

LSB INDUSTRIES INC
Form 10-Q
July 25, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 10-Q

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

For the quarterly period ended June 30, 2018

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 (I.R.S. Employer
incorporation or organization) Identification No.)

16 South Pennsylvania Avenue, Oklahoma City, Oklahoma 73107
(Address of principal executive offices) (Zip Code)

(405) 235-4546

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(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 No

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer", "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares outstanding of the Registrant's common stock was 28,613,563 shares as of July 20, 2018.

FORM 10-Q OF LSB INDUSTRIES, INC.

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PART I

FINANCIAL INFORMATION

Item 1. Financial Statements

LSB INDUSTRIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Information at June 30, 2018 is unaudited)

	June 30, 2018	December 31, 2017
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	\$47,216	\$33,619
Accounts receivable, net	39,208	59,570
Inventories:		
Finished goods	13,327	20,415
Raw materials	1,552	1,441
Total inventories	14,879	21,856
Supplies, prepaid items and other:		
Prepaid insurance	4,763	10,535
Precious metals	6,640	7,411
Supplies	28,939	27,729
Prepaid and refundable income taxes	792	1,736
Other	1,434	1,284
Total supplies, prepaid items and other	42,568	48,695
Total current assets	143,871	163,740
Property, plant and equipment, net	986,737	1,014,038
Intangible and other assets, net	9,728	11,404
	\$1,140,336	\$1,189,182

(Continued on following page)

LSB INDUSTRIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (continued)

(Information at June 30, 2018 is unaudited)

	June 30, 2018	December 31, 2017
	(In Thousands)	
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$51,278	\$55,992
Short-term financing	2,480	8,585
Accrued and other liabilities	21,387	35,573
Current portion of long-term debt	12,899	9,146
Total current liabilities	88,044	109,296
Long-term debt, net	403,464	400,253
Noncurrent accrued and other liabilities	10,656	11,691
Deferred income taxes	58,229	54,787
Commitments and contingencies (Note 7)		
Redeemable preferred stocks:		
Series E 14% cumulative, redeemable Class C preferred stock, no par value, 210,000 shares issued; 139,768 outstanding; aggregate liquidation preference of \$198,197,000 (\$185,231,000 at December 31, 2017)		
	187,421	174,959
Series F redeemable Class C preferred stock, no par value, 1 share issued and outstanding; aggregate liquidation preference of \$100		
	—	—
Stockholders' equity:		
Series B 12% cumulative, convertible preferred stock, \$100 par value; 20,000 shares issued and outstanding		
	2,000	2,000
Series D 6% cumulative, convertible Class C preferred stock, no par value; 1,000,000 shares issued and outstanding		
	1,000	1,000
Common stock, \$.10 par value; 75,000,000 shares authorized, 31,280,685 shares issued		
	3,128	3,128
Capital in excess of par value	196,792	193,956
Retained earnings	207,750	256,214
	410,670	456,298

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Less treasury stock, at cost:

Common stock, 2,667,122 shares (2,662,027 shares at December 31, 2017)	18,148	18,102
Total stockholders' equity	392,522	438,196
	\$1,140,336	\$1,189,182

See accompanying notes.

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LSB INDUSTRIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	June 30, Three Months Ended		June 30, Six Months Ended	
	2018	2017	2018	2017
	(In Thousands, Except Per Share Amounts)			
Net sales	\$103,199	\$122,853	\$203,649	\$246,197
Cost of sales	100,126	111,513	190,483	223,242
Gross profit	3,073	11,340	13,166	22,955
Selling, general and administrative expense	8,397	8,232	16,700	18,777
Other expense, net	545	3,406	451	2,155
Operating income (loss)	(5,869)	(298)	(3,985)	2,023
Interest expense, net	11,693	9,292	20,999	18,650
Loss on extinguishment of debt	5,951	—	5,951	—
Non-operating other expense (income), net	(331)	204	(1,240)	435
Loss before provision (benefit) for income taxes	(23,182)	(9,794)	(29,695)	(17,062)
Provision (benefit) for income taxes	4,324	(2,761)	3,402	(4,043)
Net loss	(27,506)	(7,033)	(33,097)	(13,019)
Dividends on convertible preferred stocks	75	75	150	150
Dividends on Series E redeemable preferred stock	6,628	5,789	12,966	11,325
Accretion of Series E redeemable preferred stock	802	1,618	2,401	3,217
Net loss attributable to common stockholders	\$(35,011)	\$(14,515)	\$(48,614)	\$(27,711)
Basic and dilutive net loss per common share:	\$(1.27)	\$(0.53)	\$(1.77)	\$(1.02)

See accompanying notes.

LSB INDUSTRIES, INC.

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

(Unaudited)

	Common Stock	Treasury Stock-Common	Non-Redeemable Preferred Stock	Common Stock Par Value	Capital in Excess of Par Value	Retained Earnings	Treasury Stock-Common	Total
(In Thousands)	Shares	Shares						
Balance at December 31, 2017	31,281	(2,662)	\$ 3,000	\$ 3,128	\$ 193,956	\$ 256,214	\$ (18,102)	\$ 438,196
Net loss						(33,097)		(33,097)
Dividend accrued on redeemable preferred stock						(12,966)		(12,966)
Accretion of redeemable preferred stock						(2,401)		(2,401)
Stock-based compensation					2,935			2,935
Other		(5)			(99)		(46)	(145)
Balance at June 30, 2018	31,281	(2,667)	\$ 3,000	\$ 3,128	\$ 196,792	\$ 207,750	\$ (18,148)	\$ 392,522

See accompanying notes.

LSB INDUSTRIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six Months Ended June 30,	
	2018	2017
	(In Thousands)	
Cash flows from continuing operating activities		
Net loss	\$(33,097)	\$(13,019)
Adjustments to reconcile net loss to net cash provided by continuing operating activities:		
Deferred income taxes	3,442	(4,004)
Loss on extinguishment of debt	5,951	—
Depreciation, depletion and amortization of property, plant and equipment	36,666	34,162
Amortization of intangible and other assets	1,197	927
Loss on sales of a business and other property and equipment	474	4,158
Other	3,930	1,943
Cash provided (used) by changes in assets and liabilities (net of effects of discontinued operations):		
Accounts receivable	6,927	(8,243)
Inventories	7,343	7,760
Prepaid insurance	5,772	6,160
Prepaid and accrued income taxes	943	(1,040)
Accounts payable	1,867	(2,364)
Accrued interest	(6,333)	(14)
Other assets and other liabilities	(1,738)	(3,485)
Net cash provided by continuing operating activities	33,344	22,941
Cash flows from continuing investing activities		
Expenditures for property, plant and equipment	(15,369)	(16,362)
Net proceeds from sale of businesses and other property and equipment	641	18,842
Proceeds from property insurance recovery associated with property, plant and equipment		
	1,531	—
Net proceeds from sale of discontinued operations	2,730	—
Other investing activities	115	952
Net cash provided (used) by continuing investing activities	(10,352)	3,432
Cash flows from continuing financing activities		
Proceeds from 9.625% senior secured notes, net of discount and fees	390,473	—
Payments on senior secured notes	(375,000)	—
Payments on other long-term debt	(6,055)	(10,653)
Payments of debt-related costs	(9,805)	(90)
Payments on short-term financing	(6,105)	(6,522)

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Payments of preferred stock modification costs	(2,677)	—
Taxes paid on equity awards	(226)	(67)
Net cash used by continuing financing activities	(9,395)	(17,332)
Cash flows of discontinued operations:		
Net cash used by operating activities	—	(1,714)
Net cash used by financing activities	—	(131)
Net cash used by discontinued operations	—	(1,845)
Net increase in cash and cash equivalents	13,597	7,196
Cash and cash equivalents at beginning of period	33,619	60,017
Cash and cash equivalents at end of period	\$47,216	\$67,213

See accompanying notes.

LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1: Summary of Significant Accounting Policies

For a complete discussion of our significant accounting policies, refer to the notes to our audited consolidated financial statements included in our Form 10-K for the year ended December 31, 2017 (“2017 Form 10-K”), filed with the Securities and Exchange Commission (“SEC”) on February 26, 2018.

Basis of Consolidation – LSB Industries, Inc. (“LSB”) and its subsidiaries (the “Company”, “We”, “Us”, or “Our”) are consolidated in the accompanying condensed consolidated financial statements. LSB is a holding company with no significant operations or assets other than cash, cash equivalents, and investments in its subsidiaries. All material intercompany accounts and transactions have been eliminated. Certain prior period amounts reported in our condensed consolidated financial statements and notes thereto have been reclassified to conform to current period presentation.

Nature of Business – We are engaged in the manufacture and sale of chemical products. The chemical products we primarily manufacture, market and sell are ammonia, fertilizer grade ammonium nitrate (“HDAN”), urea ammonium nitrate (“UAN”), and ammonium nitrate (“AN”) solution for agricultural applications, high purity and commercial grade ammonia, high purity AN, sulfuric acids, concentrated, blended and regular nitric acid, mixed nitrating acids, carbon dioxide, and diesel exhaust fluid for industrial applications, and industrial grade AN (“LDAN”) and solutions for the mining industry. We manufacture and distribute our products in four facilities; three of which we own and are located in El Dorado, Arkansas (the “El Dorado Facility”); Cherokee, Alabama (the “Cherokee Facility”); and Pryor, Oklahoma (the “Pryor Facility”); and one of which we operate on behalf of a global chemical company in Baytown, Texas (the “Baytown Facility”).

Sales to customers include farmers, ranchers, fertilizer dealers and distributors primarily in the ranch land and grain production markets in the United States (“U.S.”); industrial users of acids throughout the U.S. and parts of Canada; and explosive manufacturers in the U.S.

Other products consisted of natural gas sales from our working interests in certain natural gas properties of our former subsidiary Zena Energy L.L.C. (“Zena”) and sales of industrial machinery and related components, which were sold during the second and fourth quarters of 2017, respectively.

During July 2016, LSB completed the sale of all of the stock of Climate Control Group Inc. (an indirect subsidiary that conducted LSB’s Climate Control Business) pursuant to the terms of a stock purchase agreement. During the first quarter of 2018, we received the remaining proceeds held in a related indemnity escrow account of \$2.7 million.

In our opinion, the unaudited condensed consolidated financial statements of the Company as of June 30, 2018 and for the three and six-month periods ended June 30, 2018 and 2017 include all adjustments and accruals, consisting of normal, recurring accrual adjustments, which are necessary for a fair presentation of the results for the interim periods. These interim results are not necessarily indicative of results for a full year due, in part, to the seasonality of our sales of agricultural products and the timing of performing our major plant maintenance activities. Our selling seasons for agricultural products are primarily during the spring and fall planting seasons, which typically extend from

March through June and from September through November.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been condensed or omitted in this Form 10-Q pursuant to the rules and regulations of the SEC. These condensed consolidated financial statements should be read in connection with our audited consolidated financial statements and notes thereto included in our 2017 Form 10-K.

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

Income Taxes – We recognize deferred tax assets and liabilities for the expected future tax consequences attributable to net operating loss (“NOL”) carryforwards, tax credit carryforwards, and the differences, if any, between the financial statement carrying amounts and the tax basis of our assets and liabilities. We establish valuation allowances if we believe it is more likely than not that some or all of deferred tax assets will not be realized. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the statement of operations in the period date of enactment.

LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Note 1: Summary of Significant Accounting Policies (continued)

In addition, we do not recognize a tax benefit unless we conclude that it is more likely than not that the benefit will be sustained on audit by the relevant taxing authorities based solely on the technical merits of the associated tax position. If the recognition threshold is met, we recognize a tax benefit measured at the largest amount of the tax benefit that, in our judgment, is greater than 50% likely to be realized. We record interest related to unrecognized tax positions in interest expense and penalties in operating other expense.

Income tax benefits associated with amounts that are deductible for income tax purposes are recorded through the statement of operations. These benefits are principally generated from exercises of non-qualified stock options and restricted stock. We reduce income tax expense for investment tax credits in the period the credit arises and is earned.

See Note 9 – Income Taxes discussing the Tax Cuts and Jobs Act of 2017 and Staff Accounting Bulletin No. 118 ("SAB 118") issued by the SEC.

Redeemable Preferred Stocks – Our redeemable preferred stocks that are redeemable outside of our control are classified as temporary/mezzanine equity. The redeemable preferred stocks were recorded at fair value upon issuance, net of issuance costs or discounts. In addition, certain embedded features included in the Series E Redeemable Preferred required bifurcation and are classified as derivative liabilities. The carrying values of the redeemable preferred stocks are being increased by periodic accretions (including the amount for dividends earned but not yet declared or paid) using the interest method so that the carrying amount will equal the redemption value as of October 25, 2023, the earliest possible redemption date by the holder. The amount of accretion was recorded to retained earnings.

However, it is reasonably possible this accretion could change if the expected redemption date changes.

Recently Adopted Accounting Pronouncements

ASU 2014-09 – In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") 2014-09, Revenue from Contracts with Customers (Topic 606), which superseded nearly all existing revenue recognition guidance under GAAP. In addition, the FASB issued various ASUs further amending revenue recognition guidance, which includes ASU 2016-08, 2016-10, 2016-11, 2016-12 and 2016-20. The core principle of these ASUs (together "ASC 606") is to allow for an entity to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In addition, sales and other similar taxes we collect concurrently with revenue-producing activities are excluded from revenue. Also, we have elected to recognize the cost for freight and shipping when control of the product has transferred to the customer as an expense in cost of sales.

On January 1, 2018, we adopted ASC 606 as discussed in Note 2-Adoption of ASC 606.

ASU 2016-15 – In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This ASU made eight targeted changes to how cash receipts and cash payments are presented and classified in the statement of cash flows. On January 1, 2018, we

adopted ASU 2016-15 on a retrospective basis. The adoption of this ASU did not affect the presentation or classification of cash flow activities for the six months ended June 30, 2017.

ASU 2016-18 – In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, a consensus of the FASB Emerging Issues Task Force. The amendments in this ASU revise the guidance in Topic 230, Statement of Cash Flows, to require cash and cash equivalents to include restricted cash (and restricted cash equivalents) on the statement of cash flows. On January 1, 2018, we adopted ASU 2016-18 on retrospective basis. The adoption of this ASU did not affect the presentation of cash flow activities for the six months ended June 30, 2017.

ASU 2018-05 – See Note 9 – Income Taxes.

Recently Issued Accounting Pronouncements

ASU 2016-02 – In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which supersedes the lease requirements in Topic 840, Leases. The objective of this ASU is to establish the principles that lessees and lessors shall apply to report information to users of financial statements about the amount, timing, and uncertainty of cash flows arising from a lease. Extensive quantitative and qualitative disclosures, including significant judgments made by management, will be required to provide greater insight into the extent of revenue and expense recognized and expected to be recognized from existing contracts. As of June 30, 2018, this ASU must be adopted using a modified retrospective transition; however, the FASB has proposed an additional transition method option and that ASU is currently pending to be issued. Under the modified retrospective transition method, we are required to apply the new guidance at the beginning of the earliest comparative period presented (including recognizing a cumulative-effect adjustment as of January 1, 2017). Under the proposed additional transition method, we have the option to apply the new guidance (including recognizing a cumulative-effect adjustment) on January 1, 2019, the date we plan to adopt this ASU. Consequently, under this proposed optional

LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Note 1: Summary of Significant Accounting Policies (continued)

method, our reporting for the comparative periods presented in the financial statements issued after the date of adoption would continue to be in accordance with current GAAP, including disclosures. This ASU and ASU 2018-01 also provide for certain practical expedients that we are currently evaluating for possible election.

Although we currently have a relatively small number of leases (most are currently classified as operating leases under which we are the lessee), we have obtained and continue to obtain information relating to our leases and other right-to-use arrangements for the purpose of evaluating the effect of this guidance on our consolidated financial statements and related disclosures. In addition, we are developing and testing changes to our accounting system as the result of this ASU. We currently expect most of the effect of this guidance on our consolidated financial statements to impact our balance sheet presentation (increase the amount of our assets for the inclusion of right-of-use assets and increase the amount of our liabilities for the inclusion of the associated lease obligations). For 2017, expenses associated with our operating lease agreements, including month-to-month leases, were \$9.8 million. As of December 31, 2017, our future minimum payments on operating lease agreements with initial or remaining terms of one year or more totaled \$21.2 million.

Note 2: Adoption of ASC 606

On January 1, 2018, we adopted ASC 606 using the “modified retrospective” adoption method, meaning the standard is applied only to the most current period presented in the financial statements. Furthermore, we elected to apply the standard only to those contracts which were not completed as of the date of the adoption. Results for reporting periods beginning on the date of adoption are presented under ASC 606, while prior period amounts have not been adjusted and continue to be reported in accordance with our historical accounting methodology pursuant to ASC 605, Revenue Recognition (“ASC 605”).

Upon adoption, a cumulative effect adjustment was not required; however, the primary impact of adopting the new standard relates to the reduction in net sales, cost of sales and SG&A resulting from the elimination of certain sales revenue involving products we do not control under ASC 606, including products (we do not control) associated with marketing services we are performing as an agent for our customers. The nature of these arrangements allows for other parties to maintain control of these products throughout the production process.

The following line items in our condensed consolidated statement of operations for the current reporting periods have been provided to reflect both the adoption of ASC 606 as well as a comparative presentation in accordance with ASC 605 previously in affect:

	Three Months Ended June 30, 2018		
	As Reported	Balance without adoption of 606	Effect of Change Higher/(Lower)
	(In Thousands)		
Net sales	\$ 103,199	\$ 120,492	\$ (17,293)

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Cost of sales	100,126	117,264	(17,138)
Gross profit	3,073	3,228	(155)
Selling, general and administrative expense	8,397	8,552	(155)
Operating loss	(5,869)	(5,869)	—

Six Months Ended June 30, 2018

	As Reported	Balance without adoption of 606	Effect of Change Higher/(Lower)
(In Thousands)			
Net sales	\$203,649	\$ 237,042	\$ (33,393)
Cost of sales	190,483	223,570	(33,087)
Gross profit	13,166	13,472	(306)
Selling, general and administrative expense	16,700	17,006	(306)
Operating loss	(3,985)	(3,985)	—

Except for the change in accounting policies for revenue recognition as a result of adopting ASC 606, there have been no changes to our significant accounting policies as described in the 2017 Form 10-K that had a material impact on our condensed consolidated financial statements and related notes.

LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Note 2: Adoption of ASC 606 (continued)

As mentioned in Note 1, we primarily derive our revenues from the sales of various chemical products. The following tables present our net sales disaggregated by revenue source:

	Three Months Ended	
	June 30, 2018	2017(a)
	(Dollars In Thousands)	
Net sales:		
Agricultural products	\$ 58,024	\$ 57,236
Industrial acids and other chemical products	32,775	53,217
Mining products	12,400	10,344
Other products	—	2,056
Total net sales	\$ 103,199	\$ 122,853

	Six Months Ended	
	June 30, 2018	2017(a)
	(Dollars In Thousands)	
Net sales:		
Agricultural products	\$ 110,293	\$ 120,499
Industrial acids and other chemical products	70,912	102,097
Mining products	22,444	17,960
Other products	—	5,641
Total net sales	\$ 203,649	\$ 246,197

- (a) As noted above, prior period amounts have not been adjusted under the modified retrospective method.

Revenue Recognition and Performance Obligations

We determine revenue recognition through the following steps:

- Identification of the performance obligations in the contract;
- Determination of the transaction price;

- Allocation of the transaction price to the performance obligations in the contract; and
- Recognition of revenue when, or as, we satisfy a performance obligation.

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer and is the unit of account in ASC 606. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. Generally, satisfaction occurs when control of the promised goods is transferred to the customer or as services are rendered or completed in exchange for consideration in an amount for which we expect to be entitled. Generally, control is transferred when the preparation for shipment of the product to a customer has been completed. Most of our contracts contain a single performance obligation with the promise to transfer a specific product. When the terms of a contract include the transfer of multiple products, each distinct product is identified as a separate performance obligation.

Most of our revenue is recognized from performance obligations satisfied at a point in time, however, we have a performance obligation to perform certain services that are satisfied over a period of time. Revenue is recognized from this type of performance obligation as services are rendered and are based on the amount for which we have a right to invoice, which reflects the amount of expected consideration that corresponds directly with the value of the services performed.

We only offer assurance-type warranties for our products to meet specifications defined by our contracts with customers, and do not have any material performance obligations related to warranties, return, or refunds.

LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Note 2: Adoption of ASC 606 (continued)

Transaction Price Constraints and Variable Consideration

For most of our contracts within the scope of ASC 606, the transaction price from the inception of a contract is constrained to a short period of time (generally one month) as these contracts contain terms with variable consideration related to both price and quantity. These contract prices are often based on commodity indexes (such as NYMEX) published monthly and the contract quantities are typically based on estimated ranges. The quantities become fixed and determinable over a period of time as each sale order is received from the customer.

The nature of our contracts also gives rise to other types of variable consideration, including volume discounts and rebates, make-whole provisions, other pricing concessions, and short-fall charges. We estimate these amounts based on the expected amount to be provided to customers, which result in a transaction price adjustment reducing revenue (net sales) with the offset increasing contract or refund liabilities. These estimates are based on historical experience, anticipated performance and our best judgment at the time. We reassess these estimates on a quarterly basis.

The aforementioned constraints over transaction prices in conjunction with the variable consideration included in our material contracts prevent a practical assignment of a specific dollar amount to performance obligations at the beginning and end of the period. Therefore, we have applied the variable consideration allocation exception.

Future revenues to be earned from the satisfaction of performance obligations will be recognized when control transfers as goods are loaded and weighed or services are performed over the remaining duration of our contracts. Although most of our contracts have an original expected duration of one year or less, for our contracts with a duration greater than one year, the average remaining expected duration was approximately 16 months at June 30, 2018.

Contract Assets and Liabilities

Our contract assets consist of receivables from contracts with customers. Our net accounts receivable primarily relate to these contract assets and are presented in our condensed consolidated balance sheets. Customer payments are generally due thirty to sixty days after the invoice date.

Our contract liabilities primarily relate to deferred revenue and customer deposits associated with cash payments received in advance from customers for volume shortfall charges and product shipments. These contract liabilities are presented in Note - 5 Current and Noncurrent Accrued and Other Liabilities. For the three and six months ended June 30, 2018, revenues of \$2.3 million and \$4.0 million were recognized and included in the balance at the beginning of each period.

Practical Expedients and Other Information

We elected the transitional practical expedient for all contract modifications, such that all modifications prior to our adoption date for uncompleted contracts would be evaluated in the aggregate for any potential impact to our financial statements.

We elected the practical expedient to recognize revenue in the amount we have the right to invoice relating to certain services that are performed for customers and, as a result we do not have to disclose the value of unsatisfied performance obligations.

We elected the practical expedient by which disclosures are not required regarding the value of unsatisfied performance obligations for contracts with an original expected duration of one year or less.

We elected the practical expedient exempting the requirement to adjust the promised amount of consideration for the effects of a significant financing component if we expect the financing time period to be one year or less.

Revenue recognized in the current period from performance obligations related to prior periods (for example, due to changes in transaction price) was not material.

Our contract cost assets primarily relate to the portion of incentive compensation earned by certain employees that are considered incremental and recoverable costs of obtaining a contract with a customer. Those costs are not material. We have elected the practical expedient to expense as incurred any incremental costs of obtaining a contract if the associated period of benefit is one year or less.

LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Note 3: Loss Per Common Share

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	(Dollars In Thousands, Except Per Share Amounts)			
Numerator:				
Net loss	\$(27,506	) \$(7,033	) \$(33,097	) \$(13,019
Adjustments for basic net loss per common share:				
Dividend requirements on Series E Redeemable				
Preferred	(6,628	) (5,789	) (12,966	) (11,325
Dividend requirements on Series B Preferred	(60	) (60	) (120	) (120
Dividend requirements on Series D Preferred	(15	) (15	) (30	) (30
Accretion of Series E Redeemable Preferred	(802	) (1,618	) (2,401	) (3,217
Numerator for basic and dilutive net loss per common				
share - net loss attributable to common stockholders	\$(35,011	) \$(14,515	) \$(48,614	) \$(27,711
Denominator:				
Denominator for basic and dilutive net loss per				
common share - adjusted weighted-average				
shares (1)	27,492,979	27,249,304	27,476,180	27,248,682
Basic and dilutive net loss per common share:	\$(1.27	) \$(0.53	) \$(1.77	) \$(1.02

(1) Excludes the weighted-average shares of unvested restricted stock that are contingently returnable.

The following weighted-average shares of securities were not included in the computation of diluted net loss per common share as their effect would have been antidilutive:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Restricted stock and stock units	1,160,116	1,195,560	1,177,715	1,156,493
Convertible preferred stocks	916,666	916,666	916,666	916,666
Series E Redeemable Preferred - embedded derivative	303,646	303,646	303,646	303,646
Stock options	180,309	217,608	188,215	218,309

2,560,737	2,633,480	2,586,242	2,595,114
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Note 4: Inventories

At June 30, 2018 and December 31, 2017, because costs exceeded the net realizable value, inventory adjustments were \$567,000 and \$933,000, respectively.

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LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Note 5: Current and Noncurrent Accrued and Other Liabilities

	June 30, 2018	December 31, 2017
	(In Thousands)	
Accrued interest	\$7,091	\$ 13,424
Deferred revenue	6,101	6,987
Accrued payroll and benefits	3,459	4,855
Accrued death and other executive benefits	2,789	2,808
Series E Redeemable Preferred - embedded derivative	1,838	2,660
Accrued health and worker compensation insurance claims	1,680	1,658
Customer deposits	284	1,334
Other	8,801	13,538
	32,043	47,264
Less noncurrent portion	10,656	11,691
Current portion of accrued and other liabilities	\$21,387	\$ 35,573

Note 6: Long-Term Debt

Our long-term debt consists of the following:

	June 30, 2018	December 31, 2017
	(In Thousands)	
Working Capital Revolver Loan, with a current interest rate of 5.50% (A)	\$—	\$—
Senior Secured Notes due 2023 (B)	400,000	—
Senior Secured Notes due 2019 (B)	—	375,000
Secured Promissory Note due 2019, with a current interest rate of 5.73% (C)	7,662	8,167
Secured Promissory Note due 2021, with a current interest	9,696	11,262

rate of 5.25% (D)		
Secured Promissory Note due 2023, with a current interest		
rate of 6.25% (E)	15,675	16,665
Other	—	2,994
Unamortized discount and debt issuance costs	(16,670)	(4,689)
	416,363	409,399
Less current portion of long-term debt, net	12,899	9,146
Long-term debt due after one year, net	\$403,464	\$400,253

(A) Our revolving credit facility (the “Working Capital Revolver Loan”) provides for advances up to \$50 million (but provides an ability to expand the commitment an additional \$25 million), based on specific percentages of eligible accounts receivable and inventories and up to \$10 million of letters of credit, the outstanding amount of which reduces the available for borrowing under the Working Capital Revolver Loan. At June 30, 2018, our available borrowings under our Working Capital Revolver Loan were approximately \$34.3 million, based on our eligible collateral, less outstanding letters of credit. The maturity date of the Working Capital Revolver Loan is January 17, 2022. The Working Capital Revolver Loan also provides for a springing financial covenant (the “Financial Covenant”), which requires that, if the borrowing availability is less than or equal to the greater of 10.0% of the total revolver commitments and \$5 million, then the borrowers must maintain a minimum fixed charge coverage ratio of not less than 1.00 to 1.00. The Financial Covenant, if triggered, is tested monthly.

LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Note 6: Long-Term Debt (continued)

(B) On April 25, 2018, LSB completed the issuance and sale of \$400 million aggregate principal amount of its 9.625% Senior Secured Notes due 2023 (the “Senior Secured Notes”). The Senior Secured Notes were issued pursuant to an indenture, dated as of April 25, 2018 (the “Indenture”), by and among LSB, the subsidiary guarantors named therein, and Wilmington Trust, National Association, a national banking association, as trustee and collateral agent (the “Notes Trustee”).

The Senior Secured Notes were issued at a price equal to 99.509% of their face value. A portion of the net proceeds from the Senior Secured Notes were used to purchase/redeem the \$375 million aggregate principal amount of the 8.5% Senior Secured Notes due 2019. The remaining net proceeds were primarily used to pay related transaction fees and expenses, redemption premiums, and accrued interest on the notes purchased/redeemed.

A portion of above transaction was accounted for as an extinguishment of debt and a portion was accounted for as a non-substantial debt modification. As a result, approximately \$15.2 million of the fees/redemption premiums/discount was deferred and included in discount and debt issuance costs and approximately \$0.9 million of fees were expensed, as incurred, and are included in interest expense. In addition, we recognized a loss on extinguishment of debt of approximately \$6.0 million, primarily consisting of a portion of the redemption premiums paid and the expensing of a portion of debt issuance costs associated with the 8.5% Senior Secured Notes.

The Senior Secured Notes will mature on May 1, 2023 and rank senior in right of payment to all of our debt that is expressly subordinated in right of payment to the notes and will rank pari passu in right of payment with all of our liabilities that are not so subordinated, including the Working Capital Revolver Loan. LSB’s obligations under the Senior Secured Notes are jointly and severally guaranteed by the subsidiary guarantors named in the Indenture on a senior secured basis.

Interest on the Senior Secured Notes accrues at a rate of 9.625% per annum and is payable semi-annually in arrears on May 1 and November 1 of each year, beginning on November 1, 2018.

LSB may redeem the Senior Secured Notes at its option, in whole or in part, subject to the payment of a premium ranging from a “make-whole” premium to a premium of 3.609% of the principal amount so redeemed, in the case of any optional redemption prior to May 1, 2022. If LSB experiences a change of control, it must offer to purchase the notes at 101% of their principal amount, plus accrued and unpaid interest, if any, to but excluding the date of purchase.

The Indenture contains covenants that limit, among other things, LSB and certain of its subsidiaries’ ability to (1) incur additional indebtedness; (2) declare or pay dividends, redeem stock or make other distributions to stockholders; (3) make other restricted payments, including investments; (4) create dividend and other payment restrictions affecting its subsidiaries; (5) create liens or use assets as security in other transactions; (6) merge or consolidate, or sell, transfer, lease or dispose of all or substantially all of our assets; and (7) enter into transactions with affiliates. Further, during any such time when the Senior Secured Notes are rated investment grade by each of Moody’s Investors Service, Inc. and Standard & Poor’s Investors Ratings Services and no Default (as defined in the Indenture) has occurred and is continuing, certain of the covenants will be suspended with respect to the Senior Secured Notes.

The Indenture provides for customary events of default (subject in certain cases to customary grace and cure periods), which include nonpayment, breach of covenants in the Indenture, payment defaults or acceleration of other indebtedness, a failure to pay certain judgments and certain events of bankruptcy and insolvency.

(C) El Dorado Chemical Company (“EDC”), one of our subsidiaries, is party to a secured promissory note due June 29, 2019. Principal and interest are payable in equal monthly installments with a final balloon payment of approximately \$6.7 million.

(D) EDC is party to a secured promissory note due March 26, 2021. Principal and interest are payable in monthly installments.

(E) El Dorado Ammonia L.L.C. (“EDA”), one of our subsidiaries, is party to a secured promissory note due May 10, 2023. Principal and interest are payable in equal monthly installments with a final balloon payment of approximately \$6.1 million.

LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Note 7: Commitments and Contingencies

Natural Gas Purchase Commitments – At June 30, 2018, our natural gas contracts, which qualify as normal purchases under GAAP and thus are not mark-to-market, included minimal volume purchase commitments with fixed prices.

Legal Matters - Following is a summary of certain legal matters involving the Company:

A. Environmental Matters

Our facilities and operations are subject to numerous federal, state and local environmental laws and to other laws regarding health and safety matters (collectively, the “Environmental and Health Laws”), many of which provide for certain performance obligations, substantial fines and criminal sanctions for violations. Certain Environmental and Health Laws impose strict liability as well as joint and several liability for costs required to remediate and restore sites where hazardous substances, hydrocarbons or solid wastes have been stored or released. We may be required to remediate contaminated properties currently or formerly owned or operated by us or facilities of third parties that received waste generated by our operations regardless of whether such contamination resulted from the conduct of others or from consequences of our own actions that were in compliance with all applicable laws at the time those actions were taken. In connection with certain acquisitions, we could acquire, or be required to provide indemnification against, environmental liabilities that could expose us to material losses. In certain instances, citizen groups also have the ability to bring legal proceedings against us if we are not in compliance with environmental laws, or to challenge our ability to receive environmental permits that we need to operate. In addition, claims for damages to persons or property, including natural resources, may result from the environmental, health and safety effects of our operations.

There can be no assurance that we will not incur material costs or liabilities in complying with such laws or in paying fines or penalties for violation of such laws. Our insurance may not cover all environmental risks and costs or may not provide sufficient coverage if an environmental claim is made against us. The Environmental and Health Laws and related enforcement policies have in the past resulted, and could in the future result, in significant compliance expenses, cleanup costs (for our sites or third-party sites where our wastes were disposed of), penalties or other liabilities relating to the handling, manufacture, use, emission, discharge or disposal of hazardous or toxic materials at or from our facilities or the use or disposal of certain of its chemical products. Further, a number of our facilities are dependent on environmental permits to operate, the loss or modification of which could have a material adverse effect on their operations and our financial condition.

Historically, significant capital expenditures have been incurred by our subsidiaries in order to comply with the Environmental and Health Laws, and significant capital expenditures are expected to be incurred in the future. We will also be obligated to manage certain discharge water outlets and monitor groundwater contaminants at our facilities should we discontinue the operations of a facility. We did not operate the natural gas wells where we previously owned a working interest and compliance with Environmental and Health Laws was controlled by others. We were responsible for our working interest proportionate share of the costs involved.

As of June 30, 2018, our accrued liabilities for environmental matters totaled \$183,000 relating primarily to the matters discussed below.

1. Discharge Water Matters

Each of our manufacturing facilities generates process wastewater, which may include cooling tower and boiler water quality control streams, contact storm water and miscellaneous spills and leaks from process equipment. The process water discharge, storm-water runoff and miscellaneous spills and leaks are governed by various permits generally issued by the respective state environmental agencies as authorized and overseen by the U.S. Environmental Protection Agency (the "EPA"). These permits limit the type and amount of effluents that can be discharged and control the method of such discharge.

Our Pryor Facility is authorized by permit to inject wastewater into an on-site underground injection well through 2018. The Oklahoma Department of Environmental Quality ("ODEQ") has indicated that the permit may not be renewed following its expiration, and the Pryor Chemical Company ("PCC") may have to find an alternative means of waste water disposal after the permit expires. PCC has engaged in ongoing discussions with the ODEQ regarding future disposal of this wastewater stream.

Our El Dorado Facility is subject to a National Pollutant Discharge Elimination System ("NPDES") permit issued by the Arkansas Department of Environmental Quality ("ADEQ") in 2004. In 2010, the ADEQ issued a draft NPDES permit renewal for the El Dorado Facility, which contains more restrictive discharge limits than the previous 2004 permit.

These more restrictive limits could impose additional costs on the El Dorado Facility and may require the facility to make operational changes in order to meet these more restrictive limits. From time to time, the El Dorado Facility has had difficulty meeting the more restrictive dissolved minerals NPDES permit levels, primarily related to storm-water runoff and EDC is currently working with ADEQ to resolve this issue through a new permit, which is currently in progress.

LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Note 7: Commitments and Contingencies (continued)

We do not believe this matter regarding meeting the permit requirements as to the dissolved minerals is a continuing issue for the process wastewater as a result of the El Dorado Facility disposing its wastewater (beginning in September 2013) via a pipeline constructed by the City of El Dorado, Arkansas. On August 30, 2017, ADEQ issued a final NPDES permit, which included new dissolved mineral limits as anticipated. However, EDC objected to the form of the permit specifically around the limits of storm-water runoff and filed an appeal on September 27, 2017. The appeal places an automatic stay on the objectionable conditions and EDC is working with the ADEQ to obtain modifications to the renewed permit terms. We believe that the issue with the storm-water runoff should be resolved, if and when the appeal is resolved.

During 2012, EDC paid a penalty of \$100,000 to settle an administrative complaint issued by the EPA, and thereafter handled by the U.S. Department of Justice (“DOJ”), relating to certain alleged violations of EDC’s 2004 NPDES permit from 2004 through 2010. At the time of settlement, the DOJ advised that an additional action may be brought for alleged permit violations occurring after 2010. As of the date of this report, no action has been filed by the DOJ against EDC. As a result, the cost (or range of costs) cannot currently be reasonably estimated regarding this matter. Therefore, no liability has been established for potential future penalties as of June 30, 2018.

In November 2006, the El Dorado Facility entered into a Consent Administrative Order (the “CAO”) that recognizes the presence of nitrate contamination in the shallow groundwater. The CAO requires EDC to perform semi-annual groundwater monitoring, continue operation of a groundwater recovery system, submit a human health and ecological risk assessment, and submit a remedial action plan. The risk assessment was submitted in August 2007. In February 2015, the ADEQ stated that El Dorado Chemical was meeting the requirements of the CAO and should continue semi-annual monitoring. The ADEQ’s review of the EDC proposed remedy is ongoing. Under the CAO, the ADEQ may require additional wells be added to the program or may allow EDC to remove wells from the program. The final remedy for shallow groundwater contamination, should any remediation be required, would be selected pursuant to a new consent administrative order and based upon the risk assessment. The cost of any additional remediation that may be required would be determined based on the results of the investigation and risk assessment, of which cost (or range of costs) cannot currently be reasonably estimated. Therefore, no liability has been established at June 30, 2018, in connection with this matter.

2. Other Environmental Matters

In 2002, certain of our subsidiaries sold substantially all of their operating assets relating to a Kansas chemical facility (the “Hallowell Facility”) but retained ownership of the real property where the facility is located. Our subsidiary retained the obligation to be responsible for, and perform the activities under, a previously executed consent order to investigate the surface and subsurface contamination at the real property and develop a corrective action strategy based on the investigation. In addition, certain of our subsidiaries agreed to indemnify the buyer of such assets for these environmental matters.

As the successor to a prior owner of the Hallowell Facility, Chevron Environmental Management Company (“Chevron”) has agreed in writing, within certain limitations, to pay and has been paying one-half of the costs of the investigation and interim measures relating to this matter as approved by the Kansas Department of Health and Environment (the

“KDHE”), subject to reallocation.

Our subsidiary and Chevron have retained an environmental consultant to prepare and perform a corrective action study work plan as to the appropriate method to remediate the Hallowell Facility. The proposed strategy includes long-term surface and groundwater monitoring to track the natural decline in contamination. The KDHE is currently evaluating the corrective action strategy, and, thus, it is unknown what additional work the KDHE may require, if any, at this time. We are advised by our consultant that until the study is completed there is not sufficient information to develop a meaningful and reliable estimate (or range of estimate) as to the cost of the remediation.

We accrued our allocable portion of costs primarily for the additional testing, monitoring and risk assessments that could be reasonably estimated, which is included in our accrued liabilities for environmental matters discussed above. The estimated amount is not discounted to its present value. As more information becomes available, our estimated accrual will be refined.

B. Other Pending, Threatened or Settled Litigation

In 2013, an explosion and fire occurred at the West Fertilizer Co. (“West Fertilizer”) located in West, Texas, causing death, bodily injury and substantial property damage. West Fertilizer is not owned or controlled by us, but West Fertilizer was a customer of EDC, and purchased AN from EDC from time to time. LSB and EDC received letters from counsel purporting to represent subrogated insurance carriers, personal injury claimants and persons who suffered property damages informing LSB and EDC that their clients are conducting investigations into the cause of the explosion and fire to determine, among other things, whether AN manufactured by EDC and supplied to West Fertilizer was stored at West Fertilizer at the time of the explosion and, if so, whether such AN may have been one of the contributing factors of the explosion. Initial lawsuits filed named West Fertilizer and another supplier of AN as defendants.

LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Note 7: Commitments and Contingencies (continued)

In 2014, EDC and LSB were named as defendants, together with other AN manufacturers and brokers that arranged the transport and delivery of AN to West Fertilizer, in the case styled City of West, Texas vs. CF Industries, Inc., et al., in the District Court of McLennan County, Texas. The plaintiffs allege, among other things, that LSB and EDC were negligent in the production and marketing of fertilizer products sold to West Fertilizer, resulting in death, personal injury and property damage. EDC retained a firm specializing in cause and origin investigations with particular experience with fertilizer facilities, to assist EDC in its own investigation. LSB and EDC placed its liability insurance carrier on notice, and the carrier is handling the defense for LSB and EDC concerning this matter. Our product liability insurance policies have aggregate limits of general liability totaling \$100 million, with a self-insured retention of \$250,000, which retention limit has been met relating to this matter. In August 2015, the trial court dismissed plaintiff's negligence claims against us and EDC based on a duty to inspect but allowed the plaintiffs to proceed on claims for design defect and failure to warn.

Subsequently, we and EDC have entered into confidential settlement agreements (with approval of our insurance carriers) with several plaintiffs that had claimed wrongful death and bodily injury and insurance companies asserting subrogation claims for damages from the explosion. A portion of these settlements have been paid by the insurer as of June 30, 2018. While these settlements resolve the claims of a number of the claimants in this matter for us, we continue to be party to litigation related to this explosion by other plaintiffs, in addition to indemnification or defense obligations we may have to other defendants. We intend to continue to defend these lawsuits vigorously and we are unable to estimate a possible range of loss at this time if there is an adverse outcome in this matter as to EDC. As of June 30, 2018, no liability reserve has been established in connection with this matter, except for the unpaid portion of the settlement agreements that are covered by insurance as discussed above.

In 2015, our subsidiary, EDC, was sued in the matter styled BAE Systems Ordinance Systems, Inc. ("BAE"), et al. vs. El Dorado Chemical Company, in the United States District Court, Western District of Arkansas, for an alleged breach of a supply agreement to provide BAE certain products. In March 2018, the Court granted our motion for summary judgment and dismissed BAE's claims against the Company.

In 2015, a case styled Dennis Wilson vs. LSB Industries, Inc., et al., was filed in the United States District Court for the Southern District of New York. The plaintiff purports to represent a class of our shareholders and asserts that we violated federal securities laws by allegedly making material misstatements and omissions about delays and cost overruns at our El Dorado Chemical Company manufacturing facility and about our financial well-being and prospects. The lawsuit, which also names certain current and former officers, seeks an unspecified amount of damages. Given the uncertainty of litigation, the preliminary stage of the case, and the legal standards that must be met for, among other things, class certification and success on the merits, we cannot estimate the reasonably possible loss or range of loss that may result from this action.

In 2015, we and EDA received formal written notice from Global Industrial, Inc. ("Global") of Global's intention to assert mechanic liens for labor, service, or materials furnished under certain subcontract agreements for the improvement of the new ammonia plant at our El Dorado Facility. Global is a subcontractor of Leidos Constructors, LLC ("Leidos"), the general contractor for EDA for the construction for the ammonia plant. Leidos terminated the services of Global with respect to their work performed at our El Dorado Facility in July 2015 and Global claims it is

entitled to payment for certain work prior to its termination in the sum of approximately \$18 million. Leidos reports that it made an estimated \$6 million payment to Global on or about September 11, 2015, and EDA paid Leidos approximately \$3.5 million relating to work performed by subcontractors of Global. Leidos has not approved certain payments to Global pending the result of on-going audits and investigation undertaken to quantify the financial impact of Global's work.

EDA intends to monitor the Leidos audit, and conduct its own investigation, in an effort to determine whether any additional payment should be released to Global for any work not in dispute. LSB and EDA intend to pursue recovery of any damage or loss caused by Global's work performed at our El Dorado Facility. In January 2016, El Dorado, Leidos and Global reached an agreement whereby the approximately \$3.6 million claims of Leidos' remaining unpaid subcontracts, vendors and suppliers will be paid (and these suppliers and subcontractors will in turn issue releases of their respective claims and liens). In addition, Global will reduce the value of its claim as against Leidos, and its lien amount as against the project by a similar amount. After all such lower tier supplier and subcontractors are satisfied, the Global claim and lien amount will be reduced to approximately \$5 million. In March 2016, EDC and we were served a summons in a case styled Global Industrial, Inc. d/b/a Global Turnaround vs. Leidos Constructors, LLC et al., where in Global seeks damages under breach of contract and other claims. We have requested indemnifications from Leidos under the terms of our contracts and we intend to vigorously defend against the allegation made by Global. No liability has been established in connection with the remaining \$5 million claim. In addition, LSB and EDA intend to pursue recovery of any damage or loss caused by Global's work performed at our El Dorado Facility.

LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Note 7: Commitments and Contingencies (continued)

We are also involved in various other claims and legal actions. It is possible that the actual future development of claims could be different from our estimates but, after consultation with legal counsel, we believe that changes in our estimates will not have a material effect on our business, financial condition, results of operations or cash flows.

Note 8: Derivatives, Hedges, Financial Instruments and Carbon Credits

For the periods presented, the following significant instruments are accounted for on a fair value basis:

Carbon Credits and Associated Contractual Obligation

Periodically, we are issued climate reserve tonnes (“carbon credits”) by the Climate Action Reserve in relation to a greenhouse gas reduction project (“Project”) performed at the Baytown Facility. Pursuant to the terms of the agreement with Covestro, a certain portion of the carbon credits are to be sold and the proceeds given to Covestro to recover the costs of the Project, and any balance thereafter to be allocated between Covestro and EDN. We have no obligation to reimburse Covestro for their costs associated with the Project, except through the transfer or sale of the carbon credits when such credits are issued to us. The assets for carbon credits are accounted for on a fair value basis and the contractual obligations associated with these carbon credits are also accounted for on a fair value basis (unless we enter into a sales commitment to sell the carbon credits). At June 30, 2018 and December 31, 2017, we did not have any carbon credits or related contractual obligations.

Embedded Derivative

Certain embedded features (“embedded derivative”) relating to the redemption of the Series E Redeemable Preferred, which includes certain contingent redemption features and the participation rights value have been bifurcated from the Series E Redeemable Preferred and recorded as a liability. As the result of the financing transaction relating to the Senior Secured Notes and the letter agreement relating to the Series E Redeemable Preferred as discussed in Notes 6 and 10, we estimate that the contingent redemption features have fair value at June 30, 2018 since we estimate that it is probable that a portion of the shares of this preferred stock would be redeemed prior to October 25, 2023. For certain other embedded features, we estimate no fair value at June 30, 2018 based on our assessment that there is a remote probability that these features will be exercised.

At June 30, 2018, the fair value of the embedded derivative was valued using discounted cash flow models and primarily based on the difference in the present value of estimated future cash flows with no redemptions prior to October 25, 2023 compared to certain redemptions deemed probable during the same period and applying the effective dividend rate of the Series E Redeemable Preferred (At December 31, 2017, we estimated that contingent redemption features had no fair value based on a remote probability of redeeming any shares of this preferred stock prior to previous put date). In addition, at June 30, 2018 and December 31, 2017, the fair value of the embedded derivative included the valuation of the participation rights, which was based on the equivalent of 303,646 shares of our common stock at \$5.30 and \$8.76 per share, respectively.

The following is a summary of the classifications of valuations of fair value:

Level 1 - The valuations of contracts classified as Level 1 are based on quoted prices in active markets for identical contracts. At June 30, 2018 and December 31, 2017, we did not have any contracts classified as Level 1.

Level 2 - The valuations of contracts classified as Level 2 are based on quoted prices for similar contracts and valuation inputs other than quoted prices that are observable for these contracts. At June 30, 2018 and December 31, 2017, we did not have any significant contracts classified as Level 2.

Level 3 - The valuations of assets and liabilities classified as Level 3 are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. At June 30, 2018 and December 31, 2017, the valuations of the embedded derivative are classified as Level 3.

This derivative is valued using market information, management's redemption assumptions, the underlying number of shares as defined in the terms of the Series E Redeemable Preferred, and the market price of our common stock. In addition, no valuation input adjustments were considered necessary relating to nonperformance risk for the embedded derivative.

LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Note 8: Derivatives, Hedges, Financial Instruments and Carbon Credits (continued)

The following details our liabilities that are measured at fair value on a recurring basis at June 30, 2018 and December 31, 2017:

Description (1)	Total Fair Value at June 30, 2018 (In Thousands)	Fair Value Measurements at June 30, 2018 Using Quoted Prices			Total Fair Value at December 31, 2017
		Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)		
Liabilities - Current and noncurrent accrued and other liabilities:					
Embedded derivative	\$ (1,838)	\$ —	\$ —	\$ (1,838)	\$ (2,660)
Total	\$ (1,838)	\$ —	\$ —	\$ (1,838)	\$ (2,660)

(1) There were no assets that were measured at fair value on a recurring basis at June 30, 2018 or December 31, 2017.

None of our liabilities measured at fair value on a recurring basis transferred between Level 1 and Level 2 classifications for the periods presented below. The following is a reconciliation of the beginning and ending balances for assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

	Assets		Liabilities		Assets		Liabilities	
	Three Months Ended June 30, 2018	Three Months Ended June 30, 2017	Three Months Ended June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
Beginning balance	\$534	\$867	\$ (2,395)	\$ (3,715)	\$ —	\$ —	\$ (2,660)	\$ (2,557)

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Transfers into Level 3	—	—	—	—	—	—	—	—
Transfers out of Level 3	—	—	—	—	—	—	—	—
Total realized and unrealized gains (losses)								
included in operating results	—	—	358	(109)	534	867	623	(1,267)
Purchases	—	—	—	—	—	—	—	—
Issuances	—	—	(229)	—	—	—	(229)	—
Sales	(534)	(867)	—	—	(534)	(867)	—	—
Settlements	—	—	428	687	—	—	428	687
Ending balance	\$—	\$—	\$(1,838)	\$(3,137)	\$—	\$—	\$(1,838)	\$(3,137)
Total gains (losses) for the period included								
in operating results attributed to the change in unrealized gains or losses on assets and liabilities still held at the reporting date	\$—	\$—	\$ 252	\$(289)	\$—	\$—	\$1,051	\$(580)

LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Note 8: Derivatives, Hedges, Financial Instruments and Carbon Credits (continued)

Net gains (losses) included in operating results and the statement of operations classifications are as follows:

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2017	
	2018	2017	2018	2017
	(In Thousands)			
Total net gains (losses) included in operating results:				
Other income - Carbon credits	\$—	\$—	\$534	\$867
Other expense - Contractual obligations relating to				
carbon credits	106	180	(428)	(687)
Non-operating other income (expense) - embedded				
derivative	252	(289)	1,051	(580)
Total net gains (losses) included in operating results	\$358	\$(109)	\$1,157	\$(400)

At June 30, 2018 and December 31, 2017, we did not have any financial instruments with fair values significantly different from their carrying amounts (excluding issuance costs, if applicable). The fair value of financial instruments is not indicative of the overall fair value of our assets and liabilities since financial instruments do not include all assets, including intangibles, and all liabilities.

Note 9: Income Taxes

In December 2017, the President of the United States signed into law the Tax Cuts and Jobs Act of 2017 (the "Act"), making significant changes to the Internal Revenue Code. Changes include, but are not limited to, a federal corporate tax rate of 21%, additional limitations on executive compensation, and limitations on the deductibility of interest.

The FASB issued ASU 2018-05, Income Taxes (Topic 740): "Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118" to address the application of GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Act.

At June 30, 2018, the Company has not completed its accounting for all of the tax effects of the Act and has not made an adjustment to the provisional tax benefit recorded under SAB 118 at December 31, 2017. We have estimated our

provision for income taxes in accordance with the Act and guidance available as of the date of this filing. Our estimated annual effective tax rate may be adjusted in subsequent interim periods, due to, among other things, additional analysis, changes in interpretations and assumptions we have made, and additional regulatory guidance that may be issued.

Provision (benefit) for income taxes is as follows:

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2017	
	2018	2017	2018	2017
	(In Thousands)			
Current:				
State	\$(27)	\$1	\$(40)	\$(39)
Total Current	\$(27)	\$1	\$(40)	\$(39)
Deferred:				
Federal	\$4,633	\$(2,558)	\$3,848	\$(3,770)
State	(282)	(204)	(406)	(234)
Total Deferred	\$4,351	\$(2,762)	\$3,442	\$(4,004)
Provision (benefit) for income taxes	\$4,324	\$(2,761)	\$3,402	\$(4,043)

For the three and six months ended June 30, 2018 and 2017, the current benefit for state income taxes shown above includes regular state income tax and provisions for uncertain state income tax positions.

LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Note 9: Income Taxes (continued)

Our estimated annual effective rate for 2018 includes the impact of permanent tax differences, limits on deductible compensation, valuation allowances, and other permanent items.

We reduce our deferred tax assets by a valuation allowance if, based upon the weight of available evidence, it is more-likely-than-not that we will not realize some portion or all of the deferred tax assets. We consider relevant evidence, both positive and negative, to determine the need for a valuation allowance. Information evaluated includes our financial position and results of operations for the current and preceding years, the availability of deferred tax liabilities and tax carrybacks, as well as an evaluation of currently available information about future years. During the second quarter of 2018, we established a valuation allowance on a portion of our federal deferred tax assets. This valuation allowance is reflective of our quarterly analysis of the four sources of taxable income, including the calculation of the reversal of existing tax assets and liabilities, the impact of the recent financing activities and our 2018 second quarter results. Based on our analysis, we now believe that it is more-likely-than-not that a portion of our federal deferred tax assets will not be able to be utilized and we estimate the valuation allowance to be recorded during 2018 to be approximately \$11 million. We have also determined it was more-likely-than-not that a portion of the state deferred tax assets would not be able to be utilized before expiration and we estimate the valuation allowance associated with these state deferred tax assets to be recorded during 2018 will be approximately \$5.1 million.

We will continue to evaluate both the positive and negative evidence on a quarterly basis in determining the need for a valuation allowance with respect to our deferred tax assets. Changes in positive and negative evidence, including differences between estimated and actual results and additional guidance for various provisions of the Act, could result in changes in the valuation of our deferred tax assets that could have a material impact on our consolidated financial statements. Changes in existing tax laws could also affect actual tax results and the realization of deferred tax assets over time.

The tax provision for the six months ended June 30, 2018 was \$3.4 million (11% provision on pre-tax loss) and the tax benefit for the six months ended June 30, 2017 was \$4.0 million (24% benefit on pre-tax loss). For the first six months of 2018, the effective tax rate is less than the statutory tax rate primarily due to the impact of the valuation allowances.

LSB and certain of its subsidiaries file income tax returns in the U.S. federal jurisdiction and various state jurisdictions. With few exceptions, the 2014-2017 years remain open for all purposes of examination by the U.S. Internal Revenue Service and other major tax jurisdictions. We are currently under examination by the IRS for the tax year 2015.

Note 10. Securities Financing Including Redeemable Preferred Stocks

Series E Redeemable Preferred

In connection with the issuance and sale of the Senior Secured Notes (the “Financing Transaction”) as discussed in Note 6, we entered into a letter agreement with the holder of our Series E Redeemable Preferred. The letter agreement extended the date upon which the holder of the Series E Redeemable Preferred has the right to elect to redeem the Series E Redeemable Preferred shares from August 2, 2019 to October 25, 2023. The letter agreement also provides for the amendment of certain other terms relating to the Series E Redeemable Preferred, including an increase in the per annum dividend rate payable in respect of the Series E Redeemable Preferred (a) by 0.50% on the third anniversary of the Financing Transaction, (b) by an additional 0.50% on the fourth anniversary of the Financing Transaction and (c) by an additional 1.0% on the fifth anniversary of the Financing Transaction.

The transaction associated with the letter agreement was determined to be a non-substantial modification. As a result, and as shown in the table below, a fee paid to the holder was deferred (reduction to the Series E Redeemable Preferred balance) and will be periodically accreted using the interest method through October 25, 2023, the earliest possible redemption date by the holder. In addition, the letter agreement included a contingent redemption feature, which was bifurcated from the Series E Redeemable Preferred based on the estimated fair value. This redemption feature is included in the embedded derivative as discussed in Note 8.

As of June 30, 2018, the Series E Redeemable Preferred has a 14% annual dividend rate and a participating right in dividends and liquidating distributions equal to 303,646 shares of common stock. Dividends accrue semi-annually in arrears and are compounded.

Series F Redeemable Preferred

As of June 30, 2018, the Series F Redeemable Preferred has voting rights (the “Series F Voting Rights”) to vote as a single class on all matters which the common stock have the right to vote and is entitled to a number of votes equal to 456,225 shares of our common stock.

LSB INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Note 10. Securities Financing Including Redeemable Preferred Stocks (continued)

Changes in our Series E and Series F Redeemable Preferred are as follows:

	Series E Redeemable Preferred Shares	Amount
	(Dollars In Thousands)	
Balance at December 31, 2017	139,768	\$ 174,959
Fees associated with letter agreement	—	(2,676)
Bifurcation of embedded derivative	—	(229)
Accretion relating to liquidation preference on		
preferred stock	—	1,629
Accretion for discount and issuance costs on		
preferred stock	—	772
Accumulated dividends	—	12,966
Balance at June 30, 2018	139,768	\$ 187,421

Note 11: Related Party Transactions

Included the issuance and sale of the Senior Secured Notes as discussed in Note 6, we sold \$500,000 principal amount of these notes to Daniel D. Greenwell, our Chief Executive Officer.

No dividends were declared during the first six months of 2018 or 2017. At June 30, 2018, accumulated dividends on the Series B and Series D Preferred totaled approximately \$828,000. The Series B Preferred and Series D Preferred are non-redeemable preferred stocks issued in 1986 and 2001, respectively, of which all outstanding shares are owned by the Golsen Holders.

During the first quarter of 2017, a death benefit agreement with Jack E. Golsen was terminated pursuant to the terms of the agreement that allowed us to terminate at any time and for any reason prior to the death of the employee. As a result, the liability of approximately \$1,400,000 for the estimated death benefit associated with this agreement was extinguished and derecognized with the offset classified as operating other income in the first quarter of 2017.

Note 12: Supplemental Cash Flow Information

The following provides additional information relating to cash flow activities:

	Six Months Ended June 30,	
	2018	2017
	(In Thousands)	
Cash payments (refunds) for:		
Income taxes, net	\$(962)	\$1,040
Noncash continuing investing and financing activities:		
Accounts payable associated with additions of		
property, plant and equipment	\$13,156	\$13,967
Dividends accrued on Series E Redeemable Preferred	\$12,966	\$11,325
Accretion of Series E Redeemable Preferred	\$2,401	\$3,217
Accounts payable associated with debt issuance costs		
incurred relating to senior secured notes	\$1,109	\$—

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with a review of the other Items included in this Form 10-Q and our June 30, 2018 condensed consolidated financial statements included elsewhere in this report. A reference to a "Note" relates to a note in the accompanying notes to the condensed consolidated financial statements. This MD&A reflects our operating results, unless otherwise noted. Certain statements contained in this MD&A may be deemed to be forward-looking statements. See "Special Note Regarding Forward-Looking Statements."

Overview

General

LSB is headquartered in Oklahoma City, Oklahoma and through its subsidiaries, manufactures and sells chemical products for the agricultural, mining, and industrial markets. We own and operate facilities in Cherokee, Alabama, El Dorado, Arkansas and Pryor, Oklahoma, and operate a facility for Covestro in Baytown, Texas. Our products are sold through distributors and directly to end customers throughout the U.S.

Key Initiatives for 2018

We believe our future results of operations and financial condition will depend significantly on our ability to successfully implement the following key initiatives:

• **Improving the on-stream rates of our chemical plants.** We have several initiatives underway that we believe will assist us in improving the reliability of our plants and allow us to produce more products for sale while lowering our cost of production. In 2017, we made the decision to upgrade our existing maintenance management system through technology enhancements and work processes to improve our predictive and preventative maintenance programs at our facilities. At that time, we also made the decision to engage outside maintenance experts to assist us in expediting its implementation and in its overall use. We have completed the initial implementation. While we are still ramping up the new maintenance management systems, we expect to see benefits in the second half of 2018. Additionally, specific to our Pryor Facility, we engaged several outside engineering firms to assist us in an overall plant reliability study which will be used to enhance our reliability improvement plan for that facility. These studies were completed during the second quarter of 2018 and we are implementing numerous of the recommendations.

• **Focus on the Continued Improvement of Our Safety Performance.** We believe that high safety standards are critical to improved plant performance. With that in mind, we implemented enhanced safety programs at our facilities that focus on reducing risks and improving our safety culture in 2017. The implementation and training of these programs will continue in 2018 and we expect these will benefit our on-stream rates.

• **Continue Broadening of the distribution of our AN and Nitric Acid products.** We increased our overall sales volume of HDAN in 2017 by approximately 26% through various marketing initiatives which include: (1) storing and distributing HDAN at our Pryor and Cherokee Facilities which allows us to sell to new markets and customers out of those facilities and; (2) educating growers on the additional applications for HDAN. In 2018, we expect to continue to focus on those initiatives and other initiatives in an effort to continue to grow our annual sales volumes as compared to 2017.

In addition, through increased marketing efforts, we increased our sales volumes of nitric acid by approximately 22% in 2017. We expect to continue to focus on increasing our marketing efforts in order to expand our market for our nitric acid products in North America.

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Improving the Margins on Sales of Our Products. Over the last several years, we have focused on increasing our sales volumes to produce at optimal on-stream rates and lower our manufacturing costs per ton of product. Beginning in 2018, we expect to undertake a review of all sales to customers to determine if there are opportunities to improve the margins on sales to those customers and to explore if there are further product upgrading opportunities.

Reducing and controlling our cost structure. We have engaged outside experts to assist us in centralizing and expanding our Company-wide procurement efforts. We materially completed our initial areas of focus during the second quarter of 2018 and we expect to begin seeing benefits from these efforts in the second half of 2018. We believe that these efforts will result in an overall reduction in expenses and capital spend in the aggregate of between \$3 million to \$5 million on an annualized basis.

Since mid-2016 and through the end of 2017, we have reduced our annual SG&A and plant expenses over \$12 million. In addition to the procurement initiative discussed above, we believe there is still an opportunity to further reduce those expenses.

Focus on Improving Our Capital Structure and Overall Cost of Capital. We are actively seeking ways to improve our capital structure and reduce our overall cost of capital. We believe that the improving end markets for our products combined with our improved operating performance will be a benefit. As a part of that, in the second quarter of 2018, we refinanced our outstanding Senior Secured Notes. See discussion below concerning our recently completed financing transactions under Recent Developments.

We may not successfully implement any or all of these initiatives. Even if we successfully implement the initiatives, they may not achieve the results that we expect or desire.

Recent Developments

As discussed in Note 6, on April 25, 2018 (the date of the “Financing Transactions”), we issued \$400 million aggregate principal amount of 9.625% Senior Secured Notes due 2023 (the “Senior Secured Notes”). Most of the net proceeds from the Senior Secured Notes were used to repurchase all of our senior secured notes due 2019.

As discussed in Note 10, in connection with the financing transactions discussed above, we entered into a letter agreement with the holder of our Series E Redeemable Preferred to extend the date upon which a holder of Series E Redeemable Preferred has the right to elect to have such holder’s shares of Series E Redeemable Preferred redeemed by us from August 2, 2019 to October 25, 2023. The letter agreement also provides for the amendment of certain other terms relating to the Series E Redeemable Preferred, including an increase in the per annum dividend rate payable in respect of the Series E Redeemable Preferred (a) by 0.50% on the third anniversary of the financing transactions, (b) by an additional 0.50% on the fourth anniversary of the financing transactions and (c) by an additional 1.0% on the fifth anniversary of the financing transactions.

Key Industry Factors

Supply and Demand

Agricultural

Sales of our agricultural products were approximately 56% of our total net sales for the second quarter of 2018. The price at which our agricultural products are ultimately sold depends on numerous factors, including the supply and demand for nitrogen fertilizers which, in turn, depends upon world grain demand and production levels, the cost and availability of transportation and storage, weather conditions, competitive pricing and the availability of imports. Additionally, recent expansions or upgrades of competitors’ facilities, and international and domestic political and economic developments, including tariffs, continue to play an important role in the global nitrogen fertilizer industry economics. These factors can affect, in addition to selling prices, the level of inventories in the market which can cause price volatility and affect product margins.

Additionally, changes in corn prices can affect the number of acres of corn planted in a given year, and the number of acres planted will drive the level of nitrogen fertilizer consumption, likely effecting prices. The following estimates are associated with the corn market:

2019 Crop July Report (1)	2018 Crop July Report (1)	2017 Crop July Report (1)	Percentage Change (2)	Percentage Change (3)
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U.S. Area Planted (Million acres)	89.1	90.2	94.0	(1.2	%)	(4.0	%)
U.S. Yield per Acre (Bushels)	174.0	176.6	174.6	(1.5	%)	1.1	%
U.S. Production (Million bushels)	14,230	14,604	15,148	(2.6	%)	(3.6	%)
U.S. Ending Stocks (Million bushels)	39.4	51.5	58.3	(23.5	%)	(11.7	%)
World Ending Stocks (Million bushels)	152.0	191.7	227.7	(20.7	%)	(15.8	%)

(1) Information obtained from WASDE report dated July 12, 2018 (July Report) for the 2018/2019 (“2019 Crop”); 2017/2018 (“2018 Crop”) and 2016/2017 (“2017 Crop”) corn marketing years.

(2) Represents the percentage change in the July Report amounts for the 2019 Crop compared to the 2018 Crop.

(3) Represents the percentage change in the July Report amounts for the 2018 Crop compared to the 2017 Crop.

On the supply side, given the low price of natural gas in North America over the last several years, North American fertilizer producers have become the global low-cost producers for delivered fertilizer products to the Midwest U.S. Several years ago, the market believed that low natural gas prices would continue. That belief, combined with favorable fertilizer pricing, stimulated investment in numerous expansions of existing nitrogen chemical facilities and the construction of new nitrogen chemical facilities. Since those announcements, global nitrogen fertilizer supply has outpaced global nitrogen fertilizer demand causing oversupply in the global and North American markets. The increased fertilizer supply led to lower nitrogen fertilizer sale prices during most of 2017. Also, additional domestic supply of ammonia will change the physical flow of ammonia in North America placing pressure on ammonia and other fertilizer prices until the distribution system accepts the new supply. Beginning in the fourth quarter of 2017 and

through the first half of 2018, we have seen an increase in fertilizer prices as imports of fertilizers have decreased significantly and the distribution of the new domestic supply has been established.

Industrial

Sales of our industrial products were approximately 32% of our total net sales for the second quarter of 2018. Our industrial products sales volumes are dependent upon general economic conditions primarily in the housing, automotive, and paper industries. According to the American Chemistry Council, the U.S. economic indicators continue to be mostly positive for these sectors domestically. However, trade tension with China over recent import tariffs could lead to negative effects in these sectors. Our sales prices generally vary with the market price of our feedstock (ammonia or natural gas, as applicable) in our pricing arrangements with customers.

Mining

Sales of our mining products were approximately 12% of our total net sales for the second quarter of 2018. Our mining products are LDAN and AN Solutions, which are primary used as AN fuel oil and specialty emulsions for surface mining of coal and for usage in quarries and the construction industry. EIA is forecasting U.S. coal production in 2018 will be mostly unchanged from 2017 followed by a 3.5% decrease in 2019. U.S. coal consumption is also expected to decline due to low natural gas prices and alternate renewable energy sources and recent closure of coal-fired power plants is reducing demand for coal for coal-fired electricity generation (down 4% in 2018 and 5% in 2019). EIA also expects U.S. coal domestic and export demand to decline in 2018 and 2019. Despite year over year growth in sales volumes, we believe that coal production in the U.S. continues to face significant challenges from competition from natural gas and renewable sources of energy. While we believe our plants are well-located to support the more stable coal-producing regions in the upcoming years, our current mining sales volumes are being affected by overall lower customer demand for LDAN. We do not expect a significant increase in our mining business in the near term.

Farmer Economics

The demand for fertilizer is affected by the aggregate crop planting decisions and fertilizer application rate decisions of individual farmers. Individual farmers make planting decisions based largely on prospective profitability of a harvest, while the specific varieties and amounts of fertilizer they apply depend on factors such as their financial resources, soil conditions, weather patterns and the types of crops planted.

Natural Gas Prices

Natural gas is the primary feedstock used to produce nitrogen fertilizers at our manufacturing facilities. In recent years, U.S. natural gas reserves have increased significantly due to, among other factors, advances in extracting shale gas, which has reduced and stabilized natural gas prices, providing North America with a cost advantage over certain imports. As a result, our competitive position and that of other North American nitrogen fertilizer producers has been positively affected.

We historically have purchased natural gas in the spot market, using forward purchase contracts, or through a combination of both, and have used forward purchase contracts to lock in pricing for a portion of our natural gas requirements. These forward purchase contracts are generally either fixed-price or index-price, short-term in nature and for a fixed supply quantity. We are able to purchase natural gas at competitive prices due to our connections to large distribution systems and their proximity to interstate pipeline systems. The following table shows the volume of natural gas we purchased and the average cost per MMBtu:

	Three Months Ended June 30,	
	2018	2017
Natural gas volumes (MMBtu in millions)	6	7
Natural gas average cost per MMBtu	\$2.60	\$3.09

Transportation Costs

Costs for transporting nitrogen-based products can be significant relative to their selling price. For example, ammonia is a hazardous gas at ambient temperatures and must be transported in specialized equipment, which is more expensive than other forms of nitrogen fertilizers. In recent years, a significant amount of the ammonia consumed annually in the U.S. was imported. Therefore, nitrogen fertilizers prices in the U.S. are influenced by the cost to transport product from exporting countries, giving domestic producers who transport shorter distances an advantage.

Key Operational Factors

Facility Reliability

Consistent, reliable and safe operations at our chemical plants are critical to our financial performance and results of operations. The financial effects of planned downtime at our plants, including Turnarounds, are mitigated through a diligent planning process that considers the availability of resources to perform the needed maintenance, feedstock logistics and other factors. Unplanned downtime of our plants typically results in lost contribution margin from lost sales of our products, lost fixed cost absorption from lower production of our products and increased costs related to repairs and maintenance. All Turnarounds result in lost contribution margin from lost sales of our products, lost fixed cost absorption from lower production of our products, and increased costs related to repairs and maintenance, which repair, and maintenance costs are expensed as incurred.

For the third quarter of 2018, we have planned Turnarounds at our Cherokee and El Dorado Facilities. The Turnaround at the Cherokee Facility is expected to take 35 days to complete as we move to a three-year Turnaround cycle at that facility while the Turnaround at the El Dorado Facility is expected to take 5 days to complete given the Turnaround work we have completed during our recent unplanned downtime.

Prepay Contracts

We use forward sales of our fertilizer products to optimize our asset utilization, planning process and production scheduling. These sales are made by offering customers the opportunity to purchase product on a forward basis at prices and delivery dates that are agreed upon. We use this program to varying degrees during the year depending on market conditions and our view of changing price environments. Fixing the selling prices of our products months in advance of their ultimate delivery to customers typically causes our reported selling prices and margins to differ from spot market prices and margins available at the time of shipment.

Consolidated Results of the Second Quarter of 2018

Our consolidated net sales for the second quarter of 2018 were \$103.2 million compared to \$122.9 million for the same period in 2017. Our consolidated operating loss was \$5.9 million compared to \$0.3 million for the same period in 2017. The items impacting our operating results are discussed in more detail below and under “Results of Operations.”

Items Affecting Comparability of Results of the Second Quarter

On-Stream Rates

The on-stream rates of our plants affect our production, the absorption of fixed costs of each plant and sales of our products. It is a key operating metric that we use to manage our business. In particular, we closely monitor the on-stream rates of our ammonia plants as that is the basic product used to produce all upgraded products. At our Cherokee Facility, the ammonia plant on-stream rate for the second quarter of 2018 and 2017 was 100%.

At our El Dorado Facility, the ammonia plant’s on-stream rate for the second quarter of 2018 was 62% compared to 87% for the same period of 2017. The ammonia plant’s on-stream rate for the second quarter of 2018 was impacted by maintenance completed on its boiler relating to tube failures caused by a power outage during June 2018, which event also resulted in accelerated depreciation expense of approximately \$2.0 million and pulling forward some Turnaround work as discussed below.

At our Pryor Facility, the on-stream rate for the second quarter of 2018 for our ammonia plant was 65% compared to 78% for the same period of 2017. The ammonia plant's on-stream rate was impacted by maintenance to repair leaks in its waste heat boiler.

We expect on-stream rates for Cherokee, El Dorado and Pryor Facilities to average approximately 94%, excluding turnaround days, for the second half of 2018.

We believe that our focus on improving on-stream rates as discussed in key initiatives for 2018 and the capital investments made to the ammonia plant to date, will improve our overall on-stream rate for the remainder of 2018.

Turnaround Expense – El Dorado Facility (2018 only)

While the El Dorado's Facility's ammonia plant was out of service as discussed above, we elected to pull forward work previously planned for the September 2018 Turnaround, which will shorten the planned Turnaround in the third quarter to 5 days, from the previously announced 12 days, resulting in additional production and reduced Turnaround expense for the third quarter 2018. As a result, for the second quarter of 2018, Turnaround costs associated with this event were approximately \$1.1 million, which are included in cost of sales.

Selling Prices

During the second quarter of 2018, average agricultural selling prices for our UAN, HDAN and ammonia increased 16%, 11% and 5%, respectively, compared to 2017 average selling prices for the same period reflecting a more favorable alignment of demand with market capacity for these products. We expect that trend to continue in the second half of 2018.

However, average industrial selling prices for our nitric acid and ammonia declined compared to the same period of 2017 due to lower prices for natural gas and Tampa Ammonia as many of our industrial selling prices are indexed to pricing formulas tied to natural gas and Tampa ammonia benchmarks.

Loss on Extinguishment of Debt (2018 only)

As discussed in Note 6 and above under “Recent Developments”, as the result of the financing transactions relating to the Senior Secured Notes and repurchase of the senior secured notes due 2019, we incurred a loss on extinguishment of debt of \$6.0 million and expensed debt modification fees of \$0.9 million, which are included in interest expense.

Valuation Allowance on Deferred Tax Assets (2018 only)

As discussed in Note 9 and below under “Critical Accounting Policies and Estimates”, during the second quarter of 2018, we established a valuation allowance on a portion of our federal deferred tax assets (resulting in an income tax provision) since we currently believe that it is more-likely-than-not that a portion of our federal deferred tax assets will not be able to be utilized. We currently estimate the valuation allowance for 2018 will be approximately \$11 million.

Adoption of ASC 606 in 2018

See discussion concerning the impact from the adoption of ASC 606 in Note 2.

Results of Operations

The following Results of Operations should be read in conjunction with our condensed consolidated financial statements for the three months ended June 30, 2018 and 2017 and accompanying notes and the discussions under “Overview” and “Liquidity and Capital Resources” included in this MD&A.

We present the following information about our results of operations. Net sales to unaffiliated customers are reported in the condensed consolidated financial statements and gross profit represents net sales less cost of sales. Net sales are reported on a gross basis with the cost of freight being recorded in cost of sales.

Three Months Ended June 30, 2018 Compared to Three Months Ended June 30, 2017

The following table contains certain financial information:

	Three Months Ended			Percentage	
	June 30, 2018 (1)	2017	Change	Change	
	(Dollars In Thousands)				
Net sales:					
Agricultural products	\$58,024	\$57,236	\$788	1	%
Industrial acids and other chemical products	32,775	53,217	(20,442)	(38)	%
Mining products	12,400	10,344	2,056	20	%
Other products	—	2,056	(2,056)	(100)	%
Total net sales	\$103,199	\$122,853	\$(19,654)	(16)	%
Gross profit					
Gross profit	\$3,073	\$11,340	\$(8,267)	(73)	%
Gross profit percentage (2)	3.0	% 9.2	% (6.2)	%	
Selling, general and administrative expense	8,397	8,232	165	2	%
Other expense, net	545	3,406	(2,861)	(84)	%
Operating loss	(5,869)	(298)	(5,571)	(1,869)	%
Interest expense, net	11,693	9,292	2,401	26	%
Loss on extinguishment of debt	5,951	—	5,951	100	%
Non-operating other expense (income), net	(331)	204	(535)		
Provision (benefit) for income taxes (3)	4,324	(2,761)	7,085	(257)	%
Net loss	(27,506)	(7,033)	(20,473)	(291)	%
Property, plant and equipment improvements:	\$8,416	\$7,588	\$828	11	%
Depreciation, depletion and amortization of property, plant and equipment:					
	\$18,930	\$17,047	\$1,883	11	%

(1) See discussion concerning the impact from the adoption of ASC 606 in Note 2

(2) As a percentage of net sales

(3) See discussion above under “Items Affecting Comparability of Results of the Second Quarter-Valuation Allowance on Deferred Tax Assets” and in Note 9.

The following tables provide key operating metrics for the Agricultural Products:

Product (tons sold)	Three Months Ended			Percentage	
	June 30, 2018	2017	Change	Change	
UAN	110,336	118,488	(8,152)	(7)	%
HDAN	93,126	105,115	(11,989)	(11)	%

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Ammonia	12,956	12,248	708	6	%
Other	12,822	12,829	(7)	—	%
Total	229,240	248,680	(19,440)	(8)	%

Average Selling Prices (price per ton)	Three Months Ended			June 30,		Percentage	
	2018	2017	Change	2018	2017	Change	Change
UAN	\$192	\$165	\$ 27	16		16	%
HDAN	\$279	\$252	\$ 27	11		11	%
Ammonia	\$323	\$307	\$ 16	5		5	%

With respect to sales of Industrial Products, the following table indicates the volumes sold of our major products:

Product (tons sold)	Three Months Ended			Percentage	
	June 30, 2018	2017	Change	Change	
Ammonia	41,194	66,313	(25,119)	(38)%
Nitric Acid, excluding Baytown	33,504	24,806	8,698	35	%
Other Industrial Products	9,224	8,015	1,209	15	%
Total	83,922	99,134	(15,212)	(15)%

With respect to sales of Mining Products, the following table indicates the volumes sold of our major products:

Product (tons sold)	Three Months Ended			Percentage	
	June 30, 2018	2017	Change	Change	
LDAN/HDAN/AN Solution	48,001	39,940	8,061	20	%

Net Sales

Agricultural sales were relatively unchanged although we had an increase in average selling prices of UAN, HDAN and ammonia partially offset by decreased sales volume of those products. Excluding the impact from the adoption of ASC 606 discussed below, industrial sales decreased due to both lower volume and average selling sales prices. Mining sales increased due primarily to increased overall sales volume.

• Agricultural products sales increased slightly from higher overall average sales prices primarily relating to UAN and HDAN as a result of improved commodity pricing. This increase was partially offset by lower sales volume for HDAN and UAN. The decrease in sales volume primarily relates to lower on-stream rates experienced during the second quarter at our El Dorado and Pryor Facilities. HDAN sales volumes were also negatively affected by higher import levels of this product during the second quarter of 2018.

• As noted in the table above, industrial acids and other industrial chemical products sales decreased approximately 38%, primarily due to the impact from adopting ASC 606 as discussed in Note 2. Since we adopted ASC 606 using the “modified retrospective” method, the prior periods were not restated. If we had applied ASC 606 to these specific arrangements during the second quarter of 2017, net sales for these products would have been reduced by approximately \$15.6 million. Excluding this impact, sales decreased due to lower sales volume of industrial ammonia sales, including the impact from lower on-stream rates at our El Dorado Facility and lower overall average selling prices related to lower overall Tampa ammonia and natural gas benchmarks. This decrease was partially offset by higher sales volume of nitric acid and AN solution.

• Mining product sales increased as a result of higher sales volume of LDAN from our El Dorado Facility driven by our sales and marketing efforts and new contract awards. Our average selling prices were relatively consistent during these two periods.

Other products consisted of sales from our former business that sold industrial machinery and related components, which business was sold in October 2017, and minimal natural gas sales from our former working interests in certain natural gas properties that were sold during the second quarter of 2017.

Gross Profit

As noted in the table above, our gross profit decreased \$8.3 million compared to the second quarter of 2017, which primarily relates to:

- costs associated with lower on-stream rates, including lost absorption of fixed costs, increased Turnaround and other repair expenses, and costs to purchase ammonia used to upgrade to other downstream products;
- a recovery of precious metals of \$2.9 million in the second quarter of 2017, which metals had accumulated over time within certain manufacturing equipment;
- expenses incurred relating to certain key initiatives associated with improving the reliability of our plants and our overall procurement processes, partially offset by;
- lower average natural gas prices.

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In addition, the second quarter of 2017 included gross profit associated with our former industrial machinery business and working interests in certain natural gas properties, both sold in 2017 as discussed above.

Other Expense, net

Other expense for the second quarter of 2018 was \$0.5 million compared to \$3.4 million for the same period in 2017. During the second quarter of 2017, we incurred a total net loss on the sale of our working interest of certain natural gas properties and other non-core assets.

Interest Expense, net

Interest expense for the second quarter of 2018 was \$11.7 million compared to \$9.3 million for the same period in 2017. The increase relates primarily to the issuance of the Senior Secured Notes and approximately \$0.9 million related to debt modification fees associated with this financing transaction as discussed above under “Recent Developments” and in Note 6.

Loss on Extinguishment of Debt

For the second quarter of 2018, we incurred a loss on extinguishment of debt of approximately \$6.0 million as discussed above under “Items Affecting Comparability of Results of the Second Quarter-Loss on Extinguishment of Debt” and in Note 6.

Provision (Benefit) for Income Taxes

The provision for income taxes for the second quarter of 2018 was \$4.3 million compared to a benefit of \$2.8 million for the same period in 2017. The resulting effective tax rate for the second quarters of 2018 and 2017 was 19% (provision on pre-tax loss) and 28% (benefit on pre-tax loss), respectively. For the second quarter of 2018, the effective tax rate was impacted by adjustments made to our valuation allowances. Also see discussion above under “Items Affecting Comparability of Results of the Second Quarter-Valuation Allowance on Deferred Tax Assets” and in Note 9.

Six Months Ended June 30, 2018 Compared to Six Months Ended June 30, 2017

The following table contains certain financial information:

	Six Months Ended			Percentage Change
	June 30, 2018 (1)	2017	Change	
	(Dollars In Thousands)			
Net sales:				
Agricultural products	\$ 110,293	\$ 120,499	\$(10,206)	(8)%
Industrial acids and other chemical products	70,912	102,097	(31,185)	(31)%
Mining products	22,444	17,960	4,484	25%
Other products	—	5,641	(5,641)	(100)%
Total net sales	\$ 203,649	\$ 246,197	\$(42,548)	(17)%

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Gross profit	\$13,166	\$22,955	\$(9,789)	(43)%
Gross profit percentage (2)	6.5 %	9.3 %	(2.8)%	
Selling, general and administrative expense	16,700	18,777	(2,077)	(11)%
Other expense, net	451	2,155	(1,704)	
Operating income (loss)	(3,985)	2,023	(6,008)	(297)%
Interest expense, net	20,999	18,650	2,349	13 %
Loss on extinguishment of debt	5,951	—	5,951	100 %
Non-operating other expense (income), net	(1,240)	435	(1,675)	
Provision (benefit) for income taxes (3)	3,402	(4,043)	7,445	(184)%
Net loss	(33,097)	(13,019)	(20,078)	(154)%

Property, plant and equipment improvements:	\$11,419	\$15,216	\$(3,797)	(25)%
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Depreciation, depletion and amortization of property, plant

and equipment:	\$36,666	\$34,162	\$2,504	7 %
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(1) See discussion concerning the impact from the adoption of ASC 606 in Note 2

(2) As a percentage of net sales

(3) See discussion above under “Items Affecting Comparability of Results of the Second Quarter-Valuation Allowance on Deferred Tax Assets” and in Note 9.

The following tables provide key sales metrics for the agricultural products:

Six Months Ended				
Product (tons sold)	June 30,		Change	Percentage Change
	2018	2017		
UAN	212,538	276,272	(63,734)	(23)%
HDAN	185,839	196,286	(10,447)	(5)%
Ammonia	45,952	56,490	(10,538)	(19)%
Other	17,005	17,740	(735)	(4)%
Total	461,334	546,788	(85,454)	(16)%

Six Months Ended					
Average Selling Prices (price per ton)	June 30,		Change	Percentage Change	
	2018	2017			
UAN	\$172	\$163	\$ 9	6	%
HDAN	\$263	\$238	\$ 25	11	%
Ammonia	\$325	\$314	\$ 11	4	%

With respect to sales of Industrial Products, the following table indicates the volumes sold of our major products:

Six Months Ended				
Product (tons sold)	June 30,		Change	Percentage Change
	2018	2017		
Ammonia	109,292	110,237	(945)	(1)%
Nitric Acid, excluding Baytown	53,717	53,934	(217)	—%
Other Industrial Products	17,836	15,417	2,419	16%
Total	180,845	179,588	1,257	1%

With respect to sales of Mining Products, the following table indicates the volumes sold of our major products:

Six Months Ended	Percentage
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Product (tons sold)	June 30,		Change	Change	
	2018	2017			
LDAN/HDAN/AN Solution	86,180	68,559	17,621	26	%

Net Sales

Agricultural sales were lower primarily due a decrease in sales volume for our products partially offset by higher average prices for HDAN, UAN and ammonia. Excluding the impact from the adoption of ASC 606 discussed below, industrial sales improved due primarily to higher selling prices. Mining sales were higher primarily due to an increase in sales volume.

•Agricultural products sales decreased primarily from lower sales volume for all of our agricultural products. The decrease in sales volume primarily relates to the timing of barge shipments of UAN (3,000 tons and 24,000 tons in first half of 2018 and 2017, respectively), weather-driven planting delays for the spring application season, rail and truck transportation shortages, lower on-stream rates experienced at our three facilities and increased levels of HDAN imports during the first half of 2018. This decrease was partially offset by higher overall average sales prices primarily relating to HDAN, UAN and ammonia as the result of improved commodity pricing.

•As noted in the table above, industrial acids and other industrial chemical products sales decreased approximately 31%, primarily due to the impact from adopting ASC 606 as discussed in Note 2. Since we adopted ASC 606 using the “modified retrospective” method, the prior periods were not restated. If we had applied ASC 606 to these specific arrangements during the first half of 2017, net sales for these products would have been reduced by approximately \$33.3 million. Excluding this impact, sales increased due primarily to improved average selling prices for our products.

• Mining products sales increased primarily as a result of higher sales volume of LDAN from our El Dorado Facility related to new contract awards partially offset by lower sales of AN Solution.

• Other products consisted of sales from our former business that sold industrial machinery and related components, which business was sold in October 2017, and minimal natural gas sales from our former working interests in certain natural gas properties that were sold during the second quarter of 2017.

Gross Profit

As noted in the table above, we recognized a gross profit of \$13.2 million for the first half of 2018 compared to a \$23.0 million for the same period of 2017, or a decrease of \$9.8 million which primarily relates to:

• costs associated with lower on-stream rates, including lost absorption of fixed costs, increased Turnaround and other repair expenses, and costs to purchase ammonia used to upgrade to other downstream products;

• a recovery of precious metals of \$2.9 million in the second quarter of 2017, which metals had accumulated over time within certain manufacturing equipment;

• expenses incurred relating to certain key initiatives associated with improving the reliability of our plants and our overall procurement processes, partially offset by;

• lower average natural gas prices.

In addition, the first half of 2017 included gross profit associated with our former industrial machinery business and working interests in certain natural gas properties, both sold in 2017 as discussed above.

Selling General and Administrative

Our SG&A expenses were \$16.7 million for the first half of 2018, a decrease of \$2.1 million compared to the same period in 2017. The decrease was primarily driven by a \$0.7 million reduction in compensation-related costs, \$0.5 million reduction in professional fees, insurance and other miscellaneous costs, \$1.1 million of SG&A expenses related to former working interests in certain natural gas properties and our former business that sold industrial machinery and related components discussed above.

Other Expense, net

Our net other expense for the first six months of 2018 was \$0.5 million compared to \$2.2 million for the first six months of 2017. During the first half of 2018, other expense primarily relates to the total net loss from the sales of certain non-core assets. For the same period in 2017, we incurred a total net loss of \$4.2 million primarily relating to the sale of our working interest of certain natural gas properties and other non-core assets partially offset by the extinguishment and derecognition of a liability of approximately \$1.4 million associated with a death benefit agreement and approximately \$0.6 million of miscellaneous other income.

Interest Expense, net

Interest expense for the first six months of 2018 was \$21 million compared to \$18.7 million for the same period in 2017. The increase relates primarily to the issuance of the Senior Secured Notes and approximately \$0.9 million related to debt modification fees associated with this financing transaction as discussed above under “Recent Developments” and in Note 6.

Loss on Extinguishment of Debt

For the first half of 2018, we incurred a loss on extinguishment of debt of approximately \$6.0 million as discussed above under “Items Affecting Comparability of Results of the Second Quarter-Loss on Extinguishment of Debt” and in Note 6.

Non-operating Other Expense (Income), net