

LSB INDUSTRIES INC
Form 10-K
March 14, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2007

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
(State of Incorporation)

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

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

73107
(Zip Code)

Registrant's Telephone Number, Including Area Code: (405) 235-4546

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

Title of Each Class	Name of Each Exchange On Which Registered
Common Stock, Par Value \$.10	American Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act: Preferred Share Purchase Rights

(Facing Sheet Continued)

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

The aggregate market value of the Registrant's voting common equity held by non-affiliates of the Registrant, computed by reference to the price at which the voting common stock was last sold as of June 29, 2007, was approximately \$272 million. As a result, the Registrant is an accelerated filer as of December 31, 2007. For purposes of this computation, shares of the Registrant's common stock beneficially owned by each executive officer and director of the Registrant and by Jayhawk Capital Management, L.L.C. and its affiliates were deemed to be owned by affiliates of the Registrant as of June 29, 2007. Such determination should not be deemed an admission that such executive officers, directors and other beneficial owners of our common stock are, in fact, affiliates of the Registrant or affiliates as of the date of this Form 10-K.

As of March 7, 2008 the Registrant had 21,106,292 shares of common stock outstanding (excluding 3,448,518 shares of common stock held as treasury stock).

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PART I

ITEM 1. BUSINESS

General

LSB Industries, Inc. (the "Company", "Registrant", "LSB", "We", "Us", or "Our") was formed in 1968 as an Oklahoma corporation, and became a Delaware corporation in 1977. We are a diversified holding company. Our wholly-owned subsidiary, ThermaClime, Inc. ("ThermaClime") through its subsidiaries, owns substantially all of our core businesses consisting of the:

- Climate Control Business engaged in the manufacturing and selling of a broad range of heating, ventilation and air conditioning ("HVAC") products for the niche markets we serve. These products are used in commercial and residential new building construction, renovation of existing buildings and replacement of existing systems.
- Chemical Business engaged in the manufacturing and selling of chemical products produced from plants in Texas, Arkansas and Alabama for the industrial, mining and agricultural markets.

Certain statements contained in this Part I may be deemed to be forward-looking statements. See "Special Note Regarding Forward-Looking Statements."

We believe our Climate Control Business has developed leadership positions in niche markets by offering extensive product lines, customized products and improved technologies. Under this focused strategy, we have developed what we believe to be the most extensive line of water source heat pumps and hydronic fan coils in the United States. Further, we were a pioneer in the use of geothermal technology in the climate control industry and have used it to create what we believe to be the most energy efficient climate control systems commercially available today. We employ highly flexible production capabilities that allow us to custom design units for new construction markets and for the retrofit and replacement markets. Our products are currently installed in some of the most recognizable commercial developments in the country, including Prudential Tower, Rockefeller Plaza, Trump Tower, and Time Warner Center, and are slated to be in a number of developments currently under construction. In addition, we have a significant presence in the lodging industry with installations in numerous Hyatt, Marriott, Four Seasons, Starwood, Ritz Carlton and Hilton hotels. We also have a substantial share of resort destinations in Las Vegas where we have units installed in over 70,000 rooms for a number of premier properties, including the MGM Grand, Luxor, Venetian, Treasure Island, Bellagio, Mandalay Bay, Caesar's Palace, Monte Carlo, Mirage, Golden Nugget, Hard Rock, Wynn resorts, and many others.

Our Chemical Business has three chemical production facilities located in Baytown, Texas (the "Baytown Facility"), El Dorado, Arkansas (the "El Dorado Facility") and Cherokee, Alabama (the "Cherokee Facility"). Our Chemical Business is a supplier to some of the world's leading chemical and industrial companies. By focusing on specific geographic areas, we have developed freight and distribution advantages over many of our competitors, and we believe our Chemical Business has established leading regional market positions, a key element in the success of this

business. The primary raw material feedstocks (natural gas, anhydrous ammonia and sulfur) of the Chemical Business are commodities, subject to price fluctuations and are purchased at prices in effect at time of purchase.

The Baytown Facility consumes approximately 125,000 tons of purchased anhydrous ammonia per year. The majority of the Baytown Facility's production is sold pursuant to a long-term contract that provides for a pass-through of certain costs, including the anhydrous ammonia costs, plus a profit.

The El Dorado Facility purchases approximately 220,000 tons of anhydrous ammonia and 40,000 tons of sulfur annually and produces and sells approximately 455,000 tons of nitrogen-based products and approximately 120,000 tons of sulfuric acid per year. The anhydrous ammonia is purchased pursuant to a supply agreement whereby the El Dorado Facility secures the majority of its requirements of anhydrous ammonia from one supplier. Although anhydrous ammonia is produced from natural gas, the price does not necessarily follow the spot-price of natural gas in the U.S. because anhydrous ammonia is an internationally traded commodity and the relative price is set in the world market while natural gas is primarily a nationally traded commodity. The ammonia supply to the El Dorado Facility is transported from the Gulf of Mexico by pipeline. Our cost of anhydrous ammonia is based upon formulas indexed to published industry prices, primarily tied to import prices. Historically, the sulfur costs have been relatively stable; however, the recent world sulfur shortages have led to significant increase in the cost of this raw material.

The Cherokee Facility normally consumes 4 to 6 million MMBtu's of natural gas annually and produces and sells approximately 305,000 tons of nitrogen-based products per year. Natural gas is a primary raw material for anhydrous ammonia. Natural gas costs continue to exhibit volatility. In 2007 daily spot prices per MMBtu, excluding transportation, ranged from \$5.30 to \$10.59.

Due to the uncertainty of the sales prices of our products in relation to the cost of sulfur, anhydrous ammonia and natural gas, our Chemical Business has pursued a strategy of developing customers that purchase substantial quantities of products pursuant to sales agreements and/or pricing arrangements that provide for the pass through of these raw material costs. These pricing arrangements help mitigate the commodity risk inherent in the raw material feedstocks of natural gas, anhydrous ammonia and sulfur. For 2007, approximately 60% of the Chemical Business' sales were made pursuant to sales agreements and/or pricing arrangements that pass-through the cost of these raw materials. The remaining sales are primarily into agricultural markets at the price in effect at time of shipment. The sales prices of our agricultural products have only a moderate correlation to the anhydrous ammonia and natural gas feedstock costs and reflect market conditions for like and competing nitrogen sources. This can compromise our ability to recover our full cost to produce the product in this market. Additionally, the lack of sufficient non-seasonal sales volume to operate our manufacturing facilities at optimum levels can preclude the Chemical Business from reaching full performance potential. Our primary efforts to improve the results of our Chemical Business include maintaining the current level of non-seasonal sales volumes with an emphasis on customers that will accept the commodity risk inherent with natural gas and anhydrous ammonia, while maintaining a strong presence in the agricultural sector.

Segment Information and Foreign and Domestic Operations and Export Sales

Schedules of the amounts of net sales, gross profit, operating income (loss) and identifiable assets attributable to each of our lines of business and of the amount of our export sales in the aggregate and by major geographic area for each of the last three years appear in Note 20 of the Notes to Consolidated Financial Statements included elsewhere in this report.

Climate Control Business

General

Our Climate Control Business manufactures and sells a broad range of standard and custom designed geothermal and water source heat pumps and hydronic fan coils as well as other products for the niche markets we serve. These products are for use in commercial and residential HVAC systems, including large custom air handlers and modular chiller systems. The construction of commercial, institutional and residential buildings including multi and single-family homes, the renovation of existing buildings and the replacement of existing HVAC systems drive the demand for our Climate Control products. Our Climate Control commercial products are used in a wide variety of buildings, such as hotels, motels, office buildings, schools, universities, apartments, condominiums, hospitals, nursing homes, extended care facilities, industrial and high tech manufacturing facilities, food and chemical processing facilities, and pharmaceutical manufacturing facilities. We target many of our products to meet increasingly stringent indoor air quality and energy efficiency standards.

The following table summarizes net sales information relating to our products of the Climate Control Business:

	2007	2006	2005
Percentage of net sales of the Climate Control Business:			
Geothermal and water source heat pumps	58%	61%	54%
Hydronic fan coils	30%	27%	34%
Other HVAC products	12%	12%	12%
	100%	100%	100%
Percentage of our consolidated net sales:			
Geothermal and water source heat pumps	28%	27%	21%
Hydronic fan coils	15%	12%	13%
Other HVAC products	6%	6%	5%
	49%	45%	39%

Geothermal and Water Source Heat Pumps

We believe we are a leading provider of geothermal and water source heat pumps to the commercial construction and renovation markets in the United States. Water source heat pumps are highly efficient heating and cooling products, which enable individual room climate control through the transfer of heat through a water pipe system, which is connected to a centralized cooling tower or heat injector. Water source heat pumps enjoy a broad range of commercial

applications, particularly in medium to large sized buildings with many small, individually controlled spaces. We believe the market for commercial water source heat pumps will continue to grow due to the relative efficiency and long life of such systems as compared to other air conditioning and heating systems, as well as to the emergence of the replacement market for those systems.

Our Climate Control Business has also developed the use of geothermal water source heat pumps in residential and commercial applications. Geothermal systems, which circulate water and antifreeze through an underground heat exchanger, are among the most energy efficient systems available. We believe the longer life, lower cost to operate, and relatively short payback periods of geothermal systems, as compared with air-to-air systems, will continue to increase demand for our geothermal products. We specifically target new residential construction of moderate and high-end multi and single-family homes, as well as commercial applications.

Hydronic Fan Coils

We believe that our Climate Control Business is a leading provider of hydronic fan coils. Our Climate Control Business targets the commercial and institutional markets. Hydronic fan coils use heated or chilled water, provided by a centralized chiller or boiler through a water pipe system, to condition the air and allow individual room control. Hydronic fan coil systems are quieter and have longer lives and lower maintenance costs than other comparable systems used where individual room control is required. Important components of our strategy for competing in the commercial and institutional renovation and replacement markets include the breadth of our product line coupled with customization capability provided by a flexible manufacturing process. The lodging and hospitality industry is a significant user of hydronic fan coils; however, fan coils are used in a wide variety of applications.

Geothermal and Water Source Heat Pump and Hydronic Fan Coil Market

We estimate the annual United States market for water source heat pumps and hydronic fan coils to be approximately \$589 million based on data supplied by the Air-Conditioning and Refrigeration Institute (“ARI”). Levels of repair, replacement, and new construction activity generally drive demand in these markets.

Production and Backlog

We manufacture our products in many sizes and configurations, as required by the purchaser, to fit the space and capacity requirements of hotels, motels, schools, hospitals, apartment buildings, office buildings and other commercial or residential structures. In addition, most of these customer orders are placed well in advance of required delivery dates.

During 2006 and 2007, we invested approximately \$10.6 million in production and fabrication equipment, plant-wide process control systems and other upgrades relating to our Climate Control Business. In addition to the spending on equipment and systems, during 2006 and 2007, we invested a total of approximately \$3.8 million in facilities.

As a result of record order intake level of our heat pump products during 2006 and 2007, our backlog of confirmed orders for these products had increased to high levels and our lead times had pushed out beyond levels that we consider to be optimum for good customer service. In order to work the backlog down and to improve product lead times, we have increased unit capacity by approximately 65% (through additional shifts, overtime, investment in equipment, and facilities) since the end of 2005, with the potential for a further increase in capacity by debottlenecking and the addition of certain fabrication equipment. The facility expansion included a new 46,000 square foot building next to our existing heat pump manufacturing facility and the renovation of 110,000 square feet of an existing facility for a distribution center.

Our fan coil business also experienced significant increases in customer orders and shipments during 2007 and was able to increase production capacity through increased utilization of second shifts, equipment purchases, and the extension and reconfiguration of production assembly lines. During 2007, we also made capital investments to substantially increase our capacity of tube-in-fin heat transfer coils used in geothermal and water source heat pumps and hydronic fan coils.

For 2008, we have committed to date to spend an additional \$3.2 million for production equipment and land for future expansion. Our investment in the Climate Control Business will continue if order intake levels continue to warrant. These investments have and will increase our capacity to produce and distribute our Climate Control products.

As of December 31, 2007 and 2006, the backlog of confirmed orders for our Climate Control Business was approximately \$54.5 million and \$80.4 million, respectively. The decrease in our backlog relates primarily to utilizing the increased capacity discussed above. Our experience indicates that customers generally do not cancel orders after we receive them. We expect to ship substantially all the orders in the backlog within the next twelve months.

Marketing and Distribution

Distribution

Our Climate Control Business sells its products to mechanical contractors, original equipment manufacturers (“OEMs”) and distributors. Our sales to mechanical contractors primarily occur through independent manufacturers' representatives, who also represent complementary product lines not manufactured by us. OEMs generally consist of other air conditioning and heating equipment manufacturers who resell under their own brand name the products purchased from our Climate Control Business in competition with us. The following table summarizes net sales to OEMs relating to our products of the Climate Control Business:

		2007	2006	2005
Net sales to OEMs as a percentage of:				
Net sales of the Climate Control Business	19%	17%	22%	
Consolidated net sales	9%	8%	9%	

Market

Our Climate Control Business depends primarily on the commercial construction industry, including new construction and the remodeling and renovation of older buildings, and on the residential construction industry for both new and replacement markets relating to their geothermal products.

Raw Materials

Numerous domestic and foreign sources exist for the materials used by our Climate Control Business, which materials include compressors, steel, electric motors, valves and copper. Periodically, our Climate Control Business enters into fixed-price copper contracts. We do not anticipate any difficulties in obtaining necessary materials for our Climate Control Business. In 2008, however, changes in market volatility, supply and demand could result in increased costs, lost production and/or delayed shipments. We believe the majority of cost increases, if any, will be passed to our customers in the form of higher prices as product price increases are implemented and take effect and while we believe we will have sufficient materials, a shortage of raw materials could impact production of our Climate Control products.

Competition

Our Climate Control Business competes primarily with six companies, some of whom are also our customers. Some of our competitors serve other markets and have greater financial and other resources than we do. Our Climate Control Business manufactures a broader line of geothermal and water source heat pump and fan coil products than any other manufacturer in the United States, and we believe that we are competitive as to price, service, warranty and product performance.

Continue to Introduce New Products

Our Climate Control Business will continue to launch new products and product upgrades in an effort to maintain and increase our current market position and to establish a presence in new markets.

Chemical Business

General

Our Chemical Business manufactures three principal product lines that are derived from natural gas, anhydrous ammonia, and sulfur:

- concentrated, blended and regular nitric acid, mixed nitrating acids, metallurgical grade anhydrous ammonia, sulfuric acid, and high purity ammonium nitrate for industrial applications,
- anhydrous ammonia, fertilizer grade ammonium nitrate, urea ammonium nitrate (“UAN”), and ammonium nitrate ammonia solution (“ANA”) for the agricultural applications, and
 - industrial grade ammonium nitrate and solutions for the mining industry.

The following table summarizes net sales information relating to our products of the Chemical Business:

	2007	2006	2005
Percentage of net sales of the Chemical Business:			
Agricultural products	41%	34%	35%
Industrial acids and other chemical products	33%	37%	34%
Mining products	26%	29%	31%
	100%	100%	100%
Percentage of our consolidated net sales:			
Agricultural products	20%	18%	21%
Industrial acids and other chemical products	16%	19%	20%
Mining products	13%	16%	18%
	49%	53%	59%

Agricultural Products

Our Chemical Business produces ammonium nitrate at the El Dorado Facility and anhydrous ammonia, UAN, and ANA at the Cherokee Facility; all of which are nitrogen based fertilizers. The Cherokee Facility also has the ability to produce agricultural grade ammonium nitrate. Although, to some extent, the various forms of nitrogen-based fertilizers are interchangeable, each has its own characteristics, which produce agronomic preferences among end users. Farmers and ranchers decide which type of nitrogen-based fertilizer to apply based on the crop planted, soil and weather conditions, regional farming practices and relative nitrogen fertilizer prices. Our agricultural markets include a high concentration of pastureland and row crops, which favor our products. We sell these agricultural products to farmers, ranchers, fertilizer dealers and distributors located in the Central and Southeastern United States, which are in relatively close proximity to the El Dorado and Cherokee Facilities. We develop our market position in these areas by emphasizing high quality products, customer service and technical advice. During the past two years, we have been successful in expanding outside our traditional markets by barging to distributors on the Tennessee and Ohio rivers, and by railing into certain Western States. The El Dorado Facility produces a high performance ammonium nitrate fertilizer that, because of its uniform size, is easier to apply than many competing nitrogen-based fertilizer products. The El Dorado Facility establishes long-term relationships with end-users through its network of wholesale and retail distribution centers and the Cherokee Facility sells directly to agricultural customers.

Industrial Acids and Other Chemical Products

Our Chemical Business manufactures and sells industrial acids and other chemical products primarily to the polyurethane, paper, fibers and electronics industries. We are a major supplier of concentrated nitric acid and mixed nitrating acids, specialty products used in the manufacture of fibers, gaskets, fuel additives, ordnance, and other chemical products. In addition, at the El Dorado Facility, we produce and sell blended and regular nitric acid and we are a niche market supplier of sulfuric acid, primarily to the region's key paper manufacturers. At the Cherokee Facility, we are also a niche market supplier of industrial and high purity ammonia for many specialty applications, including chemicals to treat emissions from power plants.

We compete based upon service, price, location of production and distribution sites, product quality and performance. We also believe we are the largest domestic merchant marketer of concentrated and blended nitric acids and provide inventory management as part of the value-added services offered to certain customers.

The Baytown Facility is one of the two largest nitric acid manufacturing units in the United States, with demonstrated capacity exceeding 1,350 short tons per day. Subsidiaries within our Chemical Business entered into a series of agreements with Bayer Corporation ("Bayer") (collectively, the "Bayer Agreement"). Under the Bayer Agreement, El Dorado Nitric Company ("EDNC"), a subsidiary within our Chemical Business, operates the Baytown Facility at Bayer's Baytown, Texas operation. Bayer purchases from EDNC all of its requirements for nitric acid at its Baytown operation for a term through at least May 2009. EDNC purchases from Bayer certain of its requirements for materials, utilities and services for the manufacture of nitric acid. Upon expiration of the initial ten-year term in 2009, the Bayer Agreement may be renewed for up to six renewal terms of five years each; however, prior to each renewal period, either party to the Bayer Agreement may opt against renewal. Discussions with Bayer have begun regarding a renewal in 2009.

Mining Products

Our Chemical Business manufactures industrial grade ammonium nitrate ("AN") and 83% AN solution for the mining industry. The El Dorado Facility is a party to a long-term cost-plus supply agreement. Under this supply agreement, the El Dorado Facility supplies Orica USA, Inc. ("Orica") with a significant volume of industrial grade ammonium nitrate per year for a term through at least December 2010, with provisions for renewal thereafter.

Major Customer

The following summarizes net sales to our major customer relating to our products of the Chemical Business:

	2007	2006	2005
Net sales to Orica as a percentage of:			
Net sales of the Chemical Business	19%	20%	19%
Consolidated net sales	9%	10%	11%

Raw Materials

Anhydrous ammonia and natural gas represent the primary components in the production of most of the products of our Chemical Business. Spot natural gas and anhydrous ammonia costs have fluctuated dramatically in recent years. The following table shows, for the period indicated, the high and low published prices for natural gas based upon the daily spot price at the Tennessee 500 pipeline pricing point and for ammonia based upon the low Tampa metric price per ton as published by Ferticon and FMB Ammonia reports.

	Daily Spot Natural Gas Prices Per MMBtu		Ammonia Price Per Metric Ton	
	High	Low	High	Low
2005	\$15.25	\$5.50	\$399	\$235
2006	\$ 9.90	\$3.54	\$395	\$270
2007	\$10.59	\$5.30	\$460	\$295

As of March 7, 2008, the published price of natural gas, as described above, was approximately \$9.61 per MMBtu and ammonia was \$635 per metric ton. Natural gas is an integral raw material in the production of anhydrous ammonia. Prices of raw material feedstocks of natural gas and anhydrous ammonia remain volatile, and we have pursued a strategy of developing customers that purchase substantial quantities of products pursuant to sales agreements and/or pricing formulas that provide for the pass-through of these raw material costs. These pricing arrangements provide a hedge against the commodity risk inherent in the raw material feedstocks of natural gas and anhydrous ammonia. In addition, we use exchange-traded futures contracts to hedge the natural gas requirements for most sales commitments with firm sales prices.

Interruptions to the natural gas supply chain by the hurricanes of 2005 continued to exacerbate natural gas prices into early 2006. The Cherokee Facility was forced to temporarily curtail production in January and February of 2006 when major customers reduced purchases due to the high natural gas raw material pass-through costs. By mid-2006, the Gulf of Mexico supply was back to approximately 90% of pre-hurricane levels based on a report from the U.S. Department of the Interior. During 2007, the Cherokee Facility did not curtail production due to interruptions to their natural gas supply chain.

Under an agreement, as amended, with its principal supplier of anhydrous ammonia, the El Dorado Facility will purchase a majority of its anhydrous ammonia requirements using a market price-based formula plus transportation to the El Dorado Facility through at least December 31, 2008. We believe that we can obtain anhydrous ammonia from other sources in the event of an interruption of service under the above-referenced contract. The Cherokee Facility's natural gas feedstock requirements are generally purchased at spot market price. Periodically, the Cherokee Facility will hedge certain of its natural gas requirements with exchange-traded futures contracts as discussed above.

Historically, the sulfur costs have been relatively stable; however, as of the date of this report, the recent world sulfur shortages have led to a significant increase in the cost of this raw material during the second half at 2007 and into 2008.

Seasonality

We believe that the only seasonal products of our Chemical Business are fertilizer and related chemical products sold to the agricultural industry. The selling seasons for those products are primarily during the spring and fall planting seasons, which typically extend from March through June and from September through November in the geographical markets in which the majority of our agricultural products are distributed. As a result, our Chemical Business increases its inventory of ammonium nitrate and UAN prior to the beginning of each planting season. In addition, the amount and timing of sales to the agricultural markets depend upon weather conditions and other circumstances beyond our control.

Regulatory Matters

Our Chemical Business is subject to extensive federal, state and local environmental laws, rules and regulations as discussed under "Environmental Matters" of this Item and "Legal Proceedings" of Item 3.

Because of growing concerns over ammonium nitrate, other nitrogen fertilizers and other potentially hazardous materials, there have been new and proposed federal, state and industry requirements to place additional security controls over the distribution, transportation and handling of these products. Based on our current requirements, we believe there are no material capital expenditures to be expended relating to our security controls. However, this expectation could change in the near future.

We fully support these initiatives and believe they will not materially affect the viability of ammonium nitrate as a valued product to the agricultural industry.

Competition

Our Chemical Business competes with several chemical companies in our markets, such as CF Industries, Dyno Nobel North America, Terra Industries and Potash Corp. of Saskatchewan, many of whom have greater financial and other resources than us. We believe that competition within the markets served by our Chemical Business is primarily based upon service, price, location of production and distribution sites, and product quality and performance.

Employees

As of December 31, 2007, we employed 1,788 persons. As of that date, our Climate Control Business employed 1,363 persons, none of whom was represented by a union, and our Chemical Business employed 360 persons, with 138 represented by unions under currently unexecuted negotiated agreements which the parties expect to execute in the near future. Assuming the union agreements are executed in their current form, the agreements will expire in July through November of 2010.

Environmental Matters

Our operations are subject to numerous environmental laws ("Environmental Laws") and to other federal, state and local laws regarding health and safety matters ("Health Laws"). In particular, the manufacture and distribution of chemical products are activities which entail environmental risks and impose obligations under the Environmental Laws and the Health Laws, many of which provide for certain performance obligations, substantial fines and criminal sanctions for violations. There can be no assurance that material costs or liabilities will not be incurred by us in complying with such laws or in paying fines or penalties for violation of such laws. The Environmental Laws and Health Laws and enforcement policies thereunder relating to our Chemical Business have in the past resulted, and could in the future result, in compliance expenses, cleanup costs, penalties or other liabilities relating to the handling, manufacture, use, emission, discharge or disposal of effluents at or from our facilities or the use or disposal of certain of its chemical products. Historically, significant expenditures have been incurred by

subsidiaries within our Chemical Business in order to comply with the Environmental Laws and Health Laws and are reasonably expected to be incurred in the future.

The Company has certain facilities in our Chemical Business that contain asbestos insulation around certain piping and heated surfaces. The asbestos insulation is in adequate condition to prevent leakage and can remain in place as long as the facility is operated or remains assembled. The Company plans to maintain the facilities in an adequate condition to prevent leakage through its standard repair and maintenance activities.

1. Discharge Water Matters

The El Dorado Facility within our Chemical Business generates process wastewater. The process water discharge and storm-water run off are governed by a state National Pollutant Discharge Elimination System (“NPDES”) water discharge permit issued by the Arkansas Department of Environmental Quality (“ADEQ”), which permit is to be renewed every five years. The ADEQ issued to the El Dorado Facility a NPDES water discharge permit in 2004, and the El Dorado Facility had until June 1, 2007 to meet the compliance deadline for the more restrictive limits under the 2004 NPDES permit. In order to meet the El Dorado Facility’s June 2007 limits, the El Dorado Facility has significantly reduced the contaminant levels of its wastewater.

The El Dorado Facility has demonstrated its ability to comply with the more restrictive permit limits, and the rules which support the more restrictive dissolved minerals rules have been revised to authorize a permit modification to adopt achievable dissolved minerals permit limits. The ADEQ has agreed to issue a consent administrative order to authorize the El Dorado Facility to continue operations without incurring permit violations pending the modification of the permit to implement the revised rule and to dispose of the El Dorado Facility’s wastewater into the creek adjacent to the El Dorado Facility. A draft of the proposed consent administrative order has been prepared by the ADEQ and submitted to the El Dorado Facility for review. We are currently reviewing the proposed consent administrative order.

To meet the June 2007 permit limits, the El Dorado Facility has conducted a study of the creek adjacent to the El Dorado Facility to determine whether a permit modification allowing for the discharge into the creek is appropriate. On September 22, 2006, the Arkansas Pollution Control and Ecology Commission approved the results of the study that showed that the proposed permit modification is appropriate and the proposal to allow the El Dorado Facility to dispose of its wastewater into the creek. A public hearing was held on the matter on November 13, 2006 with minimal opposition. As a result, the El Dorado Facility has been discharging its wastewater into the creek.

In addition, the El Dorado Facility has entered into a consent administrative order (“CAO”) that recognizes the presence of nitrate contamination in the shallow groundwater at the El Dorado Facility. A new CAO to address the shallow groundwater contamination became effective on November 16, 2006 and requires the evaluation of the current conditions and remediation based upon a risk assessment. The CAO requires the El Dorado Facility to continue semi-annual groundwater monitoring, to continue operation of a groundwater recovery system and to submit a human health and ecological risk assessment to the ADEQ. The final remedy for shallow groundwater contamination, should any remediation be required, will be selected pursuant to the

new CAO and based upon the risk assessment. As an interim measure, the El Dorado Facility has installed two recovery wells to recycle groundwater and to recover nitrates. The cost of any additional remediation that may be required will be determined based on the results of the investigation and risk assessment and cannot currently be reasonably estimated. Therefore, no liability has been established at December 31, 2007.

2. Air Matters

Under the terms of a consent administrative order relating to air matters (“AirCAO”), which became effective in February 2004, resolving certain air regulatory alleged violations associated with the El Dorado Facility’s sulfuric acid plant and certain other alleged air emission violations, the El Dorado Facility is required to implement additional air emission controls at the El Dorado Facility no later than February 2010. We currently estimate the remaining environmental compliance related expenditures to be approximately \$5.6 million, which has been committed for 2008.

In December 2006, the El Dorado Facility entered into a new CAO (“2006 CAO”) with the ADEQ to resolve a problem with ammonia emissions from certain nitric acid units. The catalyst suppliers had represented the volume of ammonia emissions anticipated. The representation was the basis for the permitted emission limit, but the representation of the catalyst suppliers was not accurate. The ADEQ allowed the El Dorado Facility to re-evaluate the catalyst performance and required the El Dorado Facility to submit a permit modification with the appropriate ammonia limits. The permit modification was submitted to ADEQ on June 11, 2007, and is currently under review. Until the permit is modified, the 2006 CAO authorizes the El Dorado Facility to continue to operate certain nitric acid units (even though the El Dorado Facility is in non-compliance with the permitted emission limit for ammonia), provided that during this period of time, the El Dorado Facility monitors and reports the ammonia on a monthly basis.

3. Other Environmental Matters

In April 2002, Slurry Explosive Corporation (“Slurry”), later renamed Chemex I Corp., a subsidiary within our Chemical Business, entered into a Consent Administrative Order (“Slurry Consent Order”) with the Kansas Department of Health and Environment (“KDHE”), regarding Slurry’s Hallowell, Kansas manufacturing facility (“Hallowell Facility”). The Slurry Consent Order addressed the release of contaminants from the facility into the soils and groundwater and surface water at the Hallowell Facility. There are no known users of the groundwater in the area. The adjacent strip pit is used for fishing. Under the terms of the Slurry Consent Order, Slurry is required to, among other things, submit an environmental assessment work plan to the KDHE for review and approval, and agree with the KDHE as to any required corrective actions to be performed at the Hallowell Facility.

In December 2002, Slurry and Universal Tech Corporation (“UTeC”), both subsidiaries within our Chemical Business, sold substantially all of their operating assets but retained ownership of the real property. At December 31, 2002, even though we continued to own the real property, we did not assess our continuing involvement with our former Hallowell Facility to be significant and therefore accounted for the sale as discontinued operations. In connection with this sale, UTeC leased the real property to the buyer under a triple net long-term lease agreement.

However, Slurry retained the obligation to be responsible for, and perform the activities under, the Slurry Consent Order. In addition, certain of our subsidiaries agreed to indemnify the buyer of such assets for these environmental matters. The successor (“Chevron”), the prior owner of the Hallowell Facility has agreed, within certain limitations, to pay and has been paying one-half of the costs incurred under the Slurry Consent Order subject to reallocation.

Based on additional modeling of the site, Slurry and Chevron are pursuing a course with the KDHE of long-term surface and ground water monitoring to track the natural decline in contamination, instead of the soil excavation proposed previously. On September 12, 2007, the KDHE approved our proposal to perform two years of surface and groundwater monitoring and to implement a Mitigation Work Plan to acquire additional field data in order to more accurately characterize the nature and extent of contaminant migration off-site. The two-year monitoring program will terminate in February 2009. As a result of receiving approval from the KDHE for our proposal, we recognized a reduction in our share of the estimated costs associated with this remediation by \$377,000. This reduction is included in the net income from discontinued operations of \$348,000 for 2007 (in accordance with Statement of Financial Accounting Standards (“SFAS”) 144.

At December 31, 2007, the total estimated liability (which is included in current and noncurrent accrued and other liabilities) in connection with this remediation matter is approximately \$378,000 and Chevron’s share for these costs (which is included in accounts receivable and other assets) is approximately \$194,000. These amounts are not discounted to their present value. It is reasonably possible that a change in estimate of our liability and receivable will occur in the near term.

ITEM 1A. RISK FACTORS

Risks Related to Us and Our Business

Cost and the lack of availability of raw materials could materially affect our profitability and liquidity.

Our sales and profits are heavily affected by the costs and availability of primary raw materials. These primary raw materials, which are purchased from unrelated third parties, are subject to considerable price volatility. Historically, when there have been rapid increases in the cost of these primary raw materials, we have sometimes been unable to timely increase our sales prices to cover all of the higher costs incurred. While we periodically enter into exchange-traded futures contracts to hedge against price increases in certain of these raw materials, there can be no assurance that we will effectively manage against price fluctuations in those raw materials.

Anhydrous ammonia and natural gas represent the primary raw material feedstocks in the production of most of the products of the Chemical Business. Although our Chemical Business has a program to enter into contracts with certain customers that provide for the pass-through of raw material costs, we have a substantial amount of sales that do not provide for the pass-through of raw material costs. In addition, the Climate Control Business depends on raw materials such as copper and steel, which have shown considerable price volatility. As a result, in the future, we may not be able to pass along to all of our customers the full amount of any increases in raw

material costs. There can be no assurance that future price fluctuations in our raw materials will not have an adverse effect on our financial condition, liquidity and results of operations.

Additionally, we depend on certain vendors to deliver the primary raw materials and other key components that are required in the production of our products. Any disruption in the supply of the primary raw materials and other key components could result in lost production or delayed shipments. We have suspended in the past, and could suspend in the future, production at our chemical facilities due to, among other things, the high cost or lack of availability of such primary raw materials. Accordingly, our financial condition, liquidity and results of operations could be materially affected in the future by the lack of availability of primary raw materials and other key components.

Periodically, our Chemical Business may not generate significant positive cash flows.

Due, in part, to extensive capital expenditures, our Chemical Business may not generate significant positive cash flows periodically. Continuing significant cash flow expenditures by this business could have a material adverse effect on our financial condition and liquidity.

Our Climate Control and Chemical Businesses and their customers are sensitive to certain economic cycles.

Our Climate Control Business can be affected by cyclical factors, such as interest rates, inflation and economic downturns. Our Climate Control Business depends on sales to customers in the commercial construction and renovation industries, which are particularly sensitive to these factors. A decline in the economic activity in the United States has in the past, and could in the future, have a material adverse effect on our customers in the commercial construction and renovation industries in which our Climate Control Business sells a substantial amount of its products. Such a decline could result in a decrease in revenues and profits, and an increase in bad debts, in our Climate Control Business.

Our Chemical Business also can be affected by cyclical factors such as inflation, global energy policy and costs, global market conditions and economic downturns in specific industries. Certain sales of our Chemical Business are sensitive to the level of activity in the agricultural, mining, automotive and housing industries. A decline in the activity in these industries in the United States has in the past, and could in the future, have a material adverse effect on the results of our Chemical Business.

Weather conditions adversely affect our Chemical Business.

The agricultural products produced and sold by our Chemical Business have in the past, and could in the future, to be materially affected by adverse weather conditions (such as excessive rains or drought) in the primary markets for our fertilizer and related agricultural products. If any of these unusual weather events occur during the primary seasons for sales of our agricultural products (March-June and September-November), this could have a material adverse effect on the agricultural sales of our Chemical Business and our financial condition and results of operation.

Environmental and regulatory matters entail significant risk for us.

As discussed under “Environmental Matters” of Item 1, our Chemical Business is subject to numerous environmental laws and regulations. The manufacture and distribution of chemical products are activities, which entail environmental risks and impose obligations under environmental laws and regulations, many of which provide for substantial fines and potential criminal sanctions for violations. Our Chemical Business has in the past, and may in the future, be subject to fines, penalties and sanctions for violations of environmental laws and substantial expenditures for cleanup costs and other liabilities relating to the handling, manufacture, use, emission, discharge or disposal of effluents at or from the Chemical Business’ facilities. Further, a number of our Chemical Business’ facilities are dependent on environmental permits to operate, the loss or modification of which could have a material adverse effect on its operations and our financial condition.

We may be required to expand our security procedures and install additional security equipment for our Chemical Business in order to comply with the Homeland Security Act of 2002 and possible future government regulation.

The chemical industry in general, and producers and distributors of ammonium nitrate specifically, are scrutinized by the government, industry and public on security issues. Under the Homeland Security Act of 2002, as well as current and proposed regulations, we may be required to incur substantial additional costs relating to security at our chemical facilities, distribution centers, and our customers, as well as in the transportation of our products. These costs could have a material impact on our financial condition and results of operation. The cost of such regulatory changes, if significant enough, could lead some of our customers to choose alternate products to ammonium nitrate, which would have a significant impact on our Chemical Business.

A substantial portion of our sales is dependent upon a limited number of customers.

During 2007, four customers of our Chemical Business accounted for 44% of its net sales and 22% of our consolidated sales, and our Climate Control Business had one customer that accounted for 17% of its net sales and 8% of our consolidated sales. The loss of, or a material reduction in purchase levels by, one or more of these customers could have a material adverse effect on our business and our results of operations, financial condition and liquidity if we are unable to replace a customer on substantially similar terms.

There is intense competition in the Climate Control and Chemical industries.

Substantially all of the markets in which we participate are highly competitive with respect to product quality, price, design innovations, distribution, service, warranties, reliability and efficiency. We compete with a number of established companies that have greater financial, marketing and other resources. Competitive factors could require us to reduce prices or increase spending on product development, marketing and sales that would have a material adverse effect on our business, results of operation and financial condition.

We are effectively controlled by the Golsen Group.

Jack E. Golsen, our Chairman of the Board and Chief Executive Officer (“CEO”), members of his immediate family (spouse and children), including Barry H. Golsen, our Vice Chairman and President, entities owned by them and trusts for which they possess voting or dispositive power as trustee (collectively, the “Golsen Group”) beneficially owned as of February 29, 2008, an aggregate of 3,395,743 shares of our common stock and 1,020,000 shares of our voting preferred stock (1,000,000 of which shares have .875 votes per share, or 875,000 votes), which together votes as a class and represent approximately 19.5% of the voting power of our issued and outstanding voting securities as of that date. In addition, the Golsen Group also beneficially owned options and other convertible securities that allowed its members to acquire an additional 116,500 shares of our common stock within 60 days of February 29, 2008. Thus, the Golsen Group may be considered to effectively control us. As a result, the ability of other stockholders to influence our management and policies could be limited.

Loss of key personnel could negatively affect our business.

We believe that our performance has been and will continue to be dependent upon the efforts of our principal executive officers. We cannot promise you that our principal executive officers will continue to be available. Jack E. Golsen has an employment agreement with us. No other principal executive has an employment agreement with us. The loss of some of our principal executive officers could have a material adverse effect on us. We believe that our future success will depend in large part on our continued ability to attract and retain highly skilled and qualified personnel.

We may have inadequate insurance.

While we maintain liability insurance, including certain coverage for environmental contamination, it is subject to coverage limits and policies may exclude coverage for some types of damages (which may include warranty and product liability claims). Although there may currently be sources from which such coverage may be obtained, it may not continue to be available to us on commercially reasonable terms or the possible types of liabilities that may be incurred by us may not be covered by our insurance. In addition, our insurance carriers may not be able to meet their obligations under the policies or the dollar amount of the liabilities may exceed our policy limits. Even a partially uninsured claim, if successful and of significant magnitude, could have a material adverse effect on our business, results of operations, financial condition and liquidity.

We have not paid dividends on our outstanding common stock in many years.

We have not paid cash dividends on our outstanding common stock in many years, and we do not currently anticipate paying cash dividends on our outstanding common stock in the foreseeable future. However, our board of directors has not made a definitive decision whether or not to pay such dividends in 2008.

Terrorist attacks and other acts of violence or war, and natural disasters (such as hurricanes, pandemic health crisis, etc.), have and could negatively impact the U.S. and foreign companies, the financial markets, the industries where we operate, our operations and profitability.

Terrorist attacks and natural disasters (such as hurricanes) have in the past, and can in the future, negatively affect our operations. We cannot predict further terrorist attacks and natural disasters in the United States and elsewhere. These attacks or natural disasters have contributed to economic instability in the United States and elsewhere, and further acts of terrorism, violence, war or natural disasters could further affect the industries where we operate, our ability to purchase raw materials, our business, results of operations and financial condition. In addition, terrorist attacks and natural disasters may directly impact our physical facilities, especially our chemical facilities, or those of our suppliers or customers and could impact our sales, our production capability and our ability to deliver products to our customers. In the past, hurricanes affecting the Gulf Coast of the United States have resulted in damages to, or shutdown of, the gas pipeline to the Cherokee Facility, resulting in that facility being shutdown for several weeks. The consequences of any terrorist attacks or hostilities or natural disasters are unpredictable, and we may not be able to foresee events that could have an adverse effect on our operations.

Restatements and amendments to our 2004 audited financial statements and certain matters related to our disclosure controls and procedures may present a risk of future restatements and could in turn lead to legal exposure.

In response to comments from the Securities and Exchange Commission (“SEC”) to our 2004 Form 10-K, and as a result of changes we made internally, we restated and amended our 2004 audited financial statements and on December 30, 2005, filed a Form 10-K/A (Amendment No. 1) for year ended December 31, 2004. As a result of the restatement and amendments to our 2004 audited financial statements and SEC comments, we also filed on December 30, 2005, an amended Form 10-Q/A for each of the quarters ended March 31, 2005 and June 30, 2005.

As a result of this restatement to our 2004 financial statements, we also revised our 2004 Form 10-K and first two quarters 2005 Form 10-Qs to provide that our disclosure controls and procedures were not effective as of December 31, 2004, March 31, 2005 and June 30, 2005, in our Form 10-K/A and Forms 10-Q/A, as a result of assessing that the change from the LIFO method to the FIFO method of accounting was not material resulting in the decision at the time of the change not to disclose and not to restate the prior years financial statements. We believe that during December 2005, we corrected the weakness to our disclosure controls and procedures by, among other things, establishing a Disclosure Committee to maintain oversight activities and to examine and reevaluate our policies, procedures and criteria to determine materiality of items relative to our financial statements taken as a whole. Restatements by others have, in some cases, resulted in the filing of class action lawsuits against such companies and their management and further inquiries from the SEC. Any similar lawsuit against us could result in substantial defense and/or liability costs and would likely consume a material amount of management’s attention that might otherwise be applied to our business. Under certain circumstances, these costs might not be covered by, or might exceed the limits of, our insurance coverage.

By letter received in August 2006 from the SEC, the SEC has made an informal inquiry of us relating to the change in inventory accounting from LIFO to FIFO resulting in the restatement of our financial statements, and, at this time, we do not know if the informal inquiry:

- will rise to the level of an investigation or proceeding, or
- will result in an enforcement action, if any, by the SEC.

We are a holding company and depend, in large part, on receiving funds from our subsidiaries to fund our indebtedness.

Because we are a holding company and operations are conducted through our subsidiaries, principally ThermaClime and its subsidiaries, our ability to make scheduled payments of principal and interest on our indebtedness depend on operating performance and cash flows of our subsidiaries and the ability of our subsidiaries to make distributions and pay dividends to us. Under its loan agreements, ThermaClime and its subsidiaries may only make distributions and pay dividends to us under limited circumstances and in limited amounts. If ThermaClime is unable to make distributions or pay dividends to us, or the amounts of such distributions or dividends are not sufficient for us to service our debts, we may not be able to pay the principal or interest, or both, due on our indebtedness.

Our net operating loss carryforwards are subject to certain limitations and have not been audited or approved by the Internal Revenue Service.

Our net operating loss (“NOL”) carryforwards have resulted from certain historical losses. At December 31, 2006, we had regular NOL carryforwards of approximately \$49.9 million, all of which we have utilized or anticipate utilizing to reduce our federal income tax liability for 2007 and 2008. In future periods, our net income and liquidity will be negatively affected as we recognize and pay income taxes without the benefit of these NOL carryforwards. In addition, the amount of these NOL carryforwards utilized has not been audited or approved by the Internal Revenue Service.

Future issuance or potential issuance of our common stock could adversely affect the price of our common stock, our ability to raise funds in new stock offerings and dilute your percentage interest in our common stock.

Future sales of substantial amounts of our common stock or equity-related securities in the public market, or the perception that such sales could occur, could adversely affect prevailing trading prices of our common stock and could impair our ability to raise capital through future offerings of equity or equity-related securities. No prediction can be made as to the effect, if any, that future sales of shares of common stock or the availability of shares of common stock for future sale, will have on the trading price of our common stock. Such future sales could also significantly reduce the percentage ownership of our existing common stockholders.

We are subject to a variety of factors that could discourage other parties from attempting to acquire us.

Our certificate of incorporation provides for a staggered board of directors and, except in limited circumstances, a two-thirds vote of outstanding voting shares to approve a merger, consolidation or sale of all, or substantially all, of our assets. In addition, we have entered into severance agreements with our executive officers and some of the executive officers of our subsidiaries that provide, among other things, that if, within a specified period of time after the occurrence of a change in control of our company, these officers are terminated, other than for cause, or the officer terminates his employment for good reason, we must pay such officer an amount equal to 2.9 times the officer's average annual gross salary for the last five years preceding the change in control.

We have authorized and unissued (including shares held in treasury) 53,982,012 shares of common stock and 4,229,415 shares of preferred stock as of December 31, 2007. These unissued shares could be used by our management to make it more difficult, and thereby discourage an attempt to acquire control of us.

We have adopted a preferred share purchase plan, which is designed to ensure that all of our stockholders receive fair and equal treatment in the event of a proposed takeover or abusive tender offer.

The foregoing provisions and agreements are designed to discourage a third party tender offer or proxy contest for control of us and could have the effect of making it more difficult to remove incumbent management.

Delaware has adopted an anti-takeover law which, among other things, will delay for three years business combinations with acquirers of 15% or more of the outstanding voting stock of publicly-held companies (such as us), unless (a) the acquirer owned at least 85% of the outstanding voting stock of such company prior to commencement of the transaction, or (b) two-thirds of the stockholders, other than the acquirer, vote to approve the business combination after approval thereof by the board of directors, and (c) the stockholders decide to opt out of the statute.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

Climate Control Business

Our Climate Control Business manufactures most of its heat pump products in a 270,000 square foot facility in Oklahoma City, Oklahoma. We lease this facility, with an option to buy, through May 2016, with options to renew for three additional five-year periods. For 2007, approximately 87% of the productive capacity of this manufacturing facility was being utilized, based primarily on two ten-hour shifts per day and a four-day work week. In addition, we acquired a new 46,000

square foot building adjacent to our existing heat pump manufacturing facility, primarily used for storage of raw material inventory, and we renovated 110,000 square feet of an existing facility for a distribution center.

Our Climate Control Business conducts its fan coil manufacturing operation in a facility located in Oklahoma City, Oklahoma, consisting of approximately 265,000 square feet. We own this facility subject to a mortgage. For 2007, our Climate Control Business was using 87% of the productive capacity, based on one ten-hour shift per day and a four-day work week and a limited second shift in selected areas. The fan coil manufacturing operation increased the utilization of a second shift in order to increase its production capacity during 2007.

Our Climate Control Business conducts its large air handler manufacturing operation in a facility located in Oklahoma City, Oklahoma, consisting of approximately 110,000 square feet. We own this facility subject to a mortgage. For 2007, approximately 57% of the productive capacity of this manufacturing facility was being utilized, based on one eight-hour shift on a five-day work week and a partial second shift in selected areas.

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

Chemical Business

Our Chemical Business primarily conducts manufacturing operations (a) on 150 acres of a 1,400 acre tract of land located at the El Dorado Facility, (b) on 160 acres of a 1,300 acre tract of land located at the Cherokee Facility and (c) on leased property within Bayer's complex in the Baytown, Texas. The Company and/or its subsidiaries own all of its manufacturing facilities except the Baytown Facility. The Baytown Facility is leased pursuant to a long-term lease with an unrelated third party. Certain real property and equipment located at the El Dorado and Cherokee Facilities are being used to secure a \$50 million term loan. For 2007, the following facilities were utilized based on continuous operation:

	Percentage of Capacity
El Dorado Facility (1)	92 %
Cherokee Facility (2)	95 %
Baytown Facility	91 %

(1) The percentage of capacity for the El Dorado Facility relates to its nitric acid capacity. The El Dorado Facility has capacity to produce other nitrogen products in excess of its nitric acid capacity.

(2) The percentage of capacity for the Cherokee Facility relates to its ammonia production capacity. The Cherokee Facility has additional capacity for nitric acid, ammonium nitrate and urea in excess of its ammonia capacity.

In addition to the El Dorado and Cherokee Facilities, our Chemical Business distributes its agricultural products through 15 wholesale and retail distribution centers, with 13 of the centers located in Texas (10 of which we own and 3 of which we lease); 1 center located in Tennessee (owned); and 1 center located in Missouri (owned).

All of the properties utilized by our Chemical Business are considered by our management to be suitable and adequate to meet the current needs of that business.

ITEM 3. LEGAL PROCEEDINGS

1. Environmental See “Business-Environmental Matters” for a discussion as to:

- certain environmental matters relating to air and water issues at our El Dorado Facility; and
- certain environmental remediation matters at our former Hallowell Facility.

2. Other

Zeller Pension Plan

In February 2000, the Company’s board of directors authorized management to proceed with the sale of the automotive products business, since the automotive products business was no longer a “core business” of the Company. In May 2000, the Company sold substantially all of its assets in its automotive products business. After the authorization by the board, but prior to the sale, the automotive products business purchased the assets and assumed certain liabilities of Zeller Corporation (“Zeller”). The liabilities of Zeller assumed by the automotive products business included Zeller’s pension plan, which is not a multi-employer pension plan. In June 2003, the principal owner (“Owner”) of the buyer of the automotive products business was contacted by a representative of the Pension Benefit Guaranty Corporation (“PBGC”) regarding the plan. The Owner was informed by the PBGC of a possible under-funding of the plan and a possible takeover of the plan by the PBGC. The PBGC previously advised the Company that the PBGC may consider the Company potentially liable for the under-funding of the Zeller Plan in the event that the plan is taken over by the PBGC and alleged that the under-funding is approximately \$600,000. Our ERISA counsel has advised us that, based on certain assumptions and representations made by us to them, they believe that the possibility of an unfavorable non-appealable verdict against us in a lawsuit if the PBGC attempts to hold us liable for under-funding of the Zeller Plan is remote.

MEI Drafts

Masinexportimport Foreign Trade Company (“MEI”) has given notice to the Company and Summit Machine Tool Manufacturing Corp. (“Summit”), a subsidiary of the Company, alleging that it was owed \$1,533,000 in connection with MEI’s attempted collection of ten non-negotiable bank drafts payable to the order of MEI. The bank drafts were issued by Aerobit Ltd. (“Aerobit”), a non-U.S. company, which at the time of issuance of the bank drafts, was a subsidiary of the Company. Each of the bank drafts has a face value of \$153,300, for an aggregate principal face value of \$1,533,000. The bank drafts were issued in September 1992, and had a maturity date of December 31, 2001. Each bank draft was endorsed by LSB Corp., which at the time of endorsement, was a subsidiary of the Company.

On October 22, 1990, a settlement agreement between the Company, Summit, and MEI (the "Settlement Agreement"), was entered into, and in connection with the Settlement Agreement, Summit issued to MEI obligations totaling \$1,533,000. On May 16, 1992, the Settlement Agreement was rescinded by the Company, Summit, and MEI at the request of MEI, and replaced with an agreement purportedly substantially similar to the Settlement Agreement between MEI and Aerobit, pursuant to which MEI agreed to replace the original \$1,533,000 of Summit's obligations with Aerobit bank drafts totaling \$1,533,000, endorsed by LSB Corp. Aerobit previously advised us that MEI has not fulfilled the requirements under the bank drafts for payment thereof. All of the Company's ownership interest in LSB Corp. was sold to an unrelated third party in September 2002. Further, all of the Company's interest in Aerobit was sold to a separate unrelated third party, in a transaction completed on or before November 2002. Accordingly, neither Aerobit, which was the issuer of the bank drafts, nor LSB Corp., which was the endorser of the bank drafts, are currently subsidiaries of the Company.

During 2007, Cromus, alleged to be a Romanian company and an assignee of MEI, filed a lawsuit against us and two of our subsidiaries, Summit Machine Tool Manufacturing Corp. ("Summit") and Hercules Energy Mfg. Corp., Jack Golsen, our CEO, Mike Tepper, an officer of our company, Bank of America Corporation and others in the New York Supreme Court, in the case styled Cromus, as the assignee of MEI vs. Summit, Index No. 114890107 (NY Sup. Ct., NY Co. The complaint seeks \$1,533,000 plus interest from 1990, \$1,000,000 for failure to purchase certain equipment and \$1,000,000 in punitive damages. We intend to contest this matter vigorously. As of December 31, 2007, no liability has been established relating to these alleged damages.

The Jayhawk Group and the University of Kansas Endowment Fund

During July 2007, we mailed to all holders of record of our Series 2 Preferred a notice of redemption of all of the outstanding shares of Series 2 Preferred. The redemption of our Series 2 Preferred was completed on August 27, 2007, the redemption date. The terms of the Series 2 Preferred required that for each share of Series 2 Preferred so redeemed, we would pay, in cash, a redemption price equal to \$50.00 plus \$26.25 representing dividends in arrears thereon pro-rata to the date of redemption. There were 193,295 shares of Series 2 Preferred outstanding, net of treasury stock, as of the date the notice of redemption was mailed. Pursuant to the terms of the Series 2 Preferred, the holders of the Series 2 Preferred could convert each share into 4.329 shares of our common stock, which right to convert terminated 10 days prior to the redemption date. If a holder of the Series 2 Preferred elected to convert his, her or its shares into our common stock pursuant to its terms, the Certificate of Designations for the Series 2 Preferred provided, and it is our position, that the holder that so converts would not be entitled to receive payment of any dividends in arrears on the shares so converted. The Jayhawk Group, a former affiliate of ours, converted 155,012 shares of Series 2 Preferred into 671,046 shares of common stock. The Jayhawk Group has advised us that it may bring legal action against us for all dividends in arrears (approximately \$4 million) on the shares of Series 2 Preferred that it converted after receipt of the notice of redemption. The Company believes the likelihood that the Jayhawk Group may recover the dividends in arrears is not probable. Therefore, no liability has been established at December 31, 2007.

During the first quarter of 2008, the University of Kansas Endowment Charitable Gift Fund (“KU”) filed a lawsuit against us in the U.S. District Court, for the District of Kansas at Kansas City, styled The KU Endowment Charitable Gift Fund vs. LSB Industries, Inc., Case No. 08-CV-2066. KU alleges that we improperly refused to accept 11,200 shares of Series 2 Preferred, which KU received as a gift from the controlling party of the Jayhawk Group, in our issuer exchange tender offer. Under the issuer exchange tender offer, we offered to exchange each outstanding share of Series 2 Preferred for 7.4 shares of our common stock and a waiver of all dividends in arrears, except for certain shares of Series 2 Preferred owned by the Jayhawk Group (including its controlling party, Kent McCarthy) and the Golsen Group pursuant to an agreement entered into between us and the Jayhawk Group. The gift to KU by the controlling party of the Jayhawk Group was made after the announcement of the issuer exchange tender offer, and it is our position, among other things, that the tender of the shares given as a gift was made contrary to the agreement between us and the Jayhawk Group and contrary to the terms of our issuer exchange tender offer. KU alleges, among other things, that it suffered losses because it was required to convert the 11,200 shares of Series 2 Preferred pursuant to the conversion terms of the Series 2 Preferred, which was 4.3 shares of our common stock for each share of Series 2 Preferred, and that the conversion was less favorable than the terms of issuer exchange tender offer. KU alleges that the refusal to accept the 11,200 shares of Series 2 Preferred was in violation of §14(d) of the Securities Exchange Act of 1934 (“34 Act”), a violation of §10b and Rule 10b-5 and §18 of the 34 Act, the Kansas Uniform Securities Act and common law fraud. We intend to vigorously defend this matter. As of December 31, 2007, no liability has been established relating to this claim. We have placed the carrier under our Executive Organizational Liability Insurance Policy Including Securities Liability (“Policy”) on notice of this claim and litigation. This matter is being defended by our insurance carrier under the Policy under a reservation of rights. Our Policy is subject to a \$250,000 self insured retention for securities actions.

We received a letter dated May 23, 2007 from a law firm representing a stockholder of ours demanding that we investigate potential short-swing profit liability under Section 16(b) of the Exchange Act of the Jayhawk Group. The stockholder alleges that the surrender by the Jayhawk Group of 180,450 shares of our Series 2 Preferred in our issuer exchange tender offer in March 2007 was a sale which was subject to Section 16 and matchable against prior purchases of Series 2 Preferred by the Jayhawk Group. The Jayhawk Group advised us that they do not believe that they are liable for short-swing profits under Section 16(b). The provisions of Section 16(b) provide that if we do not file a lawsuit against the Jayhawk Group in connection with these Section 16(b) allegations within 60 days from the date of the stockholder’s notice to us, then the stockholder may pursue a Section 16(b) short-swing profit claim on our behalf. We engaged our outside corporate/securities counsel to investigate this matter. After completion of this investigation, we attempted to settle the matter with the Jayhawk Group but were unable to reach a resolution satisfactory to all parties. On October 9, 2007, the law firm representing the stockholder initiated a lawsuit against the Jayhawk Group pursuing a Section 16(b) short-swing profit claim on our behalf up to approximately \$819,000. During the first quarter of 2008, the parties have agreed to settle this claim by a payment to us by the Jayhawk Group of \$180,000, of which we will receive approximately \$125,000 after attorneys’ fees. This settlement is subject to a definitive settlement agreement.

Securities and Exchange Commission Inquiry

The SEC made an informal inquiry to the Company by letter dated August 15, 2006. The inquiry relates to the restatement of the Company's consolidated financial statements for the year ended December 31, 2004 and accounting matters relating to the change in inventory accounting from LIFO to FIFO. The Company has responded to the inquiry. At the present time, the informal inquiry is not a pending proceeding nor does it rise to the level of a government investigation. Until further communication and clarification with the SEC, if any, the Company is unable to determine:

- if the inquiry will ever rise to the level of an investigation or proceeding, or
- the materiality to the Company's financial position with respect to enforcement actions, if any, the SEC may have available to it.

Other Claims and Legal Actions

Wetherell v. Climate Master, a proposed class action filed by Donna Wetherell, individually and as a class action representative, Plaintiff, and Climate Master, Inc., Defendant, in the Circuit Court of the First Judicial Circuit, Johnson County, Illinois on September 14, 2007 alleges that certain evaporator coils sold by one of our subsidiaries in the Climate Control Business, Climate Master, Inc. ("Climate Master") in the state of Illinois from 1990 to approximately 2003 were defective. The complaint requests certification as a class action for the State of Illinois, which request has not yet been heard by the court. The plaintiff asserts claims based upon negligence, strict liability, breach of implied warranties, and the Illinois Consumer Fraud and Deceptive Business Practices Act. Climate Master has timely filed its pleadings to remove this action to federal court. Climate Master has also filed its answer denying the plaintiff's claims and asserting several affirmative defenses. Climate Master's insurers have been placed on notice of this matter. Currently the Company is unable to determine the amount of damages or the likelihood of any losses resulting from this claim. In addition, the Company intends to vigorously defend Climate Master in connection with this matter. Therefore, no liability has been established at December 31, 2007.

We are also involved in various other claims and legal actions which in the opinion of management, after consultation with legal counsel, if determined adversely to us, would not have a material effect on our business, financial condition or results of operations.

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

No matters were submitted to a vote of our shareholders during the fourth quarter of 2007.

ITEM 4A. EXECUTIVE OFFICERS OF THE REGISTRANT

Our officers serve one-year terms, renewable on an annual basis by the board of directors. Information regarding the Company's executive officers is as follows:

- Jack E. Golsen (1) Chairman of the Board and Chief Executive Officer. Mr. Golsen, age 79 first became a director in 1969. His term was renewed for 3 years at the annual meeting in 2007. Mr. Golsen, founder of the Company, is our Chairman of the Board of Directors and Chief Executive Officer and has served in those capacities since our inception in 1969. Mr. Golsen served as our President from 1969 until 2004. During 1996, he was inducted into the Oklahoma Commerce and Industry Hall of Honor as one of Oklahoma's leading industrialists. Mr. Golsen has a Bachelor of Science degree from the University of New Mexico. Mr. Golsen is a Trustee of Oklahoma City University. During his career, he acquired or started the companies which formed LSB. He has served on the boards of insurance companies, several banks and was Board Chairman of Equity Bank for Savings N.A. which was formerly owned by LSB.
- Barry H. Golsen (1) Vice Chairman of the Board, President, and President of the Climate Control Business. Mr. Golsen, age 57, first became a director in 1981. His term will expire in 2009. Mr. Golsen was elected President of the Company in 2004. Mr. Golsen has served as our Vice Chairman of the Board of Directors since August 1994, and has been the President of our Climate Control Business for more than five years. Mr. Golsen also serves as a director of the Oklahoma branch of the Federal Reserve Bank. Mr. Golsen has both his undergraduate and law degrees from the University of Oklahoma.
- David R. Goss Executive Vice President of Operations and Director. Mr. Goss, age 67, first became a director in 1971. His term will expire in 2009. Mr. Goss, a certified public accountant, is our Executive Vice President of Operations and has served in substantially the same capacity for more than five years. Mr. Goss is a graduate of Rutgers University.
- Tony M. Shelby Executive Vice President of Finance and Director. Mr. Shelby, age 66, first became a director in 1971. His term will expire in 2008. Mr. Shelby, a certified public accountant, is our Executive Vice President of Finance and Chief Financial Officer, a position he has held for more than five years. Prior to becoming our Executive Vice President of Finance and Chief Financial Officer, he served as Chief Financial Officer of a subsidiary of the Company and was with the accounting firm of Arthur Young & Co., a predecessor to Ernst & Young LLP. Mr. Shelby is a graduate of Oklahoma City University.

Jim D. Jones Senior Vice President, Corporate Controller and Treasurer. Mr. Jones, age 65, has been Senior Vice President, Controller and Treasurer since July 2003, and has served as an officer of the Company since April 1977. Mr. Jones is a certified public accountant and was with the accounting firm of Arthur Young & Co., a predecessor to Ernst & Young LLP. Mr. Jones is a graduate of the University of Central Oklahoma.

David M. Shear (1) Senior Vice President and General Counsel. Mr. Shear, age 48, has been Senior Vice President since July 2004 and General Counsel and Secretary since 1990. Mr. Shear attended Brandeis University, graduating cum laude in 1981. At Brandeis University, Mr. Shear was the founding Editor-In-Chief of Chronos, the first journal of undergraduate scholarly articles. Mr. Shear attended the Boston University School of Law, where he was a contributing Editor of the Annual Review of Banking Law. Mr. Shear acted as a staff attorney at the Bureau of Competition with the Federal Trade Commission from 1985 to 1986. From 1986 through 1989, Mr. Shear was an associate in the Boston law firm of Weiss, Angoff, Coltin, Koski and Wolf.

(1) Barry H. Golsen is the son of Jack E. Golsen and David M. Shear is married to the niece of Jack E. Golsen.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Market Information

Our common stock is listed for trading on the American Stock Exchange under the symbol "LXU". The following table shows, for the periods indicated, the high and low bid information for our common stock which reflects inter-dealer prices, without retail markup, markdown or commission, and may not represent actual transactions.

Quarter	Year Ended December 31,			
	2007		2006	
	High	Low	High	Low
First	\$ 15.71	\$ 11.41	\$ 7.48	\$ 5.87
Second	\$ 23.70	\$ 14.76	\$ 9.19	\$ 6.95
Third	\$ 25.25	\$ 17.00	\$ 10.25	\$ 8.25
Fourth	\$ 28.85	\$ 20.54	\$ 13.20	\$ 8.50

Stockholders

As of March 7, 2008, we had 698 record holders of our common stock. This number does not include investors whose ownership is recorded in the name of their brokerage company.

Dividends

We are a holding company and, accordingly, our ability to pay cash dividends on our preferred stock and our common stock depends in large part on our ability to obtain funds from our subsidiaries. The ability of ThermaClime (which owns substantially all of the companies comprising the Climate Control Business and Chemical Business) and its wholly-owned subsidiaries to pay dividends and to make distributions to us is restricted by certain covenants contained in the \$50 million revolving credit facility (the "Working Capital Revolver Loan") and the new \$50 million loan agreement due 2012 (the "Secured Term Loan"). Under the terms of these agreements, ThermaClime cannot transfer funds to us in the form of cash dividends or other distributions or advances, except for:

- the amount of income taxes that ThermaClime would be required to pay if they were not consolidated with us;
- an amount not to exceed fifty percent (50%) of ThermaClime's consolidated net income during each fiscal year determined in accordance with generally accepted accounting principles plus amounts paid to us within the first bullet above, provided that certain other conditions are met;
- the amount of direct and indirect costs and expenses incurred by us on behalf of ThermaClime pursuant to a certain services agreement;

- amounts under a certain management agreement between us and ThermaClime, provided certain conditions are met, and
- outstanding loans entered into subsequent to November 2, 2007 in excess of \$2.0 million at any time.

As of December 31, 2007, we have issued and outstanding 1,000,000 shares of Series D Preferred, 585 shares Non-Cumulative Preferred and 20,000 shares of Series B 12% Convertible, Cumulative Preferred Stock ("Series B Preferred"). Each share of preferred stock is entitled to receive an annual dividend, only when declared by our board of directors, payable as follows:

- Series D Preferred at the rate of \$.06 a share payable on October 9, which dividend is cumulative;
- Non-Cumulative Preferred at the rate of \$10.00 a share payable April 1, which are non-cumulative; and
- Series B Preferred at the rate of \$12.00 a share payable January 1, which dividend is cumulative.

Holders of our common stock are entitled to receive dividends only when declared by our board of directors. We have not paid cash dividends on our outstanding common stock in many years, and we do not currently anticipate paying cash dividends on our outstanding common stock in the foreseeable future. However, our board of directors has not made a definitive decision whether or not to pay such dividends in 2008.

ITEM 6. SELECTED FINANCIAL DATA

Years ended December 31,

	2007	2006	2005	2004	2003
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(Dollars In Thousands, Except Per Share Data)

Selected Statement of Operations Data:

Net sales	\$ 586,407	\$ 491,952	\$ 397,115	\$ 363,984	\$ 317,026
Interest expense (1)	\$ 12,078	\$ 11,915	\$ 11,407	\$ 7,393	\$ 6,097
Income from continuing operations before cumulative effect of accounting change (1) (2)	\$ 46,534	\$ 15,768	\$ 5,634	\$ 745	\$ 3,705
Cumulative effect of accounting change	\$ -	\$ -	\$ -	\$ (536)	\$ -
Net income	\$ 46,882	\$ 15,515	\$ 4,990	\$ 209	\$ 3,705
Net income (loss) applicable to common stock	\$ 41,274	\$ 12,885	\$ 2,707	\$ (2,113)	\$ 1,378
Income (loss) per common share applicable to common stock:					
Basic:					
Income (loss) from continuing operations before cumulative effect of accounting change	\$				