

LSB INDUSTRIES INC  
Form 10-K  
February 26, 2019

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, 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 of or other Jurisdiction (I.R.S. Employer  
Incorporation or Organization) Identification No.)

3503 NW 63<sup>rd</sup> Street, Suite 500,

Oklahoma City, Oklahoma 73116

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

(Address of Principal Executive Offices) (Zip Code)

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

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

	Name of Each Exchange
Title of Each Class	On Which Registered
Common Stock, Par Value \$.10	New York Stock Exchange
Preferred Share Purchase Rights	New York Stock Exchange

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 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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports submit such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 232.405 of this chapter) 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, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer	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.

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

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 30, 2018, was approximately \$111 million. As a result, the Registrant is an accelerated filer as of December 31, 2018. For purposes of this computation, shares of the Registrant's common stock beneficially owned by each executive officer and director of the Registrant and LSB Funding LLC were deemed to be owned by affiliates of the Registrant as of June 30, 2018. Such determination should not be deemed an admission that such executive officers, directors or entity of our common stock are, in fact, affiliates of the Registrant or affiliates as of the date of this Form 10-K.

As of February 22, 2019, the Registrant had 28,809,079 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's proxy statement for its annual meeting of stockholders will be filed with the Securities and Exchange Commission within 120 days after the end of its 2018 fiscal year, are incorporated by reference in Part III.

	Page
<u>PART I</u>	
Item 1. <u>Business</u>	3
Item 1A. <u>Risk Factors</u>	9
Item 1B. <u>Unresolved Staff Comments</u>	24
Item 2. <u>Properties</u>	25
Item 3. <u>Legal Proceedings</u>	26
Item 4. <u>Mine Safety Disclosures</u>	26
<u>PART II</u>	
Item 5. <u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	26
Item 6. <u>Selected Financial Data</u>	27
Item 7. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	28
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	45
Item 8. <u>Financial Statements and Supplementary Data</u>	46
Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	46
Item 9A. <u>Controls and Procedures</u>	46
Item 9B. <u>Other Information</u>	49

PART III

(Items 10, 11, 12, 13, and 14)

49

The information required by Part III, shall be incorporated by reference from our definitive proxy statement to be filed pursuant to Regulation 14A which involves the election of directors that we expect to be filed with the Securities and Exchange Commission not later than 120 days after the end of its 2018 fiscal year covered by this report.

PART IV

Item		
15.	<u>Exhibits and Financial Statement Schedules</u>	49

2

---

PART I

ITEM 1. BUSINESS

Overview

All references to "LSB Industries," "LSB," "the Company," "we," "us," and "our" refer to LSB Industries, Inc. and its subsidiaries, except where the context makes clear that the reference is only to LSB Industries, Inc. itself and not its subsidiaries. Notes referenced throughout this document refer to consolidated financial statement footnote disclosures that are found in Item 8.

The Company was formed in 1968 as an Oklahoma corporation and became a Delaware corporation in 1977. We manufacture and market chemical products for the agricultural, industrial and mining markets. We own and operate facilities in El Dorado, Arkansas (the "El Dorado Facility"), Cherokee, Alabama (the "Cherokee Facility"), and Pryor, Oklahoma (the "Pryor Facility"), and we operate a facility for Covestro AG ("Covestro") in Baytown, Texas (the "Baytown Facility"). Our products are sold through distributors and directly to end customers throughout the United States.

Our Business

Our business manufactures products for three principal markets:

- ammonia, fertilizer grade ammonium nitrate ("AN" and "HDAN") and urea ammonia nitrate ("UAN") 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 ("DEF") for industrial applications; and
- industrial grade AN ("LDAN") and AN solutions for mining applications.

The products we manufacture at our facilities are primarily derived from natural gas (a raw material feedstock). Our facilities and production processes have been designed to produce products that are marketable at nearly each stage of production. This design has allowed us to develop and deploy a business model optimizing the mix of products to capture the value opportunities in the end markets we serve with a focus on balancing our production.

The chart below highlights representative products and applications in each of our end markets.

End Market	Products	Applications
Agricultural	UAN, HDAN, ammonia	Fertilizer and fertilizer blends for corn and other crops; NPK fertilizer blends
Industrial	Nitric acid, metallurgical and commercial grade ammonia, sulfuric acid, diesel exhaust fluid and other urea	Semi-conductor and polyurethane intermediates, ordnance; Pulp and paper, alum, water treatment, metals and vanadium processing; Power plant emissions abatement, water treatment, refrigerants, metals processing; Exhaust stream additive, horticulture / greenhouse applications; refrigeration
Other	Specialty E-2 ammonium nitrate, CO2	
Mining	LDAN, AN solution, and HDAN	Specialty emulsions for mining applications, surface mining, quarries, and construction



The following table summarizes net sales information relating to our products:

	2018	2017	2016
Percentage of consolidated net sales:			
Agricultural products	50 %	43 %	44 %
Industrial acids and other chemical products	39 %	46 %	42 %
Mining products	11 %	9 %	12 %
Other products	0 %	2 %	2 %
	100 %	100 %	100 %

Prior to July 1, 2016, we manufactured and sold a range of heating, ventilation and air conditioning products and related services (the “Climate Control Business”). These products were primarily used in commercial, institutional and residential new building construction and renovations. On July 1, 2016, we sold the Climate Control Business.

For information regarding our net sales, operating results and total assets for the past three fiscal years, see the Consolidated Financial Statements included in this report.

#### Our Strategy

We pursue a strategy of balancing the sale of product as fertilizer into the agriculture markets at spot prices or short duration pre-sales and developing industrial and mining customers that purchase substantial quantities of products, primarily under contractual obligations and/or pricing arrangements that provide for the pass through of some raw material and other manufacturing costs. We believe this product and market diversification strategy allows us to have more consistent levels of production compared to some of our competitors and helps reduce the volatility risk inherent in the prices of our raw material feedstock and/or the changes in demand for our products.

The strategy of developing industrial and mining customers helps to moderate the risk inherent in the agricultural markets where spot sales prices of our agricultural products may not have a correlation to the natural gas feedstock costs but rather reflect market conditions for like and competing nitrogen sources. This volatility of sales pricing in our agricultural products may, from time to time, compromise our ability to recover our full cost to produce the product. Additionally, the lack of sufficient non-seasonal agricultural sales volume to operate our manufacturing facilities at optimum levels can preclude us from balancing production and storage capabilities. Looking forward, we continually pursue profitable growth and margin enhancement. Our strategy calls for continued emphasis on the agricultural sector, while remaining committed to further developing industrial customers who assume the volatility risk associated with the raw material costs and mitigate the effects of seasonality in the agricultural sector.

Our strategy also includes evaluating acquisitions of strategic assets or companies, mergers with other companies and investment in additional production capacity where we believe those acquisitions, mergers or expansion of production capacity will enhance the value of the Company and provide appropriate returns.

#### Key Operating Initiatives for 2019

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.** Over the past 18 months, our focus has been on upgrading our existing maintenance management system through technology enhancements and work processes to improve our predictive and preventative maintenance programs at our facilities. We engaged outside maintenance experts to assist us in expediting implementation and overall use. We have completed the initial implementation. Additionally, beginning in the third quarter of 2018, we engaged outside consultants to do a thorough review of our operating and maintenance procedures and our preventive maintenance programs at all of our facilities in an effort to determine where we may have gaps in procedures and programs and where we may need enhancements. Based on the “Gap Analysis” completed, we have several initiatives underway that we believe will improve the overall reliability of our plants and allow us to produce more products for sale while lowering our cost of production. Those initiatives are focused on operating behavior and procedure enhancements including operator training, leadership training, shift change enhancements and operating and maintenance procedures.

**Focus on the Continued Improvement of Our Safety Performance.** We believe that high safety standards are critical and a precursor 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. As a result of these programs, we significantly lowered our recordable incident rate in 2018 as compared to the prior year and we remain well below the national average for recordable safety incidents.

**Continue Broadening of the Distribution of our Products.** We increased our overall sales volume of HDAN over the past 24 months by approximately 30% through various marketing initiatives which include: (1) storing and distributing HDAN at our Pryor Facility which allows us to sell to new markets and customers out of that facility and; (2) educating growers on the agronomic benefits and the additional applications for HDAN. To further leverage our plants current production capacity, we are continuing to expand the distribution of our mining products by partnering with customers to take product further into the Western U.S. as well as markets outside the U.S. We also partnered with a current customer to position an emulsion explosives plant at our El Dorado Facility. We began selling product to that facility in the fourth quarter of 2018. We will continue to explore further guest plant opportunities at our facilities in 2019.

In addition, through increased marketing efforts, we increased our sales volumes of nitric acid over the past 24 months by approximately 35%. We continue to focus our efforts to expand our market for our nitric acid products in North America and to fully utilize available nitric acid production capacity of our facilities.

**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. In 2019, we will 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.

**Continued Focus on Procurement and Logistics.** In 2018, we engaged outside experts to assist us in centralizing and expanding our Company-wide procurement efforts. We completed our initial areas of focus during the second quarter of 2018, completed the implementation of those changes, and began to see benefits during the third quarter of 2018. We believe that these efforts along with several additional identified areas of focus, 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, which we expect to realize over the next 12 to 24 months. Additionally, we will continue to focus on improving the effectiveness and overall cost of our logistics strategy through a centrally managed team focused on building logistics partners that will help us further drive efficiencies in 2019.

**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 in achieving those efforts. As a part of that, in the second quarter of 2018, we refinanced our outstanding Senior Secured Notes. We will continue to actively seek ways to improve our capital structure going forward.

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.

## Our Competitive Strengths

### Strategically Located Chemical Assets and Long-Standing Customer Relationships

Our business benefits from highly advantageous locations with logistical and distribution benefits. We have access to the ammonia pipeline from the U.S. Gulf at our El Dorado Facility, which provides low cost transportation to distribution points. The El Dorado Facility also has rail access that is in close proximity to our HDAN customers and cost advantaged when selling a number of our products West of the Mississippi River. Our Cherokee Facility is located East of the Mississippi River, allowing it to reach customers that are not freight logical for others. Our Cherokee Facility sits adjacent to the Tennessee River, providing barge delivery access, in addition to truck and rail delivery access. Our Pryor Facility is located in the heart of the Southern Plains with close proximity to the Port of Catoosa along with strategic rail and truck delivery access.

### Advantaged Raw Material Cost Position

We currently produce ammonia at our El Dorado, Cherokee and Pryor Facilities, which allows us to take advantage of the spread between producing and purchasing ammonia at those facilities. Additionally, our Pryor Facility has a natural gas cost advantage as its cost of gas has historically been lower than our El Dorado and Cherokee Facilities.

#### Diversified Sources of Revenue

Our business serves a broad range of end markets, which we believe diminishes the cyclicity of our financial performance. Our business serves the agricultural, industrial and mining markets. The flexible nature of our production process allows us the ability to shift our product mix based on end market demand.

#### Operation of Multiple Facilities and High Production Capacity

We operate our business through several facilities. Operating multiple facilities diversifies the risk and impact of operational issues that may occur at a single plant, which gives us a strategic advantage over competitors that operate their company through a single facility. Additionally, our competitive production capacity of our combined plants allows us to decrease manufacturing costs, helping us to achieve enhanced margins.

## Market Conditions

As discussed in more detail under “Key Industry Factors” of “Management’s Discussion and Analysis of Financial Condition and Results of Operations” (“MD&A”) contained in Item 7 of this report, agricultural fertilizer demand is a significant driver of our sales volumes. This demand is influenced by the number of acres planted of crops, principally corn, that require fertilizer to grow and to enhance yield. Corn prices and those of soybean, cotton and wheat prices, affect the number of acres of corn planted in a given year, and the number of acres planted will influence nitrogen fertilizer consumption, likely affecting ammonia, UAN and urea prices. Weather also has an effect on fertilizer application and consumption. Industry reports indicated China’s recent tariffs placed on U.S. soybeans could result in a shift of 2 to 4 million acres that will be rotated from soybeans to corn in this next planting season. The USDA also estimates an increase in 2019 corn acres that is in line with other industry reports ranging between 92 million to 93 million acres. Soybean pricing concerns may drive crop planting selection when final crop choices are made at the farm level. The following February estimates are associated with the corn market:

	2019 Crop February Report (1)	2018 Crop February Report (1)	Percentage Change (2)	2017 Crop February Report (1)	Percentage Change (3)
U.S. Area Planted (Million acres)	89.1	90.2	(1.2 %)	94.0	(5.2 %)
U.S. Yield per Acre (Bushels)	176.40	176.6	(0.1 %)	174.6	1.0 %
U.S. Production (Million bushels)	14,420	14,609	(1.3 %)	15,148	(4.8 %)
U.S. Ending Stocks (Million metric tons)	44.1	54.4	(18.9 %)	58.3	(24.4 %)
World Ending Stocks (Million metric tons)	309.8	340.8	(9.1 %)	350.2	(11.5 %)

(1) Information obtained from WASDE reports dated February 8, 2019 (February Report) for the 2018/2019 (“2019 Crop”), 2017/2018 (“2018 Crop”) and 2016/2017 (“2016”) corn marketing years.

(2) Represents the percentage change between the 2019 Crop amounts compared to the 2018 Crop amounts.

(3) Represents the percentage change between the 2019 Crop amounts compared to the 2017 Crop amounts.

In our industrial markets, our sales volumes are typically driven by changes in general economic conditions, energy prices, and our contractual arrangements with certain large customers. Our mining products are generally sold into the coal and metals and mineral mining markets and are also used in the production of stone for construction and production of cement for quarrying operations. As such, U.S. annual coal production will drive sale volumes of our mining products and over the past several years, U.S. coal production has been negatively impacted by low natural gas prices among other things. As reported by the U.S. Energy Information Administration (“EIA”), annual coal production in the U.S. for the full year of 2018 was down 3% from 2017 due to this market’s weak competitive position in the electrical generation sector compared with natural gas and to a lesser degree lower export demand. EIA is forecasting another 3% decrease in U.S. coal production in 2019 followed by a continued decline of 7% in 2020. This estimated decline is based on the continual shift in utility-scale electricity generation from coal to natural gas. 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. As part of our continued effort to expand sales of our mining products, we entered into an agreement with a current customer, by which the customer has located an emulsion explosives plant at our El Dorado Facility. We will continue to explore further guest plant opportunities in 2019.

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 and other fertilizer products changed the physical flow of ammonia in North America placing pressure on ammonia and other fertilizer prices until the distribution system accepted the new supply. Beginning in the fourth quarter of 2017 and through 2018, we have seen an increase in fertilizer prices as imports of fertilizers have decreased significantly and the distribution of the new domestic supply of fertilizer has been established. We expect this trend to continue in 2019.

#### Agricultural Products

We produce and sell UAN, HDAN and ammonia, all of which are nitrogen-based fertilizers. We sell these agricultural products to farmers, ranchers, fertilizer dealers and distributors primarily in the ranch land and grain production markets in the U.S. Our nitrogen-based fertilizers are used to grow food crops, biofuel feedstock crops, pasture land for grazing livestock and forage production. We maintain long-term relationships with wholesale agricultural distributors and retailers and also sell directly to agricultural end-users through our network of wholesale and retail distribution centers.

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, expansions or upgrades of competitors' facilities and international and domestic political and economic developments 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.

We develop our market position in these areas by emphasizing high quality products, customer service and technical advice. During the past few years, we have been successful in expanding outside our traditional markets by delivering to distributors on the Tennessee and Ohio rivers by barge, and by delivering to certain Western States by rail. See our discussion above concerning broadening the distribution of our AN products under "Key Operating Initiatives for 2019".

In addition, we have an agreement with a third-party purchaser, Coffeyville Resources Nitrogen Fertilizers, LLC, ("CVR"), to market and sell a portion of our UAN. Demand for sales under this agreement is based on the expected needs of the purchaser's customers. The agreement provides the exclusive right (but not the obligation) to purchase, at market prices, substantially all of the UAN produced at our Pryor Facility. The term of the agreement runs through May 2019, with automatic one-year extensions, subject to a 180-day advance notice of termination from CVR or a 90-day advance notice from us.

We sell most of our agricultural products at the current spot market price in effect at the time of shipment, although we periodically enter into forward sales commitments for some of these products. Sales of our industrial and mining products are generally made to customers pursuant to sales contracts or pricing arrangements on terms that include the cost of the primary raw materials as a pass-through component in the sales price. These contractual sales stabilize the effect of commodity cost changes and fluctuations in demand for these products due to the cyclicity of the end markets.

#### Industrial Acids and Other Chemical Products

We manufacture and sell industrial acids and other chemical products primarily to the polyurethane, paper, fibers, emission control, and electronics industries. In addition, we produce and sell blended and regular nitric acid and industrial and high purity ammonia for many specialty applications, including the reduction of air emissions from power plants. In addition, one of our subsidiaries, El Dorado Chemical Company ("EDC") and Koch Fertilizer LLC ("Koch Fertilizer") are parties to an ammonia purchase and sale agreement, under which Koch Fertilizer agreed to purchase, with minimum purchase requirements, the ammonia that is in excess of EDC's internal needs. We began selling ammonia under this agreement during June 2016. The term of the agreement runs until June 2020, with annual renewal options.

We operate the Baytown Facility on behalf of Covestro and we believe it is one of the largest and most technologically advanced nitric acid manufacturing units in the U.S. We operate and maintain this facility pursuant to a long-term contract (the "Covestro Agreement"). The term of this agreement runs until June 2021 with options for renewal. See discussion concerning the impact from the adoption of ASC 606 in Note 2 to the Consolidated Financial Statements included in this report.

Our industrial products sales volumes are dependent upon general economic conditions primarily in the housing, automotive, and paper industries. Our sale prices generally vary with the market price of ammonia, sulfur or natural gas, as applicable, in our pricing arrangements with customers.

Our industrial business competes based upon service, price and location of production and distribution sites, product quality and performance and provides inventory management as part of the value-added services offered to certain customers. See our discussion above concerning broadening the distribution of our nitric acid products under “Key Operating Initiatives for 2019”.

#### Mining Products

We produce and sell LDAN and AN solution to the mining industry, which products are primarily used as AN fuel oil and specialty emulsions for surface mining of coal, mining of precious metals and for usage in quarries and providing aggregates to the construction industry. We have signed long-term contracts with certain customers that provide for the annual sale of LDAN under various natural-gas-based pricing arrangements. Additionally, during 2018 we entered into an agreement to have a current customer locate an emulsion explosives plant at our El Dorado Facility. We began selling product to that facility during the fourth quarter of 2018. We continue to explore further guest plant opportunities. See our discussion above concerning broadening the distribution of our mining products under “Key Operating Initiatives for 2019”.

#### Raw Materials

The products we manufacture at our facilities are primarily derived from natural gas. This raw material feedstock is a commodity and subject to price fluctuations. Natural gas is the primary raw material for producing ammonia, UAN, nitric acid and acid blends and other products at our El Dorado, Cherokee and Pryor Facilities. When operating at optimum on-stream rates, the El Dorado Facility would purchase approximately 16.6 million MMBtus of natural gas annually to produce approximately 470,000 tons of ammonia; the Cherokee Facility would purchase approximately 5.8 million MMBtus of natural gas annually in order to produce approximately

180,000 tons of ammonia; and the Pryor Facility would purchase approximately 7.0 million MMBtus of natural gas annually to produce approximately 235,000 tons of ammonia.

The chemical facilities' natural gas feedstock requirements are generally purchased at spot market price. Periodically, we enter into volume purchase commitments and/or futures/forward contracts to lock in the cost of certain of the expected natural gas requirements primarily to match quantities needed to produce product that has been sold forward. As of December 31, 2018, we did not have any volume purchase commitments with a fixed cost for natural gas.

See further discussion relating to the outlook for our business under "Key Industry Factors".

#### Regulatory Matters

We are subject to extensive federal, state and local environmental laws, rules and regulations as discussed under "Environmental, Health and Safety Matters" of this Item 1 and various risk factors under Item 1A.

#### Competition

We operate in a highly competitive market with many other larger chemical companies, such as Austin Powder Company, CF Industries Holdings, Inc., Chemtrade Logistics Inc., EuroChem, Inc., OCI Partners NV, Dyno Nobel, a subsidiary of Incitec Pivot Limited, The Gavilon Group, Helm AG, Koch Industries, Norfalco, Nutrien (formerly known as Agrium and Potash Corporation of Saskatchewan), Praxair, Inc., Trammo Inc. and Yara International (some of whom are our customers), many of whom have greater financial and other resources than we do. We believe that competition within the markets we serve is primarily based upon service, price, location of production and distribution sites, and product quality and performance.

#### Employees

As of December 31, 2018, we employed 576 persons, 193 of whom are represented by unions under agreements that expire in July of 2019 through July of 2021.

#### Environmental, Health and Safety Matters

Our facilities and operations are subject to numerous federal, state and local environmental laws and to other laws regarding health and safety matters (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 enforcement policies thereunder 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. Historically, our subsidiaries have incurred significant expenditures in order to comply with the Environmental and Health Laws and are reasonably expected to do so in the future. We will also be obligated to manage certain discharge water outlets and monitor groundwater contaminants at our chemical facilities should we discontinue the operations of a facility.

#### Available Information

We make available free of charge through our Internet website ([www.lsbindustries.com](http://www.lsbindustries.com)) or by calling Investor Relations (212) 836-9607 our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and, if applicable, amendments to those reports filed or furnished pursuant to Section 13(a) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. In addition to the reports filed or furnished with the SEC, we publicly disclose material information from time to time in press releases, at annual meetings of stockholders, in publicly accessible conferences and investor presentations, and through our website. The information included in our website does not constitute part of this Annual Report on Form 10-K.

## ITEM 1A. RISK FACTORS

### Risks Related to Our Business and Industry

We may not be able to generate sufficient cash to service our debt and may be required to take other actions to satisfy the obligations under our debt agreements or to redeem our preferred stock, which may not be successful.

Our ability to make scheduled payments on our debt obligations and our ability to satisfy the redemption obligations for the Series E cumulative redeemable Class C preferred stock (“Series E Redeemable Preferred”) depends on our financial condition and operating performance, prevailing economic and competitive conditions, and certain financial, business and other factors, some of which may be beyond our control. We may not be able to maintain a level of cash flows sufficient to pay the principal and interest on our debt, including the \$400 million principal amount of our Senior Secured Notes (the “Senior Secured Notes”), or the outstanding amount of the Working Capital Revolver Loan or to pay the cumulative dividends and redemption payment on the Series E Redeemable Preferred should the holder choose to redeem it on or after October 25, 2023, that applicable optional redemption date with respect thereto.

If cash flows and capital resources are insufficient to fund our debt, dividend or preferred stock redemption obligations, we could face substantial liquidity problems and will need to seek additional capital through the issuance of debt, the issuance of equity, asset sales or a combination of the foregoing. If we are unsuccessful, we will need to reduce or delay investments and capital expenditures, or to dispose of other assets or operations, seek additional capital, or restructure or refinance debt or redeemable equity. These alternative measures may not be successful, may not be completed on economically attractive terms, or may not be adequate for us to meet our debt or preferred stock redemption obligations when due. Additionally, our debt agreements and the operating agreements associated with our Series E Redeemable Preferred limit the use of the proceeds from many dispositions of assets or operations. As a result, we may not be permitted to use the proceeds from these dispositions to satisfy our debt or preferred stock redemption obligations. If we cannot make scheduled payments on our debt, we will be in default and the outstanding principal and interest on our debt could be declared to be due and payable, in which case we could be forced into bankruptcy or liquidation or required to substantially restructure or alter our business operations or debt obligations. In such an event, we may not have sufficient assets to repay all of our debt.

Further, if we suffer or appear to suffer from a lack of available liquidity, the evaluation of our creditworthiness by counterparties and rating agencies and the willingness of third parties to do business with us could be materially and adversely affected. In particular, our credit ratings could be lowered, suspended or withdrawn entirely at any time by the rating agencies. Downgrades in our long-term debt ratings generally cause borrowing costs to increase and the potential pool of investors and funding sources to decrease and could trigger liquidity demands pursuant to the terms of contracts, leases or other agreements. Any future transactions by us, including the issuance of additional debt, the sale of any operating assets, or any other transaction to manage our liquidity, could result in temporary or permanent downgrades of our credit ratings.

Our substantial level of indebtedness, including dividend requirements relating to our preferred stock, could limit our financial and operating activities, and adversely affect our ability to incur additional debt to fund future needs.

We currently have a substantial amount of indebtedness, as well as dividend and redemption requirements relating to our preferred stock. As a result, this level could, among other things:

- require us to dedicate a substantial portion of our cash flow to the payment of principal, interest and dividends, thereby reducing the funds available for operations and future business opportunities;
- make it more difficult for us to satisfy our obligations, including our repurchase obligations;

-

limit our ability to borrow additional money if needed for other purposes, including working capital, capital expenditures, debt service requirements, acquisitions and general corporate or other purposes, on satisfactory terms or at all;

- limit our ability to adjust to changing economic, business and competitive conditions;

place us at a competitive disadvantage with competitors who may have less indebtedness or greater access to financing;

make us more vulnerable to an increase in interest rates, a downturn in our operating performance or a decline in general economic conditions; and

make us more susceptible to changes in credit ratings, which could affect our ability to obtain financing in the future and increase the cost of such financing.

Any of the foregoing could adversely affect our operating results, financial condition, and liquidity.

Our debt agreements and our preferred stock contain covenants and restrictions that could restrict or limit our financial and business operations. A breach of these covenants or restrictions could result in an event of default under one or more of our debt agreements or contracts at different entities within our capital structure, including as a result of cross acceleration or default provisions.

Our debt agreements and our preferred stock contain various covenants and other restrictions that, among other things, limit flexibility in operating our businesses. A breach of any of these covenants or restrictions could result in a significant portion of our debt becoming due and payable or could result in significant contractual liability. These covenants and other restrictions limit our ability to, among other things:

- incur additional debt or issue preferred shares;
- pay dividends on, repurchase or make distributions in respect of capital stock, make other restricted payments;
- or make investments;
- sell or transfer assets;
- create liens on assets to secure debt;
- engage in certain fundamental corporate changes or changes to our business activities;
- make certain material acquisitions;
- consolidate, merge, sell or otherwise dispose of all or substantially all of our assets;
- enter into transactions with affiliates;
- designate subsidiaries as unrestricted subsidiaries; and
- repay, repurchase or modify certain subordinated and other material debt.

The Working Capital Revolver Loan also contains certain affirmative covenants and requires the borrowers to comply with a fixed charge coverage ratio (as defined in the Working Capital Revolver Loan) if their excess availability (as defined in the Working Capital Revolver Loan) falls below a certain level.

These covenants and restrictions could affect our ability to operate our business and may limit our ability to react to market conditions or take advantage of potential business opportunities as they arise. Additionally, our ability to comply with these covenants may be affected by events beyond our control, including general economic and credit conditions and industry downturns.

In addition, certain failures to make payments when due on, or the acceleration of, significant indebtedness constitutes a default under some of our debt instruments, including the indenture governing the notes. Further, a breach of any of the covenants or restrictions in a debt instrument could result in an event of default under such debt instrument. Upon the occurrence of an event of default under one of these debt instruments, our lenders or noteholders could elect to declare all amounts outstanding under such debt instrument to be immediately due and payable and/or terminate all commitments to extend further credit. Such actions by those lenders or noteholders could cause cross defaults or accelerations under our other debt. If we were unable to repay those amounts, the lenders or noteholders could proceed against any collateral granted to them to secure such debt. In the case of a default under debt that is guaranteed, holders of such debt could also seek to enforce the guarantees. If lenders or noteholders accelerate the repayment of all borrowings, we would likely not have sufficient assets and funds to repay those borrowings. Such occurrence could result in our or our applicable subsidiary going into bankruptcy, liquidation or insolvency.

Despite our current levels of debt, we may still incur more debt ranking senior or equal in right of payment with our existing obligations, including secured debt, which would increase the risks described herein.

The agreements relating to our debt, including the Senior Secured Notes Indenture and the credit agreement governing our Working Capital Revolver Loan, limit but do not prohibit our ability to incur additional debt, including additional secured debt. Notwithstanding the fact that the Senior Secured Notes Indenture and the credit agreement governing our Working Capital Revolver Loan limit our ability to incur additional debt or grant certain liens on our assets, the

restrictions on the incurrence of additional indebtedness and liens are subject to a number of important qualifications and exceptions, and the additional indebtedness and liens incurred in compliance with these restrictions could be substantial. If new debt is added to our current debt levels, the related risks that we now face could intensify.

Borrowings under our Working Capital Revolver Loan bear interest at a variable rate, which subjects us to interest rate risk and could cause our debt service obligations to increase.

All of our borrowings under our Working Capital Revolver Loan are at variable rates of interest and expose us to interest rate risk. If interest rates increase, our debt service obligations on this variable rate indebtedness would increase even though the amount borrowed remained the same. Although we may enter into interest rate swaps to reduce interest rate volatility, we cannot provide assurances that we will be able to do so or that such swaps will be effective.

Despite continuing investment to upgrade and replace equipment on an ongoing basis, the age of our chemical manufacturing facilities increases the risk for unplanned downtime, which may be significant.

Our business is comprised of operating units of various ages and levels of automated control. While we have continued to make significant annual capital improvements, potential age or control related issues have occurred in the past and may occur in the future, which could cause damage to the equipment and ancillary facilities. As a result, we have experienced and may continue to experience additional downtime at our chemical facilities in the future.

The equipment required for the manufacture of our products is specialized, and the time for replacement of such equipment can be lengthy, resulting in extended downtime in the affected unit. In addition, the cost for such equipment could be influenced by changes in regulatory policies (including tariffs) of foreign governments, as well as the U.S. laws and policies affecting foreign trade and investment.

Although we use various reliability and inspection programs and maintain a significant inventory of spare equipment, which are intended to mitigate the extent of production losses, unplanned outages may still occur. As a result, these planned and unplanned downtime events at our chemical facilities have in the past and could in the future adversely affect our operating results, liquidity and financial condition.

LSB is a holding company and depends, in large part, on receiving funds from its subsidiaries to fund our indebtedness.

Because LSB is a holding company and operations are conducted through its subsidiaries, LSB's ability to meet its obligations depends, in large part, on the operating performance and cash flows of its subsidiaries and the ability of its subsidiaries to make distributions and pay dividends to LSB.

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 near future. Although our Board of Directors (the "Board") has not made a decision whether or not to pay dividends on our common stock in 2019, it is unlikely we will pay dividends on our common stock until we have repaid or refinanced our debt and our preferred stock. In addition, there are certain limitations contained in our loan and securities purchase agreements that may limit our ability to pay dividends on our outstanding common stock.

Future issuances or potential issuances of our common stock or preferred stock could adversely affect the price of our common stock and our ability to raise funds in new stock offerings and could dilute the percentage ownership or voting power of our common stockholders.

Future sales of substantial amounts of our common stock, preferred stock or equity-related securities in the public market, or the issuance of a substantial amount of our common stock as the result of the conversion of our outstanding

convertible preferred stocks, or the perception that such sales or conversions could occur, could adversely affect prevailing trading prices of our common stock and could dilute the value of common stock held by our existing stockholders. No prediction can be made as to the effect, if any, that future sales of common stock, preferred stock, or equity-related securities, conversions of our outstanding preferred stocks into 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 or conversions could also significantly reduce the percentage ownership and voting power of our existing common stockholders.

Deterioration of global market and economic conditions could have a material adverse effect on our business, financial condition, results of operations and cash flow.

A slowdown of, or persistent weakness in, economic activity caused by a deterioration of global market and economic conditions could adversely affect our business in the following ways, among others: conditions in the credit markets could impact the ability of our customers and their customers to obtain sufficient credit to support their operations; the failure of our customers to fulfill their purchase obligations could result in increases in bad debts and affect our working capital; and the failure of certain key suppliers could increase our exposure to disruptions in supply or to financial losses. We also may experience declining demand and falling prices for some of our products due to our customers' reluctance to replenish inventories. The overall impact of a global economic downturn or reduced overall global trade on us is difficult to predict, and our business could be materially adversely impacted.

In addition, conditions in the international market for nitrogen fertilizer significantly influence our operating results. The international market for fertilizers is influenced by such factors as the relative value of the U.S. currency and its impact on the importation of

fertilizers, foreign agricultural policies, the existence of, or changes in, import or foreign currency exchange barriers in certain foreign markets and other regulatory policies (including tariffs) of foreign governments, as well as the U.S. laws and policies affecting foreign trade and investment.

Seasonality can adversely affect our business.

If seasonal demand is less than we expect, we may be left with excess inventory that will have to be stored (in which case our results of operations will be negatively affected by any related increased storage costs) or liquidated (in which case the selling price may be below our production, procurement and storage costs). The risks associated with excess inventory and product shortages are exacerbated by the volatility of natural gas and nitrogen fertilizer prices and the relatively brief periods during which farmers can apply nitrogen fertilizers. If prices for our products rapidly decrease, we may be subject to inventory write-downs, adversely affecting our operating results. If seasonal demand is greater than we expect, we may experience product shortages, and customers of ours may turn to our competitors for products that they would otherwise have purchased from us.

Ammonia can be very volatile and extremely hazardous. Any liability for accidents or intentional acts such as terrorism involving ammonia or other products we produce or transport that cause severe damage to property or injury to the environment and human health could have a material adverse effect on our results of operations, financial condition and ability to make cash distributions. In addition, the costs of transporting ammonia could increase significantly in the future.

We manufacture, process, store, handle, distribute and transport ammonia, which can be very volatile and extremely hazardous. Major accidents or releases involving ammonia could cause severe damage or injury to property, the environment and human health, as well as a possible disruption of supplies and markets. Such an event could result in civil lawsuits, fines, penalties and regulatory enforcement proceedings, all of which could lead to significant liabilities. Any damage to persons, equipment or property or other disruption of our ability to produce or distribute our products could result in a significant decrease in operating revenues and significant additional cost to replace or repair and insure our assets, which could have a material adverse effect on our results of operations and financial condition. We periodically experience minor releases of ammonia related to leaks from our equipment. Similar events may occur in the future.

A major factor underlying the current high level of demand for our nitrogen-based fertilizer products is the production of ethanol. A decrease in ethanol production, an increase in ethanol imports or a shift away from corn as a principal raw material used to produce ethanol could have a material adverse effect on our results of operations, financial condition and ability to make cash distributions.

A major factor underlying the solid level of demand for our nitrogen-based fertilizer products is the production of ethanol in the United States and the use of corn in ethanol production. Ethanol production in the United States is highly dependent upon a myriad of federal statutes and regulations and is made significantly more competitive by various federal and state incentives and mandated usage of renewable fuels pursuant to the federal renewable fuel standards ("RFS"). To date, the RFS has been satisfied primarily with fuel ethanol blended into gasoline. However, a number of factors, including the continuing "food versus fuel" debate and studies showing that expanded ethanol usage may increase the level of greenhouse gases in the environment as well as be unsuitable for small engine use, have resulted in calls to reduce subsidies for ethanol, allow increased ethanol imports and to repeal or waive (in whole or in part) the current RFS, any of which could have an adverse effect on corn-based ethanol production, planted corn acreage and fertilizer demand. Therefore, ethanol incentive programs may not be renewed, or if renewed, they may be renewed on terms significantly less favorable to ethanol producers than current incentive programs.



Furthermore, most ethanol is currently produced from corn and other raw grains, such as milo or sorghum, especially in the Midwest. The current trend in ethanol production research is to develop an efficient method of producing ethanol from cellulose-based biomass, such as agricultural waste, forest residue, municipal solid waste and energy crops (plants grown for use to make biofuels or directly exploited for their energy content). If an efficient method of producing ethanol from cellulose-based biomass is developed, the demand for corn may decrease significantly, which could reduce demand for nitrogen fertilizer products and have a material adverse effect on the prices we receive on sales of our ammonia products and our results of operations, financial condition and ability to make cash distributions.

Our business and customers are sensitive to adverse economic cycles.

Our business can be affected by cyclical factors such as inflation, currency exchange rates, global energy policy and costs, global market conditions and economic downturns in specific industries. Certain sales are sensitive to the level of activity in the agricultural, mining, automotive and housing industries. Therefore, substantial changes could adversely affect our operating results, liquidity, financial condition and capital resources.

Weather conditions adversely affect our business.

The products (primarily agricultural) produced and sold by us have been in the past, and could be in the future, materially affected by adverse weather conditions (such as excessive rain or drought) in the primary markets for our fertilizer and related agricultural products. In addition, weather can cause an interruption to the operations of our chemical facilities. Many scientists have concluded

that increasing concentrations of greenhouse gases in the Earth's atmosphere may produce climate changes that have significant physical effects, such as increased frequency and severity of storms, droughts and floods and other climatic events. These climate changes might also occur as the result of other phenomena that human activity is unable to influence, including changes in solar activity and volcanic activity. Regardless of the cause, 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 our agricultural sales and our financial condition and results of operations.

There is intense competition in the markets we serve.

Substantially all of the markets in which we participate are highly competitive with respect to product quality, price, distribution, service, and reliability. We compete with many companies, domestic and foreign, 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, which could have a material adverse effect on our business, results of operation and financial condition.

We compete with many U.S. producers and producers in other countries, including state-owned and government-subsidized entities. Some competitors have greater total resources and are less dependent on earnings from chemical sales, which make them less vulnerable to industry downturns and better positioned to pursue new expansion and development opportunities. Our competitive position could suffer to the extent we are not able to expand our own resources sufficiently either through investments in new or existing operations or through acquisitions, joint ventures or partnerships. An inability to compete successfully could result in the loss of customers, which could adversely affect our sales and profitability.

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

For 2018, seven customers accounted for approximately 40% of our consolidated net 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 with other sales on substantially similar terms.

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 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 futures/forward contracts to economically 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.

Natural gas represents the primary raw material feedstock in the production of most of our chemical products. Although we 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. Also, the spot sales prices of our agricultural products may not correlate to the cost of natural gas but rather reflect market conditions for similar and competing nitrogen sources. This lack of correlation can compromise our ability to recover our full cost to produce the products in this market. 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. Future price fluctuations in our raw materials may have an adverse effect on our financial condition, liquidity and results of operations.

Additionally, we depend on certain vendors to deliver natural gas and other key components that are required in the production of our products. Any disruption in the supply of natural gas and other key components could result in lost production or delayed shipments.

The price of natural gas in North America and worldwide has been volatile in recent years and has declined on average due in part to the development of significant natural gas reserves, including shale gas, and the rapid improvement in shale gas extraction techniques, such as hydraulic fracturing and horizontal drilling. Future production of natural gas from shale formations could be reduced by regulatory changes that restrict drilling or hydraulic fracturing or increase its cost or by reduction in oil exploration and development prompted by lower oil prices and resulting in production of less associated natural gas. Additionally, increased demand for natural gas, particularly in the Gulf Coast Region, due to increased industrial demand and increased natural gas exports could result in increased natural gas prices.

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 natural gas and other key components, which could adversely affect our competitiveness in the markets we serve. Accordingly, our financial condition, liquidity and results of operations could be materially affected in the future by the lack of availability of natural gas and other key components and increase costs relating to the purchase of natural gas and other key components.

We may have inadequate insurance.

While we maintain liability, property and business interruption insurance, including certain coverage for environmental contamination, it is subject to coverage limits and policies that may exclude coverage for some types of damages. Although there may currently be sources from which such coverage may be obtained, the coverage 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.

Furthermore, we are subject to litigation for which we could be obligated to bear legal, settlement and other costs, which may be in excess of any available insurance coverage. If we are required to incur all or a portion of the costs arising out of any litigation or investigation as a result of inadequate insurance proceeds, if any, our business, results of operations, financial condition and liquidity could be materially adversely affected. For further discussion of our litigation, please see “Other Pending, Threatened or Settled Litigation” in Note 9 to the Consolidated Financial Statements included in this report.

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 ensure that our principal executive officers will continue to be available (see discussion concerning our former CEO electing not to enter into a new employment agreement in Note 15 to the Consolidated Financial Statements). Although we have employment agreements with certain of our principal executive officers, including Mark T. Behrman and Cheryl A. Maguire, we do not have employment agreements with all of our key personnel. 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.

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

Terrorist attacks in the U.S and elsewhere and natural disasters (such as hurricanes or pandemic health crises) have in the past and can in the future negatively affect our operations. We cannot predict further terrorist attacks and natural disasters in the U.S. and elsewhere. These attacks or natural disasters have contributed to economic instability in the U.S. and elsewhere, and further acts of terrorism, violence, war or natural disasters could 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 affect our physical facilities, especially our chemical facilities, or those of our suppliers or customers and could affect our sales, our production capability and our ability to deliver products to our customers. In the past, hurricanes affecting the Gulf Coast of the U.S. have negatively affected our operations and those of our customers. As previously noted, some scientists have concluded that increasing concentrations of greenhouse gases in the Earth’s atmosphere may produce climate changes that have significant physical effects, such as increased frequency and severity of storms, droughts and floods and other climatic events. If any such effects, whether anthropogenic or otherwise, were to occur in areas where we or our clients operate, they could have an adverse effect on our assets and operations.

Cyber security risks could adversely affect our business operations.

As we continue to increase our dependence on information technologies to conduct our operations, the risks associated with cyber security also increase. We rely on our enterprise resource planning software (“ERP”) and other information systems, among other things, to manage our manufacturing, supply chain, accounting and financial functions. This risk not only applies to us, but also to third parties on whose systems we place significant reliance for the conduct of our business. We are significantly dependent upon internet connectivity and a third-party cloud hosting vendor. We

have implemented security procedures and measures in order to protect our information from being vulnerable to theft, loss, damage or interruption from a number of potential sources or events. Although we believe these measures and procedures are appropriate, we may not have the resources or technical sophistication to anticipate, prevent, or recover from rapidly evolving types of cyber-attacks. Compromises to our information systems could have an adverse effect on our results of operations, liquidity and financial condition.

Our transportation and distribution activities rely on third party providers, which subject us to risks and uncertainties beyond our control that may adversely affect our operations.

We rely on railroad, trucking, pipeline and other transportation service providers to transport raw materials to our manufacturing facilities, to coordinate and deliver finished products to our storage and distribution system and our retail centers and to ship finished products to our customers. These transportation operations, equipment and services are subject to various hazards, including adverse operating conditions, extreme weather conditions, system failures, work stoppages, equipment and personnel shortages, delays, accidents such as spills and derailments and other accidents and operating hazards.

In the event of a disruption of existing transportation or terminaling facilities for our products or raw materials, alternative transportation and terminaling facilities may not have sufficient capacity to fully serve all of our customers or facilities. An extended interruption in the delivery of our products to our customers or the supply of natural gas, ammonia or sulfur to our production facilities could adversely affect sales volumes and margins.

These transportation operations, equipment and services are also subject to environmental, safety, and regulatory oversight. Due to concerns related to accidents, terrorism or increasing concerns regarding transportation of potentially hazardous substances, local, provincial, state and federal governments could implement new regulations affecting the transportation of raw materials or our finished products. If transportation of our products is delayed or we are unable to obtain raw materials as a result of any third party's failure to operate properly or the other hazards described above, or if new and more stringent regulatory requirements are implemented affecting transportation operations or equipment, or if there are significant increases in the cost of these services or equipment, our revenues and cost of operations could be adversely affected. In addition, we may experience increases in our transportation costs, or changes in such costs relative to transportation costs incurred by our competitors.

Future technological innovation could affect our business.

Future technological innovation, such as the development of seeds that require less crop nutrients, or developments in the application of crop nutrients, if they occur, could have the potential to adversely affect the demand for our products and results of operations.

We are reliant on a limited number of key facilities.

Our nitrogen production is concentrated in four separate complexes. The suspension of operations at any of these complexes could adversely affect our ability to produce our products and fulfill our commitments and could have a material adverse effect on our business, financial condition, results of operations and cash flows. Moreover, our facilities may be subject to failure of equipment that may be difficult to replace and could result in operational disruptions.

Potential increase of imported agricultural products.

Russia and Ukraine both have substantial capacity to produce and export fertilizer grade AN. Producers in these countries also benefit from below-market prices for natural gas, due to government regulation and other factors.

In addition, producers in China have substantial capacity to produce and export urea. Depending on various factors, including prevailing prices from other exporters, the price of coal, and the price of China's export tariff, higher volumes of urea from China could be imported into the U.S. at prices that could have an adverse effect on the selling prices of other nitrogen products, including the nitrogen products we manufacture and sell.

Current and future legislative or regulatory requirements affecting our business may result in increased costs and decreased revenues, cash flows and liquidity or could have other negative effects on our business.

Our business is subject to numerous health, safety, security and environmental laws and regulations. The manufacture and distribution of chemical products are activities that entail health, safety and environmental risks and impose obligations under health, safety and environmental laws and regulations, many of which provide for substantial fines and potential criminal sanctions for violations. Although we believe we have established processes to monitor, review and manage our businesses to comply with the numerous health, safety and environmental laws and regulations, we previously were, and in the future, may be, subject to fines, penalties and sanctions for violations and substantial expenditures for cleanup costs and other liabilities relating to the handling, manufacture, use, emission, discharge or disposal of effluents at or from our chemical facilities. Further, a number of our chemical 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 results of operation and financial condition. These operating permits are subject to modification, renewal and revocation. In addition, third parties may contest our ability to receive or renew certain permits that we need to operate, which can lengthen the application process or even prevent us from obtaining necessary permits. We

regularly monitor and review our operations, procedures and policies for compliance with permits, laws and regulations. Despite these compliance efforts, risk of noncompliance or permit interpretation is inherent in the operation of our business.

There can be no assurance as to the amount or timing of future expenditures for environmental compliance or remediation, and actual future expenditures may be different from the amounts we currently anticipate. We try to anticipate future regulatory requirements that might be imposed and plan accordingly to remain in compliance with changing environmental laws and regulations and to minimize the costs of compliance.

Changes to the production equipment at our chemical facilities that are required in order to comply with health, safety and environmental regulations may require substantial capital expenditures.

Explosions and/or losses at other chemical facilities that we do not own (such as the April 2013 explosion in West, Texas) could also result in new or additional legislation or regulatory changes, particularly relating to public health, safety or any of the products manufactured and/or sold by us or the inability on the part of our customers to obtain or maintain insurance as to certain products manufactured and/or sold by us, which could have a negative effect on our revenues, cash flow and liquidity.

In summary, new or changed laws and regulations or the inability of our customers to obtain or maintain insurance in connection with any of our chemical products could have an adverse effect on our operating results, liquidity and financial condition.

We may be required to modify or expand our operating, sales and reporting procedures and to install additional equipment in order to comply with current and possible future government regulations.

The chemical industry in general, and producers and distributors of ammonia and AN specifically, are scrutinized by the government, industry and public on security issues. Under current and proposed regulations, we may be required to incur substantial additional costs relating to security at our chemical facilities and distribution centers, as well as in the transportation of our products. These costs could have a material effect on our results of operations, financial condition, and liquidity. The cost of such regulatory changes, if significant, could lead some of our customers to choose other products over ammonia and AN, which may have a significant adverse effect on our business.

The “Secure Handling of Ammonium Nitrate Act of 2007” was enacted by the U.S. Congress, and subsequently the U.S. Department of Homeland Security (“DHS”) published a notice of proposed rulemaking in 2011. This regulation proposes to require sellers, buyers, their agents and transporters of solid AN and certain solid mixtures containing AN to possess a valid registration issued by DHS, keep certain records, report the theft or unexplained loss of regulated materials, and comply with certain other new requirements. We and others affected by this proposal have submitted appropriate comments to DHS regarding the proposed regulation. It is possible that DHS could significantly revise the requirements currently being proposed. Depending on the provisions of the final regulation to be promulgated by DHS and on our ability to pass these costs to our customers, these requirements may have a negative effect on the profitability of our AN business and may result in fewer distributors who are willing to handle the product. DHS has not finalized this rule, and has indicated that its next action, and the timing of such an action, is undetermined.

On August 1, 2013, U.S. President Obama issued an executive order addressing the safety and security of chemical facilities in response to recent incidents involving chemicals such as the explosion at West, Texas. The President directed federal agencies to enhance existing regulations and make recommendations to the U.S. Congress to develop new laws that may affect our business. In January 2016, the U.S. Chemical Safety and Hazard Investigation Board (“CSB”) released its final report on the West, Texas incident. The CSB report identifies several federal and state regulations and standards that could be strengthened to reduce the risk of a similar incident occurring in the future. While the CSB does not have authority to directly regulate our business, the findings in this report, and other activities taken in response to the West, Texas incident by federal, state, and local regulators may result in additional regulation of our processes and products.

In January 2017, the U.S. Environmental Protection Agency (“EPA”) finalized revisions to its Risk Management Program (“RMP”). The revisions include new requirements for certain facilities to perform hazard analyses, third-party auditing, incident investigations and root cause analyses, emergency response exercises, and to publicly share chemical and process information. Compliance with many of the rule’s new requirements will be required beginning in 2021. The EPA temporarily delayed the rule’s effective date however, the delay was subsequently vacated with an immediate effective date. On December 3, 2018, the EPA published a final rule that incorporates amendments to the RMP under 40 CFR Part 68. These requirements may have a negative effect on the profitability of our AN business. The Occupational Safety and Health Administration (“OSHA”) is likewise considering changes to its Process Safety Management standards. In addition, DHS, the EPA, and the Bureau of Alcohol, Tobacco, Firearms and Explosives updated a joint chemical advisory on the safe storage, handling, and management of AN. While these actions may result in additional regulatory requirements or changes to our operators, it is difficult to predict at this time how these and any other possible regulations, if and when adopted, will affect our business, operations, liquidity or financial results.

Proposed and existing governmental laws and regulations relating to greenhouse gas and other air emissions may subject certain of our operations and customers to significant new costs and restrictions on their operations and may reduce sales of our products.



Our chemical manufacturing facilities use significant amounts of electricity, natural gas and other raw materials necessary for the production of their chemical products that result, or could result, in certain greenhouse gas emissions into the environment. Federal and state legislatures and administrative agencies, including the EPA, are considering the scope and scale of greenhouse gas or other air emission regulation. Legislation and administrative actions have been considered that would regulate greenhouse gas emissions at some point in the future for our facilities, and existing and possible actions have already affected certain of our customers, leading to closure or rate reductions of certain facilities.

In response to findings that emissions of carbon dioxide, methane and other greenhouse gases present an endangerment to public health and the environment, the EPA adopted regulations pursuant to the federal Clean Air Act to reduce greenhouse gas emissions from various sources. For example, the EPA requires certain large stationary sources to obtain preconstruction and operating permits for pollutants regulated under the Prevention of Significant Deterioration and Title V programs of the Clean Air Act. Facilities required to obtain preconstruction permits for such pollutants are also required to meet “best available control technology” standards that are being established by the states. These regulatory requirements could adversely affect our operations and restrict or delay our ability to obtain air permits for new or modified sources. The EPA has also instituted a mandatory greenhouse gas reporting requirement that began in 2010, which affects all of our chemical manufacturing sites.

Although greenhouse gas regulation could: increase the price of the electricity and other energy sources purchased by our chemical facilities; increase costs for natural gas and other raw materials (such as ammonia); potentially restrict access to or the use of certain

raw materials necessary to produce our chemical products; and require us to incur substantial expenditures to retrofit our chemical facilities to comply with the proposed new laws and regulations regulating greenhouse gas emissions. Federal, state and local governments may also pass laws mandating the use of alternative energy sources, such as wind power and solar energy, which may increase the cost of energy use in certain of our chemical and other manufacturing operations. For instance, the EPA published a rule, known as the Clean Power Plan, to limit greenhouse gases from electric power plants. The EPA is currently reviewing the Clean Power Plan however, it could result in increased electricity costs due to increased requirements for use of alternative energy sources, and a decreased demand for coal-generated electricity.

Laws, regulations or other issues related to climate change could have a material adverse effect on us.

If we, or other companies with which we do business become subject to laws or regulations related to climate change, it could have a material adverse effect on us. The United States may enact new laws, regulations and interpretations relating to climate change, including potential cap-and-trade systems, carbon taxes and other requirements relating to reduction of carbon footprints and/or greenhouse gas emissions. Other countries have enacted climate change laws and regulations and the United States has been involved in discussions regarding international climate change treaties. The federal government and some of the states and localities in which we operate have enacted certain climate change laws and regulations and/or have begun regulating carbon footprints and greenhouse gas emissions. Although these laws and regulations have not had any known material adverse effect on us to date, they could result in substantial costs, including compliance costs, monitoring and reporting costs and capital. Furthermore, our reputation could be damaged if we violate climate change laws or regulations. We cannot predict how future laws and regulations, or future interpretations of current laws and regulations, related to climate change will affect our business, results of operations, liquidity and financial condition. Lastly, the potential physical impacts of climate change on our operations are highly uncertain and would be particular to the geographic circumstances in areas in which we operate. These may include changes in rainfall and storm patterns and intensities, water shortages and changing temperatures. Any of these matters could have a material adverse effect on us.

Certain of our stockholders control a significant amount of our voting stock, and their interests could conflict with interests of other stockholders.

LSB Funding LLC (“LSB Funding”), our largest voting shareholder, owns one share of Series F redeemable Class C preferred stock (the “Series F Redeemable Preferred”), which has voting rights with common stock equal to 15.7% of the total voting power of LSB’s common stock as of February 15, 2019.

Jack E. Golsen (“J. Golsen”), Steven J. Golsen (“S. Golsen”), Barry H. Golsen (“B. Golsen”), Linda Golsen Rappaport (“L. Rappaport”), Golsen Family LLC, an Oklahoma limited liability company (“Family LLC”), SBL LLC, an Oklahoma limited liability company (“SBL LLC”), and Golsen Petroleum Corp., an Oklahoma corporation (“GPC,” and together with Messrs. J. Golsen, S. Golsen and B. Golsen, Ms. L. Rappaport, Family LLC, SBL LLC, each a “Golsen Holder” and, collectively, the “Golsen Holders”) owned as of February 15, 2019, an aggregate of 2,185,517 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 vote as a class and represent approximately 10.4% of the voting power (prior to conversion of the shares of voting preferred) of our issued and outstanding voting securities as of that date. The series of preferred represented by the 20,000 shares of voting preferred is convertible into an aggregate of 666,666 shares of our common stock.

Pursuant to a Board Representation and Standstill Agreement entered into in connection with LSB Funding’s purchase of preferred stock in December 2015, as amended in October 2017 and 2018, LSB Funding has the right to designate two directors on our Board, and the Golsen Holders have the right to appoint two directors on our Board, subject to reduction in each case in certain circumstances. This is in addition to their ability to vote generally in the election of

directors. As a result, each of LSB Funding and the Golsen Holders have significant influence over the election of directors to our Board.

The interests of LSB Funding and the Golsen Holders may conflict with interests of other stockholders (as well as with each other). As a result of the voting power and board designation rights of LSB Funding and the Golsen Holders, the ability of other stockholders to influence our management and policies could be limited.

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 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 certain subsidiaries that provide, among other things, that if, within a specified period of time after the occurrence of a change in control of LSB, these officers are terminated, other than for cause, or the officer terminates his employment for good reason, the officer would be entitled to certain severance benefits. Certain of our preferred stock series and debt instruments also provide special rights in a change of control, including in some cases the ability to be repaid in full or redeemed.

We have authorized and unissued (including shares held in treasury) 46,155,095 shares of common stock and 4,090,231 shares of preferred stock as of December 31, 2018. These unissued shares could be used by our management to make it more difficult, and thereby discourage an attempt to acquire control of us.

The foregoing provisions and agreements may discourage a third-party tender offer, proxy contest, or other attempts to acquire control of us and could have the effect of making it more difficult to remove incumbent management. In addition, LSB Funding and the Golsen Holders have significant voting power and rights to designate board representatives, all of which may further discourage a third-party tender offer, proxy contest, or other attempts to acquire control of us.

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:

- prior to such time the Board of the corporation approved the business combination that results in the stockholder becoming an invested stockholder;
- the acquirer owned at least 85% of the outstanding voting stock of such company prior to commencement of the transaction;
- two-thirds of the stockholders, other than the acquirer, vote to approve the business combination after approval thereof by the Board; or
- the stockholders of the corporation amend its articles of incorporation or by-laws electing not to be governed by this provision.

18

---

## SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements contained within this report may be deemed “Forward-Looking Statements” within the meaning of Section 27A of the Securities Act of 1933 (as amended, the “Securities Act”) and Section 21E of the Securities Exchange Act. All statements in this report other than statements of historical fact are Forward-Looking Statements that are subject to known and unknown risks, uncertainties and other factors which could cause actual results and performance of the Company to differ materially from such statements. The words “believe,” “expect,” “anticipate,” “intend,” “plan,” “may,” “could” and similar expressions identify Forward-Looking Statements. Forward-Looking Statements contained herein include, but are not limited to, the following: our ability to invest in projects that will generate best returns for our stockholders;

- our future liquidity outlook;
- the outlook our chemical products and related markets;
- the amount, timing and effect on the nitrogen market from the current nitrogen expansion projects;
- the effect from the lack of non-seasonal volume;
  - our belief that competition is based upon service, price, location of production and distribution sites, and product quality and performance;
- our outlook for the coal industry;
- the availability of raw materials;
- the result of our product and market diversification strategy
- changes in domestic fertilizer production;
- the increasing output and capacity of our existing production facilities;
- on-stream rates at our production facilities;
- our ability to moderate risk inherent in agricultural markets;
- the sources to fund our cash needs and how this cash will be used;
- the ability to enter into the additional borrowings;
- the anticipated cost and timing of our capital projects;
- certain costs covered under warranty provisions;
- our ability to pass to our customers cost increases in the form of higher prices;
- our belief as to whether we have sufficient sources for materials and components;
- annual natural gas requirements;
- compliance by our Facilities with the terms of our permits;
- the costs of compliance with environmental laws, health laws, security regulations and transportation regulations;
- our belief as to when Turnarounds will be performed and completed;
- anticipated costs of Turnarounds during 2019;
- expenses in connection with environmental projects;
- the effect of litigation and other contingencies;
- the increase in depreciation, depletion and amortization;
  - the benefits from the El Dorado expansion project;
- our ability to comply with debt servicing and covenants;
- our ability to meet debt maturities or redemption obligations when due; and
- our beliefs as to whether we can meet all required covenant tests for the next twelve months.

While we believe, the expectations reflected in such Forward-Looking Statements are reasonable, we can give no assurance such expectations will prove to have been correct. There are a variety of factors which could cause future outcomes to differ materially from those described in this report, including, but not limited to, the following:

- changes in general economic conditions, both domestic and foreign;
- material reductions in revenues;
- material changes in interest rates;
- our ability to collect in a timely manner a material amount of receivables;
- increased competitive pressures;
- adverse effects on increases in prices of raw materials;
- changes in federal, state and local laws and regulations, especially environmental regulations or the American Reinvestment and Recovery Act, or in the interpretation of such;
- changes in laws, regulations or other issues related to climate change;
- releases of pollutants into the environment exceeding our permitted limits;
- material increases in equipment, maintenance, operating or labor costs not presently anticipated by us;
- the requirement to use internally generated funds for purposes not presently anticipated;
- the inability to secure additional financing for planned capital expenditures or financing obligations due in the near future;
- our substantial existing indebtedness;
- material changes in the cost of certain precious metals, natural gas, and ammonia;
- limitations due to financial covenants;
- changes in competition;
- the loss of any significant customer;
- increases in cost to maintain internal controls over financial reporting;
- changes in operating strategy or development plans;
- an inability to fund the working capital and expansion of our businesses;
- changes in the production efficiency of our facilities;
- adverse results in our contingencies including pending litigation;
- unplanned downtime at one or more of our chemical facilities;
- changes in production rates at any of our chemical plants;
- an inability to obtain necessary raw materials and purchased components;
- material increases in cost of raw materials;
- material changes in our accounting estimates;
- significant problems within our production equipment;
- fire or natural disasters;
- an inability to obtain or retain our insurance coverage;
- difficulty obtaining necessary permits;
- difficulty obtaining third-party financing;
- risks associated with proxy contests initiated by dissident stockholders;
- changes in fertilizer production;
- reduction in acres planted for crops requiring fertilizer;

- decreases in duties for products we sell resulting in an increase in imported products into the U.S.;
- volatility of natural gas prices;
- weather conditions;
- increases in imported agricultural products;
- other factors described in the MD&A contained in this report; and
- other factors described in “Risk Factors” contained in this report.

Given these uncertainties, all parties are cautioned not to place undue reliance on such Forward-Looking Statements. We disclaim any obligation to update any such factors or to publicly announce the result of any revisions to any of the Forward-Looking Statements contained herein to reflect future events or developments.

#### Defined Terms

The following is a list of terms used in this report.

- ADEQ - The Arkansas Department of Environmental Quality.
- AN - Ammonium nitrate.
- ARO - Asset retirement obligation.
- ASU - Accounting Standard Update.
- B. Golsen - Barry H. Golsen.
- BAE - BAE Systems Ordinance Systems, Inc.
- Baytown Facility - The nitric acid production facility located in Baytown, Texas.
- CAO - A consent administrative order.
- CEO - Chief Executive Officer.
- Cherokee Facility - Our chemical production facility located in Cherokee, Alabama.
- Chevron - Chevron Environmental Management Company.
- Climate Control Business - Former business conducted through the Climate Control Group.
- Climate Control Group - Climate Control Group, Inc., a former direct, wholly owned subsidiary of Consolidated and an indirect subsidiary of LSB.
- Covestro - The party with whom our subsidiary, EDN, has entered the Covestro Agreement.

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

Covestro Agreement	- A long-term contract that (a) allows us to pass-through most of the costs of producing the nitric acid that Covestro purchases, including the cost of ammonia; (b) to receive management fees for managing the operations and marketing nitric acid at the Baytown Facility and; (c) to receive a portion of any carbon credits that are sold. The term of this agreement runs until June 2021 with options for renewal.
CVR	- Coffeyville Resources Nitrogen Fertilizers, LLC.
CVR Purchase Agreement	- An agreement between PCC and CVR, whereby CVR has agreed to purchase certain volumes of UAN from PCC.
DD&A	- Depreciation, depletion and amortization.
DEF	- Diesel Exhaust Fluid.
DHS	- The U.S. Department of Homeland Security.
EDA	- El Dorado Ammonia L.L.C.
EDC	- El Dorado Chemical Company.
EDN	- El Dorado Nitrogen L.L.C.
EIA	- The U.S. Energy Information Administration.



El Dorado Facility	-	Our chemical production facility located in El Dorado, Arkansas.
Environmental and Health Laws	-	Numerous federal, state and local environmental, health and safety laws.
ERP	-	Enterprise Resource Planning Software.
EPA	-	The U.S. Environmental Protection Agency.
Family LLC	-	Golsen Family LLC, an Oklahoma limited liability company.
FASB	-	Financial Accounting Standards Board.
Financial Covenant	-	Certain springing financial covenants associated with the working capital revolver loan.
GAAP	-	U.S. Generally Accepted Accounting Principles.
Global	-	Global Industrial, Inc., a subcontractor asserting mechanics liens for work rendered to LSB and EDC.
Golsen Holders	-	Jack E. Golsen (“J. Golsen”), Steven J. Golsen (“S. Golsen”), Barry H. Golsen (“B. Golsen”), Linda Golsen Rappaport (“L. Rappaport”), Golsen Family LLC, an Oklahoma limited liability company (“Family LLC”), SBL LLC, an Oklahoma limited liability company (“SBL LLC”), and Golsen Petroleum Corp., an Oklahoma corporation (“GPC,” and together with Messrs. J. Golsen, S. Golsen and B. Golsen, Ms. L. Rappaport, Family LLC, SBL LLC, each a “Golsen Holder” and, collectively, the “Golsen Holders”).
GPC	-	Golsen Petroleum Corp., an Oklahoma corporation.
Hallowell Facility	-	A chemical facility previously owned by two of our subsidiaries located in Kansas.
HDAN	-	High density ammonium nitrate prills used in the agricultural industry.
IRS	-	U.S. Internal Revenue Service.
J. Golsen	-	Jack E. Golsen.
KDHE	-	The Kansas Department of Health and Environment.
Koch Fertilizer	-	Koch Fertilizer L.L.C.
LDAN	-	Low density ammonium nitrate prills used in the mining industry.
Leidos	-	Leidos Constructors L.L.C.
Liquidation Preference	-	The Series E Redeemable Preferred liquidation preference of \$1,000 per share plus accrued and unpaid dividends plus the participation rights value.

LSB	-	LSB Industries, Inc.
LSB Funding	-	LSB Funding L.L.C.
MD&A	-	Management's Discussion and Analysis of Financial Condition and Results of Operations found in Item 7 of this report.
NIBE	-	NIBE Industrier AB (publ). and NIBE Energy Systems Inc., an indirect wholly owned subsidiary of NIBE Industrier AB.
NOL	-	Net Operating Loss.
NPDES	-	National Pollutant Discharge Elimination.
ODEQ	-	The Oklahoma Department of Environmental Quality.
OSHA	-	Occupational Safety and Health Administration.
PBRS	-	Performance-based restricted stock.
PCC	-	Pryor Chemical Company.
PP&E	-	Plant, property and equipment.
Pryor Facility	-	Our chemical production facility located in Pryor, Oklahoma.

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

Purchaser	-LSB Funding L.L.C.
Retirement Date	-Date of retirement of Jack E. Golsen as Executive Chairman of the Board, December 31, 2017.
RFS	-Federal renewable fuel standards.
RMP	-Risk Management Program.
RSU	-Restricted stock unit.
SBL LLC	-SBL LLC, an Oklahoma limited liability company.
S. Golsen	-Steven J. Golsen.
SEC	-The U.S. Securities and Exchange Commission.
Secured Promissory Note due 2019	-A secured promissory note between EDC and a lender which matures in June 2019.
Secured Promissory Note due 2021	-A secured promissory note between EDC and a lender which matures in March 2021.
Secured Promissory Note due 2023	-A secured promissory note between EDA and a lender which matures in May 2023.
Senior Secured Notes	-The Senior Secured Notes due on May 1, 2023 with a stated interest rate of 9.625%.
Series B Preferred	-The Series B 12% cumulative convertible Class C Preferred stock.
Series D Preferred	-The Series D 6% cumulative convertible Class C preferred stock.
Series E Redeemable Preferred	-The 14% Series E Redeemable Preferred stock with participating rights and liquidating distributions based on a certain number of shares of our common stock, including the amended terms discussed in Note 11 to the Consolidated Financial Statements.
Series F Redeemable Preferred	-The Series F Redeemable Preferred stock with one share to vote as a single class on all matters with our common stock equal to 456,225 shares of our common stock, including the amended terms discussed in Note 11 to the Consolidated Financial Statements.
SG&A	-Selling, general and administrative expense.
Tax Cut Act	-The Tax Cuts and Jobs Act of 2017.
Transition Agreement	-An agreement between Jack Golsen and LSB, dated June 30, 2017.
TSA	-A transition services agreement.

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

Turnaround	- A planned major maintenance activity.
UAN	- Urea ammonia nitrate.
U.S.	- United States.
USDA	- United States Department of Agriculture.
Warrants	- A warrant to purchase 4,103,746 shares of our common stock at a par value \$0.10, which was held by LSB Funding LLC.
WASDE	- World Agricultural Supply and Demand Estimates Report.
West Fertilizer	- West Fertilizer Company.
Working Capital	- Our secured revolving credit facility.
Revolver Loan	
Zena	- Zena Energy L.L.C., a former subsidiary of the Company.
12% Senior Secured Notes	- A former \$50 million aggregate principal amount of 12% Senior Secured Notes.
2005 Agreement	- A death benefit agreement with Jack E. Golsen.
2008 Plan	- The 2008 Incentive Stock Plan.
2016 Plan	- The 2016 Long Term Incentive Plan.

2017 Crop	-Corn crop marketing year (September 1 - August 31), which began in 2016 and ended in 2017.
2018 Crop	-Corn crop marketing year (September 1 - August 31), which began in 2017 and ending in 2018.
2019 Crop	-Corn crop marketing year (September 1 - August 31), which began in 2018 and ending in 2019.
7.75% Senior Secured Notes	-A former \$425 million aggregate principal amount of 7.75% Senior Secured Notes issued pursuant to the Original 7.75% Indenture, subsequently amended under the Supplemental Indenture, with a current interest rate of 8.50%.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

## ITEM 2. PROPERTIES

The following table presents our significant properties for 2018:

	El Dorado	Cherokee	Pryor Facility	Baytown	Chemical Distribution Centers
Facility	Facility	Facility	Pryor Facility	Facility	
Location	El Dorado, AR	Cherokee, AL	Pryor, OK	Baytown, TX	(A)
Plant Area (acres)	150	160	47	2	
Site Area (acres)	1,400	1,300	104	Covestro site	
				Operating	
Site Status	Owned	Owned	Owned	Agreement	(A)
Capacity Utilization	84% (B)	86% (C)	82% (D)	83% (E)	

(A) We distribute our agricultural products through 10 wholesale and retail distribution centers, with 9 of the centers located in Texas (8 of which we own and 1 of which we lease); and 1 center located in Missouri (owned).

(B) The percentage of utilization for the El Dorado Facility relates to its ammonia production capacity. The capacity utilization rate is based on optimal 1,350 tons per day of production. We are currently producing at above 1,300 tons per day. The listed rate excludes 12 Turnaround days during 2018.

(C) The percentage of utilization for the Cherokee Facility relates to its ammonia production capacity and is based on 515 tons per day of production for the year. The listed rate excludes 35 Turnaround days during 2018.

(D) The percentage of utilization for the Pryor Facility relates to its ammonia production capacity and is based on 675 tons per day of production for the year. We did not perform a Turnaround during 2018. The Pryor Facility has additional operational capacity for nitric acid and AN solution in excess of its current ammonia capacity.

(E) The percentage of utilization for the Baytown Facility relates to its nitric acid production capacity and is based on 1,530 tons per day of production for the year. The listed rate excludes 24 Turnaround days during 2018.

Most of our real property and equipment located at our chemical facilities are being used to secure our long-term debt. All of the properties utilized by our businesses are suitable and adequate to meet the current needs of that business and relate to domestic operations.

ITEM 3. LEGAL PROCEEDINGS

See Legal Matters under Note 9 to the Consolidated Financial Statements included in this report.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our common stock is trading on the New York Stock Exchange under the symbol "LXU".

Stockholders

As of February 15, 2019, we had approximately 414 record holders of our common stock.

Equity Compensation Plans

Discussions relating to our equity compensation plans under Item 12 of Part III are incorporated by reference to our definitive proxy statement which we intend to file with the SEC on or before April 30, 2019.

Sale of Unregistered Securities

There were no unregistered sales of equity securities in 2018 that have not been previously reported in a Quarterly Report on Form 10-Q or Current Report on Form 8-K.

## ITEM 6. SELECTED FINANCIAL DATA (1)

	Year ended December 31,				
	2018	2017	2016	2015	2014
(In Thousands, Except Per Share Data)					
<b>Selected Statement of Operations Data in Dollars:</b>					
Net sales (2)	\$378,160	\$427,504	\$374,585	\$437,695	\$495,888
Operating income (loss)	(23,025 )	(34,091 )	(90,223 )	(71,166 )	30,577
Interest expense, net	43,064	37,267	30,945	7,371	21,599
Provisions (benefit) for income taxes	1,740	(40,759 )	(41,956 )	(32,520 )	4,251
Income (loss) from continuing operations	(72,226 )	(30,293 )	(88,133 )	(46,146 )	5,087
Income from discontinued operations, net of taxes (3)	—	1,076	200,301	11,381	14,547
Net income (loss)	(72,226 )	(29,217 )	112,168	(34,765 )	19,634
Net income (loss) income attributable to common stockholders	\$(102,741 )	\$(59,447 )	\$64,760	\$(38,038 )	\$19,334
Income (loss) per common share attributable to common stockholders:					
Basic:					
Income (loss) from continuing operations	\$(3.74 )	\$(2.22 )	\$(5.28 )	\$(2.17 )	\$0.21
Income from discontinued operations, net of taxes	\$—	\$0.04	\$7.82	\$0.50	\$0.65
Net income (loss)	\$(3.74 )	\$(2.18 )	\$2.54	\$(1.67 )	\$0.86
Diluted:					
Income (loss) from continuing operations	\$(3.74 )	\$(2.22 )	\$(5.28 )	\$(2.17 )	\$0.21
Income from discontinued operations, net of taxes	\$—	\$0.04	\$7.82	\$0.50	\$0.64
Net income (loss)	\$(3.74 )	\$(2.18 )	\$2.54	\$(1.67 )	\$0.85
<b>Selected Balance Sheet Data in Dollars:</b>					
Total assets	\$1,148,333	\$1,189,182	\$1,270,420	\$1,361,827	\$1,130,572
Long-term debt, including current portion, net	\$425,199	\$409,399	\$420,220	\$520,422	\$450,885
Redeemable preferred stocks	\$202,169	\$174,959	\$145,029	\$177,272	\$—
Stockholders' equity	\$342,197	\$438,196	\$492,513	\$421,580	\$434,048
<b>Selected Other Data in Dollars:</b>					
Cash dividends declared per common share	\$—	\$—	\$—	\$—	\$—

(1) The following selected consolidated financial data were derived from our audited consolidated financial statements and should be read in conjunction with, and are qualified by reference, to the MD&A contained in Item 7 of Part II of this report. The financial information presented may not be indicative of our future performance.

(2) See discussion concerning the impact from the adoption of ASC 606 in Note 2 to the Consolidated Financial Statements.

(3) See discussion of our discontinued operations in Note 17 to the Consolidated Financial Statements.



## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following MD&A should be read in conjunction with a review of the other Items included in this Form 10-K and our December 31, 2018 Consolidated Financial Statements included elsewhere in this report. 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 Operating Initiatives for 2019

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.** Over the past 18 months, our focus has been on upgrading our existing maintenance management system through technology enhancements and work processes to improve our predictive and preventative maintenance programs at our facilities. We engaged outside maintenance experts to assist us in expediting implementation and overall use. We have completed the initial implementation. Additionally, beginning in the third quarter of 2018, we engaged outside consultants to do a thorough review of our operating and maintenance procedures and our preventive maintenance programs at all of our facilities in an effort to determine where we may have gaps in procedures and programs and where we may need enhancements. Based on the "Gap Analysis" completed, we have several initiatives underway that we believe will improve the overall reliability of our plants and allow us to produce more products for sale while lowering our cost of production. Those initiatives are focused on operating behavior and procedure enhancements including operator training, leadership training, shift change enhancements and operating and maintenance procedures.

• **Focus on the Continued Improvement of Our Safety Performance.** We believe that high safety standards are critical and a precursor 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. As a result of these programs, we significantly lowered our recordable incident rate in 2018 as compared to the prior year and we remain well below the national average for recordable safety incidents.

• **Continue Broadening of the Distribution of our Products.** We increased our overall sales volume of HDAN over the past 24 months by approximately 30% through various marketing initiatives which include: (1) storing and distributing HDAN at our Pryor Facility which allows us to sell to new markets and customers out of that facility and; (2) educating growers on the agronomic benefits and the additional applications for HDAN. To further leverage our plants' current production capacity, we are continuing to expand the distribution of our mining products by partnering with customers to take product further into the Western U.S. as well as markets outside the U.S. We also partnered with a current customer to position an emulsion explosives plant at our El Dorado Facility. We began selling product to that facility in the fourth quarter of 2018. We will continue to explore further guest plant opportunities at our facilities in 2019.

In addition, through increased marketing efforts, we increased our sales volumes of nitric acid over the past 24 months by approximately 35%. We continue to focus our efforts to expand our market for our nitric acid products in North

America and to fully utilize available nitric acid production capacity of our facilities.

**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. In 2019, we will 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.

28

---

**Continued Focus on Procurement and Logistics.** In 2018, we engaged outside experts to assist us in centralizing and expanding our Company-wide procurement efforts. We completed our initial areas of focus during the second quarter of 2018, completed the implementation of those changes, and began to see benefits during the third quarter of 2018. We believe that these efforts along with several additional identified areas of focus, 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, which we expect to realize over the next 12 to 24 months. Additionally, we will continue to focus on improving the effectiveness and overall cost of our logistics strategy through a centrally managed team focused on building logistics partners that will help us further drive efficiencies in 2019.

**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 in achieving those efforts. As a part of that, in the second quarter of 2018, we refinanced our outstanding Senior Secured Notes. We will continue to actively seek ways to improve our capital structure going forward.

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.

## Business Developments - 2018

### Financing Transaction and Series E Redeemable Preferred Letter Agreement

As discussed in Note 7 to the Consolidated Financial Statements, 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 11, 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.

### Completion of a Turnaround at Cherokee

During 2018, we successfully completed a 35-day Turnaround performed on our plants at our Cherokee Facility. The next Turnaround for this facility is scheduled in 2021. See additional discussion below under “Items Affecting Comparability of Results.”

### Sale of Certain Non-Core Assets

During 2018, we sold certain non-core assets (primarily real estate properties) for approximately \$6.0 million of net proceeds and recognized a net gain of approximately \$2.4 million that is included in other income. We continue to evaluate our assets to determine if there are additional non-core assets that we should consider monetizing.

## Key Industry Factors

### Supply and Demand

Agricultural

Sales of our agricultural products were approximately 50% of our total net sales for 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, expansions or upgrades of competitors' facilities and international and domestic political and economic developments 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 effect product margins.

Additionally, changes in corn prices and those of soybean, cotton and wheat 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. Industry reports indicated China’s recent tariffs placed on U.S. soybeans could result in a shift of 2 to 4 million acres that will be rotated from soybeans to corn in this next planting season. The USDA also estimates an increase in 2019 corn acres that is in line with other industry reports ranging between 92 million to 93 million acres. Soybean pricing concerns may drive crop planting selection when final crop choices are made at the farm level. The following February estimates are associated with the corn market:

	2019 Crop February Report (1)	2018 Crop February Report (1)	Percentage Change (2)	2017 Crop February Report (1)	Percentage Change (3)
U.S. Area Planted (Million acres)	89.1	90.2	(1.2 %)	94.0	(5.2 %)
U.S. Yield per Acre (Bushels)	176.40	176.6	(0.1 %)	174.6	1.0 %
U.S. Production (Million bushels)	14,420	14,609	(1.3 %)	15,148	(4.8 %)
U.S. Ending Stocks (Million metric tons)	44.1	54.4	(18.9 %)	58.3	(24.4 %)
World Ending Stocks (Million metric tons)	309.8	340.8	(9.1 %)	350.2	(11.5 %)

(1) Information obtained from WASDE reports dated February 8, 2019 (February Report) for the 2018/2019 (“2019 Crop”), 2017/2018 (“2018 Crop”) and 2016/2017 (“2016”) corn marketing years.

(2) Represents the percentage change between the 2019 Crop amounts compared to the 2018 Crop amounts.

(3) Represents the percentage change between the 2019 Crop amounts compared to the 2017 Crop amounts.

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 and other fertilizer products changed the physical flow of ammonia in North America placing pressure on ammonia and other fertilizer prices until the distribution system accepted the new supply. Beginning in the fourth quarter of 2017 and through 2018, we have seen an increase in fertilizer prices as imports of fertilizers have decreased significantly and the distribution of the new domestic supply of fertilizer has been established. We expect this trend to continue into 2019.

## Industrial

Sales of our industrial products were approximately 39% of our total net sales for 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 positive for these sectors domestically. Our sales prices generally vary with the market price of ammonia or natural gas, as applicable, in our pricing arrangements with customers.

## Mining

Sales of our mining products were approximately 11% of our total net sales for 2018. Our mining products are LDAN and AN solutions, which are primarily used as AN fuel oil and specialty emulsions for surface mining of coal and for usage in quarries and the construction industry. As reported by the EIA, annual coal production in the U.S. for the full year of 2018 is down 3% from 2017 due to this market's weak competitive position in the electrical generation sector compared with natural gas and to a lesser degree lower export demand. EIA is forecasting another 3% decrease in U.S. coal production in 2019 followed by a continued decline of 7% in 2020. This estimated decline is based on the continual shift in utility-scale electricity generation from coal to natural gas. 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. As part of our continued effort to expand sales of our mining products, we entered into an agreement with a current customer, by which the customer has located an emulsion explosives plant at our El Dorado Facility. We will continue to explore further guest plant opportunities in 2019.

#### 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 annual volume of natural gas we purchased and the average cost per MMBtu:

	2018	2017
Natural gas volumes (MMBtu in millions)	28	27
Natural gas average cost per MMBtu	\$2.91	\$3.04

#### 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. However, we continue to evaluate the recent rising costs of rail and truck freight domestically. Higher transportation costs may impact our margins if we are not able to pass through these costs. As a result, we continue to evaluate supply chain efficiencies to reduce or counter the impact of higher logistics costs.

#### 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 is 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. Also see the Turnaround costs presented in the Quarterly Financial Data of the Consolidated Financial Statements included in this report.

Our El Dorado Facility performed partial Turnaround activities in the second and third quarters of 2018. The remaining portion of this Turnaround activity will be performed in the third quarter of 2019. Following the completion of this work, we expect the El Dorado Facility to move to a three-year Turnaround cycle with the next Turnaround planned in the third quarter of 2022.

Our Cherokee Facility is currently on a three-year Turnaround cycle, with the last Turnaround performed in the third quarter of 2018 lasting 35 days. The next Turnaround to be performed is expected to occur in the third quarter of

2021.

During the unplanned outage in the fourth quarter of 2017 at our Pryor Facility, we replaced the process gas pre-heat system which was originally planned for a scheduled Turnaround in 2018. Completing the Turnaround at that time allowed us to avoid the previously planned Turnaround in 2018. A Turnaround is scheduled for the third quarter of 2019 and we expect to continue with a two-year Turnaround cycle at this facility with the next Turnaround planned for the third quarter of 2021. At that time, we will seek to move to a three-year Turnaround cycle.

#### 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 for 2018

Our consolidated net sales for 2018 were \$378.2 million compared to \$427.5 million for 2017. Our consolidated operating loss was \$23.0 million compared to \$34.1 million for 2017. The items affecting our operating results are discussed below and under "Results of Operations."

31

---



## Items Affecting Comparability of Results

### Turnaround Expense

During 2018, we incurred Turnaround costs totaling approximately \$9.8 million associated with a 35-day Turnaround performed on our plants at our Cherokee Facility and a total of 12 days associated with Turnaround activity at our El Dorado Facility.

During 2017, we incurred Turnaround costs of approximately \$1.3 million primarily relating to a 17-day Turnaround at our Pryor Facility. Turnaround costs are included in cost of sales. The Turnaround costs noted above do not include the impact on operating results relating to lost absorption of fixed costs or the reduced margins due to the lost production and subsequent product sales from our plants being shut down during the Turnaround.

### 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 ammonia is the basic product as used to produce all upgraded products. The on-stream rates noted below exclude Turnaround days, when applicable.

At our Cherokee Facility, the ammonia plant on-stream rate for 2018 was 94% compared to 99% for the same period of 2017. The ammonia plant's on-stream rate was impacted by maintenance completed on its primary reformer during the first quarter of 2018. Our target on-stream rate for this ammonia plant for 2019 is 95%.

At our El Dorado Facility, the ammonia plant's on-stream rate for 2018 was 88% compared to 86% for the same period of 2017. The ammonia plant's on-stream rate for 2018 was impacted by maintenance completed on its boiler relating to tube failures caused by a power outage during June 2018. The El Dorado Facility's ammonia plant operated at 93% during the second half of 2018 and we are targeting an ammonia plant average on-stream rate for 2019 of 95%.

At our Pryor Facility, the on-stream rate for 2018 for our ammonia plant increased to 89% from 69% in 2017. Despite having to perform maintenance to repair leaks in the ammonia plant's waste heat boiler during 2018, this was the Pryor Facility's best full year performance since we brought the facility online in 2010. We view this result as an indication that the leadership changes in personnel and reliability investments made, coupled with the maintenance management systems, procedures and preventative maintenance programs being implementing are yielding positive results. While we anticipate brief periods of unscheduled downtime during 2019 as we continue to take actions to improve long-term reliability, we are targeting an ammonia plant average on-stream rate for 2019 of 90%.

We believe that our focus on improving on-stream rates as discussed in key operating initiatives will continue to improve our overall on-stream rate for 2019.

### Selling Prices

During 2018, we experienced improved selling prices for our agricultural products compared to 2017. Average selling prices for our ammonia, UAN and HDAN increased 16%, 15% and 11%, respectively compared to 2017 average selling prices. This increase reflects a more favorable alignment of demand with market capacity for these products. We expect these overall sales price levels to continue into 2019.

Our 2018 average industrial selling prices for our ammonia also improved compared to 2017. 2018 average Tampa Ammonia pricing improved 12% as compared to 2017 and many of our industrial contracts are indexed to the Tampa

Ammonia price.

#### Depreciation Expense

During 2018 and 2017, depreciation expense was \$70.3 million and \$67.0 million, respectively. For 2018, approximately \$2.0 million relates to accelerated depreciation at the El Dorado Facility due to the tube failures discussed above.

#### Interest Expense

During 2018 and 2017, interest expense was \$43.1 million and \$37.3 million, respectively. The change primarily relates to our Senior Secured Notes, which includes approximately \$0.9 million related to debt modification fees associated with the financing transactions discussed above under “Business Developments - 2018” and in Note 7 to the Consolidated Financial Statements.

#### Loss on Extinguishment of Debt (2018 only)

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.

#### Valuation Allowance on Deferred Tax Assets (2018 only)

As discussed in Note 8 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. The impact from the valuation allowance in 2018 was approximately \$15 million.

#### Severance Benefits and Accelerated Stock-based Compensation (2018 only)

We incurred \$5.3 million associated with certain severance benefits and accelerated stock-based compensation relating to Daniel D. Greenwell, our former Chief Executive Officer (“CEO”), electing not to renew his employment agreement in December 2018.

#### Recovery from a Settlement with a Vendor (2018 only)

We and a vendor mediated a settlement relating primarily to a business interruption claim caused by defective work performed by the vendor at our Pryor Facility. As a result of the settlement, the vendor paid us \$4.0 million. As part of the settlement, we paid the vendor \$0.5 million to settle \$1.1 million of invoices that were held in our accounts payable. As a result, we recognized a recovery from this settlement totaling \$4.6 million of which \$4.4 million was classified as a reduction to cost of sales (primarily relating to our business interruption claim) and the remaining balance of \$0.2 million as a reduction to PP&E.

#### 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 consolidated financial statements for the years ended December 31, 2018, 2017, and 2016 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 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.

#### Year Ended December 31, 2018 Compared to Year Ended December 31, 2017

The following table contains certain financial information relating to our continuing operations:

	2018	2017	Change	Percentage Change	
	(Dollars In Thousands)				
<b>Net sales:</b>					
Agricultural products	\$ 187,164	\$ 184,054	\$ 3,110	2	%
Industrial acids and other chemical products (1)	148,598	196,029	(47,431)	(24)	)%
Mining products	42,398	38,854	3,544	9	%
Other products	—	8,567	(8,567 )	(100)	)%
Total net sales	\$ 378,160	\$ 427,504	\$(49,344)	(12)	)%
<b>Gross profit</b>					
	\$ 15,835	\$ 5,466	\$ 10,369	190	%

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

Gross profit percentage (2)	4.2	%	1.3	%	2.9	%
Selling, general and administrative expense	40,811		34,990		5,821	17 %
Other expense (income), net	(1,951 )		4,567		(6,518 )	
Operating loss	(23,025 )		(34,091 )		11,066	(32 )%
Interest expense, net	43,064		37,267		5,797	16 %
Loss on extinguishment of debt	5,951		—		5,951	
Non-operating other income, net	(1,554 )		(306 )		(1,248 )	
Provision (benefit) for income taxes (3)	1,740		(40,759 )		42,499	(104 )%
Loss from continuing operations	(72,226 )		(30,293 )		(41,933 )	(138 )%
Property, plant and equipment expenditures:	\$ 37,050		\$ 35,425		\$ 1,625	5 %
Depreciation, depletion and amortization of						
property, plant and equipment:	\$ 70,266		\$ 66,996		\$ 3,270	5 %

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

(2) As a percentage of net sales

(3) See discussion in Note 8 to the Consolidated Financial Statements

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

Product (tons sold)	2018	2017	Change	Percentage Change
UAN	400,054	488,794	(88,740)	(18)%
HDAN	284,433	279,789	4,644	2%
Ammonia	82,586	94,210	(11,624)	(12)%
Other	23,422	25,664	(2,242)	(9)%
Total	790,495	888,457	(97,962)	(11)%

Gross Average Selling Prices (price per ton)	2018	2017	Change	Percentage Change
UAN	\$176	\$153	\$23	15%
HDAN	\$264	\$237	\$27	11%
Ammonia	\$319	\$276	\$43	16%

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

Product (tons sold)	2018	2017	Change	Percentage Change
Ammonia	238,520	228,849	9,671	4%
Nitric Acid - excluding Baytown	110,975	100,628	10,347	10%
Other Industrial Products	32,110	31,485	625	2%
Total	381,605	360,962	20,643	6%

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

Product (tons sold)	2018	2017	Change	Percentage Change
LDAN/HDAN/AN Solution	163,308	149,345	13,963	9%

## Net Sales

• Agricultural products sales increased primarily from higher average sales prices for our major products as a result of improved commodity pricing and overall higher product selling prices. This increase was partially offset by the lost production at our Cherokee Facility resulting from a 35-day Turnaround performed during 2018. UAN volumes were also higher in 2017 due to the timing of barge shipments that crossed over year-end and landed in the first

quarter of 2017. Additionally, ammonia sales volumes were lower as a result of a poor fall application season. The delayed 2018 fall harvest coupled with poor weather conditions resulted in a decline of approximately 55% of fall ammonia applications compared to the 2017 fall application season. As a result of the lower demand, a portion of our agricultural ammonia was sold into our industrial markets. HDAN sales volumes, although slightly higher than 2017, were also impacted by substantially higher rainfall amounts occurring during the last few months of 2018.

Industrial acids and other industrial chemical products sales decreased approximately 24%, 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 2017, net sales for these products would have been reduced by approximately \$65.4 million to \$130.7 million representing a \$17.9 million or 13.7% increase for 2018 compared to 2017. Excluding this impact, sales increased primarily due to improved average selling prices and stronger sales volumes reflecting expanded marketing efforts and the continued strength of the U.S. economy.

Mining product sales increased primarily as a result of the broadening of our AN distribution markets combined with new guest plant arrangements.

Other products consist of natural gas sales from our former working interests in certain natural gas properties and sales from our former business that sold industrial machinery and related components, both of which were sold during 2017.

## Gross Profit

As noted in the table above, we recognized a gross profit of \$15.8 million in 2018 compared to \$5.5 million in 2017, or an increase in gross profit of approximately \$10.3 million. In addition to the net positive effect from the higher sales discussed above, our gross profit improvement includes a net reduction of natural gas cost of approximately \$1.3 million from lower average natural gas prices, partially offset by higher natural gas volumes purchased as the result of improved on-stream and production rates at our Pryor and El Dorado Facilities, which are the result of implementing our key operating initiatives to improve plant reliability. Our gross profit was also impacted by the following:

- approximately \$8.5 million from higher expenses associated with the Turnarounds primarily performed at our Cherokee and El Dorado Facilities and the resulting lost production during the 35-day and 12-day Turnarounds at Cherokee and El Dorado; and
- approximately \$3.2 million from additional consulting costs associated with our reliability and purchasing initiatives.

Also, as discussed above under “Items Affecting Comparability-Recovery from a Settlement with a Vendor”, our 2018 gross profit included a recovery from a settlement with a vendor of \$4.4 million classified as a reduction to cost of sales (primarily relating to our business interruption claim).

In addition, 2017 gross profit included a recovery of precious metals of \$2.9 million and approximately \$3.3 million of gross profit associated with our former industrial machinery business and working interests in certain natural gas properties, both sold in 2017.

## Selling General and Administrative Expense

Our SG&A expenses were \$40.8 million for 2018, an increase of \$5.8 million compared to 2017, of which \$5.3 million associated with severance benefits and accelerated stock-based compensation relating to our former CEO electing not to renew his employment agreement in December 2018. Excluding this impact, SG&A expenses increased \$0.5 million including higher professional fees of \$2.6 million associated with our legal matters partially offset by a reduction in insurance and other miscellaneous expenses of \$0.5 million and the impact from \$1.6 million of SG&A expenses related to two former businesses that were sold in 2017.

## Other Expense (Income), net

Other income for 2018 was \$2.0 million that includes a net gain from the sales of certain non-core assets (primarily consisting of real estate). Other expense for 2017 was \$4.6 million for 2017 that includes a total net loss of \$7.0 million primarily from the sales of our engineered products business (industrial machinery and related components) 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 \$1.0 million in miscellaneous items.

## Interest Expense, net

Interest expense for 2018 was \$43.1 million compared to \$37.3 million for 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 as discussed in Note 7 to the Consolidated Financial Statements.

## Loss on Extinguishment of Debt

During 2018, we incurred a loss on extinguishment of debt of approximately \$6.0 million as discussed above under “Items Affecting Comparability of Results - Loss on Extinguishment of Debt” and in Note 7.

Provision (Benefit) for Income Taxes

The provision for income taxes for 2018 was \$1.7 million compared to a \$40.8 million benefit in the same period in 2017. The effective tax rate, including the impact of tax reform adjustments, was 2.5%, as compared to a benefit rate of 57% for 2017. The 2018 effective tax rate was impacted by adjustments made to our valuation allowances during 2018 including a reversal of approximately \$2.3 million of state valuation allowance related to tax law changes. The significant tax benefit in 2017 was primarily due to the adjustments recorded in 2017 on the deferred tax assets and liabilities from the decrease in the federal enacted tax rate as a result of tax reform in 2017.

Income from Discontinued Operations, net of taxes

The results of operations of our former Climate Control Business are presented as discontinued operations. For 2017, income from discontinued operations was \$1.1 million, consisting of a gain of \$2.6 million relating primarily to estimate revisions to contingent obligations and net of a tax provision of \$1.5 million.



Edgar Filing: LSB INDUSTRIES INC - Form 10-K

Year Ended December 31, 2017 Compared to Year Ended December 31, 2016

The following table contains certain financial information relating to our continuing operations:

	2017	2016	Change	Percentage Change	
	(Dollars In Thousands)				
<b>Net sales:</b>					
Agricultural products	\$184,054	\$166,180	\$17,874	11	%
Industrial acids and other chemical products	196,029	155,744	40,285	26	%
Mining products	38,854	43,532	(4,678 )	(11)	)%
Other products	8,567	9,129	(562 )	(6)	)%
Total net sales	\$427,504	\$374,585	\$52,919	14	%
<b>Gross profit (loss)</b>					
Gross profit (loss)	\$5,466	\$(49,306 )	\$54,772	111	%
Gross profit (loss) percentage (1)	1.3	% (13.2 )%	14.5	%	
Selling, general and administrative expense	34,990	40,168	(5,178 )	(13)	)%
Impairment of goodwill	—	1,621	(1,621 )	(100)	)%
Other expense (income), net	4,567	(872 )	5,439		
Operating loss	(34,091 )	(90,223 )	56,132	62	%
Interest expense, net	37,267	30,945	6,322	20	%
Loss on extinguishment of debt	—	8,703	(8,703 )	100	%
Non-operating other expense (income), net	(306 )	218	(524 )		
Benefit for income taxes	(40,759 )	(41,956 )	1,197	(3)	)%
Loss from continuing operations	(30,293 )	(88,133 )	57,840	66	%
<b>Additions to property, plant and equipment:</b>					
Additions to property, plant and equipment:	\$37,433	\$165,104	\$(127,671)	(77)	)%
<b>Depreciation, depletion and amortization of property, plant and equipment:</b>					
Depreciation, depletion and amortization of property, plant and equipment:	\$66,996	\$59,354	\$7,642	13	%

(1) As a percentage of net sales

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

Product (tons sold)	2017	2016	Change	Percentage Change	
UAN	488,794	372,593	116,201	31	%
HDAN	279,789	218,283	61,506	28	%
Ammonia	94,210	93,013	1,197	1	%
Other	25,664	23,290	2,374	10	%
Total	888,457	707,179	181,278	26	%

Percentage

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

Average Selling Prices (price per ton)	2017	2016	Change	Change
UAN	\$153	\$173	\$(20 )	(12 )%
HDAN	\$237	\$253	\$(16 )	(6 )%
Ammonia	\$276	\$331	\$(55 )	(17 )%

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

Product (tons sold)	2017	2016	Change	Percentage Change	
Ammonia	228,849	127,265	101,584	80	%
Nitric Acid - excluding Baytown	100,628	82,237	18,391	22	%
Other Industrial Products	31,485	38,059	(6,574 )	(17	)%
Total	360,962	247,561	113,401	46	%

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

Product (tons sold)	2017	2016	Change	Percentage Change	
LDAN/HDAN/AN Solution	149,345	153,535	(4,190 )	(3	)%

#### Net Sales

Agricultural and industrial sales for 2017 were both significantly higher due to increased sales volumes that were partially offset by decreased average selling prices while mining sales for 2017 were lower due to lower average prices and a net decrease in sales volume compared to 2016.

•Agricultural products sales increased primarily from higher sales volume across all product categories. The increase in sales volume was primarily the result of overall improved on-stream and production rates at our El Dorado and Cherokee Facilities, the absence of a Cherokee Turnaround in 2017 and the broadening of our distribution of HDAN to new markets and customers. Partially offsetting the increase in sales volume was lower average selling prices, primarily due to: (1) lower average commodity prices; (2) weather in the early spring that caused less ammonia to be applied during pre-plant season which caused an inventory buildup and; (3) the nitrogen production capacity being added globally, and in North America specifically.

•Industrial acids and other chemical products sales increased driven by strong industrial ammonia sales at our El Dorado Facility from higher plant on-stream rates (minimal ammonia production during the first half of 2016 from this facility). In addition, nitric acid sales from El Dorado continued to expand and sales volume was significantly higher compared to 2016, although at lower net prices due to longer shipping distances and stronger market competitive pressures.

•Mining products sales decreased primarily as the result of both lower sales volume and lower selling prices of AN Solution partially offset by increases in LDAN sales volume from our El Dorado Facility. We continued to face lower sales volume of AN Solution from our Cherokee Facility as demand from our customers remained suppressed by overall Appalachia coal market conditions and increased competitive production capacity in our region.

•Other products consist of natural gas sales from our former working interests in certain natural gas properties and sales from our former business that sold industrial machinery and related components, both of which were sold during 2017.

#### Gross Profit

As noted in the table above, we recognized a gross profit of \$5.5 million in 2017 compared to a gross loss of \$49.3 million in 2016, or an increase in gross profit of \$54.8 million. In addition to the net positive effect from the higher sales discussed above, our gross profit improved primarily through:

- a reduction in our feedstock and other operating costs at our El Dorado Facility as (i) this facility produced ammonia from natural gas during 2017 compared to purchasing ammonia during most of the first half of 2016 and (ii) costs associated with the start-up, commissioning and optimizing activities performed on the ammonia plant during 2016 that were not incurred in 2017;

- a reduction in overall fixed plant expenses;

- a recovery of precious metals of \$2.9 million during 2017, which metals had accumulated over time within certain manufacturing equipment; and

- improved absorption of fixed costs from improved on-stream and production rates at our Cherokee and El Dorado Facilities and lower Turnaround expense at the Cherokee Facility as a Turnaround was not required in 2017.

The increase in gross profit was partially offset by an increase in overall depreciation expense of approximately \$7.6 million primarily as a result of our new ammonia plant at our El Dorado Facility not being put into service until mid-May 2016, lower absorption of

fixed costs from lower on-stream rates at our Pryor Facility and higher average natural gas feedstock cost at our Cherokee and Pryor Facilities.

In addition, during 2016, we incurred a one-time cost of \$12.1 million relating to consulting services associated with the reduction of property taxes from fixing the assessed value for our El Dorado Facility.

#### Selling General and Administrative Expense

Our SG&A expenses were \$35.0 million for 2017, a decrease of \$5.2 million compared to 2016. The decrease was driven by a \$2.2 million reduction in compensation-related costs, \$1.9 million reduction in insurance and other miscellaneous costs and \$1.1 million reduction in professional fees.

#### Impairment of Long-Lived Assets and Goodwill

During 2016, we recognized a non-cash impairment charge of \$1.6 million to fully write-off the carrying value of goodwill.

#### Other Expense (Income), net

Our net other expense for 2017 was \$4.6 million compared to net other income of \$0.9 million for 2016. The change primarily consists of a total net loss of \$7.0 million relating to the sale of our working interest of certain natural gas properties, the sale of our engineered products business (industrial machinery and related components) 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 \$0.1 million in miscellaneous items.

#### Interest Expense, net

Interest expense for 2017 was \$37.3 million compared to \$30.9 million for 2016. The increase is due primarily to a reduction in capitalized interest during 2017 of \$14.7 million as a result of the El Dorado expansion project completion during 2016. This increase was partially offset by a decrease of \$5.5 million relating to the 12% Senior Secured Notes sold in 2015 and repaid in 2016 and \$2.2 million as a result of the debt modification associated with a consent solicitation completed in 2016.

#### Loss on Extinguishment of Debt

As a result of the repayment of \$50 million of the 7.75% Senior Secured Notes and all of our 12% Senior Secured Notes in 2016, we incurred a loss on extinguishment of debt of \$8.7 million, consisting of prepayment premiums and writing off associated unamortized debt issuance costs.

#### Benefit for Income Taxes

The benefit for income taxes for continuing operations in 2017 was \$41 million compared to \$42 million for the same period in 2016. The effective tax rate, including the impact of tax reform adjustments, was 57% for 2017 compared to 32% for 2016. The increase in the benefit rate is primarily due to the adjustments on the deferred tax assets and liabilities from the enacted tax rate as a result of tax reform in 2017. The provisional adjustments related to tax reform resulted in recording a tax benefit of \$23 million.

#### Income from Discontinued Operations, net of taxes

The results of operations of our former Climate Control Business are presented as discontinued operations. For 2017, income from discontinued operations was \$1.1 million, consisting of a gain of \$2.6 million relating primarily to estimate revisions to contingent obligations and net of a tax provision of \$1.5 million. For 2016, income from discontinued operations was \$200.3 million, including a gain of \$282 million and net of a tax provision of \$91.7 million.

## LIQUIDITY AND CAPITAL RESOURCES

The following table summarizes our continuing cash flow activities for 2018 and 2017:

	2018	2017	Change
	(In Thousands)		
Net cash flows from continuing operating activities	\$17,622	\$2,276	\$15,346
Net cash flows from continuing investing activities	\$(25,740)	\$(10,845)	\$(14,895)
Net cash flows from continuing financing activities	\$547	\$(16,132)	\$16,679

## Cash Flow from Continuing Operating Activities

Net cash provided by continuing operating activities was \$17.6 million for 2018 compared to \$2.3 million for 2017, an improvement of approximately \$15.3 million.

For 2018, the net cash provided is the result of a net loss of \$72.2 million plus adjustments of \$70.3 million for depreciation, depletion and amortization of PP&E, \$8.4 million for stock-based compensation, \$6.0 million for a loss on extinguishment of debt, \$1.8 million for deferred taxes and other adjustments totaling approximately \$2.8 million and net cash provided of approximately \$0.5 million primarily from our working capital including an increase in inventories and accounts payables and a decrease in accrued interest.

For 2017, the net cash provided is the result of a net loss of \$29.2 million plus a noncash adjustment of \$67 million for depreciation, depletion and amortization of PP&E and other noncash adjustments totaling approximately \$13.7 million less an adjustment of \$40.4 million for deferred income taxes and approximately \$8.8 million of net cash used primarily from our working capital including an increase in our trade accounts receivable.

## Cash Flow from Continuing Investing Activities

Net cash used by continuing investing activities was \$25.7 million for 2018 compared to \$10.8 million for 2017, a change of \$14.9 million.

For 2018, the net cash used is the result of \$37.1 million on expenditures for PP&E partially offset by \$6.7 million from net proceeds from the sale of PP&E, \$2.7 million representing the remaining proceeds from an indemnity escrow account associated with the sale of the Climate Control business in 2016 and approximately \$2.0 million relating to a recovery from a property insurance claim and other investing activities.

For 2017, the net cash used relates to expenditures for PP&E of \$35.4 million partially offset by net proceeds of \$23.8 million from the sale of our working interests in certain natural gas properties, engineered products business (industrial machinery and related components) and other property and equipment and \$0.8 million associated with other activities.

## Cash Flow from Continuing Financing Activities

Net cash provided by continuing financing activities was \$0.5 million for 2018 compared to net cash used \$16.1 million for 2017, a change of approximately \$16.6 million.

For 2018, the net cash provided consists of net proceeds of \$390.5 million from the Senior Secured Notes, \$10.9 million from short-term financing, and \$10.0 million from our Working Capital Revolver Loan partially offset by \$375 million repayment of the senior secured notes due 2019, payments of \$20.0 million on other long-term debt and short-term financing, payments of \$11.0 million for debt related costs, payments of \$2.8 million of fees associated with the modification of terms of our Series E Redeemable Preferred and approximately \$2.1 million of other financing activities.

For 2017, the net cash used consists of payments on long-term debt and related costs of \$14.2 million and \$1.9 million of other activities.



## Capitalization

The following is our total current cash, long-term debt, redeemable preferred stock and stockholders' equity:

	December 31,	
	2018	2017
	(In Millions)	
Cash and cash equivalents	\$26.0	\$33.6
Revolving credit facility and long-term debt:		
Working Capital Revolver Loan	10.0	—
Senior Secured Notes due 2023 (1)	400.0	—
Senior Secured Notes due 2019 (1)	—	375.0
Secured Promissory Note due 2019	7.2	8.2
Secured Promissory Note due 2021	8.1	11.2
Secured Promissory Note due 2023	14.7	16.7
Other	0.2	3.0
Unamortized discount and debt issuance costs	(15.0)	(4.7)
Total long-term debt, including current portion, net	\$425.2	\$409.4
Series E and F redeemable preferred stock (2)	\$202.2	\$175.0
Total stockholders' equity	\$342.2	\$438.2

(1) See discussion contained in Note 7 to the Consolidated Financial Statements.

(2) Liquidation preference of \$212.1 million as of December 31, 2018.

We currently have a revolving credit facility, our Working Capital Revolver Loan, with a borrowing base of \$50 million. During the fourth quarter of 2018, we delivered product to several customers with extended short-term payment terms as a means of optimizing our inventory and storage capacity headed into the spring season. We utilized the revolver to finance normal working capital fluctuations such as these receivables. As of December 31, 2018, our Working Capital Revolver Loan had outstanding borrowings of \$10.0 million and \$37.2 million of availability.

As discussed below, we have planned capital expenditures relating to maintaining and enhancing safety and reliability at our facilities of approximately \$30 million to \$35 million. This is inclusive of a new sulfuric acid converter at our El Dorado Facility that we plan to install in the fourth quarter of 2019 and estimate will cost approximately \$7.5 million. We expect this investment to significantly improve the reliability of that plant while increasing the production capacity from approximately 140,000 tons to 160,000 tons allowing us to take advantage of attractive market conditions. We are finalizing the equipment financing for this capital project.

We believe that the combination of our cash on hand, the availability on our revolving credit facility, and our cash flow from operations will be sufficient to fund our anticipated liquidity needs for the next twelve months.

## Compliance with Long - Term Debt Covenants

As discussed below under "Loan Agreements," the Working Capital Revolver Loan requires, among other things, that we meet certain financial covenants. The Working Capital Revolver Loan does not include financial covenant requirements unless a defined covenant trigger event has occurred and is continuing. As of December 31, 2018, no trigger event had occurred.

Loan Agreements and Redeemable Preferred Stock

Senior Secured Notes due 2019 and 2023 - See discussion contained in Note 7 to the Consolidated Financial Statements. As a result of the financing transactions, our interest expense has increased as compared to 2017.

Secured Promissory Note due 2019 – EDC is party to a secured promissory note due in June 2019. This promissory note bears interest at the annual rate of 5.73%. Principal and interest are payable in equal monthly installments with a final balloon payment of approximately \$6.7 million.

Secured Promissory Note due 2021 – EDC is party to a secured promissory note due in March 2021. This promissory note bears interest at the annual rate of 5.25%. Principal and interest are payable in monthly installments.

Secured Promissory Note due 2023 - EDA is party to a secured promissory note due in May 2023. Principal and interest are payable in equal monthly installments with a final balloon payment of approximately \$6.1 million. This promissory note bears interest at a rate that is based on the monthly LIBOR rate plus a base rate for a current total rate of 6.76%.

Working Capital Revolver Loan - At December 31, 2018, we had \$10.0 million outstanding borrowings under the Working Capital Revolver Loan and the net credit available for borrowings under our Working Capital Revolver Loan was approximately \$37.2

million, based on our eligible collateral, less outstanding letters of credit as of that date. Also see discussion above under “Compliance with Long-Term Debt Covenants.

Redemption of Series E Redeemable Preferred – At December 31, 2018, there were 139,768 outstanding shares of Series E Redeemable Preferred.

At any time on or after October 25, 2023, each Series E holder has the right to elect to have such holder’s shares redeemed by us at a redemption price per share equal to the liquidation preference per share of \$1,000 plus accrued and unpaid dividends plus the participation rights value (the “Liquidation Preference”). Additionally, at our option, we may redeem the Series E Redeemable Preferred at any time at a redemption price per share equal to the Liquidation Preference of such share as of the redemption date. Lastly, with receipt of (i) prior consent of the electing Series E holder or a majority of shares of Series E Redeemable Preferred and (ii) all other required approvals, including under any principal U.S. securities exchange on which our common stock is then listed for trading, we can redeem the Series E Redeemable Preferred by the issuance of shares of common stock having an aggregate common stock price equal to the amount of the aggregate Liquidation Preference of such shares being redeemed in shares of common stock in lieu of cash at the redemption date.

In the event of liquidation, the Series E Redeemable Preferred is entitled to receive its Liquidation Preference before any such distribution of assets or proceeds is made to or set aside for the holders of our common stock and any other junior stock. In the event of a change of control, we must make an offer to purchase all of the shares of Series E Redeemable Preferred outstanding at the Liquidation Preference.

Since 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, this accretion has and will continue to affect income (loss) per common share. In addition, this accretion could accelerate if the expected redemption date is earlier than October 25, 2023.

As of December 31, 2018, the aggregate liquidation preference (par value plus accrued dividends) was \$212.1 million.

Also, see discussion in Note 11 to the Consolidated Financial Statements included in this report.

#### Capital Expenditures – 2018

For 2018, capital expenditures relating to PP&E were \$37.1 million, which expenditures include approximately \$0.9 million associated with maintaining compliance with environmental laws, regulations and guidelines. The capital expenditures were funded primarily from cash and working capital.

See discussion above under “Capitalization” for our expected annual capital expenditures for 2019.

#### Expenses Associated with Environmental Regulatory Compliance

We are subject to specific federal and state environmental compliance laws, regulations and guidelines. As a result, we incurred expenses of \$3.2 million in 2018 in connection with environmental projects. For 2019, we expect to incur expenses ranging from \$3.2 million to \$4.2 million in connection with additional environmental projects. However, it is possible that the actual costs could be significantly different than our estimates.

#### Dividends

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 near future.

Dividends on the Series E Redeemable Preferred are cumulative and payable semi-annually (May 1 and November 1) in arrears at the current annual rate of 14% of the liquidation value of \$1,000 per share, but such annual rate will increase beginning on April 25, 2021 as discussed in Note 11. Each share of Series E Redeemable Preferred is entitled to receive a semi-annual dividend, only when declared by our Board. In addition, dividends in arrears at the dividend date, until paid, shall compound additional dividends at the current annual rate of 14%, but such annual rate will increase beginning on April 25, 2021. The current semi-annual compounded dividend is approximately \$103.83 per share for the current aggregate semi-annual dividend of \$14.5 million. We also must declare a dividend on the Series E Redeemable Preferred on a pro rata basis with our common stock. As long as the Purchaser holds at least 10% of the Series E Redeemable Preferred, we may not declare dividends on our common stock and other preferred stocks unless and until dividends have been declared and paid on the Series E Redeemable Preferred for the then current dividend period in cash. As of December 31, 2018, the amount of accumulated dividends on the Series E Redeemable Preferred was approximately \$72.3 million.

Dividends on the Series D 6% cumulative convertible Class C preferred stock (the "Series D Preferred") and Series B 12% cumulative convertible Class C Preferred Stock (the "Series B Preferred") are payable annually, only when declared by our Board, as follows:

\$0.06 per share on our outstanding non-redeemable Series D Preferred for an aggregate dividend of \$60,000, and \$12.00 per share on our outstanding non-redeemable Series B Preferred for an aggregate dividend of \$240,000.

As of December 31, 2018, the amount of accumulated dividends on the Series D Preferred and Series B Preferred totaled approximately \$1.0 million. All shares of the Series D Preferred and Series B Preferred are owned by the Golsen Holders. There are no optional or mandatory redemption rights with respect to the Series B Preferred or Series D Preferred.

#### Seasonality

We believe fertilizer products sold to the agricultural industry are seasonal while sales into the industrial and mining sectors generally are less susceptible. The 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 in the geographical markets we distribute the majority of our agricultural products. As a result, we typically increase our inventory of fertilizer products prior to the beginning of each planting season in order to meet the demand for our products. In addition, the amount and timing of sales to the agricultural markets depend upon weather conditions and other circumstances beyond our control.

#### Performance and Payment Bonds

We are contingently liable to sureties in respect of insurance bonds issued by the sureties in connection with certain contracts entered into by subsidiaries in the normal course of business. These insurance bonds primarily represent guarantees of future performance of our subsidiaries. As of December 31, 2018, we have agreed to indemnify the sureties for payments, up to \$10 million, made by them in respect of such bonds. All of these insurance bonds are expected to expire or be renewed in 2019.

#### Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of Regulation S-K under the Securities Exchange Act of 1934.

## Aggregate Contractual Obligations

As of December 31, 2018, our aggregate contractual obligations are summarized in the following table:

Contractual Obligations	Total	Payments Due in the Year Ending December 31,					Thereafter
		2019	2020	2021	2022	2023	
(In Thousands)							
<b>Long-term debt:</b>							
Senior Secured Notes	\$400,000	\$—	\$—	\$—	\$—	\$400,000	\$—
Other	40,161	12,552	5,544	3,239	12,025	6,801	—
Total long-term debt	440,161	12,552	5,544	3,239	12,025	406,801	—
<b>Interest payments on long-term debt</b>							
(1)	179,093	40,553	40,042	39,757	39,315	19,426	—
<b>Series E redeemable preferred stock</b>							
(2)	139,768	—	—	—	—	139,768	—
<b>Dividends earned Series E redeemable preferred stock (2)</b>							
	276,783	—	—	—	—	276,783	—
Other capital expenditures (3)	35,000	35,000	—	—	—	—	—
Operating leases	18,760	6,674	3,547	2,364	1,949	1,696	2,530
Natural gas pipeline commitment (4)	5,220	720	720	720	720	720	1,620
Other contractual obligations	19,346	4,530	3,008	2,697	2,226	4,421	2,464
<b>Other contractual obligations included in</b>							
<b>noncurrent accrued and other liabilities (5)</b>							
	4,385	—	2,545	41	33	1,659	107
<b>Total</b>	<b>\$1,118,516</b>	<b>\$100,029</b>	<b>\$55,406</b>	<b>\$48,818</b>	<b>\$56,268</b>	<b>\$851,274</b>	<b>\$ 6,721</b>

- (1) The estimated interest payments relating to variable interest rate debt are based on interest rates at December 31, 2018.
- (2) The Series E redeemable preferred stock (including dividends) are assumed to be redeemed and paid on the earliest possible redemption date by the holder (October 25, 2023) and that dividends are accrued until that date.
- (3) Other capital expenditures include only the estimated committed amounts (high end of range) at December 31, 2018 which includes approximately \$7.5 million in financing we are finalizing as discussed above under Capitalization.
- (4) Our proportionate share of the minimum costs to ensure capacity relating to a gathering and pipeline system.
- (5) The future cash flows relating to executive and death benefits are based on estimates at December 31, 2018. The participation rights value associated with embedded derivative of our Series E redeemable preferred stock is based the value of our common stock at December 31, 2018 and is based on the earliest possible redemption date by the holder, October 25, 2023.

### New Accounting Pronouncements

For recently adopted and recently issued accounting standards, see discussions in Note 1 to the Consolidated Financial Statements included in this report.

### Critical Accounting Policies and Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amount of assets, liabilities, revenues and expenses, and disclosures of contingencies and fair values. It is reasonably possible that the estimates and assumptions utilized as of December 31, 2018, could change in the near term. The more critical areas of financial reporting affected by management's judgment, estimates and assumptions include the following:

**Contingencies** – Certain conditions may exist which may result in a loss, but which will only be resolved when future events occur. We and our legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. If the assessment of a contingency indicates that it is probable that a loss has been incurred, we would accrue for such contingent losses when such losses can be reasonably estimated. If the assessment indicates that a potentially material loss contingency is not probable but reasonably possible, or is probable but cannot be estimated, the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed. Estimates of potential legal fees and other directly related costs associated with contingencies are not accrued but rather are expensed as incurred. Loss contingency liabilities are included in current and noncurrent accrued and other liabilities and are based on current estimates that may be revised in the near term. In addition, we recognize contingent gains when such gains are realized or realizable and earned.

We are involved in various legal matters that require management to make estimates and assumptions, including costs relating to the lawsuit styled City of West, Texas v CF Industries, Inc., et al, discussed under “Other Pending, Threatened or Settled Litigation” of Note 9 to the Consolidated Financial Statements include in this report.

It is reasonably possible that the actual costs could be significantly different than our estimates.

**Regulatory Compliance** – As discussed under “Environmental, Health and Safety Matters” in Item 1 of this report, we are subject to specific federal and state regulatory compliance laws and guidelines. We have developed policies and procedures related to regulatory compliance. We must continually monitor whether we have maintained compliance with such laws and regulations and the operating implications, if any, and amount of penalties, fines and assessments that may result from noncompliance. We will also be obligated to manage certain discharge water outlets and monitor groundwater contaminants at our chemical facilities should we discontinue the operations of a facility. However, certain conditions exist which may result in a loss, but which will only be resolved when future events occur relating to these matters. We are involved in various environmental matters that require management to make estimates and assumptions, including our current inability to develop a meaningful and reliable estimate (or range of estimate) as to the costs relating to a corrective action study work plan approved by the Kansas Department of Health and Environment (“KDHE”) discussed under footnote 3 – Other Environmental Matters of Note 9. At December 31, 2018 and 2017, liabilities totaling \$0.2 million for both periods have been accrued relating to these issues as discussed. This liability is included in current accrued and other liabilities and is based on current estimates that may be revised in the near term. At the time that cost estimates for any corrective action are received, we will adjust our accrual accordingly. It is reasonably possible that the adjustment to the accrual and the actual costs could be significantly different than our current estimates.

**Income Tax** – As discussed in Note 8, 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 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 the valuation allowance recorded during 2018 was approximately \$15 million.

Senior Secured Notes – As discussed in Note 7, LSB completed the issuance and sale of the Senior Secured Notes in April 2018. A portion of this 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 extinguishment and modification conclusion impacts the treatment of discounts and debt issuance costs. In addition, certain embedded features included in the Senior Secured Notes were evaluated to identify if those features represented a derivative and required bifurcation.



Redeemable Preferred Stocks – In December 2015, we issued the Series E and F Redeemable Preferred. The redeemable preferred stocks are redeemable outside of our control and are classified as temporary/mezzanine equity on our consolidated balance sheet. In addition, certain embedded features (the “embedded derivative”) included in the Series E Redeemable Preferred required bifurcation and are classified as derivative liabilities. As discussed in Note 11, the terms of the Series E Redeemable Preferred were amended in 2018 associated with a letter agreement in connection with the issuance and sale of the Senior Secured Notes discussed above. The amended terms associated with the letter agreement were determined to result in a nonsubstantial modification, which determination included estimates regarding the probability, timing and amount of shares redeemed prior to October 25, 2023, the earliest possible redemption date by the holder. In addition, the letter agreement included a contingent redemption feature, which required bifurcation from the Series E Redeemable Preferred and is classified as a derivative liability.

Currently, the carrying values of the redeemable preferred stocks are being increased by periodic accretions (recorded to retained earnings and included in determining income or loss per share) 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. Approximately \$30 million of accretion (including the amount for earned dividends) was recorded to retained earnings in 2018. At December 31, 2018, the carrying value of these redeemable preferred stocks was \$202.1 million.

For the embedded derivative, changes in fair value are recorded in our statement of operations. As the result of the financing transaction relating to the Senior Secured Notes and the letter agreement, we estimate that the contingent redemption features have fair value at December 31, 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.

At December 31, 2018 and 2017, the fair value of the embedded derivative was \$1.6 million and \$2.7 million, respectively, primarily relating to the participation rights based on the equivalent of 303,646 shares of our common stock at \$5.52 and \$8.76 per share, respectively. No valuation input adjustments were considered necessary relating to nonperformance risk for the embedded derivative based on our current forecast. The valuation is classified as Level 3.

Management’s judgment and estimates in the above areas are based on information available from internal and external resources at that time. Actual results could differ materially from these estimates and judgments, as additional information becomes known.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### General

Our results of operations and operating cash flows are affected by changes in market prices of natural gas, changes in market interest rates and changes in market currency exchange rates.

### Forward Sales Commitments Risk

Periodically, we enter into forward firm sales commitments for products to be delivered in future periods. As a result, we could be exposed to embedded losses should our product costs exceed the firm sales prices. At December 31, 2018, we had no embedded losses associated with sales commitments with firm sales prices.

### Commodity Price Risk

A substantial portion of our products and raw materials are commodities whose prices fluctuate as market supply and demand fundamentals change. We are exposed to commodity price risk as we generally do not use derivative financial instruments to manage risks related to changes in prices of commodities. We periodically enter into contracts

to purchase natural gas for anticipated production needs. Generally, these contracts are considered normal purchases because they provide for the purchase of natural gas that will be delivered in quantities expected to be used over a reasonable period of time in the normal course of business, these contracts are exempt from the accounting and reporting requirements relating to derivatives. At December 31, 2018, we did not have any natural gas derivatives not meeting the definition of a normal purchase and sale.

#### Interest Rate Risk

Generally, we are exposed to variable interest rate risk with respect to our revolving credit facility. As of December 31, 2018, we have \$10.0 million borrowings on this credit facility. We are also exposed to interest rate risk on variable rate borrowings for certain commercial loans in the amount of approximately \$14.7 million. We currently do not hedge our interest rate risk associated with these variable interest loans.

The following table presents principal amounts and related weighted-average interest rates by maturity date for our interest rate sensitive debt agreements as of December 31, 2018:

	Years ending December 31,						Thereafter	Total
	2019	2020	2021	2022	2023			
(Dollars In Thousands)								
Expected maturities of long-term debt (1):								
Variable interest rate debt	\$1,980	\$1,980	\$1,980	\$11,980	\$6,765	\$	—	\$24,685
Weighted-average interest rate	6.44 %	6.41 %	6.37 %	6.46 %	6.75 %	\$	—	6.53 %
Fixed interest rate debt	\$10,572	\$3,564	\$1,259	\$45	\$400,036	\$	—	\$415,476
Weighted-average interest rate	9.52 %	9.59 %	9.62 %	9.62 %	9.62 %	\$	—	9.62 %

(1) The variable and fixed interest rate debt balances and weighted-average interest rate are based on the aggregate amount of debt outstanding as of December 31, 2018.

At December 31, 2018 and 2017, we did not have any financial instruments with fair values significantly different from their carrying amounts (which excludes 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.

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

We have included the financial statements and supplementary financial information required by this item immediately following Part IV of this report and hereby incorporate by reference the relevant portions of those statements and information into this Item 8.

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

## ITEM 9A. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we carried out an evaluation, with the participation of our Principal Executive Officer and Principal Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15 under the Exchange Act). Our disclosure controls and procedures are designed to provide reasonable assurance that the information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. These include controls and procedures designed to ensure that this information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Based upon that evaluation, our Principal Executive Officer and our Principal Financial Officer have concluded that our disclosure controls and procedures were effective. There were no changes to our internal control over financial reporting during the quarter ended December 31, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



### Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining effective internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act). Our internal control system is a process, under the supervision of the Company's Chief Executive Officer and Chief Financial Officer, designed to provide reasonable assurance to our management and Board of Directors regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of our internal control over financial reporting as of December 31, 2018. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control - Integrated Framework (2013 Framework). Based on our assessment, we believe that, as of December 31, 2018, our internal control over financial reporting is effective based on those criteria.

Our independent registered public accounting firm has issued an attestation report on our internal control over financial reporting. This report appears on the following page.

## Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of LSB Industries, Inc.

### Opinion on Internal Control over Financial Reporting

We have audited LSB Industries, Inc.'s internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). In our opinion, LSB Industries, Inc. (the Company) maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the 2018 consolidated financial statements of the Company and our report dated February 26, 2019 expressed an unqualified opinion thereon.

### Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

### Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Ernst & Young LLP

Oklahoma City, Oklahoma

February 26, 2019

48

---

ITEM 9B. OTHER INFORMATION

None.

PART III

Item 10, Item 11, Item 12, Item 13 and Item 14 are incorporated by reference to our definitive proxy statement which we intend to file with the SEC on or before April 30, 2019.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) (1) Financial Statements

The following consolidated financial statements of the Company appear immediately following this Part IV:

	Page
<u>Report of Independent Registered Public Accounting Firm</u>	F-2
<u>Consolidated Balance Sheets at December 31, 2018 and 2017</u>	F-3
<u>Consolidated Statements of Operations for each of the three years in the period ended December 31, 2018</u>	F-5
<u>Consolidated Statements of Stockholders' Equity for each of the three years in the period ended December 31, 2018</u>	F-6
<u>Consolidated Statements of Cash Flows for each of the three years in the period ended December 31, 2018</u>	F-7
<u>Notes to Consolidated Financial Statements</u>	F-9
<u>Quarterly Financial Data (Unaudited)</u>	F-41

(a) (2) Financial Statement Schedule

The Company has included the following schedule in this report:



II - Valuation and Qualifying Accounts F-43

We have omitted all other schedules because the conditions requiring their filing do not exist or because the required information appears in our Consolidated Financial Statements, including the notes to those statements.

(a)(3) Exhibits

Exhibit Number	Exhibit Title	Incorporated by Reference to the Following
3(i).1	<u>Restated Certificate of Incorporation of LSB Industries, Inc., dated January 21, 1977, as amended August 27, 1987</u>	Exhibit 3(i).1 to the Company's Form 10-K filed on February 28, 2013
3(ii).1	<u>Amended and Restated Bylaws of LSB Industries, Inc. dated August 20, 2009, as amended February 18, 2010, January 17, 2014, February 4, 2014 and August 21, 2014</u>	Exhibit 3(ii).1 to the Company's Form 8-K filed August 27, 2014
3(ii).2	<u>Fifth Amendment to the Amended and Restated Bylaws of LSB Industries, Inc., dated as of April 26, 2015</u>	Exhibit 3(ii) to the Company's Form 8-K filed April 30, 2015
3(ii).3	<u>Sixth Amendment to the Amended and Restated Bylaws of LSB Industries, Inc., dated as of December 2, 2015</u>	Exhibit 3(ii) to the Company's Form 8-K filed December 8, 2015
3(ii).4	<u>Seventh Amendment to the Amended and Restated Bylaws of LSB Industries, Inc., dated as of December 22, 2015</u>	Exhibit 3(ii) to the Company's Form 8-K filed December 29, 2015
4.1(P)	Specimen Certificate for the Company's Series B Preferred Stock	Exhibit 4.27 to the Company's Registration Statement on Form S-3 No. 33-9848
4.2	<u>Specimen Certificate for the Company's Series D 6% Cumulative, Convertible Class C Preferred Stock</u>	Exhibit 4.3 to the Company's Form 10-K filed March 3, 2011
4.3	<u>Specimen Certificate for the Company's Common Stock</u>	Exhibit 4.3 to the Company's Registration Statement on Form S-3 ASR filed November 16, 2012
4.4	<u>Certificate of Designations of Series E Cumulative Redeemable Class C Preferred Stock of LSB Industries, Inc., dated as of December 4, 2015</u>	Exhibit 4.1 to the Company's Form 8-K filed December 8, 2015
4.5	<u>Certificate of Designations of Series E-1 Cumulative Redeemable Class C Preferred Stock of LSB Industries, Inc., dated as of October 18, 2018</u>	Exhibit 4.1 to the Company's Form 8-K filed October 19, 2018
4.6	<u>Certificate of Correction to Certificate of Designations of the Series E-1 Cumulative Redeemable Class C Preferred Stock of LSB Industries, Inc.</u>	Exhibit 4.1 to the Company's Form 8-K filed November 2, 2018
4.7	<u>Certificate of Designations of Series F Cumulative Redeemable Class C Preferred Stock of LSB Industries, Inc., dated as of</u>	Exhibit 4.2 to the Company's Form 8-K filed December 8, 2015

December 4, 2015

- |      |  |  |
|------|--|--|
| 4.8  | <u>Certificate of Designations of Series F-1 Redeemable Class C Preferred Stock of LSB Industries, Inc., dated as of October 18, 2018</u>                        | Exhibit 4.2 to the Company's Form 8-K filed October 19, 2018 |
| 4.9  | <u>Renewed Rights Agreement, dated as of December 2, 2008, between the Company and UMB Bank, n.a.</u>  | Exhibit 4.1 to the Company's Form 8-K filed December 5, 2008 |
| 4.10 | <u>Amendment to Renewed Rights Agreement, dated December 3, 2008, between LSB Industries, Inc. and UMB Bank, n.a.</u>  | Exhibit 4.3 to the Company's Form 8-K filed December 5, 2008 |
| 4.11 | <u>Amendment to Renewed Rights Agreement, dated as of December 4, 2015, by and between LSB Industries, Inc. and UMB Bank, n.a., dated as of December 4, 2015</u> | Exhibit 4.3 to the Company's Form 8-K filed December 8, 2015 |
| 4.12 | <u>Indenture, dated August 7, 2013, among LSB Industries, Inc., the guarantors named therein and UMB Bank, n.a., as trustee</u>                                  | Exhibit 4.1 to the Company's Form 8-K filed August 14, 2013  |

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

Exhibit Number	Exhibit Title	Incorporated by Reference to the Following
4.13	<u>First Supplemental Indenture, dated as of September 7, 2016, by and among LSB Industries, Inc., the guarantors party thereto and UMB Bank, n.a., as trustee and notes collateral agent</u>	Exhibit 4.1 to the Company's Form 8-K filed October 4, 2016.
4.14	<u>Intercreditor Agreement, dated August 7, 2013, by and among Wells Fargo Capital Finance, Inc., as agent and UMB Bank, n.a., as collateral agent, and acknowledged and agreed to by LSB Industries, Inc. and the other grantors named therein</u>	Exhibit 99.1 to the Company's Form 8-K filed August 14, 2013
4.15	<u>Indenture, dated as of April 25, 2018, among LSB Industries, Inc., the subsidiary guarantors party thereto and Wilmington Trust, National Association, as trustee and collateral agent.</u>	Exhibit 4.1 to the Company's Form 8-K filed April 25, 2018
4.16	<u>Form of 9.625% Senior Secured Notes due 2023 (included in Exhibit 4.1).</u>	Exhibit 4.2 to the Company's Form 8-K filed April 25, 2018
10.1*	<u>Form of Death Benefit Plan Agreement, dated April 1, 1981</u>	Exhibit 10.2 to the Company's Form 10-K filed March 31, 2006
10.2*	<u>LSB Industries, Inc. Outside Directors Stock Purchase Plan, dated May 24, 1999</u>	Exhibit 99.2 to the Company's Form 8-K filed October 23, 2014
10.3*	<u>LSB Industries, Inc. 2008 Incentive Stock Plan, effective June 5, 2008, as amended by First Amendment, effective June 5, 2014</u>	Exhibit 99.3 to the Company's Form 8-K filed June 11, 2014
10.4*	<u>Form of Restricted Stock Agreement</u>	Exhibit 10.3 to the Company's Form 8-K filed January 8, 2016
10.5*	<u>Form of Incentive Stock Option Agreement for 2008 Plan</u>	Exhibit 10.8 to the Company's Form 10-K filed February 29, 2016
10.6*	<u>LSB Industries, Inc. 2016 Long Term Incentive Plan</u>	Exhibit 4.8 to the Company's Form S-8 filed June 28, 2016
10.7*	<u>Form of LSB Industries, Inc. 2016 Long Term Incentive Plan Stock Option Agreement</u>	Exhibit 4.9 to the Company's Form S-8 filed June 28, 2016

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

10.8*	<u>Form of LSB Industries, Inc. 2016 Long Term Incentive Plan Restricted Stock Unit Agreement (Director Award)</u>	Exhibit 4.10 to the Company's Form S-8 filed June 28, 2016
10.9*	<u>Form of LSB Industries, Inc. 2016 Long Term Incentive Plan Restricted Stock Agreement</u>	Exhibit 4.11 to the Company's Form S-8 filed June 28, 2016
10.10*	<u>Form of Time-Based Restricted Stock Agreement of LSB Industries, Inc.</u>	Exhibit 10.4 to the Company's Form 8-K filed January 3, 2019
10.11*	<u>Form of Performance-Based Restricted Stock Agreement of LSB Industries, Inc.</u>	Exhibit 10.5 to the Company's Form 8-K filed January 3, 2019
10.12*(a)	<u>Notice Period Extension Regarding Employment Agreement by and between LSB Industries, Inc. and Mark Behrman</u>	
10.13*	<u>Notice Period Extension Regarding Employment Agreement by and between LSB Industries, Inc. and Mark Behrman</u>	Exhibit 10.4 to the Company's Form 10-Q filed October 24, 2018
10.14*	<u>Employment Agreement, dated December 30, 2018, between LSB Industries, Inc. and Mark T. Behrman</u>	Exhibit 10.1 to the Company's Form 8-K filed January 3, 2019
10.15*	<u>Restricted Stock Agreement by and between LSB Industries, Inc. and Mark Behrman, dated as of December 31, 2015</u>	Exhibit 10.17 to the Company's Form 10-K filed February 29, 2016
10.16*	<u>Employment Agreement by and between LSB Industries, Inc. and Daniel D. Greenwell, dated as of December 31, 2015</u>	Exhibit 10.1 to the Company's Form 8-K/A filed January 7, 2016

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

Exhibit Number	Exhibit Title	Incorporated by Reference to the Following
10.17*	<u>Notice Period Extension Regarding Employment Agreement by and between LSB Industries, Inc. and Daniel D. Greenwell</u>	Exhibit 10.3 to the Company's Form 10-Q filed October 24, 2018
10.18*(a)	<u>Notice Period Extension Regarding Employment Agreement by and between LSB Industries, Inc. and Daniel D. Greenwell</u>	
10.19*(a)	<u>General Release Agreement by and between LSB Industries, Inc. and Daniel D. Greenwell, dated as of January 14, 2019</u>	
10.20*	<u>Restricted Stock Agreement by and between LSB Industries, Inc. and Daniel D. Greenwell, dated as of December 31, 2015</u>	Exhibit 10.2 to the Company's Form 8-K/A filed January 7, 2016
10.21*	<u>Employment Agreement by and between LSB Industries, Inc. and Michael Foster, dated as of January 5, 2016</u>	Exhibit 10.25 to the Company's Form 10-K filed February 29, 2016
10.22*	<u>Notice Period Extension Regarding Employment Agreement by and between LSB Industries, Inc. and Michael J. Foster</u>	Exhibit 10.5 to the Company's Form 10-Q filed October 24, 2018
10.23*(a)	<u>Notice Period Extension Regarding Employment Agreement by and between LSB Industries, Inc. and Michael J. Foster</u>	
10.24*	<u>Employment Agreement, dated December 30, 2018, between LSB Industries, Inc. and Michael J. Foster</u>	Exhibit 10.3 to the Company's Form 8-K filed January 3, 2019
10.25*	<u>Restricted Stock Agreement by and between LSB Industries, Inc. and Michael Foster, dated as of January 5, 2016</u>	Exhibit 10.26 to the Company's Form 10-K filed February 29, 2016
10.26*	<u>Separation and Release Agreement by and between LSB Industries, Inc. and Tony M. Shelby, dated as of February 22, 2016</u>	Exhibit 10.1 to the Company's Form 8-K filed February 25, 2016
10.27*	<u>Employment Agreement by and between LSB Industries, Inc. and John Diesch, executed as of July 21, 2016</u>	Exhibit 10.1 to the Company's Form 8-K filed August 2, 2016
10.28*	<u>Employment Agreement by and between LSB Industries, Inc. and John Diesch, executed as of July 21, 2016</u>	Exhibit 10.1 to the Company's Form 8-K filed February 11, 2019

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

10.29*	<u>Employment Agreement, dated December 30, 2018, between LSB Industries, Inc. and Cheryl Maguire</u>	Exhibit 10.2 to the Company's Form 8-K filed January 3, 2019
10.30*	<u>Form of Retention Bonus Agreement</u>	Exhibit 10.28 to the Company's Form 10-K filed February 29, 2016
10.31	<u>Indemnification Agreement, dated October 14, 2015, by and between the Company and Jack E. Golsen, together with a schedule identifying other substantially identical agreements between the Company and each of the other directors identified on the schedule</u>	Exhibit 10.1 to the Company's Form 8-K filed October 19, 2015
10.32	<u>Indemnification Agreement, dated October 14, 2015 by and between the Company and David M. Shear, together with a schedule identifying other substantially identical agreements between the Company and each of its executive officers identified on the schedule</u>	Exhibit 10.2 to the Company's Form 8-K filed October 19, 2015
10.33	<u>Indemnification Agreement, dated as of December 4, 2015, by and between LSB Industries, Inc. and Jonathan S. Bobb, together with a schedule identifying other substantially identical agreements between the Company and each of the other directors identified on the schedule</u>	Exhibit 10.5 to the Company's Form 8-K filed December 8, 2015

Exhibit	Incorporated by Reference
Number	Exhibit Title
10.34	<u>Nitric Acid Supply, Operating and Maintenance Agreement, dated October 23, 2008, by and among El Dorado Nitrogen, L.P., El Dorado Chemical Company and Bayer MaterialScience LLC</u>
	Exhibit 10.1 to the Company's Form 10-Q filed November 6, 2008
	CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A COMMISSION ORDER CF #30125, DATED OCTOBER 4, 2013, GRANTING REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT.
10.35	<u>Second Amendment to the Nitric Acid Supply, Operating and Maintenance Agreement, dated June 16, 2010, by and among El Dorado Nitrogen, L.P., El Dorado Chemical Company and Bayer MaterialScience LLC</u>
	Exhibit 10.2 to the Company's Form 10-Q filed August 6, 2010
	CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A COMMISSION ORDER CF #30124, DATED OCTOBER 4, 2013, GRANTING REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT.
10.36	<u>Third Amendment to the Nitric Acid Supply, Operating and Maintenance Agreement, dated June 25, 2013, by and among El Dorado Nitrogen, L.P., El Dorado Chemical Company and Bayer MaterialScience LLC</u>
	Exhibit 10.3 to the Company's Form 10-Q filed August 9, 2013
	CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS SUBJECT OF A COMMISSION ORDER CF #30123, DATED OCTOBER 4, 2013, GRANTING REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT.



Edgar Filing: LSB INDUSTRIES INC - Form 10-K

- 10.37 Asset Purchase Agreement, dated as of December 6, 2002, by and among Energetic Systems Inc. LLC, UTeC Corporation, LLC, SEC Investment Corp. LLC, DetaCorp Inc. LLC, Energetic Properties, LLC, Slurry Explosive Corporation, Universal Tech Corporation, El Dorado Chemical Company, LSB Chemical Corp., LSB Industries, Inc. and Slurry Explosive Manufacturing Corporation, LLC Exhibit 2.1 to the Company's Form 8-K dated December 27, 2002
- 10.38 Exhibits and Disclosure Letters to the Asset Purchase Agreement, dated as of December 6, 2002, by and among Energetic Systems Inc. LLC, UTeC Corporation, LLC, SEC Investment Corp. LLC, DetaCorp Inc. LLC, Energetic Properties, LLC, Slurry Explosive Corporation, Universal Tech Corporation, El Dorado Chemical Company, LSB Chemical Corp., LSB Industries, Inc. and Slurry Explosive Manufacturing Corporation, LLC Exhibit 10.1b to the Company's Form 10-Q filed August 6, 2010

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

Exhibit	Incorporated by Reference
Number Exhibit Title	to the Following
10.39 <u>Ammonia Purchase and Sale Agreement by and between El Dorado Chemical Company and Koch Fertilizer, LLC, dated as of November 2, 2015</u>	Exhibit 10.49 to the Company's Form 10-K filed February 29, 2016  CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A COMMISSION ORDER CF #33502, DATED APRIL 4, 2016, GRANTING REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT.
10.40 <u>Urea Ammonium Nitrate Purchase and Sale Agreement dated as of March 3, 2016 and effective as of June 1, 2016 between Coffeyville Resources Nitrogen Fertilizers, LLC and Pryor Chemical Company</u>	Exhibit 10.1 to the Company's Form 10-Q filed August 8, 2016  CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A COMMISSION ORDER CF #33783. DATED AUGUST 30, 2016, GRANTING REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT.
10.41 <u>Stock Purchase Agreement by and among Consolidated Industries L.L.C. The Climate Control Group, Inc., NIBE Energy Systems Inc. and, solely for purposes of Sections 6.8, 6.19 and 11.15 therein, LSB Industries, Inc., and solely for purposes of Section 11.16 therein, NIBE Industrier AB (publ), dated as of May 11, 2016.</u>	Exhibit 10.1 to the Company's Form 8-K filed May 13, 2016
10.42 <u>Contract on the supply of Basic Engineering Package, Detail Engineering Package, Tagged Major Equipment and related Advisory Services, between Weatherly Inc. and El Dorado Chemical Company, dated November 30, 2012</u>	Exhibit 99.2 to the Company's Form 8-K filed December 6, 2012
10.43 <u>Engineering, Procurement and Construction Agreement, dated August 12, 2013, between El Dorado Ammonia L.L.C. and SAIC Constructors,</u>	Exhibit 10.1 to the Company's Form 8-K filed August 15, 2013

LLC

- |       |  |  |
|-------|--|--|
| 10.44 | <u>Construction Agreement-DMW2, dated November 6, 2013, between El Dorado Chemical Company and SAIC Constructors, LLC</u>  | Exhibit 99.1 to the Company's Form 8-K filed November 12, 2013 |
| 10.45 | <u>Construction Agreement – NACSAC, dated November 6, 2013, between El Dorado Chemical Company and SAIC Constructors, LLC</u>                                      | Exhibit 99.2 to the Company's Form 8-K filed November 12, 2013 |
| 10.46 | <u>Engineering, Procurement and Construction Agreement, dated December 31, 2013, between El Dorado Chemical Company and SAIC Constructors, LLC</u>                 | Exhibit 99.1 to the Company's Form 8-K filed January 7, 2014   |
| 10.47 | <u>Engineering, Procurement and Construction Contract, Amendment No. 1 dated October 20, 2015, by and between El Dorado Ammonia LLC and SAIC Constructors, LLC</u> | Exhibit 10.1 to the Company's Form 8-K filed October 26, 2015  |

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

Exhibit		Incorporated by Reference
Number	Exhibit Title	to the Following
10.48	<u>Settlement Agreement, dated April 26, 2015, by and among the Company and Starboard Value LP and its certain affiliates and associates</u>	Exhibit 99.1 to the Company's Form 8-K filed April 30, 2015
10.49	<u>Consent Decree, dated May 28, 2014, by and among, LSB Industries, Inc., El Dorado Chemical Co., Cherokee Nitrogen Co., Pryor Chemical Co., El Dorado Nitrogen, L.P., the U.S. Department of Justice, the U.S. Environmental Protection Agency, the Alabama Department of Environmental Management, and the Oklahoma Department of Environment Quality</u>	Exhibit 99.1 to the Company's Form 8-K filed June 3, 2014
10.50	<u>Second Amended and Restated Loan and Security Agreement, dated December 31, 2013, by and among LSB Industries, Inc., each of its subsidiaries that are signatories thereto, the lenders signatories thereto, and Wells Fargo Capital Finance, LLC</u>	Exhibit 4.9 to the Company's Form 10-K filed February 27, 2014
10.51	<u>Amendment No. 1 to the Second Amended and Restated Loan and Security Agreement, dated as of June 11, 2015, by and among LSB Industries, Inc. its subsidiaries identified on the signature pages thereof, the lenders identified on the signature pages thereof and Wells Fargo Capital Finance, LLC, as the arranger and administrative agent for the Lenders</u>	Exhibit 99.1 to the Company's Form 8-K filed June 17, 2015
10.52	<u>Amendment No. 2 to the Second Amended and Restated Loan and Security Agreement, dated as of November 9, 2015, by and among LSB Industries, Inc., its subsidiaries identified on the signature pages thereof, the lenders identified on the signature pages thereof, and Wells Fargo Capital Finance, LLC, as the arranger and administrative agent for the Lenders</u>	Exhibit 10.3 to the Company's Form 8-K filed November 16, 2015
10.53	<u>Third Amended and Restated Loan and Security Agreement, dated as of January 17, 2017, by and among LSB Industries, Inc., the subsidiaries of LSB Industries, Inc. party thereto, the lenders party thereto, and Wells Fargo Capital Finance, LLC, as the arranger and administrative agent.</u>	Exhibit 10.1 to the Company's Form 8-K filed January 20, 2017
10.54	<u>First Amendment to Third Amended and Restated Loan and Security Agreement, dated as of April 16, 2018, by and among Wells Fargo Capital Finance, LLC, as the arranger and administrative agent, the lenders party thereto, LSB Industries, Inc. and its subsidiaries identified on the signature pages thereto as borrowers and the Company's subsidiaries identified on the signature pages thereto as guarantors.</u>	Exhibit 10.1 to the Company's Form 8-K filed April 20, 2018
10.55	<u>Security Agreement dated as of August 7, 2013, among LSB Industries, Inc. and the other grantors identified therein in favor of UMB Bank, N.A. as Collateral Agent</u>	Exhibit 10.72 to the Company's Form 10-K filed February 29, 2016
10.56	<u>Supplement No. 1 to Security Agreement February 12, 2014 among LSB Industries, Inc. and the other grantors identified therein in favor of UMB Bank, N.A., as</u>	Exhibit 10.73 to the Company's Form 10-K

Collateral Agent

filed February 29, 2016

- 10.57 Note Purchase Agreement, dated November 9, 2015, by and among LSB Industries, Inc., the guarantors party thereto and LSB Funding LLC Exhibit 10.1 to the Company's Form 8-K filed November 16, 2015
- 10.58 Promissory Note, dated November 9, 2015, by LSB Industries, Inc. Exhibit 10.2 to the Company's Form 8-K filed November 16, 2015

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

Exhibit	Number Exhibit Title	Incorporated by Reference
		to the Following
	10.59 <u>Joinder Agreement to Intercreditor Agreement, dated November 9, 2015, by and among LSB Funding LLC, Wells Fargo Capital Finance, Inc., as ABL Agent, UMB Bank, N.A., as Notes Agent, LSB Industries, Inc. and the guarantors party thereto</u>	Exhibit 10.4 to the Company's Form 8-K filed November 16, 2015
	10.60 <u>Amendment No. 1 to Intercreditor Agreement, dated as of April 25, 2018, among Wells Fargo Capital Finance, LLC, UMB Bank, n.a. and Wilmington Trust, National Association, and acknowledged by LSB Industries, Inc. and the subsidiary guarantors party thereto.</u>	Exhibit 10.1 to the Company's Form 8-K filed April 25, 2018
	10.61 <u>Joinder Agreement to Security Agreement, dated November 9, 2015, by and among LSB Funding LLC, UMB Bank, N.A., as Collateral Agent, LSB Industries, Inc. and the guarantors party thereto</u>	Exhibit 10.5 to the Company's Form 8-K filed November 16, 2015
	10.62 <u>Securities Purchase Agreement by and among LSB Industries, Inc., LSB Funding LLC, and Security Benefit Corporation, dated as of December 4, 2015</u>	Exhibit 10.1 to the Company's Form 8-K filed December 8, 2015
	10.63 <u>Warrant to Purchase Common Stock issued by LSB Industries, Inc. to LSB Funding LLC, dated as of December 4, 2015</u>	Exhibit 10.2 to the Company's Form 8-K filed December 8, 2015
	10.64 <u>Board Representation and Standstill Agreement by and among LSB Industries, Inc., LSB Funding LLC, Security Benefit Corporation, Todd Boehly and the Golsen Holders (as defined therein), dated as of December 4, 2015</u>	Exhibit 10.3 to the Company's Form 8-K filed December 8, 2015
	10.65 <u>Registration Rights Agreement by and between LSB Industries, Inc. and LSB Funding LLC, dated as of December 4, 2015</u>	Exhibit 10.4 to the Company's Form 8-K filed December 8, 2015
	10.66 <u>Letter Agreement, dated as of August 12, 2016, by and among LSB Industries, Inc., LSB Funding LLC and Security Benefit Corporation</u>	Exhibit 10.1 to the Company's Form 8-K filed August 12, 2016
	10.67 <u>Securities Exchange Agreement, dated as of October 18, 2018, by and between LSB Industries, Inc. and LSB Funding LLC</u>	Exhibit 10.1 to the Company's Form 8-K filed October 19, 2018
	10.68 <u>Purchase and Sale Agreement dated May 11, 2017 between Zena Energy L.L.C and BKV Chelsea, LLC</u>	Exhibit 10.1 to the Company's Form 8-K filed May 11, 2017.

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

- 10.69\* Transition Agreement dated June 30, 2017 by and between Jack E. Golsen and LSB Industries, Inc. Exhibit 10.1 to the Company's Form 8-K filed on June 30, 2017
- 10.70 Amendment, dated October 26, 2017, to the Board Representation and Standstill Agreement by and between LSB Industries, Inc., LSB Funding LLC, Security Benefit Corporation, Todd Boehly, Jack E. Golsen, Barry H. Golsen, Linda Golsen Rappaport, Golsen Family LLC, SBL LLC and Golsen Petroleum Corp., dated as of December 4, 2015 Exhibit 10.1. to the Company's Form 8-K Filed on October 26, 2017
- 10.71 Amendment to Board Representation and Standstill Agreement, dated as of October 18, 2018, by and among LSB Industries, Inc., LSB Funding LLC, Security Benefit Corporation, Todd Boehly and the Golsen Holders (as defined therein) Exhibit 10.2 to the Company's Form 8-K filed October 19, 2018
- 21.1(a) Subsidiaries of the Company
- 23.1(a) Consent of Independent Registered Public Accounting Firm
- 31.1(a) Certification of Mark T. Behrman, Chief Executive Officer, pursuant to Sarbanes-Oxley Act of 2002, Section 302

Exhibit		Incorporated by
Number	Exhibit Title	Reference
		to the Following
31.2(a)	<u>Certification of Cheryl A. Maguire, Chief Financial Officer, pursuant to Sarbanes-Oxley Act of 2002, Section 302</u>	
32.1(b)	<u>Certification of Mark T. Behrman, Chief Executive Officer, furnished pursuant to Sarbanes-Oxley Act of 2002, Section 906</u>	
32.2(b)	<u>Certification of Cheryl A. Maguire, Chief Financial Officer, furnished pursuant to Sarbanes-Oxley Act of 2002, Section 906</u>	
101.INS(a)	XBRL Instance Document	
101.SCH(a)	XBRL Taxonomy Extension Schema Document	
101.CAL(a)	XBRL Taxonomy Extension Calculation Linkbase Document	
101.DEF(a)	XBRL Taxonomy Extension Definition Linkbase Document	
101.LAB(a)	XBRL Taxonomy Extension Labels Linkbase Document	
101.PRE(a)	XBRL Taxonomy Extension Presentation Linkbase Document	

\*Executive Compensation Plan or Arrangement

(a) Filed herewith

(b) Furnished herewith

(P) Paper copy filed

57

---



LSB Industries, Inc.

Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: February 26, 2019 By: /s/ Mark T. Behrman  
Mark T. Behrman, President, Chief Executive Officer and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Dated: February 26, 2019 By: /s/ Mark T. Behrman  
Mark T. Behrman, President and Chief Executive Officer  
(Principal Executive Officer) and Director

Dated: February 26, 2019 By: /s/ Cheryl A. Maguire  
Cheryl A. Maguire, Senior Vice President and Chief Financial Officer (Principal Financial Officer)

Dated: February 26, 2019 By: /s/ Harold L. Rieker Jr.  
Harold L. Rieker Jr., Vice President and Corporate Controller (Principal Accounting Officer)

Dated: February 26, 2019 By: /s/ Richard W. Roedel  
Richard W. Roedel, Chairman of the Board of Directors

Dated: February 26, 2019 By: /s/ Jonathan S. Bobb  
Jonathan S. Bobb, Director

Dated: February 26, 2019 By: /s/ Jack E. Golsen  
Jack E. Golsen, Chairman Emeritus

Dated: February 26, 2019 By: /s/ Barry H. Golsen  
Barry H. Golsen, Director

Dated: By: /s/ Kanna Kitamura  
Kanna Kitamura, Director

February 26,  
2019

Dated: By: /s/ Richard S. Sanders Jr.  
February 26,  
2019 Richard S. Sanders Jr., Director

Dated: By: /s/ Lynn F. White  
February 26,  
2019 Lynn F. White, Director

LSB Industries, Inc.

Consolidated Financial Statements

And Schedule for Inclusion in Form 10-K

For the Fiscal Year ended December 31, 2018

Table of Contents

	Page
Financial Statements	
<u>Report of Independent Registered Public Accounting Firm</u>	F-2
<u>Consolidated Balance Sheets</u>	F-3
<u>Consolidated Statements of Operations</u>	F-5
<u>Consolidated Statements of Stockholders' Equity</u>	F-6
<u>Consolidated Statements of Cash Flows</u>	F-7
<u>Notes to Consolidated Financial Statements</u>	F-9
<u>Quarterly Financial Data (Unaudited)</u>	F-41
Financial Statement Schedule	
<u>Schedule II – Valuation and Qualifying Accounts</u>	F-43

F-1

---

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of LSB Industries, Inc.

### Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of LSB Industries, Inc. (the Company) as of December 31, 2018 and 2017, the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2018, and the related notes and the financial statement schedule listed in the index at Item 15(a) (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated February 26, 2019 expressed an unqualified opinion thereon.

### Adoption of ASU No. 2014-09 (Topic 606)

As discussed in Note 1 and Note 2 to the consolidated financial statements, the Company changed its method of accounting for revenue recognition on contracts with customers in the 2018 financial statements to reflect the accounting method change due to the adoption of ASU 2014-09 Revenue from Contracts with Customers (Topic 606).

### Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the US federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Ernst & Young LLP

We have served as the Company's auditor since 1968.

Oklahoma City, Oklahoma

February 26, 2019

F-2

---

LSB Industries, Inc.

## Consolidated Balance Sheets

	December 31,	
	2018	2017
	(In Thousands)	
<b>Assets</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$26,048	\$33,619
Accounts receivable	67,043	59,873
Allowance for doubtful accounts	(351 )	(303 )
Accounts receivable, net	66,692	59,570
<b>Inventories:</b>		
Finished goods	27,726	20,415
Raw materials	1,483	1,441
Total inventories	29,209	21,856
<b>Supplies, prepaid items and other:</b>		
Prepaid insurance	10,924	10,535
Supplies	24,576	27,729
Prepaid and refundable income taxes	661	1,736
Other	8,303	8,695
Total supplies, prepaid items and other	44,464	48,695
Total current assets	166,413	163,740
Property, plant and equipment, net	974,248	1,014,038
Intangible and other assets, net	7,672	11,404
	\$1,148,333	\$1,189,182

(Continued on following page)

F-3

LSB Industries, Inc.

Consolidated Balance Sheets (continued)

	December 31,	
	2018	2017
	(In Thousands)	
<b>Liabilities and Stockholders' Equity</b>		
<b>Current liabilities:</b>		
Accounts payable	\$62,589	\$55,992
Short-term financing	8,577	8,585
Accrued and other liabilities	42,129	35,573
Current portion of long-term debt	12,518	9,146
<b>Total current liabilities</b>	<b>125,813</b>	<b>109,296</b>
Long-term debt, net	412,681	400,253
Noncurrent accrued and other liabilities	8,861	11,691
Deferred income taxes	56,612	54,787
<b>Commitments and contingencies (Note 9)</b>		
<b>Redeemable preferred stocks:</b>		
Series E 14% cumulative, redeemable Class C preferred stock, no par value, 210,000 shares issued; 139,768 outstanding; aggregate liquidation preference of \$212,071,000 (\$185,231,000 at December 31, 2017)		
	202,169	174,959
Series F redeemable Class C preferred stock, no par value, 1 share issued and outstanding; aggregate liquidation preference of \$100		
	—	—
<b>Stockholders' equity:</b>		
Series B 12% cumulative, convertible preferred stock, \$100 par value; 20,000 shares issued and outstanding; aggregate liquidation preference of \$2,785,000 (\$2,545,000 at December 31, 2017)		
	2,000	2,000
Series D 6% cumulative, convertible Class C preferred stock, no par value; 1,000,000 shares issued and outstanding; aggregate liquidation preference of \$1,192,000 (\$1,132,000 at December 31, 2017)		
	1,000	1,000
Common stock, \$.10 par value; 75,000,000 shares authorized, 31,283,210 shares issued (31,280,685 shares at December 31, 2017)		
	3,128	3,128

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

Capital in excess of par value	198,482	193,956
Retained earnings	153,773	256,214
	358,383	456,298
Less treasury stock, at cost:		
Common stock, 2,438,305 shares (2,662,027 shares at December 31, 2017)	16,186	18,102
Total stockholders' equity	342,197	438,196
	\$1,148,333	\$1,189,182

See accompanying notes.

F-4

---



LSB Industries, Inc.

## Consolidated Statements of Operations

	Year Ended December 31,		
	2018	2017	2016
	(In Thousands, Except Per Share Amounts)		
Net sales	\$378,160	\$427,504	\$374,585
Cost of sales	362,325	422,038	423,891
Gross profit (loss)	15,835	5,466	(49,306 )
Selling, general and administrative expense	40,811	34,990	40,168
Impairment of goodwill	—	—	1,621
Other expense (income), net	(1,951 )	4,567	(872 )
Operating loss	(23,025 )	(34,091 )	(90,223 )
Interest expense, net	43,064	37,267	30,945
Loss on extinguishment of debt	5,951	—	8,703
Non-operating other expense (income), net	(1,554 )	(306 )	218
Loss from continuing operations before			
provision (benefit) for income taxes	(70,486 )	(71,052 )	(130,089)
Provision (benefit) for income taxes	1,740	(40,759 )	(41,956 )
Loss from continuing operations	(72,226 )	(30,293 )	(88,133 )
Income from discontinued operations, net of taxes	—	1,076	200,301
Net income (loss)	(72,226 )	(29,217 )	112,168
Dividends on convertible preferred stocks	300	300	300
Dividends on Series E redeemable preferred stock	26,840	23,443	27,761
Accretion of Series E redeemable preferred stock	3,375	6,487	18,256
Net income attributable to participating securities	—	—	1,091
Net income (loss) attributable to common stockholders	\$(102,741)	\$(59,447 )	\$64,760
Basic and dilutive income (loss) per common share:			
Loss from continuing operations	\$(3.74 )	\$(2.22 )	\$(5.28 )
Income from discontinued operations, net of taxes	—	0.04	7.82
Net income (loss)	\$(3.74 )	\$(2.18 )	\$2.54

See accompanying notes.



LSB Industries, Inc.

## Consolidated Statements of Stockholders' Equity

	Common Stock Shares (In Thousands)	Treasury Stock-Common Shares	Non-Redeemable Preferred Stock	Common Stock Par Value	Capital in Excess of Par Value	Retained Earnings	Treasury Stock-Common	Total
Balance at December 31, 2015	27,132	(3,736 )	3,000	2,713	192,249	248,150	(24,532 )	421,580
Net income						112,168		112,168
Dividend accrued on redeemable preferred stock						(27,761 )		(27,761 )
Accretion of redeemable preferred stock						(18,256 )		(18,256 )
Stock-based compensation					4,979			4,979
Exercise of stock options	45			4	367			371
Exercise of warrants, net	4,104	(34 )		411			(411 )	—
Issuance of restricted stock, net		765			(5,339 )		4,855	(484 )
Excess income tax detriment associated with stock-based compensation					(84 )			(84 )
Balance at December 31, 2016	31,281	(3,005 )	3,000	3,128	192,172	314,301	(20,088 )	492,513
Cumulative effect of change in accounting principle						1,060		1,060
Net loss						(29,217 )		(29,217 )
Dividend accrued on redeemable preferred stock						(23,443 )		(23,443 )
Accretion of redeemable preferred stock						(6,487 )		(6,487 )
Stock-based compensation					5,099			5,099
Issuance of restricted stock, net		317			(3,175 )		1,814	(1,361 )

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

Other	26	(140 )			172	32		
Balance at December 31, 2017	31,281	(2,662 )	3,000	3,128	193,956	256,214	(18,102 )	438,196
Net loss						(72,226 )		(72,226 )
Dividend accrued on redeemable preferred stock						(26,840 )		(26,840 )
Accretion of redeemable preferred stock						(3,375 )		(3,375 )
Stock-based compensation				8,358				8,358
Issuance of restricted stock, net	224				(3,852 )	1,916		(1,936 )
Other	2			20				20
Balance at December 31, 2018	31,283	(2,438 )	3,000	3,128	198,482	153,773	(16,186 )	342,197

See accompanying notes.

F-6

---

LSB Industries, Inc.

## Consolidated Statements of Cash Flows

	Year Ended December 31,		
	2018	2017	2016
	(In Thousands)		
<b>Cash flows from continuing operating activities</b>			
Net income (loss)	\$(72,226)	\$(29,217)	\$112,168
Adjustments to reconcile net income (loss) to net cash provided (used)			
by continuing operating activities:			
Income from discontinued operations, net of taxes	—	(1,076 )	(200,301)
Deferred income taxes	1,825	(40,445)	(42,013 )
Loss on extinguishment of debt	5,951	—	8,703
Depreciation, depletion and amortization of property, plant and equipment	70,266	66,996	59,354
Amortization of intangible and other assets	2,361	2,147	1,940
Loss (gain) on sales of businesses and other property and equipment	(1,637 )	6,977	356
Stock-based compensation	8,358	5,213	3,992
Impairment of goodwill	—	—	1,621
Other	2,098	434	4,471
Cash provided (used) by changes in assets and liabilities			
(net of effects of discontinued operations):			
Accounts receivable	(2,167 )	(6,321 )	(6 )
Inventories	(6,698 )	56	1,372
Prepaid insurance	(389 )	635	(2,296 )
Prepaid and accrued income taxes	1,074	(543 )	5,619
Other supplies, prepaid items and other	(121 )	(2,231 )	167
Accounts payable	14,208	1,374	16,632
Accrued interest	(6,919 )	(1 )	(2,305 )
Other current and noncurrent liabilities	1,638	(1,722 )	8,488
Net cash provided (used) by continuing operating activities	17,622	2,276	(22,038 )
<b>Cash flows from continuing investing activities</b>			
Expenditures for property, plant and equipment	(37,050)	(35,425)	(212,543)
Proceeds from sales of businesses and other property and equipment	6,660	23,841	5,259
Net proceeds from sale of discontinued operations	2,730	—	356,704
Proceeds from property insurance recovery associated with property, plant and equipment	1,531	—	—
Other investing activities	389	739	3,877
Net cash provided (used) by continuing investing activities	(25,740)	(10,845)	153,297

(Continued on following page)

F-7

---

LSB Industries, Inc.

## Consolidated Statements of Cash Flows (continued)

	Year Ended December 31,		
	2018	2017	2016
	(In Thousands)		
<b>Cash flows from continuing financing activities</b>			
Proceeds from revolving debt facility	\$10,000	\$—	\$76,516
Payments on revolving debt facility	—	—	(76,516 )
Proceeds from 9.625% senior secured notes, net of discount and fees	390,473	—	—
Payments on senior secured notes	(375,000)	—	(100,000)
Proceeds from other long-term debt, net of fees	—	—	14,751
Payments on other long-term debt	(9,170 )	(14,121)	(15,402 )
Payments of debt-related costs, including extinguishment and modification costs	(10,974 )	(90 )	(12,270 )
Proceeds from short-term financing	10,865	10,919	11,161
Payments on short-term financing	(10,872 )	(11,479)	(11,392 )
Payments of preferred stock modification costs	(2,777 )	—	(785 )
Redemption of preferred stock	—	—	(71,966 )
Proceeds from exercises of stock options	20	—	371
Taxes paid on equity awards	(2,018 )	(1,361 )	(149 )
Dividends paid on preferred stock	—	—	(8,028 )
Net cash provided (used) by continuing financing activities	547	(16,132)	(193,709)
<b>Cash flows of discontinued operations:</b>			
Net cash used by operating activities	—	(1,461 )	(1,363 )
Net cash used by investing activities	—	—	(1,025 )
Net cash used by financing activities	—	(236 )	(2,340 )
Net cash used by discontinued operations	—	(1,697 )	(4,728 )
Net decrease in cash and cash equivalents	(7,571 )	(26,398)	(67,178 )
Cash and cash equivalents at beginning of year	33,619	60,017	127,195
Cash and cash equivalents at end of year	\$26,048	\$33,619	\$60,017

See accompanying notes.

LSB Industries, Inc.

Notes to Consolidated Financial Statements

## 1. Summary of Significant Accounting Policies

**Basis of Consolidation** – LSB Industries, Inc. (“LSB”) and its subsidiaries (the “Company”, “We”, “Us”, or “Our”) are consolidated in the accompanying 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 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 AN (“HDAN”) and UAN 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 2017.

During 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 as discussed in Note 17 – Discontinued Operations.

**Use of Estimates** – The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles (“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.

**Cash and Cash Equivalents** – Investments, which consist of highly liquid investments with original maturities of three months or less, are considered cash equivalents.

**Accounts Receivable** – Our accounts receivable are stated at net realizable value. This value includes an appropriate allowance for estimated uncollectible accounts to reflect any loss anticipated on accounts receivable balances. Our estimate is based on historical experience and periodic assessment of outstanding accounts receivable, particularly those accounts that are past due (based upon the terms of the sale). Our periodic assessment of our accounts receivable is based on our best estimate of amounts that are not recoverable.



Sales to our customers are generally unsecured. Credit is extended to customers based on an evaluation of the customer's financial condition and other factors. Concentrations of credit risk with respect to trade receivables are monitored and this risk is reduced due to short-term payment terms relating to most of our significant customers. Six customers (including their affiliates) account for approximately 39% of our total net receivables (excluding the receivable amount related to the Wilson Settlement Agreement discussed in Note 9) at December 31, 2018.

Inventories – Inventories are stated at the lower of cost (determined using the first-in, first-out (“FIFO”) basis) or net realizable value, which is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, transportation or disposal. Finished goods include material, labor, and manufacturing overhead costs.

Because cost exceeded the net realizable value, inventory reserves were \$278,000 and \$933,000 at December 31, 2018 and 2017, respectively.

F-9

---

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

### 1. Summary of Significant Accounting Policies (continued)

Property, Plant and Equipment – Property, plant and equipment (“PP&E”) are stated at cost, net of accumulated depreciation, depletion and amortization (“DD&A”). Leases meeting capital lease criteria are capitalized in PP&E. Major renewals and improvements that increase the life, value, or productive capacity of assets are capitalized in PP&E while maintenance, repairs and minor renewals are expensed as incurred. In addition, maintenance, repairs and minor renewal costs relating to planned major maintenance activities (“Turnarounds”) are expensed as they are incurred. All long-lived assets relate to domestic operations.

Fully depreciated assets are retained in PP&E and accumulated DD&A accounts until disposal. When PP&E are retired, sold, or otherwise disposed, the asset’s carrying amount and related accumulated DD&A are removed from the accounts and any gain or loss is included in other income or expense.

For financial reporting purposes, depreciation of the costs of PP&E is primarily computed using the straight-line method over the estimated useful lives of the assets. No provision for depreciation is made on construction in progress or capital spare parts until such time as the relevant assets are put into service. In general, assets held for sale are reported at the lower of the carrying amounts of the assets or fair values less costs to sell. At December 31, 2018 and 2017, we had no long-lived assets classified as held for sale.

Impairment of Long-Lived Assets and Goodwill – Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset (asset group) may not be recoverable. An impairment loss would be recognized when the carrying amount of an asset (asset group) exceeds the estimated undiscounted future cash flows expected to result from the use of the asset (asset group) and its eventual disposition. If assets to be held and used are considered to be impaired, the impairment to be recognized is the amount by which the carrying amounts of the assets exceed the fair values of the assets as measured by the present value of future net cash flows expected to be generated by the assets or their appraised value. In general, and depending on the event or change in circumstances, our asset groups are reviewed for impairment on a facility-by-facility basis (such as the Cherokee, El Dorado or Pryor Facility).

In addition, if the event or change in circumstance relates to the probable sale of an asset (or group of assets), the specific asset (or group of assets) is reviewed for impairment. In addition, goodwill was reviewed for impairment at least annually. An impairment loss generally would be recognized when the carrying amount of the reporting unit’s net assets exceeds the estimated fair value of the reporting unit. See discussion below under 2016.

#### 2016 Goodwill Impairment

Historically, the evaluation of goodwill for impairment involved a two-step test. Step 1 involved comparing the estimated fair value of each respective reporting unit to its carrying value, including goodwill. Step 2 involved calculating an implied fair value of goodwill by performing a hypothetical allocation of the estimated fair value of the reporting unit determined in step 1 to the respective tangible and intangible net assets of the reporting unit. To the extent the carrying amount of goodwill exceeded the implied goodwill, the difference was the amount of the goodwill impairment.

During 2016, pricing for our key product groups deteriorated well below expectations and the lower price environment was expected to continue throughout 2017. We determined the fair value of goodwill related to our El

Dorado Facility was less than its carrying amount (goodwill and other) implied under step 2, which resulted in an impairment charge of \$1.6 million to fully write-down the carrying value of goodwill.

Concentration of Credit Risks for Cash and Cash Equivalents and Sales – Financial instruments relating to cash and cash equivalents potentially subject us to concentrations of credit risk. These financial instruments were held by financial institutions within the U.S. None of the financial instruments held within U.S. were in excess of the federally insured limits.

Net sales to one customer, Koch Fertilizer LLC (“Koch Fertilizer”), represented approximately 13%, 10% and 11% of our total net sales for 2018, 2017 and 2016, respectively. Net sales to one customer, Coffeyville Resources Nitrogen Fertilizer, LLC (“CVR”), represented approximately 11% of our total net sales for 2018. Net sales to one customer, Covestro AG (“Covestro”), represented approximately 12% and 13% of our total net sales for 2017 and 2016, respectively.

Capitalized Interest – Interest cost on borrowings incurred during a significant construction or development project is capitalized. Capitalized interest is added to the associated underlying asset and amortized over the estimated useful lives of the assets. For 2017, and 2016, interest capitalized amounted to \$0.3 million and \$15.0 million, respectively (none in 2018).

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

**Accrued Insurance Liabilities** – We are self-insured up to certain limits for group health, workers’ compensation and general liability claims. Above these limits, we have commercial stop-loss insurance coverage for our contractual exposure on group health claims and statutory limits under workers’ compensation obligations. We also carry umbrella insurance of \$100 million for most general liability and auto liability risks. We have a separate \$50 million insurance policy covering pollution liability at our chemical facilities. Additional pollution liability coverage for our other facilities is provided in our general liability and umbrella policies. As it related to our natural gas properties that we did not operate but only owned a working interest, insurance policies were maintained by the operator, which we were responsible for our proportionate share of the costs involved.

Our accrued self-insurance liabilities are based on estimates of claims, which include the reported incurred claims amounts plus the reserves established by our insurance adjustors and/or estimates provided by attorneys handling the claims, if any, up to the amount of our self-insurance limits. In addition, our accrued insurance liabilities include estimates of incurred, but not reported, claims based on historical claims experience. The determination of such claims and the appropriateness of the related liability is periodically reviewed and revised, if needed. Changes in these estimated liabilities are charged to operations. Potential legal fees and other directly related costs associated with insurance claims are not accrued but rather are expensed as incurred. Accrued insurance claims are included in accrued and other liabilities. It is reasonably possible that the actual development of claims could be different than our estimates.

**Executive Benefit Agreements** – We are party to certain benefit agreements with certain key current and former executives. Costs associated with these individual benefit agreements are accrued based on the estimated remaining service period when such benefits become probable, they will be paid. Total costs accrued equal the present value of specified payments to be made after benefits become payable.

**Income Taxes** – Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those 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 that includes the enactment date. 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. Significant judgment is applied in evaluating the need for and the magnitude of appropriate valuation allowances against deferred tax assets.

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

Contingencies – Certain conditions may exist which may result in a loss, but which will only be resolved when future events occur. We and our legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. If the assessment of a contingency indicates that it is probable that a loss has been incurred, we would accrue for such contingent losses when such losses can be reasonably estimated. If the assessment indicates that a potentially material loss contingency is not probable but reasonably possible, or is probable but cannot be estimated, the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed. Estimates of potential legal fees and other directly related costs associated with contingencies are not accrued but rather are expensed as incurred. Loss contingency liabilities are included in current and noncurrent accrued and other liabilities and are based on current estimates that may be revised in the near term. In addition, we recognize contingent gains when such gains are realized or when the contingencies have been resolved (generally at the time a settlement has been reached).

Asset Retirement Obligations – In general, we record the estimated fair value of an asset retirement obligation ("ARO") associated with tangible long-lived assets in the period it is incurred and when there is sufficient information available to estimate the fair value. An ARO associated with long-lived assets is a legal obligation under existing or enacted law, statute, written or oral contract or legal construction. AROs, which are initially recorded based on estimated discounted cash flows, are accreted to full value over time through charges to cost of sales. In addition, we capitalize the corresponding asset retirement cost as PP&E, which cost is depreciated or depleted over the related asset's respective useful life. We do not have any assets restricted for the purpose of settling our AROs.

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

**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 accretion was recorded to retained earnings.

However, this accretion could change if the expected redemption date changes.

**Equity Awards** – Equity award transactions with employees are measured based on the estimated fair value of the equity awards issued. For equity awards with service conditions that have a graded vesting period, we recognize compensation cost on a straight-line basis over the requisite service period for the entire award. Forfeitures are accounted for as they occur. In addition, historically we issue new shares of common stock upon the exercise of stock options, but treasury shares may be used.

**Revenue Recognition and Other Information** – See Note 2-Adoption of ASC 606 for discussion of our revenue recognition accounting policy. 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.

All net sales and long-lived assets relate to domestic operations for the periods presented. In addition, net sales to non-U.S. customers were minimal.

**Recognition of Incentive Tax Credits (Other Than Credits Associated with Income Taxes)** – If an incentive tax credit relates to a recovery of taxes (other than income taxes) incurred, we recognize the incentive tax credit when it is probable and reasonably estimable. If an incentive tax credit relates to an amount in excess of taxes incurred, the incentive tax credit is a contingent gain, which we recognize the incentive tax credit when it is realized or when the contingencies have been resolved (generally at the time a settlement has been reached). Amounts recoverable from the taxing authorities, if any, are included in accounts receivable. The same financial statement classification is used for an incentive tax credit as the associated tax incurred.

During 2017, we received notification from the State of Arkansas that incentive tax credits had been approved associated with certain capital expenditures associated with the El Dorado Facility's expansion projects completed primarily in the fourth quarter of 2015 and the second quarter of 2016. As a result, in 2017, we recognized a current and noncurrent receivable totaling approximately \$8.1 million associated with these incentive tax credits with the offset reducing PP&E (covered by the tax credit) by approximately \$7.4 million and the remaining balance of \$0.7 million as a reduction to cost of sales (recovery of previously incurred depreciation expense related to the PP&E). At December 31, 2018 and 2017, our current and noncurrent incentive tax credits receivable totaled \$3.1 million and \$7.4 million, respectively.

**Recognition of Insurance Recoveries** – If an insurance claim relates to a recovery of our losses, we recognize the recovery when it is probable and reasonably estimable. If our insurance claim relates to a contingent gain, we

recognize the recovery when it is realized or when the contingencies have been resolved (generally at the time a settlement has been reached). Amounts recoverable from our insurance carriers, if any, are included in accounts receivable. An insurance recovery in excess of recoverable costs relating to a business interruption claim, if any, is a reduction to cost of sales. An insurance recovery in excess of recoverable costs relating to a property insurance claim, if any, is included in property insurance recoveries in excess of losses incurred.

Cost of Sales – Cost of sales includes materials, labor and overhead costs to manufacture the products sold plus inbound freight, purchasing and receiving costs, inspection costs, internal transfer costs, loading and handling costs, warehousing costs, railcar lease costs and outbound freight. Maintenance, repairs and minor renewal costs relating to Turnarounds are included in cost of sales as they are incurred. Precious metals used as a catalyst and consumed during the manufacturing process are included in cost of sales. Recoveries and gains from precious metals and business interruption insurance claims, if any, are reductions to cost of sales. Provisions for (realization of) losses associated with inventory reserves, gains and losses (realized and unrealized), if any, from our commodities contracts, and provision for losses, if any, on firm sales/purchase commitments are included in cost of sales.

Selling, General and Administrative Expense – Selling, general and administrative expense (“SG&A”) includes costs associated with the sales, marketing and administrative functions. Such costs include personnel costs, including benefits, professional fees, office and occupancy costs associated with the sales, marketing and administrative functions. Also included in SG&A are any distribution fees paid to third parties to distribute our products.

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

### 1. Summary of Significant Accounting Policies (continued)

**Derivatives, Hedges and Financial Instruments** – Derivatives are recognized in the balance sheet and are measured at fair value. Changes in fair value of derivatives are recorded in results of operations unless the normal purchase or sale exceptions apply, or hedge accounting is elected.

The fair value amounts recognized for our derivative contracts executed with the same counterparty under a master netting arrangement may be offset. We have the choice to offset or not, but that choice must be applied consistently. A master netting arrangement exists if the reporting entity has multiple contracts with a single counterparty that are subject to a contractual agreement that provides for the net settlement of all contracts through a single payment in a single currency in the event of default on or termination of any one contract. Offsetting the fair values recognized for the derivative contracts outstanding with a single counterparty results in the net fair value of the transactions being reported as an asset or a liability in the balance sheet. We have chosen to present the fair values of our derivative contracts under master netting agreements using a gross fair value presentation as there were no derivatives with fair values that were eligible to be offset as of December 31, 2018 and 2017.

**Income (Loss) per Common Share** – Net income (loss) attributable to common stockholders is computed by adjusting net income (loss) by the amount of dividends and dividend requirements on preferred stocks and the accretion of redeemable preferred stocks, if applicable. Basic loss per common share is computed by dividing net loss attributable to common stockholders by the weighted average number of common shares outstanding, excluding contingently returnable common shares (unvested restricted stock), if applicable. For periods we earn net income, a proportional share of net income is allocated to participating securities, if applicable, determined by dividing total weighted average participating securities by the sum of the total weighted average common shares and participating securities (the “two-class method”). Certain securities (Series E Redeemable Preferred and restricted stock units) participate in dividends declared on our common stock and are therefore considered to be participating securities.

Participating securities have the effect of diluting both basic and diluted income per common share during periods of net income. For periods we incur a net loss, no loss is allocated to participating securities because they have no contractual obligation to share in our losses. Diluted loss per common share is computed after giving consideration to the dilutive effect of our potential common stock instruments that are outstanding during the period, except where such non-participating securities would be anti-dilutive.

**Segment Information** - With the sale of our Climate Control Business during July 2016, we operate in one principal business segment – our chemical business.

#### 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 other ASUs further amending revenue recognition guidance (together “ASC 606”). On January 1, 2018, we adopted ASC 606 as discussed in Note 2.

**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 2017 or 2016.

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. As the result of adopting this ASU, we removed the presentation of investing cash flow activities relating to current and noncurrent restricted cash and cash equivalents from our statement of cash flows for 2016, which change did not impact the total amount of net cash provided by continuing investing activities.

ASU 2018-05 – See Note 8 – Income Taxes.

F-13

---

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 1. Summary of Significant Accounting Policies (continued)

### Recently Issued Accounting Pronouncements

ASU 2016-02 and related ASUs – 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.

We completed our assessment, design and plan for implementation and implementation of Topic 842 in order to adopt this standard and will elect the additional transition method option provided by ASU 2018-11. Under this transition method, we will apply the new accounting guidance (we expect the cumulative effect, if any, not to be material) on January 1, 2019, the date of adoption.

Consequently, our reporting for the comparative periods presented in the financial statements issued after the date of adoption would continue to be in accordance with Topic 840, including disclosures. Upon adoption, we plan to elect the following accounting policies or practical expedients related to Topic 842:

- not reassess whether any expired or existing contracts are or contain leases, not reassess the lease classification for any expired or existing leases, and not reassess initial direct costs for any existing leases;
- apply accounting similar to Topic 840 operating leases accounting to leases that meet the definition of short-term leases; and
- not evaluate land easements that exist or expired before January 1, 2019 and that were not previously accounted for as leases under Topic 840.

Currently, most of our leases are classified as operating leases under which we are the lessee. In addition, our leases classified as capital leases and other leases under which we are the lessor are not material. Upon adoption, we currently expect the effect of this guidance on our consolidated financial statements will impact our balance sheet presentation (increase the amount of our assets for the inclusion of right-of-use assets of approximately \$15 million and an increase the amount of our liabilities for the inclusion of the associated lease obligations of approximately \$15 million).

## 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

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

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 consolidated statement of operations for the current reporting period has been provided to reflect both the adoption of ASC 606 as well as a comparative presentation in accordance with ASC 605 previously in affect:

	2018		
	As Reported (In Thousands)	Balance without adoption of 606	Effect of Change Higher/(Lower)
Net sales	\$378,160	\$ 443,821	\$ (65,661 )
Cost of sales	362,325	427,405	(65,080 )
Gross profit	15,835	16,415	(580 )
Selling, general and administrative expense	40,811	41,391	(580 )
Operating loss	(23,025 )	(23,025 )	—

F-14

---

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 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 table presents our net sales disaggregated by our principal markets, which disaggregation is consistent with other financial information utilized or provided outside of our consolidated financial statements:

	2018	2017(a)	2016(a)
	(Dollars In Thousands)		
Net sales:			
Agricultural products	\$ 187,164	\$ 184,054	\$ 166,180
Industrial acids and other chemical products	148,598	196,029	155,744
Mining products	42,398	38,854	43,532
Other products	—	8,567	9,129
Total net sales	\$ 378,160	\$ 427,504	\$ 374,585

- (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.

### 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.

F-15

---

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 2: Adoption of ASC 606 (continued)

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 14 months at December 31, 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 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. We had approximately \$7.0 million and \$8.3 million of contract liabilities as of December 31, 2018 and 2017, respectively. During 2018, revenues of \$3.1 million were recognized and included in the balance at the beginning of the 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 Consolidated Financial Statements (continued)

## 3. Income (loss) per Common Share

The following table sets forth the computation of basic and diluted net income (loss) per common share:

	2018	2017	2016
	(Dollars In Thousands, Except Per Share Amounts)		
<b>Numerator:</b>			
Net income (loss):	\$ (72,226 )	\$ (29,217 )	\$ 112,168
Adjustments for basic net income (loss) per common share:			
Dividend requirements on Series E Redeemable Preferred	(26,840 )	(23,443 )	(27,761 )
Dividend requirements on Series B Preferred	(240 )	(240 )	(240 )
Dividend requirements on Series D Preferred	(60 )	(60 )	(60 )
Accretion of Series E Redeemable Preferred	(3,375 )	(6,487 )	(18,256 )
Net income attributable to participating securities	—	—	(1,091 )
Numerator for basic and dilutive net income (loss) per common share - net income (loss) attributable to common stockholders	\$ (102,741 )	\$ (59,447 )	\$ 64,760
<b>Denominator:</b>			
Denominator for basic and dilutive net income (loss) per common share - adjusted weighted-average shares (1)	27,490,717	27,250,876	25,454,311
<b>Basic and dilutive net income (loss) per common share:</b>			
Loss from continuing operations	\$ (3.74 )	\$ (2.22 )	\$ (5.28 )
Income from discontinued operations, net of taxes	—	0.04	7.82
Net income (loss)	\$ (3.74 )	\$ (2.18 )	\$ 2.54

(1) All periods exclude 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 income (loss) per common share as their effect would have been antidilutive:

2018	2017	2016
------	------	------



Edgar Filing: LSB INDUSTRIES INC - Form 10-K

Convertible preferred stocks	916,666	916,666	916,666
Restricted stock and stock units	1,183,622	1,187,525	908,568
Series E redeemable preferred stock - embedded derivative	303,646	303,646	412,869
Stock options	175,454	215,067	361,168
	2,579,388	2,622,904	2,599,271

F-17

---

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 4. Property, Plant and Equipment

	Useful lives in years	December 31, 2018      2017 (In Thousands)	
Machinery, equipment and automotive	3 - 30	\$ 1,189,438	\$ 1,163,532
Buildings and improvements	10 - 30	39,032	42,886
Land improvements	10 - 40	8,076	8,111
Furniture, fixtures and store equipment	3	1,122	1,466
Construction in progress	N/A	28,753	27,973
Capital spare parts	N/A	28,945	29,835
Land	N/A	4,583	7,764
		1,299,949	1,281,567
Less accumulated depreciation and amortization		325,701	267,529
		\$974,248	\$ 1,014,038

Machinery, equipment and automotive primarily includes the categories of property and equipment and estimated useful lives as follows: processing plants and plant infrastructure (15-30 years); certain processing plant components (3-10 years); and trucks, automobiles, trailers, and other rolling stock (2-7 years).

## 5. Current and Noncurrent Accrued and Other Liabilities

	December 31, 2018      2017 (In Thousands)	
Accrued litigation settlement (See Note 9)	\$ 18,450	\$—
Accrued payroll and benefits (1)	7,259	4,855
Accrued interest	6,505	13,424
Deferred revenue	5,216	6,987
Accrued death and other executive benefits	2,777	2,808
Customer deposits	1,783	1,334
Series E redeemable preferred - embedded derivative	1,642	2,660
Accrued health and worker compensation insurance claims	1,107	1,658
Other	6,251	13,538
	50,990	47,264
Less noncurrent portion	8,861	11,691

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

Current portion of accrued and other liabilities	\$42,129	\$35,573
--	----------	----------

(1) At December 31, 2018, the amount includes certain severance benefits as discussed in Note 15.

F-18

---

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 6. Asset Retirement Obligations

Currently, we have various legal requirements related to operations at our chemical facilities, including the disposal of wastewater generated at certain of these facilities. Currently, there is insufficient information to estimate the fair value for certain of our AROs. As a result, a liability for only certain AROs has been established. However, we will continue to review these obligations and record a liability when a reasonable estimate of the fair value can be made. At December 31, 2018 and 2017, our accrued liability for AROs was \$100,000, respectively.

## 7. Long-Term Debt

	December 31, 2018	December 31, 2017
	(In Thousands)	
Working Capital Revolver Loan, with a current interest rate of		
6.00% (A)	\$10,000	\$—
Senior Secured Notes due 2023 (B)	400,000	—
Senior Secured Notes due 2019 (B)	—	375,000
Secured Promissory Note due 2019, with a current rate		
of 5.73% (C)	7,165	8,167
Secured Promissory Note due 2021, with a current interest rate		
of 5.25% (D)	8,090	11,262
Secured Promissory Note due 2023, with a current interest rate		
of 6.76% (E)	14,685	16,665
Other	221	2,994
Unamortized discount and debt issuance costs	(14,962 )	(4,689 )
	425,199	409,399
Less current portion of long-term debt (F)	12,518	9,146
Long-term debt due after one year, net (F)	\$412,681	\$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 December 31, 2018, our available borrowings under our Working Capital Revolver Loan were approximately \$37.2 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.

Interest accrues on outstanding borrowings under the Working Capital Revolver Loan at a rate equal to, at our election, either (a) LIBOR for an interest period selected by us plus an applicable margin equal to 1.50% per annum or 1.75% per annum, depending on borrowing availability under the Working Capital Revolver Loan, or (b) Wells Fargo Capital Finance’s prime rate plus an applicable margin equal to 0.50% per annum or 0.75% per annum, depending on borrowing availability under the Working Capital Revolver Loan. Interest is paid monthly, if applicable.

The Working Capital Revolver Loan contains customary covenants including limitations on asset sales, liens, debt incurrence, restricted payments, investments, dividends and transactions with affiliates.

The Working Capital Revolver Loan includes customary events of default. Upon the occurrence of any event of default, the obligations under the Working Capital Revolver Loan may be accelerated and the revolver commitments may be terminated.

Obligations under the Working Capital Revolver Loan are secured by a first priority security interest in substantially all of our current assets, including accounts receivable and inventory, subject to certain customary exceptions.

F-19

---

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

7. 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, which began 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.

Obligations in respect of the Senior Secured Notes are secured by a first priority security interest in substantially all of our fixed assets, subject to certain customary exceptions.

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

F-20

---

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 7. Long-Term Debt (continued)

(F) Maturities of long-term debt for each of the five years after December 31, 2018 are as follows (in thousands):

2019	\$12,552
2020	5,544
2021	3,239
2022	12,025
2023	406,801
Thereafter	—
Less: Discount and debt issuance costs	14,962
	\$425,199

## 8. Income Taxes

In December 2017, the President of the United States signed into law the Tax Cuts and Jobs Act of 2017 (the “Tax Cut 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 Tax Cut Act.

In 2017 and the first nine months of 2018, we recorded provisional amounts for certain enactment-date effects of the Tax Cut Act by applying the guidance in SAB 118 because we had not yet completed our enactment-date accounting for these effects. In 2018 and 2017, we recorded tax expense related to these effects including the decrease in the federal corporate tax rate, additional limitations on executive compensation, and limitations on the deductibility of interest. During the fourth quarter of 2018, we completed the accounting for tax reform and there was no adjustment to provisional amounts recorded.

Provision (benefit) for income taxes from continuing operations are as follows:

	2018	2017	2016
	(In Thousands)		
Current:			
Federal	\$11	\$67	\$46
State	(96 )	(381 )	11
Total Current	\$(85 )	\$(314 )	\$57
Deferred:			



Edgar Filing: LSB INDUSTRIES INC - Form 10-K

Federal	\$ 1,415	\$(50,084)	\$(46,926)
State	410	9,639	4,913
Total Deferred	\$ 1,825	\$(40,445)	\$(42,013)
Provision (benefit) for income taxes	\$ 1,740	\$(40,759)	\$(41,956)

The current provision for federal income taxes shown above includes regular federal income tax after the consideration of permanent and temporary differences between income for GAAP and tax purposes. The current provision (benefit) for state income taxes includes regular state income tax and provisions for uncertain income tax positions, and other similar adjustments.

The deferred tax provision (benefit) results from the recognition of changes in our prior year deferred tax assets and liabilities, and the utilization of state NOL carryforwards and other temporary differences. We reduce income tax expense for tax credits in the year they arise and are earned. At December 31, 2018, our gross amount of tax credits available to offset state income taxes was not material. Most of these tax credits do not expire and carryforward indefinitely. The gross amount of federal tax credits was \$8.1 million. These credits carryforward for 20 years and begin expiring in 2034.

We utilized approximately \$3.4 million, which includes the impact of changes in tax law, and \$0.4 million of state NOL carryforwards to reduce tax liabilities in 2018 and 2016, respectively, (none in 2017). At December 31, 2018, we have remaining federal and state tax NOL carryforwards of \$577.3 million and \$667.9 million, respectively. The federal NOL carryforwards begin expiring in 2033 and the state NOL carryforwards began expiring in 2018.

F-21

---

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 8. Income Taxes (continued)

We considered both positive and negative evidence in our determination of the need for valuation allowances for the deferred tax assets associated with federal and state NOLs and federal credits and in conjunction with the IRC Section 382 limitation. 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. In the second quarter of 2018, we established a valuation allowance on a portion of our federal deferred tax assets. Valuation allowances are 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 results of operations. Based on our analysis, 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 and the valuation allowance recorded for 2018 is approximately \$14.6 million. For 2018, 2017 and 2016, we determined it was more-likely-than-not that approximately \$608.9 million, \$536.0 million and \$312.3 million, respectively, of the state deferred tax assets would not be able to be utilized before expiration and a valuation allowance was maintained for the deferred tax assets associated with these carryforwards, net of federal benefit, of approximately \$31.0 million and \$26.9 million at December 31, 2018 and 2017, respectively. This includes a reversal of approximately \$2.3 million of valuation allowance related to tax law changes in 2018.

Deferred tax assets and liabilities include temporary differences and carryforwards as follows:

	December 31,	
	2018	2017
	(In Thousands)	
Deferred compensation	\$2,637	\$2,393
Other accrued liabilities	1,579	1,964
Interest expense carryforward	11,267	—
Net operating loss	154,914	142,950
Other	12,581	15,933
Less valuation allowance on deferred tax assets	(45,625 )	(26,920 )
Total deferred tax assets	\$137,353	\$136,320
Property, plant and equipment	(191,369)	(186,561)
Prepaid and other insurance reserves	(2,596 )	(2,561 )
Other	—	(1,985 )
Total deferred tax liabilities	\$(193,965)	\$(191,107)
Net deferred tax liabilities	\$(56,612 )	\$(54,787 )

All of our loss before taxes relates to domestic operations. Detailed below are the differences between the amount of the provision (benefit) for income taxes and the amount which would result from the application of the federal statutory rate to “Loss from continuing operations before provision (benefit) for income taxes”.

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

	2018	2017	2016
	(In Thousands)		
Benefit for income taxes at federal statutory rate	\$(14,802)	\$(24,868)	\$(45,531)
State current and deferred income tax benefit	(4,089 )	(2,699 )	(4,452 )
Valuation allowance - Federal	14,604	—	—
Valuation allowance - State	4,112	7,651	11,855
Tax reform	—	(22,988)	—
Energy credit	—	—	(888 )
Other	1,915	2,145	(2,940 )
Provision (benefit) for income taxes	\$1,740	\$(40,759)	\$(41,956)

F-22

---

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 8. Income Taxes (continued)

A reconciliation of the beginning and ending amount of uncertain tax positions is as follows:

	2018	2017	2016
	(In Thousands)		
Balance at beginning of year	\$618	\$657	\$259
Additions based on tax positions related to the current year	—	11	454
Additions based on tax positions of prior years	—	—	4
Reductions for tax positions of prior years	(41)	(50)	(60)
Settlements	—	—	—
Balance at end of year	\$577	\$618	\$657

We expect that the amount of unrecognized tax benefits may change as the result of ongoing operations, the outcomes of audits, and the expiration of statute of limitations. This change is not expected to have a significant effect on our results of operations or financial condition. For 2018, 2017, and 2016, if recognized, the effect on the effective tax rate from unrecognized tax benefits would be insignificant.

We record interest related to unrecognized tax positions in interest expense and penalties in operating other expense. We recognized \$0.1 million of interest and penalties associated with unrecognized tax benefits in 2017 (minimal amounts in 2018 and 2016). At December 31, 2018 and 2017, approximately \$0.2 million, respectively is accrued for interest and penalties.

LSB and certain of its subsidiaries file income tax returns in the U.S. federal jurisdiction and various state jurisdictions. With few exceptions, the 2015-2018 years remain open for all purposes of examination by the U.S. Internal Revenue Service (“IRS”) and other major tax jurisdictions. During 2018, the IRS concluded their examination of our 2015 tax return and there are no changes to our financial position, results of operations or cash flow resulting from the audit.

## 9. Commitments and Contingencies

Operating Leases - We lease certain PP&E under non-cancelable operating leases. Future minimum payments on operating leases associated with our operations with initial or remaining terms of one year or more at December 31, 2018, are as follows:

	Operating Leases
2019	\$ 6,674
2020	3,547

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

2021	2,364
2022	1,949
2023	1,696
Thereafter	2,530
Total minimum lease payments	\$ 18,760

Expenses associated with our operating lease agreements, including month-to-month leases, were \$10,235,000 in 2018, \$9,813,000 in 2017 and \$9,933,000 in 2016. Renewal options are available under certain of the lease agreements for various periods at approximately the existing annual rental amounts.

Purchase and Sales Commitments – We have the following significant purchase and sales commitments.

UAN supply agreement – The Pryor Chemical Company (“PCC”) is party to an agreement with CVR. CVR has the exclusive right (but not the obligation) to purchase all the tons of UAN that are produced by PCC with certain limitations. If CVR fails to take delivery of certain tons, PCC pursuant to the terms of the agreement may immediately sell such unpurchased product to a third-party without restriction. The initial term of the agreement expires in May 2019, but includes automatic renewals for one or more additional one-year terms unless terminated by either party by delivering a notice of termination at least twelve months prior to the end of term in effect. However, CVR may unilaterally terminate the agreement upon 180 days’ advance written notice of termination to PCC; provided, however, that each party’s rights and obligations pertaining to UAN that CVR committed to purchase before such advance notice will survive termination. Additionally, PCC can terminate the CVR Purchase Agreement upon 90 days’ advance written notice of termination to CVR; provided, however, that each party’s rights and obligations pertaining to UAN that PCC committed to sell prior to such advance notice will survive termination.

F-23

---

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

#### 9. Commitments and Contingencies (continued)

Ammonia supply agreement – EDC is party to an agreement, as amended, with Koch Fertilizer under which Koch Fertilizer agrees to purchase, with minimum purchase requirements, the ammonia that (a) will be produced at the El Dorado Facility and (b) that is in excess of El Dorado's needs. The term of the agreement expires in June 2020 but automatically continues for one or more additional one-year terms unless terminated by either party by delivering a notice of termination at least nine months prior to the end of term in effect.

Covestro agreement – El Dorado Nitrogen LLC (“EDN”) and EDC, are party to an agreement (the “Covestro Agreement”) with Covestro. EDN operates the Baytown Facility located within Covestro's chemical manufacturing complex located in Baytown, Texas. Under the terms of the Covestro Agreement, EDN is responsible for the maintenance and operation of the Baytown Facility, which facility produces all of Covestro's requirements for nitric acid for use in Covestro's chemical manufacturing complex. If there is a change in control of EDN, Covestro has the right to terminate the Covestro Agreement upon payment of certain fees to EDN. The Covestro Agreement expires in June 2021, with options for renewal.

See discussions in Note 10 for our commitments relating to derivative contracts at December 31, 2018. Certain of our subsidiaries are parties to contracts to purchase natural gas for anticipated production needs at certain of our facilities. Since these contracts are considered normal purchases because they provide for the purchase of natural gas that will be delivered in quantities expected to be used over a reasonable period of time in the normal course of business and are documented as such, these contracts are exempt from the accounting and reporting requirements relating to derivatives. At December 31, 2018, we did not have any natural gas contracts that included volume purchase commitments with fixed costs. In addition, we had standby letters of credit outstanding of approximately \$2.7 million at December 31, 2018. We also had deposits from customers of \$1.8 million for forward sales commitments at December 31, 2018.

Wastewater Pipeline Operating Agreement – EDC is party to an operating agreement for the right to use a pipeline to dispose its wastewater. EDC is contractually obligated to pay a portion of the operating costs of the pipeline, which portion is estimated to be \$100,000 to \$150,000 annually. The initial term of the operating agreement is through December 2053.

Performance and Payment Bonds – We are contingently liable to sureties in respect of certain insurance bonds issued by the sureties in connection with certain contracts entered into by certain subsidiaries in the normal course of business. These insurance bonds primarily represent guarantees of future performance of our subsidiaries. As of December 31, 2018, we have agreed to indemnify the sureties for payments, up to \$10 million, made by them in respect of such bonds. All of these insurance bonds are expected to expire or be renewed in 2019.

Employment and Severance Agreements - We have employment and severance agreements with several of our officers. The agreements, as amended, provide for annual base salaries, bonuses and other benefits commonly found in such agreements. In the event of termination of employment due to a change in control (as defined in the agreements), the agreements provide for payments aggregating \$6.2 million at December 31, 2018. Also see Note 15-Related Party Transactions.

Settlement of a Gain Contingency - During 2018, we and a vendor mediated a settlement relating primarily to a business interruption claim caused by defective work performed by the vendor at our Pryor Facility. As a result of the

settlement, the vendor paid us \$4.0 million. As part of the settlement, we paid the vendor \$0.5 million to settle \$1.1 million of invoices that were held in our accounts payable. As a result, we recognized a recovery from this settlement totaling \$4.6 million of which \$4.4 million was classified as a reduction to cost of sales (primarily relating to our business interruption claim) and the remaining balance of \$0.2 million as a reduction to PP&E.

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.

F-24

---

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 9. Commitments and Contingencies (continued)

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 December 31, 2018, our accrued liabilities for environmental matters totaled \$183,000 relating primarily to the matters discussed below. It is reasonably possible that a change in the estimate of our liability could occur in the near term. Also, see discussion in Note 6 – Asset Retirement Obligations.

### 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. These permits limit the type and amount of effluents that can be discharged and control the method of such discharge.

On October 5, 2017, PCC filed a Permit Renewal Application for its Non-Hazardous Injection Well Permit at the Pryor facility. Although the Injection Well Permit expired in 2018, PCC continues to operate the injection well pending the Oklahoma Department of Environmental Quality (“ODEQ”) action on the Permit Renewal Application. PCC and ODEQ are engaged in ongoing discussions related to the renewal of the injection well to address the 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.

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. In August 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 in September 2017. In September 2018, ADEQ formalized a Consent Administrative Order (“CAO”) to resolve all outstanding permit violations and imposed a penalty in the amount of \$124,000. On October 12, 2018, EDC and ADEQ entered into CAO 18-085 that resolved all outstanding violations of the NPDES Permit, and EDC paid the previously agreed upon penalty.

In November 2006, the El Dorado Facility entered into a 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.

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 9. Commitments and Contingencies (continued)

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, if any,) cannot currently be reasonably estimated. Therefore, no liability has been established at December 31, 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 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.

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. These settlements have been paid by the insurer as of December 31, 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 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 December 31, 2018, no liability reserve has been established in connection with this matter.

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

#### 9. Commitments and Contingencies (continued)

In May 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.

On October 11, 2018, LSB entered into a preliminary, binding term sheet to settle Dennis Wilson vs. LSB Industries, Inc., et al., which was subject to approval by the court. On January 17, 2019, the parties entered into a Stipulation and Agreement of Settlement (The “Wilson Settlement Agreement”), pursuant to which the settlement amount of approximately \$18.5 million is to be paid by our insurers on behalf of LSB and certain current and former officers in exchange for, among other things, a release of all claims. The Wilson Settlement Agreement received preliminary approval from the Court on February 25, 2019 and will be further reviewed by the Court at a settlement hearing schedule for June 28, 2019. A liability for the settlement amount has been accrued and a receivable for the loss recovery from our insurers for the settlement amount has been recognized as of December 31, 2018.

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.

LSB and EDA intend to pursue recovery of any damage or loss caused by Global’s work performed at our El Dorado Facility. 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 which they have denied, and we intend to vigorously defend against the allegation made by Global and seek reimbursement of legal expenses from Leidos under our contracts. Except for the invoices totaling approximately \$3.5 million that were not approved by Leidos for payment that are included in our accounts payable, no liability has been established in connection with the claims asserted by Global. On September 25, 2018, the Court bifurcated the case into: (1) Global’s claims against Leidos and LSB, and (2) the cross-claims between Leidos and LSB. Part (1) of the case was tried to the Court during the fall of 2018. The Court took the matter under advisement, will consider the evidence and render judgment. LSB intends to vigorously prosecute its claims against Leidos in Part (2) of the matter. A trial date for Part (2) of this matter is not yet set.

We are also involved in various other claims and legal actions (including matters involving gain contingencies). 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.

F-27

---

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 10. Derivatives Hedges and Financial Instruments

For the periods presented, the following significant instrument is accounted for on a fair value basis:

### 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 7 and 11, we estimate that the contingent redemption features have fair value at December 31, 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 estimated no fair value at December 31, 2018 based on our assessment that there is a remote probability that these features will be exercised.

At December 31, 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 December 31, 2018 and 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 \$5.52 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 December 31, 2018 and 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 December 31, 2018 and 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 December 31, 2018 and 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.

The line items identified as “Other” relate to carbon credits issued by the Climate Action Reserve in relation to a greenhouse gas reduction program performed at the Baytown Facility. At December 31, 2018, the valuation (\$2.35 per carbon credit) of the carbon credits and the contractual obligations associated with these carbon credits is classified as Level 3 and is based on the most recent sales transaction and reevaluated for market changes, if any, and

on the range of ask/bid prices obtained from a broker adjusted for minimal market volume activity. At December 31, 2017, we did not have any carbon credits or related contractual obligations associated with carbon credits. The valuation is using undiscounted cash flows based on management's assumption that the carbon credits would be sold, and the associated contractual obligations would be extinguished in the near term.

F-28

---

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

10. Derivatives Hedges and Financial Instruments (continued)

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

Description	Fair Value Measurements at				
	Total Fair Value at December 31, 2018 (In Thousands)	Marked Significant for Other Identical Observable Inputs (Level 1)	Marked Significant for Other Identical Observable Inputs (Level 2)	Marked Significant for Unobservable Inputs (Level 3)	Total Fair Value at December 31, 2017
<b>Assets - Supplies, prepaid items and other:</b>					
Other	\$533	\$—	\$—	\$ 533	\$ —
<b>Total</b>	<b>\$533</b>	<b>\$—</b>	<b>\$—</b>	<b>\$ 533</b>	<b>\$ —</b>
<b>Liabilities - Current and noncurrent accrued and other liabilities:</b>					
Embedded derivative	\$(1,642)	\$—	\$—	\$(1,642)	\$(2,660)
Other	(533)	—	—	(533)	—
<b>Total</b>	<b>\$(2,175)</b>	<b>\$—</b>	<b>\$—</b>	<b>\$(2,175)</b>	<b>\$(2,660)</b>

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		
2018	2017	2016	2018	2017	2016



Edgar Filing: LSB INDUSTRIES INC - Form 10-K

	(In Thousands)					
Beginning balance	\$—	\$—	\$1,154	\$(2,660)	\$(2,557)	\$(1,154)
Transfers into Level 3	—	—	—	—	—	(5,817)
Transfers out of Level 3	—	—	—	—	—	—
<b>Total realized and unrealized gains (losses)</b>						
included in operating results	2,214	2,031	1,256	(606 )	(1,690)	802
Purchases	—	—	—	—	—	—
Issuances	—	—	—	(229 )	—	—
Sales	(1,681)	(2,031)	(2,410)	—	—	—
Settlements	—	—	—	1,320	1,587	3,612
Ending balance	\$533	\$—	\$—	\$(2,175)	\$(2,660)	\$(2,557)
<b>Total gains (losses) for the period included in</b>						
operating results attributed to the change in						
unrealized gains or losses on assets and						
liabilities still held at the reporting date						
	\$533	\$—	\$—	\$(1,780)	\$(103 )	\$(983 )

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 10. Derivatives Hedges and Financial Instruments (continued)

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

	2018	2017	2016
	(In Thousands)		
Total net gains (losses) included in operating results:			
Cost of sales - Undesignated commodities contracts	\$—	\$—	\$140
Cost of sales - Undesignated foreign exchange contracts	—	—	5
Other income, net - Other	361	444	532
Non-operating other income (expense) - embedded derivative	1,247	(103)	(983)
Total net gains (losses) included in operating results	\$1,608	\$341	\$(306)

At December 31, 2018 and 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.

Also, see discussions concerning the utilization of fair value in conjunction with the evaluation certain assets and liabilities initially accounted for on a fair value basis under Note 6 – Asset Retirement Obligations.

## 11. Securities Financing Including Redeemable Preferred Stocks

## Securities Purchase Agreement Including Redeemable Preferred Stocks

In December 2015 and pursuant to a securities purchase agreement between LSB and LSB Funding LLC (the “Purchaser”) and Security Benefit Corporation, a Kansas corporation, both of which were unrelated third parties, LSB sold to the Purchaser:

\$210,000,000 of the Series E Redeemable Preferred,  
 • warrants to purchase 4,103,746 shares of common stock, par value \$0.10 (the “Warrants”), and  
 • one share of Series F Redeemable Class C preferred stock (the “Series F Redeemable Preferred”).  
 In connection with the closing of the Private Placement (the “Closing”), we entered into

• the Certificate of Designations setting forth the rights, preferences, privileges and restrictions applicable to the Series E Redeemable Preferred and Series F Redeemable Preferred, as filed with the Secretary of State of the State of Delaware;

•

a Registration Rights Agreement by and between LSB and LSB Funding, which agreement expired in December 2018; and

an amendment to renewed rights agreement, which amended agreement expired in January 2019 and we do not intend to renew the agreement.

The Series E and Series F Redeemable Preferred and Warrants were recorded at fair value upon issuance, net of issuance costs or discounts. The valuations were classified as Level 3. The Warrants were valued based on a Black-Scholes-Merton option pricing model and a Finnerty model to determine the estimated discount for lack of marketability. The Series E Redeemable Preferred was valued with discounted cash flow models that calculated the present value of future cash flows using possible redemption scenarios and using published market yields for publicly traded unsecured fixed income securities with similar credit ratings. No valuation input adjustments were considered necessary relating to the nonperformance risk for the Warrants or Series E Redeemable Preferred. Based on the terms of the Series F Redeemable Preferred, we determined that this share had minimal economic value.

#### Series E Redeemable Preferred

During 2016, we redeemed 70,232 shares of the Series E Redeemable Preferred (the "Series E Redemption") for approximately \$80 million, which included \$78.3 million for the liquidation preference of \$1,000 per share, plus accumulated dividends (the "Liquidation Preference") and \$1.7 million for the participation rights value associated with the Series E Redemption. The Series E Redemption was funded from a portion of the proceeds from the sale of our Climate Control Business. After the redemption, 139,768 shares of the Series E Redeemable Preferred were outstanding.

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

#### 11. Securities Financing Including Redeemable Preferred Stocks (continued)

During 2018, in connection with the issuance and sale of the Senior Secured Notes (the “Financing Transaction”) as discussed in Note 7, 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 provided 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. To reflect the changes stated in the letter agreement, we subsequently entered into a securities exchange agreement by and between LSB and the holder and entered into the Certificate of Designations setting forth the rights, preferences, privileges and restrictions currently applicable to the Series E Redeemable Preferred and Series F Redeemable Preferred, as filed with the Secretary of State of the State of Delaware (the “Series E COD” and “Series F COD”). The Series E COD authorizes 139,768 shares of Series E Redeemable Preferred, which is the number of shares outstanding at December 31, 2018.

The transaction associated with the letter agreement was determined to be a non-substantial modification. As a result, and as included in the table below, a fee paid to the holder was deferred (reducing 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 10.

With respect to the distribution of assets upon liquidation, dissolution or winding up of LSB, whether voluntary or involuntary, the Series E Redeemable Preferred ranks (i) senior to the common stock, the Series B 12% Cumulative Convertible Preferred Stock, the Series D 6% Cumulative Convertible Class C Preferred Stock, the Series 4 Junior Participating Class C Preferred Stock and any other class or series of stock of LSB (other than Series E Redeemable Preferred) that ranks junior to the Series E Redeemable Preferred either or both as to the payment of dividends and/or as to the distribution of assets on any liquidation, dissolution or winding up of the Corporation (the “Junior Stock”); (ii) on a parity with the other shares of Series E Redeemable Preferred and any other class or series of stock of LSB (other than Series E Redeemable Preferred) created after the date of the Series E COD (that specifically ranks pari passu to the Series E Redeemable Preferred) and (iii) junior to any other class or series of stock of LSB created after the date of the Series E COD that specifically ranks senior to the Series E Redeemable Preferred.

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 as of December 31, 2018. Generally, the holders of the Series E Redeemable Preferred Shares (the “Series E Holders”) will not have any voting rights or powers, and consent of the Series E Holders will not be required for taking of any action by us. However, the Series E Holders’ consent is required for

- amendments to increase or decrease the authorized amount of Series E Redeemable Preferred,
- the creation or increase of any shares of any class or series of capital stock of LSB ranking pari passu with or senior to the Series E Redeemable Preferred, or
- any amendment that adversely affect the powers, preferences or special rights of the Series E Redeemable Preferred.

Dividends accrue semi-annually in arrears and are compounded. Dividends are payable only when and if declared by the Board of Directors (the "Board").

Additionally, we must declare a dividend on the Series E Redeemable Preferred on a pro rata basis with the common stock. As long as LSB Funding holds at least 10% of the Series E Redeemable Preferred, we may only declare dividends on Junior Stock unless and until dividends have been declared and paid on the Series E Redeemable Preferred for the then current dividend period in cash. The Series E Redeemable Preferred has a liquidation preference per share of \$1,000 plus accrued and unpaid dividends plus the participation rights value. The participation rights value is the product of the pro rata number of Series E Redeemable Preferred shares being redeemed and the price of our common stock as of such date.

F-31

---

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

#### 11. Securities Financing Including Redeemable Preferred Stocks (continued)

At any time on or after October 25, 2023, each Series E Holder has the right to elect to have such holder's shares redeemed by us at a redemption price per share equal to the Liquidation Preference of such share as of the redemption date. Additionally, we, at our option, may redeem the Series E Redeemable Preferred at any time at a redemption price per share equal to the Liquidation Preference of such share as of the redemption date. Lastly, with receipt of (i) prior consent of the electing Series E Holder or a majority of shares of Series E Redeemable Preferred and (ii) all other required approvals, including under any principal U.S. securities exchange on which our common stock is then listed for trading, we can redeem the Series E Redeemable Preferred by the issuance of shares of common stock having an aggregate common stock price equal to the amount of the aggregate Liquidation Preference of such shares being redeemed in shares of common stock in lieu of cash at the redemption date.

In the event of liquidation, the Series E Redeemable Preferred is entitled to receive its Liquidation Preference before any such distribution of assets or proceeds is made to or set aside for the holders of our common stock and any other Junior Stock. In the event of a change of control, we must make an offer to purchase all of the shares of Series E Redeemable Preferred outstanding.

The Series E Redeemable Preferred is redeemable outside of our control and is therefore classified as temporary/mezzanine equity. As a result of an analysis performed on the embedded derivatives within the Series E Redeemable Preferred, certain contingent redemption features were determined to not be clearly and closely related to the debt-like host and also did not meet any other scope exceptions for derivative accounting. Therefore, these redemption features and participation rights value are being accounted for as derivative instruments and the fair value of these derivative instruments were bifurcated from the Series E Redeemable Preferred and recorded as a liability. See discussion in Note 10.

#### Series F Redeemable Preferred

The Series F COD authorizes one (1) shares of Series F Redeemable Preferred. The Series F Redeemable Preferred had 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 was entitled to a number of votes equal to 4,559,971 shares of our common stock, but, the number of votes that may be cast by the Series F Redeemable Preferred was reduced automatically to 456,225 shares of common stock upon the exercise of the warrants during 2016 as discussed below.

With respect to the distribution of assets upon liquidation, dissolution or winding up of LSB, whether voluntary or involuntary, the Series F Redeemable Preferred ranks (i) senior to our common stock and (ii) ranks junior to LSB's Series B 12% Cumulative Convertible Preferred Stock, Series D 6% Cumulative Convertible Class C Preferred Stock, Series 4 Junior Participating Class C Preferred Stock, Series E Redeemable Preferred and any other class or series of stock of LSB after the date of the Series F COD that specifically ranks senior to the Series F Redeemable Preferred.

The Series F Redeemable Preferred will be automatically redeemed by LSB, in whole and not in part, for \$0.01 immediately following the date upon which the Series F Voting Rights have been reduced to zero.

In the event of liquidation, the Series F Redeemable Preferred is entitled to receive its liquidation preference of \$100 before any such distribution of assets or proceeds is made to or set aside for the holders of our common stock and any other stock junior to the Series F Redeemable Preferred.

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

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

	Series E Redeemable Preferred Shares	Amount (Dollars In Thousands)	Series F Redeemable Preferred Shares	Amount
Balance at December 31, 2017	139,768	\$ 174,959	1	\$ —
Fees associated with letter agreement		(2,776 )	—	—
Bifurcation of embedded derivative		(229 )	—	—
Accretion relating to liquidation preference on				
preferred stock	—	2,153	—	—
Accretion for discount and issuance costs on				
preferred stock	—	1,222	—	—
Accumulated dividends	—	26,840	—	—
Balance at December 31, 2018	139,768	\$ 202,169	1	\$ —

F-32

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 11. Securities Financing Including Redeemable Preferred Stocks (continued)

### Warrants

In conjunction with the issuance of the Series E and Series F Redeemable Preferred in December 2015 to the Purchaser, we issued warrants to the Purchaser to purchase 4,103,746 shares of common stock. Each warrant afforded the holder the opportunity to purchase one share of common stock at a warrant exercise price of \$0.10. During 2016, all of the Warrants were exercised by the holder in a cashless exercise resulting in the issuance of 4,103,746 shares of our common stock, of which 34,422 shares of common stock were surrendered (shares classified as treasury stock) by the holder in payment of the exercise price.

## 12. Stockholders' Equity

2016 Long Term Incentive Plan – During 2016, our Board adopted our 2016 Long Term Incentive Plan (the “2016 Plan”), which plan was approved by our shareholders at our annual meeting of shareholders held on June 2, 2016. The effective date of the 2016 Plan is April 19, 2016 and no awards may be granted under the 2016 Plan on and after the tenth anniversary of its effective date.

In addition, no further awards will be granted under our 2008 Incentive Stock Plan (the “2008 Plan”) or our Outside Directors Stock Purchase Plan (the “Outside Director Plan”) on or after the effective date of the 2016 Plan. Any awards that remain outstanding under the 2008 Plan or the Outside Director Plan will continue to be governed by the respective plan’s terms and the terms of the specific award agreement, as applicable.

The maximum aggregate number of shares reserved and available for issuance under the 2016 Plan shall not exceed 2,750,000 shares plus any shares that become available for reissuance under the share counting provisions of the 2008 Plan following the effective date of the 2016 Plan, subject to adjustment as permitted under the 2016 Plan. Shares subject to any award that is canceled, forfeited, expires unexercised, settled in cash in lieu of common stock or otherwise terminated without a delivery of shares to a participant will again be available for awards under the 2016 Plan to the extent allowable by law. Under the 2016 Plan, awards may be made to employees, directors and consultants (for services rendered) of LSB or our subsidiaries subject to limitations as defined by the 2016 Plan.

The 2016 Plan will be administered by the compensation committee (the “Committee”) of our Board. Our Board or the Committee may amend the 2016 Plan, except that if any applicable statute, rule or regulation requires shareholder approval with respect to any amendment of the 2016 Plan, then to the extent so required, shareholder approval will be obtained. Shareholder approval will also be obtained for any amendment that would increase the number of shares stated as available for issuance under the 2016 Plan.

The following may be granted by the Committee under the 2016 Plan:

Stock Options – The Committee may grant either incentive stock options or non-qualified stock options. The Committee sets option exercise prices and terms, except that the exercise price of a stock option may be no less than 100% of the fair market value, as defined in the 2016 Plan, of the shares on the date of grant. At the time of grant, the Committee will have sole discretion in determining when stock options are exercisable and when they expire, except that the term of a stock option cannot exceed 10 years subject to certain conditions.





LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 12. Stockholders' Equity (continued)

Stock Appreciation Rights ("SARs") – The Committee may grant SARs as a right in tandem with the number of shares underlying stock options granted under the 2016 Plan or on a stand-alone basis. SARs are the right to receive payment per share of the SAR exercised in stock or in cash equal to the excess of the share's fair market value, as defined in the 2016 Plan, on the date of exercise over its fair market value on the date the SAR was granted. Exercise of a SAR issued in tandem with stock options will result in the reduction of the number of shares underlying the related stock option to the extent of the SAR exercise.

Stock Awards, Restricted Stock, Restricted Stock Units, and Other Awards – The Committee may grant awards of restricted stock, restricted stock units, and other stock and cash-based awards, which may include the payment of stock in lieu of cash (including cash payable under other incentive or bonus programs) or the payment of cash (which may or may not be based on the price of our common stock).

Stock Incentive Plans - The following information relates to our long-term incentive plans:

	December 31, 2018	
	2016 Plan	2008 Plan
Maximum number of securities for issuance	2,750,000	
Number of awards available to be granted (1)	1,825,150	
Number of unvested restricted stock/restricted		
stock units outstanding	597,533	210,266
Number of options outstanding	—	124,000
Number of options exercisable	—	100,620

(1) Includes 2008 Plan shares canceled, forfeited, expired unexercised, which became available for reissuance under the 2016 Plan after the effective date of the 2016 Plan.

Restricted Stock and Restricted Stock Units – During 2018, 2017, and 2016, the Committee approved various grants under the 2016 Plan of shares of restricted stock to certain executives and employees. Most of these shares vest at the end of each one-year period at the rate of one-third per year for three years while a portion of these grants vest 100% at the end of three years. The unvested restricted shares carry dividend and voting rights. Sales of these shares are restricted prior to the date of vesting. Pursuant to the terms of the underlying restricted stock agreements, unvested restricted shares will immediately vest upon the occurrence of a change in control (as defined by agreement), termination without cause or death. The unvested shares carry dividend and voting rights. Sales of these shares are restricted prior to the date of vesting.

During 2016, four employees surrendered a total of 280,000 shares of stock options previously granted under the 2008 Plan. These employees were also granted shares of restricted stock. These transactions were accounted for as modifications of stock awards. The total incremental fair value of these modified awards (additional compensation cost) was approximately \$1.5 million and will be recognized on a straight-line basis over the requisite service period

of three years.

During 2018, 2017 and 2016, the Committee approved the grant of shares of restricted stock units (“RSU”) to our non-employee directors for payment of a portion of their director fees under the 2016 Plan. Each RSU represents a right to receive one share of our common stock following the grant date and are non-forfeitable. Vesting occurs upon the earliest to occur: (i) the director’s separation from service, (ii) the third anniversary of the grant date, or (iii) the occurrence of a change of control as defined by the agreement. Based on terms of the RSU agreements, the grant date fair value was recognized as stock-based compensation expense (SG&A) on the grant date in 2018, 2017 and 2016.

On December 30, 2018, the Committee approved the grant of 210,602 shares of performance-based restricted stock (“PBRS”) to certain executives. However, key information to finalize the performance targets and range of vesting shares are based on projections which required approval from the Board. As the approval was obtained in early January, the grant date for financial reporting purposes is January 2019. Therefore, these PBRS shares are not reflected in the information below.

F-34

---

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

12. Stockholders' Equity (continued)

A summary of restricted stock activity during 2018 is presented below:

	Restricted Stocks		Restricted Stock Units	
	Shares	Weighted-Average Grant Date Fair Value	Shares	Weighted-Average Grant Date Fair Value
Unvested restricted stock outstanding at beginning of year	1,189,473	\$ 7.51	43,764	\$ 11.42
Granted	369,350	\$ 5.47	35,511	\$ 5.28
Vested	(806,927 )	\$ 9.11	(10,941)	\$ 11.42
Cancelled or forfeited	(12,431 )	\$ 6.20	—	\$ —
Unvested restricted stock outstanding at end of year	739,465	\$ 7.79	68,334	\$ 8.23

	Restricted Stock		
	2018	2017	2016
Shares of restricted stock granted	369,350	469,465	850,771
Total fair value of restricted stock granted	\$2,019,000	\$4,277,000	\$6,652,000
Weighted-average fair value per restricted stock granted during year	\$5.47	\$9.11	\$7.82
Stock-based compensation expense - Cost of sales	\$385,000	\$312,000	\$240,000
Stock-based compensation expense - SG&A (1)	\$7,574,000	\$3,987,000	\$2,773,000
Income tax benefit	\$(398,000 )	\$(1,659,000)	\$(1,157,000)
Total weighted-average remaining vesting period in years	1.78	1.95	2.41
Total fair value of restricted stock vested during the year	\$7,355,000	\$3,124,000	\$2,579,000

(1) See Note 15-Related Party Transactions.

	Restricted Stock Units		
	2018	2017	2016
Shares of restricted stock units granted	35,511	37,992	27,654
Total fair value of restricted stock unit granted	\$187,000	\$375,000	\$375,000
Weighted-average fair value per restricted stock unit granted during year	\$5.28	\$9.87	\$13.56
Stock-based compensation expense - SG&A	\$187,000	\$375,000	\$375,000
Income tax benefit	\$(34,000 )	\$(115,000)	\$(144,000)
Total weighted-average remaining vesting period in years	1.75	3.05	2.50
Total fair value of restricted stock vested during the year	\$125,000	\$250,000	\$—

Stock Options – No stock options have been granted under the 2016 Plan during 2018, 2017 or 2016. As it relates to stock options granted under the 2008 plan, the exercise price of the outstanding options granted were equal to the market value of our common stock at the date of grant and vest at the end of each one-year period at the rate of 16.5% per year for the first five years and the remaining unvested options will vest at the end of the sixth year. The fair value for of the stock options granted under the 2008 Plan were estimated, using an option pricing model, as of the date of the grant, which date was also the service inception date.

The following table summarizes information about these granted stock options:

	2018	2017	2016
Total weighted-average remaining vesting period in years	1.05	1.53	2.25
Stock-based compensation expense - Cost of Sales	\$ 141,000	\$ 317,000	\$ 321,000
Stock-based compensation expense - SG&A	\$ 71,000	\$ 108,000	\$ 836,000
Income tax benefit	\$(54,000 )	\$(164,000)	\$(444,000)

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

12. Stockholders' Equity (continued)

At December 31, 2018, the total stock-based compensation expense not yet recognized is \$3,228,000, relating to non-vested restricted stock and stock options, which we will be amortizing (subject to adjustments for actual forfeitures) through the respective remaining vesting periods through December 2021.

The following information relates to our stock options:

	2018	
	Shares	Weighted-Average Exercise Price
Outstanding at beginning of year	206,210	\$ 30.34
Granted	—	\$ —
Exercised	(2,525 )	\$ 7.86
Forfeited or expired	(79,685 )	\$ 25.59
Outstanding at end of year	124,000	\$ 33.86
Exercisable at end of year	100,620	\$ 33.97

	2018	2017	2016
Total intrinsic value of options exercised during the year	\$—	\$—	\$216,000
Total fair value of options vested during the year	\$169,000	\$451,000	\$469,000

Stock Options Outstanding At December 31,  
2018

		Weighted-Average		
		Remaining	Weighted-	Intrinsic
		Contractual	Average	Value of
Shares	Life	Exercise	Exercise	Shares
Exercise Prices	Outstanding	Years	Price	Outstanding
\$ 33.36	70,000	3.34	\$ 18.83	—
\$ 34.50	54,000	1.27	\$ 15.02	—
\$33.36 - \$34.50	124,000	4.61	\$ 33.85	\$ —

Stock Options Exercisable At December 31,  
2018

Exercise Prices	Shares Outstanding	Weighted- Average Remaining Contractual Life in Years	Weighted- Average Exercise Price	Intrinsic Value of Shares Outstanding
\$ 33.36	46,620	2.74	\$ 15.46	—
\$ 34.50	54,000	1.57	\$ 18.52	—
\$33.36 - \$34.50	100,620	4.31	\$ 33.98	\$ —

Other – As of December 31, 2018, we have reserved 1.4 million shares of common stock issuable upon potential conversion of preferred stocks and equity awards pursuant to their respective terms.

### 13. Non-Redeemable Preferred Stock

Series Non-Redeemable B Preferred – The 20,000 shares of Series B 12% cumulative, convertible preferred stock (“Series B Preferred”), \$100 par value, are convertible, in whole or in part, into 666,666 shares of our common stock (33.3333 shares of common stock for each share of preferred stock) at any time at the option of the holder and entitle the holder to one vote per share. The Series B Preferred provides for annual cumulative dividends of 12% (\$12.00 per share) from date of issue, payable when and as declared. All of the outstanding shares of the Series B Preferred are owned by the Golsen Holders.

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 13. Non-Redeemable Preferred Stock (continued)

Series Non-Redeemable D Preferred – The 1,000,000 shares of Series D 6% cumulative, convertible Class C preferred stock (“Series D Preferred”) have no par value and are convertible, in whole or in part, into 250,000 shares of our common stock (1 share of common stock for 4 shares of preferred stock) at any time at the option of the holder. Dividends on the Series D Preferred are cumulative and payable annually in arrears at the rate of 6% per annum (\$0.06 per share) of the liquidation preference of \$1.00 per share. Each holder of the Series D Preferred shall be entitled to .875 votes per share. All of the outstanding shares of Series D Preferred are owned by the Golsen Holders.

See discussions concerning dividends on the Series B and D Preferred in Note 15 – Related Party Transactions.

Other – At December 31, 2018, we are authorized to issue an additional 230,000 shares of \$100 par value preferred stock and an additional 3,860,000 shares of no-par value preferred stock. Upon issuance, our Board will determine the specific terms and conditions of such preferred stock.

## 14. Executive Benefit Agreement, Employee Savings Plans and Collective Bargaining Agreements

We are party to death benefit agreement (“2005 Agreement”) with Jack E. Golsen, who retired as discussed in Note 15-Related Party Transactions.

The 2005 Agreement provides that, upon Mr. Golsen’s death, we will pay to the designated beneficiary, a lump-sum payment of \$2,500,000 to be funded from the net proceeds received by us under certain life insurance policies on his life that are owned by us. We are obligated to keep in existence life insurance policies with a total face amount of no less than \$2,500,000 of the stated death benefit.

The following table includes information about these agreements:

	December 31,	
	2018	2017
	(In Thousands)	
Total undiscounted death benefit	\$2,500	\$2,424
Total accrued death benefit	\$2,585	\$2,533

December 31,  
2018 2017 2016



(In Thousands)

Costs (recovery of costs) associated with executive benefit			
included in SG&A, net (1)	\$17	\$ 9	\$(341)

(1) During 2016, the employment of certain executives were terminated, resulting in the forfeiture of the respective benefits. As a result of this event, the accrual for this estimated benefit was derecognized resulting in a net recovery of costs associated with certain executive benefits.

The accrued executive benefit under the 2005 Agreement is included in noncurrent accrued and other liabilities. We accrue for such liabilities when they become probable and discount the liabilities to their present value.

To assist us in funding the 2005 Agreement and for other business reasons, we purchased life insurance policies on various individuals in which we are the beneficiary. Some of these life insurance policies have cash surrender values that we have borrowed against. The net cash surrender values of these policies are included in other assets.

F-37

---

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 14. Executive Benefit Agreement, Employee Savings Plans and Collective Bargaining Agreements (continued)

The following table summarizes certain information about these life insurance policies.

	December 31,	
	2018	2017
	(In Thousands)	
Total face value of life insurance policies	\$4,500	\$4,500
Total cash surrender values of life insurance policies	\$1,656	\$1,804
Loans on cash surrender values	(1,559)	(1,482)
Net cash surrender values	\$97	\$322

	2018	2017	2016
	(In Thousands)		
Cost of life insurance premiums	\$54	\$14	\$481
Decreases (increases) in cash surrender values	149	162	(51)
Net cost of life insurance premiums included in SG&A	\$203	\$176	\$430

Employee Savings Plans - We sponsor a savings plan under Section 401(k) of the Internal Revenue Code under which participation is available to substantially all full-time employees. We do not presently contribute to this plan except for certain employees, which amounts were not material for each of the three years ended December 31, 2018. Beginning in January 2019, we will begin matching 50% of an employee's contribution, up to 6%, for substantially all full-time employees.

Collective Bargaining Agreements - As of December 31, 2018, we employed 576 persons, 193 of whom are represented by unions under agreements, which will expire in July of 2019 through July of 2021.

## 15. Related Party Transactions

During 2018, we sold \$50.0 million and \$0.5 million principal amount of notes to an affiliate of Security Benefit Corporation ("SBC") and Daniel D. Greenwell, respectively, associated with the issuance and sale of the Senior Secured Notes discussed in footnote (B) of Note 7. As discussed in Note 11, we paid a fee of \$2.7 million to an affiliate of SBC relating to the letter agreement amending the terms of the Series E Redeemable Preferred. As discussed in Note 11, all outstanding shares of the Series E and Series F Redeemable Preferred are held by this affiliate. Pursuant to the terms of the Board Representation and Standstill Agreement, our Board includes two directors that are employees of SBC and affiliates. During 2018, 2017 and 2016, we incurred director fees associated with these directors totaling approximately \$0.3 million for each respective year.

Effective December 30, 2018, Daniel D. Greenwell elected not to enter into a new employment agreement and resigned from the Board and his roles as Chairman and our Chief Executive Officer. Subject to the execution of a release agreement, which was executed in January 2019, Mr. Greenwell was entitled to certain severance benefits pursuant to the terms of his employment agreement. At December 31, 2018, our accrued and other liabilities include approximately \$2.8 million relating primarily to severance benefits owed to Mr. Greenwell. In addition, approximately \$2.7 million of share-based compensation was incurred due to the accelerated vesting of 312,369 shares of restricted stock.

No dividends were declared during 2018, 2017 and 2016. At December 31, 2018, accumulated dividends on the Series B and Series D Preferred totaled approximately \$978,000. 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 2018, 2017 and 2016, we incurred director fees associated with Barry H. Golsen totaling approximately \$0.1 million for each respective year.

As the result of Jack E. Golsen (“J. Golsen”) informing the Board of his election to retire as Executive Chairman effective December 31, 2017, we determined not to extend the employment agreement with J. Golsen beyond its current term expiring on December 31, 2017 (the “Retirement Date”) and, in accordance with the terms his employment agreement, delivered a notice of non-renewal to J. Golsen. J. Golsen will remain a member of the Board and, following the Retirement Date, will have the title of Chairman Emeritus.

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

#### 15. Related Party Transactions (continued)

During 2017, we entered into a transition agreement (the “Transition Agreement”) with J. Golsen that commenced on January 1, 2018 and end upon the earlier of his death or a change in control as defined in the Transition Agreement. During the term, J. Golsen will receive an annual cash retainer of \$480,000 and an additional monthly amount of \$4,400 to cover certain expenses. In accordance with the terms of the Transition Agreement, we will also reimburse J. Golsen for his cost of certain medical insurance coverage until his death. Effective as of the Retirement Date, our existing severance agreement with J. Golsen will terminate. In consideration for his services, including as Chairman Emeritus, we will pay J. Golsen a one-time payment equal to \$2,320,000 upon the consummation of a change in control that occurs prior to his death.

During 2017, a death benefit agreement with J. 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 \$1.4 million for the estimated death benefit associated with this agreement was extinguished and derecognized with the offset classified as operating other income in 2017.

During 2017, we sold our engineered products business (industrial machinery and related components) to Industrial Acquisitions LLC and Industrial Products LLC (both entities are owned by immediate family members of J. Golsen) for \$3.5 million which sale resulted in a loss of approximately \$0.8 million, classified as operating other expense.

During 2016, we entered into a consulting agreement with Steven J. Golsen (“S. Golsen”), son of J. Golsen and former employee and President and Chief Operating Officer of the Climate Control Business. Pursuant to the terms of the agreement, S. Golsen provided services relating to the sale of the Climate Control Business and subsequent services to improve the transition process from LSB to NIBE. The total consulting fee was approximately \$0.4 million and the term of the agreement was for 2 years through May 2018.

During 2016, we executed agreements, sold and assigned our rights in certain life insurance policies owned by us as beneficiary. The purchase price of these policies was the cash surrender value at the time of purchase. These policies insured our two Board members, J. Golsen and Barry H. Golsen and a former employee, S. Golsen. We received approximately \$1.7 million from the sale of these life insurance policies.

During 2016, we incurred consulting fees of approximately \$0.1 million from one of our Board members, Mr. Richard Sanders. These fees relate to services performed by Mr. Sanders as an Interim Executive Vice President, Chemical Manufacturing, which involved the oversight of our chemical plant operations during this time period. On August 1, 2016, these consulting services ceased when we appointed Mr. John Diesch in this executive position.

#### 16. Supplemental Cash Flow Information

The following provides additional information relating to cash flow activities:

2018	2017	2016
------	------	------

Edgar Filing: LSB INDUSTRIES INC - Form 10-K

(In Thousands)

Cash payments (refunds) for:			
Interest on long-term debt and other, net of capitalized			
interest	\$35,719	\$34,274	\$28,049
Income taxes, net	\$(1,138 )	\$(674 )	\$(2,611 )
Noncash investing and financing activities:			
Incentive tax credit receivable associated with property,			
plant and equipment	\$—	\$8,125	\$—
Supplies and accounts payable associated with			
additions of property, plant and equipment	\$16,484	\$17,105	\$16,056
Dividend accrued on redeemable preferred stock	\$26,840	\$23,443	\$19,733
Accretion of redeemable preferred stock	\$3,375	\$6,487	\$6,546

F-39

---

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

## 17. Discontinued Operations

During 2016, LSB completed the sale of all the stock of Climate Control Group Inc. (an indirect subsidiary that conducted LSB's Climate Control Business) pursuant to the terms of the stock purchase agreement. Additionally, pursuant to the stock purchase agreement, we agreed to have a certain portion of the purchase price proceeds deposited in an indemnity escrow account. In conjunction with the Climate Control Business sale, we entered into a transition services agreement ("TSA"), pursuant to which, among other things, we agreed to provide certain information technology, payroll, legal, tax and other general services, which services have been completed. At December 31, 2017 our accounts receivable included approximately \$2.7 million relating to the sale of our Climate Control Business representing an indemnity escrow balance which balance was received in 2018.

Summarized results of discontinued operations are as follows for:

	Year Ended December 31, 2017 2016 (In Thousands)	
Net sales	\$—	\$138,609
Cost of sales	—	93,178
Selling, general and administrative expense	—	32,719
Transaction costs	—	2,535
Other expense (income), net	—	175
Income from operations of discontinued operations	—	10,002
Gain on sale of discontinued operations	2,595	281,990
Provision for income taxes	1,519	91,691
Income from discontinued operations, net of taxes	\$1,076	\$200,301

Summarized condensed cash flow information of discontinued operations is as follows:

	Year Ended December 31, 2017 2016 (In Thousands)	
Deferred income taxes	\$2,461	\$88,356
Depreciation and amortization of property, plant and equipment	\$—	\$1,607
Stock-based compensation	\$—	\$955
Expenditures for property, plant and equipment	\$—	\$273
Software and software development costs	\$—	\$675

F-40

---

LSB Industries, Inc.

Supplementary Information

Quarterly Financial Data (Unaudited)

Summarized unaudited quarterly financial data for 2018 and 2017 are as follows.

	Three months ended			
	March 31	June 30	September 30	December 31
	(In Thousands, Except Per Share Amounts)			
<b>2018</b>				
Net sales	\$100,450	\$103,199	\$79,781	\$94,730
Gross profit (loss) (1)	\$10,093	\$3,073	\$(9,742)	\$12,411
Net loss (1) (2)	\$(5,591)	\$(27,506)	\$(26,084)	\$(13,045)
Net loss attributable to common stockholders	\$(13,603)	\$(35,011)	\$(33,422)	\$(20,705)
Basic and dilutive loss per common share:	\$(0.49)	\$(1.27)	\$(1.22)	\$(0.75)
<b>2017</b>				
Net sales	\$123,344	\$122,853	\$92,390	\$88,917
Gross profit (loss) (1)	\$11,615	\$11,340	\$(7,285)	\$(10,204)
Net income (loss) (1) (2)	\$(5,986)	\$(7,033)	\$(17,112)	\$914
Net loss attributable to common stockholders	\$(13,196)	\$(14,515)	\$(24,745)	\$(6,991)
Income (loss) per common share:				
Basic and dilutive:				
Loss from continuing operations	\$(0.48)	\$(0.53)	\$(0.91)	\$(0.30)
Income from discontinued operations, net of taxes	—	—	—	0.04
Net income (loss)	\$(0.48)	\$(0.53)	\$(0.91)	\$(0.26)

F-41



LSB Industries, Inc.

Supplementary Financial Data

Quarterly Financial Data (Unaudited)

(1) The following income (expense) items impacted gross profit (loss) and net income (loss):

	Three months ended			
	March 31	June 30	September 30	December 31
	(In Thousands)			
<b>Recovery from a settlement with a vendor</b>				
2018	\$—	\$—	\$—	\$ 4,419
<b>Turnaround expense: (A)</b>				
2018	\$(302)	\$(1,412)	\$(7,939)	\$(116)
2017	\$—	\$(120)	\$(1,098)	\$(102)
<b>Recovery of precious metals:</b>				
2017	\$—	\$2,905	\$—	\$—

(2) The following income (expense) items impacted net income (loss):

<b>Loss on extinguishment of debt</b>				
2018	\$—	\$—	\$(5,951)	\$—
<b>Interest expense, net:</b>				
2018	\$(9,306)	\$(11,693)	\$(11,009)	\$(11,056)
2017	\$(9,358)	\$(9,292)	\$(9,291)	\$(9,326)
<b>Severance benefits and accelerated stock-based compensation</b>				
2018	\$—	\$—	\$—	\$(5,300)
<b>Benefit (provision) for income taxes:</b>				
2018	\$922	\$(4,324)	\$2,426	\$(764)
2017	\$1,282	\$2,761	\$6,698	\$30,018
<b>Income from discontinued operations, net of taxes</b>				
2017	\$—	\$—	\$—	\$1,076

(A) Turnaround expenses do not include the impact on operating results relating to lost absorption or reduced margins due to the associated plants being shut down.

F-42

---

LSB Industries, Inc.

## Schedule II - Valuation and Qualifying Accounts

Years ended December 31, 2018, 2017, and 2016

(In Thousands)

Description (1)	Balance at Beginning of Year	Additions-		Balance at End of Year
		Charges to (Recovery of) Costs and Expenses	Deductions- Write- offs/Costs Incurred	
<b>Accounts receivable - allowance for doubtful accounts:</b>				
2018	\$ 303	\$ 124	\$ 76	\$ 351
2017	\$ 357	\$ (54 )	\$ —	\$ 303
2016	\$ 525	\$ 80	\$ 248	\$ 357
<b>Supplies-reserve for slow-moving items:</b>				
2018	\$ 15	\$ —	\$ —	\$ 15
2017	\$ 15	\$ —	\$ —	\$ 15
2016	\$ 928	\$ —	\$ 913	\$ 15
<b>Notes receivable - allowance for doubtful accounts:</b>				
2016	\$ 970	\$ —	\$ 970	\$ —
<b>Deferred tax assets - valuation allowance:</b>				
2018	\$ 26,920	\$ 21,042	\$ 2,336	\$ 45,626
2017	\$ 13,128	\$ 13,792	\$ —	\$ 26,920
2016	\$ 1,242	\$ 11,886	\$ —	\$ 13,128

(1)Deducted in the consolidated balance sheet from the related assets to which the reserve applies. Other valuation and qualifying accounts are detailed in our notes to consolidated financial statements.

F-43