPTIVE TRADE PRACTICES - CONSUMER PROTECTION ACT, SECTION 17.41 ET. SEQ. BUSINESS & COMMERCE CODE, A

LAW THAT GIVES CONSUMERS SPECIAL RIGHTS AND PROTECTIONS. AFTER CONSULTATION WITH AN ATTORNEY OF THE BORROWERS' OWN SELECTION, THE BORROWERS VOLUNTARILY CONSENT TO THIS WAIVER. BORROWERS EXPRESSLY WARRANT AND REPRESENT THAT THE BORROWERS (a) ARE NOT IN A SIGNIFICANTLY DISPARATE BARGAINING POSITION RELATIVE TO LENDER, AND (b) HAS BEEN REPRESENTED BY LEGAL COUNSEL IN CONNECTION WITH THE TRANSACTIONS CONTEMPLATED BY THIS AGREEMENT.

BORROWERS HAVE READ AND UNDERSTAND SECTION 12.7: \_\_\_\_\_

(INITIALS OF AUTHORIZED OFFICER OF BORROWERS)

12.8 ORAL AGREEMENTS INEFFECTIVE. THIS AGREEMENT AND THE OTHER FINANCING AGREEMENTS REPRESENT THE FINAL AGREEMENT BETWEEN THE PARTIES AND THE SAME MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS, OR SUBSEQUENT ORAL AGREEMENTS OF THE PARTIES. THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN THE PARTIES.

BORROWERS AND LENDER EACH READ AND UNDERSTAND THIS SECTION 12.8:

\_\_\_\_ (INITIALS OF AUTHORIZED OFFICER OF BORROWER)  
\_\_\_\_ (INITIALS OF AUTHORIZED OFFICER OF BORROWER)  
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\_\_\_\_ (INITIALS OF AUTHORIZED OFFICER OF LENDER)

IN WITNESS WHEREOF, Lender and Borrowers have caused these presents to be duly executed as of the day and year first above written.

LENDER

\_\_\_\_\_

CONGRESS FINANCIAL  
CORPORATION (SOUTHWEST)

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Address:

\_\_\_\_\_

1201 Main Street, Ste. 1625  
Dallas, TX 75250

BORROWERS

\_\_\_\_\_

L&S AUTOMOTIVE PRODUCTS CO.

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Chief Executive Office:

\_\_\_\_\_

6 South Pennsylvania  
Oklahoma City, Oklahoma 73107

L&S BEARING CO.

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Chief Executive Office:

\_\_\_\_\_

6 South Pennsylvania  
Oklahoma City, Oklahoma 73107

LSB EXTRUSION CO.

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Chief Executive Office:

\_\_\_\_\_

6 South Pennsylvania  
Oklahoma City, Oklahoma 73107

ROTEX CORPORATION

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

Chief Executive Office:

\_\_\_\_\_

6 South Pennsylvania  
Oklahoma City, Oklahoma 73107

TRIBONETICS CORPORATION

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

Chief Executive Office:

\_\_\_\_\_

6 South Pennsylvania  
Oklahoma City, Oklahoma 73107

INTERNATIONAL BEARINGS, INC.

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

Chief Executive Office:

\_\_\_\_\_

1775 Airways Boulevard  
Memphis, Tennessee 38114

TERMINATION AND MUTUAL GENERAL  
RELEASE AGREEMENT

THIS TERMINATION AND MUTUAL GENERAL RELEASE AGREEMENT (this "Agreement") is dated as of May 10, 1999 and is entered into by and among L&S Bearing Co. ("Borrower"), L&S Automotive Products Co. ("Automotive"), LSB Extrusion Co. ("Extrusion"), Rotex Corporation ("Rotex"), Tribonetics Corporation ("Tribonetics"), International Bearings, Inc. ("Bearings") (Automotive, Extrusion, Rotex, Tribonetics and Bearings each being referred to individually as "Guarantor" and collectively as "Guarantors"), and Bank of America National Trust and Savings Association (successor-in-interest to BankAmerica Business Credit, Inc.) ("Lender").

RECITALS

This Agreement is entered into in reference to the following facts:

A. Lender and Borrower have entered into that certain Amended and Restated Loan and Security Agreement dated as of November 21, 1997 as amended by that certain First Amendment to Amended and Restated Loan and Security Agreement dated as of March 12, 1998, that certain Second Amendment to Amended and Restated Loan and Security Agreement dated as of June 30, 1998, that certain Third Amendment to Amended and Restated Loan and Security Agreement dated as of August 14, 1998, that certain Fourth Amendment to Amended and Restated Loan and Security Agreement dated as of November 19, 1998, and that certain Fifth Amendment to Amended and Restated Loan and Security Agreement dated as of April 8, 1999 (as so amended, the "Loan Agreement");

B. In connection with the Loan Agreement, each Guarantor executed a Continuing Guaranty dated as of November 21, 1997, and Borrower, Lender and all Guarantors entered into a Cross-Collateralization and Cross-Guaranty Agreement dated of even date

1

therewith, guaranteeing both Borrower's obligations under the Loan Agreement as well as the obligations of certain affiliates of Borrower under other "LSB-Related Loan Agreements" (as defined in the Loan Agreement).

C. Borrower and the Guarantors have obtained alternative financing and have repaid the Obligations that they owe to Lender, either directly or indirectly (the "Pay-out Amount").

D. Lender, Borrower, and the Guarantors have agreed to terminate their relationship and release each other from all claims as set forth in this Agreement.

NOW, THEREFORE, in consideration of the mutual covenants contained herein and for other good and valuable consideration, the parties agree as follows:

1. Lender's Representations and Agreements. In consideration of the payment in full of the Pay-Out Amount to Lender as set forth above, Lender hereby: (a) represents that lender has no other credit agreements with, loans outstanding to, guaranties by, or interests or liens against Borrower or Guarantors, Borrower's real or personal property, stock of Borrower, or of the Guarantors; (b) agrees that all security interests and liens which Borrower or Guarantors may have granted to Lender are released and terminated; (c) agrees that all security interests, if any, in the stock of Borrower or Guarantors are released and terminated; and (d) acknowledges and agrees that Borrower and the Guarantors have no further liability or obligation and are hereby released by Lender from any liability or obligation whether or not now known or suspected, under or in connection with the Loan Agreement or any other Loan Documents and that payment to Lender of the Pay-Out Amount has satisfied in full all of Borrower's and the Guarantors' obligations to Lender.

2. Releases. Borrower and each Guarantor hereby represent and warrant that there are no claims or offsets against, or defenses or counterclaims to, the terms and provisions of and the other obligations created or evidenced by the Loan Agreement or the other Loan Documents. Borrower and each Guarantor hereby releases,



acquits, and forever discharges Lender, and its successors,

assigns, and predecessors in interest, their parents, subsidiaries and affiliated organizations, and the officers, employees, attorneys, and agents of each of the foregoing (all of whom are herein jointly and severally referred to as the "Released Parties") from any and all liability, damages, losses, obligations, costs, expenses, suits, claims, demands, causes of action for damages or any other relief, whether or not now known or suspected, of any kind, nature, or character, at law or in equity, which Borrower or any Guarantor now has or may have ever had against any of the Released Parties relating to the Loan Agreement or the other Loan Documents, including, but not limited to, those relating to (a) usury or penalties or damages therefor, (b) allegations that a partnership existed between Borrower or any Guarantor and the Released Parties, (c) allegations of unconscionable acts, deceptive trade practices, lack of good faith or fair dealing, lack of commercial reasonableness or special relationships, such as fiduciary, trust or confidential relationships, (d) allegations of dominion, control, alter ego, instrumentality, fraud, misrepresentation, duress, coercion, undue influence, interference or negligence, (e) allegations of tortious interference with present or prospective business relationships or of antitrust, or (f) slander, libel or damage to reputation, (all of the above hereinafter being collectively referred to as the "Claims"), all of which Claims are hereby waived.

3. No Assignment of Claims; Advice of Counsel. The parties hereby warrant and represent that they have not assigned or in any other way conveyed, transferred, or encumbered all or any portion of the claims or rights covered by this Agreement. The parties, and each of them, execute this Agreement voluntarily, after consultation with counsel, and with full knowledge of its significance.

4. Sole Agreement; Amendments. This Agreement, the Loan Agreement and the other written documents and instruments between the parties set forth in full all of the representations and agreements of the parties, and this Agreement may not be modified or amended, nor may any rights hereunder be waived, except in writing signed by the parties hereto.

SIGNED:

BORROWER:

L&S BEARING CO.

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

GUARANTORS:

L&S AUTOMOTIVE PRODUCTS CO.

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

LSB EXTRUSION CO.

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

ROTEX CORPORATION

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

TRIBONETICS CORPORATION

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

INTERNATIONAL BEARINGS, INC.

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

"LENDER":

BANK OF AMERICA NATIONAL TRUST AND  
SAVINGS ASSOCIATION

By: \_\_\_\_\_

Michael J. Jasaitis,  
Vice President

May 19, 1999

Congress Financial Corporation (Southwest)  
1201 Main Street, Suite 1625  
Dallas, Texas 75250

Ladies and Gentlemen:

Reference is made to the financing agreements (the "Financing Documents") between L&S Bearing Co., LSB Extrusion Co., Tribonetics Corporation, Rotex Corporation, L&S Automotive Products Co., and International Bearings, Inc. (collectively, "Borrower") and Bank of American National Trust and Savings Association, successor-in-interest to BankAmerica Business Credit, Inc. ("Lender"). We understand that, on the Payoff Date (as hereinafter defined), Borrower expects to obtain financing (the "Financing") from Congress Financial Corporation (Southwest) ("Congress") for the purpose of repaying in full all of the obligations and liabilities of Borrower to Lender under or in respect of the Financing Documents (the "Lender Obligations").

1. This letter will confirm that, upon receipt by Lender of:

(a) no later than 12:00 p.m., Pacific time on May 10, 1999, a wire transfer of immediately available funds to Lender in the aggregate amount of \$11,834,739.33, subject to adjustment as set forth in this paragraph 1 (as so adjusted the "Payout Amount"), consisting of:

(i) \$11,723,071.78 in respect of unpaid principal outstanding under the Financing Documents (assuming no further loans or repayments are made); and

(ii) \$109,136.29 in respect of accrued and unpaid interest on such unpaid principal amount, assuming no changes in applicable interest rates and no changes in the outstanding principal amount (the per diem accrual of such interest being \$2,464.42 per day);

(iii) \$2,531.26 representing expenses of Lender payable by Borrower pursuant to the Financing Documents consisting of (A) \$0 in respect of letter of credit obligations outstanding, (B) \$63.39 in respect of letter credit fees and expenses, and (C) \$2,467.87 in respect of unused line fees.

(b) a fully executed counterpart of this letter agreement signed by Borrower.

(the date on which all of the foregoing conditions shall first be satisfied herein called the "Payoff Date"), all of the Lender Obligations shall be terminated and satisfied in full. If the assumptions set forth above with respect to the calculation of the principal and interest components of the Payout Amount are not correct, we will so advise Borrower and Congress and notify each of them writing on or before the Payoff Date of the adjusted figure for the Payout Amount, reflecting the appropriate changes in the amounts of principal and interest. Upon receipt of the Payout Amount in accordance with the foregoing and satisfaction of the other conditions referred to above, Lender agrees to release, on and with effect from the Payoff Date, all of its security interests, liens and other documents created as security for the Lender Obligations.

2. Please transfer the Payout Amount to Bank of America, San Francisco, California, ABA No. 121000358, Account No. 12575-03561 (reference LSB Industries), by wire transfer of immediately available funds, for receipt no later than

12:00 p.m., Pacific time, on the Payoff Date.

3. Borrower hereby confirms that the commitments of Lender to make loans to Borrower under the Financing Documents are terminated as of the Payoff Date.

4. Lender will, concurrently with the satisfaction of the conditions referred to in Paragraph 1 above, execute and deliver any Uniform Commercial Code termination statements, lien releases, mortgage releases, re-assignments of trademarks, discharges of security interests, and other similar discharge or release documents (and if applicable, in recordable form) as are reasonably necessary to release, as of record, the security interests, financing statements, and all other notices of security interests and liens previously filed by Lender with respect to the Lender Obligations.

5. Lender will, as promptly as practicable upon the satisfaction of the conditions referred to in Paragraph 1 above, return to Borrower the originals of any and all promissory notes and other documents evidencing or securing Borrowers' obligations to Lender previously delivered to Lender in connection with the Financing Documents, duly marked "paid in full" or "cancelled" (or with written authorizations to so mark such documents after the Payoff Date actually occurs) as may be appropriate.

6. Lender shall execute and deliver to or for Borrower or Congress such additional documents and shall provide additional information as Borrower or Congress may reasonably require to carry out the terms of this letter agreement.

7. Borrower acknowledges that the amounts referred to in Paragraph 1 above are enforceable obligations of it owed to Lender pursuant to the provisions of the Financing Documents and confirms its agreement to the terms and provisions of this letter by returning to Lender a signed counterpart of this

letter. This letter may be executed by each party on a separate counterpart, each of which when so executed and delivered shall be an original, but all of which together shall constitute one agreement.

Very truly yours,

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, successor-in-trust to BankAmerica Business Credit, Inc.

By: \_\_\_\_\_

Title: \_\_\_\_\_

Agreed to by the undersigned:

L&S BEARING CO.

By: \_\_\_\_\_

Title: \_\_\_\_\_

LSB EXTRUSION CO.

By: \_\_\_\_\_

Title: \_\_\_\_\_

TRIBONETICS CORPORATION

By: \_\_\_\_\_

Title: \_\_\_\_\_

ROTEX CORPORATION

By: \_\_\_\_\_

Title: \_\_\_\_\_

L&S AUTOMOTIVE PRODUCTS CO.

By: \_\_\_\_\_

Title: \_\_\_\_\_

INTERNATIONAL BEARINGS, INC.

By: \_\_\_\_\_

Title: \_\_\_\_\_



ASSET PURCHASE AGREEMENT\*

Between

QUANTUM EXPLOSIVES PTY LIMITED  
ACN 087 119 515  
("Purchaser")

and

TOTAL ENERGY SYSTEMS LIMITED  
ACN 010 876 150  
("TES")

and

T.E.S. MINING SERVICES PTY LTD  
ACN 010 975 676  
("TES Mining")

and

TOTAL ENERGY SYSTEMS (INTERNATIONAL) PTY LTD  
ACN 084 562 247  
("TES International")

and

TOTAL ENERGY SYSTEMS (NZ) LIMITED  
(DN/682396)  
("TES NZ")

LEGAL & CONTRACT SERVICES  
THIESS CONTRACTORS PTY LIMITED  
PO Box 199 Archerfield Qld 4108  
Ph: (07) 3275-8563 Fax: (07) 3275-8633  
email address: rsinclair@thiess.com.au  
Copyright 1999

\*INFORMATION IN THIS DOCUMENT HAS BEEN OMITTED FROM THIS PUBLIC FILING PURSUANT TO A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST.

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\*\*\*INDICATES INFORMATION IN THIS DOCUMENT WHICH HAS BEEN OMITTED FROM THIS PUBLIC FILING PURSUANT TO A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST.

AGREEMENT made 1999  
PARTIES TOTAL ENERGY SYSTEMS LIMITED ACN 010 876 150 ("TES")  
T.E.S. MINING SERVICES PTY LTD ACN 010 975 676  
("TES Mining")  
TOTAL ENERGY SYSTEMS (INTERNATIONAL) PTY LTD  
ACN 084 562 247 ("TES International")  
and TOTAL ENERGY SYSTEMS (NZ) LIMITED ("TES NZ")  
(DN/682396)  
all c/- Level 7, 371 Queen Street, Brisbane, Queensland  
("Vendors")

AND QUANTUM EXPLOSIVES PTY LIMITED ACN 087 119 515 of 146 Kerry  
Road, Archerfield, Queensland ("Purchaser")

## INTRODUCTION

- A. The Vendors conduct the Business in Australia and elsewhere.
- B. TES is a wholly owned indirect subsidiary of LSB Chemical. TES Mining, TES International and TES NZ are subsidiaries of TES.
- C. The Vendors have agreed to sell the Assets and the Business as a going concern to the Purchaser and the Purchaser has agreed to buy the Assets and the Business as a going concern from the Vendors on the terms of this Agreement.

## IT IS AGREED

### 1. Definitions and Interpretation

#### 1.1 Definitions

In this Agreement:

- 1.1.1 "Advertising Material" means all advertising, sales and marketing material owned or controlled by the Vendors and used by the Vendors in relation to the Business;
- 1.1.2 "Agreement" means this document, including any schedule or annexure to it;
- 1.1.3 "Assets" means the property of the Vendors (other than the Book Debts) used in the Business at the opening of business on the Completion Date, comprising:
  - .1 the Plant and Equipment and any other plant, equipment, fixtures and fittings used in connection with the Business at the date of this Agreement or acquired or constructed by the Vendors in connection with the Business after the date of this Agreement and prior to Completion;
  - .2 the goodwill of the Business including any Know-how, Technical Data, Advertising Material (including licence to use it) and copyright in any labelling or printing used by the Vendors in connection with the Business and any goodwill attaching to the trade marks and to the Business Names;
  - .3 the Intellectual Property used in connection with the Business at the date of this Agreement or acquired by the Vendors in connection with the Business after the date of this Agreement and prior to Completion including the Intellectual Property listed in

Schedule 3 but excluding the technology previously licensed to the Vendors by Mining Services International Inc. and the Toprime trademark;

- .4 the Inventory; and
- .5 the Material Contracts, the Property Leases, and, to the extent that they are capable of assignment or novation, all other contracts including all burdens and obligations of the Vendors thereunder entered into by the Vendors in the course of carrying on the Business and subsisting at the opening of business on the Completion Date including without limitation the Operating Leases and the Financing Leases;

- 1.1.4 "Balance Date" means the date to which the most recent balance sheet and profit and loss account of the Business have been made up;
- 1.1.5 "Book Debts" means the receivables of the Business owing to the Vendors as of the Completion Date;
- 1.1.6 "Business" means the Vendors' business of manufacturing and supplying bulk and packaged explosives and blasting agents and other products and services to the mining, quarrying, civil engineering and other industries in Australia, New Zealand and elsewhere;
- 1.1.7 "Business Day" means a day that is not a Saturday, Sunday or any other day which is a public holiday or a bank holiday in the place where an act is to be performed or a payment is to be made;
- 1.1.8 "Business Names" means those names set out in Schedule 4;
- 1.1.9 "Business Premises" means the premises and land that is the subject of the Property Leases;
- 1.1.10 "Business Records" means all books of account, accounts, records and data however recorded and all other documents relating to the Business and the Assets;
- 1.1.11 "Completion" means the performance of the acts set out in clause 10 to be performed on the Completion Date;
- 1.1.12 "Completion Date" means:
  - .1 1 June 1999 if the conditions precedent are satisfied or waived by 27 May 1999; otherwise
  - .2 1 July 1999.;
- 1.1.13 "Contaminant" includes:
  - .1 a gas, liquid or solid;
  - .2 an odour;
  - .3 energy including noise, heat, radioactivity and electromagnetic radiation; and
  - .4 a combination of contaminants.

- 1.1.14 "Contamination" means any release (whether by act or omission) of a Contaminant;
- 1.1.15 "Default Rate" means 10% per annum;
- 1.1.16 "Employees" means the persons employed by the Vendors in the Business at the date of this Agreement specified in Schedule 7 and any other persons who become so employed prior to Completion;
- 1.1.17 "Encumbrance" means any legal or equitable interest or power:
- .1 reserved in or over any Asset or any interest in any Asset; or
  - .2 created or otherwise arising in or over any Asset or any interest in any Asset under a transfer, bill of sale, mortgage, fixed or floating charge, lien (other than repairer's liens which will be discharged by the Vendors in the ordinary course), pledge, trust or power;
- by way of security for the payment of a debt, any other pecuniary obligation or the performance of any other obligation but does not include the burden of obligations and duties to be performed under the Property Leases, Material Contracts, Financing Leases, Operating Leases and other contracts relating to the Business and any existing licence or sublicense attaching to the Intellectual Property including without limitation the sublicense to Quin Investments Pty Ltd.;
- 1.1.18 "Environmental Law" means any law, whether statute or common law, concerning environmental matters, and includes but is not limited to law concerning land use, development, pollution, waste disposal, toxic and hazardous substances, conservation of natural and cultural resources and resource allocation including any law relating to exploration for or development of any natural resource;
- 1.1.19 "Environmental Liability" means any liability, obligation, expense, penalty or fine, whether present, prospective or contingent, under any Environmental Law;
- 1.1.20 "Existing Environmental Cost" has the meaning given in clause 37.3;
- 1.1.21 "Excluded Employees" means those Employees as agreed by the Purchaser and the Vendors, to whom the Purchaser does not have to make an offer of employment;
- 1.1.22 "Expert" means a person agreed in writing by the Vendors and the Purchaser or in default of agreement, a person appointed by the President for the time being of the Queensland Law Society on the application of either the Vendors or the Purchaser.
- 1.1.23 "Final Instalment Date" means 21 days after the Completion Date;
- 1.1.24 "Financing Leases" means the leases and hire purchase agreements listed in Schedule 12;
- 1.1.25 "Intellectual Property" means trade marks, logos, service marks, trade names, business names, copyrights, designs, patents, inventions, processes and other technical know-how and other rights in industrial property and applications for them and licence agreements or other arrangements

under which a person has the right to use any of  
the foregoing but excluding the technology  
previously licensed to the Vendors by Mining  
Services International Inc.;

- 1.1.26 "Know-how" means all the knowledge and information (whether contained in the Business Records or otherwise) which the Vendors or any Related Body Corporate have relating to the Business and which the Vendors are able to assign to the Purchaser without breaching any law or contract;
- 1.1.27 "Leased Plant and Equipment" means those items of Plant and Equipment specified in Schedule 12 as being subject to a Financing Lease.
- 1.1.28 "Liability" includes a present, prospective or contingent liability;
- 1.1.29 "LSB Chemical" means LSB Chemical Corp of 165 Pennsylvania Avenue, Oklahoma City, United State of America;
- 1.1.30 "LSB Industries" means LSB Industries Inc of 165 Pennsylvania Avenue, Oklahoma City, United State of America;
- 1.1.31 "Material Contracts" means the contracts specified in Schedule 6 including all burdens and obligations of the Vendors thereunder;
- 1.1.32 "Materials" means all files, input materials, output materials, media upon which input and output materials are located (including cards, disks, tapes and other storage facilities), software programs or packages and any related documentation to the extent that they are capable of assignment or novation, source codes and all other materials, reports, information and results in relation to the Business
- 1.1.33 "Necessary Approvals" means any consent, registration, filing, certificate, licence, approval, permit, authority or the like necessary to enable the Purchaser to conduct the Business including those specified in Schedule 9;
- 1.1.34 "Non-transferring Employees" means all of the Employees (other than Excluded Employees) who do not become Transferring Employees on or before the Completion Date;
- 1.1.35 "\*\*\* Assets" means the plant and equipment listed in Schedule 10;
- 1.1.36 "Operating Leases" means the leases listed in Schedule 11;
- 1.1.37 "Plant and Equipment" means the plant, equipment, vehicles, furniture, fixtures and fittings (including spare parts) specified in Schedule 2 and any additions or deletions thereto agreed by the parties;
- 1.1.38 "Plant Leases" means any leasing agreements, hiring agreements and hire purchase agreements affecting the Plant and Equipment prior to the Completion Date other than the Financing Leases;
- 1.1.39 "Property Leases" means the real property leases specified in Schedule 5 including all burdens and obligations thereunder;
- 1.1.40 "Purchase Price" means the purchase price stated in clause 6.1;
- 1.1.41 "PVI" means the total minimum Financing Lease lease payments less future finance charges and executory costs as shown in TES' lease statutory accounts disclosure report prepared in accordance with TES' usual practice as at the Completion Date;



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- 1.1.42 "Related Body Corporate" has the meaning given in section 9 of the Corporations Law;
- 1.1.43 "Inventory" means all trading stock, consumables, packaging and packaging materials, work-in-progress, raw materials and finished goods held, used or to be used in the Business and owned, unencumbered by the Vendors at the opening of business on the Completion Date;
- 1.1.44 "Satisfaction Date" means 29 June 1999 or such later date as the Parties may agree;
- 1.1.45 "SEC" means Slurry Explosive Corporation of 5700 North Portland, Oklahoma City, Oklahoma, United States of America;
- 1.1.46 "Technical Data" means all designs, drawings, specifications, formulae, manufacturing processes, operating procedures and other technical data and information of whatever kind relating to the Business which the Vendors are able to assign to the Purchaser without breaching any law or contract;
- 1.1.47 "Transferring Employees" means all Employees who accept the offers of employment made by the Purchaser under clause 15.1 on or before the Completion Date;
- 1.1.48 "Vendors" means TES, TES Mining, TES International and TES NZ; and
- 1.1.49 "Warranty" means a representation or warranty contained in Schedule 1A and 1 B.

## 1.2 Interpretation

### 1.2.1 Reference to:

- .1 one gender includes the others;
- .2 the singular includes the plural and the plural includes the singular;
- .3 a person includes a body corporate;
- .4 a party includes the party's executors, administrators, successors and permitted assigns;
- .5 a statute, regulation or provision of a statute or regulation ("Statutory Provision") includes:
  - (i) that Statutory Provision as amended or re-enacted from time to time; and
  - (ii) a statute, regulation or provision enacted in replacement of that Statutory Provision; and
- .6 money is to Australian dollars, unless otherwise stated.

1.2.2 "Including" and similar expressions are not words of limitation.

1.2.3 Where a word or expression is given a particular meaning, other parts of speech and grammatical forms of that word or expression have a corresponding meaning.

- 1.2.4 Headings are for convenience only and do not form part of this Agreement or affect its interpretation.
- 1.2.5 A provision of this Agreement must not be construed to the disadvantage of a party merely because that party was responsible for the preparation of the Agreement or the inclusion of the provision in the Agreement.
- 1.2.6 If an act must be done on a specified day which is not a Business Day, it must be done instead on the next Business Day.

### 1.3 Parties

- 1.3.1 If a party consists of more than 1 person, this Agreement binds each of them separately and any 2 or more of them jointly.
- 1.3.2 An obligation, representation or warranty in favour of more than 1 person is for the benefit of them separately and jointly.
- 1.3.3 A party which is a trustee is bound both personally and in its capacity as a trustee.

## 2. Conditions Precedent

2.1 This Agreement is subject to each of the following conditions precedent to the sale and purchase being fulfilled on or before the Satisfaction Date (unless otherwise stated):

- 2.1.1 the lessors, and the lessors' mortgagees (if required by the lessor), consenting to assignment of the Property Leases from the Vendors to the Purchaser with only such modifications or conditions as are reasonably acceptable to the Purchaser but the Purchaser shall accept as a condition of any such assignment that it provide to the lessors replacement security deposits or guarantees for those lodged by or on behalf of the Vendors;
- 2.1.2 all parties to the Material Contracts consenting to the assignment or novation of those contracts in favour of the Purchaser with only such modifications or conditions as are reasonably acceptable to the Purchaser but the Purchaser shall accept as a condition of any such assignment or novation that it provide to the other parties to the Material Contracts replacement security deposits or guarantees for those lodged by or on behalf of the Vendors;
- 2.1.3 the Minister for Mines and Energy for and on behalf of the State of Queensland:
  - .1 granting or otherwise agreeing in writing to grant to the Purchaser a new occupancy agreement, licence or lease to occupy the \*\*\* Explosive Reserve site on terms reasonably satisfactory to the Purchaser provided that a lease or licence or occupancy agreement on substantially similar terms to that currently held by TES will be reasonably satisfactory; and
  - .2 consenting to TES terminating without liability its existing Occupancy Agreement in respect of this site with effect on and from the Completion Date;

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2.1.4 the Purchaser (by the Completion Date) obtaining all Necessary Approvals in its own name on terms and conditions (if any) acceptable to the Purchaser provided the Purchaser has been advised and hereby acknowledges and agrees and understands that the Vendors operate a Business requiring licences under the Environmental Protection Act and that it will be necessary for an assignment of those licences or new licences to be obtained by the Purchaser in order to properly operate the Business;

2.1.5 the Purchaser entering an agreement with LSB Industries, under which LSB Industries agrees to supply the Purchaser ammonium nitrate on terms reasonably satisfactory to both the Purchaser and LSB Industries;

2.1.6 THIESS Contractors Pty Limited ACN 010 221 486 validly executing and giving to the Vendors a Guarantee in the form attached as Annexure A within 14 days after the execution of this Agreement or such longer time up to the Satisfaction Date as to which the Vendors, in their sole discretion may consent;

2.1.7 subject to clause 2.3 the Vendors and the Purchaser each in their absolute discretion being satisfied with the Existing Environmental Cost but the Vendors and the Purchaser will be satisfied with the Existing Environmental Cost if it is not in excess of \$100,000;

2.1.8 LSB Industries validly executing and giving to the Purchaser a guarantee in the form attached as Annexure B;

2.1.9 Subject to clause 38, SEC consenting to the assignment or novation of the Licence Agreement, dated 1 October 1996 between SEC and TES, from TES to the Purchaser on terms reasonably acceptable to the Purchaser. \*\*\*. The Purchaser also accepts that it will be a reasonably acceptable term of the assignment or novation of the licence agreement that the Purchaser cannot assign the licence or sublicense its rights thereunder without the consent of SEC which consent will not be unreasonably withheld in the case of a sublicense for the purpose of the production of product for the Purchaser's own use in selling to its customers; and

2.1.10 the Vendors (by the Completion Date) either, purchasing the Leased Plant and Equipment free from any Financing Lease or Encumbrance or, all parties to the Financing Leases consenting to the assignment or novation of those contracts in favour of the Purchaser with only such modifications or conditions as are reasonably acceptable to the Purchaser. Provided that the Purchaser shall accept as a condition of any such assignment or novation that where the lessor holds title in the Leased Plant and Equipment that fact may be registered pursuant to the Motor Vehicles Securities Act 1986 (Qld) or any similar legislation in any other Australian State.

2.2 Each party must at its own cost use its reasonable endeavours and co-operate with the other parties to procure satisfaction of the conditions precedent as quickly as possible.

2.3 Except as otherwise provided in this clause 2.3, each condition precedent is for the sole benefit of the Purchaser which may waive it by giving notice to the Vendors, provided that the Purchaser shall be deemed to have waived any failure of any such condition precedent if such failure arises as a result of the Purchaser's default. The condition

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precedent in clause 2.1.6 is for the sole benefit of the Vendors and may be waived by the Vendors in their absolute discretion. The condition precedent in clause 2.1.7 is for the benefit of both the Vendors and the Purchaser and cannot be waived without the agreement of the Parties provided that that condition precedent will be deemed to be satisfied where the Existing Environmental Cost exceeds \$100,000 if any of the following apply:

- 2.3.1 the Parties agree how the amount by which the Existing Environmental Cost exceeds \$100,000 ("Excess Amount") is to be borne between them;
- 2.3.2 the Vendor elects in its absolute discretion to accept the Existing Environmental Cost; or
- 2.3.3 the Purchaser agrees to bear the Excess Amount and in such a case the deduction from the Purchase Price in clause 6.1.4 shall be limited to \$100,000.

2.4 Subject to clauses 2.5, 2.6 and 2.7 if the conditions precedent are not satisfied or waived by the Satisfaction Date then this Agreement may be rescinded by the Purchaser or the Vendors by notice to the other without penalty.

2.5 Notwithstanding clause 2.1.1 and clause 10.2.10 the parties agree that there shall be no failure to fulfil the condition precedent and no breach of the completion obligation in those clauses where at the Satisfaction Date the consent of the lessor and if required by the lessor, the lessor's mortgagee to the assignment of the relevant Property Lease has not been obtained in respect of the premises described as \*\*\* or those premises which are used for residential purposes only In such a case the Vendors and the Purchaser will continue to pursue the lessors for consent to the assignment subsequent to the Completion Date.

2.6 Notwithstanding clause 2.1.2 and clause 10.2.2 the parties agree that there shall be no failure to fulfil the condition precedent and no breach of the completion obligation in those clauses if by the Satisfaction Date the consent of Denasa Detonantes Nacionales S.A. ("DDN") to the assignment of its contract with TES to the Purchaser has not been obtained, provided TES agrees to obtain goods under that contract for the Purchaser at the same price and otherwise on the same terms as TES has with DDN.

2.7 Notwithstanding clause 2.1.2 and clause 10.2.2 the parties agree that there shall be no failure to fulfil the condition precedent and no breach of the completion obligation in those clauses if by the Satisfaction Date the consent of Beston Chemical International Limited ("Beston") to the assignment of its contract with TES to the Purchaser has not been obtained, provided TES agrees to obtain goods under that contract for the Purchaser at the same price and otherwise on the same terms as TES has with Beston. Subject to the Beston contract being assigned to the Purchaser, the Purchaser shall on Completion pay to the Vendors in addition to the Purchase Price, an amount equal to the amount of credit available to TES and transferred to the Purchaser against the price for future purchases of goods under that contract.

2.8 Notwithstanding clause 2.1.2 and clause 10.2.2 the parties agree that there shall be no failure to fulfil the condition precedent and no breach of the completion obligation in those clauses if by the Satisfaction Date the consent of \*\*\* to the assignment of its contract with TES ("the \*\*\* Contract") to the Purchaser has not been obtained, provided TES agrees to obtain goods under that contract for the Purchaser at the same price and otherwise on the same terms as TES has with \*\*\*. The Purchaser acknowledges and agrees that it must order and pay for not less than 1200 tonnes of a combination of ammonium nitrate at 90% concentration and in prill form per 12 week period under the \*\*\* Contract.

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### 3. FIRB Approval

3.1 Within 3 Business Days after the date of this Agreement the Purchaser must apply to FIRB for approval to purchase the Assets and the Business as a going concern. The Purchaser must take all reasonable steps to obtain approval by the Completion Date ("Approval Date").

3.2 The Purchaser may terminate this Agreement by notice to the Vendors if by the Approval Date:

3.2.1 the Treasurer of the Commonwealth of Australia advises either the Vendors or the Purchaser that it objects to the purchase of the Assets and the Business as a going concern by the Purchaser;

3.2.2. the Treasurer has not notified the Vendors or Purchaser of his or her decision concerning the Purchaser's application; or

3.2.3 the Treasurer approves the purchase subject to conditions which are unsatisfactory to the Purchaser in exercise of the Purchaser's reasonable judgment.

### 4. Sale and Purchase

4.1 Subject to the terms, conditions and limitations of this Agreement, the Vendors sell to the Purchaser and the Purchaser purchases from the Vendors, the Assets and the Business as a going concern, free from Encumbrances.

### 5. Risk and Property

5.1 Subject to Completion, the title in and right to possession of the Assets passes to the Purchaser at the opening of business on the Completion Date.

5.2 The Assets remain at the risk of the Vendors until Completion, at which time such risk shall pass to the Purchaser.

### 6. Purchase Price

6.1 The Purchase Price for the Assets and the Business is the aggregate of:

6.1.1 \*\*\*;

6.1.2 \*\*\*;

minus:

6.1.3 \*\*\*;

6.1.4 \*\*\*;

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6.1.5 \*\*\*.

6.2 That part of the Purchase Price payable under clause 6.1.1 is apportioned as follows:

Goodwill	\$***
Plant and Equipment	***

It is agreed that, although the price for the goodwill of the Business has been specified, the goodwill has or may have (having regard to the provisions of this Agreement as a whole), a value to the Purchaser in excess of that price and, in the event of a breach of contract by the Vendors in relation to that Asset, the Purchaser is not restricted in claiming damages for the breach, to that price.

6.3 The Purchaser must pay the Purchase Price to the Vendors in accordance with clauses 10.5 and 11.

## 7. Inventory

7.1 The adjustments to the value of Inventory are determined in accordance with this clause 7.

7.2 The Vendors shall undertake their usual monthly physical stocktake of the Inventory as at the day prior to the Completion Date and representatives of the Purchaser may be present during that stocktake.

7.3 The Vendors and the Purchaser must use their reasonable endeavours to ensure that the stocktake of Inventory is completed prior to the opening of business on the Completion Date and that the value of Inventory is agreed not later than 15 days after the Completion Date.

7.4 The values ascribed to each item of Inventory must be \*\*\*.

7.5 The Vendors must not acquire any further Inventory after the date of this Agreement and prior to the Completion Date which would be excessive to the needs of the Business in the ordinary course.

7.6 Subject to clauses 7.5 and 11.1.2, in addition to the Purchase Price the Purchaser shall pay to the Vendors upon presentation of relevant invoices or bills of lading and reasonably satisfactory proof of payment, the costs payable by the Vendors (including invoiced costs, freight and transport charges, export and import duties and other incidental costs) for all raw materials and finished goods in transit or ordered by the Vendors but not delivered as at the Completion Date. Upon receipt of such payment the Vendor shall transfer to the Purchaser full and unencumbered title to and possession of those raw materials and finished goods. Provided that the Vendors may direct the Purchaser to make the necessary payments direct to the relevant supplier/creditor if upon the making of such payment full and unencumbered title to and possession of those raw materials and finished goods vests in the Purchaser.

## 8. Accrued Liabilities

8.1 The value of accrued liabilities referred to in clause 6.1.3 must be determined by the Vendors in accordance with this clause 8 and notified by the Vendors to the Purchaser not later than 15 days after the Completion Date.

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8.2 Annual leave must be calculated on the basis of full statutory entitlements on all service of Transferring Employees at the close of business on the last Business Day prior to the Completion Date less leave taken.

8.3 Long service leave must be calculated on the service of Transferring Employees to the close of business on the last Business Day prior to the Completion Date as:

8.3.1 Full Statutory Entitlements where an Employee is entitled to them, less leave taken; or

8.3.2 where an Employee has been employed for not less than 1/2 of the Qualifying Period, the same proportion of the Full Statutory Entitlements as the period of service of the Employee bears to the period of service required for Full Statutory Entitlements.

8.4 For the purpose of clause 8.3:

8.4.1 "Full Statutory Entitlements" means the entitlements of an Employee who has served the period required to entitle the Employee by law to take full long service leave without leaving the employment; and

8.4.2 "Qualifying Period" means the period which entitles an Employee by law to a proportional payment for long service leave if the employment terminates.

8.5 The Vendors must supply to the Purchaser on or prior to the Final Instalment Date such verification of the calculation of the accrued liabilities as the Purchaser may reasonably require.

## 9. Damage to Business Premises or Assets

9.1 If between the date of this Agreement and Completion, the Business Premises are damaged or destroyed or any item of Plant and Equipment is lost damaged or destroyed then:

9.1.1 if the destruction or damage renders the Business wholly or substantially incapable of being conducted for a period in excess of 21 days, the Purchaser may terminate this Agreement; or

9.1.2 if clause 9.1.1 does not apply, the Purchaser may deduct from the Purchase Price a sum equal to the \*\*\* value used in calculating that part of the Purchase Price constituted by the item which has been destroyed or lost or the cost of repair of the item which has been damaged.

## 10. Completion

10.1 Completion must take place at the office of the solicitors for the Vendors, in Brisbane, on the Completion Date or on such other date and place as may be agreed by the Vendors and the Purchaser.

10.2 At Completion, the Vendors must deliver the Assets and the Business to the Purchaser by giving to the Purchaser possession of the Assets and handing to the Purchaser:

10.2.1 all Business Records (including a complete and up-to-date list of customers and suppliers and records relating to each item of plant);

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- 10.2.2 assignments or novations of the Material Contracts and such assignments or novations of other contracts relating to the Business as it has then obtained together with the originals or counterparts of all contracts held by the Vendors;
- 10.2.3 "statements of change of persons in relation to whom business name is registered" in respect of the Business Names, signed by the Vendors, together with the certificates of registration of the Business Names;
- 10.2.4 [intentionally deleted];
- 10.2.5 a release of the deeds of charge given by the Vendors to \*\*\* so far as they relate to the Assets;
- 10.2.6 deeds of assignment of the trade marks which are owned by the Vendors (other than the "HEF" trademark ) together with certificates of registration of the trade marks;
- 10.2.7 if the Vendors are recorded, or have applied to be recorded, as claiming an interest in, or a right in respect of, a trade mark (other than the "HEF" trademark ), an application in the approved form signed by the registered owner of or applicant for the trade mark, to have a claim by the Purchaser to the same interest or right recorded in the register, together with a written consent by the Vendors to the cancellation of their claim;
- 10.2.8 all Technical Data, Materials and Advertising Material in the possession or under the control of the Vendors;
- 10.2.9 notices by the Vendors of disposition of all motor vehicles and certificates of roadworthiness for those motor vehicles;
- 10.2.10 assignments of the Property Leases signed by the Vendors and the lessors of the Property Leases, consents in writing of the lessors' mortgagees (if required by the lessor) to the Property Leases and the assignment of those Property Leases, and stamped counterparts of the Property Leases;
- 10.2.11 evidence to the reasonable satisfaction of the Purchaser of the purchase by the Vendors of any of the Plant and Equipment which had been subject to Plant Leases;
- 10.2.12 all documents signed by the Vendors that may be required to enable the Purchaser to apply for the transfer into its name of all permits, registrations, licences and documents necessary to enable the Purchaser to legally and effectively to carry on the Business other than the Necessary Approvals required to be obtained by the Purchaser prior to Completion under clause 2.1.4 which do not involve the transfer of existing licences or permits held by the Vendors or such Necessary Approvals which the Purchaser has applied for and for which the Purchaser has received written assurances from the relevant government authorities to the Purchaser's satisfaction;
- 10.2.13 releases of all Encumbrances affecting the Assets other than the Leased Plant and Equipment which is subject to a lease and that lease is assigned to the Purchaser and under that lease the relevant lessor retains the beneficial ownership of the relevant item of Leased Plant and Equipment;
- 10.2.14 particulars of all outstanding contracts or orders for the supply of goods or services of the

Business that have not been provided to the  
Purchaser;

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- 10.2.15 particulars of all outstanding contracts or orders for the acquisition of Materials, consumables, components and other supplies and services that have not been provided to the Purchaser;
- 10.2.16 particulars of the service and maintenance agreements relating to the Business that have not been provided to the Purchaser;
- 10.2.17 the employment records of all Employees;
- 10.2.18 details of the superannuation records of all Transferring Employees;
- 10.2.19 details of all payments to be made in respect of all Employees under any applicable legislation, registered industrial awards and contracts of employment;
- 10.2.20 all documents required from the Vendors to enable the Purchaser to obtain the telephone and facsimile services and numbers of the Business;
- 10.2.21 all keys and codes required to gain access to the Business Premises, all computer systems and all other property sold under this Agreement;
- 10.2.22 all other documents and information to be delivered to the Purchaser under this Agreement; and
- 10.2.23 all other information, items and documents relating to the Business which the Purchaser may reasonably require.

10.3 The Purchaser must prepare and submit to the Vendors within a reasonable time before Completion all assignments, applications and other documents which the Vendors are required to sign and hand to the Purchaser on Completion.

10.4 At Completion, the Vendors must:

- 10.4.1 use its best endeavours to transfer to the Purchaser the Financing Leases, the Operating Leases, any contracts, including all burdens and obligations of the Vendors thereunder, (other than the Material Contracts and the Property Leases) entered into by the Vendors in the course of carrying on the Business;
- 10.4.2 do (at the Vendors cost) all things (including executing deeds, documents and instruments) reasonably required by the Purchaser to transfer the legal and beneficial ownership and possession of the Assets and the Business to the Purchaser provided that the Purchaser shall prepare at its own cost, all such deeds, documents and instruments required to transfer the legal and beneficial ownership and possession of the Assets and the Business, including all deeds required to assign the Property Leases and the Material Contracts; and
- 10.4.3 comply with all requirements, notices, orders and directions given by any statutory, public or other competent authority affecting the Business or the Business Premises with regard to the conduct of the Business, which issued or of which the Vendors were aware, (although no notice was issued), before the date of this Agreement.

10.5 At Completion, the Purchaser must, subject to the Vendors performing all their obligations under this Agreement required to be performed by the Vendors at Completion pay to TES by telegraphic transfer and/or bank cheques drawn in the manner advised by the Vendors in writing:

10.5.1 \*\*\*;

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10.5.2 \*\*\*;

minus:

10.5.3 \*\*\*

10.5.4 \*\*\*.

10.6 Subject to this Agreement, the Vendors are entitled to the income of the Business, and must pay the outgoings of the Business, in respect of the period up to the close of business on the last Business Day prior to the Completion Date and, subject to this Agreement and to Completion, the Purchaser is entitled to the income of the Business and must pay the outgoings of the Business in respect of the period after that date.

10.7 Within 7 months from Completion or such longer period as the Purchaser may agree, the Vendors must change their names to names that do not include the words "Total" or "Energy" or any similar words but during that period the Vendors may continue to operate under their existing names subject to clause 23.

## 11. Final Instalment

11.1 At the Final Instalment Date:

11.1.1 the Purchaser must pay to TES the sum by which the Purchase Price exceeds the amount paid to TES under clause 10.5;

11.1.2 the Purchaser must reimburse the Vendors for:

.1 any payments made in advance by the Vendors prior to the opening of business on the Completion Date in respect of goods to be supplied and services to be rendered to the Business in the ordinary course after that time for the benefit of the Purchaser, other than any payments under contracts made in breach of Warranty; and

.2 any other payment made in advance by the Vendors in respect of the Business in the ordinary course prior to the opening of business on the Completion Date, the benefit of which is not received by the Business until after that time; and

11.1.3 the Vendors must reimburse the Purchaser for:

.1 any payments received in advance by the Vendors prior to the opening of business on the Completion Date in respect of goods to be supplied or services to be rendered after that time;

.2 any goods supplied and services rendered to the Vendors in respect of the Business prior to the opening of business on the Completion Date, payment for which must be made by the Purchaser after that time; and

.3 any payment which the Purchaser will become liable to make in respect of the Business after the opening of business on the Completion Date, the benefit of which was received by the Business before that time.

11.2 The Vendors must provide the Purchaser with details of all the payments referred to in clause 11.1 in writing not later than 15 days after the Completion Date together with such verification as the Purchaser may reasonably require.

CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION.  
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## 12. Warranties

- 12.1 The Vendors jointly and each of them separately warrant to the Purchaser in terms of the Warranties set out in Schedule 1A.
- 12.2 The Purchaser warrants to the Vendors in terms of the Warranties set out in Schedule 1B.
- 12.3 Each of the Warranties is made and applies at the date of this Agreement.
- 12.4 Each of the Warranties is made and applies at the Completion Date.
- 12.5 A Warranty which refers to "the knowledge, information and belief" of the Vendors, or which refers to their "knowledge", or contains words to that effect, or which refers to them or any of them being aware or not being aware of a matter, must be treated as including an additional Warranty that the Vendors have made due and reasonable enquiry as to the matter.
- 12.6 Any action for the breach of any Warranty made under this Agreement must be taken, if at all, within twelve (12) months after the Completion Date. Thereafter the person to whom the Warranty is made will have no right, claim or cause of action whatsoever arising out of any breach of or inaccuracy in the Warranties.
- 12.7 The Purchaser and Vendors acknowledge and agree that, other than as set out in Schedule 1A and 1B, neither the Vendors, the Purchaser, nor any other person for or on their behalf have made any representations, warranties or statements concerning the Business, the Assets or the subject matter of this Agreement.
- 12.8 The Inventory is sold to the Purchaser as is, where is, and with all faults. There is no express or implied warranty as to the condition, design, workmanship, or the lack of any latent defects in connection with any of the Inventory and the Vendors make no warranty of merchantability in respect of the Inventory or of the fitness of the Inventory for any particular purpose.

## 13. Indemnities

- 13.1 The Vendors indemnify the Purchaser against all Liabilities and the cost of all demands, actions and other proceedings against the Purchaser (including legal costs on a solicitor and own client basis) arising directly or indirectly as a result of or in connection with, any breach or non-performance of the Warranties made by the Vendors or obligations of the Vendors, whether express or implied, under this Agreement, provided however that the aggregate liability of the Vendors for all claims made for such breach or non performance shall not in any circumstances exceed \$1,000,000.
- 13.2 The Purchaser indemnifies the Vendors against all Liabilities and the cost of all demands, actions and other proceedings against the Vendors (including legal costs on a solicitor and own client basis) arising directly or indirectly as a result of or in connection with, any breach or non-performance by the Purchaser of the warranties made by the Purchaser or the obligations of the Purchaser, whether express or implied, under this Agreement or under any other agreement assigned to the Purchaser under this Agreement, provided however that the aggregate liability of the Purchasers for all claims made for such breach or non performance shall not in any circumstances exceed \$1,000,000.
- 13.3 If a claim is made by any person against a party ("Indemnified Party") which, if satisfied or paid by the Indemnified Party, would permit the Indemnified Party to make a claim against another party ("Indemnifier") under

this Agreement:

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- 13.3.1 the Indemnified Party must give notice of the claim to the Indemnifier; and
- 13.3.2 the Indemnifier must, within 21 days after receipt of that notice, either:
  - .1 cause the Indemnified Party to be put in sufficient funds to satisfy or pay the claim; or
  - .2 by notice to the Indemnified Party, request the Indemnified Party not to satisfy or pay the claim in whole or in part but, at the expense and direction of the Indemnifier, to take such action (including legal proceedings) and in such manner as the Indemnifier may direct, to avoid, dispute, defend, appeal or compromise the claim and any adjudication of it and the Indemnifier must also cause the Indemnified Party to be immediately put (and thereafter maintained) in sufficient funds in sufficient time to pay all costs and expenses of the action directed by the Indemnifier and indemnify the Indemnified Party against any Liability incurred in respect of the action and subject to this clause 13.3.2.2, the Indemnified Party must comply with the directions of the Indemnifier.

13.4 If the Indemnified Party becomes aware of a potential claim by any person against the Indemnified Party which, if satisfied by the Indemnified Party, would permit the Indemnified Party to make a claim against the Indemnifier under this Agreement, the Indemnified Party must give notice to the Indemnifier within 28 days after becoming aware of it.

#### 14. Debtors and Creditors

- 14.1 The Vendors must within 15 days of the Date of Completion hand to the Purchaser a list of the Vendors' Book Debts incurred prior to opening of business on the Completion Date.
- 14.2 The Purchaser, as agent for the Vendors, must collect the Vendors' Book Debts and bank all money so collected into a bank account nominated by the Vendors and account to the Vendors for the Book Debts so collected.
- 14.3 The Purchaser's obligations under this clause 14 are subject to the Vendors complying with their obligations under clause 14.6.
- 14.4 The Purchaser's obligations under this clause 14 are confined to receiving money from the Vendors' debtors and banking it into the bank account referred to in clause 14.2.
- 14.5 The Purchaser's obligations under this clause 14 cease at the expiration of 3 months from the Completion Date at which time the Vendors and the Purchaser shall deliver notice to each person responsible for the then outstanding Book Debts as to whom and where such Book Debts are to be paid so as to allow the Vendors to collect such remaining Book Debts directly.
- 14.6 The Vendors must not unreasonably dispute or delay any payments which are due by the Vendors at the Completion Date or become due by the Vendors thereafter to any creditors who are suppliers to the Business.

#### 15. Employees

- 15.1 At least 14 days prior to the Completion Date, the Purchaser must make offers of employment to each of the Employees (other than the Excluded Employees) upon terms and conditions generally no less favourable than those under which each Employee is employed by the Vendors at the date of this Agreement, requesting each of them to notify the

Vendors prior to the Satisfaction Date whether he or she intends to accept the offer. The Vendors and the Purchaser must use their best endeavours to encourage the Employees to accept the offers.

- 15.2 The Vendors agree, subject to Completion, to release all Transferring Employees from the employment of the Vendors from the close of business on the last Business Day prior to the Completion Date and to pay to all Transferring Employees all their outstanding wages, salaries and other entitlements, prior to the Completion Date, other than their entitlements in respect of long service leave, sick leave and holiday pay.
- 15.3 The Purchaser assumes all sick leave, long service leave, holiday pay and redundancy or severance obligations in respect of the Transferring Employees on the basis that there has been a transmission of the Business and that the past service of each Transferring Employee with the Vendors is, for these purposes, taken to be service with the Purchaser.
- 15.4 Subject to the Vendors complying with its obligations under clauses 15.1, 15.2 and 16.2 and Warranty 8 (Schedule 1A), the Purchaser indemnifies the Vendors against all claims for salary and wages, long service leave, sick leave, holiday pay (including applicable loadings), redundancy payments, severance payments, superannuation, rostered days off and other entitlements to which the Transferring Employees are or may become entitled whether under any contract of employment, award or otherwise and against all liability to payroll tax which is or may become payable from and after Completion
- 15.5 The Vendors must pay the cost of any redundancy payments or severance payments for Non-transferring and Excluded Employees, provided that the Purchaser must reimburse the Vendors for the full amount of any redundancy payment or severance payment paid by the Vendors to a Non-transferring or Excluded Employee where:
- 15.5.1 the Non-transferring or Excluded Employee is employed or re-employed by the Purchaser within 6 months of receiving the redundancy payment or severance payment; and
- 15.5.2 the Vendors have, at Completion, given the Purchaser notice of the Employees who have been paid redundancy or severance payments and of the amounts paid to each.
- 15.6 The Vendors must use their best endeavours to ensure that the Transferring Employees do not resign prior to or after the Completion Date and must not for the longest valid period specified in clause 23.1.2 employ or approach any of them for the purpose of employing them or removing them from the Business.

## 16. Superannuation

- 16.1 In respect of each Transferring Employee who is a member of a superannuation scheme operated for the benefit of Employees of the Vendors ("Vendors' Scheme"), the Purchaser must offer to such Employee immediate membership of a superannuation scheme operated for the benefit of employees of the Purchaser ("Purchaser's Scheme") by virtue of which:
- 16.1.1 superannuation benefits accrue in future on the usual basis applicable to members of the Purchaser's Scheme; and
- 16.1.2 superannuation benefits which have accrued under the Vendors' Scheme in respect of previous employment or scheme membership are at least preserved under the Purchaser's Scheme except that the benefits secured under the Purchaser's Scheme in respect of past employment or scheme membership may be adjusted on an equitable basis if the amount or assets transferred is insufficient to support the provision of the preserved benefits.
- 16.2 If a Transferring Employee elects to become a member of the

Purchaser's Scheme, the Vendors must cause the amount or assets representing the Employee's equitable entitlements under the Vendors' Scheme to be transferred to the Purchaser's Scheme as soon as practicable after the



Completion Date and must also cause to be provided to the Purchaser such information as the Purchaser or the trustee of the Purchaser's Scheme reasonably requests regarding the Employee's entitlements under the Vendors' Scheme.

#### 17. Plant Leases and Financing Leases

- 17.1 For the avoidance of doubt the Vendors must purchase any Plant and Equipment the subject of a Plant Lease and transfer such Plant and Equipment to the Purchaser on Completion free from any Plant Lease or Encumbrance.
- 17.2 The Purchaser acknowledges that the Financing Leases represent leases of certain items of the Plant and Equipment which would require the Vendors to pay sums whether or not characterised as penalties, in addition to the PVI thereunder in order to obtain unencumbered title to the relevant Plant and Equipment. On and from the Completion Date the Purchaser will assume all obligations of the Vendors under those Financing Leases which the Vendors cause to be assigned or novated to the Purchaser. Provided that the Purchaser shall accept as a condition of any such assignment or novation that where the lessor holds title in the Leased Plant and Equipment that fact may be registered pursuant to the Motor Vehicles Securities Act 1986 (Qld) or any similar legislation in any other Australian State.
- 17.3 If a Financing Lease cannot be assigned or novated to the Purchaser the Vendors must purchase the Plant and Equipment the subject of any such Financing Lease.

#### 18. Other Contracts

- 18.1 If any of the contracts entered into by the Vendors in relation to the Business including the Property Leases or the Operating Leases cannot be effectively transferred to the Purchaser as contemplated by this Agreement except by novation or by assignment made with the consent of a third party, the Vendors must upon the signing of this Agreement or so soon afterwards as is practical, do everything it can to procure the novation or the consent to the assignment.
- 18.2 In the period (if any) from the opening of business on the Completion Date until the particular contract, Operating Lease or any Property Lease, has been novated or effectively assigned to the Purchaser or has terminated, the Purchaser must pay, perform and discharge all of the obligations of the Vendors under the contract (including the return or relinquishment to a third party of any confidential information, know-how or technical data which may come into the possession of the Purchaser which the Vendors are obliged by law or contract to return or relinquish to that party) and the Vendors must permit the Purchaser to receive and must account to the Purchaser for all the proceeds and benefits arising from the contract. The Purchaser shall, subject to the terms of this Agreement, indemnify and keep indemnified the Vendors against all Liability, claims or demands of whatsoever nature which they may incur arising under such contracts on and from the Completion Date as a result of the acts or omissions of the Purchaser.
- 18.3 Where any of the contracts entered into by the Vendors in relation to the Business (including the Operating Leases ) or any of the Property Leases cannot be assigned or novated to the Purchaser despite the reasonable endeavours of both the Vendors and the Purchaser (the Unassignable Contracts) then on and from the Completion Date the Purchaser must pay, perform and discharge all the obligations of the Vendors under the Unassignable Contracts and the Vendors must permit the Purchaser to receive all benefits arising from the Unassignable Contracts on and from the Completion Date. The Purchaser shall, subject to the terms of this Agreement, indemnify and keep indemnified the Vendors against all liability of whatsoever nature which they may incur at any time on or from the Completion Date arising under the



## 19. Contractual Indemnity

- 19.1 The Purchaser shall indemnify and keep indemnified the Vendors against all Liabilities, claims, demands and costs suffered or incurred by the Vendors under any of the Material Contracts, Property Leases, Operating Leases, Financing Leases and other contracts entered into by the Vendors in relation to the Business which the Vendors may suffer or incur due to any failure by the Purchaser on and from the Completion Date to discharge the burdens and otherwise comply with the obligations of the Vendors under those contracts and leases.
- 19.2 The Purchaser shall indemnify and keep indemnified each of the Vendors, LSB Industries, LSB Chemical and their respective Related Bodies Corporate against all Liabilities, claims, demands and costs suffered or incurred by any of them under any Guarantees (as defined in clause 19.3) as a result of any failure by the Purchaser on and from the Completion Date to discharge the burdens and otherwise comply with the obligations of the Vendors under those contracts and leases in respect of which the Guarantees have been given. The Purchaser acknowledges and agrees that LSB Industries, LSB Chemical and their respective Related Bodies Corporate are deemed to have accepted the benefit of this indemnity by having given written notice to that effect to the Purchaser on or about the date hereof. The Purchaser acknowledges and agrees that it has received valuable consideration for this indemnity by LSB Chemical and LSB Industries causing the Vendors to enter into this Agreement.
- 19.3 Where any of the Material Contracts, Property Leases, Operating Leases, Financing Leases or other contracts entered into by the Vendors in relation to the Business are subject to a guarantee, guarantee and indemnity or other form of security ("Guarantee") given by or on behalf of the Vendors, LSB Industries, LSB Chemical or any Related Body Corporate to either or both companies, the Purchaser shall accept as a reasonable requirement of effecting the assignment of those instruments that it obtain or provide a replacement or substitute Guarantee in order that the existing Guarantee can be fully released and discharged.

## 20. Transition

- 20.1 A party must not make any media release or announcement or public statement (other than as may be required by law or under the listing rules of any relevant stock exchange) without the consent of the other parties and must consult with each other as to the timing and wording of their respective announcements of the sale and purchase of the Assets and the Business.
- 20.2 The Vendors must use its good offices to procure good relationships between the Purchaser and suppliers and customers of the Business.
- 20.3 The Vendors must give notice in writing of this sale and purchase to current customers of the Business in a form approved by the Purchaser.
- 20.4 Between the date of this Agreement and the Completion Date, the Vendors must allow a reasonable number of persons properly authorised by the Purchaser, reasonable access during normal business hours to inspect the Assets, Business Records and Materials.
- 20.5 The Vendors must use its best endeavours to maintain and preserve the Assets and the Business from the date of this Agreement to the Completion Date.
- 20.6 Until the Completion Date the Vendors:
- 20.6.1 must continue to carry on the Business in the ordinary and usual course; and
- 20.6.2 must not without the written consent of the

Purchaser, which the Purchaser may give or  
withhold at the discretion of the Purchaser:

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- .1 enter into or incur in the name or on behalf of the Business, any commitments or Liabilities, other than commitments or Liabilities in the ordinary course of business; or
- .2 enter into any arrangement or agreement in connection with the Business having a value or involving an amount in excess of \$100,000.

20.7 The Vendors must comply with any requirement, notice, order or direction given by any statutory, public or other competent authority affecting the Assets, the Business or the Business Premises with regard to the conduct of the Business which has issued or may issue or of which the Vendors are or becomes aware (although no notice is issued) before the Completion Date.

20.8 The Purchaser must comply with any requirement, notice, order or direction given by any statutory, public or other competent authority affecting the Business or the Business Premises with regard to the conduct of the Business issued or made known after the Completion Date. The Purchaser shall indemnify the Vendors against any Liability they may incur arising out of the Purchaser's failure to comply with any such requirements, notices, or direction.

## 21. Other Obligations after Completion

21.1 The Purchaser must preserve the Business Records received on Completion for 7 years and the Vendors, at reasonable times, may inspect and, at its expense, obtain copies of those records for taxation purposes or for litigation. The Vendors and their auditors shall have reasonable access at reasonable times, to the Business Records including without limitation use of computer processing facilities for the purposes of closing their books of account up to the Completion Date. The Vendors shall also be supplied with such reasonable assistance as they may require from the Transferred Employees in respect of processing information to close their books of account subsequent to Completion.

21.2 The Purchaser is not liable for accidental loss, destruction or damage to any of the Business Records, provided the Purchaser has taken the same efforts to safeguard the Business Records as it does its own records.

21.3 The Vendors must until 1 year after the Completion Date retain and, upon request, make available to the Purchaser any records, documents, Materials and papers not handed to the Purchaser on Completion which are necessary to enable the Purchaser to verify the Business Records and the Warranties.

## 22. Default

22.1 In this clause 22:

22.1.1 "Defaulting Party" has the meaning given to it in clause 22.2; and

22.1.2 "Correlative Party" means:

- .1 where the Purchaser is the Defaulting Party, the Vendors; and
- .2 where any of the Vendors are the Defaulting Party, the Purchaser.

22.2 Any of the Vendors or the Purchaser is a "Defaulting Party" for the purposes of clause 22 if any of the following apply:

22.2.1 the Defaulting Party fails to carry out any provision of this Agreement, the failure is capable of remedy and the Defaulting Party does not remedy that failure within 7 days after



written notice to the Defaulting Party by a Correlative Party requiring it to be remedied;

22.2.2 the Defaulting Party fails to carry out any material provision of this Agreement and the failure is not capable of remedy;

22.2.3 execution or other process of a court or authority or distress is levied for an amount exceeding \$10,000 upon any of the Defaulting Party's property and is not satisfied, set aside or withdrawn within 7 days.

22.2.4 the Defaulting Party suspends payment of its debts;

22.2.5 a Warranty given by the Defaulting Party in this Agreement is materially incorrect as of the date given;

22.2.6 it becomes unlawful for the Defaulting Party to perform its obligations under this Agreement;

22.2.7 where the Defaulting Party is a body corporate:

- .1 the Defaulting Party becomes an externally-administered body corporate under the Corporations Law;
- .2 steps are taken by any person towards making the Defaulting Party an externally-administered body corporate;
- .3 a controller (as defined in section 9 of the Corporations Law) is appointed of any of the property of the Defaulting Party or any steps are taken for the appointment of such a person;
- .4 the Defaulting Party is taken to have failed to comply with a statutory demand within the meaning of section 459F of the Corporations Law; or
- .5 a resolution is passed for the reduction of capital of the Defaulting Party or notice of intention to propose such a resolution is given, without the prior written consent of the other parties to this Agreement.

22.3 The Purchaser may at any time (without prejudice to its other rights and remedies under this Agreement or at law), if the Vendors are a Defaulting Party within the meaning of clause 22.2, terminate this Agreement by giving notice in writing to the Vendors.

22.4 The Vendors may at any time (without prejudice to its other rights and remedies under this Agreement or at law) if the Purchaser is a Defaulting Party within the meaning of clause 22.2, terminate this Agreement by giving notice in writing to the Purchaser.

22.5 Termination under this clause 22 does not prejudice any claim which a party may have against another at the time of termination.

22.6 If the notice referred to in clause 22.2.1 is given within 7 days prior to the Completion Date, then the Completion Date is extended to coincide with the expiry of the notice period.

22.7 Subject to clauses 13.1 and 13.2 a Defaulting Party must on demand pay to the Correlative Parties all of the expenses (including legal costs on a solicitor and client basis) incurred by the Correlative Parties in connection with the breach or default (including the giving of a notice under clause 22.2.1) and otherwise in connection with the





termination of this Agreement. Should notice be served on more than one party in connection with the same breach or default those parties are liable under this clause 22.7 jointly and each of them separately.

22.8 If the Purchaser terminates this Agreement under either clause 22.3 or its other rights under this Agreement or at law, the Vendors must, without prejudice to any other rights and remedies of the Purchaser, immediately refund to the Purchaser all money paid by the Purchaser to the Vendors under this Agreement.

22.9 If the Vendors terminate this Agreement under either clause 22.4 or its other rights under this Agreement or at law then:

22.9.1 the Vendors may either:

- .1 retain the Assets and the Business and sue for damages for breach of this Agreement; or
- .2 resell the Assets and the Business in such manner as the Vendors see fit and recover any deficiency in the Purchase Price on the resale and any costs and resulting expenses by way of liquidated damages; and

22.9.2 the Vendors may, pending determination of damages, retain any other money paid under this Agreement and may apply that money in satisfaction or part satisfaction of those damages.

## 23. Restraint on Competition

23.1 The Vendors, jointly and separately agree with the Purchaser that in order to protect the goodwill of the Business none of the Vendors will either directly or indirectly at any time:

23.1.1 within the area of:

- .1 Australia;
- .2 New Zealand;
- .3 Queensland;
- .4 Western Australia;
- .5 New South Wales;
- .6 South Australia;
- .7 Myanmar; and
- .8 The Solomon Islands;

23.1.2 for a period up to and including the Completion Date ("Pre-completion Period") and a period of:

- .1 3 years after the Completion Date; and
- .2 1 year after the Completion Date; and
- .3 6 months after the Completion Date.

either:

23.1.3 canvass or solicit:

- .1 orders for goods or services supplied by the Business in the 3 months prior to the Completion Date;
- .2 business the same as or similar to the Business in the 3 months prior to the Completion Date;

from any person who is or has been in the 12 months prior to the Completion Date a client or customer of the Business other than, during the Pre-completion Period, for the Business;

or:

23.1.4 engage or be concerned or interested in any business:

- .1 the same as or similar to the Business on the Completion Date;
- .2 the same as or similar to a material part of the Business on the Completion Date;

other than, during the Pre-completion Period, the Business.

23.2 The agreement by the Vendors in clause 23.1 applies to any of them acting:

23.2.1 either alone or in partnership or in association with another person;

23.2.2 as principal, agent, representative, director, officer or employee;

23.2.3 as member, shareholder, debenture holder, note holder or holder of any other security;

23.2.4 as trustee of or as a consultant or adviser to any person (other than the Purchaser); or

23.2.5 in any other capacity.

23.3 Clauses 23.1 and 23.2 have effect as comprising each of the separate provisions which results from each combination of a capacity referred to in clause 23.2, an area referred to in clause 23.1.1, a period referred to in clause 23.1.2 and a category of conduct referred to in clause 23.1.3 or clause 23.1.4. Each of these separate provisions operates concurrently and independently.

23.4 If any separate provision referred to in clause 23.3 is unenforceable, illegal or void, that provision is severed and the other provisions remain in force. Each of the Vendors acknowledges that each of those separate provisions is a fair and reasonable restraint of trade.

23.5 This clause 23 does not preclude the Vendors from owning securities of a corporation or trust which are quoted on a recognised stock exchange in Australia or elsewhere provided that they hold not more than 15% of the total quoted securities.

## 24. Expert Determination

24.1 If any dispute arises in relation to any provision of this Agreement, then either party may refer the dispute to the Expert for determination and:

24.1.1 the Expert acts as an expert and not as an arbitrator;



24.1.2 the decision of the Expert is final and binding on the parties; and

24.1.3 the parties must bear the costs of the determination in such manner as the Expert directs.

25. International Sale of Goods - Exclusion of Vienna Convention

25.1 The application of the United Nations Convention on Contracts for the International Sale of Goods (known as the Vienna Sales Convention 1980) is excluded.

26. Interest

26.1 If a party fails to pay an amount on the due date for payment, that party must pay to the other party interest at the Default Rate on that amount, calculated and payable daily, computed from the due date until the amount is paid in full.

27. Continuing Obligations

27.1 Each obligation and warranty (except an obligation fully performed at Completion) continues in force despite Completion.

28. Reconstruction of Authority

28.1 Where:

28.1.1 there is a reference to an authority, institution, association or body whether statutory or otherwise ("Authority"); and

28.1.2 the Authority is reconstituted, reconstructed, privatised, ceases to exist or is replaced or its powers or functions are transferred to another entity;

the reference must be read as being to the reconstituted, reconstructed or privatised entity or an entity established or constituted in replacement of or which succeeds to the relevant powers and functions of or which serves substantially the same purposes or has substantially the same objects as the Authority.

29. Further Assurance

29.1 Each party must promptly at its own cost do all things (including executing all documents) necessary or desirable to give full effect to this Agreement.

30. Severability

30.1 If anything in this Agreement is unenforceable, illegal or void then it is severed and the rest of this Agreement remains in force.

31. Entire Understanding

31.1 This Agreement:

31.1.1 is the entire agreement and understanding between the parties on everything connected with the subject matter of this Agreement; and

31.1.2 supersedes any prior agreement or understanding on anything connected with that subject matter.

31.2 Each party has entered into this Agreement without relying on any representation by any other party or any person purporting to represent that party.

## 32. Variation

32.1 An amendment or variation to this Agreement is not effective unless it is in writing and signed by the parties.

## 33. Waiver

33.1 A party's failure or delay to exercise a power or right does not operate as a waiver of that power or right.

33.2 The exercise of a power or right does not preclude either its exercise in the future or the exercise of any other power or right.

33.3 A waiver is not effective unless it is in writing.

33.4 Waiver of a power or right is effective only in respect of the specific instance to which it relates and for the specific purpose for which it is given.

## 34. Costs and Outlays

34.1 Each party must pay its own costs and outlays connected with the negotiation, preparation and execution of this Agreement.

34.2 The Purchaser must pay all stamp duty and other government imposts payable in connection with this Agreement and all other documents and matters referred to in this Agreement when due or earlier if requested in writing by the Vendors.

## 35. Notices

35.1 A notice or other communication connected with this Agreement ("Notice") has no legal effect unless it is in writing.

35.2 In addition to any other method of service provided by law, the Notice may be:

35.2.1 sent by prepaid registered post to the address for service of the addressee, if the address is in Australia and the Notice is sent from within Australia;

35.2.2 sent by prepaid airmail or internationally recognised delivery service (eg. DHL or Federal Express) to the address for service of the addressee, if the address is outside Australia or if the Notice is sent from outside Australia;

35.2.3 sent by facsimile to the facsimile number of the addressee; or

35.2.4 delivered at the address for service of the addressee.

- 35.3 A certificate signed by a party giving a Notice or by an officer or employee of that party stating the date on which that Notice was sent or delivered under clause 35.2 is prima facie evidence of the date on which that Notice was sent or delivered.
- 35.4 If the Notice is sent or delivered in a manner provided by clause 35.2, it must be treated as given to and received by the party to which it is addressed:
- 35.4.1 if mailed from within Australia to an address in Australia, on the sooner of actual delivery to that address as evidenced by Australia Post documentation or 3 days after mailing;
  - 35.4.2 if mailed to an address outside Australia or mailed from outside Australia, on the 5th Business Day (at the address to which it is mailed) after mailing;
  - 35.4.3 if sent by facsimile and confirmed as transmitted by the sending machine before 5 p.m. on a Business Day at the place of receipt, on the day at the place of receipt it is sent and otherwise at 8.00am on the next Business Day at the place of receipt; or
  - 35.4.4 if otherwise delivered before 5 p.m. on a Business Day at the place of delivery, upon delivery, and otherwise at 8.00am on the next Business Day at the place of delivery.
- 35.5 If a Notice is served by a method which is provided by law but is not provided by clause 35.2, and the service takes place after 5 p.m. on a Business Day, or on a day which is not a Business Day, it must be treated as taking place at 8.00am on the next Business Day.
- 35.6 A Notice sent or delivered in a manner provided by clause 35.2 must be treated as validly given to and received by the party to which it is addressed even if:
- 35.6.1 the addressee has been liquidated or deregistered or is absent from the place at which the Notice is delivered or to which it is sent; or
  - 35.6.2 the Notice is returned unclaimed.
- 35.7 The Vendors' address for service and facsimile number are:
- Name : Total Energy Systems Limited  
Attention : Kevin Harman  
Address : Level 7, 371 Queen Street, Brisbane  
Facsimile No. : (07) 3251 0040  
With copy to : Total Energy Systems Limited  
Attention: General Counsel  
Address : 16S., Pennsylvania Oklahoma City,  
Oklahoma USA 73107  
Facsimile No. : 405 236 1209
- 35.8 The Purchaser's address for service and facsimile number are:
- Name : Quantum Explosives Pty Ltd  
Attention : Nick Jukes  
Address : 146 Kerry Road, Archerfield, Brisbane  
Facsimile No. : 07 3275 8637
- 35.9 A party may change its address for service or facsimile number by giving Notice of that change to each other party.
- 35.10 If the party to which a Notice is intended to be given consists of more than 1 person then the Notice must be treated as given to that party if given to any of those persons.
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35.11 Any Notice by a party may be given and may be signed by its solicitor.

### 36. Governing Law and Jurisdiction

36.1 The law of Queensland governs this Agreement.

36.2 The parties submit to the non-exclusive jurisdiction of the courts of Queensland and the Federal Court of Australia.

### 37. Contaminated Land

37.1 The Purchaser and the Vendors shall at the Purchaser's cost, commission an investigation to be carried out ("site investigation") and a report to be prepared ("site investigation report") in respect of Contamination \*\*\*. The terms of this commission including the extent and nature of the investigation and report shall be settled by the Purchaser and the Vendors.

37.2 Any site investigation and site investigation report must be carried out and prepared by or at the direction of Dames & Moore Consulting Engineers of 127 Creek Street, Brisbane, Queensland.

37.3 The site investigation report must clearly state a reasonable estimate of the costs of doing all things necessary to avoid any Environmental Liability existing as at the Completion Date arising directly or indirectly as a result of or in connection with any Contamination identified at \*\*\* ("Existing Environmental Cost").

37.4 The Purchaser shall, subject to the terms of this Agreement, indemnify and keep indemnified the Vendors against all Liability, claims or demands of whatsoever nature which they may incur, arising in respect of Contamination the subject of a site investigation and site investigation report, \*\*\*.

### 38. Licence from SEC

38.1 The Purchaser acknowledges and agrees that it will take any assignment or novation of the licence agreement with SEC as referred to in clause 2.1.9 subject to and conditional upon the Purchaser assuming the rights and obligations of TES under a sublicense to \*\*\* ("the \*\*\* Sublicence"). The Purchaser shall pay to SEC that proportion of the monies paid to the Purchaser by \*\*\* under the \*\*\* Sublicence equal to the amount TES would have been required to pay to SEC if TES was still a party to the Licence agreement with SEC in respect of the use of the technology by \*\*\* under the \*\*\* Sublicence.

### 39. \*\*\* Assets

39.1 The Purchaser acknowledges and agrees that the Vendors may on or before the Completion Date sell to another party the \*\*\* Assets at a price equal to or higher than the \*\*\* and the Vendors may assign the benefit and obligations of the \*\*\* contract to such party.

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39.2 If the Vendors effect the sale referred to in clause 39.1, then the \*\*\* Assets shall be excluded from this Agreement and shall be deemed not to form part of the Assets for the purpose of this Agreement and the Purchase Price shall be calculated (in accordance with clause 6.1.1) without reference to the depreciated value of the \*\*\* Assets and the \*\*\* contract will not be assigned or novated to or otherwise benefit the Purchaser and it shall not be a Material Contract. If the Vendors do not effect a sale of the \*\*\* Assets in accordance with clause 39.1, then the \*\*\* Assets shall form part of the Assets under this Agreement and the depreciated value of those assets as shown in the books of account of the Vendors shall be taken into account in calculating the Purchase Price under clause 6.1.1. The \*\*\* contract shall in that case remain a Material Contract.

#### 40. Confidentiality

40.1 Subject to Completion all information concerning the Business and the Assets shall remain the confidential information of the Vendors and shall not be disclosed by the Purchaser to any person (except with the prior written consent of the Vendors) except to those of the Purchaser's employees requiring to know that information to discharge the Purchaser's obligations under this Agreement, its legal and financial advisers and bankers and then only if the recipient agrees prior to receipt to keep the information disclosed confidential.

40.2 This Agreement and its terms shall be kept confidential by the parties and shall not be disclosed to any other person except that party's legal and financial advisers and bankers and then only if the recipient agrees prior to receipt to keep the information disclosed confidential. This restriction does not apply to any disclosure of information:

40.2.1 made by the Vendors or the Purchaser in order to permit them to comply with their obligations under this Agreement; or

40.2.2 which is required by law or the rules of a relevant stock exchange to be communicated to a person who is authorised by law or by those rules to receive that information.

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SCHEDULE 1A  
(Clauses 1.1.50 and 12)  
Vendors' Warranties

1. Introduction and Information

The statements made in the Introduction are true and correct in every particular.

2. Names

The Vendors have not allowed or consented to or to the Vendors' knowledge suffered:

2.1 the use by any other person; or

2.2 the registration as a business name;

of a name similar to the any of the Vendors' names or the Business Names but the Purchasers acknowledge the existence of a company unrelated to the Vendors called "Total Mining Systems Pty Ltd".

3. Litigation and Outstanding Undertakings, Preservation of Rights

3.1 They are not aware of any facts or circumstances which are likely to lead to prosecution, litigation or arbitration involving the Assets or the Business except for the claim made against TES due to \*\*\*.

3.2 The Vendors have full power and has obtained all necessary consents of all persons and authorities to own, operate and lease the Assets and to conduct the Business.

3.3 Other than the lessors under the Property Leases and Operating Leases, the other contracting parties under the Material Contracts, the mortgagees of any of the Assets and the Lessors of the Leased Plant and Equipment, the Vendors have the legal right and power without obtaining the consent of any person or authority to enter into this Agreement and to sell the Assets and there is no Encumbrance over them which will not be discharged on or prior to Completion. The Parties acknowledge and agree that the Leased Plant and Equipment subject to leases which are assigned to the Purchaser shall remain the property of the lessor and may be subject to encumbrances which do no more than confirm that ownership. The Purchaser will obtain beneficial ownership of any Leased Plant and Equipment subject to leases which are assigned to the Purchaser only in accordance with the terms of the relevant Financing Leases.

3.4 Subject to Warranty 3.3, the beneficial ownership of the Assets will, on Completion, vest in the Purchaser free from all Encumbrances (whether arising by way of statute or otherwise).

3.5 No statutory or contractual notices have been or will, prior to the Completion Date, be served in respect of any of the Assets or the Business which in any material respect impair, prevent or otherwise interfere with the use of or proprietary rights in the Assets or the Business.

3.6 The Vendors are not an externally-administered body corporate under the Corporations Law and steps have not been taken by any person towards making the Vendors an externally-administered body corporate;

3.7 A controller (as defined in section 9 of the Corporations Law) has not been appointed of any of the property of the Vendors or any steps taken for the appointment of such a person.

3.8 The Vendors have not been served with a demand under section 459E of the Corporations Law which it is taken, under section 459F of the Corporations Law, to have failed to comply with.

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- 3.9 There are not and will not on the Completion Date, be any contracts binding upon the Vendors relating to the Business entered into outside the ordinary course of business.
- 3.10 The Vendors have produced or made available to the Purchaser, all Material Contracts, Property Leases and Plant Leases and, to the best of its knowledge, information and belief, all employee records (including details of annual compensation and accrued entitlements), superannuation plans, labour and employee service contracts, Intellectual Property rights, licences (including permits, consents, approvals, authorisations, qualifications and orders) and documentation relating to threatened or pending litigation, arbitration or governmental investigations concerning the Assets or the Business in its possession.
- 3.11 The Vendors are not aware of any proposals of any government, governmental body or authority or any organisation representing the Employees, the implementation of which (whether by force of law or voluntarily) might adversely affect the profitability of the Business or require any substantial capital expenditure by the Purchaser.
- 3.12 At the date of this Agreement and at the Completion Date, there are no claims made, proceedings issued or disputes in existence involving the Vendors or any other person under which a party is claiming that an Asset is defective and that loss or damage has been suffered as a result of the defect.

#### 4. Financial Matters

- 4.1 The Business Records have been fully, properly and accurately prepared, kept and completed in accordance with usual accounting concepts and practices and in accordance with the accounting concepts and practices adopted by the Vendors in the previous 3 financial years.
- 4.2 The most recent balance sheet and profit and loss account of the Business:
- 4.2.1 present a true and fair view of the profit or loss of the Business for the accounting period expiring on the Balance Date and the state of affairs of the Business at the Balance Date;
  - 4.2.2 accurately disclose the assets and liabilities of the Vendors in respect of the Business at the Balance Date;
  - 4.2.3 are not affected by any unusual or non-recurring item; and
  - 4.2.4 take account of all gains and losses, whether realised or unrealised, arising from foreign currency transactions.
- 4.3 Since the Date of this Agreement, no material change detrimental to the interests of the Purchaser has taken place in the financial position or business affairs of the Vendors or the Business.
- 4.4 The Vendors have not, since the Date of this Agreement, acquired any assets in respect of the Business other than in the ordinary course of the Business.
- 4.5 The Vendors do not in respect of the Business have any debts or liabilities other than those debts and Liabilities disclosed in the most recent balance sheet and debts and Liabilities which:
- 4.5.1 have been incurred in the ordinary course of the Business up to the Completion Date; and
  - 4.5.2 are neither:
    - .1 of an unusual nature; nor

.2 of an unusually large amount.

## 5. Statutory Returns

5.1 The Vendors have completed and lodged all returns and statements required to be lodged by law with any agency, department, authority or commission and the returns and statements so lodged were true and correct in every respect.

5.2 The books, records and registers of the Vendors in respect of the Business have been kept in accordance with all statutory requirements.

## 6. Disclosures

6.1 To the best of the knowledge and belief of the Vendors, all details relating to the Assets and the Business which would be material for disclosure to a prudent intending purchaser of the Assets and the Business have been disclosed to the Purchaser.

## 7. Conduct of the Business

7.1 The Business has been conducted in a normal and proper manner and there has not been any capital expenditure or agreement to incur capital expenditure since the Balance Date other than as notified to and approved of by the Purchasers except for the upgrade of TES 13 and the conversion to emulsion pumping of the two pump trucks as part of the \*\*\* Operations.

7.2 No schemes or arrangements operated by or relating to the Vendors in respect of the Business exist, which provide to any officer, Employee, independent contractor or agent of the Vendors a commission, remuneration or other payment calculated by reference to the whole or part of the turnover, profits or sales of the Vendors or the Business.

## 8. Employment

8.1 Full disclosure of all remuneration payable to each Employee has been made to the Purchaser and the Vendors are under no Liability to pay wages, superannuation payments or provide any other benefits to any Employee upon retirement, death, disability, attainment of a specified age or completion of a specified number of years of service at a rate or in a manner exceeding that Employee's entitlement under the legislation, industrial awards and registered industrial agreements applicable to that Employee other than as disclosed..

8.2 Full disclosure of all Liabilities for any long service leave, superannuation payments or any other payments or liabilities to any Employees due under any industrial award or state or federal legislation or any contract, agreement or arrangement has been made and there are no retirement benefit schemes, pension schemes or other superannuation or pension arrangements, whether legally enforceable or not, relating to the Business other than those disclosed in Schedule 8.

8.3 There are no existing, pending or threatened industrial disputes, whether between any trade union and the Vendors or not, relevant to the conduct of the Business and they are not aware of any claims or other facts or circumstances which may result in an industrial dispute and the Vendors have no undisclosed agreements with any trade union.

8.4 After the date of this Agreement and prior to the Completion Date, there will not be any change to the terms of employment (including remuneration) of the persons employed in the Business except pursuant to any award, determination or legislation.

## 9. Vehicles, Plant and Equipment

Each item of Plant and Equipment and each item leased by the Vendors under the Plant Leases:

9.1 is in good repair and condition taking into account normal

wear and tear;

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9.2 has been fully and properly cared for, repaired, maintained and serviced;

9.3 is of a specification and quality and in a condition to do satisfactorily the work for which it was designed;

9.4 is within the physical possession of the Vendors; and

9.5 is not a fixture to any real property other than a fixture which the Vendors have the right to remove.

#### 10. No Contravention of Any Law

10.1 To the best of their knowledge, information and belief, the Vendors, its officers, agents and Employees have not, within the 5 years preceding the Completion Date, permitted or omitted to do any act or thing the commission or omission of which is, or could be, in contravention of any law and which could have a material effect on the Assets or the Business.

10.2 The Vendors are not a party to any contract, arrangement or understanding which is in breach of the Trade Practices Act 1974 or any other law.

#### 11. Contracts

11.1 The Vendors have disclosed all material agreements or arrangements made in relation to the Business and all of the contractual documentation relating to any Material Contracts, the Property Leases, the Financing Leases and the Operating Leases.

11.2 The Vendors will not, on the Completion Date, be in default in any material respect, under any Material Contract or have committed any breach which would entitle the other contracting party to terminate the Material Contract or be in default in any material respect under any other contract entered into by it which is relevant to the Business or be in default in respect of any other obligations of the Vendors in respect of the Business.

11.3 The Vendors have not received notice of termination, rescission, avoidance or repudiation of any Material Contract.

11.4 At the date of this Agreement, the Vendors have and at the Completion Date will have, complied with all material terms and conditions of the Financing Leases and the Operating Leases, the Property Leases and in particular, terms and conditions relating to the payment of rent, repair and reinstatement of the leased Business Premises and the assets the subject of the Operating Leases or the Financing Leases and is not, at the date of this Agreement, and will not at the Completion Date be, in breach, in any material respect, or have committed any breach which would entitle the lessor to terminate the lease.

11.5 There is no agreement or arrangement with the Vendors in respect of the Business in respect of which any person is in default (without regard to any requirement of notice or period of grace or both).

11.6 No substantial customer or supplier of the Business has ceased trading with or supplying to the Business in the 6 months prior to the date of this Agreement or indicated an intention to cease or substantially reduce trading with or supply to the Business after the date of this Agreement.

11.7 With the consent of the other contracting party, the Vendors have the power and is entitled to assign the Material Contracts to the Purchaser.

11.8 There is no offer, tender or quotation given or made by the Vendors in respect of the Business, other than in the ordinary course of the Business, and still outstanding capable of giving rise to a contract by unilateral act of a third party.

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## 12. Intellectual Property

- 12.1 The Vendors are not aware of any product or publication of the Business or any process, drawing or machine carried out or used in the ordinary course of the Business, constitutes or may constitute an infringement of a patent, design, trade mark or copyright of any other person.
- 12.2 No proceedings have been instituted or are pending or are, to their knowledge, threatened, which challenge the validity of the ownership by the Vendors of the Intellectual Property used in the Business.
- 12.3 The Vendors have not licensed and are not obliged to licence anyone to use any of the Intellectual Property used in the Business other than sublicense for the use of the technology licence to TES by Slurry Explosives Corporation granted by TES to \*\*\* under the terms of the processing contract between the parties.
- 12.4 The Vendors are not aware of any infringing use or infringement by any other person of the Intellectual Property used in the Business.
- 12.5 The Vendors have and will at Completion have, the right to use all of the software used in the Business at the date of this Agreement and will provide to the Purchaser at Completion, licences to use all of the software currently used in the Business at the date of this Agreement.
- 12.6 The Vendors own or possess adequate and enforceable licences or other rights to use all Intellectual Property used in the Business at the date of this Agreement and has not received any notice of conflict with the rights of any other person.
- 12.7 The Vendors have not passed off any of its goods or services as those of any other person and its own use of Intellectual Property in respect of the Business does not infringe the rights of any other person.

## 13. Licences, Permits Etc.

- 13.1 The Vendors hold all permits, licences, authorities, rights to use, approvals, registrations, qualifications, orders and consents necessary for carrying on the Business (collectively "Permits") and the Permits are valid and in good standing and the Vendors are not in breach of any of them and has not failed to comply with any requirements of any of them and all material reports, returns and other information required to be made or given have been duly made or given.
- 13.2 There is no circumstance or fact involving the Vendors or its affairs which may result in the variation in any material respect, or revocation, of any permit, licence, authority or consent which it holds in respect of the Business.

## 14. Powers of Attorney Etc.

There is no subsisting power of attorney, appointment of agent or other authority to act on behalf of the Vendors in respect of the Business given by the Vendors to any person.

## 15. Land

- 15.1 All land and interests in land owned, leased, occupied or used by the Vendors in respect of the Business (other than in New Zealand and the \*\*\* Explosives Reserve) are set out in Schedule 5.
- 15.2 The buildings and other improvements constructed on or in the land owned, leased, occupied or used by the Vendors in respect of the Business, are in good condition and repair and fit for the purpose of carrying on the Business and the land, buildings and other improvements are not subject to any defect or other matter or circumstance (other than

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Contamination or Environmental Liability) which will, or may with the lapse of time, materially decrease the value of the land, buildings or improvements.

16. Inventory

16.1 On Completion the Vendors' Inventory position including Inventory on order and Inventory in transit or in bond or held on a consignment basis by customers of the Vendors, will be fully and accurately reflected in the Business Records with Inventory being valued on the same basis as for the most recent balance sheet of the Business.

17. No Unauthorised Disclosures

They have no knowledge of any unauthorised disclosure of any of the financial or trade secrets or other confidential information of the Vendors in respect of the Business.



SCHEDULE 1B  
(Clause 1.1.50)

Purchaser's Warranties

1. The Purchaser represents and warrants to the Vendors that:-
  - 1.1 It has the power to execute and deliver this Agreement and perform its obligations under or as contemplated by this Agreement. All necessary corporate and other action has been taken to authorise such execution, delivery and performance.
  - 1.2 This Agreement constitutes valid and legally binding obligations enforceable against the Purchaser in accordance with the terms of this Agreement.
  - 1.3 The execution and delivery by the Purchaser of, the performance by the Purchaser of its obligations under and the compliance by the Purchaser with the provisions of this Agreement shall not contravene any existing applicable law to which the Purchaser is subject or any deed or arrangement binding the Purchaser.
  - 1.4 The Purchaser has or will procure the skill, competence, resources, commitment of experienced personnel available to perform its obligations under this Agreement.
  - 1.5 No litigation, arbitration, tax claim, dispute or administrative proceeding is presently current or pending or, to the Purchaser's knowledge, threatened, which is likely to have a material adverse effect upon the Purchaser's ability to perform its financial and other obligations under this Agreement.

SCHEDULE 2  
(Clause 1.1.37)

Plant, Equipment, Fixtures and Fittings

Refer to separate bound document.

SCHEDULE 3  
(Clause 1.1.3.3)

Intellectual Property

Trademark	Owner	Class	Registration Application No.
TOTALPRILL	TES	13 - explosives in the form of prills or pellets made by prilling	732097
SX WATERGEL	TES	13 - explosives	732100
TOTALGEL	TES	13 - explosives	732102
BLACK THUNDER	TES	13 - explosives and explosive compositions including emulsion explosives	764108
HI-DRIVE	TES	13 - explosives including packaged explosives and emulsion explosives	774736
TOTAL	TES	13 - explosives, explosive powders, explosive cartridges, detonating fuses for explosives, detonating caps (other than toys), Detonators, fuses for explosives and all other explosive compounds or compositions in this class	779004
SCALERITE	TES	13 - explosives	722663
TES TOTAL ENERGY SYSTEMS QUALITY EXPLOSIVES	TES	13 - explosives	732089
SLX600	TES	13 - explosives	732091
TOTALPRIME	TES	13 - explosives	732092
TOTALCORD	TES	13 - explosives	732093
BREAKRITE	TES	13 - explosives	732095
NITREX	TES	13 - explosives	732096
BLASTMAX	TES	13 - explosives	732098



SCHEDULE 4  
(Clause 1.1.8)

Business Names

Name	State of Registration	Registration No.
Total Mining Chemicals	Queensland	BN6827251
Total Mining Chemicals	Western Australia	0230737C
Total Mining Chemicals	Tasmania	114386B
Total Mining Chemicals	New South Wales	U6377808
Total Mining Chemicals	Northern Territory	69186B
Total Mining Chemicals	South Australia	0427835X
Total Mining Chemicals	Victoria	1374989X

SCHEDULE 5  
(Schedule 1A Warranty 15.1)

Property Leases

Part A - Business Leases

Location	Lessor	Start Date
***	Queensland Investment Corporation	14/04/97
***	Queensland Investment Corporation	22/04/96
***	BHP -Utah Coal Limited and others (sublessors from the crown of special lease no. 12/42239)	30/03/89
***	Robert Hector McKenna	08/12/96
***	Sabemo (WA) Pty Ltd	15/09/98
***	The Minister for Mining (WA)	1996 (undated and unsigned)

Part B - Residential Leases

Lease	Location	Start Date
Queensland Property Management (Queensland Housing Commission)	***	17/06/97
Queensland Property Management	***	17/06/97
Queensland Property Management	***	17/06/97
Queensland Property Management	***	13/02/98
Queensland Property Management	***	17/06/97
Clermont Agencies	***	10/98
Ray Hooper Real Estate	***	11/96
North West Realty	***	12/06/98
D & C Bourke	***	20/03/95
Professionals Robe	***	20/03/96

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SCHEDULE 6  
(Clause 1.1.31)

Material Contracts

Contract	Parties	Location	Start Date
***	***	***	08/97
***	***	***	03/98
***	***	***	01/10/98
***	***	***	09/98
***	***	***	00/11/98
***	***	***	01/12/98
***	***	***	01/09/98
***	***	***	01/08/98

Supply Contract between TES and \*\*\*.

Supply Contract between TES and \*\*\*.

Processing Agreement between TES and \*\*\* dated 22 November 1996.

Ammonium Nitrate Supply Agreement between TES and \*\*\* as set out in a letter dated 19 June 1998.

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SCHEDULE 7  
(Clause 1.1.16)

Employees

Management	Position	Category
***	***	Perm
***	***	Perm
***	***	Perm
***	***	Perm
***	***	Perm
***	***	Perm
***	***	Perm
***	***	Perm
***	***	Perm
***	***	Perm
***	***	Perm
***	***	Perm
***	***	Perm
***	***	Perm
***	***	SIT
Administrative		
***	***	Contract
***	***	Part Time
***	***	Perm
***	***	Perm
***	***	Perm
***	***	Perm
***	***	Perm
***	***	Perm
***	***	Perm
Operators		
BW Govaars		Casual
CC O'Niell		Perm
D G Medlin		Casual
G X Carige		Casual
J B Barnicoat		Casual
J I Medlin		Perm
J J Mallett		Casual
JN Hudson		Casual
K J Backo		Casual
M E Clarke		Casual
N E Eaton		Casual
P J Platzke		Casual
S J M Medlin		Casual
V J Lee		Casual
W J Eaton		Casual
W G Offord		Casual
D E Roberts		Perm
D P Gallagher		Perm
M T Petrovic		Perm
C B Wickett		Perm
D P Kelly		Casual
G H Brown		Perm
R L Bingham		Casual

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Management	Position	Category
S C Ruyter		Perm
A T McHardy		Perm
B V Fisher		Perm
D P Hilder		Perm
L T Sibeko		Casual
P A Miller		Casual
P A Morrison		Casual
S W Walker		Casual
T Park		Casual
W B Gardener		Perm
D I P Sargeant		Casual
P A Galanty		Casual
D L White		Casual
D K P Stewart		Casual
D P Kelly		Casual
C B Wickett		Perm
Z J Martin		Casual
P Wowinski		Perm
S R Staunton		Perm
T G Hicks		Perm
J S Tisdall		Casual
M J Page		Casual
P Rangi		Casual
R Bentley		Casual
A G Hundloe		Perm
A Parsons		Casual
D A Parish		Casual
J M Malone		Casual
L R Malone		Casual
L R Gurr		Perm
M J Polsen		Casual
P J White		Casual
P D Watts		Casual
S J Eustace		Operators
I R Press		Casual
P Huttel		Casual
R B Johnson		Casual
W J Sutherland		Perm
A S Brown		Perm

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SCHEDULE 8  
(Schedule 1 Warranty 8.2)

Retirement Benefit Schemes, Pension Schemes  
and Other Superannuation or Pension Arrangements

The following public offer accumulation fund:

Colonial Master Fund Superannuation Fund (SFN 2975/329/46)

SCHEDULE 9  
(Clause 1.1.33)

Necessary Approvals

EXPLOSIVE AND ENVIRONMENTAL LICENCES

Location	License to Manufacture Explosives	License to Store Explosives	Environmental License	Others
Queensland-General				<p>Licence to Import Explosives in Queensland Date Granted: 27-08-98 Expiry Date: 30-06-99</p> <p>Licence to Sell Explosives in Queensland Date Granted: 27-08-98 Expiry Date: 30-06-99 Licence No.: 1236 Licensee: TES</p>
***	<p>General Licence to Manufacture Explosives Dated Granted: 27-08-98 Expiry Date: 30-06-99 Licence No.: 0040 Licensee: TES</p>	<p>General Licence Store More than 250KG Date Granted: 27-08-98 Expiry Date: 30-06-99 Licence No. 1236 Licensee: TES</p>	<p>Licence appears to be required for the activities at this site</p>	
***	<p>Licences are required for this site</p>	<p>Licences are required for this site</p>		
***	<p>Licence required if TES is currently manufacturing on site</p>	<p>Licence to Store Explosives/ Magazine License - Magazine T3 50,000Kg Dated Granted: 04-12-98</p>		

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Location	License to Manufacture Explosives	License to Store Explosives	Environmental License	Others
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Expiry Date:  
01-12-99  
Licensee: TES

License to Store Explosives - Magazine DET  
Capacity 2,000  
Date Granted: 17-01-99  
Expiry Date: 16-01-2000  
Licensee: TES

\*\*\* Licences have expired      Licenses have expired

AUTHORISATIONS FOR EXPLOSIVES

Description	UN No & Class	Date of Gazettal (where available)
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New South Wales

PRILL BLENDED ANFO	0082/1.1D	26-4-94
BESTON (BST) BOOSTERS	0042/1.1D	21-8-96
DETAGEL CONTINUOUS PRESPLIT	0241/1.1D	30-10-96

New Zealand

FRAGMAX 60-100	0332/1.5D	13-3-97
ERT ROGEL F PRESPLIT/RIOSPLIT	0241/1.1D	13-3-97
DENASA PREMADETS	0360/1.1B	13-3-97
TROJAN BOOSTER	0042/1.1D	13-3-97
TOTAL CORD 3	0065/1.1D	13-3-97

Northern Territory

SX-WATERGELS	0332/1.5D	7-2-94
ORANGE CAP BOOSTER	23-3-94	
GREEN CAP BOOSTER	23-3-94	
PRILL BLENDED ANFO	0222/1.1D	20-4-94
TOTAL PRIME		23-1-97
TOTALCORD		23-9-94

Queensland

ANFO ISL, L, TOE PACK	0082/1.1D	31-5-90
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Description	UN No & Class	Date of Gazettal (where available)
AU 1000	0082/1.1D	15-3-90
AU 220	0082/1.1D	7-12-90
BESTON (BST) BOOSTERS / AND/OR TOTALPRIME	0042/1.1D	18-10-96
BLASTRITE	0241/1.1D	15-3-90
BREAKRITE	0241/1.1D	15-3-90
DETAGEL HS DETAGEL PRE-SPLIT	0241/1.1D	1-8-85
1.25 X 8 (32X)		
DETAGEL HS DETAGEL PRE-SPLIT	0241/1.1D	1-8-85
EMULEX 500 SERIES	0241/1.1D	13-3-92
EMULEX 700 SERIES	0241/1.1D	13-3-92
EMULINE - CONTINUOUS PRE-SPLIT	0241/1.1D	15-3-90
FANEL DETS MS, LP TRUNK	0030/1.1B	15-9-90
FRAG & FRAGMAX	0030/1.1B	15-9-90
HEF EMULSION FOR HANFO		24-8-89
HEXAPOUR AND HEXAPOUR SD	0082/1.1D	6-7-89
HX SERIES 110, 120, 130, 135- HX HEAVY ANFO HX	0082/1.1D	17-8-89
HXSERIES 110, 120, 130, 135- HX 130 and 301	0082/1.1D	17-8-89
HYDROMITE 600 SERIES	0241/1.1D	13-3-92
MINERITE	0241/1.1D	15-3-90
MS CONNECTORS-(EB) PRIMADET MS C		15-3-90
MS CONNECTORS(EB) PRIMADET MS C		15-3-90
MS CONNECTORS-(EB) PRIMADET MS C		15-3-90
MS CONNECTORS-(EB) PRIMADET MS C		15-3-90
MS CONNECTORS-(EB) PRIMADET MS50		15-3-90
MS CONNECTORS-(ETI) DETINEL MS CO		15-3-90
MS CONNECTORS-MS230 CONNECTORS		15-3-90
MS CONNECTORS-P/DET MSC CONN MS		15-3-90
MS CONNECTORS-P/DET MSC CONN MS		15-3-90
PENTACORD 3PE, 5PE, 10PE- 10PE CORD	0065/1.1D	15-3-90
ASSET PURCHASE AGREEMENT B/222128	46	C COPYRIGHT 1999

Description	UN No & Class	Date of Gazettal (where available)
PENTACORD 3PE, 5PE, 10PE - 5PE CORD NEW	0065/1.1D	15-3-90
PRILL BELNDED ANFO-	0082/1.1D	24-8-94
ROCK CRUSHER BOOSTER	0042/1.1D	27-8-92
ROCK STAR ELECTRIC DETONATORS	0030/1.1B	15-1-90
SX-WATERGEL-SX550 COAL DUST SL	0241/1.1D	25-5-89
SX 20	0241/1.1D	7-12-90
		14-10-97
SX 500, 550, 600	0241/1.1D	14-10-97
TOTALCORD (3, 5, 10 GM)	0065/1.1D	24-8-94
TOTALGEL 60-100	332/1.5D	19-3-97
SX WATERGEL TRIMRITE - TRIMRITE 25MM X 40	0241/1.1D	14-10-97
TRIMRITE - TRIMRITE 25MM X 44	0241/1.1D	5-10-90
RIOGEL 2F-25 AND RIOGEL G		31-5-90
RIOGEL TTX		31-5-90
DETAGEL PRE SPLIT		18-10-96
TOTAL GEL		15-12-94

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South Australia

DETAGEL PRESPLIT	0241/1.1D	16-4-93
DETAGEL	0241/1.1D	16-4-93
ORANGE CAP CAST BOOSTER (454G)	0042/1.1D	16-4-93
GREEN CAP CAST BOOSTER (151G)	0042/1.1D	19-4-93
SCOTCH CORD	0065/1.1D	19-4-93
SCALERITE	0241/1.1D	16-6-97
BREAKRITE	0241/1.1D	16-6-97
TOTALPRIME	0241/1.1D	5-11-96
TOTALCORD-3	0065/1.1D	15-8-94
TOTALCORD-5	0065/1.1D	15-8-94
TOTALCORD-10	0065/1.1D	15-8-94
A"CORD	0065/1.1D	28-1-93

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Western Australia - Explosives  
& Dangerous Goods Act 1961 and  
Explosive Regulations 1963

Description	UN No & Class	Date of Gazettal (where available)
ANFO-BLASTING AGENT	0222/1.1D	28-4-94
AU100 WATERGEL	0332/1.5D	
AU200 WATERGEL	0332/1.5D	
AU600 WATERGEL	0332/1.5D	
BLACK CAP CAST BOOSTER (340G)	0042/1.1D	31-3-94
BLASTRITE	0241/1.1D	
CBS A-CORD DETONATING CORD	0065/1.1D	
CXA MS CONNECTORS	0360/1.1B	
DETAGEL-1.25X8	0241/1.1D	
DETAGEL 1X8	0241/1.1D	
DETAGEL PRE-SPLIT	0241/1.1D	
DETONATORS-DET.NITRONOBELDY	0029/1.1B	
EMULEX 500 SERIES-EMULEX 510 1.25X12	0241/1.1D	7-10-92
EMULEX 500 SERIES-EMULEX 520 1.5X12	0241/1.1D	7-10-92
EMULEX 700 SERIES-EMULEX 720 2.5X16	0241/1.1D	7-10-92
EMULEX 700 SERIES-EMULINE 1.25 INCH	0241/1.1D	7-10-92
ENSIGN BICKFORD H.D. PRIMACORD	0065/1.1D	
ETINEL NON-ELECTRIC DETONATORS	0360/1.1B	
ETINEL NON-ELECTRIC DETONATORS	0360/1.1B	
FANEL NON-ELECTRIC DELAY DETONATORS	0360/1.1B	
FRAGMAX SERIES	0332/1.5D	
HEF90FRAGMAX		
GREEN CAP CAST BOOSTER (151G)	0042/1.1D	31-3-94
HEXAPOUR	0332/1.5D	
MINERITE 2	0241/1.1D	
NITREX -***	0082/1.1D	
NONEL PRIMADETS (EB) PRIMADET SL P1	0360/1.1B	
NONEL PRIMADETS 12M PRIMADET P15 M	0360/1.1B	
NONEL PRIMADETS 3.6M P/DET P1 MS 25 1	0360/1.1B	
NONEL PRIMADETS 3.6M PRIMADET P8 M	0360/1.1B	
NONEL PRIMADETS 6M PRIMADET P1 MS	0360/1.1B	
NONEL PRIMADETS 6M PRIMADET P13 M	0360/1.1B	
NONEL PRIMADETS 6M PRIMADET P14 M	0360/1.1B	
NONEL PRIMADETS 6M PRIMADET P15 M	0360/1.1B	
NONEL PRIMADETS 6M PRIMADET P2 MS	0360/1.1B	

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Description	UN No & Class	Date of Gazettal (where available)
NONEL PRIMADETS 6M PRIMADET P4 MS	0360/1.1B	
NONEL PRIMADETS 6M PRIMADET P5 MS	0360/1.1B	
NONEL PRIMADETS 6M PRIMADET P6 MS	0360/1.1B	
NONEL PRIMADETS 6M PRIMADET P7 MS	0360/1.1B	
NONEL PRIMADETS 6M PRIMADET P8 MS	0360/1.1B	
ORANGE CAP BOOSTER (454G)	0042/1.1D	31-3-94
PENTACORD 3PE	0042/1.1D	
PENTACORD 5PE	0065/1.1D	
PRIMADET MS CONNECTORS	0360/1.1B	
PRIMADET TRUNKLINE DELAYS	0360/1.1B	
3.6M P/DET NTD MS17		
PRIMADET TRUNKLINE DELAYS	0360/1.1B	
3.6M P/DET NTD MS42		
PRIMADET TRUNKLINE DELAYS	0360/1.1B	
6M P/DET NTD MS100		
PRIMADET TRUNKLINE DELAYS	0360/1.1B	
6M P/DET NTD MS25 2		
PRIMADET TRUNKLINE DELAYS	0360/1.1B	
9M (EB) NTD P4 MS10		
RIOGEL 2SX200	0241/1.1D	
RIOGEL 32X200	0241/1.1D	
RIOGEL 55X400	0241/1.1D	
RIOGEL 55X400	0241/1.1D	
ROCK CRUSHER BOOSTERS 454G	0042/1.1D	7-10-92
ROCK CRUSHER BOOSTERS 908G	0042/1.1D	
ROCK STAR DETONATORS	0030/1.1B	
SCOTCH CORD	0065/1.1D	
SHOCK STAR MS DELAYS DETONATORS	0360/1.1B	19-6-92
3.6M SOCKSTAR P8		
SHOCK STAR MS DELAYS DETONATORS	0360/1.1B	19-6-92
6M SHOCKSTAR P3 M		
SHOCK STAR SURFACE DELAY NON-ELECTRIC	0360/1.1B	31-3-94
SILVER NUGGET CAST BOOSTER	0042/1.1D	31-3-94

Description	UN No & Class	Date of Gazettal (where available)
TRIMITE	0241/1.1D	12-7-93
WHITE CAP BOOSTER (907G)	0042/1.1D	31-3-94

VEHICLE - EXPLOSIVES AND DANGEROUS GOODS LICENCES

Vehicle/License	Date Granted	Expiry Date	Licence No.	Licences	Authority/ State
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793 EOD Ford Courier	01-10-98	15-09-99	38/056832/8	TES	Dangerous Goods Act 1975 (NSW)
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Carriage of  
Explosives

1000KG of 1.1D  
Explosives

379 CJT Volvo FL 10 Pump	27-08-98	30-06-99	1040	TES	Explosives Act 1952 (QLD)
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Carriage of  
Explosives

9.3 Tonnes of  
1.5D Watergel

379 CJT Volvo FL 10	27-08-98	30-06-99	1161	TES	Explosives Act 1952 (QLD)
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Manufacture  
of Explosives  
on/by vehicle

026 CXN Volvo FL 10 Pump	27-08-98	30-06-99	1176	TES	Explosives Act (1952) (QLD)
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Carriage of  
Explosives  
Above 10  
tonnes-  
rigid body

127 CCO Volvo FL 10 Bowl 2	27-08-98	30-06-99	1160	TES	Explosives Act 1952 (QLD)
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Carriage of  
Explosives-  
semi-trailers

127 CCO Volvo FL 10 Bowl 2	27-08-98	30-06-99	1160	TES	Explosives Act 1952 (QLD)
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Manufacture  
of Explosives  
on/by vehicle

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Vehicle/License	Date Granted	Expiry Date	Licence No.	Licences	Authority/ State
732 DDH Volvo  Carriage of Explosives above 10tonnes - -rigid body	27-08-98	30-06-99	0804	TES	Explosives Act 1952 (QLD)
732 DDH Volvo  Manufacture of Explosives on/by Vehicle	27-08-98	30-06-99	1024	TES	Explosives Act 1952 (QLD)
563 CWR Holden\Rodeo  Carriage of Explosives up to 1000kg	27-08-98	30-06-99	1107	TES	Explosives Act 1952 (QLD)
668 DRA Nissan Patrol  Carriage of Explosives up to 1000kg	27-08-98	30-06-99	1197	TES	Explosives Act 1952 (QLD)
135 DZJ Volvo  Manufacture of Explosives on/by Vehicle	27-08-98	30-06-99	1015	TES	Explosives Act 1952 (QLD)
986 QCT Trailer  Carriage of Dangerous Goods	24-9-99	03-10-99	NA	TES	Dangerous Goods by Road Act 1984 & Regulations (QLD)
***					
9BR 195 Mazda  Licence to Convey Blasting Agent Mixing Vehicles	19-06-98	18-06-99	NA	TES	Explosives and Dangerous Goods Act 1961 (WA)
9MA 964 Volvo  Licence to Convey Explosives	23-9-98	22-09-99	NA	TES	Explosives & Dangerous Goods Act 1961 (WA)
8KP 430	31-12-97	30-12-98	NA	TES	Explosives & Dangerous

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Vehicle/License	Date Granted	Expiry Date	Licence No.	Licences	Authority/ State
Licence to Convey Blasting Agent Mixing Vehicles					Goods Act 1961 (WA)
9MU 330	13-08-97	19-08-98	NA	TES	Explosives & Dangerous Goods Act 1961 (WA)
Licence to Convey Blasting Agent Mixing Vehicles					
1ACP 119	03-02-98	19-02-99	NA	TES	Explosives & Dangerous Goods Act 1961 (WA)
Licence to Convey Blasting Agent Mixing Vehicles					
8PD 912	26-01-98	25-01-99	NA	TES	Explosives & Dangerous Goods Act 1961 (WA)
Licence to Convey Blasting Agent Mixing Vehicles					



SCHEDULE 10  
(Clause 1.1.35)

\*\*\* Assets

ASSET DESCRIPTION	TAG NUMBER
Handport FM 138-156 mhz Radio	
Tait T3010 Hand Held Portable Radio	
Evacuation Alarm and Siren	
2 Acid Tanks	
Powder Coat 2 SS Acid Tanks	
AN Store	
Process Building	
Amenities Building	
Nokia 232 Cellphone	
4 Drawer Filing Cabinet	
2 Draw Filing Cabinet	
Cat Pump	2259
Ingersoll 100-80 CPX-125 Pump	2251
Ingersoll 65-40 CPX-125 Pump	2252
Container-Vivian Containers	
Site Upgrade for Environmental purpose	
Storage Tank-4 tonne SX	2258
Solution Volumatic Tank 2.5mt	2246
Auger EX KG 6"	2248
Four Wheel Drive	
Isotanker	
Magazines	
Transfer Pump	
Shipping Containers	
HiLux	
Isuzu Bowl	
Misc Plant & Equip	
Mono Pump	
Sheds	
SX Plant	

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SCHEDULE 11  
(Clause 1.1.36)

Operating Leases

Lease	Location/Item	Start Date
Ricoh Business Centre	***	28/08/98
R Duncan Pty Ltd	***	04/97
R Duncan Pty Ltd	***	10/03/98
R Duncan Pty Ltd	***	01/08/96
R Duncan Pty Ltd	***	01/08/96
R Duncan Pty Ltd	***	01/08/96
R Duncan Pty Ltd	***	01/08/96
R Duncan Pty Ltd	***	
R Duncan Pty Ltd	***	
R Duncan Pty Ltd	***	
R Duncan Pty Ltd	***	
R Duncan Pty Ltd	***	
James Hardies Building Systems	***	10/04/98
James Hardies Building Systems	***	02/04/98
James Hardies Building Systems	***	1993
James Hardies Building Systems	***	05/05/94
James Hardies Building Systems	***	05/05/94
AGC	***	28/11/97
The Capital Corporation Limited ACN 065 745 735 (AT & T Capital)	***	14/08/98
The Capital Corporation Limited ACN 065 745 735 (AT & T Capital)	***	11/06/96
The Capital Corporation Limited ACN 065 745 735 (AT & T Capital)	***	10/09/97
The Capital Corporation Limited ACN 065 745 735 (AT & T Capital)	***	22/07/97
Red Australia	***	01/08/98
Red Australia	***	01/08/98
Red Australia	***	21/06/95
Western Portables	***	
Brambles	***	
Brambles	***	
Brambles	***	

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Schedule 12  
(Clause 1.1.24)

Financing Leases

LESSOR	ASSET No.	DESCRIPTION
AT & T CAPITAL	0004527000 295002.000	SELEX PHOTOCOPIER
SANWA	1B0049279 960008.000	NISSAN DX 4 X 4 UTE REG 811 DOQ
SANWA	1B0049287 960009.000	NISSAN DX 4 x 4 UTE REG 9MA 734
SANWA	1B0049295 960010.000	NISSAN PATROL WAGON REG 564 DNZ
SANWA	1B0050472 960012.000	NISSAN PATROL RX WAGON REG 9KA 303
SANWA	1B0050499 960013.000	NISSAN PATROL RX WAGON REG 9KA 302
SANWA	1B0050501 960014.000	NISSAN PATROL LEAF SPRING CAB CHASS REG 668 DRA
SANWA	1B0050510 960015.000	NISSAN PATROL LEAF SPRING CAB CHASS REG 9JX 912
ESANDA	449521594 960004.000	MITSUBISHI CANTER DEWATERING UNIT REG 060 DMK
ESANDA	449546492 960006.000	HOLDEN BS COMMODORE ACCLAIM V6 3.8L REG 172 DMI
ESANDA	449547305 295001.000	NISSAN PATROL ST TURBO WAGON
ADVANCE LEASING	85651/001 970821.000	TNT KOMATSU FORKLIFT MODEL FD25T-12
ORIX	888478 970816.000	MITSUBISHI VERADA E1 SEDAN
ORIX	934607 970815.000	MITSUBISHI KE VERADA E1 AUTO SEDAN
GE CAPITAL	CE0712S1 950001.000	VOLVO BOWL TRUCK B#4
GE CAPITAL	CE0712S2 950004.001	MITSUBISHI CANTER DEWATERING UNIT
GE CAPITAL	CE0712S3 940004.000	SANDERSON TELECOPIER
GE CAPITAL	CE0713S1 940005.000	93 VOLVO FL10 PUMP REG 379 CJT P#3
GE CAPITAL	CE0713S2 950052.000	HOLDEN RODEO 1995
GE CAPITAL	CE0714S1 940006.000	ISUZU PUMP BOWLER TRUCK REG 8PD 912 TES#11
GE CAPITAL	CE0714S3 950004.000	VOLVO FL 10 REG 026 CXN B#5(BODY)
GE CAPITAL	CE0714S4 950005.000	KOMATSU FD3-5 FORKLIFT 4 TONNE

GE CAPITAL	CE0714S5 960001.000	ISUZU FV7 1400 MEDIUM CAB CHASSIS REG 8PD 912
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GE CAPITAL	CE0714S6 960002.000	NISSAN PATROL 4 x 4 TRAY TOP UTE
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ASSET PURCHASE AGREEMENT B/222128	55	C COPYRIGHT 1999
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REG 9GB 225

GE CAPITAL	CE0714S6 960003.000	NISSAN PATROL 4 x 4 TRAY TOP UTE REG 9GB 162
GE CAPITAL	CE0714S7 960005.000	MITSUBISHI FS42855 8 x 4 TRUCK 1996 REG 91H 282
GE CAPITAL	CE0922S2 960011.000	COMPUTER SYSTEM BRISBANE OFFICE
GE CAPITAL	CE0922S3 970817.000	CHASSIS TRIPLE P EXPLOSIVES TRUCK
GE CAPITAL	CE0922S3 970818.000	BODY TRIPLE P EXPLOSIVE TRUCK
GE CAPITAL	CE0922S4 970820.000	TRIPLE P EXPLOSIVE TRUCK
GE CAPITAL	CE0922S4 970819.000	CHASSIS TRIPLE P EXPLOSIVES TRUCK
GE CAPITAL	CE0922S5 980028.000	VOLVO FL10 CAB CHASSIS
CAPITAL COMMERCIAL FINANCE LTD.	LC/1/4/5966 950038.000 950024.000 930049.000  920038.000  920024.000	HEF STORAGE FIRE HYDRANTS X 2 ISUZU ANFO BLOWER 8EV02 TRUCK MAC HEAVY ANFO TRUCK REG 296 CTE VOLVO F7-P2 2ND HAND CHASSIS REG 9ET 727
CAPITAL COMMERCIAL FINANCE LTD.	LC/1/4/6161 LC/1/4/6532 LC/1/6/5967 950006.000	BOWL PUMP TRUCK TES 14 REG 1AJR033
CAPITAL COMMERCIAL FINANCE LTD.	LC/1/6/6141 950007.000	ISUZU BOWL PUMP TM 327 B#7
ZAMOFAST	950002.000	VOLVO BOWL TRUCK REG 9CO 347 #3
QLD WEIGHING MACHINES PTY LTD	960007.000	25M CONCRETE WEIGH- BRIDGE SN 16438

EXECUTED as an agreement.

EXECUTED by TOTAL ENERGY SYSTEMS  
LIMITED ACN 010 876 150 in  
accordance with section 127 of  
the Corporations Law:

/s/ R. A. Rogers  
Director/Company Secretary

R. A. Rogers  
Name of Director/Company  
LETTERS)  
Secretary

/s/ Peter Ivan Felix Geroff  
Director

Name of Director (BLOCK  
LETTERS)  
Peter Ivan Felix Geroff

EXECUTED by T.E.S. MINING  
SERVICES PTY LTD ACN 010 175 676  
in accordance with section 127  
of the Corporations Law:

/s/ R. A. Rogers  
Director/Company Secretary

R. A. Rogers  
Name of Director/Company  
Secretary (BLOCK LETTERS)

/s/ James L. Wewers  
Director

Name of Director (BLOCK LETTERS)  
James L. Wewers

EXECUTED by TOTAL ENERGY SYSTEMS  
(INTERNATIONAL) PTY LTD ACN 084  
562 24 in accordance with  
section 127 of the Corporations  
Law:

/s/ R. A. Rogers  
Director/Company Secretary

R. A. Rogers  
Name of Director/Company  
Secretary (BLOCK LETTERS)

/s/ Peter Ivan Felix Geroff  
Director

Peter Ivan Felix Geroff

EXECUTED by TOTAL ENERGY SYSTEMS )  
(NZ) LIMITED DN/682396 in )  
accordance with resolution of a )  
meeting of its board of directors )

/s/ David Shear  
Director/Company Secretary

David Shear  
Name of Director/Company  
Secretary

/s/ James L. Wewers  
Director

Name of Director (BLOCK LETTERS)  
James L. Wewers

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EXECUTED by QUANTUM EXPLOSIVES )  
PTY LIMITED ACN 087 119 515 in )  
accordance with section 127 of )  
the Corporations Law:

/s/ Wrixon Frank Gasteen  
Director/Company Secretary

Wrixon Frank Gasteen  
Name of Director/Company  
Secretary

---

/s/ Nicholas Neil Jukes  
Director

Name of Director (BLOCK LETTERS)

Nicholas Neil Junes

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ANNEXURE A

Purchaser's Parent Agreement



DEED OF GUARANTEE

By

THIESS CONTRACTORS PTY LIMITED  
ACN 010 221 486  
("Guarantor")

in favour of

TOTAL ENERGY SYSTEMS LIMITED  
ACN 010 876 150,

T.E.S. MINING SERVICES PTY LTD  
ACN 010 975 676,

TOTAL ENERGY SYSTEMS (INTERNATIONAL) PTY LTD  
ACN 084 562 247

and

TOTAL ENERGY SYSTEMS (NZ) LIMITED  
DN/682396  
("THE VENDORS")

LEGAL & CONTRACT SERVICES  
THIESS CONTRACTORS PTY LIMITED  
po Box 199 Archerfield Qld 4108  
Ph: (07) 3275-8563 Fax: (07) 3275-8633  
email address: rsinclair@thiess.com.au  
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## DEED OF GUARANTEE

THIS DEED is made on the seventh day of May 1999.

BY

THIESS CONTRACTORS PTY LIMITED (ACN 010 221 486) of 146 Kerry Road, Archerfield, Queensland, Australia (with its successors and permitted assigns "Guarantor")

IN FAVOUR OF

Total Energy Systems Limited ACN 010 876 150, T.E.S. Mining Services Pty Ltd ACN 010 975 676, Total Energy Systems (International) Pty Ltd ACN 084 462 247 and Total Energy Systems (NZ) Limited DN/682396 (together with their successors and permitted assigns "Vendors").

## RECITALS

- A Quantum Explosives Pty Limited ACN 087 119 515 ("the Purchaser") is a wholly owned subsidiary of the Guarantor.
- B The Vendors are in the business of manufacturing and supplying bulk and packaged explosives and blasting agents and other products and services to the mining, quarrying, civil engineering and other industries in Australia, New Zealand and elsewhere ("Business").
- C At the request of the Guarantor, the Purchaser has entered an asset purchase agreement with the Vendors dated the seventh day of May 1999 for the purchase of the assets used by the Vendors in the conduct of the Business ("Agreement").
- D It is a condition precedent to performance under the Agreement that the Guarantor enter into and execute this Deed.

## OPERATIVE

### 1. Guarantee

The Guarantor guarantees to the Vendors the due and punctual performance of all terms, provisions and conditions contained in the Agreement on the part of the Purchaser to be performed ("Guaranteed Obligations").

### 2. Indemnity

The Guarantor indemnifies the Vendors and agrees to keep the Vendors indemnified from and against all loss, damage, costs and expenses suffered or incurred by any of the Vendors directly or indirectly by reason of:

- 2.1 the Purchaser's default, breach or non-performance or non-observance by the Purchaser of any of the Guaranteed Obligations; and
- 2.2 any matter which the Purchaser has warranted to the Vendor not being as warranted;

provided that in no circumstance shall the Guarantor be liable under this Guarantee and Indemnity to any greater extent than the Purchaser would have been liable to the Vendors for such default, breach, non performance, non observance or failure of warranty in accordance with the terms of the Agreement if the Agreement was otherwise of full force and effect against the Purchaser.

### 3. Enforcement

#### 3.1 If:

- 3.1.1. The Purchaser defaults in the due and punctual performance of any of the Guaranteed Obligations and at any time after that default the Vendors give written notice to the Guarantor of that default and of the Vendors' intention to exercise their rights under this Deed in respect of that default; and

3.1.2 within 30 days of the giving of that notice, the Purchaser (or the Guarantor on its behalf) has failed to remedy the default,

the Guarantor shall (without further notice from the Vendors) immediately remedy or cause to be remedied the default.

#### 4. Obligations absolute and unconditional

The Guarantor remains liable under this Deed even if:

- 4.1 there is any modification of the liabilities of the Purchaser under this Agreement;
- 4.2 any arrangement is made between the Vendors and the Purchaser with or without assent of the Guarantor;
- 4.3 there is any alteration in the obligations undertaken by the Purchaser under the Agreement including, without limitation any forbearance as to payment, time, performance or otherwise;
- 4.4 the Purchaser:
  - 4.4.1 enters into any composition or scheme of arrangement with creditors; or
  - 4.4.2 enters into liquidation or are wound up;
- 4.5 The Vendors cannot, for any reason, enforce the Agreement against the Purchaser;
- 4.6 The Vendors have not, for any reason, exercised or do not exercise all or any one or more of their rights or powers against the Purchaser;
- 4.7 The Vendors grant any time or other indulgence or concession to the Purchaser;
- 4.8 The Vendors compound, compromise, release, abandon, waive, vary, relinquish or renew any of the Vendors' rights against the Purchaser, or waive or vary any other provision of the Agreement; or
- 4.9 Any part of the Purchaser's liability to the Vendors is satisfied by a payment which (whether because it is a preference or for any other reason) the Vendors must pay back or otherwise lose the benefit of, to the extent of the repayment or benefit so lost.

#### 5. Duration of Deed

This Deed shall continue and shall remain in full force until all of the Guaranteed Obligations or any other obligation or liability arising under the Agreement have been fully performed, observed and satisfied by the Purchaser or the Guarantor.

#### 6. Service of notices

- 6.1 Any notice required pursuant to this Deed must be:
  - 6.1.1 in writing; and
  - 6.1.2 either sent by facsimile transmission, certified mail or delivered by hand.
- 6.2 A notice to the Vendors must be addressed to the Vendors at care of LSB Industries Inc 16 S Pennsylvania Avenue, Oklahoma City, Oklahoma, USA - facsimile no. 405 236 1209 or such other address as may be notified.
- 6.3 A notice to the Guarantor must be addressed to the Guarantor at the address on page 1 of this Deed or such other address as may be notified or to facsimile number 07 3275 8633.
- 6.4 A notice sent by certified mail or delivered by hand is effective upon receipt.
- 6.5 A notice sent by facsimile transmission is effective upon transmission unless it is transmitted after the close of normal business hours, or on a Saturday, Sunday or public holiday, in which case it is effective on the opening of business on the next business day at the intended place of

receipt.

7. Representations

The Guarantor acknowledges that it has not been induced to enter into this Agreement by virtue of any representation by or on behalf of the Vendors but has acted entirely on its own responsibility.

8. Costs

Each party shall pay its own legal costs of and incidental to the preparation and execution of this Deed but any stamp duty payable thereon shall be paid by the Guarantor.

9. Governing Law and Jurisdiction

9.1 This Deed and all questions arising in connection with it are governed by and will be construed according to the laws from time to time in force in the State of Queensland and the Guarantor hereby submits to the jurisdiction of those courts having jurisdiction in the State of Queensland.

10. Construction

A reference in this Deed to the Vendors includes a reference to the Vendors collectively and to each of the Vendors separately.

Executed as a Deed

THE COMMON SEAL of THIESS CONTRACTORS PTY LTD )  
is hereunto affixed in accordance with its )  
Constitution: )

\_\_\_\_\_  
Director

\_\_\_\_\_  
Director/Secretary

\_\_\_\_\_  
Name (printed)

\_\_\_\_\_  
Name (printed)

ANNEXURE B

Vendor's Parent Guarantee



DEED OF GUARANTEE

By

LSB INDUSTRIES INC  
("Guarantor")

in favour of

QUANTUM EXPLOSIVES PTY LIMITED  
ACN 087 119 515

("Quantum Explosives")

LEGAL & CONTRACT SERVICES  
THIESS CONTRACTORS PTY LIMITED  
po Box 199 Archerfield Qld 4108  
Ph: (07) 3275-8563 Fax: (07) 3275-8633  
email address: rsinclair@thiess.com.au  
C Copyright 1999

## DEED OF GUARANTEE

THIS DEED is made on the seventh day of May 1999.

BY

LSB INDUSTRIES INC of 165 Pennsylvania Avenue Oklahoma City,  
Oklahoma, USA (with its successors and permitted assigns "Guarantor")

IN FAVOUR OF

QUANTUM EXPLOSIVES PTY LIMITED (ACN 087 119 515 of 146 Kerry Road,  
Archerfield, Queensland, Australia (with its successors and permitted  
assigns "Quantum Explosives").

## RECITALS

- A Total Energy Systems Limited (ACN 010 876 150), T.E.S. Mining Services Pty Ltd (ACN 010 975 676), Total Energy Systems (International) Pty Ltd (ACN 084 562 247), Total Mining Systems Pty Ltd (ACN 709 315) and Total Energy Systems (NZ) Limited all c/-Level 7, 371 Queen Street, Brisbane, Queensland, Australia ("Vendors") are ultimately wholly owned subsidiaries of the Guarantor.
- B The Vendors are in the business of manufacturing and supplying bulk and packaged explosives and blasting agents and other products and services to the mining, quarrying, civil engineering and other industries in Australia, New Zealand and elsewhere ("Business").
- C At the request of the Guarantor, Quantum Explosives has entered an asset purchase agreement with the Vendors dated the seventh day of May 1999 for the purchase of the assets used by the Vendors in the conduct of the Business ("Agreement").
- D It is a condition precedent to performance under the Agreement that the Guarantor enter into and execute this Deed.

## OPERATIVE

### 1. Guarantee

The Guarantor guarantees to Quantum Explosives the due and punctual performance by the Vendors of all terms, provisions and conditions contained in the Agreement on the part of the Vendors to be performed ("Guaranteed Obligations"). The Guarantor acknowledges that it has read and understood the Agreement, which is attached hereto.

### 2. Indemnity

The Guarantor indemnifies Quantum Explosives and agrees to keep Quantum Explosives indemnified from and against all loss, damage, costs and expenses including legal costs suffered or incurred by Quantum Explosives directly or indirectly by reason of:

- 2.1 the Vendors' default, breach or non-performance or non-observance by the Vendors of any of the Guaranteed Obligations; and
- 2.2 any matter which the Vendors have warranted to Quantum Explosives not being as warranted;

provided that in no circumstance shall the Guarantor be liable under this Guarantee and Indemnity to any greater extent than the Vendors would have been liable to Quantum Explosives for such default, breach, non performance, non observance or failure of warranty in accordance with the terms of the Agreement if the Agreement was otherwise of full force and effect against the Vendors.

### 3. Enforcement

#### 3.1 If:

- 3.1.1. the Vendors defaults in the due and punctual

performance of any of the Guaranteed Obligations and at any time after that default Quantum Explosives gives written notice to the Guarantor of that default and of Quantum Explosives' intention to exercise its rights under this Deed in respect of that default; and

3.1.2 within 30 days of the giving of that notice, the Vendors (or the Guarantor on its behalf) has failed to remedy the default,

the Guarantor shall (without further notice from Quantum Explosives) immediately remedy or cause to be remedied the default.

#### 4. Obligations absolute and unconditional

The Guarantor remains liable under this Deed even if:

- 4.1 there is any modification of the liabilities of the Vendors under this Agreement;
- 4.2 any arrangement is made between the Vendors and Quantum Explosives with or without assent of the Guarantor;
- 4.3 there is any alteration in the obligations undertaken by the Vendors under the Agreement including, without limitation any forbearance as to payment, time, performance or otherwise;
- 4.4 the Vendors:
  - 4.4.1 enter into any composition or scheme of arrangement with creditors; or
  - 4.4.2 enters into liquidation or are wound up;
- 4.5 Quantum Explosives cannot, for any reason, enforce the Agreement against the Vendors;
- 4.6 Quantum Explosives, for any reason, has not exercised or does not exercise all or any one or more of its rights or powers against the Vendors;
- 4.7 Quantum Explosives grants any time or other indulgence or concession to the Vendors;
- 4.8 Quantum Explosives compounds, compromises, releases, abandons, waives, varies, relinquishes or renews any of Quantum Explosives' rights against the Vendors, or waives or varies any other provision of the Agreement; or
- 4.9 Any part of the Vendors' liability to Quantum Explosives is satisfied by a payment which (whether because it is a preference or for any other reason) Quantum Explosives must pay back or otherwise lose the benefit of, to the extent of the repayment or benefit so lost.

#### 5. Duration of Deed

This Deed shall continue and shall remain in full force until all of the Guaranteed Obligations or any other obligation or liability arising under the Agreement have been fully performed, observed and satisfied by the Vendors or the Guarantor.

#### 6. Service of notices

- 6.1 Any notice required pursuant to this Deed must be:
  - 6.1.1 in writing; and
  - 6.1.2 either sent by facsimile transmission, certified mail or delivered by hand.
- 6.2 A notice to Quantum Explosives must be addressed to Quantum Explosives at the address on page 1 of this Deed or such other address as may be notified.
- 6.3 A notice to the Guarantor must be addressed to the Guarantor at the address on page 1 of this Deed or such other address as may be notified or to facsimile number 0015-1-405 236 1209 attention: General Counsel.
- 6.4 A notice sent by certified mail or delivered by hand is effective upon receipt.
- 6.5 A notice sent by facsimile transmission is effective upon transmission unless it is transmitted after the close of normal business hours, or on a Saturday, Sunday or public holiday, in which case it is effective on the opening of business on the next business day at the intended place of receipt.

6.6 The Guarantor nominates Corrs Chambers Westgarth, Level 35, Waterfront Place, 1 Eagle Street, Brisbane to receive service of documents on the Guarantor's behalf in respect of this Deed provided that a copy of each document so served shall as soon as possible thereafter be forwarded by facsimile to the Guarantor's General Counsel on facsimile no. 0015-1-405 236 1209. The agent must accept service of documents on the Guarantor's behalf with respect to any action, proceeding or other process in connection with this Deed.

7. Representations

The Guarantor acknowledges that it has not been induced to enter into this Agreement by virtue of any representation by or on behalf of Quantum Explosives but has acted entirely on its own responsibility.

8. Costs

Each party shall pay its own legal costs of and incidental to the preparation and execution of this Deed but any stamp duty payable thereon shall be paid by the Guarantor.

9. Governing Law and Jurisdiction

9.1 This Deed and all questions arising in connection with it are governed by and will be construed according to the laws from time to time in force in the States of Queensland and Oklahoma. Any injunctions, orders or judgements issued or granted therefrom shall be enforceable within the Commonwealth of Australia and the United States of America, including Oklahoma or any county or state with which the Commonwealth of Australia or the State of Queensland has agreed reciprocally to enforce injunctions, orders or judgements, as the case may be.

9.2 The Guarantor must do all acts deeds or things necessary for this Deed to be properly acknowledged, certified and legalised by all relevant authorities, Governmental, judicial or otherwise, for its enforcement within Oklahoma and/or Queensland.

10. Construction

A reference in this Deed to the Vendors includes a reference to the Vendors collectively and to each of the Vendors separately.

Executed as a Deed

EXECUTED by LSB INDUSTRIES, INC., )  
by its duly authorised officer pursuant )  
to a resolution adopted by its Board of )  
Directors at a duly called meeting of )  
the Board of Directors )

\_\_\_\_\_  
Authorised Officer of LSB Industries, Inc.

\_\_\_\_\_  
Name (printed)

I, the notary public named below, hereby certify that the person specified as the Authorised Officer above did in fact appear and sign this Deed on behalf of LSB Industries, Inc.

\_\_\_\_\_  
Notary Public

\_\_\_\_\_  
Name (printed)

Letter of Acknowledgment RE: Unaudited Financial Information

The Board of Directors  
LSB Industries, Inc.

We are aware of the incorporation by reference in the Registration Statement (Form S-8 No. 33-8302) pertaining to the 1981 and 1986 Incentive Stock Option Plans, the Registration Statement (Form S-8 No. 333-58225) pertaining to the 1993 Stock Option and Incentive Plan, the Registration Statements (Forms S-8 No. 333-62831, No. 333-62835, No. 333-62839, No. 333-62843, and No. 333-62841) pertaining to the registration of an aggregate 225,000 shares of common stock pursuant to certain Non-Qualified Stock Option Agreements for various employees and the Registration Statement (Form S-3 No. 33-69800) of LSB Industries, Inc. and in the related Prospectuses of our report dated May 14, 1999, 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, 1999.

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

/s/ Ernst & Young LLP

Ernst & Young LLP

Oklahoma City, Oklahoma  
May 14, 1999



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DEC-31-1999

MAR-31-1999

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