3COM CORP
Form S-3
January 17, 2003

QuickLinks -- Click here to rapidly navigate through this document

As filed with the Securities and Exchange Commission on January 17, 2003
Registration No. 333-

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM S-3
REGISTRATION STATEMENT

Under
The Securities Act of 1933

3COM CORPORATION

(Exact name of Registrant as specified in its charter)

Delaware	**94-2605794**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

5500 Great America Parkway
Santa Clara, CA 95052-8145
(408) 326-5000

(Address, including zip code, and telephone number, including area code, of Registrant's principal executive offices)

Mark D. Michael
Vice President, Secretary and General Counsel
3Com Corporation
5500 Great America Parkway
Santa Clara, CA 95052-8145
(408) 326-5000

(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

Katharine A. Martin, Esq.
Jeffrey S. Cannon, Esq.
Wilson Sonsini Goodrich & Rosati
Professional Corporation
650 Page Mill Road
Palo Alto, California 94304
(650) 493-9300

Approximate date of commencement of proposed sale to the public: From time to time after the effective date of this Registration Statement.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. o

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only connection with dividend or interest reinvestment plans, check the following box. ý

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. o

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered	Proposed Maximum Offering Price Per Share	Proposed Maximum Aggregate Offering Price	Amount of Registration Fee
Common Stock, $0.01 par value	7,100,000	$9.31(1)	$66,101,000(1)	$6,081.29

(1) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(g) under the Securities Act of 1933, as amended.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with section 8(a) of the Securities Act of 1933, as amended (the "Securities Act") or until this Registration Statement shall become effective on such date as the Securities Exchange Commission (the "SEC"), acting pursuant to said Section 8(a), may determine.

SUBJECT TO COMPLETION, DATED JANUARY 17, 2003

PROSPECTUS

The information in this Prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This Prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

7,100,000 Shares

3Com Corporation

Common Stock

($0.01 Par Value)

This is an offering of common stock of 3Com Corporation, or 3Com. All of the shares are being offered by the selling stockholder listed in the section of this prospectus entitled "Selling Stockholder." We will not receive any of the proceeds from the sale of the 7,100,000 shares being offered by the selling stockholder. The shares of common stock are issuable to the selling stockholder upon an exercise of a warrant. We may receive proceeds upon the exercise of the warrant. The warrant has an exercise price of $9.31 per share.

Our common stock trades on the Nasdaq National Market under the symbol "COMS." On January 15, 2003, the closing sales price for our common stock on the Nasdaq National Market was $4.79 per share.

Investment in our common stock involves a high degree of risk. See "Risk Factors" beginning on page 2 of this prospectus to read about risks of investing in our common stock.

Neither the Securities and Exchange Commission, nor any state securities commission, has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is .

TABLE OF CONTENTS

We have not authorized any person to give any information or to make any representation other than those contained in this prospectus in connection with this offering. You should not rely on such information or representation. Neither the delivery of this prospectus or any sale made pursuant to this prospectus shall create any implication that the information contained in this prospectus is correct as of any time subsequent to the date hereof. This prospectus does not constitute an offer to sell or solicitation of an offer to buy any security other than the common stock covered by this prospectus.

SUMMARY OF THE OFFERING

Under this prospectus, the selling stockholder listed in the section of this prospectus entitled "Selling Stockholder" may offer and sell shares of our common stock that they may acquire through the exercise of a warrant they hold to purchase up to 7,100,000 shares of our common stock.

The selling stockholder may sell its shares of common stock in the open market at prevailing market prices or in private transactions at negotiated prices. It may sell the shares directly, or may sell them through underwriters, brokers or dealers. Underwriters, brokers or dealers may receive discounts, concessions or commissions from the selling stockholders or from the purchaser, and this compensation might be in excess of the compensation customary in the type of transaction involved. See the section of this prospectus entitled "Plan of Distribution."

We will not receive any proceeds from the potential sale of the 7,100,000 shares offered by the selling stockholder. We may receive proceeds upon the exercise of the warrant. The warrant has an exercise price of $9.31 per share.

RECENT DEVELOPMENTS

We adopted Statement of Financial Accounting Standards ("SFAS") 142 on June 1, 2002 and ceased amortization of net goodwill totaling $66.5 million, which included $0.7 million of acquired workforce intangible previously classified as purchased intangible assets. We completed the transitional goodwill impairment evaluation prescribed by SFAS 142 in the second quarter of fiscal 2003, and have amended our Quarterly Report on Form 10-Q for the quarterly period ended August 30, 2002 to record a charge totaling $65.6 million as a change in accounting principle effective June 1, 2002 to write off goodwill of $45.4 million in our Enterprise Networking segment and $20.2 million in our CommWorks segment. The remaining recorded goodwill after this impairment charge was $0.9 million as of August 30, 2002, and related solely to our Connectivity segment. A reconciliation of previously reported net income (loss) and net income (loss) per share to the amounts adjusted for the exclusion of goodwill and acquired workforce amortization follows (in thousands, except per share amounts):

	Year ended		
	May 31, 2002	**June 1, 2001**	**June 2, 2000**
Reported net income (loss)	$ (595,950)	$ (965,376)	$ 674,303
Add back goodwill and acquired workforce amortization, net of taxes	31,813	34,323	12,699
Adjusted net income (loss)	$ (564,137)	$ (931,053)	$ 687,002
Basic earnings per share			
Reported net income (loss) per share	$ (1.71)	$ (2.80)	$ 1.94
Add back goodwill and acquired workforce amortization, net of taxes	0.10	0.10	0.03
Adjusted net income (loss)	$ (1.61)	$ (2.70)	$ 1.97
Diluted earnings per share			
Reported net income (loss) per share	$ (1.71)	$ (2.80)	$ 1.88
Add back goodwill and acquired workforce amortization, net of taxes	0.10	0.10	0.03
Adjusted net income (loss)	$ (1.61)	$ (2.70)	$ 1.91
Shares used in computing per share amounts:			
Basic	349,489	345,027	348,314
Diluted	349,489	345,027	357,883

RISK FACTORS

An investment in our common stock involves a high degree of risk. In addition to the other information contained in this prospectus, you should carefully consider the following risks before purchasing our common stock. If any of these risks occurs, our business, financial condition and operating results could be materially adversely affected. In that case, the trading price of our common stock could decline and you could lose all or part of your investment.

You should not rely upon the forward-looking statements in this prospectus.

We make many statements in this prospectus that are forward-looking statements. These statements relate to our future plans, objectives, expectations and intentions. We may identify these statements by the use of words such as "expect," "anticipate," "intend," "plan" and similar expressions. These forward-looking statements involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those we discuss in "Risk Factors" and elsewhere in this prospectus. These forward-looking statements speak only as of the date of this prospectus, and you should not rely on these statements without also considering the risks and uncertainties associated with these statements and our business.

Business Environment and Industry Trends

Industry trends and specific risks may affect our future business and results in our business. Some of the factors that could cause future results to materially differ from past results or those described in forward-looking statements include the matters discussed below.

Our business and our ability to grow revenues has been adversely impacted by the economic slowdown and related uncertainties affecting markets in which we operate

Adverse economic conditions worldwide have contributed to a technology industry slowdown and impacted our business resulting in:

- reduced demand for most of our products;
- increased price competition for our products;
- increased risk of excess and obsolete inventories;
- excess facilities and manufacturing capacity; and
- higher overhead costs, as a percentage of revenues.

Recent political and social turmoil in many parts of the world, including actual incidents and potential future acts of terrorism and war, may continue to put pressure on global economic conditions. These political, social and economic conditions and uncertainties make it extremely difficult for 3Com, our customers and our vendors to accurately forecast and plan future business activities. This reduced predictability challenges our ability to operate profitably or to increase revenues. In particular, it is difficult to develop and implement strategies, sustainable business models and efficient operations, and effectively manage outsourced relationships for certain contract manufacturing and information technology services. If the current economic or market conditions continue or further deteriorate, there could be additional material adverse impact on our financial position, revenues, results of operations and cash flow.

We face operational risks in implementing our strategy to evaluate and implement the outsourcing of certain functions that do not differentiate our ability to compete successfully and achieve profitable growth

We are continuing to evaluate the potential for outsourcing certain functions or operations that do not differentiate 3Com or create a competitive advantage for our company supporting profitable growth. This outsourcing strategy has included certain software development for IT applications and outsourcing a substantial portion of 3Com's IT infrastructure. Implementation of such outsourcing may not result in reduction of actual costs associated with such services or function and may increase risk of disruption of operations upon which we rely on third parties to meet our needs. Moreover, future events are unpredictable and there may be substantial penalties for terminating agreements early or failing to maintain minimum service levels.

We face operational risks in consolidating our research and development design centers

As part of our ongoing cost reduction efforts in our CommWorks business, we are consolidating our research and development activities into fewer design centers. These consolidation activities involve significant transfers of product development efforts among design centers and reductions in employment. Failure to properly manage the consolidation activities could result in disruptions to our

product development programs which, in turn, could adversely impact the cost or timing of introducing new or enhanced products, revenues or overall financial performance.

Cost containment and expense reductions are critical to achieving positive cash flow from operations and profitability

We are continuing efforts to reduce our expense structure. We believe strict cost containment and expense reductions are essential to achieving positive cash flow from operations in future quarters and returning to profitability, especially since the outlook for future quarters is subject to numerous challenges. Further costs and expense reductions may be sought if revenues and market conditions do not improve. A number of factors could preclude us from successfully bringing costs and expenses in line with our revenues, such as our inability to accurately forecast business activities, further deterioration of our revenues, and our inability to reduce our General and Administrative expenses commensurate with, and at the same pace as, any further deterioration in our revenues. If we are not able to effectively reduce our costs and achieve an expense structure commensurate with our business activities and revenues, we may have inadequate levels of cash for operations or for capital requirements, which could significantly harm our ability to operate the business.

We face increased competition and our financial performance and future growth depend upon sustaining or growing market positions in our existing markets and successfully targeting new markets

We face competitive challenges that are likely to arise from a number of factors, including:

- industry volatility resulting from rapid development and maturation of technologies;
- industry consolidation resulting in competitors with greater financial, marketing and technical resources;
- greater competition for fewer customers as a result of consolidation in the reseller and distribution channels; potential consolidation among networking equipment providers; as well as consolidation in the telecommunications service provider market due to excess capacity and the financial difficulties being experienced by some service providers; and the potential emergence of new competitors with lower cost structures and more competitive offerings;
- increasing price competition in the face of weakening economic conditions, excess inventories and excess capacity in the telecommunications service provider market; and
- continuing silicon integration of networking products.

We compete in three specific markets that serve enterprise and telecommunications service provider customers. Our competitors range from large, diversified telecommunications equipment and networking companies to smaller companies with a more specialized focus. Our principal competitors in the Enterprise Networking segment include: Avaya, Inc., Cisco Systems, Inc. (Cisco), Dell Computer Corporation (Dell), D-Link Systems Inc. (D-Link), Enterasys Networks, Inc., Extreme Networks, Inc, Hewlett-Packard Company (HP), Linksys, Lucent Technologies Inc. (Lucent), and Nortel Networks Corporation (Nortel). In the Connectivity segment, our principal competitor is Intel Corporation; other competitors include Accton Technology Corporation, Broadcom Corporation, D-Link, Linksys and NetGear, Inc. Principal competitors in the telecommunications service provider market on a worldwide basis include: Cisco, Comverse Technology, Inc., Lucent, Nortel, and Sonus Networks, Inc.; other key competitors in selected regional markets include Huawei Technologies Co., Ltd., ZTE Corporation, NEC Corporation, and Oki Electric Industry Co., Ltd. As siliconization continues and networking functions become more embedded on the motherboard, we are increasingly facing competition from parties who are also our current suppliers of products. Our failure to compete successfully against current or future competitors could harm our business, operating results or financial condition. Likewise, integration of networking, communications, and computer processing functionality on a

reduced number of semiconductor components may adversely affect our future sales growth and operating results.

We are making significant investments in various technologies for emerging product lines. These investments include XRN technology, Gigabit Ethernet technology, IP telephony, CDMA wireless networking products and services, softswitch technologies, wireless LANs, Layer 3+ switching, network security technology (such as our embedded firewall products) and Network Jack switches. We expect these product lines to account for a higher percentage of our future sales over time, although the markets for these products and solutions are still emerging and may not develop to our expectations. Industry standards for some of these technologies are yet to be widely adopted and the market potential remains unproven. If the markets for these new technologies or products do not develop or grow as we expect, or if we have not adopted optimal sales and go-to-market strategies for these new technologies and products, our financial results could be adversely affected and we might need to change our business strategy.

Also, in the markets in which we compete, products have short life cycles and rapid technology transitions. Therefore, our success depends on our ability to identify new market and product opportunities, to develop and introduce new products in a timely manner, to gain market acceptance of new products, particularly in our targeted emerging markets, and to rapidly and efficiently transition our customers from older to newer connectivity technologies. Additionally, as we increase our reliance on relationships with strategic partners, such as original design manufacturer's (ODMs), we may encounter greater difficulties in quickly and effectively introducing new products with the quality, functionality, costs and features that are optimal for the market. This increased reliance may also limit our ability to independently identify current product and technology trends and respond to such trends. Any delay in new product introductions, lower than anticipated demand for our new products, failure to meet market needs for features or functionality or higher manufacturing costs could have an adverse affect on our operating results or financial condition, particularly in those product markets we have identified as emerging high-growth opportunities.

Future cash requirements or restrictions on cash could adversely impact our financial position; and an event of default under the Credit Facility may impair our ability to conduct business operations

We incurred net losses in fiscal 2002 and in the first half of fiscal 2003. Our overall cash balance declined in fiscal 2002 and, although we generated cash in the first half of fiscal 2003 we could incur negative overall cash flow in future quarters. If cash flow significantly deteriorates in the future, our liquidity and ability to operate our business could be adversely impacted. Additionally, our ability to raise financial capital may be hindered due to our net losses and the possibility of future negative cash flow, thus reducing our operating flexibility.

The following items could require unexpected future cash payments, limit our ability to generate cash or restrict our use of cash:

- triggering of certain payment obligations, breach of covenants or acceleration of payment obligations under our revolving and term loan facilities;
- inability to dispose of real estate holdings;
- taxes due upon the transfer of cash held in foreign locations; and
- taxes assessed by local authorities where we conduct business.

During fiscal 2002, we entered into a $210,000,000 revolving and term loan facility with a syndication of financial institutions led by Bank of America (the "Credit Facility") and, contemporaneously, we retired the operating lease arrangements we had with respect to certain of our real properties. The Credit Facility has a term of three years and is secured by priority liens over

certain assets (including inventory, accounts receivable, plant and equipment and certain real properties), but specifically excludes our cash, cash equivalents, short-term investments, equity investments and intellectual property. The primary financial covenant under the Credit Facility obligates us to maintain a minimum of $400 million of available cash, cash equivalents and short-term investments. Falling below $400 million would be an event of default and, among other things, (i) Bank of America may accelerate the payment of the complete facility, (ii) use of cash in certain bank accounts will be severely restricted, and (iii) significant operational constraints such as limitations on selling assets and funding certain operations, will automatically take effect. We also have the ability to prepay and terminate the Credit Facility at any time.

While we plan to adhere to the financial covenants of the Credit Facility and avoid an event of default, in the event that it appears we are unable to avoid an event of default, it may be necessary or advisable to retire and terminate the Credit Facility and pay all remaining balances borrowed. Such payment of the Credit Facility would further limit our available cash and cash equivalents. Furthermore, we may not be able to retire the Credit Facility if we do not have adequate resources available when necessary to avoid an event of default or if, because of a rapid decline in revenues and cash and cash equivalents, we do not have adequate time to retire the Credit Facility. The consequences of an event of default under the Credit Facility may prevent us from conducting normal business operations.

As we continue our efforts to consolidate our real estate portfolio and liquidate certain real estate holdings that we occupy or lease to third parties, we may enter into other financial arrangements, such as sale-leaseback or mortgage arrangements that may subject us to additional financial covenants and restrictions, thereby further reducing our operating flexibility. Notwithstanding the foregoing, because of the economic conditions in the U.S. and the fact that much of our real estate holdings are in Silicon Valley, which has been particularly hard hit by the technology industry slowdown, our ability to consolidate and liquidate our holdings or to use our real estate to support other financial arrangements to gain additional liquidity may be impaired. Additionally, to the extent that we continue to own excess facilities and are not able to lease the facilities, we will be adversely affected through continuing to bear the operating costs associated with these properties and the inability to generate rental income.

We maintain substantial cash deposits in foreign locations, portions of which may be subject to significant tax or tax withholding upon transfer or withdrawal. This risk is mitigated, but not completely eliminated, by the existence of our net operating losses and tax credit carryforwards. Furthermore, we regularly engage in discussions with tax authorities in various jurisdictions where we operate about our tax positions. While we believe our tax positions in these various jurisdictions are proper and fully defensible, these tax authorities may nevertheless assess taxes and render judgments against us if we are unable to convince them of our position. In such an event, we could be required to make unexpected cash payments in satisfaction of such assessments or judgments or incur additional expenses to defend our position.

The above cash requirements or restrictions could lead to an inadequate level of cash for operations or for capital requirements, which could have a material negative impact on our financial position and significantly harm our ability to operate the business.

Retaining key employees and management are critical to our success

Our success depends upon retaining and recruiting highly qualified employees and management personnel. This is especially important in our current operating structure involving three operating segments, since each management team must possess the skills, experience and talent to run its business on an independent basis. However, like many companies in the industries in which we operate, we face challenges in attracting and retaining highly qualified employees and management personnel. In addition, the significant downturn in our business environment has had a negative impact on our operations, and as a result, we have restructured our operations to reduce our workforce and

implement other cost reduction activities. Although we believe these various changes and actions will improve our organizational effectiveness and competitiveness, they could lead, in the short term, to disruptions in our business, reduced employee morale and productivity, increased attrition and problems with retaining existing employees and recruiting future employees and increased financial costs.

Recruiting and retaining skilled personnel, including engineers, sales representatives and product marketing managers, continues to be difficult. At certain locations where we operate the cost of living is extremely high and it may be difficult to attract and retain key employees and management personnel at a reasonable cost. If we cannot successfully recruit and retain such persons, our product introduction schedules, customer relationships, operating results and financial condition may become impaired and our overall ability to compete may be adversely affected.

A significant portion of our revenues is derived from sales to a small number of customers who may decide not to purchase our products in the future

We distribute many of our enterprise networking and connectivity products through two-tier distribution channels that include distributors, systems integrators and value-added resellers. We also sell to PC OEMs and telecommunications service providers. For enterprise networking and connectivity products, a significant portion of our sales is concentrated among a few distributors and OEM customers. There has been a recent trend of decreased demand for connectivity products from OEM customers such as Dell and HP, due to increased siliconization of networking connections and also to factors specific to our OEM customers. Additionally, consolidation in our distribution channels and among PC OEMs is reducing the number of customers in the domestic and international markets. In an effort to streamline our operations, we may increase the focus of our distribution sales resources on selected distribution channel customers.

For CommWorks products, a significant portion of our sales is concentrated with the major telecommunications service providers. We cannot be certain that these customers will continue to purchase our products at current levels, particularly in light of the serious challenges confronting the worldwide telecommunications industry. Such challenges are causing telecommunications service providers to experience serious credit problems and other financial difficulties and may result in far fewer companies surviving, thereby reducing competition and negatively impacting the amount and timing of purchases of telecommunications infrastructure equipment from us or other suppliers.

Our results of operations, financial condition, or market share could be adversely affected if our customers:

stop purchasing our products or focus more on buying or reselling our competitors' products;

reduce, delay, or cancel their orders or defer implementation of new emerging technologies and products; or

experience competitive, operational, or financial difficulties, impairing our ability to collect payments from them.

We depend on distributors who could negatively affect our operations by reducing the level of our products in their inventory

Our distributors maintain inventories of our products. We work closely with our distributors to monitor channel inventory levels and ensure that appropriate levels of products are available to resellers and end users. Notwithstanding such efforts, if our channel partners reduce their levels of inventory of our products or if they do not maintain sufficient levels of inventory of our products to meet customer demand, our sales could be negatively impacted.

Changes in sales channel mix to PC OEMs and product mix to lower margin connectivity products may negatively impact our revenues and margins

We sell our connectivity products to PC OEMs, PC ODMs who sell to PC OEMs, and to distributors who, in turn, sell to commercial enterprises. Sales to distributors typically generate higher ASPs and gross margins than sales to PC OEMs. The trend in sales for our enterprise connectivity products over the past several years has been a shift from two-tier distribution to PC OEMs and ODMs, with the result that our revenue from distribution sales has decreased as a percentage of our total revenues. This mix shift towards PC OEMs and ODMs has lowered the ASPs for our products. If this trend continues and we cannot lower our costs of the products or transition customers to products with higher ASPs, then our margins will be reduced and our financial results will be adversely impacted.

We derive a significant portion of our sales of connectivity products from PC OEMs such as Dell, Gateway, Inc., HP and International Business Machines Corporation, all of which are manufacturers that incorporate our NICs, PC cards, Mini-PCI, and ASIC products into their products. These companies also have begun utilizing chip sets that contain integrated Ethernet LAN connectivity solutions into their products. As Ethernet connectivity technology continues to mature, we have seen the incorporation of NIC, PC Card, and Mini-PCI product features into lower-priced form factors such as LOM and integrated into the chip sets on the motherboard. Certain competitors that have a significant share of the PC chip set market may be bundling such PC chip sets with integrated LAN connectivity at little or no price premium to PC chip sets without LAN connectivity. This bundling of PC chip sets and LAN connectivity will have an adverse impact on competition in the LAN connectivity market, including a significant negative impact on our ability to sell LAN connectivity solutions to our existing PC OEM or ODM customers. We expect that PC OEMs and ODMs increasingly will purchase the lower-priced form factors of connectivity products. If we cannot lower our costs of the products or transition customers to products with higher ASPs, then our margins will be reduced and our financial results will be adversely impacted.

Continued slowdown of capital expenditures in the telecommunications industry may negatively impact CommWorks revenues

CommWorks' customers in the telecommunications service provider market include incumbent local exchange carriers (ILECs), interexchange carriers (IXCs), post, telephone, and telegraph administrators (PTTs), competitive local exchange carriers (CLECs), wireless service operators, Internet service providers (ISPs) and other alternative service providers. The deteriorating economic conditions prevailing in the telecommunications industry over the past several quarters have combined to exert downward pressure on service provider revenues, margins, and profitability and have resulted in longer sales cycles and decreased levels of capital expenditures for new equipment and services. Moreover, the challenges presented by the current industry environment are causing many telecommunications service providers and equipment vendors to experience serious credit problems and other financial difficulties and could result in additional bankruptcies and consolidations. A continuation or worsening of the current depressed economic conditions in the telecommunications industry could have a material adverse effect on our revenues and overall financial performance.

Revenues from sales of our CommWorks products are subject to substantial fluctuations from period to period and are difficult to predict. Such fluctuations and difficult predictability are the result of several factors characteristic of the CommWorks business, including the relatively small number of key customers, the uncertainty related to the rate of deployment of new equipment and services by customers, uncertainty related to lengthening sales cycles and the timing of individual sales transactions, and product acceptance requirements that can impact the timing of the recognition of the sale. For these reasons, revenues in any particular quarter from sales of our CommWorks products may be more prone to and adversely affected by operational decisions of individual customers.

Our increased reliance on contract manufacturing and our excess manufacturing capacity may adversely impact our financial results and operations

We have changed our manufacturing strategy so that more of our products are being sourced from contract manufacturers. Also, during the second quarter of fiscal 2003, CommWorks completed the transition of its contract manufacturing requirements from Manufacturers' Serviced Limited, which previously announced its intentions to cease manufacturing operations at its Mount Prospect facility, to another of our existing suppliers.

We have sold manufacturing operations and facilities associated with those products now sourced from contract manufacturers. Therefore, our ability to resume internal manufacturing operations for those products is severely limited. The cost, quality, performance and availability of contract manufacturing operations are and will be essential to the successful production and sale of many of our products. The inability of any contract manufacturer to meet our cost, quality, performance and availability standards could adversely impact our financial condition or results of operations. We may not be able to provide contract manufacturers with product volumes that are high enough to achieve sufficient cost savings. If shipments fall below forecasted levels, we may incur increased costs or be required to take ownership of the inventory. Also, our ability to control the quality of products produced by contract manufacturers may be limited and quality issues may not be resolved in a timely manner, which could adversely impact our financial condition or results of operations.

We are implementing a direct ship program in a phased manner with our manufacturing partners. Through this program, we will be relying on such partners for fulfillment of customer demand. This program may not yield the efficiencies that we expect, which would negatively impact our financial performance. Any disruptions to on-time delivery to customers would adversely impact our business and revenues.

Furthermore, because we have outsourced significant manufacturing operations to contract manufacturers and have exited a number of businesses, we now have excess manufacturing capacity in existing facilities. We are currently restructuring our operations and implementing cost reduction activities to eliminate this excess capacity, including the consolidation of our real estate portfolio and facilities associated with our former manufacturing and other business operations in Santa Clara, Ireland, and the U.K. In fiscal 2002 we sold our Singapore manufacturing facility and have leased back space for our Asia Pacific region distribution center and office location for sales management, information technology, training and customer service and support operations. In fiscal 2003 we sold our manufacturing facility in Mount Prospect, our office and research and development facility in Salt Lake City, and our manufacturing, research and development, and office facility in Marlborough, a portion of which we are leasing back. Our ability to reduce our excess manufacturing capacity and to consolidate facilities may be made more difficult by further weakening of the networking industry and worsening of general economic conditions in the United States and globally. If we are unable to reduce our excess manufacturing capacity and facilities, this may negatively impact our operations, cost structure and financial performance.

Demand forecasting, increased contract manufacturing, delivery and logistics disruptions and historical component shortages continue to pose major supply chain risks

Current business conditions and operational challenges in managing our supply chain affect our business in a number of ways:

- certain key components, in the recent past, have had limited availability;
- there are a smaller number of suppliers and we have narrowed our supplier base, including in some cases the sole sourcing of certain components from a single supplier;

- as siliconization of networking features continues, we are increasingly facing competition from parties who have traditionally been and are currently our suppliers;
- our ability to accurately forecast demand is diminished, especially in light of general economic weakness and uncertainty following the terrorist events in the last year and continually deteriorating conditions in the telecommunications industry;

- our significantly increased reliance on and long-term arrangements with third-party manufacturers places much of the supply chain process out of our direct control and heightens the need for accurate forecasting and reduces our ability to transition quickly to alternative supply chain strategies;

- our present manufacturing capacities exceed our current needs; and

- we may experience disruptions to our logistics, such as the recent lock-outs that have occurred in west coast ports.

Some of our suppliers are also our competitors. We cannot be certain that in the future our suppliers, particularly those who are also in active competition with us, will be able or willing to meet our demand for components in a timely and cost-effective manner.

Increasingly, we have been sourcing a greater number of components from a smaller number of vendors. Also, there has recently been a trend toward consolidation of vendors of electronic components. This greater reliance on a smaller number of suppliers and the inability to quickly switch vendors increase the risk of logistics disruptions, unfavorable price fluctuations or disruptions in supply, particularly in a supply-constrained environment.

Operation of the supply chain requires accurate forecasting of demand, which has become more challenging. If overall demand for our products, product mix and growth of these markets is significantly different from our expectations, we may face inadequate, or excess, component supply. This would result in orders for products that could not be manufactured in a timely manner, or a buildup of inventory that could not easily be sold. Either of these situations could adversely affect our revenues, financial results or market share. If our demand forecasts are too high or our forecasts of product mix are inaccurate, we may experience excess and obsolete inventories and excess manufacturing capacity, which could adversely affect our financial results.

Our current and future decisions to exit certain product lines may have unforeseen negative impacts to our business

In fiscal 2001 and early fiscal 2002, we exited certain business and product lines, including the cable modem business. In certain cases, we continue to be responsible pursuant to the original warranty obligations for these products. Our exiting of these business and product lines may have adversely impacted our relationships with channel partners and end customers since many of these channel partners and customers perceived our remaining products as not being part of a larger integrated or complementary solution or questioned our commitment to their markets and therefore shifted to products from alternative vendors. We may consider exiting other businesses that do not meet our goal of delivering appropriate financial returns in a reasonable amount of time. Future decisions to exit businesses could result in deterioration of our channel partner and customer relationships, increased employee costs (such as severance, outplacement and other benefits), contract termination costs and asset impairments. We may also experience delays in the execution of our plan to exit a business that may create disruptions in our transactions with suppliers and customers.

The reduced role of acquisitions in our current business strategy may negatively impact our growth and increase our reliance on strategic relationships

Historically, acquisitions, some of them substantive, had been a major part of 3Com's strategy. However, commensurate with the downturn in the IT industry, we have not made any acquisitions since the third quarter of fiscal 2001. We expect that the number of acquisitions of businesses or product lines could remain at this level. The networking business is highly competitive, and while we continue to evaluate possible acquisitions, our decision not to complete any such transactions in the recent past could hamper our ability to enhance existing products and introduce new products on a timely basis. Future consolidations in the networking industry may result in new companies with greater resources and stronger competitive positions and products than us. Furthermore, companies may be created that are able to respond more rapidly to market opportunities. Continued consolidation in our industry may adversely affect our operating results or financial condition.

If industry and company performance stabilizes and we continue to have a strong balance sheet, we may begin to pursue acquisitions, investments, or other strategic relationships to complement internal development of new technologies and enhancement of existing products and to exploit market potentials. These strategic relationships can present additional problems since, in most cases, we must compete in some business areas with companies with which we have strategic alliances and, at the same time, cooperate with the same companies in other business areas. If these companies fail to perform, or if these relationships fail to materialize as expected, we could suffer delays in product or market development or other operational difficulties. Furthermore, our results of operations or financial condition could be adversely impacted if we experience difficulties managing relationships with our partners or if projects with partners are unsuccessful. In addition, if our strategic partners are acquired by third parties or if our competitors enter into successful strategic relationships, we may face increased competition.

Certain of our international markets are risky and may negatively impact our operating results

We operate internationally and expect that international markets will continue to account for a significant percentage of our sales. The recent global economic slowdown has already had and is likely to continue to have a negative effect on various international markets in which we operate. This may cause us to simplify our international legal entity structure and reduce our presence in certain countries, which may negatively affect the overall level of business in such countries. Continuing political and social turmoil may likely further exacerbate existing economic and political instability and currency fluctuations in certain international markets in which we participate, and such conditions can adversely affect our operating results or financial condition. Unforeseen conditions and events will positively or negatively impact the level of international sales or our international operations in different regions. For example, a strengthening of the U.S. dollar relative to other countries' currencies could make our products more expensive than locally manufactured products, thereby negatively impacting demand for our products. Also, our contract manufacturers manufacture many of our products overseas, sometimes in politically or economically unstable countries. Should international regions experience economic or political instability, our results of operations may be adversely affected, our ability to forecast demand for our products may also be impacted and our supply of products may be interrupted.

Our reliance on industry standards, a favorable regulatory environment, technological change in the marketplace and new product initiatives may cause our revenues to fluctuate or decline

The networking industry in which we compete is characterized by rapid changes in technology and customer requirements, evolving industry standards and complex government regulation. As a result, our success depends on:

- the emergence of new technology or the convergence of technologies such as voice and data networking or IP telephony;
- our ability to develop new products to address changes in technologies and related customer requirements on a timely basis;
- the timely adoption and market acceptance of industry standards, and timely resolution of conflicting U.S. and international industry standards;
- our ability to influence the development of emerging industry standards and to introduce new and enhanced products that are compatible with such standards; and
- a favorable regulatory environment.

Slow market acceptance of new technologies, products or industry standards could adversely affect our revenues or overall financial performance. In addition, if our technology is not included in an industry standard on a timely basis or if we fail to achieve timely certification of compliance to industry standards for our products, our revenues from sales of such products or our overall financial performance could be adversely affected.

The telecommunications industry, in particular, is subject to complex government regulation, including regulations defined by the U.S. federal government, its agencies such as the Federal Communications Commission, state public service commissions and various governmental authorities in foreign countries. Failure to obtain all necessary regulatory approvals for our products or to comply with all applicable government regulations could adversely impact our revenues or overall financial performance or expose us to fines or other penalties. In addition, new or revised government regulations could adversely affect the basic business economics for new technologies or their rates of acceptance or adoption by potential customers; in turn, this could adversely impact our revenues or overall financial performance.

Our customer order fulfillment capabilities fluctuate and may negatively impact our operating results

The timing and amount of our sales depend on a number of factors that make estimating operating results uncertain. Throughout our business, we do not typically maintain a significant backlog, and sales are partially dependent on our ability to appropriately forecast product demand. In addition, our customers historically request fulfillment of orders in a short period, resulting in limited visibility to sales trends and potential pricing pressures. Consequently, our operating results depend on the volume and timing of orders and our ability to fulfill orders in a timely manner. Historically, sales in the third month of the quarter have been higher than sales in each of the first two months of the quarter. Non-linear sales patterns make business planning difficult, and increase the risk that our quarterly results will fluctuate due to disruptions in functions such as manufacturing, order management, information systems, and shipping.

We may not always be able to adequately protect or maintain our intellectual property rights

Many of our competitors, such as telecommunications, networking and computer equipment manufacturers, have large intellectual property portfolios, including patents that may cover technologies that are relevant to our business. In addition, many smaller companies, universities, and individual inventors have obtained or applied for patents in areas of technology that may relate to our business.

The industry is moving towards aggressive assertion, licensing, and litigation of patents and other intellectual property rights.

In the course of our business, we frequently receive claims of infringement or otherwise become aware of potentially relevant patents or other intellectual property rights held by other parties. We evaluate the validity and applicability of these intellectual property rights, and determine in each case whether we must negotiate licenses or cross-licenses to incorporate or use the proprietary technologies, protocols, or specifications in our products. If we are unable to obtain and maintain licenses on favorable terms for intellectual property rights required for the manufacture, sale, and use of our products, particularly those that must comply with industry standard protocols and specifications to be commercially viable, our results of operations or financial condition could be adversely impacted.

In addition to disputes relating to the validity or alleged infringement of other parties' rights, we may become involved in disputes relating to our assertion of our intellectual property rights. Whether we are defending the assertion of intellectual property rights against us or asserting our intellectual property rights against others, intellectual property litigation can be complex, costly, protracted, and highly disruptive to business operations by diverting the attention and energies of management and key technical personnel. Further, plaintiffs in intellectual property cases often seek injunctive relief and the measures of damages in intellectual property litigation are complex and often subjective or uncertain. Thus, the existence of or any adverse determinations in this litigation could subject us to significant liabilities and costs. In addition, if we are the alleged infringer, we could be required to seek licenses from others or be prevented from manufacturing or selling our products, which could cause disruptions to our operations or the markets in which we compete. If we are asserting our intellectual property rights, we could be prevented from stopping others from manufacturing or selling competitive products. Any one of these factors could adversely affect our product margins, results of operations, financial condition, or cash flows.

Our future quarterly operating results are subject to factors that can cause fluctuations in our stock price

Historically, our stock price has experienced substantial price volatility. We expect that our stock price may continue to experience volatility in the future, due to a variety of potential factors such as fluctuations in our quarterly operating results, changes in our cash balances, variations between our actual financial results and the published analysts' expectations and announcements by our competitors. In addition, over the past several quarters, the stock market has experienced extreme price and volume fluctuations that have affected the stock prices of many technology companies. These factors, as well as general economic and political conditions or investors' concerns regarding the credibility of corporate financial statements and the accounting profession, may have a material adverse affect on the market price of our stock in the future.

Some of our facilities in California are located near an earthquake fault, and an earthquake or other types of natural disasters could disrupt our operations and adversely effect results

Significant portions of our operations are concentrated at a single location in the Silicon Valley area of California, and we also have various functions and related infrastructure to support our international operations in the U.K. In the event of a natural disaster, such as an earthquake or flood, or localized extended outages of critical utilities or transportation systems, we do not have a formal business continuity or disaster recovery plan, and could therefore experience a significant business interruption.

Legacy computer systems may be vulnerable to breaches of security

We use computer systems, including our enterprise-wide financial system, that may not include the most advanced security features available. There is a risk of unauthorized access to computer systems, including our financial systems. While management makes concerted efforts to assess risks and prevent and detect such security breaches, including our current project to upgrade our existing enterprise-wide financial system to a new SAP release, our financial results could be impacted if such an unauthorized access were to occur and not be detected within our normal internal control procedures.

USE OF PROCEEDS

We will not receive any proceeds from the sale of up to 7,100,000 shares of our common stock being offered by the selling stockholder.

SELLING STOCKHOLDER

The table below sets forth the name of the selling stockholder, the number of shares of common stock issuable upon exercise of a warrant owned by the selling stockholder immediately prior to the date of this prospectus and the number of shares being offered by the selling stockholder in this prospectus. The selling stockholder will not own any shares of 3Com after completion of this offering, assuming that all of the shares of 3Com common stock being offered are sold and assuming that no shares of 3Com common stock are purchased by the selling stockholder prior to the sale of all 3Com common stock being offered under this prospectus.

The selling stockholder is a supplier of certain products to us. Sales to us and our manufacturing subcontractors represented 3% of the selling stockholder's net revenue for the year 2002 (through November 29, 2002), 7.3% of the selling stockholder's net revenue in 2001 and 15.1% of the selling stockholder's net revenue in 2000.

In December 2000, we issued to the selling stockholder a warrant (the Warrant), the underlying shares of common stock (the Shares) of which are the subject of this registration statement. The selling stockholder paid for the Warrant by issuance of a promissory note in the principal amount of $21 million. In November 2002, we and the selling stockholder entered into a settlement agreement, pursuant to which, among other things, the promissory note and interest accrued thereon were canceled. In connection with the settlement agreement, the selling stockholder agreed to pay us $22 million, plus interest on the unpaid principal balance at an annual rate of 2.7775% in installments, with the final of five installments due in November 2003. In addition, pursuant to the settlement agreement, the term of the Warrant was extended until December 2003.

Name of selling stockholder	Number of shares of 3Com common stock owned prior to the offering	Number of shares of 3Com common stock being offered
Broadcom Corporation	7,100,000	7,100,000

PLAN OF DISTRIBUTION

The selling stockholder has not entered into any agreement, arrangement or understanding with any particular broker, dealer, agent or underwriter with respect to the sale of the shares covered by this Prospectus.

The selling stockholder and its successors, including its transferees, pledges or donees, may offer and sell shares of Common Stock issuable upon exercise of the Warrant, or the Shares, from time to time directly or, alternatively, through underwriters, broker-dealers or agents, who may receive compensation in the form of discounts, concessions, or commissions from the selling stockholder and/or the purchasers of these securities. This compensation as to a particular underwriter, broker, dealer or agent might exceed customary commissions.

The Shares may be sold in one or more transactions at fixed prices, at prevailing market prices at the time of sale, at prices related to the prevailing market prices, at varying prices determined at the time of sale, or at negotiated prices.

The Shares may be sold on any national securities exchange or U.S. inter-dealer quotation system of a registered national securities association on which the common stock may be listed or quoted at the time of sale, in the over-the-counter market, or otherwise. The methods by which such sales may be effected (which may involve crosses or block transactions) include:

- a block trade in which the broker or dealer so engaged will attempt to sell the securities as an agent but may position and resell a portion of the block as a principal to facilitate the transaction;
- purchases by a broker or dealer as a principal and resale by that broker or dealer for its account;
- ordinary brokerage transactions and transactions in which the broker solicits purchasers;
- through the writing of options;
- short sales of the securities and sales to cover short sales;
- the pledge or loan of the common stock as security for any loan or obligation, including pledges to brokers or dealers who may, from time to time, themselves effect distributions of the securities or interest therein;
- hedging transactions with broker-dealers, which may in turn engage in short sales in the course of hedging positions they assume; and
- any combination of any of the above.

In addition, any securities covered by this prospectus that qualify for sale under Rule 144 of the Securities Act may be sold under Rule 144 rather than under this prospectus. The selling stockholder is not required to sell any common stock issuable upon exercise of the Warrant described in this prospectus and may transfer, devise or gift these securities by other means not described in this prospectus.

Brokers or dealers engaged by the selling stockholder may arrange for other broker-dealers to participate in selling shares. The selling stockholder and any participating broker-dealers may be deemed to be "underwriters" within the meaning of the Securities Act in connection with sales of shares covered by this prospectus. Any commission, discount or concession received by a broker or dealer and any profit on the resale of shares sold by them while acting as principals might be deemed to be underwriting discounts or commissions under the Securities Act. Because the selling stockholder may be deemed to be an underwriter within the meaning of the Securities Act, the selling stockholder will be subject to the prospectus delivery requirements of the Securities Act. The selling stockholder and any other person participating in the distribution will be subject to applicable provisions of the Securities Exchange Act of 1934, as amended (the "*Exchange Act*"), including without limitation, Regulation M.

This offering will terminate on the earlier of:

- the date on which all shares held by the selling stockholder can be sold in a three-month period under Rule 144; or
- the date on which all shares offered have been sold by the selling stockholder.

We have agreed to pay the expenses of registering the shares under the Securities Act, including registration and filing fees, printing expenses, administrative expenses and certain legal and accounting fees. The selling stockholder will bear all discounts, commissions or other amounts payable to underwriters, dealers or agents as well as fees and disbursements for legal counsel retained by any selling stockholder.

The selling stockholder may agree to indemnify any agent, dealer or broker-dealer that participates in transactions involving sales of shares against liabilities, including liabilities arising under the Securities Act.

To the extent required, the shares of common stock to be sold, the purchase price of a sale, the names of any agent, broker, dealer, or underwriter or arrangements relating to any such entity or applicable commissions with respect to a particular offer or sale will be set forth in an accompanying prospectus supplement or, if appropriate, a post-effective amendment to the registration statement of which this prospectus is a part.

LEGAL MATTERS

The validity of the issuance of the shares of common stock in this offering hereby will be passed upon for us by Wilson Sonsini Goodrich & Rosati, Professional Corporation, Palo Alto, California.

EXPERTS

The consolidated financial statements and the related consolidated financial statement schedule incorporated in this prospectus by reference from the Company's Annual Report on Form 10-K for the year ended May 31, 2002 have been audited by Deloitte & Touche LLP, independent auditors, as stated in their report dated June 24, 2002 (July 16, 2002 as to Note 21), which is incorporated herein by reference, and have been so incorporated in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

INCORPORATION OF CERTAIN INFORMATION BY REFERENCE

The Securities and Exchange Commission, or SEC, allows us to "incorporate by reference" in this prospectus the information that we file with the SEC. This means that we can disclose important information by referring the reader to those SEC filings. The information incorporated by reference is considered to be part of this prospectus, and later information we file with the SEC will update and supersede this information. We incorporate by reference the documents listed below and any future filings made with the SEC under Section 13(a), 13(c), 14, or 15(d) of the Exchange Act prior to the termination of the offering:

- our Annual Report on Form 10-K for our fiscal year ended May 31, 2002;

- our Quarterly Reports on Form 10-Q relating to our fiscal quarters ended August 30, 2002, as amended, and November 29, 2002;

- our Current Reports on Form 8-K filed with the SEC on August 2, 2002 and November 14, 2002, and our two Current Reports on Form 8-K filed on December 2, 2002; and

- the description of our common stock contained in our registration statement on Form 8-A filed with the SEC on September 18, 1984, including any amendment or report filed for the purpose of updating this description.

This prospectus may contain information that updates, modifies or is contrary to information in one or more of the documents incorporated by reference in this prospectus. Reports we file with the SEC after the date of this prospectus may also contain information that updates, modifies or is contrary to information in this prospectus or in documents incorporated by reference in this prospectus. Investors should review these reports as they may disclose a change in our business, prospects, financial condition or other affairs after the date of this prospectus.

WHERE YOU CAN FIND MORE INFORMATION

Upon your written or oral request, we will provide at no cost to you a copy of any and all of the information that is incorporated by reference in this prospectus, not including exhibits to such information unless those exhibits are specifically incorporated herein by reference.

Requests for such documents should be directed to Investor Relations, 3Com Corporation, 5500 Great America Parkway, Santa Clara, California 95052-8145, telephone number (408) 326-5000. Please note that additional information can be obtained from our website at www.3Com.com.

We file annual, quarterly and current reports, proxy statements and other information with the SEC. Our reports, proxy statements and other information may be accessed over the Internet at a site maintained by the SEC at *http://www.sec.gov*. You may also read and copy any materials we file with the SEC at the following public SEC reference room:

Public Reference Room
450 Fifth Street, N.W.
Washington, D.C. 20549

You may obtain further information about the operation of the SEC's public reference room by calling the SEC at 1-800-SEC-0330.

We have filed a registration statement under the Securities Act with the SEC with respect to the shares to be sold by the selling stockholders. This prospectus has been filed as part of the registration statement. This prospectus does not contain all of the information set forth in the registration statement because certain parts of the registration statement are omitted in accordance with the rules and regulations of the SEC. The registration statement is available for inspection and copying as set forth above.

17

PART II

INFORMATION NOT REQUIRED IN PROSPECTUS

Item 14. Other Expenses of Issuance and Distribution.

The following table sets forth the costs and expenses payable by the Registrant in connection with the sale of common stock being registered. All amounts are estimates except the Securities and Exchange Commission registration fee.

Securities and Exchange Commission registration fee	$	6,081
Nasdaq National Market additional listing fee	$	0
Accounting fees and expenses	$	5,000
Legal fees and expenses	$	15,000
Printing and related fees	$	5,000
Miscellaneous	$	5,000
Total	$	36,081

Item 15. Indemnification of Directors and Officers.

Section 145 of the General Corporation Law of the State of Delaware authorizes a Delaware corporation to indemnify officers, directors, employees, and agents of the corporation, in connection with actual or threatened actions, suits or proceedings provided that such officer, director, employee, or agent acted in good faith and in a manner such officer reasonably believed to be in or not opposed to the corporation's best interests, and, for criminal proceedings, had no reasonable cause to believe his or her conduct was unlawful. This authority is sufficiently broad to permit indemnification under certain circumstances for liabilities (including reimbursement for expenses incurred) arising under the Securities Act of 1933, as amended.

The Registrant's By-laws provide for indemnification of officers and directors to the fullest extent permitted by Delaware law. In addition, the Registrant has, and intends in the future to enter into, agreements to provide indemnification for directors and officers in addition to that provided for in the By-laws.

The Registrant maintains insurance on behalf of any person who is a director or officer against any loss arising from any claim asserted against such person and expense incurred by such person in any capacity, subject to certain exclusions.

Item 16. Exhibits.

Exhibit Number	Description
4.1	Warrant to Purchase Common Stock, dated December 4, 2000, between the Registrant and Broadcom Corporation (1)
4.2	Amendment Number One to Warrant, dated November 1, 2002, between the Registrant and Broadcom Corporation (2)
5.1	Opinion of Wilson Sonsini Goodrich & Rosati, Professional Corporation
23.1	Consent of Deloitte & Touche LLP, Independent Accountants
23.2	Consent of Wilson Sonsini Goodrich & Rosati (contained in Exhibit 5.1)
24.1	Power of Attorney (included on the signature page hereto)

(1) Incorporated by reference to Exhibit 10.24 of the Registrant's quarterly report on Form 10-Q for the quarter ended November 29, 2002.

(2) Incorporated by reference to Exhibit 10.25 of the Registrant's quarterly report on Form 10-Q for the quarter ended November 29, 2002.

Item 17. Undertakings.

(a) The undersigned registrant hereby undertakes:

(1) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement:

(i) To include any prospectus required by Section 10(a)(3) of the Securities Act;

(ii) To reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually, or in the aggregate, represent a fundamental change in the information set forth in the registration statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the SEC pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than a 20% change in the maximum aggregate offering price set forth in the "Calculation of Registration Fee" table in the effective registration statement; and

(iii) To include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement;

provided, however, that the undertakings set forth in clauses (i) and (ii) above shall not apply if the information required to be included in a post-effective amendment by these clauses is contained in periodic reports filed by the registrant pursuant to Section 13 or Section 15(d) of the Exchange Act that are incorporated by reference in this registration statement

(2) That, for the purpose of determining any liability under the Securities Act, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(3)

To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering.

(b) The undersigned Registrant hereby undertakes that, for purposes of determining any liability under the Securities Act, each filing of the Registrant's annual report pursuant to section 13(a) or section 15(d) of the Exchange Act (and, where applicable, each filing of an employee benefit plan's annual report pursuant to section 15(d) of the Exchange Act) that is incorporated by reference in the registration statement shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(c) Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of the Registrant pursuant to the foregoing provisions, or otherwise, the Registrant has been advised that in the opinion of the SEC such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the Registrant of expenses incurred or paid by a director, officer or controlling person of the Registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the Registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, the registrant certifies that it has reasonable grounds to believe that it meets all of the requirements for filing on Form S-3 and has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Santa Clara, State of California, on 13th day of January, 2003.

3COM CORPORATION

By: /s/ BRUCE L. CLAFLIN

Bruce L. Claflin
President and Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Bruce L. Claflin and Mark Slaven his attorney-in-fact, with full power of substitution in each, for him in any and all capacities to sign any amendments to this registration statement on Form S-3, and to file the same, with exhibits thereto and other documents in connection therewith, with the SEC, hereby ratifying and confirming all that said attorney-in-fact, or his substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Act of 1933, this registration statement has been signed by the following persons in the capacities and on the dates indicated.

Signature	Title	Date
/s/ BRUCE L. CLAFLIN Bruce L. Claflin	President and Chief Executive Officer	January 13, 2003
/s/ MARK SLAVEN Mark Slaven	Senior Vice President, Finance and Planning and Chief Financial Officer (principal financial and accounting officer)	January 13, 2003
/s/ ERIC A. BENHAMOU	Chairman of the Board	January 15, 2003

Signature	Title	Date
Eric A. Benhamou		
/s/ FRED D. ANDERSON	Director	January 15, 2003
Fred D. Anderson		
/s/ GARY T. DICAMILLO	Director	January 14, 2003
Gary T. DiCamillo		
/s/ JAMES R. LONG	Director	January 13, 2003
James R. Long		
/s/ RAJ REDDY	Director	January 14, 2003
Raj Reddy		
/s/ PAUL G. YOVOVICH	Director	January 15, 2003
Paul G. Yovovich		

II-3

INDEX TO EXHIBITS

Exhibit Number	Description
4.1	Warrant to Purchase Common Stock, dated December 4, 2000, between the Registrant and Broadcom Corporation (1)
4.2	Amendment Number One to Warrant, dated November 1, 2002, between the Registrant and Broadcom Corporation (2)
5.1	Opinion of Wilson Sonsini Goodrich & Rosati
23.1	Consent of Deloitte & Touche LLP, Independent Accountants
23.2	Consent of Wilson Sonsini Goodrich & Rosati (contained in Exhibit 5.1)
24.1	Power of Attorney (included on the signature page hereto)

(1) Incorporated by reference to Exhibit 10.24 of the Registrant's quarterly report on Form 10-Q for the quarter ended November 29, 2002.

(2) Incorporated by reference to Exhibit 10.25 of the Registrant's quarterly report on Form 10-Q for the quarter ended November 29, 2002.

QuickLinks

ecured Notes using proceeds from a Financing Agreement was accounted for as a voluntary debt restructuring. As a result, all future interest payments associated with the Financing Agreement debt was recognized against the implied gain on the transaction.

-23-

ITEM 6. SELECTED FINANCIAL DATA (CONTINUED)

	Years ended December 31,				
	2002	2001	2000	1999	1998
	(Dollars in thousands, except per share data)				
Selected Balance Sheet Data (1):					
Total assets	$162,263	$ 179,524	$193,480	$189,193	$223,359
Long-term debt, including current portion	$113,361	$ 131,620	$134,980	$157,077	$149,775
Redeemable preferred stock	$ 111	$ 123	$ 139	$ 139	$ 139
Stockholders' equity (deficit)	$ 503	$ (1,962)	$ (9,442)	$ (14,173)	$ 35,059
Selected other data:					
Cash dividends declared per common share	$ -	$ -	$ -	$ -	$ ..02

(1) Amounts are shown excluding balances related to businesses disposed of and discontinued operations.

-24-

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with a review of our December 31, 2002 Consolidated Financial Statements, Item 6 "Selected Financial Data" and Item 1 "Business" included elsewhere in this report.

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

All discussions below relate to our continuing operations and accordingly exclude the discontinued operations of SEC and UTeC and the automotive products business sold in 2002 and 2000, respectively. See Note 4 of Notes to the Consolidated Financial Statements.

Critical Accounting Policies

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 contingent liabilities. The more significant areas of financial reporting impacted by management's judgment, estimates and assumptions include the following:

Impairment of Long-Lived Assets including Goodwill - We have considered impairment of our long-lived assets and related goodwill related to our Chemical operations as a result of unfavorable operating results over the last several years. We have made estimates of the fair values associated with the El Dorado Facility and the Cherokee Facility. These estimates include third party appraisals for certain of the assets and internal estimates for others. Should these estimates of fair values change in future periods based on changes in the business environment from our expectations of the Chemical Business or our estimate of the cost to comply with the new Discharge Water Permit, a portion of our net carrying cost may be impaired in the near future. See Item 1 "Business Environmental Matters - Discharge Water Permit for El Dorado, Arkansas Plant".

Repurchase of Senior Unsecured Notes Due 2007 - As fully discussed in "Liquidity and Capital Resources - Loan Agreements - Terms and Conditions" and Note 7 of Notes to Consolidated Financial Statements, ClimaChem completed a voluntary debt restructuring transaction whereby ClimaChem repurchased $52.3 million face value of its outstanding public 10 3/4% Senior Unsecured Notes ("Notes"). The cost to ClimaChem of the repurchased Notes was approximately $21 million below ClimaChem's carrying value. The Notes were repurchased with the proceeds of new loans ("New Loans") provided to ClimaChem by affiliates of the sellers of the Notes. It was determined that this implied gain should not be accounted for as a gain in the second quarter of 2002, but deferred over the term of the New Loans. Based upon certain criteria including, but not limited to, unfavorable changes in ClimaChem's financial condition since the Notes were originally sold and the high interest rates on the New Loans, the transaction was accounted for as a debt restructuring.

Compliance with Long-Term Debt Covenants - As fully discussed in "Liquidity and Capital Resources - Loan Agreements - Terms and Conditions"

-25-

and Note 7 of Notes to Consolidated Financial Statements, the Financing Agreement and Working Capital Revolver Loan as amended, of ClimaChem and its subsidiaries require that ClimaChem meet certain lender defined earnings before interest, income taxes, depreciation and amortization ("EBITDA") amounts quarterly, on a trailing twelve-month basis and annually achieve a specified fixed charge coverage rate. ClimaChem forecasts for 2003 indicate that ClimaChem will be able to meet all required covenant tests for all quarters and the year ending in December 2003.

The Financing Agreement requires that if ClimaChem fails to maintain EBITDA, as defined, on a trailing twelve-month basis of at least $12 million (a "Trigger Event"), then within 210 days of the end of such quarter, ClimaChem shall pay the Lenders an amount equal to 33.3% ($10.6 million as of December 31, 2002) of then outstanding principal of the Loans plus related cash and additional interest. However, if ClimaChem maintains EBITDA on a trailing twelve-month basis of at least $12 million as of the end of each of the two quarters immediately following the Trigger Event, then within 210 days of such Trigger Event, ClimaChem shall pay the Lenders an amount equal to 10% ($3.2 million as of December 31, 2002) of then outstanding principal of the Loans plus related cash and additional interest.

In addition, the Working Capital Revolver Loan contains "a material adverse change in operating results or financial condition" provision which is construed to be a subjective acceleration clause. Our ability to realize our assets and discharge our liabilities is dependent upon, among other things, the lender not exercising its rights under the subjective acceleration clause and our ability to successfully meet the EBITDA covenant for 2003 and beyond. See Notes 3 and

7 of Notes to Consolidated Financial Statements.

Environmental and Regulatory Compliance - We operate in the Chemical Business that is subject to specific federal and state regulatory and environmental compliance laws and guidelines. We have developed policies and procedures related to environmental and 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 believe we will be successful in addressing the Arkansas Department of Environmental Quality ("ADEQ") Discharge Water Permit through various site modification projects currently underway and other projects acceptable to the ADEQ. We currently estimate that the site modification projects will cost approximately $3 - $4 million. We believe EDC will be able to obtain appropriate modifications to the permit, either through negotiations, appeal to the Commission, or through court proceedings. However, if we are not able to obtain appropriate modifications to the permit based on our current liquidity and information currently available to us, we do not believe that EDC will be able to comply with the terms of the permit or have the necessary liquidity to make all of the capital improvements required to comply with the permit's terms.

Contingencies - We are a party to various litigation and other contingencies, the ultimate outcome of which is not presently known. Should the ultimate outcome of these contingencies be adverse and we are required to fund a significant judgment, that may represent an event of default under ClimaChem's Working Capital Revolver Loan and the Financing Agreement and may adversely impact our liquidity and capital resources. See Note 12 of Notes to Consolidated Financial Statements.

Management's judgment and estimates in these areas are based on

-26-

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. Our significant accounting policies are discussed in greater detail in Note 2 of Notes to Consolidated Financial Statements.

Overview

General

We finance our working capital requirements for ClimaChem and its wholly-owned subsidiaries through borrowings under a $50 million credit facility with a lender (the "Working Capital Revolver Loan"). The Working Capital Revolver Loan matures in April 2005 subject to an acceleration clause.

In May 2002, ClimaChem repurchased $52.3 million face value aggregate principal amount of its Senior Unsecured Notes. The purchase price per $1,000 of aggregate principal amount of Senior Unsecured Notes was approximately $575, resulting in an aggregate purchase price of approximately $30.1 million. As a result of the repurchase, the balance of the aggregate principal amount of the Senior Unsecured Notes outstanding and in the hands of unrelated third parties is $18.3 million.

In order to fund the repurchase of the Senior Unsecured Notes, ClimaChem entered into a Financing Agreement with certain lenders (the "Lenders") with each lender being an affiliate of the sellers of the Senior Unsecured Notes. Each Lender is also an affiliate of the other Lenders. Pursuant to the terms of the Financing Agreement, the Lenders loaned $35 million to ClimaChem (collectively, the "Loans"). The Loans mature on June 30, 2005, and bear interest at 10 1/2% per annum, payable quarterly. Additional interest of 5 1/2% is payable either at maturity or upon prepayment. The Lenders and affiliates of the Lenders owned the Senior Unsecured Notes which were repurchased by ClimaChem. See discussion in "Liquidity and Capital Resources-Loan Agreements-Terms and Conditions."

The Company is actively marketing its chemical plant located in Pryor, Oklahoma. As of the date of this report, no agreement has been reached, but the Company is in discussions with a possible buyer. Upon sale of this plant, the Company intends to use the proceeds from the sale to reduce debt.

As discussed below in "Chemical Business" and Notes 4 and 7 of Notes to Consolidated Financial Statements, in December 2002, SEC and UTeC sold all of their operating assets. Approximately $3.5 million of the sales proceeds were used as a prepayment on the Loans under the Financing Agreement. Due to this prepayment, ClimaChem recognized a gain on extinguishment of debt of $1.5 million.

-27-

Our Consolidated Financial Statements reflect the operations of SEC and UTeC and the automotive products business as discontinued operations for all periods presented. Therefore, the operations of SEC and UTeC are excluded from the results of our Chemical Business and our former automotive products business is not presented as a reportable segment. Certain statements contained in this overview are forward-looking statements, and future results could differ materially from such statements. The following table contains certain of the information from Note 19 of Notes to Consolidated Financial Statements about our operations in different industry segments for each of the three years ended December 31:

	2002	2001	2000
		(In thousands)	
Net sales:			
Chemical (1) (2)	$ 151,358	$ 170,092	$ 131,687
Climate Control	128,128	138,435	130,574
Other (3)	4,325	6,415	10,407
	$ 283,811	$ 314,942	$ 272,668
Gross profit: (4)			
Chemical (2)	$ 6,911	$ 11,007	$ 9,287
Climate Control	37,454	37,890	34,475
Other	1,332	1,877	2,839
	$ 45,697	$ 50,774	$ 46,601
Operating profit(loss): (5)			
Chemical (2)	$ 500	$ 3,702	$ (367)
Climate Control	14,705	12,500	10,961
	15,205	16,202	10,594
General corporate expense and otherbusiness operations, net	(5,950)	(7,358)	(4,524)
Interest expense	(7,590)	(13,338)	(14,707)
Gains on sales of property and equipment	47	6,615	-
Gains on extinguishment of debt	1,458	2,631	20,086
Benefit from termination of (provision for loss on) firm sales and purchase commitments - Chemical	(414)	2,688	(3,395)
Income from continuing operations before provision for income taxes and cumulative effect of accounting change	$ 2,756	$ 7,440	$ 8,054
Total assets:			
Chemical	$ 93,017	$ 94,764	$ 102,741
Climate Control	52,438	61,682	66,101
Corporate assets and other	16,808	14,068	17,707
Discontinued operations	-	9,010	6,931
Total assets	$ 162,263	$ 179,524	$ 193,480

-28-

(1) Chemical net sales for 2002, 2001 and 2000 include approximately $33.4 million, $35.9 million and $7.1 million, respectively, associated with a subsidiary's operation of the Cherokee Facility acquired on October 31, 2000.

(2) On April 8, 2002, a portion of our subsidiary's chemical plant complex in El Dorado, Arkansas experienced damage from high winds and a likely tornado. Plant management and engineers surveyed the damage which affected the production facilities for ammonium nitrate, certain acid plants, a large cooling tower, and other equipment. The repairs were completed in 2002. During the repair time, we were not able to produce industrial grade ammonium nitrate until the middle of May 2002. Production of our other products, agricultural grade ammonium nitrate and industrial acids, continued without material interruption. Our property insurance covering the chemical plant entitled us to receive approximate replacement value for the damaged property less an aggregate $1 million deductible. We also had a thirty-day waiting period before our business interruption insurance coverage became effective. In October of 2002, a final settlement of $2.5 million, net of the $1 million deductible, was reached for the property and business interruption insurance claims. The net proceeds relating to our property insurance claim exceeded the cash expenditures for repairs and the depreciated value of the damaged assets. As a result, a net gain relating to property damage of approximately $1.4 million is classified as other income and a business interruption insurance recovery of approximately $.3 million is classified as a reduction of cost of sales and is included in the Consolidated Statement of Income for 2002.

(3) Excludes intersegment sales to Climate Control of $371,000 and $757,000 2001 and 2000, respectively. There were no intersegment sales in 2002.

(4) Gross profit by industry segment represents net sales less cost of sales. Chemical gross profit for 2002 and 2000 includes a loss of $1.4 million and $1 million, respectively, and a profit of $1.3 million for 2001 associated with the Cherokee Facility as discussed above.

(5) Operating profit (loss) by industry segment represents net sales less operating expenses before adding or deducting general corporate expense and other business operations, interest expense, gains on sales of property and equipment, gains on extinguishment of debt, benefit from termination of (provision for loss on) firm sales and purchase commitments, income taxes, results from discontinued operations and cumulative effect of accounting change. Chemical operating profit for 2002, 2001 and 2000 includes an operating loss of approximately $2.1 million, $.1 million and $1.1 million, respectively, associated with the Cherokee Facility as discussed above.

-29-

Chemical Business

Our Chemical Business manufactures three principal product lines that are derived from natural gas and anhydrous ammonia: (1) fertilizer grade ammonium nitrate and urea ammonium nitrate for the agricultural industry, (2) industrial grade ammonium nitrate and solutions for the mining industry and (3) concentrated, blended and regular nitric acid and metallurgical grade ammonia for industrial applications. In addition, we also produce sulfuric acid for the paper industry.

Anhydrous ammonia and natural gas represent the primary raw materials in the production of most of the products of our Chemical Business. In December 2002, EDC reached an agreement with its then-current supplier of anhydrous ammonia whereby the former long-term purchase commitment was terminated effective October 31, 2002. Under the new agreement, EDC will purchase 100% of its requirements of purchased ammonia pursuant to a formula-based market price plus transportation to the El Dorado Facility through December 31, 2004. The Chemical Business' natural gas feedstock requirements are purchased at spot market price for delivery to the Cherokee Facility. The purchase cost of anhydrous ammonia and natural gas increased substantially during the third and fourth quarters of 2002 and have continued to increase through the date of this report. During the third and fourth quarters of 2002, the market price of the Chemical Business' agricultural products, which are not sold pursuant to cost-plus contracts, did not increase sufficiently to recover the full amount of the increases in its raw materials resulting in lower gross profit in 2002. Beginning in 2003 and at the time of this report, product pricing has increased substantially. However, it is too early in the spring season to determine if current pricing will be sustained.

In February 2002, due to certain alleged violations of explosives storage and related regulations, the government regulator, the Bureau of Alcohol, Tobacco and Firearms ("BATF"), issued an order revoking the manufacturing license of SEC for its Hallowell Facility to produce certain mining products and confiscated certain high explosives inventory. The license revocation order was upheld by an administrative law judge after an administrative trial. In addition, we have received grand jury subpoenas from the U.S. Attorney's office of Wichita, Kansas requesting business records of SEC. We have complied with such subpoenas. Since February 2002, SEC continued to manufacture certain non-explosive products at its Hallowell Facility. SEC had other production facilities where it could produce some mining products to service its customers.

UTeC filed an application with the BATF to obtain a manufacturing license for the Hallowell Facility. On September 30, 2002, UTeC obtained from the BATF the license to manufacture certain mining products at the Hallowell Facility and manufacturing was resumed until the sale of all of the operating assets of SEC and UTeC.

In December 2002, the Company consummated the sale of all of the operating assets of SEC and UTeC, each an indirect wholly owned subsidiary of the Company. SEC and UTeC were principally in the packaged explosives business, which business was not considered by the Company to be part of its core Chemical Business.

The sales price was approximately $10.2 million, consisting of a base price of $7 million, plus approximately $2.8 million for inventory and accounts receivable and $.4 million of assumed liabilities under an equipment

lease. Of the proceeds from the Sale, (a) approximately $.3 million was placed in escrow to warrant the collection of the purchased accounts receivable, (b) approximately $3.5 million was paid to a term lender, and (c) the balance of the proceeds was applied against ClimaChem's revolving line of credit.

Climate Control

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

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

As of December 31, 2002 and 2001, the backlog of confirmed orders for our Climate Control Business was approximately $25.1 million and $24 million respectively. As of the date of this report, our Climate Control Business had released the majority of the December 31, 2002 backlog to production. All of the December 31, 2002 backlog is expected to be filled during 2003. See "Special Note Regarding Forward-Looking Statements."

Results of Operations

Our Climate Control Business' operating results for 2002 are considerably better than 2001 as discussed below. On the other hand, our Chemical Business has fallen significantly behind that of 2001.

The negative cash flow in the Chemical Business in 2002 is a result of disruptions caused by the storm damage, the losses due to the revocation of SEC's license to produce its profitable high explosives at its Hallowell, Kansas facility and the operating losses in the agricultural nitrogen business of the El Dorado Facility and Cherokee Facility. Losses in the agricultural nitrogen business have resulted from the low selling prices compared to the cost of the raw material feedstocks, natural gas and anhydrous ammonia. The feedstocks of natural gas and ammonia have historically experienced significant price volatility. The profit problem has been due primarily to an oversupply in the market of agricultural nitrogen products of the kind we produce and the inability in the past to pass through the natural gas and ammonia cost increases when they occur. This applies to approximately 50% of the volume for our Chemical Business. The other approximate 50% of the products produced by the various plants that make up our Chemical Business are sold pursuant to long-term contracts that provide for cost-plus pricing. We continue to plan to increase the production level to the optimum permitted and practical capacity levels to cover the fixed costs of the El Dorado Facility and Cherokee Facility as market conditions will allow.

Our Chemical plants are volume sensitive. The volumes of certain products through 2002 have been below the break-even point due in part to supply and demand and due in part to the two unusual events that occurred during the year. These unusual events are the storm and related damage at the El Dorado Facility and the revocation of SEC's BATF license, both of which are discussed above.

-31-

Year Ended December 31, 2002 vs. Year Ended December 31, 2001

Net Sales

Net sales for 2002 were $283.8 million compared to $314.9 million for 2001 or a decrease of $31.1 million. The decrease in sales resulted primarily from decreased sales in our Chemical Business of $18.7 million resulting from (i) a decrease in sales of mining products of $17.7 million resulting primarily from the elimination of certain products subsequent to the sale of all of its distribution centers for mining products in October 2001, (ii) lower sales prices, due primarily to lower cost of the raw material feedstock which is passed through to the sales prices, (iii) an over-supply of agricultural products within the market we serve and (iv) the reduction in volume of industrial grade ammonium nitrate due to the business interruption at the El Dorado Facility in April 2002. Our Climate Control Business sales were lower by approximately $10.3 million resulting principally from the elimination of an unprofitable product line during the fourth quarter of 2001 and a reduction in volume of hydronic fan coil and water source heat pump products, due in part, to a general softening in demand from the markets we serve.

Gross Profit

Gross profit was $45.7 million or 16.1% as a percentage of net sales for 2002, compared to $50.8 million or 16.1% for 2001. The profit margins in our Climate Control Business improved, due in part, to the elimination of certain low-margin products during the fourth quarter of 2001 and improved profit margins for the majority of remaining non-OEM products resulting from a combination of price increases and cost reductions. This improvement was offset by lower profit margins in our Chemical Business due primarily to (i) the effect of the business interruption at the El Dorado which lasted approximately 50 days, (ii) a decrease in profit margins relating to agricultural products, due in part, to an over supply within our market and (iii) the increase in the amount of inventory write-downs due to the costs of certain products exceeding the actual sales prices.

Selling, General and Administrative Expenses

Selling, general and administrative ("SG&A") expenses were $39.9 million for 2002, compared to $44 million for 2001. This decrease is primarily the result of the reduction of expenses relating to the elimination of certain low-margin products in our Climate Control Business and our non-core businesses during 2001.

Other Income

Other income for 2002 includes the recognition of $1.5 million from the recovery of property insurance, an increase of $.4 million in the cash surrender value of certain life insurance policies and the recovery of $.3 million of precious metals used in the manufacturing process of our Chemical Business. Other income for 2001 includes the recovery of

$1.1 million of precious metals and the recognition of $.5 million from the recovery of property insurance.

Gains on Sales of Property and Equipment

For 2001, we recognized gains on sales of property and equipment of $6.6 million (the amount for 2002 was minimal). The gain in 2001 includes $3.3 million from the sale of the Crystal City Plant site and $2.7 million from the sale of distribution sites for mining products.

Gains on Extinguishment of Debt

As discussed in Overview-Chemical Business and Notes 4 and 7 of Notes to Consolidated Financial Statements, in December 2002, SEC and UTeC sold all of their operating assets. Approximately $3.5 million of the sales proceeds were used as a prepayment on borrowings under a Financing Agreement entered into in May 2002. Due to this prepayment, ClimaChem recognized a gain on extinguishment of debt of $1.5 million representing accrued interest through maturity on the prepaid principal.

During 2001, ClimaChem repurchased Senior Unsecured Notes having a face value of $4.7 million and recognized a gain of $2.6 million.

Benefit from Termination of (Provision for Loss on) Firm Sales and Purchase Commitments

We had a loss of $.4 million on firm sales and purchase commitments for 2002 compared to a gain of $2.7 million for 2001.

Interest Expense

Interest expense was $7.6 million in 2002 compared to $13.3 million in 2001. The decrease of $5.7 million primarily resulted from the elimination of interest expense recognition on the Financing Agreement indebtedness, (as that transaction was accounted for as a voluntary debt restructuring during the second quarter of 2002), the repurchase of Senior Unsecured Notes during the third quarter of 2001, lower interest rates and the decrease in borrowings from our revolving credit facilities.

Income from Continuing Operations before Provision for Income Taxes and Cumulative Effect of Accounting Change

As a result of the items discussed above, we had income from continuing operations before provision for income taxes and cumulative effect of accounting change of $2.8 million for 2002 compared to income of $7.4 million for 2001. Our Climate Control Business reported a substantial increase in operating results for 2002 compared to 2001. Our Chemical Business reported a significant decline in operating results in 2002 as compared to 2001 due to selling prices for agricultural products decreasing more than the cost of raw material feedstock and the business interruption losses incurred relating to the storm damage as discussed above.

Provision for Income Taxes

As a result of providing deferred tax asset valuation allowances related to our net operating loss carry-forwards, the provision for income taxes relates only to current state income taxes for 2002 and 2001.

Income (Loss) from Discontinued Operations

As discussed in Overview-Chemical Business and Note 4 of Notes to Consolidated Financial Statements, in December 2002, all of the operating assets of SEC and UTeC were sold which operations are reflected as discontinued operations. These operations were formerly included in the Chemical Business. The loss from discontinued operations of $3.5 million for 2002 is net of a gain on disposal of $1.6 million. For 2001, we recognized income from discontinued operations of $1.2 million.

Cumulative Effect of Accounting Change

Upon adoption of Statement No. 142, "Goodwill and Other Intangible Assets" on January 1, 2002, we recognized $.9

million of negative goodwill as a cumulative effect of accounting change for 2002.

Year ended December 31, 2001 Compared to Year ended December 31, 2000

Net Sales

Net sales for 2001 were $314.9 million, compared to $272.7 million for 2000, an increase of $42.2 million. Approximately $28.8 million of this increase in sales resulted from the Cherokee Facility acquired in October 2000. The remaining increase resulted from: (i) increased sales of $14.5 million relating to agricultural and mining products in our Chemical Business, due in part, from increased customer demand and higher sales prices and (ii) increased sales of $7.9 million in our Climate Control Business, due primarily from an increase in customer demand relating to heat pump products and the increase in sales of new products and services introduced in 2001 and 2000. This increase in sales was partially offset by an elimination of certain low-margin products in our Climate Control Business.

Gross Profit

Gross profit was $50.8 million or 16.1% as a percentage of net sales in 2001 compared to $46.6 million or 17.1% in 2000. The increase in gross profit was due to the increased sales. The reduction in gross profit as a percent of sales was the result of lower profit margins in our Chemical Business due primarily to increased raw material costs, resulting in part, from the extremely high cost of natural gas in late 2000 and the first two quarters of 2001 and competitive pressures on sales prices of agricultural products. This decrease as a percent of net sales was partially offset by improved margins of the heat pump and certain other products in our Climate Control Business.

Selling, General and Administrative Expenses

Selling, general and administrative ("SG&A") expenses were $44 million for 2001 compared to $43.7 million for 2000. This increase is primarily the result of expenses relating to start-up operations in the Climate Control Business beginning in 2001 and 2000, increase in insurance costs, increase in incentive compensation and expenses incurred relating to the Working Capital Revolver Loan. This increase was offset, in part, by a reduction in bad debt expense, lower expenses relating to the elimination of certain products in our Climate Control Business and other business operations and the amortization of negative goodwill resulting from the acquired Cherokee Facility.

-34-

Other Income

Other income for 2001 includes the recovery of $1.1 million of precious metals and the recognition of $.5 million from the recovery of property insurance. Other income for 2000 includes the recapture of prior period provision for loss on advances of $1.6 million, our equity interest in an unconsolidated joint venture of $.7 million, interest income of $.6 million, gain on sale of equity securities of an unrelated party of $.4 million, income from oil and gas properties of $.3 million and rental income of $.3 million.

Gains on Sales of Property and Equipment

For the year ended December 31, 2001, we recognized gains on sales of property and equipment of $6.6 million. The gain in 2001 includes $3.3 million from the sale of the Crystal City Plant site and $2.7 million from the sale of distribution sites for mining products.

Gains on Extinguishment of Debt

During 2001 and 2000, certain of our subsidiaries repurchased Senior Unsecured Notes having a face value of $4.7

million and $29.7 million, respectively, and recognized a gain of $2.6 million and $20.1 million, respectively.

Benefit from Termination of (Provision for Loss on) Firm Sales and Purchase Commitments

We had a gain of $2.7 million from the termination of firm purchase commitments for the year ended December 31, 2001 compared to a provision for loss on firm sales and purchase commitments of $3.4 million for the year ended December 31, 2000. In June 2001, we reached an agreement with our supplier of anhydrous ammonia whereby the former long-term purchase commitment was terminated effective June 30, 2001. As consideration to terminate the prior above-market priced take-or-pay purchase commitment which provided, among other things, for a market price based on natural gas and required minimum monthly purchase volumes, EDC agreed to pay the supplier a one-time settlement fee. The remaining accrued liability associated with the above-market purchase commitment, net of the one-time settlement fee, was eliminated resulting in a gain on termination of the purchase commitment of $2.3 million in 2001. Also the supplier agreed to refund EDC up to $.7 million contingent on minimum monthly purchase volumes for which EDC recognized an additional gain on termination of the purchase commitment of $.4 million for the year ended December 31, 2001. See discussion in Note 16 of the Notes to Consolidated Financial Statements.

Interest Expense

Interest expense was $13.3 million for 2001, compared to $14.7 million for 2000. The decrease of $1.4 million primarily resulted from the reduced debt outstanding resulting from the repurchase of the Senior Unsecured Notes during 2001 and 2000 and lowered interest rates offset, in part, by the increase in borrowings from the Working Capital Revolver Loan.

Other Expense

Other expense for 2001 and 2000 was $1.2 million and $2.2 million,

-35-

respectively. Other expense for 2001 includes expenses incurred due to mark-to-market adjustments relating to the exchange-traded futures contracts for metals used in our Climate Control Business of $.2 million and financing fees of $.2 million relating to extending the maturity of the former revolving credit facility. Other expense for 2000 includes $.6 million in costs incurred by us in attempts to renegotiate the terms and conditions of the Indenture related to the Senior Unsecured Notes of ClimaChem, a provision for a litigation settlement of $.6 million and start up costs of $.2 million associated with a new subsidiary in our Climate Control Business.

Income (Loss) from Continuing Operations before Income Taxes

As a result of the items discussed above, we had income from continuing operations before income taxes of $7.4 million for 2001 compared to income of $8.1 million for 2000.

Provision for Income Taxes

As a result of our net operating loss carry-forward for income tax purposes as discussed elsewhere herein and in Note 8 of Notes to Consolidated Financial Statements, the provisions for income taxes associated with continuing operations in 2001 and 2000 were related to current state income taxes.

Income (Loss) from Discontinued Operations

The income from discontinued operations was $1.2 million for 2001 compared to a loss of $1.8 million for 2000. As discussed in Note 4 of Notes to Consolidated Financial Statements, in December 2002, all of the operating assets of

SEC and UTeC were sold which operations are reflected as discontinued operations for all periods presented. The loss from discontinued operations for 2000 is net of income of $1.3 million from the operations of SEC and UTeC (2001 relates entirely to SEC and UTeC). On April 5, 2000, our Board of Directors approved a plan of disposal of our Automotive Products Business ("Automotive"). The sale of Automotive was concluded on May 4, 2000. Following the sale of Automotive, we remained a guarantor on certain of Automotive's indebtedness. In the fourth quarter of 2000, we performed on certain of the equipment note guarantees and in 2001, were required to fund our $1.0 million guaranty on the buyer's revolving credit agreement. We acquired certain of this debt from the original lender and in other situations, negotiated revised terms. We recognized our obligations under the guaranties as of December 31, 2000 in the amount of $4.3 million. We also recognized a loss in the amount of $2.6 million representing our estimate of ultimate loss, net of the collateral value, associated with guaranteed indebtedness of Automotive. This loss, and $.5 million associated with the final adjustment for Automotive's 2000 operations from the amount accrued as of December 31, 1999, are included in the loss from discontinued operations for 2000.

Liquidity and Capital Resources
Cash Flow From Operations

Historically, our primary cash needs have been for operating expenses, working capital and capital expenditures. We have financed our cash requirements primarily through internally generated cash flow, borrowings under our revolving credit facilities, secured equipment financing and

-36-

the sale of assets. See additional discussion concerning cash flows from our Chemical and Climate Control Businesses in "Source of Funds."

Net cash provided by continuing operating activities for 2002 was $22.3 million resulting from operating cash flow and reductions in current assets, primarily accounts receivable and inventory and net cash provided from changes in accrued and other noncurrent liabilities. These provisions were partially offset by an increase in supplies and prepaid items and a decrease in accounts payable. The reduction in receivables is primarily due to the decrease in sales in the Chemical Business as a result of selling the distribution assets related to its mining products in the fourth quarter of 2001, the decrease in sales in the Climate Control Business resulting principally from the elimination of an unprofitable product line during the fourth quarter of 2001, the reduction in volume of hydronic fan coil and heat pump products in the fourth quarter of 2002 and a reduction in the number of days outstanding in the Climate Control Business. The reduction in inventory is due, in part, to planned reductions in the Climate Control Business. This reduction was partially offset by an increase in inventory at the Cherokee Facility in the Chemical Business. The cash provided from changes in accrued and other noncurrent liabilities is primarily due to the increase in the amount of customer deposits held by the Chemical Business and the decrease in accrued interest due to the repurchase of Senior Unsecured Notes in 2002. This provision was offset, in part, by a decrease in billings in excess of costs and estimated earnings on uncompleted contracts in the Climate Control Business. The increase in supplies and prepaid items is primarily due to an increase in prepaid supplies used in the maintenance of the chemical plants in the Chemical Business and an increase in prepaid insurance. The decrease in accounts payable is primarily due to the reduction in inventories in the Climate Control Business. This decrease was partially offset by an increase in payables relating to the Chemical Business relating to the higher cost of raw materials.

Cash Flow from Investing and Financing Activities

Net cash used by investing activities for 2002 included $10 million for capital expenditures primarily for the benefit of the Chemical Business, including the improvement and replacement of plant and equipment damaged by the storm at the El Dorado Facility. The proceeds from sales of property and equipment of $1.1 million consists primarily from the sale of land which was nonessential to the Company's core businesses. The restricted cash held in escrow of $1.5 million includes a cash collateral account established pursuant to the terms of the Financing Agreement dated May 24, 2002 described below. The decrease in other assets includes the utilization of noncurrent prepaid supplies at the El Dorado Facility.

Net cash used in financing activities for 2002 included payments on long-term and other debt of $10.8 million and a net decrease in revolving debt of $9.7 million offset by long-term borrowings of $2.6 million. See "Loan Agreements-Terms and Conditions" and Note 7 of Notes to Consolidated Financial Statements for discussion on the voluntary debt restructuring transaction involving the repurchase of a significant portion of the Senior Unsecured Notes using the proceeds of new loans under a financing agreement.

Obligations and Commitments

In the operation of our businesses, we enter into contracts, leases and borrowing arrangements. In connection with a series of agreements with Bayer

-37-

Corporation ("Bayer") to supply nitric acid with a provision for pass through of production costs with certain performance obligations on our part, a subsidiary of ClimaChem entered into a 10 year leveraged lease in June 1999 that requires minimum future net lease rentals of approximately $56.4 million at December 31, 2002. The lease payments are includable costs in these agreements. These lease rentals are made monthly with one annual payment each year representing a majority of the amount due for the year. Our ability to perform on this lease commitment is contingent upon Bayer's performance under the related purchase agreement.

Our commitments and obligations as of December 31, 2002, are summarized in the following table. See discussion below in "Loan Agreements - Terms and Conditions" and Notes 3, 7 and 12 of Notes to Consolidated Financial Statements.

-38-

		Due in the Year Ending December 31,					
Type of Obligation	Total	2003	2004	2005 (in thousands)	2006	2007	Thereafter
Long-term debt:							
Working Capital Revolver Loan (2)	$ 27,209	$ 27,209	$ -	$ -	$ -	$ -	$ -
Senior Unsecured Notes due 2007 (1)	18,300	-	-	-	-	18,300	
Financing Agreement due 2005	31,700	-	-	31,700	-	-	-
Accrued interest on Financing Agreement due 2005 (1)	14,656	3,375	3,384	7,897	-	-	-
Other	21,496	8,305	3,184	1,734	1,208	1,222	5,843
Total long-term debt	113,361	38,889	6,568	41,331	1,208	19,522	5,843
Baytown leveraged lease	56,374	7,666	13,001	2,250	8,175	9,227	16,055

Other operating leases	13,475	2,775	2,086	1,419	966	721	5,508
Purchase commitments	6,374	1,133	953	953	953	953	1,429
	$ 189,584	$ 50,463	$ 22,608	$ 45,953	$ 11,302	$ 30,423	$ 28,835

(1) See Note 7 of Notes to Consolidated Financial Statements for a discussion of the repurchase of $52.3 million aggregate principal amount of ClimaChem's Senior Unsecured Notes and the financing arrangement with certain lenders to fund this repurchase.

(2) The Working Capital Revolver Loan is not due by its terms until April 2005; however, the underlying agreement contains "a material adverse change in operating results or financial condition" provision which is construed to be a subjective acceleration clause. Therefore, the Loan is classified as due within one year at December 31, 2002 in the accompanying consolidated balance sheet.

-39-

Source of Funds

We are a diversified holding company and, as a result, depend on credit agreements and our ability to obtain funds from our subsidiaries in order to pay our debts and obligations. Our wholly owned subsidiary, ClimaChem through its subsidiaries, owns substantially all of our core businesses consisting of the Chemical and Climate Control Businesses. Historically ClimaChem's primary cash needs have been for operating expenses, working capital and capital expenditures. ClimaChem and its subsidiaries depend on credit agreements with lenders, internally generated cash flows, secured equipment financing and the sale of assets in order to fund their operations and pay their debts and obligations.

ClimaChem is restricted as to the funds that it may transfer to LSB, the non-ClimaChem companies and certain ClimaChem companies under the terms contained in the Financing Agreement and the Working Capital Revolver Loan. Under the terms, ClimaChem is permitted to distribute funds in the form of (a) advances, loans and investments, in an aggregate amount not to exceed $2,000,000, at any time outstanding, and (b) distribute or pay in the form of dividends and other distributions an aggregate amount not to exceed, during each year, 50% of ClimaChem's consolidated net income for such year (calculated after deducting all other dividends and distributions made by ClimaChem to us during the year). This limitation will not prohibit payment of amounts due under a Services Agreement, Management Agreement and a Tax Sharing Agreement. ClimaChem did not declare and pay to the Company a dividend during 2002 and there were no management fees due or paid pursuant to the EBITDA formula in the Management Agreement. At December 31, 2002, ClimaChem owed the Company approximately $7.9 million, including $2.7 million under the Tax Sharing Agreement.

Our ability to maintain an adequate amount of borrowing availability depends on the cash flow from operations, the investing activities and required debt amortization.

LSB (and its subsidiaries other than ClimaChem) have limited cash requirements as it relates to debt service and capital expenditures. Principal payments on long-term debt aggregate $3.3 million for 2003 while capital expenditures are essentially discretionary. LSB's cash flow from operations, which includes that from the Company's industrial products business and cash flow from equipment leased to ClimaChem are expected to be sufficient to meet its cash flow needs during 2003.

The Company's Summit Machine Tool Manufacturing Corp. ("Summit") subsidiary that is not a subsidiary of ClimaChem finances its Working Capital requirements through borrowings under a credit facility ("Facility") with a different lender than ClimaChem's lender. The Facility is scheduled to mature on April 1, 2004. The Facility provides a revolving line of credit of $.6 million.

On March 24, 2003, a subsidiary of LSB obtained a two-year term loan of $804,000 collateralized by equipment. The proceeds of the loan were used to pay debt ($203,000) and provide additional working capital for ClimaChem ($601,000).

Effective March 25, 2003, the Company completed a transaction with Jayhawk Institutional Partners, L.P., in which Jayhawk purchased from the Company, in a private placement transaction, 450,000 share of the Company's common stock

-40

and a five year warrant to purchase up to 112,500 share of the Company's common stock, subject to anti-dilution adjustments under certain conditions. The total price paid by Jayhawk to the Company for the shares of common stock and the warrant was $1,570,500. The average closing price of the Company's common stock over the 30 day period prior to the transaction was $3.49. If Jayhawk exercises the warrant, the warrant price per share of common stock so purchased would be $3.49 a share. Jayhawk has certain registration rights. Prior to the completion of this transaction and based on information provided to the Company by Jayhawk, Jayhawk and its affiliates beneficially owned 798,500 shares of the Company's common stock and 323,650 shares of the Company's $3.25 convertible exchangeable class C preferred stock ("$3.25 Preferred"). The shares of $3.25 Preferred beneficially owned by Jayhawk and its affiliates are convertible into 1,401,081 shares of the Company's common stock. Immediately prior to closing of the transaction with Jayhawk, the Company had issued and outstanding 11,970,688 shares of common stock and 623,550 shares of $3.25 Preferred.

At December 31, 2002, ClimaChem owed the Company approximately $2.7 million under the Tax Sharing Agreement. Subject to availability by ClimaChem, this amount could be paid to LSB should LSB and its subsidiaries other than ClimaChem have a need for such funds.

LSB is actively marketing its chemical plant located in Pryor, Oklahoma. As of the date of this report, no agreement has been reached, but the Company is in discussions with a possible buyer. If this plant is sold, the Company intends to use the proceeds from the sale to reduce debt.

ClimaChem and its subsidiaries finance their working capital requirements through borrowings under a $50 million asset-based Working Capital Revolver (See Note 7). The Working Capital Revolver matures in 2005 (see paragraph below) and is secured by receivables, inventories and intangibles of all the ClimaChem entities other than El Dorado Nitric Co. and its subsidiaries. The Working Capital Revolver agreement provides for available advances to ClimaChem based upon specified percentages of eligible accounts receivable and inventories, less a $.5 million reserve against such aggregate availability. As of December 31, 2002, borrowings outstanding under the Working Capital Revolver were $27.2 million and the net credit available for additional borrowings was $5.8 million. The Working Capital Revolver requires that ClimaChem and its Climate Control Business meet certain financial covenants on a quarterly basis and/or an annual basis as discussed in Note 7. Included in the financial covenants is the requirement to maintain quarterly earnings before interest, taxes, depreciation and amortization ("EBITDA") on a trailing twelve-month basis at specified amounts. ClimaChem and its Climate Control Business exceeded the required EBITDA amounts for 2002. The EBITDA amounts for 2003 were recently set at amounts less than those required for 2002, and below those forecasted by management as necessary for 2003.

Under a lock-box arrangement pursuant to the Working Capital Revolver, ClimaChem's customers remit payments on their accounts directly to the lender and the lender applies such payments to reduce the debt outstanding under the Working Capital Revolver. ClimaChem may request additional borrowings under the Working Capital Revolver, however, one of several conditions (as determined by the lender) precedent to all additional borrowings is that no "material adverse change" (as defined in the Working Capital Revolver) shall

-41-

have occurred. This provision in the Working Capital Revolver allows the lender, solely within their discretion, to terminate additional borrowings by ClimaChem and effectively accelerate the scheduled maturity of the debt under conditions that may not be objectively determinable (the subjective acceleration clause). Management does not anticipate that the lender will invoke the subjective acceleration clause in 2003. In the event that the lender exercised its rights under the subjective acceleration clause in the Working Capital Revolver and terminated additional borrowings, ClimaChem would have no borrowing availability and its plan to obtain the funds needed to meet its obligations as they become due could include a significant curtailment of its operations. If the proceeds from sales of remaining inventories and collections of accounts receivable of the businesses involved did not provide sufficient funds, ClimaChem may be required to sell other key assets. The curtailment of operations and/or the sale of the assets could result in losses that may be material. In this event, ClimaChem would be required to obtain working capital financing from other sources for its remaining businesses. There are no assurances that the Company would be successful in replacing, on a timely basis, the Working Capital Revolver needed to fund ClimaChem's remaining operations.

Based upon the current outlook for the Chemical Business and the Climate Control Business subject to the continuation of the Working Capital Revolver, management expects to maintain adequate borrowing availability under the Working Capital Revolver to meet the working capital requirements during 2003. However due to anticipated higher costs for the Chemical Business feed stocks, natural gas and ammonia, management expects to fully utilize the net borrowing availability provided by the Working Capital Revolver during the spring agricultural season of 2003. After that period of high usage, the borrowing availability is forecasted to increase. The forecast is based upon information currently available. The current outlook is subject to changes in economic conditions as well as market pricing of our products and costs of the various raw materials consumed.

Pursuant to the repurchase of Senior Unsecured Notes in May 2002, ClimaChem entered into a Financing Agreement with certain Lenders (See Note 7). Borrowings under the Financing Agreement are collateralized by Chemical plants in El Dorado, Arkansas and Cherokee, Alabama. The Financing Agreement requires that ClimaChem and its Climate Control Business meet certain financial covenants on a quarterly and/or annual basis as discussed in Note 7. ClimaChem is in compliance with all the financial covenants, as amended. For quarters ending after December 31, 2002, if ClimaChem fails to maintain EBITDA (as defined) on a trailing twelve-month basis of at least $12 million (a "Trigger Event"), then within 210 days of the end of such quarter, ClimaChem shall pay the Lenders an amount equal to 33.3% of then outstanding principal of the Loans ($10.6 million at December 31, 2002) plus related cash and additional interest. However, if ClimaChem maintains EBITDA on a trailing twelve-month basis of at least $12 million as of the end of each of the two quarters immediately following the Trigger Event, then within 210 days of such Trigger Event, ClimaChem shall pay the lenders an amount equal to 10% ($3.2 million as of December 31, 2002) of then outstanding principal of the Loans plus related cash and additional interest. ClimaChem does not expect that a Trigger Event will occur in 2003. In connection with the closing of the Financing Agreement, the lenders thereunder entered into an Inter-Creditor Agreement with ClimaChem's Working Capital Revolver lenders. The Working Capital Revolver agreement and the Financing Agreement contain cross-default provisions. If the Trigger Event occurs and/or ClimaChem fails to meet the other financial covenants of the Financing Agreement, the lender

-42-

may declare an event of default, making all or a portion of the debt due on demand. If this should occur, there are no assurances that the Company would have funds available to pay such amount nor that alternative borrowing arrangements would be available. Accordingly, ClimaChem may be required to curtail operations and/or sell key assets as discussed above. These actions could result in the recognition of losses that may be material.

In order to supplement the Working Capital Revolver and the internally generated funds as sources to meet capital requirements, management is pursuing the following funding sources for ClimaChem.

Management is currently in discussions with lenders to obtain long-term financing on two Chemical plants. If consummated, the loan proceeds will be used to reduce Working Capital Revolver debt. During February 2003, the Company engaged an investment banker to assist the Company, on a best efforts basis, in arranging financing of the concentrated nitric acid plant on which debt was paid off in 2002. Management is also attempting to secure long-term financing of its Cherokee Nitrogen Plant in Cherokee, Alabama. The Cherokee plant is currently pledged as part of the collateral for ClimaChem's debt under the Financing Agreement. If this plant is financed, it is anticipated that half of the net proceeds would be used to pay down the Senior Secured Notes and the other half would be used as working capital.

On March 3, 2003, ClimaChem obtained a term loan of $800,000 collateralized by equipment. The proceeds of the loan were used to pay debt on the Working Capital Revolver.

Due to the Company and ClimaChem's previous operating losses and limited borrowing ability under the credit facility then in effect, we discontinued payment of cash dividends on Common Stock for periods subsequent to January 1, 1999, until the Board of Directors determines otherwise. As of December 31, 2002, we have not paid the regular quarterly dividend of $.8125 on the outstanding $3.25 Convertible Exchangeable Class C Preferred Stock Series 2 ("Series 2 Preferred") since June 15, 1999, resulting in approximately $7.1 million in total accrued and unpaid dividends on the Series 2 Preferred. We also did not declare and pay the regular annual dividend of $12.00 on the Series B Preferred since 1999, resulting in $.7 million in accrued and unpaid dividends on the Series B Preferred. In addition, we did not declare and pay the 6% per annum cumulative dividend payable in arrears on the Series D preferred resulting in $.1 million in accrued and unpaid dividends. We do not anticipate having funds available to pay dividends on our stock for the foreseeable future.

Excluding the operations of and the net proceeds from the sale of SEC and UteC as discussed in Note 4 of Notes to Consolidated Financial Statements, the Company's net cash provided by operating activities for 2002 was $22.3 million. The sale of the Chemical Business's packaged explosives business (SEC & UTeC) provided an additional $5 million. Cash used in investing activities included $10 million for capital expenditures primarily in the Chemical Business. Cash used in financing activities included a net reduction of long-term debt and the reduction of the Working Capital Revolver. As of December 31, 2002, ClimaChem had cash and borrowing availability under the Working Capital Revolver of $7.9 million compared to $7.4 million at December 31, 2001.

-43-

For the periods covered by this report, the Climate Control Business has consistently generated a positive cash flow and conversely the Chemical Business has generated a negative cash flow.

The negative cash flow in the Chemical Business in 2002 is a result of disruptions caused by the storm damage, the losses due to the revocation of SEC's license to produce its profitable high explosives at its Hallowell, Kansas facility and the operating losses in the agricultural nitrogen business of the El Dorado, Arkansas and Cherokee, Alabama plants. Losses in the agricultural nitrogen business have resulted from the low selling prices compared to the cost of the raw material feed stocks, natural gas and anhydrous ammonia. The feedstocks of natural gas and ammonia have historically experienced significant price volatility. The profit problem has been due primarily to an oversupply in the market of agricultural nitrogen products of the kind we produce and the inability in the past to pass through the natural gas and ammonia cost increases when they occur. Currently, although its too early to predict with any certainty, it appears that the over supply problem of nitrogen fertilizer has subsided to the point that the outlook for pricing of product in relation to the cost of raw materials has improved. We cannot however, predict whether the current sales prices will go up or down as the agricultural season progresses into April and May of 2003. Both natural gas and ammonia prices have risen significantly during early 2003. Approximately 45% of the Chemical Business' sales volume of manufactured product is tied to sales contracts that allow these feed stock costs to pass through. The balance of the sales volume moves as agricultural fertilizer into the Company's freight logical geographical markets at spot prices.

In early 2003, the agricultural fertilizer spot market prices have risen due to an improvement in the balance of supply and demand due primarily to lesser amounts of imported products and the closing of certain of our competitors plants over the past two years. Additionally during late
February and early March 2003, many nitrogen fertilizer plants in the United States were shut down temporarily due to high gas and ammonia prices creating a perceived tightness of supply for the spring 2003 season.

Although the higher selling prices are favorable, the higher costs of feedstock places pressure on the credit limits and the available Working Capital. As a result, the Company is pursuing other sources of Working Capital to ensure adequate liquidity as discussed above.

Management's plan for the Chemical Business anticipates that the industrial-grade products of El Dorado Chemical and Cherokee Nitrogen that are sold pursuant to long-term cost-plus agreements will continue in 2003 at or about the same volume levels as in 2002. El Dorado and Cherokee's 2003 production level for industrial-grade nitrogen products sold as fertilizers into the agricultural markets will approximate the 2002 volume levels but the sales as expressed in dollars will be higher due to correspondingly higher unit sales prices. However, due to the volatility of sales prices and the corresponding costs of feed stocks, anhydrous ammonia and natural gas, ultimate profitability is difficult to predict.

Historically the Climate Control Business has been very stable and has consistently managed to report steady earnings. As a result, the Company has been able to satisfy the various financial loan covenants. The 2002 earnings were significantly better than for 2001. Included in Climate Control's 2002 operating results are three start-up product lines and/or services that

-44-

adversely affected the results. Although we don't expect these new product lines to reach positive results in 2003, there is the expectation that the results will be made closer to a breakeven. Management's plan for 2003 anticipates that the Climate Control Business will continue to operate at approximately the same sales volume and profitability levels as in 2002.

The planned capital expenditures for 2003 are approximately $6.4 million, but such capital expenditures are dependent upon an adequate amount of liquidity and/or obtaining acceptable funding. As discussed in Note 12 of Notes to Consolidated Financial Statements, the Discharge Water issue is not yet finally determined but is currently expected to require capital expenditures of approximately $3.6 million over the next 3 to 4 years provided the Discharge Water permit is corrected, the City of El Dorado, Arkansas (the "City") builds its own discharge pipeline to a nearby river and we are permitted to tie our pipeline into the City's pipeline. Management is continuing to review the design and configurations of treatment and discharge facilities to address the permitting issues. Also as discussed in Note 12 of Notes to Consolidated Financial Statements, there will be certain expenditures required to bring the sulfuric acid plant's air emissions into acceptable limits. The design of additional emission controls at this plant is underway. At this point, the capital expenditures to achieve the required emission level are undeterminable but management believes that such expenditures when finally determined will be manageable within the capital expenditure budget for 2003 and/or 2004.

Although the volatility of the Chemical Business is such that the forecasted results can fluctuate significantly, ClimaChem's cash flow forecasts indicate that there will be sufficient liquidity to meet their obligations as they come due.

Loan Agreements - Terms and Conditions

The Company and/or its subsidiaries are subject to various loan agreements. The loans provide the Company's debt capitalization. ClimaChem owns substantially all of the Company's core businesses. ClimaChem is the primary obligor on all the significant loan agreements.

Summit Machine Tool Manufacturing Corp., ("Summit"), one of our subsidiaries, that is not a subsidiary of ClimaChem, finances its working capital requirement through borrowings under a credit facility (the "Facility") with a different lender than ClimaChem's lender. In March 2003, Summit entered into an amendment to the Facility which reduced the revolving line of credit to $.6 million. The Facility terminates on April 1, 2004. The Facility requires monthly payments of interest which accrue based on the lender's prime rate plus 7%. The effective rate at December 31, 2002 was 11.25%. Summit may terminate the Facility with proper notice without premium or penalty. The Company guarantees the Facility.

ClimaChem and its subsidiaries are parties to the $50 million Working Capital Revolver. The Working Capital

Revolver provides for advances based on specified percentages of eligible accounts receivable and inventories of ClimaChem and its subsidiaries and accrues interest at a base rate (generally equivalent to the prime rate) plus 2% or LIBOR plus 4.5%. The effective rate at December 31, 2002 was 6.25%. Interest is due monthly. The facility provides for up to $8.5 million of letters of credit. All letters of credit outstanding reduce availability under the facility.

-45-

The Working Capital Revolver matures in April 2005 and is secured by receivables, inventories and intangibles of all the ClimaChem entities other than El Dorado Nitric Co. and its subsidiaries ("EDNC"). EDNC is neither a borrower nor guarantor of the Working Capital Revolver. In connection with the completion of the Financing Agreement as discussed below, ClimaChem and our subsidiaries which are guarantors of ClimaChem's Working Capital Revolver entered into an amendment to the Working Capital Revolver pursuant to which we and certain of ClimaChem's subsidiaries pledged additional collateral to secure ClimaChem's obligations under the Working Capital Revolver. The additional collateral consisted of a second mortgage on the assets to which the lenders of the Financing Agreement discussed below were granted a first lien.

The Working Capital Revolver, as amended, required ClimaChem to maintain quarterly earnings before interest, taxes, depreciation and amortization (EBITDA), as defined by the lenders, for ClimaChem and its Climate Control Business on a trailing twelve-month basis, of $14 million and $10 million, respectively, measured as of December 31, 2002. ClimaChem and its Climate Control Business's EBITDA for the twelve-month period ended December 31, 2002 was in excess of the required amounts. The Working Capital Revolver, as amended, requires ClimaChem to maintain quarterly EBITDA, as defined, for ClimaChem and its Climate Control Business on a trailing twelve-month basis of $12.3 million and $10 million, respectively, measured as of March 31, 2003, $13.4 million and $10 million, respectively, measured as of June 30, 2003, $13.5 million and $10 million, respectively, measured as of September 30, 2003, and $12.5 million and $10 million, respectively, measured as of December 31, 2003 . For the quarters ending after December 31, 2003, the EBITDA requirement shall be determined based on ClimaChem's forecasted financial statements, however, if ClimaChem and the provider of the Working Capital Revolver can not reach an agreement, the EBITDA requirement shall not be less than $15 million. The Working Capital Revolver also requires ClimaChem to achieve an annual fixed charge coverage ratio of at least 1 to 1 and limits capital expenditures to $11.2 million annually. The Working Capital Revolver requires that ClimaChem's excess availability, as defined, equal an amount not less than $.5 million. It also requires ClimaChem's excess availability, as defined equal an amount not less than $1.5 million on the date of the periodic interest payments due on its 10-3/4% Senior Unsecured Notes due 2007 (discussed below) and interest due on certain debt issued pursuant to a financing arrangement entered into in May 2002 (discussed below). The Working Capital Revolver also contains covenants that, among other things, limit the borrowers' ability to: (i) incur additional indebtedness, (ii) incur liens, (iii) make restricted payments or loans to affiliates who are not borrowers, or (iv) engage in mergers, consolidations or other forms of recapitalization, (v) dispose of assets, and (vi) repurchase ClimaChem's 10-3/4% Senior Unsecured Notes. The Working Capital Revolver also requires all collections on accounts receivable be made through an account in the name of the lender or their agents and gives the lender the sole discretion to determine whether there has been any material adverse change, as defined, in the financial condition of the borrowers or LSB Industries, Inc., as guarantor, prior to granting additional advances. The lender may, upon an event of default as defined, terminate the Working Capital Revolver and make the balance outstanding due and payable in full. Amounts available for additional borrowing under the Working Capital Revolver at December 31, 2002 were $5.8 million.

Pursuant to loans made by Lenders in May 2002 to facilitate the repurchase by ClimaChem of a significant portion of its Senior Unsecured Notes,

-46-

ClimaChem is subject to the terms of a Financing Agreement. Pursuant to the terms of the Financing Agreement, the Lenders loaned $35 million to ClimaChem (collectively, the "Loans"). The Loans mature on June 30, 2005, and bear interest at 10 1/2% per annum, payable quarterly. Additional interest of 5 1/2% is payable either at maturity or upon prepayment. The Lenders and affiliates of the Lenders owned the Senior Unsecured Notes which were repurchased by ClimaChem.

In connection with the closing of the Loans, the Lenders entered into an Intercreditor Agreement with ClimaChem's Working Capital Revolver lender. The Financing Agreement contains cross-default provisions to the Working Capital Revolver agreement.

The Financing Agreement required ClimaChem to maintain quarterly EBITDA, as defined, for ClimaChem and its Climate Control Business on a trailing twelve-month basis of $16 million and $10 million, respectively, measured as of December 31, 2002. ClimaChem and its Climate Control Business's EBITDA, as defined, for the twelve-month period ended December 31, 2002 was in excess of the required amounts. The Financing Agreement, as amended, requires ClimaChem to maintain quarterly EBITDA, as defined, for ClimaChem and its Climate Control Business on a trailing twelve-month basis equal to those of the Working Capital Revolver discussed above. For quarters ending after December 31, 2002, if ClimaChem fails to maintain EBITDA, as defined, on a trailing twelve-month basis of at least $12 million (a "Trigger Event"), then within 210 days of the end of such quarter, ClimaChem shall pay the Lenders an amount equal to 33.3% ($10.6 million as of December 31, 2002) of then outstanding principal of the Loans plus related cash and additional interest. However, if ClimaChem maintains EBITDA on a trailing twelve-month basis of at least $12 million as of the end of each of the two quarters immediately following the Trigger Event, then within 210 days of such Trigger Event, ClimaChem shall pay the Lenders an amount equal to 10% ($3.2 million as of December 31, 2002) of then outstanding principal of the Loans plus related cash and additional interest.

The Financing Agreement, as amended, also requires ClimaChem to achieve an annual fixed charge coverage ratio of at least 1 to 1 and limits annual capital expenditures to $11.2 million measured quarterly on a trailing twelve-month basis. The Financing Agreement also contains covenants that, among other things, limit ClimaChem's ability to: (i) incur additional indebtedness, (ii) incur liens, (iii) provide certain guarantees (iv) engage in mergers, consolidations or other forms of recapitalization and (v) dispose of assets. The Lenders may, upon an event of default as defined, terminate the Financing Agreement and demand the balance outstanding due and payable in full. The Financing Agreement includes a prepayment fee equal to 2% of the principal amount paid should ClimaChem elect to prepay any principal amount prior to May 24, 2003. This fee is reduced to 1% during the second twelve-month period and to .5% during the third twelve-month period.

The Loans are secured by (a) a first lien on (i) certain real property and equipment located at the El Dorado, Arkansas manufacturing facility (excluding the DSN Plant and other exceptions) (the "EDC Plant") (ii) certain real property and equipment located at the Cherokee, Alabama manufacturing facility (the "Cherokee Plant") owned by a subsidiary of the Company that is not a subsidiary of ClimaChem, (iii) a cash collateral account of $1.8 million, and (b) a second lien on the assets upon which ClimaChem's Working Capital Revolver lender has a first lien. The Loans are guaranteed by the Company and certain subsidiaries of ClimaChem.

-47-

Based upon certain criteria including but not limited to unfavorable changes in ClimaChem's financial condition since the Notes were originally sold and the high interest rates on the new Loans, the transaction was accounted for as a debt restructuring. As a result, the gain on the transaction was limited to the difference between the carrying value of the Notes repurchased and the principal of the new Loans due 2005, plus the cumulative interest due and payable during the three year term thereof including interest due at maturity.

Since the implied gain relating to this transaction was deferred, all of the future interest payments associated with the Loans has been recognized in long-term debt. All future interest payments on the Loans will be charged against the debt balance presently accrued on the balance sheet.

As discussed in Note 4 of Notes to the Consolidated Financial Statements, in December 2002, SEC and UTeC sold all of their operating assets. Approximately $3.5 million of the sales proceeds were used as a prepayment on the Loans. Due to this prepayment, ClimaChem will not incur the interest accrued on the Loans prepaid and has thus recognized a gain on extinguishment of debt of $1.5 million for 2002.

At December 31, 2002, the carrying amount of long-term debt owed the Lenders is $46.4 million which includes $14.7 million interest due on the Loans through maturity. Of this, interest of $3.4 million is included in current portion of long-term debt at December 31, 2002.

ClimaChem's 10-3/4% Senior Unsecured Notes due 2007 (the "Notes") bear interest at an annual rate of 10-3/4% payable semiannually in arrears on June 1 and December 1 of each year. The Notes are senior unsecured obligations of ClimaChem and rank equal in right of payment to all existing and future senior unsecured indebtedness of ClimaChem and its subsidiaries. The Notes are effectively subordinated to all existing and future secured indebtedness of ClimaChem.

ClimaChem owns substantially all of the companies comprising our Chemical and Climate Control Businesses. ClimaChem is a holding company with no significant assets (other than the notes receivable from us), or operations other than its investments in its subsidiaries, and each of its subsidiaries is wholly-owned, directly or indirectly, by ClimaChem. ClimaChem's payment obligations under the Notes are fully, unconditionally and joint and severally guaranteed by all of the existing subsidiaries of ClimaChem, except for EDNC.

Availability of Company's Loss Carry-Overs

Our cash flow in future years may benefit from our ability to use net operating loss ("NOL") carry-overs from prior periods to reduce the federal income tax payments which we would otherwise be required to make with respect to income generated in such future years. Such benefit, if any, is dependent on our ability to generate taxable income in future periods, for which there is no assurance. Such benefit, if any, will be limited by our reduced NOL for alternative minimum tax purposes, which was $16.3 million at December 31, 2002. As of December 31, 2002, we had available regular tax NOL carry-overs of approximately $40 million based on our federal income tax returns as filed with the Internal Revenue Service for taxable years through 2001 and our estimated Federal taxable income for the year 2002. There are no regular tax NOLs that expire in 2003. Due to our recent history of reporting taxable losses, we

-48-

have established a valuation allowance on all of our NOLs and thus have not recognized any benefit of our NOLs in the accompanying Consolidated Financial Statements.

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

Contingencies

We have several contingencies that could impact our operating results and/or liquidity in the event that we are unsuccessful in defending against the claimants. Although we do not anticipate that these claims will result in substantial adverse impacts on our operating results and/or liquidity, it is not possible to determine the outcome. See "Business", "Legal Proceedings" and Note 12 of Notes to Consolidated Financial Statements for an expanded discussion. This paragraph contains forward-looking statements that involve a number of risks and uncertainties that could cause actual results to differ materially. See "Special Note Regarding Forward-Looking Statements."

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

General

Our results of operations and operating cash flows are impacted by changes in market interest rates and changes in market prices of anhydrous ammonia and natural gas. Our Chemical Business buys substantial quantities of anhydrous ammonia and natural gas as feedstocks for use in manufacturing processes generally at spot market prices. Periodically, the Chemical Business enters into fixed-price natural gas contracts, however, there were no purchase commitments on these contracts at December 31, 2002.

Interest Rate Risk

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

The following table presents principal amounts and related weighted-average interest rates by maturity date for our interest rate sensitive financial instruments as of December 31, 2002.

	YEARS ENDING DECEMBER 31, (Dollars in thousands)						
	2003	2004	2005	2006	2007	THEREAFTER	TOTAL
Expected maturities of long-term debt:							
Variable rate debt (1)	$28,528	$ 615	$ 1,029	$ 597	$ 611	$1,451	$32,831
Weighted average interest rate (2)	5.80%	4.28%	4.34%	4.45%	4.73%	4.97%	4.76%
Fixed rate debt	$10,361	$5,953	$40,302	$ 611	$18,911	$4,392	$80,530
Weighted average interest rate (3)(4)	4.03%	3.78%	5.38%	9.85%	9.38%	6.66%	4.21%

(1) The Working Capital Revolver Loan is not due by its terms until April 2005; however, the underlying agreement contains "a material adverse change in operating results or financial condition" provision which is construed to be a subjective acceleration clause. Therefore, the Loan ($27,209 of this total) is classified as due within one year at December 31, 2002 in the accompanying consolidated balance sheet.

(2) Interest rate is based on the aggregate amount of debt outstanding as of December 31, 2002. On ClimaChem's Working Capital Revolver Loan, the interest rate is based on the lender's prime rate plus 2% per annum, or at its option, LIBOR plus 4.5% per annum.

(3) Interest rate is based on the aggregate amount of debt outstanding as of December 31, 2002.

(4) In the second quarter of 2002, the repurchase of certain Senior Unsecured Notes using the proceeds from a Financing Agreement due 2005 was accounted for as a voluntary debt restructuring. As a result, all future interest payments associated with the Financing Agreement indebtedness was recognized against the implied gain on the transactions. Therefore the weighted average interest rate through 2005 reflects a zero interest rate on such borrowing.

-50-

	December 31, 2002		December 31, 2001	
	Estimated Fair Value	Carrying Value	Estimated Fair Value	Carrying Value
	(in thousands)			
Variable Rate:				
Bank debt and equipment financing	$ 32,831	$ 32,831	$ 42,428	$ 42,428
Fixed Rate:				
Bank debt and equipment financing	17,346	15,874	19,745	18,585
Financing Agreement (including accrued interest) due 2005 (2)	35,351	46,356	-	-
Senior Unsecured Notes due 2007 (1)(2)	7,320	18,300	35,304	70,607
	$ 92,848	$ 113,361	$ 97,477	$ 131,620

(1) The fair value of ClimaChem's Senior Unsecured Notes was determined based on a market quotation for such securities.

(2) In the second quarter of 2002, the repurchase of certain Senior Unsecured Notes using the proceeds from a Financing Agreement was accounted for as a voluntary debt restructuring. As a result, all future interest payments associated with the Financing Agreement indebtedness was accrued and classified as debt.

-51-

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

-52-

SPECIAL NOTE REGARDING
FORWARD-LOOKING STATEMENTS

Certain statements contained within this report may be deemed "Forward-Looking Statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements in this report other than statements of historical fact are Forward-Looking Statements that are subject to known and unknown risks, uncertainties and other factors which could cause actual results and performance of the Company to differ materially from such statements. The words "believe", "expect", "anticipate", "intend", "will", and similar expressions identify Forward-Looking Statements. Forward-Looking Statements contained herein relate to, among other things,

- the demand for our geothermal products will increase,
- the "E-2" brand ammonium nitrate fertilizer is recognized as a premium product,

- the agricultural products are the only seasonal products,
- competition within the Chemical and Climate Control Businesses is primarily based on price, service, warranty and product performance,
- the market for commercial water source heat pumps will continue to grow,
- the backlog of confirmed orders for Climate Control products at December 31, 2002 will be filled by December 31, 2003,
- we will not incur difficulties obtaining necessary materials for our Chemical and Climate Control Businesses,
- EDC or its employees have a criminal exposure in the equalization pond matter,
- the anticipated consent order for SEC will not have a material adverse effect on the Company,
- availability of net operating loss carryovers,
- amount to be spent relating to compliance with federal, state and local environmental laws at the El Dorado Facility,
- liquidity and availability of funds,
- anticipated financial performance,
- adequate cash flows to meet our presently anticipated working capital requirements,
- adequate resources to meet our obligations as they come due,
- ability to make planned capital improvements,
- amount of and ability to obtain financing for the Discharge Water disposal project,
- under the terms of an agreement with a supplier, EDC will purchase 100% of its requirements of purchased ammonia through December 31, 2004,
- under the terms of an agreement with a customer, EDC will supply this customer with approximately 200,000 tons of industrial grade ammonium nitrate per year through at least November 2006,
- under the terms of an agreement with a customer, CNC will supply this customer its requirements of 83% ammonium nitrate through at least October 2006,
- under the terms of an agreement, Bayer will purchase from EDNC all of its requirements for nitric acid at its Baytown operation through at least May 2009,
- ClimaChem's forecasts for 2003 for ClimaChem's operating results will meet all required covenant tests for all quarters and the year ending in 2003, and
- management does not anticipate that these contingent claims will result in substantial adverse impact on our operating results and/or liquidity.
- the permit governing the Discharge Water will be corrected to provide

appropriate credits and effluent guidelines that are acceptable to EDC,

- the amount of additional expenditures required under the modified Discharge Water permit,
-

- EDC's inability to comply with the terms of the modified permit due to current liquidity and other information,
- use of proceeds if we sell our Chemical plant in Pryor, Oklahoma,
- management fully utilizing the net borrowing availability under the Working Capital Revolver,
- improvement in the pricing of Chemical products in relation to cost of raw materials,
- continuation of EDC and CNA sales of industrial grade products and continuation of Climate Control sales at 2002 levels, and
- the effects of, and what the Company anticipates it can do if, its Working Capital lender decides not to continue to fund the Company's ClimaChem subsidiaries under it Working Capital Revolver.

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,

- decline in general economic conditions, both domestic and foreign,
- material reduction in revenues,
- material increase in interest rates,
- ability to collect in a timely manner a material amount of receivables,
- increased competitive pressures,
- changes in federal, state and local laws and regulations, especially environmental regulations, or in interpretation of such, pending,
- additional releases (particularly air emissions) into the environment,
- 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,
- the cost for the purchase of anhydrous ammonia and natural gas,
- changes in competition,
- the loss of any significant customer,
- changes in operating strategy or development plans,
- inability to fund the working capital and expansion of our businesses,
- adverse results in any of our pending litigation,

- inability to obtain necessary raw materials,
- inability to have the permit governing the Discharge Water corrected to comply with legal guidelines that the El Dorado Facility will be able to meet,
- inability to obtain a replacement for its current working capital line if its working capital lender terminates the Company's ability to borrow additional funds and effectively accelerates its Working Capital Revolver, and
- other factors described in "Management's Discussion and Analysis of Financial Condition and Results of Operation" contained in this report.

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

-54-

to any of the Forward-Looking Statements contained herein to reflect future events or developments.

-55-

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE COMPANY

Information regarding our executive officers is set forth under Item 4A of Part I of this report. The other information required by this item is incorporated by reference from the definitive proxy statement (the "Proxy Statement") which we intend to file with the Securities and Exchange Commission on or before April 30, 2003, in connection with our 2003 annual meeting of stockholders under the captions "Directors" and "Section 16(a) Beneficial Ownership Reporting Compliance."

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is incorporated by reference from the Proxy Statement under the caption "Executive Compensation."

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT STOCKHOLDERS MATTERS

The information required by this item is incorporated by reference from the Proxy Statement under the caption "Security Ownership of Certain Beneficial Owners and Management."

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this item is incorporated by reference from the Proxy Statement under the caption "Certain Relationships and Related Transactions."

ITEM 14. CONTROLS AND PROCEDURES

Within 90 days prior to the date of this report, the Company's management, including our chief executive officer and chief financial officer, carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures to provide reasonable assurance that a registrant is able to record, process, summarize and report the information required in the registrant's quarterly and annual reports under the Securities Exchange Act of 1934. Based on this evaluation, our chief executive officer and chief financial officer believe that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in our periodic reports filed with the Securities and Exchange Commission. While they believe our existing disclosure controls and procedures have been effective to accomplish these objectives, we intend to continue to examine, refine and formalize our disclosure controls and procedures and to maintain ongoing developments in this area. In addition, we reviewed our internal controls, and there have been no significant changes in our internal controls or in other factors that could significantly affect those internal controls subsequent to the date we carried out our last evaluation.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) (1) Financial Statements

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

	Pages
Report of Independent Auditors	F-1
Consolidated Balance Sheets at December 31, 2002 and 2001	F-2 to F-3
Consolidated Statements of Income for each of the three years in the period ended December 31, 2002	F-4
Consolidated Statements of Stockholders' Equity (Deficit) for each of the three years in the period ended December 31, 2002	F-5 to F-6
Consolidated Statements of Cash Flows for each of the three years in the period ended December 31, 2002	F-7 to F-8
Notes to Consolidated Financial Statements	F-9 to F-63
Quarterly Financial Data (Unaudited)	F-64 to F-66

(a) (2) Financial Statement Schedule

The Company has included the following schedule in this report:

II - Valuation and Qualifying Accounts	F-67 to F-68

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

2.1. Stock Purchase Agreement and Stock Pledge Agreement between Dr. Hauri AG, a Swiss Corporation, and LSB Chemical Corp., which the Company hereby incorporates by reference from Exhibit 2.2 to the Company's Form 10-K for fiscal year ended December 31, 1994.

3.1. Restated Certificate of Incorporation, the Certificate of Designation dated February 17, 1989, and certificate of Elimination dated April 30, 1993, which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Registration Statement, No. 33-61640; Certificate of Designation for the Company's $3.25 Convertible Exchangeable Class C Preferred Stock, Series 2, which the Company hereby incorporates by reference from Exhibit 4.6 to the Company's Registration Statement, No. 33-61640.

3.2. Bylaws, as amended, which the Company hereby incorporates by reference from Exhibit 3(ii) to the Company's Form 10-Q for the quarter ended June 30, 1998.

4.1. Specimen Certificate for the Company's Non-cumulative Preferred Stock, having a par value of $100 per share, which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 10-Q for the quarter ended June 30, 1983.

4.2. Specimen Certificate for the Company's Series B Preferred Stock, having a par value of $100 per share, which the Company hereby incorporates by reference from Exhibit 4.27 to the Company's Registration Statement No. 33-9848.

4.3. Specimen Certificate for the Company's Series 2 Preferred, which the Company hereby incorporates by reference from Exhibit 4.5 to the Company's Registration Statement No. 33-61640.

4.4. Specimen Certificate for the Company's Common Stock, which the Company incorporates by reference from Exhibit 4.4 to the Company's Registration Statement No. 33-61640.

4.5. Renewed Rights Agreement, dated January 6, 1999, between the Company and Bank One, N.A., which the Company hereby incorporates by reference from Exhibit No. 1 to the Company's Form 8-A Registration Statement, dated January 27, 1999.

4.6. Indenture, dated as of November 26, 1997, by and among ClimaChem, Inc., the Subsidiary Guarantors and Bank One, NA, as trustee, which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 8-K, dated November 26, 1997.

4.7. Form of 10 3/4% Series B Senior Notes due 2007 which the Company hereby incorporates by reference from Exhibit 4.3 to the ClimaChem Registration Statement, No. 333-44905.

4.8. First Supplemental Indenture, dated February 8, 1999, by and among ClimaChem, Inc., the Guarantors, and Bank One N.A., which the Company hereby incorporates by reference from Exhibit 4.19 to the Company's Form 10-K for the year ended December 31, 1998.

-58-

4.9. Second Amended and Restated Loan and Security Agreement dated May 10, 1999, by and between Bank of America National Trust and Savings Association and LSB Industries, Inc., Summit Machine Tool Manufacturing Corp., and Morey Machinery Manufacturing Corporation, which the Company hereby incorporates by reference from Exhibit 4.2 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1999.

4.10. Specimen of Certificate of Series D 6% Cumulative, Convertible Class C Preferred Stock which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2001.

4.11. Second Amendment to Loan and Security Agreement, dated May 24, 2002, by and among the Company, LSB, certain subsidiaries of the Company, Foothill Capital Corporation ("Foothill") and Congress Financial Corporation (Southwest), which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 8-K, dated May 24, 2002. Omitted are exhibits and schedules attached thereto. The Agreement contains a list of such exhibits and schedules, which the Company agrees to file with the Commission supplementally upon the Commission's request.

4.12. Securities Purchase Agreement, dated May 24, 2002 ("Agreement"), which the Company hereby incorporates by reference from Exhibit 4.2 to the Company's Form 8-K, dated May 24, 2002. Omitted are exhibits and schedules attached thereto. The Agreement contains a list of such exhibits and schedules, which the Company agrees to file with the Commission supplementally upon the Commission's request.

4.13. Fifth Supplemental Indenture, dated May 24, 2002, among the Company, the Guarantors, and Bank One, N.A, which the Company hereby incorporates by reference from Exhibit 4.3 to the Company's Form 8-K, dated May 24, 2002.

4.14. Promissory Note, dated May 24, 2002, granted by the Company in favor of one of the Lenders in the original principal amount of $7,786,927, which the Company hereby incorporates by reference from Exhibit 4.4 to the Company's Form 8-K, dated May 24, 2002. Substantially similar Promissory Notes, dated May 24, 2002, were granted by the Company to each of the other Lenders in the original principal amount indicated: (a) a Promissory Note granted in favor of one Lender in the original principal amount of $3,478,410, (b) two Promissory Notes granted in favor of a

Lender in the original aggregate principal amount of $20,000,000, (c) a Promissory Note granted in favor of a Lender in the original principal amount of $3,734,663. Copies of these Promissory Notes will be provided to the Commission upon request.

4.15. Letter, dated July 10, 2002, to document certain items not reflected in the Securities Purchase Agreement which the Company hereby incorporates by reference from Exhibit 4.5 to the Company's Form 10-Q for the fiscal quarter ended June 30, 2002.

4.16. Third Amendment, dated as of November 18, 2002, to the Loan and Security Agreement dated as of April 13, 2001, as amended by the First Amendment dated as of August 3, 2001 and the second Amendment dated as of May 24, 2002, by and among LSB Industries, Inc., ClimaChem, Inc., and certain subsidiaries of ClimaChem, Congress Financial Corporation (Southwest) and Foothill Capital Corporation which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 10-Q for the fiscal quarter

-59-

ended September 30, 2002.

4.17. Second Amendment to Securities Purchase Agreement, dated February 28, 2003 by and among ClimaChem, Inc. and certain of its subsidiaries, the Purchasers and Guggenheim Investment Management, LLC.

4.18. Fourth Amendment, dated as of March 3, 2003, to the Loan and Security Agreement dated as of April 13, 2001, as amended by the First, Second, and Third Amendments, by and among LSB Industries, Inc., ClimaChem, Inc., and certain subsidiaries of ClimaChem, Inc., Congress Financial Corporation (Southwest) and Foothill Capital Corporation.

4.19 Letter, dated March 3, 2003, to document the consent to increase capital expenditures, as defined in the Securities Purchase Agreement.

10.1. Form of Death Benefit Plan Agreement between the Company and the employees covered under the plan, which the Company hereby incorporates by reference from Exhibit 10(c) (1) to the Company's Form 10-K for the year ended December 31, 1980.

10.2. The Company's 1993 Stock Option and Incentive Plan which the Company hereby incorporates by reference from Exhibit 10.6 to the Company's Form 10-K for the fiscal year ended December 31, 1993.

10.3. The Company's 1993 Non-employee Director Stock Option Plan which the Company hereby incorporates by reference from Exhibit 10.7 to the Company's Form 10-K for the fiscal year ended December 31, 1993.

10.4. Limited Partnership Agreement dated as of May 4, 1995, between the general partner, and LSB Holdings, Inc., an Oklahoma Corporation, as limited partner which the Company hereby incorporates by reference from Exhibit 10.11 to the Company's Form 10-K for the fiscal year ended December 31, 1995.

10.5. Severance Agreement, dated January 17, 1989, between the Company and Jack E. Golsen, which the Company hereby incorporates by reference from Exhibit 10.48 to the Company's Form 10-K for fiscal year ended December 31, 1988. The Company also entered into identical agreements with Tony M. Shelby, David R. Goss, Barry H. Golsen, David M. Shear, and Jim D. Jones and the Company will provide copies thereof to the Commission upon request.

10.6. Employment Agreement and Amendment to Severance Agreement dated January 12, 1989 between the Company and Jack E. Golsen, dated March 21, 1996 which the Company hereby incorporates by reference from Exhibit 10.15 to the Company's Form 10-K for fiscal year ended December 31, 1995.

10.7. First Amendment to Non-Qualified Stock Option Agreement, dated March 2, 1994, and Second Amendment to Stock Option Agreement, dated April 3, 1995, each between the Company and Jack E. Golsen, which the Company hereby incorporates by reference from Exhibit 10.1 to the Company's Form 10-Q for the fiscal quarter ended March 31, 1995.

10.8. Baytown Nitric Acid Project and Supply Agreement dated June 27, 1997, by and among El Dorado Nitrogen Company, El Dorado Chemical Company and Bayer Corporation which the Company hereby incorporates by reference from Exhibit 10.2 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #5551, DATED SEPTEMBER 25, 1997, GRANTING A**

-60-

REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.

10.9. First Amendment to Baytown Nitric Acid Project and Supply Agreement, dated February 1, 1999, between El Dorado Nitrogen Company and Bayer Corporation, which the Company hereby incorporates by reference from Exhibit 10.30 to the Company's Form 10-K for the year ended December 31, 1998. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #7927, DATED JUNE 9, 1999, GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.**

10.10. Service Agreement, dated June 27, 1997, between Bayer Corporation and El Dorado Nitrogen Company which the0 Company hereby incorporates by reference from Exhibit 10.3 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #5551, DATED SEPTEMBER 25, 1997, GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.**

10.11. Ground Lease dated June 27, 1997, between Bayer Corporation and El Dorado Nitrogen Company which the Companyhereby incorporates by reference from Exhibit 10.4 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #5551, DATED SEPTEMBER 25, 1997, GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.**

10.12. Participation Agreement, dated as of June 27, 1997, among El Dorado Nitrogen Company, Boatmen's Trust Company of Texas as Owner Trustee, Security Pacific Leasing Corporation, as Owner Participant and a Construction Lender, Wilmington Trust Company, Bayerische Landes Bank, New York Branch, as a Construction Lender and the Note Purchaser, and Bank of America National Trust and Savings Association, as Construction Loan Agent which the Company hereby incorporates by reference from Exhibit 10.5 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #5551, DATED SEPTEMBER 25, 1997, GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.**

10.13. Lease Agreement, dated as of June 27, 1997, between Boatmen's Trust Company of Texas as Owner Trustee and El Dorado Nitrogen Company which the Company hereby incorporates by reference from Exhibit 10.6 to the

Company's Form 10-Q for the fiscal quarter ended June 30, 1997.

10.14. Security Agreement and Collateral Assignment of Construction Documents, dated as of June 27, 1997, made by El Dorado Nitrogen Company which the Company hereby incorporates by reference from Exhibit 10.7 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997.

10.15. Security Agreement and Collateral Assignment of Facility Documents, dated as of June 27, 1997, made by El Dorado Nitrogen Company and consented to by Bayer Corporation which the Company hereby incorporates by reference from Exhibit 10.8 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997.

-61-

10.16. Non-Qualified Stock Option Agreement, dated April 22, 1998, between the Company and Robert C. Brown, M.D. The Company entered into substantially identical agreements with Bernard G. Ille, Raymond B. Ackerman, Horace G. Rhodes, and Donald W. Munson. The Company will provide copies of these agreements to the Commission upon request.

10.17. The Company's 1998 Stock Option and Incentive Plan, which the Company hereby incorporates by reference from Exhibit 10.44 to the Company's Form 10-K for the year ended December 31, 1998.

10.18. Letter Agreement, dated March 12, 1999, between Kestrel Aircraft Company and LSB Industries, Inc., Prime Financial Corporation, Herman Meinders, Carlan K. Yates, Larry H. Lemon, Co-Trustee Larry H. Lemon Living Trust, which the Company hereby incorporates by reference from Exhibit 10.45 to the Company's Form 10-K for the year ended December 31, 1998.

10.19. LSB Industries, Inc. 1998 Stock Option and Incentive Plan which the Company hereby incorporates by reference from Exhibit "B" to the LSB Proxy Statement, dated May 24, 1999, for Annual Meeting of Stockholders.

10.20. LSB Industries, Inc. Outside Directors Stock Option Plan which the Company hereby incorporates by reference from Exhibit "C" to the LSB Proxy Statement, dated May 24, 1999, for Annual Meeting of Stockholders.

10.21. First Amendment to Second Amended and Restated Loan and Security Agreement, dated January 1, 2000, by and between Bank of America, N.A. and LSB Industries, Inc., Summit Machine Tool Manufacturing Corp., and Morey Machinery Manufacturing Corporation, which the Company hereby incorporates by reference from Exhibit 10.3 to the Company's Form 8-K dated December 30, 1999.

10.22. Second Amendment to Second Amended and Restated Loan and Security Agreement, dated March 1, 2000 by and between Bank of America, N.A. and LSB Industries Inc., Summit Machine Tool Manufacturing Corp., and Morey Machinery Manufacturing Corporation, which the Company hereby incorporates by reference from Exhibit 10.3 to the Company's Form 8-K dated March 1, 2000.

10.23. Third Amendment to Second Amended and Restated Loan and Security Agreement, dated March 31, 2000 by and between Bank of America, N.A. and LSB Industries Inc., Summit Machine Tool Manufacturing Corp., and Morey Machinery Manufacturing Corporation, which the Company hereby incorporates by reference from Exhibit 10.14 to the Company's Form 10-Q for the fiscal quarter ended March 31, 2000.

10.24. Loan Agreement dated December 23, 1999 between Climate Craft, Inc. and the City of Oklahoma City, which the Company hereby incorporates by reference from Exhibit 10.49 to the Company's Amendment No. 2 to its 1999 Form 10-K.

10.25. Letter, dated April 1, 2000, executed by SBL to Prime amending the Promissory Note, which the Company incorporates by reference from Exhibit 10.52 to the Company's Amendment No. 2 to its 1999 Form 10-K.

10.26. Fourth Amendment to Second Amended and Restated Loan and Security Agreement dated October 10, 2000 by and between Bank of America, N.A. and LSB Industries, Inc., Summit Machine Tool Manufacturing Corp., and Morey Machinery Manufacturing Corporation, which the Company hereby incorporates by

-62-

reference from Exhibit 10.2 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2000.

10.27. Letter Agreement, dated August 23, 2000, between LSB Chemical Corp. and Orica USA, Inc., which the Company hereby incorporates by reference from Exhibit 10.4 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2000. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #10714, DATED FEBRUARY 21, 2001 GRANTING A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.**

10.28. Agreement, dated October 31, 2000, between Orica Nitrogen, L.L.C., Orica USA, Inc., and LSB Chemical Corp., which the Company hereby incorporates by reference from Exhibit 10.5 to the Company's Form 10-Q for the fiscal quarter ended September 20, 2000. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #10714, DATED FEBRUARY 21, 2001 GRANTING A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.**

10.29. Letter, dated April 1, 2001, executed by SBL to Prime amending the Promissory Note, which the Company hereby incorporates by reference from Exhibit 10.55 to the Company's Form 10-K for the fiscal year ended December 31, 2000.

10.30. Agreement, dated April 2, 2001, between Crystal City Nitrogen Company and River Cement Company, which the Company hereby incorporates by reference from Exhibit 10.57 to the Company's Form 10-K for the fiscal year ended December 31, 2000.

10.31. Assignment, dated May 8, 2001, between Climate Master, Inc. and Prime Financial Corporation, which the Company hereby incorporates by reference from Exhibit 10.2 to the Company's Form 10-Q for the fiscal quarter ended March 31, 2001.

10.32. Agreement for Purchase and Sale, dated April 10, 2001, by and between Prime Financial Corporation and Raptor Master, L.L.C. which the Company hereby incorporates by reference from Exhibit 10.3 to the Company's Form 10-Q for the fiscal quarter ended March 31, 2001.

10.33. Amended and Restated Lease Agreement, dated May 8, 2001, between Raptor Master, L.L.C. and Climate Master, Inc. which the Company hereby incorporates by reference from Exhibit 10.4 to the Company's Form 10-Q for the fiscal quarter ended March 31, 2001.

10.34. Option Agreement, dated May 8, 2001, between Raptor Master, L.L.C.and Climate Master, Inc., which the Company hereby incorporates by reference from Exhibit 10.5 to the Company's Form 10-Q for the fiscal quarter ended March 31, 2001.

10.35. Stock Purchase Agreement, dated September 30, 2001, by and between Summit Machinery Company and SBL Corporation, which the Company hereby incorporates by reference from Exhibit 10.1 to the Company' Form 10-Q for the fiscal quarter ended September 30, 2001.

10.36. Agreement, dated October 18, 2001, by and between LSB Industries,

-63-

Inc., Prime Financial Corporation, and SBL Corporation, which the Company hereby incorporates by reference from Exhibit 10.2 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2001.

10.37. Certificate of Designations of LSB Industries, Inc., relating to the issuance of a new series of Class C Preferred Stock, which the Company hereby incorporates by reference form Exhibit 10.3 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2001.

10.38. Asset Purchase Agreement, dated October 22, 2001, between Orica USA, Inc. and El Dorado Chemical Company and Northwest Financial Corporation, which the Company hereby incorporates by reference from Exhibit 99.1 to the Company's Form 8-K dated December 28, 2001. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST.**

10.39. AN Supply Agreement, dated November 1, 2001, between Orica USA, Inc. and El Dorado Company, which the Company hereby incorporates by reference from Exhibit 99.2 to the Company's Form 8-K dated December 28, 2001. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF**

INFORMATION ACT. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST.

10.40. Ammonium Nitrate Sales Agreement between Nelson Brothers, L.L.C. and Cherokee Nitrogen Company, which the Company hereby incorporates by reference from Exhibit 99.3 to the Company's Form 8-K dated December 28, 2001. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST.**

10.41 Loan and Security Agreement, dated April 13, 2001 by and among LSB Industries, Inc., ClimaChem and each of its Subsidiaries that are Signatories, the Lenders that are Signatories and Foothill Capital Corporation, which the Company hereby incorporates by reference from Exhibit 10.51 to ClimaChem, Inc.'s amendment No. 1 to Form 10-K for the year ended December 31, 2000.

10.42. Agreement, dated August 4, 2001, between El Dorado Chemical Company and Paper, Allied-Industrial, Chemical and Energy Workers International Union AFL-C10 and its Local 5-434, which the Company hereby incorporates by reference from Exhibit 10.65 to the Company's Form 10-K for the year ended December 31, 2001.

10.43. Agreement, dated October 16, 2001, between El Dorado Chemical Company and International Association of Machinists and Aerospace Workers, AFL-C10 Local No. 224, which the Company hereby incorporates by reference from Exhibit 10.66 to the Company's Form 10-K for the year ended December 31, 2001.

-64-

10.44. First Amendment to Third Amended and Restated Loan and Security Agreement, dated March 29, 2002, entered into by and between Bank of America, N.A. and Summit Machine Tool Manufacturing Corp, which the Company hereby incorporates by reference from Exhibit 10.67 to the Company's Form 10-K for the year ended December 31, 2001.

10.45. Warrant, dated May 24, 2002, granted by the Company to a Lender for the right to purchase up to 132,508 shares of the Company's common stock at an exercise price of $0.10 per share, which the Company hereby incorporates by reference from Exhibit 99.1 to the Company's Form 8-K, dated May 24, 2002. Four substantially similar Warrants, dated May 24, 2002, for the purchase of an aggregate additional 463,077 shares at an exercise price of $0.10 were issued. Copies of these Warrants will be provided to the Commission upon request.

10.46. Intercreditor Agreement, which the Company hereby incorporates by reference from Exhibit 99.2 to the Company's Form 8-K, dated May 24, 2002.

10.47. 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, which the Company hereby incorporates by reference from Exhibit 2.1 to the Company's Form 8-K, dated December 12, 2002. The asset purchase agreement contains a brief list identifying all schedules and exhibits to the asset purchase agreement. Such schedules and exhibits are not filed herewith, and the Registrant agrees to furnish supplementally a copy of the omitted schedules and exhibits to the commission upon request.

10.48. Anhydrous Ammonia Sales Agreement, dated December 9, 2002, between Koch Nitrogen Company and El Dorado Chemical Company. CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST.

10.49. Registration Rights Agreement, dated March 25, 2003, among LSB Industries, Inc., Kent C. McCarthy, Jayhawk Capital management, L.L.C., Jayhawk Investments, L.P. and Jayhawk Institutioal Partners, L.P.

10.50. Subscription Agreement, dated March 25, 2003, by and between LSB Industries, Inc. and Jayhawk

Institutional Partners, L.P.

10.51. Warrant Agreement, dated March 25, 2003, between LSB Industries, Inc. and Jayhawk Institutional Partners, L.P.

21.1 Subsidiaries of the Company.

23.1. Consent of Independent Auditors.

99.1 Certification of Jack E. Golsen, Chief Executive Officer, pursuant to 18 U.S.C. Section 1350. A signed original of this written statement required by Section 906 has been provided to LSB Industries, Inc. and will be retained by LSB Industries, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

-65-

99.2 Certification of Tony M. Shelby, Chief Financial Officer pursuant to 18 U.S.C. Section 1350. A signed original of this written statement required by Section 906 has been provided to LSB Industries, Inc. and will be retained by LSB Industries, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

(b) REPORTS ON FORM 8-K. We filed the following report on Form 8-K during the fourth quarter of 2002.

(i) Form 8-K, dated December 27, 2002. (date of earliest event: December 12, 2002). The item reported was Item 2, "Acquisition or Disposition of Assets", discussing the sale of all of the operating assets of Slurry Explosive Corporation and Universal Tech Corporation to four wholly owned subsidiaries of Energetic Systems Inc., LLC pursuant to the terms of an Asset Purchase Agreement, dated December 6, 2002.

-66-

Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Company has caused the undersigned, duly-authorized, to sign this report on its behalf of this 2nd day of April, 2003.

LSB INDUSTRIES, INC.
By:
/s/ Jack E. Golsen
Jack E. Golsen
Chairman of the Board and President
(Principal Executive Officer)
By:
/s/ Tony M. Shelby
Tony M. Shelby
Senior Vice President of Finance
(Principal Financial Officer)
By:
/s/ Jim D. Jones
Jim D. Jones
Vice President, Controller and Treasurer
(Principal Accounting Officer)

-67-

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the undersigned have signed this report on behalf of the Company, in the capacities and on the dates indicated.

Dated: April 2, 2003	By:

	/s/ Jack E. Golsen Jack E. Golsen, Director
Dated: April 2, 2003	By: /s/ Tony M. Shelby Tony M. Shelby, Director
Dated: April 2, 2003	By: /s/ David R. Goss David R. Goss, Director
Dated: April 2, 2003	By: /s/ Barry H. Golsen Barry H. Golsen, Director
Dated: April 2, 2003	By: /s/ Robert C. Brown MD Robert C. Brown MD, Director
Dated: April 2, 2003	By: /s/ Bernard G. Ille Bernard G. Ille, Director
Dated: April 2, 2003	By: /s/ Raymond B. Ackerman Raymond B. Ackerman, Director
Dated: April 2, 2003	By: /s/ Horace G. Rhodes Horace G. Rhodes, Director
Dated: April 2, 2003	By: /s/ Donald W. Munson Donald W. Munson, Director
Dated: April 2, 2003	By: /s/ Charles A. Burtch Charles A. Burtch, Director
Dated: April 2, 2003	By: /s/ Grant Donavan Grant Donovan, Director
Dated: April 2, 2003	By: /s/ Dr. Allen Ford Dr. Allen Ford, Director

-68-

CERTIFICATION

I, Jack E. Golsen, President and Chief Executive Officer, certify that:

1. I have reviewed this annual report on Form 10-K of LSB Industries, Inc.;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as

of, and for, the periods presented in this annual report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 28, 2003

/s/ Jack E. Golsen
Jack E. Golsen
President
(Principal Executive Officer)

-69-

CERTIFICATION

-

I, Tony M. Shelby, Senior Vice President and Chief Financial Officer, certify that:

1. I have reviewed this annual report on Form 10-K of LSB Industries, Inc.;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as

of, and for, the periods presented in this annual report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 28, 2003

/s/ Tony M. Shelby
Tony M. Shelby
Senior Vice President
(Principal Financial Officer)

-70-

Report of Independent Auditors

The Board of Directors and Stockholders
LSB Industries, Inc.

We have audited the accompanying consolidated balance sheets of LSB Industries, Inc. as of December 31, 2002 and 2001, and the related consolidated statements of income, stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2002. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of LSB Industries, Inc. at December 31, 2002 and 2001, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 2 to the consolidated financial statements, effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangibles.

ERNST & YOUNG LLP

Oklahoma City, Oklahoma
March 28, 2003

F-1

LSB Industries, Inc.

Consolidated Balance Sheet

	December 31, 2002	2001
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	$ 2,091	$ 628
Restricted cash	1,838	350
Trade accounts and notes receivable, net	35,060	40,683
Inventories	26,976	28,901
Supplies and prepaid items	8,222	7,020
Current assets of discontinued operations	-	5,440
Total current assets	74,187	83,022
Property, plant and equipment, net	73,588	73,282
Other assets, net:		
Debt issuance costs	1,455	3,260
Other	13,033	16,390
Noncurrent assets of discontinued operations	-	3,570
	$ 162,263	$ 179,524

(Continued on following page)

F-2

LSB Industries, Inc.

Consolidated Balance Sheets (continued)

	December 31, 2002	December 31, 2001
	(In Thousands)	
Liabilities and Stockholders' Equity (Deficit)		
Current liabilities:		
Accounts and drafts payable	$ 24,018	$ 23,923
Accrued liabilities	16,709	16,632
Current liabilities of discontinued operations	-	1,402
Current portion of long-term debt	38,889	43,614
Total current liabilities	79,616	85,571
Long-term debt	74,472	88,006
Other noncurrent liabilities:		
Negative goodwill	-	860
Other	7,561	6,926
	7,561	7,786
Commitments and contingencies (Note 12)	-	-
Redeemable, noncumulative, convertible preferred stock, $100 par value; 1,167 shares issued and outstanding (1,295 in 2001)	111	123
Stockholders' equity (deficit):		
Series B 12% cumulative, convertible preferred stock, $100 par value; 20,000 shares issued and outstanding; aggregate liquidation preference of $2,720,000 in 2002 ($2,480,000 in 2001)	2,000	2,000
Series 2 $3.25 convertible, exchangeable Class C preferred stock, $50 stated value; 628,550 shares issued; aggregate liquidation preference of $38,521,000 in 2002 ($36,494,000 in 2001)	31,427	31,427
Series D 6% cumulative, convertible Class C preferred stock, no par value; 1,000,000 shares issued; aggregate liquidation preference of $1,060,000 in 2002	1,000	1,000
Common stock, $.10 par value; 75,000,000 shares authorized, 15,236,114 shares issued (15,205,989 in 2001)	1,524	1,521
Capital in excess of par value	54,503	52,430
Accumulated other comprehensive loss	(1,859)	(2,149)
Accumulated deficit	(71,824)	(71,923)
	16,771	14,306
Less treasury stock, at cost:		
Series 2 preferred, 5,000 shares	200	200
Common stock, 3,272,426 shares	16,068	16,068
Total stockholders' equity (deficit)	503	(1,962)
	$ 162,263	$ 179,524

See accompanying notes.

LSB Industries, Inc.

Consolidated Statements of Income

	Year ended December 31,		
	2002	2001	2000
	(In Thousands, Except Per Share Amounts)		
Net sales	$ 283,811	$ 314,942	$ 272,668
Cost of sales	238,114	264,168	226,067
Gross profit	45,697	50,774	46,601
Selling, general and administrative	39,909	44,038	43,680
Operating income	5,788	6,736	2,921
Other income (expense):			
Other income	4,030	3,304	5,410
Gains on sales of property and equipment	47	6,615	-
Gains on extinguishment of debt	1,458	2,631	20,086
Benefit from termination of (provision for loss on) firm sales and purchase commitments	(414)	2,688	(3,395)
Interest expense	(7,590)	(13,338)	(14,707)
Other expense	(563)	(1,196)	(2,261)
Income from continuing operations before provision for income taxes and cumulative effect of accounting change	2,756	7,440	8,054
Provision for income taxes	(56)	(110)	(85)
Income from continuing operations before cumulative effect of accounting change	2,700	7,330	7,969
Income (loss) from discontinued operations, net	(3,461)	1,227	(1,774)
Cumulative effect of accounting change (Note 2)	860	-	-
Net income	99	8,557	6,195
Preferred stock dividend requirements	(2,327)	(2,267)	(2,771)
Net income (loss) applicable to common stock	$ (2,228)	$ 6,290	$ 3,424
Income (loss) per common share:			
Basic:			
Income from continuing operations before cumulative effect of accounting change	$ ..03	$ ..43	$ ..44
Income (loss) from discontinued operations, net	(.29)	.10	(.15)
Cumulative effect of accounting change	.07	-	-
Net income (loss)	$ (.19)	$ .53	$ .29
Diluted:			
Income from continuing operations before cumulative effect of accounting change	$ ..03	$ ..41	$ ..43
Income (loss) from discontinued operations, net	(.29)	.09	(.14)
Cumulative effect of accounting change	.07	-	-
Net income (loss)	$ (.19)	$ .50	$ .29

See accompanying notes.

LSB Industries, Inc.

Consolidated Statements of Stockholders' Equity (Deficit)

	Common Stock Shares	Non-Redeemable Preferred Stock	Common Stock Par Value	Capital in Excess of Par Value	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Treasury Stock - Preferred	Treasury Stock - Common	Total
					(In Thousands)				
Balance at December 31, 1999	15,109	$ 48,000	$ 1,511	$39,277	$ -	$ (86,675)	$ (200)	$ (16,086)	$ (14,173)
Net income						6,195			6,195
Repurchase of 278,700 shares of non-redeemable preferred stock		(13,935)		12,290					(1,645)
Conversion of 12,750 shares of non-redeemable preferred stock to common stock	55	(638)	5	633					-
Grant of 185,000 stock options to a former employee				137					137
Remeasurement of 30,000 stock options with employer loan feature				39					39
Exchange of 4,000 shares of common stock held in treasury for Board of Directors fees								5	5
Balance at December 31, 2000	15,164	33,427	1,516	52,376	-	(80,480)	(200)	(16,081)	(9,442)
Net income						8,557			8,557
Cumulative effect of change in accounting for derivative financial instruments					(2,439)				(2,439)
Reclassification to operations					290				290
Total comprehensive income									6,408
Issuance of 1,000,000 shares of Series D preferred stock in exchange for $1,000,000 of long-term debt		1,000							1,000
Exercise of stock options	35		4		39				43
Conversion of 167 shares of redeemable preferred stock to									

common stock	7		1	15					16
Net change in treasury stock-common								13	13
Balance at December 31, 2001	15,206	34,427	1,521	52,430	(2,149)	(71,923)	(200)	(16,068)	(1,962)

(Continued on following page)

LSB Industries, Inc.

Consolidated Statements of Stockholders' Equity (Deficit) (continued)

	Common Stock Shares	Non-Redeemable Preferred Stock	Common Stock Par Value	Capital in Excess of Par Value	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Treasury Stock - Preferred	Treasury Stock - Common	Total
					(In Thousands)				
Net income						99			99
Reclassification to operations					290				290
Total comprehensive income									389
Issuance of 595,585 common stock purchase warrants (Note 7)				1,983					1,983
Grant of 115,000 stock options to former employees				48					48
Exercise of stock options	25		3	30					33
Conversion of 128 shares of redeemable preferred stock to common stock	5			12					12
Balance at December 31, 2002	15,236	$ 34,427	$ 1,524	$ 54,503	$ (1,859)	$ (71,824)	$ (200)	$ (16,068)	$ 503

See accompanying notes.

LSB Industries, Inc.

Consolidated Statements of Cash Flows

	Year ended December 31,		
	2002	2001	2000
	(In Thousands)		
Cash flows from operating activities			
Net income	$ 99	$ 8,557	$ 6,195
Adjustments to reconcile net income to net cash provided (used) by continuing operating activities:			
Loss (income) from discontinued operations, net	3,461	(1,227)	1,774
Cumulative effect of accounting change	(860)	-	-
Gains on extinguishment of debt	(1,458)	(2,631)	(20,086)
Gain on restructuring of debt	(99)	-	-
Gains on sales of property and equipment	(47)	(6,615)	-
Provision for losses on (realization and reversal of) firm sales and purchase commitments	704	(7,825)	389
Provision for inventory write-downs	918	304	-
Depreciation of property, plant and equipment	9,497	9,693	8,809
Amortization	1,066	1,013	1,093
Provision for losses on inventory and receivables	**968**	188	1,947
Recapture of prior period provisions for loss on advances and loans receivable	-	-	(1,576)
Other	(15)	(464)	176
Cash provided (used) by changes in assets and liabilities (net of effects of discontinued operations):			
Trade accounts receivable	6,269	6,622	(5,280)
Inventories	**658**	371	(2,084)
Supplies and prepaid items	(1,143)	(838)	(2,595)
Accounts payable	(137)	(2,669)	7,717
Accrued and other noncurrent liabilities	2,369	(5,420)	9,695
Net cash provided (used) by continuing operating activities	22,250	(941)	6,174

(Continued on following page)

LSB Industries, Inc.

Consolidated Statements of Cash Flows (continued)

	Year ended December 31,		
	2002	2001	2000
	(In Thousands)		
Cash flows from investing activities			
Capital expenditures	$ (10,029)	$ (5,840)	$ (7,352)
Proceeds from sales of property and equipment	1,092	8,618	76
Restricted cash held in escrow	(1,488)	(350)	-
Other assets	986	(679)	3,137
Net cash provided (used) by investing activities	(9,439)	1,749	(4,139)
Cash flows from financing activities			

Payments on long-term and other debt	(10,824)	(8,264)	(5,149)
Long-term and other borrowings, net of origination fees	2,550	3,891	5,666
Proceeds from Financing Agreement, net of fees	32,155	-	-
Acquisition of 10 3/4% Senior Unsecured Notes	(30,065)	(2,066)	(8,712)
Net change in revolving debt facilities	(9,694)	4,153	6,992
Net change in drafts payable	(50)	(134)	(136)
Purchases of preferred and treasury stock	-	-	(1,645)
Net proceeds from issuance of common stock	33	32	-
Net cash used by financing activities	(15,895)	(2,388)	(2,984)
Net cash provided (used) by discontinued operations	4,547	(855)	900
Net increase (decrease) in cash and cash equivalents	1,463	(2,435)	(49)
Cash and cash equivalents at beginning of year	628	3,063	3,112
Cash and cash equivalents at end of year	$ 2,091	$ 628	$ 3,063

See accompanying notes.

F-8

LSB Industries, Inc.

Notes to Consolidated Financial Statements
December 31, 2002,2001 and 2000

1. Basis of Presentation

The accompanying consolidated financial statements include the accounts of LSB Industries, Inc. (the "Company", "We", Us", or "Our") and its subsidiaries. We are a diversified holding company which is engaged, through our subsidiaries, in the manufacture and sale of chemical products (the "Chemical Business") and the manufacture and sale of a broad range of air handling and heat pump products (the "Climate Control Business"). See Note 19 - Segment Information. In December 2002, we sold all of the operating assets of Slurry Explosive Corporation ("SEC") and Universal Technology Corporation ("UTeC") which operations were formerly included in the Chemical Business. In May 2000, we sold our Automotive Products Division. Our consolidated financial statements and notes reflect SEC, UTeC and the Automotive Products Division as discontinued operations for all periods presented. (See Note 4 - Discontinued Operations).

All material intercompany accounts and transactions have been eliminated. Certain reclassifications have been made in our consolidated financial statements for 2001 and 2000 to conform to our consolidated financial statement presentation for 2002.

2. Summary of Significant Accounting Policies

Use of Estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles 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.

Receivables and Credit Risk

As of December 31, 2002 and 2001, our trade accounts and notes receivable includes trade receivables of $33.8 million and $40.7 million net of allowance for doubtful accounts of $2.4 million and $2 million, respectively, and notes receivable of $1.3 million as of December 31, 2002. Sales to contractors and independent sales representatives are generally secured by a mechanics lien in the Climate Control Business. Other sales are generally unsecured. Credit is extended to customers based on an evaluation of the customer's financial condition and other factors. Credit losses are provided for in the financial statements based on historical experience and periodic assessment of outstanding accounts receivable, particularly those accounts which are past due. Our periodic assessment of accounts and credit loss provisions are based on our best estimate of amounts that are not recoverable. Concentrations of credit risk with respect to trade receivables are limited due to the large number of customers comprising our customer bases, and their dispersion across many different industries and geographic areas.

2. Summary of Significant Accounting Policies (continued)

Inventories

Inventories are priced at the lower of cost or market, with cost being determined using the first-in, first-out basis, except for certain heat pump products with a current cost of $7,670,000 at December 31, 2002 ($8,471,000 at December 31, 2001), which are carried at the lower of cost or market, with cost being determined using the last-in, first-out (LIFO) basis. The difference between current cost and the LIFO basis was $701,000 and $678,000 at December 31, 2002 and 2001, respectively.

Property, Plant and Equipment

Property, plant and equipment are carried at cost. For financial reporting purposes, depreciation is primarily computed using the straight-line method over the estimated useful lives of the assets ranging from 3 to 30 years. Property, plant and equipment leases which are deemed to be installment purchase obligations have been capitalized and included in property, plant and equipment. Maintenance, repairs and minor renewals are charged to operations while major renewals and improvements are capitalized. The Company accrues in advance the costs expected to be incurred in the next planned major maintenance activities.

Excess of Purchase Price Over Net Assets Acquired

As of December 31, 2002 and 2001, the excess of purchase price over net assets acquired, which is included in other assets in the accompanying balance sheets, was $1,724,000, net of accumulated amortization, of $5,014,000. For 2001 and 2000, amortization of the excess of purchase price over net assets acquired was not material. Beginning January 1, 2002, the excess of purchase price over net assets acquired is no longer being amortized but is being reviewed for impairment at least annually.

Impairment of Long-Lived Assets

Long-lived assets and certain identifiable intangibles are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amounts of the assets to future net cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amounts of the assets exceed the fair values of the assets. Assets to be disposed of are reported at the lower of the carrying amounts or fair values less costs to sell.

We have made estimates of the fair values of our Chemical Business in order to determine recoverability of our carrying amounts. We have also assumed that we will have sufficient funds available for necessary capital expenditures required and be able to comply with the new discharge water permit involving the Company's El Dorado, Arkansas facility. See Note 12-Commitment and Contingencies. Based on these estimates and assumptions, no impairment was recognized at December 31, 2002; however, it is reasonably possible that we may recognize

2. Summary of Significant Accounting Policies (continued)

impairments in this business in the near term if we experience continued or further deterioration of the Chemical Business.

Debt Issuance Costs

Debt issuance costs are amortized over the term of the associated debt instrument using the straight-line method. Such costs, which are included in other assets in the accompanying balance sheets, were $1,455,000 and $3,260,000, net of accumulated amortization, of $1,141,000 and $1,705,000 as of December 31, 2002 and 2001, respectively. In 2002, debt issuance costs of $2,055,000 and accumulated amortization of $912,000 were written off against the gain resulting from the repurchase of Senior Unsecured Notes (see Note 7 (C)).

Product Warranty

Our Climate Control Business sells equipment that has an expected life, under normal circumstances and use, that extends over several years. As such, purchasers of the equipment expect us to provide warranties after equipment delivery/installation covering defects in materials and workmanship.

Generally, the warranty coverage for the manufactured equipment in the Climate Control Business is limited to eighteen months from the date of delivery or twelve months from the date of installation, whichever is shorter, and to ninety days for spare parts. In most cases, equipment is required to be returned to the factory or its authorized representative and the warranty is limited to the repair and replacement of the defective product, with a maximum warranty of the refund of the purchase price. Furthermore, companies within the Climate Control Business do not make any warranties related to merchantability or fitness for any particular purpose and disclaim and exclude any liability for consequential or incidental damages. In some cases, an extended warranty may be purchased. The above discussion is generally applicable but variations do occur depending upon specific contractual obligations, certain system components and local laws.

Our accounting policy and methodology for warranty arrangements is to periodically measure and recognize the expense and liability for such warranty obligations using a percentage of net sales, based upon our historical warranty costs.

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

The carrying amount of the warranty obligation is as follows:

Description	Balance at Beginning of Year	Additions-Charged to Costs and Expenses	Deductions-Costs Incurred	Balance at End of Year
		(In Thousands)		
Product warranty:				
2002	$ 2,558	$ 1,391	$ 2,027	$ 1,922
2001	$ 2,581	$ 2,318	$ 2,341	$ 2,558

Stock Options

At December 31, 2002, we have several Qualified and Non-Qualified Stock Option Plans, which are described more fully in Note 10-Stockholders' Equity (Deficit). We account for those plans under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. No stock-based compensation cost is usually reflected in net income (loss), as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant, except in 2002 and 2000, our Board of Directors granted options for 165,000 shares and 185,000 shares, respectively, to former employees to replace the options these individuals held prior to leaving us. We recognized compensation expense of $48,000 in 2002 and $137,000 in 2000 related to the granting of these shares.

The following table illustrates the effect on net income (loss) and net income (loss) per share if we had applied the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation, to stock-based compensation. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions for 2002, 2001 and 2000, respectively: risk-free interest rates of 3.60%, 4.31% and 6.13%; a dividend yield of 0%; volatility factors of the expected market price of our common stock of .85, .95 and .55; and a weighted average expected life of the options of 7.4, 9.7 and 8.1 years.

The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option pricing models require the input of highly subjective assumptions including the expected stock price volatility. Because our employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of our employee stock options.

2. Summary of Significant Accounting Policies (continued)

For purposes of pro forma disclosures, the estimated fair value of the qualified and non-qualified stock options is amortized to expense over the options' vesting period.

	Year ended December 31		
	2002	2001	2000
	(In Thousands)		
Net income (loss) applicable to common stock, as reported	$ (2,228)	$ 6,290	$ 3,424
Add: Stock-based compensation expense included in reported net income, net of related tax effects	48	-	137
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	(624)	(371)	(586)
Pro forma net income (loss) applicable to common stock	$ (2,804)	$ 5,919	$ 2,975
Net income (loss) per share:			
Basic-as reported	$ (.19)	$ .53	$ .29
Basic-pro forma	$ (.24)	$ .50	$ .25
Diluted-as reported	$ (.19)	$ .50	$ .29
Diluted-pro forma	$ (.24)	$ .47	$ .25

Revenue Recognition

We recognize revenue for substantially all of our operations at the time title to the goods transfers to the buyer and there remains no significant future performance obligations by us. If revenue relates to construction contracts, we recognize revenue using the percentage-of-completion method based primarily on contract costs incurred to date compared with total estimated contract costs. Changes to total estimated contract costs or losses, if any, are recognized in the period in which they are determined.

Shipping and Handling Costs

The Chemical Business records its shipping and handling costs in net sales and the Climate Control Business records shipping and handling costs in selling, general and administrative expense. For 2002, 2001 and 2000, the shipping and handling costs of the Chemical Business amounted to $7,744,000, $8,382,000 and $8,578,000, respectively, while the cost in the Climate Control Business amounted to $3,385,000, $3,908,000 and $4,044,000, respectively.

2. Summary of Significant Accounting Policies (continued)

Research and Development Costs

Costs in connection with product research and development are expensed as incurred. Such costs amounted to $125,000 in 2002, $147,000 in 2001 and $132,000 in 2000.

Advertising Costs

Costs in connection with advertising and promotion of our products are expensed as incurred. Such costs amounted to $700,000 in 2002, $514,000 in 2001 and $863,000 in 2000.

Raw Materials Price Risk Management

The Chemical Business periodically enters into fixed-price natural gas contracts and the Climate Control Business periodically enters into exchange-traded futures contracts for copper, steel and aluminum, which contracts are generally accounted for on a mark to market basis.

Income (Loss) per Share

Net income (loss) applicable to common stock is computed by adjusting net income (loss) by the amount of preferred stock dividends. Basic income (loss) per common share is based upon net income (loss) applicable to common stock and the weighted average number of common shares outstanding during each year. Diluted income (loss) per share, if applicable, is based on the weighted average number of common shares and dilutive common equivalent shares outstanding, if any, and the assumed conversion of dilutive convertible securities outstanding, if any. See Note 9 - Redeemable Preferred Stock, Note 10 - Stockholders' Equity (Deficit), and Note 11 - Non-Redeemable Preferred Stock for a full description of securities which may have a dilutive effect in future years.

F-14

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

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

(Dollars in thousands, except per share amounts)

	2002	2001	2000
Numerator:			
Net income	$ 99	$ 8,557	$ 6,195
Preferred stock dividend requirements	(2,327)	(2,267)	(2,771)
Numerator for basic net income (loss) per share - net income (loss) applicable to common stock	(2,228)	6,290	3,424
Preferred stock dividend requirements on preferred stock assumed to be converted, if dilutive	-	240	240
Numerator for diluted net income (loss) per share	$ (2,228)	$ 6,530	$ 3,664
Denominator:			
Denominator for basic net income (loss) per share - weighted average shares	11,948,772	11,913,031	11,871,211
Effect of dilutive securities:			
Employee stock options	-	380,078	101
Convertible preferred stock	-	784,681	725,136
Convertible note payable	-	4,000	4,000
Dilutive potential common shares	-	1,168,759	729,237

Denominator for dilutive net income (loss) per share - adjusted weighted average shares and assumed conversions	11,948,772	13,081,790	12,600,448
Basic net income (loss) per share	$ (.19)	$ .53	$ .29
Diluted net income (loss) per share	$ (.19)	$ .50	$ .29

2. Summary of Significant Accounting Policies (continued)

Recently Issued Pronouncements

In July 2001, the FASB issued Statement No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets" which requires that goodwill and intangible assets with indefinite lives no longer be amortized but be tested for impairment at least annually. SFAS 142 became effective for the Company on January 1, 2002. Upon adoption of SFAS 142, we recognized $860,000 of negative goodwill as a cumulative effect of accounting change.

Also in July 2001, the FASB issued Statement No. 143 ("SFAS 143"), "Accounting for Asset Retirement Obligations" which addresses obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. It applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or the normal operation of a long-lived asset, except for certain obligations of lessees. As used in this Statement, a legal obligation is an obligation that a party is required to settle as a result of an existing or enacted law, statute, ordinance, or written or oral contract or by legal construction of a contract under the doctrine of promissory estopple. We will adopt SFAS 143 effective January 1, 2003. Currently, we expect that the only impact of SFAS 143 relates to our possible requirement to continue to operate discharge water equipment, if we should decide to no longer operate the chemical plant in El Dorado, Arkansas, the cost and timing of which is presently unknown.

In August 2001, the FASB issued Statement No. 144 ("SFAS 144") "Accounting for the Impairment or Disposal of Long-Lived Assets" which modified the accounting for and potentially the financial statement presentation of assets held for disposal. We adopted SFAS 144 on January 1, 2002. In December 2002, we sold all of the operating assets of SEC and UTeC. Under the provisions of SFAS 144, our consolidated financial statements and notes reflect SEC and UTeC as discontinued operations for all periods presented.

In April 2002, the FASB issued Statement No. 145 ("SFAS 145") "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections," related to accounting for debt extinguishments, leases, and intangible assets of motor carriers. The provisions of SFAS 145 are effective for fiscal years beginning after May 15, 2002 with earlier adoption encouraged. Accordingly, we elected to early adopt SFAS 145, as of the beginning of the second quarter beginning April 1, 2002, and implemented the applicable provisions in conjunction with the filing of this report. Prior periods have been conformed to the provisions of SFAS 145 by changing the presentation of gains on extinguishment of debt of $2.6 million and $20.1 million recognized in 2001 and 2000, respectively, which are no longer classified as an extraordinary items.

In June 2002, the FASB issued Statement No. 146 ("SFAS 146"), Accounting for Costs Associated with Exit or Disposal Activities which requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. The provisions of SFAS 146 are effective for exit or disposal activities of the Company that are initiated after December 31, 2002.

In November 2002, the FASB issued Interpretation No. 45 ("FIN 45") "Guarantor's Accounting and Disclosure Requirements of Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN 45 elaborates on the disclosures to be made by a guarantor in its financial statements about its obligations under certain guarantees that it has issued. FIN 45 also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The disclosure requirements of FIN 45 became effective for the Company on December 31, 2002. Accordingly, we have included these required disclosures under Product Warranty included in this Note 2 and Note 12 - Commitments and Contingencies. The initial recognition and measurement provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002.

In December 2002, the FASB issued Statement 148 ("SFAS 148") "Accounting for Stock-Based Compensation - Transition and Disclosure." SFAS 148 amends SFAS 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 123. The disclosure requirement provisions in SFAS 148 became effective for the Company on December 31, 2002. See discussion under Stock Options included in this Note 2.

In January 2003, the FASB issued Interpretation No. 46 ("FIN 46") "Consolidation of Variable Interest Entities." FIN 46 addresses the consolidation by certain companies of variable interest entities which meet certain characteristics. In January 2003, FIN 46 became effective for variable interest entities created or in which an enterprise obtains an interest after January 31, 2003. FIN 46 is effective for the Company on July 1, 2003 for variable interest entities in which we hold a variable interest acquired before February 1, 2003. The Company and it subsidiaries have not provided a residual value guarantee on the value of the equipment related to a subsidiary's long-term leverage lease of a nitric acid plant in Baytown, Texas and have given Bayer Corporation a right of first refusal on the fixed-price purchase option in 2009. Accordingly, the Company does not expect, under its current interpretation of FIN 46, to be required to consolidate the special purpose entity involved with the Baytown leveraged lease. We have not yet determined other impacts, if any, of FIN 46 upon our financial statements.

Statements of Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash, overnight funds and interest bearing deposits with maturities, when purchased by the Company, of 90 days or less.

2. Summary of Significant Accounting Policies (continued)

Supplemental cash flow information includes:

	2002	2001	2000
		(In Thousands)	
Cash payments for:			
Interest on long-term debt and other	$ 7,924	$ 13,572	$ 14,776
Income taxes, net of refunds	$ 32	$ 81	$ 136
Noncash financing and investing activities-			
Long-term debt issued for property, plant and equipment	$ 13	$ -	$ 81
Grant of warrants to purchase common stock in connection with debt restructuring	$ 1,983	$ -	$ -
Accrued liability assumed in connection with debt guarantee performance	$ -	$ -	$ 4,266
Preferred stock issued in exchange for long-term debt	$ -	$ 1,000	$ -
Cumulative effect of change in accounting for derivative financial instruments	$ -	$ 2,439	$ -
Grant of non-qualified stock options	$ 48	$ -	$ 137

3. Liquidity and Management's Plan

We are a diversified holding company and, as a result, depend on credit agreements and our ability to obtain funds from our subsidiaries in order to pay our debts and obligations. Our wholly owned subsidiary, ClimaChem through its subsidiaries, owns substantially all of our core businesses consisting of the Chemical and Climate Control Businesses. Historically ClimaChem's primary cash needs have been for operating expenses, working capital and capital expenditures. ClimaChem and its subsidiaries depend on credit agreements with lenders, internally generated cash flows, secured equipment financing and the sale of assets in order to fund their operations and pay their debts and obligations.

ClimaChem is restricted as to the funds that it may transfer to LSB, the non-ClimaChem companies and certain ClimaChem companies under the terms contained in the Financing Agreement and the Working Capital Revolver Loan. Under the terms, ClimaChem is permitted to distribute funds in the form of (a) advances, loans and investments, in an aggregate amount not to exceed $2,000,000, at any time outstanding, and (b) distribute or pay in the form of dividends and other distributions an aggregate amount not to exceed, during each year, 50% of ClimaChem's consolidated net income for such year (calculated after deducting all other dividends and distributions made by ClimaChem to us during the year). This limitation will not prohibit payment of amounts due under a Services Agreement, Management Agreement and a Tax Sharing Agreement. ClimaChem did not declare and pay to the Company a dividend during 2002 and there were no management fees due or paid pursuant to the EBITDA formula in the

3. Liquidity and Management's Plan (continued)

Management Agreement. At December 31, 2002, ClimaChem owed the Company approximately $7.9 million, including $2.7 million under the Tax Sharing Agreement.

Our ability to maintain an adequate amount of borrowing availability depends on the cash flow from operations, the investing activities and required debt amortization.

LSB (and its subsidiaries other than ClimaChem) have limited cash requirements as it relates to debt service and capital expenditures. Principal payments on long-term debt aggregate $3.3 million for 2003 while capital expenditures are essentially discretionary. LSB's cash flow from operations, which includes that from the Company's industrial products business and cash flow from equipment leased to ClimaChem are expected to be sufficient to meet its cash flow needs during 2003.

The Company's Summit Machine Tool Manufacturing Corp. ("Summit") subsidiary that is not a subsidiary of ClimaChem finances its Working Capital requirements through borrowings under a credit facility ("Facility") with a different lender than ClimaChem's lender. The Facility is scheduled to mature on April 1, 2004. The Facility provides a revolving line of credit of $.6 million.

On March 24, 2003, a subsidiary of LSB obtained a term loan of $804,000 collateralized by equipment. The proceeds of the loan were used to pay debt ($203,000) and provide additional working capital for ClimaChem ($601,000).

Effective March 25, 2003, the Company sold common stock and warrants, proceeds of which aggregated $1,570,500. See Note 10-Stockholders' Equity (Deficit).

At December 31, 2002, ClimaChem owed the Company approximately $2.7 million under the Tax Sharing Agreement. Subject to availability by ClimaChem, this amount could be paid to LSB should LSB and its subsidiaries other than ClimaChem have a need for such funds.

LSB is actively marketing its chemical plant located in Pryor, Oklahoma. As of the date of this report, no agreement has been reached, but the Company is in discussions with a possible buyer. If this plant is sold, the Company intends to use the proceeds from the sale to reduce debt.

ClimaChem and its subsidiaries finance their working capital requirements through borrowings under a $50 million asset-based Working Capital Revolver (See Note 7). The Working Capital Revolver matures in 2005 (see paragraph below) and is secured by receivables, inventories and intangibles of all the ClimaChem entities other than El Dorado Nitric Co. and its subsidiaries. The Working Capital Revolver agreement provides for available advances to ClimaChem based upon specified percentages of eligible accounts receivable and inventories, less a $.5 million reserve against such aggregate availability. As of December 31, 2002, borrowings outstanding under the Working Capital Revolver were $27.2 million and the net credit available for

3. Liquidity and Management's Plan (continued)

additional borrowings was $5.8 million. The Working Capital Revolver requires that ClimaChem and its Climate Control Business meet certain financial covenants on a quarterly basis and/or an annual basis as discussed in Note 7. Included in the financial covenants is the requirement to maintain quarterly earnings before interest, taxes, depreciation and amortization ("EBITDA") on a trailing twelve-month basis at specified amounts. ClimaChem and its Climate Control Business exceeded the required EBITDA amounts for 2002. The EBITDA amounts for 2003 were recently set at amounts less than those required for 2002, and below those

forecasted by management as necessary for 2003.

Under a lock-box arrangement pursuant to the Working Capital Revolver, ClimaChem's customers remit payments on their accounts directly to the lender and the lender applies such payments to reduce the debt outstanding under the Working Capital Revolver. ClimaChem may request additional borrowings under the Working Capital Revolver, however, one of several conditions (as determined by the lender) precedent to all additional borrowings is that no "material adverse change" (as defined in the Working Capital Revolver) shall have occurred. This provision in the Working Capital Revolver allows the lender, solely within their discretion, to terminate additional borrowings by ClimaChem and effectively accelerate the scheduled maturity of the debt under conditions that may not be objectively determinable (the subjective acceleration clause). Management does not anticipate that the lender will invoke the subjective acceleration clause in 2003. In the event that the lender exercised its rights under the subjective acceleration clause in the Working Capital Revolver and terminated additional borrowings, ClimaChem would have no borrowing availability and its plan to obtain the funds needed to meet its obligations as they become due could include a significant curtailment of its operations. If the proceeds from sales of remaining inventories and collections of accounts receivable of the businesses involved did not provide sufficient funds, ClimaChem may be required to sell other key assets. The curtailment of operations and/or the sale of the assets could result in losses that may be material. In this event, ClimaChem would be required to obtain working capital financing from other sources for its remaining businesses. There are no assurances that the Company would be successful in replacing, on a timely basis, the Working Capital Revolver needed to fund ClimaChem's remaining operations.

Based upon the current outlook for the Chemical Business and the Climate Control Business subject to the continuation of the Working Capital Revolver, management expects to maintain adequate borrowing availability under the Working Capital Revolver to meet the working capital requirements during 2003. However due to anticipated higher costs for the Chemical Business feed stocks, natural gas and ammonia, management expects to fully utilize the net borrowing availability provided by the Working Capital Revolver during the spring agricultural season of 2003. After that period of high usage, the borrowing availability is forecasted to increase. The forecast is based upon information currently available. The current outlook is subject to changes in economic conditions as well as market pricing of our products and costs of the various raw materials consumed.

3. Liquidity and Management's Plan (continued)

Pursuant to the repurchase of Senior Unsecured Notes in May 2002, ClimaChem entered into a Financing Agreement with certain Lenders (See Note 7). Borrowings under the Financing Agreement are collateralized by Chemical plants in El Dorado, Arkansas and Cherokee, Alabama. The Financing Agreement requires that ClimaChem and its Climate Control Business meet certain financial covenants on a quarterly and/or annual basis as discussed in Note 7. ClimaChem is in compliance with all the financial covenants, as amended. For quarters ending after December 31, 2002, if ClimaChem fails to maintain EBITDA (as defined) on a trailing twelve-month basis of at least $12 million (a "Trigger Event"), then within 210 days of the end of such quarter, ClimaChem shall pay the Lenders an amount equal to 33.3% of then outstanding principal of the Loans ($10.6 million at December 31, 2002) plus related cash and additional interest. However, if ClimaChem maintains EBITDA on a trailing twelve-month basis of at least $12 million as of the end of each of the two quarters immediately following the Trigger Event, then within 210 days of such Trigger Event, ClimaChem shall pay the Lenders an amount equal to 10% ($3.2 million as of December 31, 2002) of then outstanding principal of the

Loans plus related cash and additional interest. ClimaChem does not expect that a Trigger Event will occur in 2003. In connection with the closing of the Financing Agreement, the lenders thereunder entered into an Inter-Creditor Agreement with ClimaChem's Working Capital Revolver lenders. The Working Capital Revolver agreement and the Financing Agreement contain cross-default provisions. If the Trigger Event occurs and/or ClimaChem fails to meet the other financial covenants of the Financing Agreement, the lender may declare an event of default, making all or a portion of the debt due on demand. If this should occur, there are no assurances that the Company would have funds available to pay such amount nor that alternative borrowing arrangements would be available. Accordingly, ClimaChem may be required to curtail operations and/or sell key assets as discussed above. These actions could result in the recognition of losses that may be material.

In order to supplement the Working Capital Revolver and the internally generated funds as sources to meet capital requirements, management is pursuing the following funding sources for ClimaChem.

Management is currently in discussions with lenders to obtain long-term financing on two Chemical plants. If consummated, the loan proceeds, will be used to reduce Working Capital Revolver debt. During February 2003, the Company engaged an investment banker to assist the Company, on a best efforts basis, in arranging financing of the concentrated nitric acid plant on which debt was paid off in 2002. Management is also attempting to secure long-term financing of its Cherokee Nitrogen Plant in Cherokee, Alabama. The Cherokee plant is currently pledged as part of the collateral for ClimaChem's debt under the Financing Agreement. If this plant is financed, it is anticipated that half of the net proceeds would be used to pay down the Senior Secured Notes and the other half would be used as working capital.

On March 3, 2003, ClimaChem obtained a term loan of $800,000 collateralized by equipment. The proceeds of the loan were used to pay debt on the Working Capital Revolver.

F-21

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

3. Liquidity and Management's Plan (continued)

Due to the Company and ClimaChem's previous operating losses and limited borrowing ability under the credit facility then in effect, we discontinued payment of cash dividends on Common Stock for periods subsequent to January 1, 1999, until the Board of Directors determines otherwise. As of December 31, 2002, we have not paid the regular quarterly dividend of $.8125 on the outstanding $3.25 Convertible Exchangeable Class C Preferred Stock Series 2 ("Series 2 Preferred") since June 15, 1999, resulting in approximately $7.1 million in total accrued and unpaid dividends on the Series 2 Preferred. We also did not declare and pay the regular annual dividend of $12.00 on the Series B Preferred since 1999, resulting in $.7 million in accrued and unpaid dividends on the Series B Preferred. In addition, we did not declare and pay the 6% per annum cumulative dividend payable in arrears on the Series D preferred resulting in $.1 million in accrued and unpaid dividends. We do not anticipate having funds available to pay dividends on our stock for the foreseeable future.

Excluding the operations of and the net proceeds from the sale of SEC and UteC as discussed in Note 4, the Company's net cash provided by operating activities for 2002 was $22.3 million. The sale of the Chemical Business's packaged explosives business (SEC & UTeC) provided an additional $5 million. Cash used in investing activities included $10 million for capital expenditures primarily in the Chemical Business. Cash used in financing activities included a net reduction of long-term debt and the reduction of the Working Capital Revolver. As of December 31, 2002, ClimaChem had cash and borrowing availability under the Working Capital Revolver of $7.9 million compared to $7.4 million at December 31, 2001.

For the periods covered by this report, the Climate Control Business has consistently generated a positive cash flow and conversely the Chemical Business has generated a negative cash flow.

The negative cash flow in the Chemical Business in 2002 is a result of disruptions caused by the storm damage, the losses due to the revocation of SEC's license to produce its profitable high explosives at its Hallowell, Kansas facility and the operating losses in the agricultural nitrogen business of the El Dorado, Arkansas and Cherokee, Alabama plants. Losses in the agricultural nitrogen business have resulted from the low selling prices compared to the cost of the raw material feed stocks, natural gas and anhydrous ammonia. The feedstocks of natural gas and ammonia have historically experienced significant price volatility. The profit problem has been due primarily to an oversupply in the market of agricultural nitrogen products of the kind we produce and the inability in the past to pass through the natural gas and ammonia cost increases when they occur. Currently, although its too early to predict with any certainty, it appears that the over supply problem of nitrogen fertilizer has subsided to the point that the outlook for pricing of product in relation to the cost of raw materials has improved. We cannot however, predict whether the current sales prices will go up or down as the agricultural season progresses into April and May of 2003. Both natural gas and ammonia prices have risen significantly during early 2003. Approximately 45% of the Chemical Business' sales volume of manufactured product is tied to sales contracts that allow these feed stock costs to pass through. The balance of the sales volume moves as agricultural fertilizer into the Company's freight logical geographical

markets at spot prices.

In early 2003, the agricultural fertilizer spot market prices have risen due to an improvement in the balance of supply and demand due primarily to lesser amounts of imported products and the closing of certain of our competitors plants over the past two years. Additionally during late
February and early March 2003, many nitrogen fertilizer plants in the United States were shut down temporarily due to high gas and ammonia prices creating a perceived tightness of supply for the spring 2003 season.

Although the higher selling prices are favorable, the higher costs of feedstock places pressure on the credit limits and the available Working Capital. As a result, the Company is pursuing other sources of Working Capital to ensure adequate liquidity as discussed above.

Management's plan for the Chemical Business anticipates that the industrial-grade products of El Dorado Chemical and Cherokee Nitrogen that are sold pursuant to long-term cost-plus agreements will continue in 2003 at or about the same volume levels as in 2002. El Dorado and Cherokee's 2003 production level for industrial-grade nitrogen products sold as fertilizers into the agricultural markets will approximate the 2002 volume levels but the sales as expressed in dollars will be higher due to correspondingly higher unit sales prices. However, due to the volatility of sales prices and the corresponding costs of feed stocks, anhydrous ammonia and natural gas, ultimate profitability is difficult to predict.

Historically the Climate Control Business has been very stable and has consistently managed to report steady earnings. As a result, the Company has been able to satisfy the various financial loan covenants. The 2002 earnings were significantly better than for 2001. Included in Climate Control's 2002 operating results are three start-up product lines and/or services that adversely affected the results. Although we don't expect these new product lines to reach positive results in 2003, there is the expectation that the results will be made closer to a breakeven. Management's plan for 2003 anticipates that the Climate Control Business will continue to operate at approximately the same sales volume and profitability levels as in 2002.

The planned capital expenditures for 2003 are approximately $6.4 million, but such capital expenditures are dependent upon an adequate amount of liquidity and/or obtaining acceptable funding. As discussed in Note 12, the Discharge Water issue is not yet finally determined but is currently expected to require capital expenditures of approximately $3.6 million over the next 3 to 4 years provided the Discharge Water permit is corrected, the City of El Dorado, Arkansas (the "City") builds its own discharge pipeline to a nearby river and we are permitted to tie our pipeline into the City's pipeline. Management is continuing to review the design and configurations of treatment and discharge facilities to address the permitting issues. Also as discussed in Note 12, there will be certain expenditures required to bring the sulfuric acid plant's air emissions into acceptable limits. The design of additional emission controls at this plant is underway. At this point, the capital expenditures to achieve the required emission level are undeterminable but management believes that such expenditures when finally determined will be manageable within the capital expenditure budget for 2003 and/or 2004.

3. Liquidity and Management's Plan (continued)

Although the volatility of the Chemical Business is such that the forecasted results can fluctuate significantly, ClimaChem's cash flow forecasts indicate that there will be sufficient liquidity to meet their obligations as they come due.

4. Discontinued Operations

In December 2002, Slurry Explosive Corporation ("SEC") and Universal Tech Corporation ("UTeC"), each an indirect, wholly owned subsidiary of the Company (SEC and UTeC), collectively, the "Sellers" consummated the sale (the "Sale") of all of their operating assets to four wholly owned subsidiaries of Energetic Systems Inc., LLC (collectively, the "Buyers"), pursuant to the terms of an Asset Purchase Agreement (the "Purchase Agreement"). The assets sold by the Sellers comprised all of the explosives manufacturing and distribution business within our Chemical Business.

The purchase price ("Purchase Price") paid by the Buyers under the Purchase Agreement at the closing of the Sale was approximately $10.2 million, consisting of a base price of $7 million, plus approximately $2.8 million for inventory and accounts receivable and $.4 million of assumed liabilities under an equipment lease. Of the proceeds from the Sale, (a) approximately $.3 million was placed in escrow, (b) approximately $3.5 million was paid to a term lender, and (c) the balance of the proceeds was applied against ClimaChem's secured revolving credit facility.

Assets and liabilities of discontinued operations as of December 31, 2001 were as follows:

	2001 (In Thousands)
Accounts receivable, net	$ 3,244
Inventories	2,166

Supplies and prepaid items	30
Total current assets	$ 5,440
Property, plant and equipment, net	$ 3,397
Other assets, net	173
Total noncurrent assets	$ 3,570
Accounts payable and accrued liabilities	$ 1,320
Current portion of long-term debt	82
Total current liabilities	$ 1,402
Long-term debt	$ 9

4. Discontinued Operations (continued)

On April 5, 2000, the Board of Directors approved a plan of disposal of our Automotive Products Business ("Automotive"). The sale of Automotive was concluded on May 4, 2000, to Drive Line Technologies ("DLT"). We received notes for our net investment of approximately $8.7 million, and the buyer assumed substantially all of Automotive's liabilities.

The terms of the notes received in the sale called for no payments of principal for the first two years following the close. Interest was to accrue at Wall Street Journal Prime plus 1.0% but was not to be paid until DLT's availability under its credit agreement reached a level of $1 million.

Due to the terms of the notes received by us in connection with the sale of Automotive and the possibility of non-collectibility of those notes, we fully reserved the total amount of the notes at the time of sale. In May 2001, DLT agreed to allow its lenders to complete a peaceful repossession of its collateral.

Following the sale of Automotive, we remained a guarantor on certain of Automotive's indebtedness. In the fourth quarter of 2000, we performed on certain of the equipment note guarantees and in 2001, were required to fund our $1 million guaranty on DLT's revolving credit agreement. We acquired certain of this debt from the original lender and in other situations, negotiated revised terms. We recognized our obligations under the guarantees in 2000 in the amount of $4.3 million. We also recognized a loss in the 2000 statement of operations in the amount of $2.6 million representing our estimate of ultimate loss, net of the collateral value, associated with guaranteed indebtedness of Automotive. This loss, and that associated with the final adjustment for 2000 operations from the amount accrued as of December 31, 1999, is included in the 2000 net loss from discontinued operations.

Operating results of the discontinued operations for the year ended December 31:

	2002	2001	2000
		(In Thousands)	
Net sales	$ 8,981	$ 21,688	$ 28,252
Income (loss) from discontinued operations before gain (loss) on disposal	$ (5,051)	$ 1,227	$ 802
Gain (loss) on disposal	1,590	-	(2,576)
Net income (loss) from discontinued operations	$ (3,461)	$ 1,227	$ (1,774)

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

5. Inventories

Inventories at December 31, 2002 and 2001 consist of:

	Finished (or Purchased) Goods	Work-in-Process	Raw Materials	Total
	(In Thousands)			
2002:				
Chemical products	$ 11,255	$ -	$ 1,748	$ 13,003
Climate Control products	4,376	1,752	6,935	13,063
Machinery and industrial supplies	1,487	-	-	1,487
	17,118	1,752	8,683	27,553
Less amount not expected to be realized within one year	577	-	-	577
	$ 16,541	$ 1,752	$ 8,683	$ 26,976
2001 total	$ 18,793	$ 2,613	$ 8,326	$ 29,732
Less amount not expected to be realized within one year	831	-	-	831
	$ 17,962	$ 2,613	$ 8,326	$ 28,901

6. Property, Plant and Equipment

Property, plant and equipment consists of:

	December 31, 2002	2001
	(In Thousands)	
Land and improvements	$ 2,275	$ 3,000
Buildings and improvements	21,538	20,715
Machinery, equipment and automotive	122,477	115,512
Furniture, fixtures and store equipment	6,003	5,712
	152,293	144,939
Less accumulated depreciation	78,705	71,657
	$ 73,588	$ 73,282

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

7. Long-Term Debt

Long-term debt consists of the following:

	December 31, 2002	December 31, 2001
	(In Thousands)	
Secured revolving credit facility - ClimaChem (A)	$ 27,209	$ 36,271
Secured revolving credit facility - LSB (B)	710	1,342
Financing Agreement due 2005 (C)	31,700	-
Accrued interest on Financing Agreement (C)	14,656	-
10-3/4% Senior Unsecured Notes due 2007 (D)	18,300	70,607
Other, with interest at rates of 2% to 15%, most of which is secured by machinery, equipment and real estate (E)	20,786	23,400
	113,361	131,620
Less current portion of long-term debt	38,889	43,614
Long-term debt due after one year	$ 74,472	$ 88,006

(A) In April 2001, ClimaChem and its subsidiaries, ("the borrowers"), entered into a $50 million credit facility with a new lender (the "Working Capital Revolver Loan") replacing the existing revolving credit facility. The Working Capital Revolver Loan provides for advances based on specified percentages of eligible accounts receivable and inventories of ClimaChem and its subsidiaries and accrues interest at a base rate (generally equivalent to the prime rate) plus 2% or LIBOR plus 4.5%. The effective rate at December 31, 2002 was 6.25%. Interest is due monthly. The facility provides for up to $8.5 million of letters of credit. All letters of credit outstanding reduce availability under the facility. Under the Working Capital Revolver Loan, the lender also requires the borrowers to pay a letter of credit fee equal to 2.75% per annum of the undrawn amount of all outstanding letters of credit, an unused line fee equal to .5% per annum for the excess amount available under the facility not drawn and various other audit, appraisal and valuation charges.

The Working Capital Revolver Loan matures in April 2005, but gives the lender the sole discretion to determine whether there has been any material adverse change; as defined, in the financial condition of the borrowers or LSB Industries, Inc., as guarantor, prior to making additional advances. The lender may, upon an event of default as defined, terminate the Working Capital Revolver Loan and make the balance outstanding due and payable in full. The Working Capital Revolver Loan is secured by receivables, inventories and intangibles of all the ClimaChem entities other than El Dorado Nitric Co. and its subsidiaries ("EDNC"). EDNC is neither a borrower nor guarantor of the Working Capital Revolver Loan. In connection with the completion of the Financing Agreement as discussed in (C) below, ClimaChem and our subsidiaries which are guarantors of ClimaChem's Working Capital Revolver Loan entered into an amendment to the Working Capital Revolver Loan pursuant to which we and certain of ClimaChem's subsidiaries pledged additional collateral to secure ClimaChem's obligations under the Working Capital Revolver Loan. The additional collateral consisted of a second mortgage on the assets to which the lenders of the

7. Long-Term Debt (continued)

Financing Agreement discussed in (C) below were granted a first lien. A prepayment penalty equal to 3% of the facility is due to the lender should the borrowers elect to prepay the facility prior to April 2003. This penalty is reduced 1% per year through maturity.

The Working Capital Revolver Loan, as amended, required ClimaChem to maintain quarterly earnings before interest, taxes, depreciation and amortization (EBITDA) for ClimaChem and its Climate Control Business on a trailing twelve-month basis, of $14 million and $10 million, respectively, measured as of December 31, 2002. ClimaChem and its Climate Control Business's EBITDA for the twelve-month period ended December 31, 2002 was in excess of the required amounts. The Working Capital Revolver Loan, as amended, requires ClimaChem to maintain quarterly EBITDA, as defined, for ClimaChem and its Climate Control Business on a trailing twelve-month basis of $12.3 million and $10 million, respectively, measured as of March 31, 2003, $13.4 million and $10 million, respectively, measured as of June 30, 2003, $13.5 million and $10 million, respectively, measured as of September 30, 2003, and $12.5 million and $10 million, respectively, measured as of December 31, 2003 . For the fiscal quarters ending after December 31, 2003, the EBITDA requirement shall be determined based on ClimaChem's forecasted financial statements, however, if ClimaChem and the provider of the Working Capital Revolver Loan can not reach an agreement, the EBITDA requirement shall not be less than $15 million. The Working Capital Revolver Loan also requires ClimaChem to achieve an annual fixed charge coverage ratio of at least 1 to 1 and limits capital expenditures to $11.2 million annually. The Working Capital Revolver Loan requires that ClimaChem's excess availability, as defined, equal an amount not less than $.5 million. It also requires ClimaChem's excess availability, as defined, equal an amount not less than $1.5 million on the date of the periodic interest payments due on its 10-3/4% Senior Unsecured Notes due 2007 (discussed in (D) below) and interest due on certain debt issued pursuant to a financing arrangement entered into in May 2002 (discussed in (C) below). The Working Capital Revolver Loan also contains covenants that, among other things, limit the borrowers' ability to: (i) incur additional indebtedness, (ii) incur liens, (iii) make restricted payments or loans to affiliates who are not borrowers, or (iv) engage in mergers, consolidations or other forms of recapitalization, (v) dispose of assets, and (vi) repurchase ClimaChem's 10-3/4% Senior Unsecured Notes. The Working Capital Revolver Loan also requires all collections on accounts receivable be made through an account in the name of the lender or their agent. Amounts available for additional borrowing under the Working Capital Revolver Loan at December 31, 2002 were $5.8 million.

(B) Summit Machine Tool Manufacturing Corp., ("Summit"), one of our subsidiaries, that is not a subsidiary of ClimaChem, finances its working capital requirement through borrowings under a credit facility (the "Facility") with a different lender than ClimaChem's lender. In March 2003, Summit entered into an amendment to the Facility which reduced the revolving line of credit to $600,000. The Facility terminates on April 1, 2004. The Facility requires monthly payments of interest which accrue based on the lender's prime rate plus 7%.

The effective rate at December 31, 2002 was 11.25%. Summit may terminate the Facility with proper notice without premium or penalty. We guarantee the Facility.

(C) In May 2002, ClimaChem repurchased $52.3 million face value aggregate principal amount of its Senior Unsecured Notes. The purchase price per $1,000 of aggregate principal amount of Senior Unsecured Notes was approximately $575, resulting in an aggregate purchase price of approximately $30.1 million. In order to fund the repurchase of the Senior Unsecured Notes, ClimaChem entered into a Financing Agreement with certain lenders (the "Lenders"). Each Lender is an affiliate of the other Lenders. Pursuant to the terms of the Financing Agreement, the Lenders loaned $35 million to ClimaChem (collectively, the "Loans"). The Loans mature on June 30, 2005, and bear interest at 10 1/2% per annum (cash interest), payable quarterly. Additional interest of 5 1/2% is payable either at maturity or upon prepayment. The Lenders and affiliates of the Lenders owned the Senior Unsecured Notes which were repurchased by ClimaChem.

The proceeds of the Loans were used to fund the repurchase of the Senior Unsecured Notes by ClimaChem from the

Lenders and certain affiliates of the Lenders, to pay the closing costs, fees and expenses incurred in connection with the Loans of approximately $3.2 million and to fund a cash collateral account of approximately $1.8 million. The cash collateral will be available to ClimaChem at the earlier of (i) the date the Loans are paid in full or (ii) November 23, 2003 so long as no default or event of default is then continuing. Therefore the $1.8 million is classified as restricted cash and is included in current assets at December 31, 2002. In connection with the closing of the Loans, the Lenders entered into an Intercreditor Agreement with ClimaChem's Working Capital Revolver Loan lender. The Financing Agreement contains cross-default provisions to the Working Capital Revolver Loan agreement.

The Financing Agreement required ClimaChem to maintain quarterly EBITDA, as defined, for ClimaChem and its Climate Control Business on a trailing twelve-month basis of $16 million and $10 million, respectively, measured as of December 31, 2002. The agreement provides that all transaction costs deducted from operations in the second quarter of 2002, that are directly related to the transaction to repurchase the Notes and enter into the Financing Agreement of approximately $3.2 million, are an add back to the second quarter 2002 EBITDA. ClimaChem and its Climate Control Business's EBITDA, as defined, for the twelve-month period ended December 31, 2002 was in excess of the required amounts. The Financing Agreement, as amended, requires ClimaChem to maintain quarterly EBITDA, as defined, for ClimaChem and its Climate Control Business on a trailing twelve-month basis of the same amounts required under the Working Capital Revolver Loan as discussed in (A). For quarters ending after December 31, 2003, the EBITDA requirement shall be determined based on ClimaChem's forecasted financial statements, however, if ClimaChem and the Lenders can not reach an agreement, the EBITDA requirement shall not be less than $15 million. For quarters ending after December 31, 2002, if ClimaChem fails to

maintain EBITDA, as defined, on a trailing twelve-month basis of at least $12 million (a "Trigger Event"), then within 210 days of the end of such quarter, ClimaChem shall pay the Lenders an amount equal to 33.3% ($10.6 million as of December 31, 2002) of then outstanding principal of the Loans plus related cash and additional interest. However, if ClimaChem maintains EBITDA on a trailing twelve-month basis of at least $12 million as of the end of each of the two quarters immediately following the Trigger Event, then within 210 days of such Trigger Event, ClimaChem shall pay the Lenders an amount equal to 10% ($3.2 million as of December 31, 2002) of then outstanding principal of the Loans plus related cash and additional interest.

The Financing Agreement, as amended, also requires ClimaChem to achieve an annual fixed charge coverage ratio of at least 1 to 1 and limits annual capital expenditures to $11.2 million measured quarterly on a trailing twelve-month basis. The Financing Agreement also contains covenants that, among other things, limit ClimaChem's ability to: (i) incur additional indebtedness, (ii) incur liens, (iii) provide certain guarantees (iv) engage in mergers, consolidations or other forms of recapitalization and (v) dispose of assets. The Lenders may, upon an event of default as defined, terminate the Financing Agreement and demand the balance outstanding due and payable in full. The Financing Agreement includes a prepayment fee equal to 2% of the principal amount paid should ClimaChem elect to prepay any principal amount prior to May 24, 2003. This fee is reduced to 1% during the second twelve-month period and to .5% during the third twelve-month period.

The Loans are secured by (a) a first lien on (i) certain real property and equipment located at the El Dorado, Arkansas manufacturing facility (excluding the DSN Plant and other exceptions) (the "EDC Plant") (ii) certain real property and equipment located at the Cherokee, Alabama manufacturing facility (the "Cherokee Plant") owned by a subsidiary of the Company that is not a subsidiary of ClimaChem, (iii) a cash collateral account of $1.8 million, and (b) a second lien on the assets upon which ClimaChem's Working Capital Revolver lender has a first lien. The Loans are guaranteed by the Company and certain subsidiaries of ClimaChem.

As required by the Lenders, as a condition precedent to the completion of the Loans and the transactions contemplated by the Financing Agreement, we granted to the Lenders warrants to purchase 595,585 shares of our common stock subject to certain anti-dilution adjustments. The exercise price of the warrants is $0.10 per share and contains a provision for cashless exercise. The warrants have a 10-year exercise period beginning on May 24, 2002. The warrants provide for certain demand registration rights and piggyback registration rights. The estimated fair value of the warrants ($1,983,000) was accounted for as debt issuance costs.

Based upon certain criteria, including but not limited to, unfavorable changes in ClimaChem's financial condition since the Senior Unsecured Notes were originally sold and the high interest rates on the Loans, the transaction was accounted for as a debt restructuring.

7. Long-Term Debt (continued)

As a result, the gain on the transaction was limited to the difference between the carrying value of the Senior Unsecured Notes repurchased and the principal of the Loans due 2005, plus the cumulative interest due and payable during the three year term thereof including such additional interest due at maturity. Accordingly, the net gain recognizable in 2002 relating to this debt restructuring was limited to only $.1 million and is included in other income in the accompanying consolidated statements of income for 2002.

Since the implied gain relating to this transaction was deferred, all of the future interest payments associated with the Loans has been recognized in long-term debt. All future interest payments on the Loans will be charged against the debt balance presently accrued on the balance sheet.

As discussed in Note 4 - Discontinued Operations, in December 2002, SEC and UTeC sold all of their operating assets. Approximately $3.5 million of the sales proceeds were used as a prepayment on the Loans. Due to this prepayment, ClimaChem will not incur the interest accrued on the Loans prepaid and has thus recognized a gain on extinguishment of debt of $1.5 million which is included in the accompanying consolidated statements of income for 2002.

At December 31, 2002, the carrying amount of long-term debt owed the Lenders is $46.4 million which includes $14.7 million interest due on the Loans through maturity. Of this, interest of $3.4 million is included in current portion of long-term debt at December 31, 2002.

(D) In 1997, ClimaChem completed the sale of its 10-3/4% Senior Unsecured Notes due 2007 (the "Notes"). The Notes bear interest at an annual rate of 10-3/4% payable semiannually in arrears on June 1 and December 1 of each year. The Notes are senior unsecured obligations of ClimaChem and rank equal in right of payment to all existing and future senior unsecured indebtedness of ClimaChem and its subsidiaries. The Notes are effectively subordinated to all existing and future secured indebtedness of ClimaChem.

Prior to the repurchase of the Notes as discussed in (C) above, ClimaChem and the trustee under the Indenture (as defined below), with the consent of the holders of at least 66 2/3% of the aggregate principal amount of the outstanding Notes (the "Holders"), entered into a Fifth Supplemental Indenture, dated May 24, 2002 (the "Supplement"), to the Indenture dated November 27, 1997, as amended (the "Indenture"), which governs ClimaChem's Notes. The Supplement amends the Indenture by, among other things, (a) deleting most of the restrictive covenants, (b) deleting the requirements upon a change of control of ClimaChem or sale of all or substantially all of the assets of ClimaChem, (c) specifying ClimaChem's subsidiaries which are guarantors of the Notes and deleting the requirement that certain future subsidiaries of ClimaChem be guarantors, (d) deleting certain events from the definition of "Event of Default," and (e) providing for conforming changes to the Indenture and the

F-31

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

7. Long-Term Debt (continued)

promissory note executed by ClimaChem pursuant to the terms of the Indenture.

The Notes are subject to redemption at the option of ClimaChem, in whole or in part, at the redemption prices set forth in the Indenture, plus accrued and unpaid interest thereon, plus liquidated damages, if any, to the applicable redemption date.

During 2001 and 2000, subsidiaries of the Company repurchased Notes having a face value of approximately $4.7 million and $29.7 million, respectively, on the open market for approximately $2.1 million and $8.7 million and recognized gains, after writing off approximately $.1 million and $.9 million of loan origination costs, of approximately $2.6 million and $20.1 million, respectively.

ClimaChem owns substantially all of the companies comprising our Chemical and Climate Control Businesses. ClimaChem is a holding company with no significant assets (other than the notes receivable from us), or operations other than its investments in its subsidiaries, and each of its subsidiaries is wholly-owned, directly or indirectly, by ClimaChem. ClimaChem's payment obligations under the Notes are fully, unconditionally and joint and severally guaranteed by all of the existing subsidiaries of ClimaChem, except for EDNC ("Non-Guarantor Subsidiaries").

Set forth below is consolidating financial information of ClimaChem's Guarantor Subsidiaries, the Non-Guarantor Subsidiaries, which are not guarantors of the Notes, and ClimaChem.

F-32

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

7. Long-Term Debt (continued)

ClimaChem, Inc.
Condensed Consolidating Balance Sheet
As of December 31, 2002
(In thousands)

	Combined Guarantor Subsidiaries	Consolidated Non-Guarantor Subsidiaries	ClimaChem, Inc. (Parent)	Eliminations	Consolidated
Assets					
Current assets:					
Cash	$ 410	$ -	$ 950		$ 1,360
Restricted cash	-	-	1,838		1,838
Trade accounts receivable, net	29,515	3,166	39		32,720
Inventories	25,947	119	-		26,066
Supplies and prepaid items	4,007	24	1,309		5,340
Deferred income taxes	-	-	3,520	$ (520)	3,000
Total current assets	59,879	3,309	7,656	(520)	70,324
Property, plant and equipment, net	66,321	2,017	61		68,399
Due from LSB and affiliates	-	-	14,648		14,648
Investment in and advances to affiliates	-	-	89,977	(89,977)	-
Receivable from Parent	-	10,185	-	(10,185)	-
Other assets, net:					
Deferred income taxes	-	-	2,101	(435)	1,666
Other	9,534	41	1,716		11,291
	$ 135,734	$ 15,552	$ 116,159	$ (101,117)	$ 166,328
Liabilities and Stockholders' Equity					
Current liabilities:					
Accounts payable	$ 19,747	$ 2,736	$ 287		$ 22,770
Accrued liabilities	12,993	1,061	1,059		15,113
Due to LSB and affiliates, net	-	-	4,679		4,679
Deferred income taxes	520	-	-	$ (520)	-
Current portion of long-term debt	2,190	353	29,490		32,033
Total current liabilities	35,450	4,150	35,515	(520)	74,595
Long-term debt	4,984	1,559	65,782		72,325
Deferred income taxes	435	-	-	(435)	-
Due to LSB	-	-	3,183		3,183
Other noncurrent liabilities	2,547	3,858	-		6,405
Payable to Parent	42,681	-	-	(42,681)	-
Stockholders' equity:					
Common stock	64	1	1	(65)	1
Capital in excess of par value	77,678	-	12,652	(77,678)	12,652
Accumulated other comprehensive loss	-	(1,859)	-		(1,859)
Retained earnings (accumulated deficit)	(28,105)	7,843	(974)	20,262	(974)
Total stockholders' equity	49,637	5,985	11,679	(57,481)	9,820
	$ 135,734	$ 15,552	$ 116,159	$ (101,117)	$ 166,328

F-33

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

7. Long-Term Debt (continued)

	Combined Guarantor Subsidiaries	Consolidated Non-Guarantor Subsidiaries	ClimaChem, Inc. (Parent)	Eliminations	Consolidated
Assets					
Current assets:					
Cash	$ 264	$ 16	$ 29		$ 309
Trade accounts receivable, net	36,047	2,837	24		38,908
Inventories	27,614	179	-		27,793
Supplies and prepaid items	5,141	29	814		5,984
Deferred income taxes	-	-	2,000		2,000
Current assets of discontinued operations	5,440				5,440
Total current assets	74,506	3,061	2,867		80,434
Property, plant and equipment, net	64,850	1,785	90		66,725
Due from LSB and affiliates	-	-	14,407		14,407
Investment in and advances to affiliates	-	-	107,340	$ (107,340)	-
Receivable from Parent	-	8,235	-	(8,235)	-
Other assets, net	11,014	46	3,473	-	14,533
Noncurrent assets of discontinued operations	3,570				3,570
	$ 153,940	$ 13,127	$ 128,177	$ (115,575)	$ 179,669
Liabilities and Stockholders' Equity					
Current liabilities:					
Accounts payable	$ 19,697	$ 2,220	$ 526		$ 22,443
Accrued liabilities	11,446	1,449	1,164		14,059
Current liabilities of discontinued operations	1,402				1,402
Due to LSB and affiliates	-	-	1,310		1,310
Deferred income taxes	550	-		$ (550)	-
Current portion of long-term debt	4,322	353	34,844		39,519
Total current liabilities	37,417	4,022	37,844	(550)	78,733
Long-term debt	5,259	1,912	75,121		82,292
Deferred income taxes	405	-	3,120	(405)	3,120
Due to LSB	-	-	1,200		1,200
Other non-current liabilities	2,203	3,378	-		5,581
Payable to Parent	54,107	-	-	(54,107)	-
Stockholders' equity:					
Common stock	64	1	1	(65)	1
Capital in excess of par value	79,217	-	12,652	(79,217)	12,652
Accumulated other comprehensive loss	-	(2,149)	-		(2,149)
Retained earnings (accumulated deficit)	(24,732)	5,963	(1,761)	18,769	(1,761)
Total stockholders' equity	54,549	3,815	10,892	(60,513)	8,743
	$ 153,940	$ 13,127	$ 128,177	$ (115,575)	$ 179,669

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

7. Long-Term Debt (continued)

ClimaChem, Inc.
Condensed Consolidating Statement of Operations
Year ended December 31, 2002
(In thousands)

	Combined Guarantor Subsidiaries	Consolidated Non-Guarantor Subsidiaries	ClimaChem, Inc. (Parent)	Eliminations	Consolidated
Net sales	$ 244,737	$ 34,749			$ 279,486
Cost of sales	205,516	31,142	$ 591	$ (5)	237,244
Gross profit	39,221	3,607	(591)	5	42,242
Selling, general and administrative	33,119	387	1,826	(7)	35,325
Operating income (loss)	6,102	3,220	(2,417)	12	6,917
Other income (expense):					
Interest and other income (expense), net	2,678	(79)	11,858	(10,882)	3,575
Gain on extinguishment of debt	-	-	1,458		1,458
Provision for loss on firm sales and purchase commitments	(414)	-	-		(414)
Interest expense	(10,744)	(59)	(6,908)	10,870	(6,841)
Income (loss) from continuing operations before benefit (provision) for income taxes	(2,378)	3,082	3,991	-	4,695
Equity in losses of subsidiaries	-	-	(3,032)	3,032	-
Benefit (provision) for income taxes	927	(1,202)	(172)		(447)
Loss from discontinued operations, net	(3,461)	-			(3,461)
Net income (loss)	$ (4,912)	$ 1,880	$ 787	$ 3,032	$ 787

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

7. Long-Term Debt (continued)

ClimaChem, Inc.
Condensed Consolidating Statement of Operations
Year ended December 31, 2001
(In thousands)

Combined Guarantor Subsidiaries	Consolidated Non-Guarantor Subsidiaries	ClimaChem, Inc. (Parent)	Eliminations	Consolidated

Net sales	$ 271,988	$ 36,539			$ 308,527
Cost of sales	228,757	33,018	$ 895	$ (4)	262,666
Gross profit	43,231	3,521	(895)	4	45,861
Selling, general and administrative	37,052	201	4,382	(7)	41,628
Operating income (loss)	6,179	3,320	(5,277)	11	4,233
Other income (expense):					
Interest and other income (expense), net	(19)	21	11,703	(10,451)	1,254
Gain on sales of property and equipment	2,898	-	-		2,898
Gain on extinguishment of debt	-	-	2,631		2,631
Benefit from termination of firm sales and purchase commitments	2,688	-	-		2,688
Interest expense	(11,778)	(108)	(10,856)	10,440	(12,302)
Income (loss) from continuing operations before benefit (provision) for income taxes	(32)	3,233	(1,799)	-	1,402
Equity in earnings of subsidiaries	-	-	1,978	(1,978)	-
Benefit (provision) for income taxes	(1,530)	(920)	1,330		(1,120)
Income from discontinued operations, net	1,227	-	-		1,227
Net income (loss)	$ (335)	$ 2,313	$ 1,509	$ (1,978)	$ 1,509

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

7. Long-Term Debt (continued)

ClimaChem, Inc.
Condensed Consolidating Statement of Operations
Year ended December 31, 2000
(In thousands)

	Combined Guarantor Subsidiaries	Non-Guarantor Subsidiary	ClimaChem, Inc. (Parent)	Eliminations	Consolidated
Net sales	$ 220,151	$ 41,869			$ 262,020
Cost of sales	180,919	38,345	$ 1,232		220,496
Gross profit	39,232	3,524	(1,232)		41,524
Selling, general and administrative	36,881	428	4,516		41,825
Operating income (loss)	2,351	3,096	(5,748)		(301)
Other income (expense):					
Interest and other income (expense), net	791	100	8,742	$ (7,940)	1,693
Gain on extinguishment of debt	-	-	17,421		17,421

Provision for loss on firm sales and purchase commitments	(3,395)	-	-		(3,395)
Interest expense	(11,470)	(17)	(9,665)	7,940	(13,212)
Income (loss) from continuing operations before benefit (provision) for income taxes	(11,723)	3,179	10,750	-	2,206
Equity in losses of subsidiaries	-	-	(9,072)	9,072	-
Benefit (provision) for income taxes	(812)	(1,043)	1,570		(285)
Income from discontinued operations, net	1,327	-	-		1,327
Net income (loss)	$ (11,208)	$ 2,136	$ 3,248	$ 9,072	$ 3,248

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

7. Long-Term Debt (continued)

ClimaChem, Inc.
Condensed Consolidating Statement of Cash Flows
Year ended December 31, 2002
(In thousands)

	Combined Guarantor Subsidiaries	Consolidated Non-Guarantor Subsidiaries	ClimaChem, Inc. (Parent)	Eliminations	Consolidated
Cash flows provided (used) by continuing operating activities	$ 18,767	$ 2,744	$ (1,697)		$ 19,814
Cash flows from investing activities:					
Capital expenditures	(9,511)	(456)	(8)		(9,975)
Proceeds from sales of property and equipment	227	-	1		228
Restricted cash held in escrow	-	-	(1,838)		(1,838)
Other assets	275	(1)	(15)		259
Net cash used by investing activities	(9,009)	(457)	(1,860)		(11,326)
Cash flows from financing activities:					
Payments on long-term debt	(2,171)	(353)	(5,650)		(8,174)
Proceeds from Financing Agreement net of fees	-	-	32,155		32,155
Acquisition of 10 3/4 % Senior Unsecured Notes	-	-	(30,065)		(30,065)
Net change in revolving debt	(332)	-	(8,730)		(9,062)
Net change in due to/from LSB and affiliates	-	-	3,162		3,162
Advances to/from affiliates	(11,656)	(1,950)	13,606		-

Net cash provided (used) by financing activities	(14,159)	(2,303)	4,478		(11,984)
Net cash provided by discontinued operations	4,547	-	-		4,547
Net increase (decrease) in cash and cash equivalents from all activities	146	(16)	921		1,051
Cash and cash equivalents at the beginning of year	264	16	29		309
Cash and cash equivalents at the end of year	$ 410	$ -	$ 950		$ 1,360

F-38

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

7. Long-Term Debt (continued)

ClimaChem, Inc.
Condensed Consolidating Statement of Cash Flows
Year ended December 31, 2001
(In thousands)

	Combined Guarantor Subsidiaries	Consolidated Non-Guarantor Subsidiaries	ClimaChem, Inc. (Parent)	Eliminations	Consolidated
Cash flows provided (used) by continuing operating activities	$ (2,174)	$ 154	$ 821		$ (1,199)
Cash flows from investing activities:					
Capital expenditures	(4,739)	(697)	(40)		(5,476)
Proceeds from sales of property and equipment	3,677	-	-		3,677
Other assets	249	6	(1,680)		(1,425)
Net cash used by investing activities	(813)	(691)	(1,720)		(3,224)
Cash flows from financing activities:					
Payments on long-term debt	(3,915)	(235)	-		(4,150)
Long-term and other borrowing, net of origination fee	-	950	-		950
Acquisition of 10 3/4 % Senior Unsecured Notes	-	-	(21)		(21)
Net change in revolving debt	(30,046)	(170)	34,746		4,530
Net change in due to/from LSB and affiliates	-	-	1,440		1,440
Advances to/from affiliates	35,285	-	(35,285)		-
Net cash provided by financing activities	1,324	545	880		2,749
Net cash used by discontinued operations	(855)	-	-		(855)
Net increase (decrease) in cash and cash equivalents from all activities	(2,518)	8	(19)		(2,529)

Cash and cash equivalents at the beginning of year	2,782	8	48		2,838
Cash and cash equivalents at the end of year	$ 264	$ 16	$ 29		$ 309

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

7. Long-Term Debt (continued)

ClimaChem, Inc.
Condensed Consolidating Statement of Cash Flows
Year ended December 31, 2000
(In thousands)

	Combined Guarantor Subsidiaries	Non-Guarantor Subsidiary	ClimaChem, Inc. (Parent)	Eliminations	Consolidated
Cash flows provided (used) by continuing operating activities	$ (2,642)	$ 4,830	$ (184)		$ 2,004
Cash flows from investing activities:					
Capital expenditures	(5,531)	(780)	(83)		(6,394)
Purchase of Senior Notes of parent	-	(5,688)	-	$ 5,688	-
Other assets	1,495	(777)	(49)		669
Net cash used by investing activities	(4,036)	(7,245)	(132)	5,688	(5,725)
Cash flows from financing activities:					
Payments on long-term debt	(3,671)	-	-		(3,671)
Long-term and other borrowings, net of origination fee	3,500	1,550	-		5,050
Acquisition of 10 3/4% Senior Unsecured Notes	-	-	(1,314)	(5,688)	(7,002)
Net change in revolving debt	7,408	170	87		7,665
Net change in due to/from LSB affiliates	-	-	437		437
Net cash provided (used) by financing activities	7,237	1,720	(790)	(5,688)	2,479
Net cash provided by discontinued operations	1,425	-	-		1,425
Net increase (decrease) in cash and cash equivalents from all activities	1,984	(695)	(1,106)	-	183
Cash and cash equivalents at the beginning of year	798	703	1,154	-	2,655
Cash and cash equivalents at the end of year	$ 2,782	$ 8	$ 48	$ -	$ 2,838

(E) Includes a $.2 million note payable ($.4 million at December 31, 2001), to an unconsolidated related party. The note is unsecured, bears interest at 10.75% per annum payable monthly, and is due upon demand.

Maturities (in thousands) of long-term debt for each of the five years after December 31, 2002 are: 2003--$38,889 (including $27,209 due in 2005 unless the lender demands earlier payment); 2004--$6,568; 2005--$41,331; 2006--$1,208; 2007--$19,522 and thereafter--$5,843.

F-40

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

8. Income Taxes

The tax effects of each type of temporary difference and carry forward that are used in computing deferred tax assets and liabilities and the valuation allowance related to deferred tax assets at December 31, 2002 and 2001 are as follows:

	December 31,	
	2002	2001
	(In Thousands)	
Deferred tax assets		
Amounts not deductible for tax purposes:		
Allowance for doubtful accounts	$ 2,132	$ 2,255
Asset impairment	5,948	6,461
Accrued liabilities	1,190	1,118
Other	1,840	1,207
Excess of tax gain over book gain resulting from debt refinancing	8,894	
Capitalization of certain costs as inventory for tax purposes	1,213	1,236
Net operating loss carry forwards	15,780	25,861
Investment tax and alternative minimum tax credit carry forwards	793	793
Total deferred tax assets	37,790	38,931
Less valuation allowance on deferred tax assets	28,632	28,240
Net deferred tax assets	$ 9,158	$ 10,691
Deferred tax liabilities		
Accelerated depreciation used for tax purposes	$ 7,019	$ 8,552
Inventory basis difference resulting from a business combination	2,139	2,139
Total deferred tax liabilities	$ 9,158	$ 10,691

We are able to realize deferred tax assets up to an amount equal to the future reversals of existing taxable temporary differences. The taxable temporary differences will turn around in the loss carry forward period as the differences are depreciated or amortized. Other differences will turn around as the assets are disposed of in the normal course of business.

F-41

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

8. Income Taxes (continued)

The differences between the amount of the provision for income taxes (consisting solely of current state taxes) and the amount which would result from the application of the federal statutory rate to "Income (loss) from continuing operations before provision for income taxes and cumulative effect of accounting change" for each of the three years in the period ended December 31, 2002 are detailed below:

	Year Ended December 31,		
	2002	2001	2000
	(In Thousands)		
Provision for income taxes at federal statutory rate	$ 944	$ 2,604	$ 2,819
Changes in the valuation allowance related to deferred tax assets, net of rate differential	392	(3,272)	(12,049)
Effect of discontinued operations, and other on valuation allowance	(1,332)	765	9,040
State income taxes, net of federal benefit	35	110	85
Permanent differences	17	(97)	190
Provision for income taxes	$ 56	$ 110	$ 85

At December 31, 2002, we have regular-tax net operating loss ("NOL") carry forwards of approximately $40 million ($16.3 million alternative minimum tax NOLs).

9. Redeemable Preferred Stock

Each share of noncumulative redeemable preferred stock, $100 par value, is convertible into 40 shares of our common stock at any time at the option of the holder; entitles the holder to one vote; and is redeemable at par. The redeemable preferred stock provides for a noncumulative annual dividend of 10%, payable when and as declared.

10. Stockholders' Equity (Deficit)

Qualified Stock Option Plans

We have a 1981 Incentive Stock Option Plan (1,350,000 shares), a 1986 Incentive Stock Option Plan (1,500,000 shares), a 1993 Stock Option and Incentive Plan (850,000 shares) and a 1998 Stock Option Plan (1,000,000 shares). Under these plans, we are authorized to grant options to purchase up to 4,700,000 shares of our common stock to our key employees. The 1981 and 1986 Incentive Stock Option Plans have expired and, accordingly, no additional options may be granted from these plans. Options granted prior to the expiration of these plans continue to remain valid thereafter in accordance with their terms. At December 31, 2002, there are 10,000 options outstanding related to these two plans. At December 31, 2002, there are 492,000 options outstanding related to the 1993 Stock Option and Incentive Plan and 922,600 options outstanding relating to the 1998 Stock Option Plan which continue to be effective. These options become exercisable 20% after one year from date of grant, 40% after two years, 70% after three years,

Notes to Consolidated Financial Statements (continued)

10. Stockholders' Equity (Deficit) (continued)

100% after four years and lapse at the end of ten years. The exercise price of options granted under this plan were equal to the market value of our common stock at the date of grant. For participants who own 10% or more of our common stock at the date of grant, the option price is 110% of the market value at the date of grant and the options lapse after five years from the date of grant.

Activity in our qualified stock option plans during each of the three years in the period ended December 31, 2002 is as follows:

	2002		2001		2000	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	1,655,800	$ 2.39	1,740,500	$ 2.69	1,985,500	$ 2.73
Granted	-	-	232,500	2.75	-	-
Exercised	(90,300)	2.84	(20,400)	1.19	-	-
Canceled, forfeited or expired	(140,900)	2.65	(296,800)	4.51	(245,000)	3.02
Outstanding at end of year	1,424,600	$ 2.34	1,655,800	$ 2.39	1,740,500	$ 2.69
Exercisable at end of year	1,015,900	$ 2.54	879,100	$ 2.98	1,010,100	$ 3.71
Weighted average fair value of options granted during year		N/A		$ 2.40		NA

Outstanding options to acquire 1,414,600 shares of stock at December 31, 2002 had exercise prices ranging from $1.25 to $4.88 per share (1,005,900 of which are exercisable at a weighted average price of $2.47 per share) and had a weighted average exercise price of $2.29 and remaining contractual life of 5.1 years. The balance of options outstanding at December 31, 2002 had an exercise price of $9.00 per share (all of which are exercisable at a weighted average exercise price of $9.00 per share) and had a remaining contractual life of .25 years.

Non-Qualified Stock Option Plans

Our Board of Directors approved the grants of non-qualified stock options to our outside directors, our President and certain key employees, as detailed below. The option prices are generally based on the market value of our common stock at the dates of grants.

These options have vesting terms and lives specific to each grant but generally vest over 48 months and expire five or ten years from the grant date. We have a 1993 Non-employee Director Stock Option Plan (the "Outside Director Plan"). The Outside Director Plan authorizes the grant of non-qualified stock options to each member of our Board of Directors who is not an officer or employee of the Company or its subsidiaries. The maximum number of shares of our

common stock that may be issued under the Outside Director Plan is 150,000 shares (subject to adjustment as provided in the Outside Director Plan).

We have agreed to automatically grant to each outside director an option to acquire 5,000 shares of our common stock on April 30 following the end of each year in which we realize net income of $9.2 million or more for such year. The exercise price for an option granted under this plan is the fair market value of the shares of common stock at the time the option is granted. Each option granted under this plan to the extent not exercised terminates upon the earlier of the termination as a member of our Board of Directors or the fifth anniversary of the date such option was granted. During 2002, 2001 and 2000, there were no options granted under this plan.

In 2000, the Board of Directors granted 185,000 to a former employee of the Company to replace the options this individual held prior to leaving the Company. These options were fully vested at the date of grant and 100,000 of these options expire nine years from the date of grant and 85,000 expire seven years from the date of grant. We recognized compensation expense of $137,000 in 2000 related to the grant of these shares. In 2001, the Board of Directors granted 102,500 stock options to an employee that vest over 48 months and have contractual lives of ten years. In 2002, the Board of Directors granted 50,000 stock options that vest over 48 months and have contractual lives of ten years as well as 115,000 stock options principally to former employees of the Company to replace the options these individuals held prior to leaving the Company (a portion of the 165,000 stock options granted had exercise prices that exceeded the last average bid and asked price of our common stock at the date of the grant). The options to former employees were fully vested at the date of grant and expire between one and nine years from the date of grant. We recognized compensation expense of $48,000 in 2002 related to the grant of these shares.

Activity in our non-qualified stock option plans during each of the three years in the period ended December 31, 2002 is as follows:

	2002		2001		2000	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	1,208,000	$ 2.32	1,175,500	$ 2.46	1,103,500	$ 2.36
Granted	165,000	2.82	102,500	2.73	185,000	2.82
Exercised	-	-	(15,000)	1.25	-	-
Surrendered, forfeited, or expired	(25,000)	4.19	(55,000)	6.37	(113,000)	2.06
Outstanding at end of year	1,348,000	$ 2.35	1,208,000	$ 2.32	1,175,500	$ 2.46
Exercisable at end of year	995,050	$ 2.34	694,400	$ 2.47	617,900	$ 2.90
Weighted average fair value of options granted during year		$ 1.87		$ 2.44		$ ..64

Outstanding options to acquire 1,339,000 shares of stock at December 31, 2002 had exercise prices ranging from $1.25 to $4.54 per share (986,050 of which are exercisable at a weighted average price of $2.29 per share) and had a weighted average exercise price of $2.32 and remaining contractual life of 5.78 years. The balance of options outstanding at December 31, 2002 had exercise prices of $5.36 and $9.00 per share (all of which are exercisable) at a weighted average exercise price of $6.98 per share, and had a remaining contractual life of 2.7 years.

Preferred Share Purchase Rights

In January 1999, our Board of Directors approved the renewal (the "Renewed Rights Plan") of our existing Preferred Share Purchase Rights Plan ("Existing Rights Plan") and declared a dividend distribution of one Renewed Preferred Share Purchase Right (the "Renewed Preferred Right") for each outstanding share of our common stock outstanding upon the Existing Rights Plan's expiration date. The Renewed Preferred Rights are designed to ensure that all of our stockholders receive fair and equal treatment in the event of a proposed takeover or abusive tender offer.

The Renewed Preferred Rights are generally exercisable when a person or group, other than our Chairman and his affiliates, acquire beneficial ownership of 20% or more of our common stock (such a person or group will be referred to as the "Acquirer"). Each Renewed Preferred Right (excluding Renewed Preferred Rights owned by the Acquirer) entitles stockholders to buy one one-hundredth (1/100) of a share of a new series of participating preferred stock at an exercise price of $20. Following the acquisition by the Acquirer of beneficial ownership of 20% or more of our common stock, and prior to the acquisition of 50% or more of our common stock by the Acquirer, our Board of Directors may exchange all or a portion of the Renewed Preferred Rights (other than Renewed Preferred Rights owned by the Acquirer) for our common stock at the rate of one share of common stock per Renewed Preferred Right. Following acquisition by the Acquirer of 20% or more of our common stock, each Renewed Preferred Right (other than the Renewed Preferred Rights owned by the Acquirer) will entitle its holder to purchase a number of our common shares having a market value of two times the Renewed Preferred Right's exercise price in lieu of the new preferred stock.

If we are acquired, each Renewed Preferred Right (other than the Renewed Preferred Rights owned by the Acquirer) will entitle its holder to purchase a number of the Acquirer's common shares having a market value at the time of two times the Renewed Preferred Right's exercise price.

Prior to the acquisition by the Acquirer of beneficial ownership of 20% or more of our stock, our Board of Directors may redeem the Renewed Preferred Rights for $.01 per Renewed Preferred Right.

10. Stockholders' Equity (Deficit) (continued)

In May 2002, the Company issued warrants to purchase 595,585 shares of our common stock for $.10 per share (see Note 7).

In March 2003, the Company sold for $1,570,500 in cash 450,000 shares of common stock held in treasury and a warrant (exercisable at $3.49 per share until March 2008) to purchase 112,500 shares of common stock. The proceeds were used to reduce debt.

11. Non-Redeemable Preferred Stock

The 20,000 shares of Series B cumulative, convertible preferred stock, $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 entitles the holder to one vote per share. The Series B preferred stock provides for annual cumulative dividends of 12% from date of issue, payable when and as declared. At December 31, 2002, $.7 million of dividends ($36.00 per share) on the Series B preferred stock were in arrears.

The Class C preferred stock, designated as a $3.25 convertible exchangeable Class C preferred stock, Series 2, has no par value ("Series 2 Preferred"). The Series 2 Preferred has a liquidation preference of $50.00 per share plus accrued and unpaid dividends and is convertible at the option of the holder at any time, unless previously redeemed, into our common stock at an initial conversion price of $11.55 per share (equivalent to a conversion rate of approximately 4.3 shares of common stock for each share of Series 2 Preferred), subject to adjustment under certain conditions. Upon the mailing of notice of certain corporate actions, holders will have special conversion rights for a 45-day period.

The Series 2 Preferred is redeemable at our option, in whole or in part, at prices decreasing annually to $50.00 per share on or after June 15, 2003, plus accrued and unpaid dividends to the redemption date. The redemption price at December 31, 2002 was $50.33 per share. Dividends on the Series 2 Preferred are cumulative and are payable quarterly in arrears. At December 31, 2002, $7.1 million of dividends ($11.375 per share) on the Series 2 Preferred were in arrears.

The Series 2 Preferred also is exchangeable in whole, but not in part, at our option on any dividend payment date for our 6.50% Convertible Subordinated Debentures due 2018 (the "Debentures") at the rate of $50.00 principal amount of Debentures for each share of Series 2 Preferred. Interest on the Debentures, if issued, will be payable semiannually in arrears. The Debentures will, if issued, contain conversion and optional redemption provisions similar to those of the Series 2 Preferred and will be subject to a mandatory annual sinking fund redemption of five percent of the amount of Debentures initially issued, commencing June 15, 2003 (or the June 15 following their issuance, if later).

The 1,000,000 shares of Class C preferred stock, designated as 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 of the liquidation preference of $1.00 per share but will be paid only after accrued and unpaid dividends are paid on the Series 2 Preferred. At December 31, 2002, $.1 million of dividends ($.06 per share) on the Series D Preferred were in arrears. Each holder of the Series D Preferred shall be entitled to .875 votes per share.

At December 31, 2002, we are authorized to issue an additional 3,200 shares of $100 par value preferred stock and an additional 3,371,450 shares of no par value preferred stock. Upon issuance, our Board of Directors will determine the specific terms and conditions of such preferred stock.

As of December 31, 2002, we have reserved approximately 3.6 million shares of common stock issuable upon conversion of preferred stock.

12. Commitments and Contingencies

Operating Leases

We and our subsidiaries lease certain property, plant and equipment under non-cancelable operating leases. Future minimum payments on operating leases, including the Nitric Acid Plant and Purchase Commitment discussed below with initial or remaining terms of one year or more at December 31, 2002 are as follows:

	(In Thousands)
2003	$ 11,574
2004	16,040
2005	4,622
2006	10,094
2007	10,901
Thereafter	22,992
	$ 76,223

Rent expense under all operating lease agreements, including month-to-month leases, was $14,122,000 in 2002, $15,770,000 in 2001 and $12,353,000 in 2000. Renewal options are available under certain of the lease agreements for various periods at approximately the existing annual rental amounts. Rent expense paid to related parties was $38,000 in 2002 and $45,000 in 2001 and 2000.

Nitric Acid Plant

Our wholly owned subsidiary, El Dorado Nitric Co. and its subsidiaries ("EDNC"), operates a nitric acid plant (the "Baytown Plant") at Bayer's Baytown, Texas chemical facility in accordance with a series of agreements with Bayer Corporation ("Bayer") (collectively, the "Bayer Agreement"). Under the terms of the Bayer Agreement, EDNC is leasing the Baytown Plant pursuant to a leveraged lease from an unrelated third party with an initial lease term of ten

12. Commitments and Contingencies (continued)

years. The schedule of future minimum payments on operating leases above includes $7,666,000 in 2003, $13,001,000 in 2004, $2,250,000 in 2005, $8,175,000 in 2006, $9,227,000 in 2007, and $16,055,000 after 2007 related to lease payments on the Baytown Plant. Upon expiration of the initial ten-year term, the Bayer Agreement may be renewed for up to six renewal terms of five years each; however, prior to each renewal period, either party to the Bayer Agreement may opt against renewal. The Company and its subsidiaries have not provided a residual value guarantee on the value of the equipment related to the leveraged lease and have given Bayer a right of first refusal on the fixed-price purchase option in 2009. EDNC's ability to perform on its lease commitments is contingent upon Bayer's performance under the Bayer Agreement. One of our subsidiaries has guaranteed the performance of EDNC's obligations under the Bayer Agreement.

Purchase and Sales Commitments

In December 2002, one of our subsidiaries, El Dorado Chemical Company ("EDC") reached an agreement with its supplier of anhydrous ammonia whereby the former long-term purchase commitment was terminated effective October 31, 2002. Under a new agreement effective November 1, 2002, EDC will purchase 100% of its requirements of purchased ammonia using a market price-based formula plus transportation to the manufacturing facility in El Dorado, Arkansas through December 31, 2004.

Our subsidiaries also enter into agreements with suppliers of raw materials which require them to provide finished goods in exchange therefore. They did not have a significant commitment to provide finished goods with their suppliers under these exchange agreements at December 31, 2002.

In 1995, one of our subsidiaries entered into a product supply agreement with a third party whereby the subsidiary is required to make monthly facility fee and other payments which aggregate $79,000. In return for this payment, the subsidiary is entitled to certain quantities of compressed oxygen produced by the third party. Except in circumstances as defined by the agreement, the monthly payment is payable regardless of the quantity of compressed oxygen used by the subsidiary. The term of this agreement, which has been included in the above minimum operating lease commitments, is for a term of 15 years; however, the subsidiary can currently terminate the agreement without cause at a cost of approximately $4.5 million. Based on the subsidiary's estimate of compressed oxygen demands of the plant, the cost of the oxygen under this agreement is expected to be favorable compared to floating market prices. Purchases under this agreement aggregated $947,000, $959,000, and $933,000 in 2002, 2001, and 2000, respectively.

At December 31, 2002, we also have standby letters of credit outstanding of $1.4 million of which $1 million relates to our Climate Control Business.

Effective October 1, 2001, our subsidiary, Cherokee Nitrogen Company ("CNC") entered into a long term 83% ammonium nitrate solution supply agreement with a third party ("Solution Agreement"). Under the Solution Agreement, CNC will supply to the third party its

requirements of 83% ammonium nitrate solution from CNC's Cherokee, Alabama manufacturing plant for a term of no less than five (5) years on a cost-plus basis.

On November 1, 2001, EDC entered into a long-term cost-plus industrial grade ammonium nitrate supply agreement ("Supply Agreement") with a third party. Under the Supply Agreement, EDC will supply from it's El Dorado, Arkansas plant approximately 200,000 tons of industrial grade ammonium nitrate per year, which is approximately 90% of the plant's manufacturing capacity for that product, for a term of no less than five (5) years.

Guarantees

In the normal course of business, the Company and its subsidiaries enter into certain types of guarantees which are subject to the disclosure requirements of FIN 45, Guarantor's Accounting and Disclosure requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. These guarantees are summarized below.

EDC purchases certain products relating to its agricultural business from a certain supplier. In January of 2001, a guarantee was issued by ClimaChem which guarantees payment of these purchases up to $1.5 million if EDC should fail to pay. This guarantee remains in effect until the sixth day after the date on which the supplier receives a written notice from the ClimaChem revoking this guarantee. No amounts were owed this supplier by EDC at December 31, 2002. No amounts have been recorded by the Company in conjunction with this guarantee.

EDC purchases certain products relating to its agricultural business from another supplier. In March of 2002, a guarantee was issued by ClimaChem which guarantees payment of these purchases if EDC should fail to pay. The guarantee remains in effect so long as purchases are being made from this supplier by EDC. No amounts were owed this supplier by EDC at December 31, 2002. No amounts have been recorded by the Company in conjunction with this guarantee.

Cherokee Nitrogen ("Cherokee"), a division of EDC, purchases natural gas from a certain supplier. In October of 2000, a guarantee was issued by ClimaChem which guarantees payment of these purchases if Cherokee should fail to pay. The guarantee remains in effect until revoked by ClimaChem, on not less than a thirty day notice. Cherokee owed this supplier $.3 million at December 31, 2002. No amounts have been recorded by the Company in conjunction with this guarantee.

EDNC buys various supplies and services from Bayer and has various performance obligations under the terms of the agreements between the parties. In May of 1999, a guarantee was issued by EDC which guarantees fulfillment of these performance provisions, including certain payment obligations. EDC also guarantees the lease payments of the Baytown Plant as discussed under Nitric Acid Plant in this Note 12. The guarantee remains in effect until termination of the

agreements between the parties. No amounts have been recorded by the Company in conjunction with this guarantee.

Legal Matters

Following is a summary of certain legal actions involving the Company:

Our operations are subject to numerous environmental laws ("Environmental Laws") and to other federal, state and local laws regarding health and safety matters ("Health Laws"). In particular, the manufacture and distribution of chemical products are activities which entail environmental risks and impose obligations under the Environmental Laws and the Health Laws, many of which provide for substantial fines and criminal sanctions for violations. There can be no assurance that material costs or liabilities will not be incurred by us in complying with such laws or in paying fines or penalties for violation of such laws. The Environmental Laws and Health Laws and enforcement policies thereunder relating to our Chemical Business have in the past resulted, and could in the future result, in penalties, cleanup costs, or other liabilities relating to the handling, manufacture, use, emission, discharge or disposal of pollutants or other substances at or from our facilities or the use or disposal of certain of its chemical products. Significant expenditures have been incurred by our Chemical Business at the El Dorado, Arkansas plant (the "El Dorado Facility") and the Hallowell, Kansas facility ("Hallowell Facility") in order to comply with the Environmental Laws and Health Laws. Our Chemical Business could be required to make significant additional site or operational modifications at these or other facilities involving substantial expenditures. In addition, if we should decide to no longer operate the El Dorado Facility and if such facility is retired, we may be required to continue to operate discharge water equipment, the cost and timing of which is unknown.

Discharge Water Permit for El Dorado, Arkansas Plant

Our Chemical Business' El Dorado Facility generates process water discharge consisting of cooling tower and boiler blowdown streams, contact storm water (rainfall inside the plant area which picks up contaminants), and miscellaneous spills and leaks from process equipment. This process water has historically been collected and transported to a small pond for pH adjustment and then to a large pond for biological oxidation. Primary contaminants are ammonia, and nitrate and sulfate compounds.

The process water discharge and storm water run off ("Discharge Water") are governed by a State permit renewed every five (5) years. The current permit expired in 1995, and the State was preparing to issue the facility a new permit in early 1997, which included much more stringent limits which the current treatment system could not meet. Negotiations were held with the Director of the State agency in March, 1997, and he agreed to a formal Consent Administrative Order ("CAO") in September, 1998, which CAO contained certain deadlines for the completion of activities at the El Dorado Chemical Company ("EDC") plant site pending issuance of a new permit. The Arkansas Department of Environmental Quality ("ADEQ") did not timely issue the

permit and agreed to extend the CAO deadlines. In June 2002 a formal amendment to the CAO, executed by ADEQ and EDC, became effective, which extended the compliance date until three (3) years after the effective date of the renewal permit. The renewal permit has now been issued by the ADEQ, and it includes new, more restrictive permit limits which, based on current information, EDC does not believe it would be able to comply with. However, counsel has advised us that he does not believe that the permit as issued applies, or correctly applies, the applicable effluent guidelines for fertilizer facilities, resulting in permit effluent restrictions which are far more restrictive than required by the guidelines and which would not be feasible for EDC to achieve. EDC also believes that the permit, as issued, contains other material obligations which would not be feasible for EDC to implement. EDC has appealed the permit to the Arkansas Pollution Control & Ecology Commission ("Commission") and the permit will not become effective until the appeal to the Commission is resolved. EDC and ADEQ have agreed to suspend the appeal proceedings temporarily and to attempt to negotiate mutually acceptable revisions to the permit. At the request of EDC, ADEQ has assigned a more experienced engineer to the project to facilitate the negotiations. These negotiations have resulted in an agreement in principal between the ADEQ permit engineer and EDC which provides for the application of the effluent guidelines in a manner that is acceptable to EDC. We believe these negotiations will result in a permit that will provide EDC appropriate credits for storm water. At this time it is not possible to predict the limits that will be included in the new permit, or what type of treatment will be required to comply with the new permit limits. However, based on estimates and calculations made by EDC's engineering consultant, we believe that, based on the current status of negotiations, the new permit will require additional expenditures, estimated to be approximately $3.6 million, which will be expended over a period of three to four years. If EDC is unable to obtain appropriate modifications to the permit, either through negotiations, appeal to the Commission, or through court proceedings, based on our current liquidity and information currently available to us, we do not believe that EDC will be able to comply with the terms of the permit or have the necessary liquidity to make all of the capital improvements required to comply with the permit's terms. An inability to obtain satisfactory modifications to the permit could result in EDC having either to substantially reduce the operations of the El Dorado Facility or to sell the El Dorado Facility, either of which could have a material adverse effect on its financial condition and may result in the recognition of impairment of certain long-lived assets and may result in an event of default in other material contracts. For 2002, EDC's net sales from the El Dorado Facility were approximately $84.4 million. For the calendar years 2001 and 2000, EDC's net sales from the El Dorado Facility were approximately $104.9 million and $94.4 million, respectively.

The CAO recognizes the presence of ammonium nitrate contamination in the shallow groundwater, and requires EDC to undertake onsite bioremediation. The bioremediation has not proven to be effective, and EDC is currently undertaking a comprehensive evaluation of the shallow groundwater trends in contamination reduction and movement. The final remedy for shallow groundwater contamination will be selected in the future. There are no known users of

this shallow groundwater in the area, and preliminary risk assessments have not identified any risk that would require additional remediation.

The CAO included a $183,700 penalty assessment of which $125,000 was satisfied over five years by expenditures of $25,000 per year for discharge minimization activities. An additional $57,000 was satisfied by funding approved supplemental environmental projects. The monetary civil penalty payment of $1,700 has been paid.

Draining of Equalization Pond at the El Dorado, Arkansas Plant

In September 2001, in response to a maintenance emergency and to prevent an uncontrolled release, the large equalization pond located at our Chemical Business' El Dorado, Arkansas manufacturing facility was drained as a result of a weld break in the pond's underground discharge pipe. After the break occurred, it was determined to allow water to be released through the valve into the permitted discharge to avoid erosion of a levy, to permit monitoring and sampling of Discharged Water, and to direct the discharge to the permitted outfall. No adverse environmental conditions were noted at the discharge, however, the sustained discharge was out of compliance with the mass effluent limits contained in the permit. EDC's environmental compliance manager determined that proper procedure would be to notify ADEQ in the month end report. The ADEQ disagreed and took the position that they should have been notified immediately. In April 2002, EDC and the ADEQ entered into a Consent Administrative Order to settle any civil penalty claims relating to this discharge event whereby EDC paid a $50,000 civil penalty to the ADEQ and will spend another $50,000 on supplemental environmental projects.

EDC and two EDC employees received letters dated April 4, 2002, from the United States Attorney's office in Fort Smith, Arkansas indicating that a criminal charge could be brought against EDC and the two employees as a result of the draining of the equalization pond. The letter further requested that the recipients, through counsel, contact the Assistant United States Attorney ("AUSA"). EDC has retained counsel and has arranged for counsel for the two employees. In discussions between such counsel and the AUSA, the AUSA expressed satisfaction that EDC and the employees responded promptly to the letters, and indicated that he desired a communication with EDC to ensure that EDC was adequately addressing its environmental obligations. In further discussions with the AUSA, the AUSA suggested that the Company and the individuals settle any claims by pleading to a misdemeanor violation in connection with Discharge Water permit violations resulting from the release of Discharge Water from the large equalization pond. EDC is engaging in discussions with the AUSA in an attempt to resolve the above concerns.

12. Commitments and Contingencies (continued)

Consent Order for the Hallowell, Kansas Facility

In April 2002, Slurry Explosive Corporation ("SEC") entered into a consent administrative order ("Slurry Consent Order") with the Kansas Department of Health and Environment ("KDHE"), regarding SEC's Hallowell, Kansas manufacturing facility ("Hallowell Facility"). The Slurry Consent Order states that there exists soil and groundwater contamination and there exists surface water contamination in the strip pit adjacent to the Hallowell Facility. There are no known users of the groundwater in the area. The adjacent strip pit is used for fishing. The Slurry Consent Order also provides that SEC has not verified the presence of such contaminants. Under the terms of the Slurry Consent Order, SEC is required a) to submit an environmental assessment work plan to the KDHE for review and approval, b) to agree with the KDHE as to any required corrective actions to be performed at the Hallowell Facility, and c) to provide reports to the KDHE. A draft work plan was submitted to the KDHE. SEC has received KDHE's comments on the draft work plan, and SEC agreed to expand the sampling to include additional interconnected strip pits. SEC and KDHE jointly conducted sampling of an adjacent strip pit. The results of such sampling indicated elevated levels of nitrate compounds, ammonia and perchlorate. Additional surface water sampling was performed with the results showing little or no ammonium perchlorate contamination in outlying ponds. We believe, although there can be no assurance, that compliance by SEC with the anticipated Slurry Consent Order will not have a material adverse effect on the Company. In connection with the sale of all of the operating assets of SEC and UTeC, subsidiaries of the Company, in December 2002, UTeC leased the Hallowell Facility to the buyer under a long-term lease agreement. However, SEC retained the obligation to perform the required activities under the Slurry Consent Order.

Surface Water and Soil Testing at Hallowell, Kansas Underwater Laboratory Site

On August 7, 2002 the KDHE took samples of surface water and soil samples at UTeC's underwater laboratory site in Hallowell, Kansas. The KDHE had indicated that it would test the samples for nitrate compounds and perchlorates. UTeC was not aware of the existence of any such contamination. The analytical report has been issued by KDHE and forwarded to the Environmental Protection Agency with a recommendation of no further action.

Proposed Consent Administrative Order for the El Dorado, Arkansas Plant

From March 2001 through January 2002, EDC experienced eleven alleged air emissions violations. One of the alleged violations involved a malfunctioning continuous air emissions monitor, one of the alleged violations was based on a typographical error, six of the alleged violations involved air emissions point source tests that were allegedly performed in a manner not in compliance with testing procedures, two of the alleged violations involved tests that failed to meet emissions criteria, and one of the alleged violations involved the simultaneous operation of two boilers which is not permitted under the air permit. EDC and the ADEQ have been in negotiations regarding applicable penalties for certain of these violations. On July 24, 2002, EDC

12. Commitments and Contingencies (continued)

received a proposed Consent Administrative Order ("Air CAO") with the ADEQ to resolve the above alleged violations. The draft Air CAO provides for a civil penalty of $10,000 and requires EDC to establish a system to monitor air quality at the perimeter of the El Dorado, Arkansas plant facility and to submit revised testing protocols for demonstrating compliance at the various emission sources.

As part of ADEQ's investigation of an application filed by EDC for a permit modification relating to the sulfuric acid plant, ADEQ initiated an inquiry regarding historical equipment upgrades and repairs at the sulfuric acid plant, and whether any of those modifications should have been reviewed under the Prevention of Significant Deterioration regulations, 40 CFR 52.21 ("PSD Rules"). ADEQ and EDC have entered into negotiations in an attempt to compromise and resolve a potential dispute as to whether PSD Rules should apply to El Dorado's sulfuric acid plant. These negotiations have resulted in the drafting of language added to the draft AIR CAO that would resolve any possible regulatory PSD Rule violations associated with the sulfuric acid plant through the implementation of additional emission controls at that plant. The ADEQ enforcement director who is negotiating this issue has indicated that he is satisfied with this proposal. This matter remains in negotiations and there are no assurances that the possible PSD Rule dispute can be resolved as presently under negotiations. Although we do not anticipate that these negotiations will result in a substantial adverse impact on our operations and/or liquidity, it is not possible to determine the ultimate outcome.

Property Damage Lawsuit

On January 17, 2003, the owners of 283 acres of property adjacent to the EDC facility filed suit against EDC alleging property damage. The EDC facility utilizes a wastewater treatment system which discharges into a creek which passes through that property. The plaintiffs contend that these permitted discharges into the creek have damaged their property, have resulted in fish kills in the creek, and that leakage from EDC's two holding ponds has contaminated the shallow groundwater on the plaintiff's property. Plaintiffs are pursuing claims under theories of negligence, trespass and nuisance, and are claiming punitive damages.

Investigation into these claims has just begun. EDC's wastewater discharge contains elevated levels of ammonia and nitrogen. However, monitoring wells around its treatment ponds indicate little, if any, impact on the shallow groundwater. At this point, EDC has no information which would substantiate any property damage sustained by the plaintiff's which would relate to EDC's activities. EDC will continue its investigation into this matter. As of December 31, 2002, no amounts have been reserved for loss, if any, associated with the matter as loss is not presently probable nor estimable.

License Revocation Order

In February 2002, due to certain alleged violations of explosives storage and related regulations, the government regulator, the Bureau of Alcohol, Tobacco and Firearms ("BATF"), issued an

order revoking the manufacturing license of SEC for its Hallowell Facility to produce certain mining products and confiscated certain high explosives inventory. The license revocation order was upheld by an administrative law judge after an administrative trial. In addition, we have received grand jury subpoenas from the U.S. Attorney's office of Wichita, Kansas requesting business records of SEC. We have complied with such subpoenas.

Other

In 1989 and 1991, the Company entered into severance agreements with certain of its executive officers that become effective after the occurrence of a change in control, as defined, if the Company substantially changes or terminates the officer's employment or if the officer becomes incapacitated. These agreements require the Company to pay the executive officers an amount equal to 2.9 times their average annual base compensation, as defined, upon such termination. As of December 31, 2002, severance payments required would amount to $4.3 million.

The Company has retained certain risks associated with its operations, choosing to self-insure up to various specified amounts under its insurance programs. The Company reviews the programs on at least a quarterly basis to balance the cost/benefit between its coverage and retained exposure and has accrued its share of the estimated liabilities.

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

13. Employee Benefit Plan

We sponsor a retirement 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 EDC union employees and EDNC employees.

14. Fair Value of Financial Instruments

The following discussion of fair values is not indicative of the overall fair value of our assets and liabilities since the provisions of SFAS No. 107, "Disclosures About Fair Value of Financial Instruments," do not apply to all assets, including intangibles.

As of December 31, 2002 and 2001, due to their short term nature, the carrying values of cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities approximated their estimated fair values.

14. Fair Value of Financial Instruments (continued)

Carrying values for variable rate borrowings of $32.9 million and $42.4 million are believed to approximate their fair value as of December 31, 2002 and 2001, respectively. As of December 31, 2002 and 2001, carrying values of fixed rate debt which aggregated $80.5 million and $89.2 million, respectively, had estimated fair values of approximately $60 million and $55 million, respectively. Fair values for fixed rate borrowings, other than the Notes, are estimated using a discounted cash flow analysis that applies interest rates currently being offered on borrowings of similar amounts and terms to those currently outstanding while also taking into consideration our current credit worthiness. Fair value of the Notes is based on market quotations obtained at December 31.

15. Gains on Sales of Property and Equipment

In December 2002, SEC and UTeC sold all of their operating assets. See Note 4 - Discontinued Operations.

On November 1, 2001, one of our subsidiaries sold a significant portion of its assets relating to the distribution of mining products. The total sales price for the distribution sites was $3.5 million. We recognized a gain on the sale of these assets of approximately $2.7 million.

On October 31, 2000 one of our subsidiaries, which is not a subsidiary of ClimaChem, acquired a chemical plant for the purpose of indirectly expanding our geographical marketing area. This plant, located at Crystal City, Missouri ("Crystal City Plant"), was shut down concurrent with the purchase thereof. In July 2001, the Crystal City Plant was dismantled for parts and the land was sold to a third party for approximately $4 million. We recognized a gain on the sale of the Crystal City Plant of approximately $3.3 million.

16. **Inventory Write-Down and Benefit From Termination of (Provision for Loss on) Firm Sales and Purchase Commitments**

In 2002 and 2000, our Chemical Business entered into forward sales commitments with customers for deliveries in 2003 and 2001, respectively, which ultimately were at prices below its costs as of December 31, 2002 and 2000, respectively. In connection therewith, we recognized a loss on these sales commitments in 2002 and 2000 of $.7 million and $.9 million, respectively.

Also in June 2001, we reached an agreement with our supplier of anhydrous ammonia whereby the former long-term purchase commitment was terminated effective June 30, 2001. As consideration to terminate the above-market priced take-or-pay purchase commitment which provided, among other things, for a market price based on natural gas and required minimum monthly purchase volumes, EDC agreed to pay the supplier a one-time settlement fee. The remaining accrued liability as of June 30, 2001, associated with the above-market purchase commitment, net of the one-time settlement fee, was recognized as a gain on termination of the purchase commitment of $2.3 million in 2001. The supplier also agreed to refund EDC up to $.7 million contingent on minimum monthly purchase volumes for which EDC recognized an

16. **Inventory Write-Down and Benefit From Termination of (Provision for Loss on) Firm Sales and Purchase Commitments (continued)**

additional gain on termination of the purchase commitment of $.3 million and $.4 million in 2002 and 2001, respectively. In 2001, EDC realized, through cost of goods sold, approximately $2.1 million of the accrued liability previously established for loss on the former firm purchase commitment.

Prior to the termination discussed above, EDC had a firm commitment to purchase anhydrous ammonia pursuant to the terms of a supply contract that were higher than the then current market spot price. As a result, EDC recorded loss provisions for anhydrous ammonia required to be purchased during the remainder of the contract aggregating approximately $2.5 million in 2000. During 2002 and 2001, our Chemical Business also wrote down the carrying value of certain nitrate-based inventories by approximately $.9 million and $.3 million, respectively which is included in cost of sales in the accompanying consolidated statement of income.

17. Property and Business Interruption Insurance Recovery

In 2002, a portion of our subsidiary's chemical plant complex in El Dorado, Arkansas experienced damage from high winds and a likely tornado. Plant management and engineers surveyed the damage which affected the production facilities for ammonium nitrate, certain acid plants, a large cooling tower, and other equipment. The repairs were completed in 2002.

During the repair time, we were not able to produce industrial grade ammonium nitrate until the middle of May 2002. Production of our other products, agricultural grade ammonium nitrate and industrial acids, continued without material interruption. Our property insurance covering the chemical plant entitled us to receive approximate replacement value for the damaged property less as aggregate $1 million deductible. We also had a thirty-day waiting period before our business interruption insurance coverage became effective. During the fourth quarter of 2002, a final settlement of $2.5 million, net of the $1 million deductible, was reached for the property and business interruption insurance claims. The net proceeds relating to our property insurance claim exceeded the cash expenditures for repairs and the depreciated value of the damaged assets. As a result, a net gain relating to property damage of approximately $1.4 million is classified as other income and a business interruption insurance recovery of approximately $.3 million is classified as a reduction of cost of sales in the accompanying consolidated statement of income for 2002.

In 2000, a nitric acid plant ("Baytown Plant") operated by El Dorado Nitric Company ("EDNC"), a subsidiary of ClimaChem and the Company, experienced a mechanical failure resulting in an interruption of production. To supply nitric acid to EDNC's customers during the interruption, EDNC purchased nitric acid produced by a subsidiary of the Company, El Dorado Chemical Company ("EDC"), as well as from third party producers. The repairs to the Baytown Plant were completed in January 2001.

F-57

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

17. Property and Business Interruption Insurance Recovery (continued)

Because EDC increased its production of nitric acid to supply EDNC during the interruption, this increase negatively impacted its capability to produce agricultural products to be sold during 2001 spring season. Therefore we received and recognized a business interruption insurance recovery of approximately $1.6 million during 2001 which is classified as a reduction of cost of sales in the accompanying consolidated statement of income for 2001.

18. Business Combination

On October 31, 2000, we acquired two plants previously owned and operated by LaRoche Industries, Inc. ("LaRoche") for approximately $3 million through an asset purchase agreement involving Orica, USA, who acquired other operating assets of LaRoche. The acquisition by our subsidiaries, which are not subsidiaries of ClimaChem, included inventory, spare parts, precious metals and an operating nitrogen-based products plant in Cherokee, Alabama (the "Cherokee Plant") and the Crystal City Plant which was sold in July 2001. (See Note 15-Gains on Sales of Property and Equipment). The Cherokee Plant, which produces solid and liquid fertilizer products and anhydrous ammonia, had unaudited sales for the nine months ended September 30, 2000 of $30 million. The Cherokee Plant also had an unaudited operating loss before selling, general and administrative expense for the nine months ended September 30, 2000 of $.1 million. On a proforma basis, giving effect to this acquisition as if it occurred on January 1, 2000, we would have reported the following operating results for the year ended December 31, 2000.

18. Business Combination (continued)

	2000
	(unaudited) (in millions, except

	per share amounts)
Net sales	$ 311.9
Income from continuing operations	$ 7.9
Basic:	
Income per share from continuing operations applicable to common stock	$ ..44
Diluted:	
Income per share from continuing operations applicable to common stock	$ ..43

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

19. Segment Information

Factors used by Management to Identify the Enterprise's Reportable Segments and Measurement of Segment Profit or Loss and Segment Assets

We have two continuing reportable segments: the Chemical Business and Climate Control Business. Our reportable segments are based on business units that offer similar products and services. The reportable segments are each managed separately because they manufacture and distribute distinct products with different production processes.

We evaluate performance and allocate resources based on operating profit or loss. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies.

Description of each Reportable Segment

Chemical

This segment manufactures and sells fertilizer grade ammonium nitrate, urea ammonium nitrate and anhydrous ammonia for agricultural applications, industrial grade ammonium nitrate and solutions for the mining industry and concentrated, blended and regular nitric acid, metallurgical grade ammonia, anhydrous ammonia and sulfuric acid for commercial and industrial applications. Our primary manufacturing facilities are located in El Dorado, Arkansas, Baytown, Texas and Cherokee, Alabama. Sales to customers of this segment primarily include farmers, ranchers and dealers in the Central, South Central and Southeast regions of the United States, explosive manufacturers in the United States and commercial and industrial users of acids in the Southern and Eastern regions of the United States. In addition to the industrial grade ammonium nitrate products, EDC's Arkansas plant has manufacturing capacity for approximately 250,000 tons per year of agricultural grade ammonium nitrate products, 90,000 tons per year of concentrated nitric acid, and 100,000 tons per year of sulfuric acid.

The Chemical Business is subject to various federal, state and local environmental regulations. Although we have designed policies and procedures to help reduce or minimize the likelihood of significant chemical accidents and/or environmental contamination, there can be no assurances that we will not sustain a significant future operating loss related thereto.

Climate Control

This business segment manufactures and sells, primarily from its various facilities in Oklahoma City, a variety of hydronic fan coil, water source heat pump products and other HVAC products for use in commercial and residential air conditioning and heating systems. Our various facilities in Oklahoma City comprise substantially all of the Climate Control segment's operations. Sales to customers of this segment primarily include original equipment manufacturers, contractors and independent sales representatives located throughout the world.

19. Segment Information (continued)

Information about our continuing operations in different industry segments for each of the three years in the period ended December 31, 2002 is detailed below.

	2002	2001	2000
		(In Thousands)	
Net sales:			
Chemical:			
Agricultural Products	$ 58,397	$ 60,742	$ 40,671
Mining Products	37,290	54,944	33,727
Industrial Acids	55,671	54,406	57,289
Total Chemical	151,358	170,092	131,687
Climate Control:			
Water source heat pumps	57,663	61,134	54,242
Hydronic fan coils	56,020	61,397	61,111
Other HVAC products	14,445	15,904	15,221
Total Climate Control	128,128	138,435	130,574
Other	4,325	6,415	10,407
	$ 283,811	$ 314,942	$ 272,668
Gross profit:			
Chemical	$ 6,911	$ 11,007	$ 9,287
Climate Control	37,454	37,890	34,475
Other	1,332	1,877	2,839
	$ 45,697	$ 50,774	$ 46,601
Operating profit (loss):			
Chemical	$ 500	$ 3,702	$ (367)
Climate Control	14,705	12,500	10,961
	15,205	16,202	10,594
General corporate expenses and other business operations, net	(5,950)	(7,358)	(4,524)
Interest expense	(7,590)	(13,338)	(14,707)
Gains on sales of property and equipment	47	6,615	-
Gains on extinguishment of debt	1,458	2,631	20,086
Benefit from termination of (provision for loss on) firm sales and purchase commitments - Chemical	(414)	2,688	(3,395)
Income from continuing operations before provision for income taxes and cumulative effect of accounting change	$ 2,756	$ 7,440	$ 8,054

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

19. Segment Information (continued)

	2002	2001	2000
		(In Thousands)	
Depreciation of property, plant and equipment:			
Chemical	$ 6,966	$ 6,601	$ 6,172
Climate Control	2,317	2,421	2,174
Corporate assets and other	214	671	463
Total depreciation of property, plant and equipment	$ 9,497	$ 9,693	$ 8,809
Additions to property, plant and equipment:			
Chemical	$ 9,315	$ 4,639	$ 3,807
Climate Control	652	1,144	3,180
Corporate assets and other	62	57	365
Total additions to property, plant and equipment	$ 10,029	$ 5,840	$ 7,352
Total assets:			
Chemical	$ 93,017	$ 94,764	$ 102,741
Climate Control	52,438	61,682	66,101
Corporate assets and other	16,808	14,068	17,707
Discontinued operations	-	9,010	6,931
Total assets	$ 162,263	$ 179,524	$ 193,480

Net sales by industry segment include net sales to unaffiliated customers as reported in the consolidated financial statements. Intersegment net sales, which are accounted for at transfer prices ranging from the cost of producing or acquiring the product or service to normal prices to unaffiliated customers, are not significant.

Gross profit by industry segment represents net sales less cost of sales. Operating profit (loss) by industry segment represents operating income plus other income and other expense (all as reported in the consolidated financial statements) plus general corporate expenses and other business operations, net. In computing operating profit (loss) from continuing operations, none of the following items have been added or deducted: general corporate expenses and other business operations, interest expense, gains on sales of property and equipment, gains on extinguishment of debt, benefit from termination of (provision for loss on) firm sales and purchase commitments, income taxes, results from discontinued operations or cumulative effect of accounting change.

F-61

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

19. Segment Information (continued)

Identifiable assets by industry segment are those assets used in the operations of each industry. Corporate assets are those principally owned by the parent company or by subsidiaries not involved in the three identified industries.

Information about our domestic and foreign operations from continuing operations for each of the three years in the period ended December 31, 2002 is detailed below:

Geographic Region	2002	2001 (In Thousands)	2000
Net sales:			
Domestic	$ 282,550	$ 311,881	$ 265,964
Foreign	1,261	3,061	6,704
	$ 283,811	$ 314,942	$ 272,668
Income (loss) from continuing operations before provision for income taxes and cumulative effect of accounting change:			
Domestic	$ 2,742	$ 7,511	$ 8,386
Foreign	14	(71)	(332)
	$ 2,756	$ 7,440	$ 8,054
Long-lived assets:			
Domestic	$ 73,585	$ 73,280	$ 78,811
Foreign	3	2	2
	$ 73,588	$ 73,282	$ 78,813

F-62

LSB Industries, Inc.

Notes to Consolidated Financial Statements (continued)

19. Segment Information (continued)

Net sales by geographic region include net sales to unaffiliated customers, as reported in the consolidated financial statements. Net sales earned from sales or transfers between affiliates in different geographic regions are shown as net sales of the transferring region and are eliminated in consolidation.

Net sales to unaffiliated customers include foreign export sales as follows:

Geographic Area	2002	2001 (In Thousands)	2000
Canada	$ 5,910	$ 6,479	$ 5,083
Middle East	1,921	1,609	3,697
Mexico, Central and South America	1,280	449	493
Other	2,237	3,804	3,503
	$ 11,348	$ 12,341	$ 12,776

Major Customer

Net sales to one customer, Bayer Corporation ("Bayer") of our Chemical Business segment represented approximately 10%, 10% and 14% of our total net sales for 2002, 2001 and 2000, respectively. As discussed in Note 12 - Commitments and Contingencies, under the terms of the Bayer Agreement, Bayer will purchase, from one of our subsidiaries, all of its requirements for nitric acid to be used at the Baytown, Texas facility for an initial ten-year term ending May 2009.

LSB Industries, Inc.

Supplementary Financial Data

Quarterly Financial Data (Unaudited)

(In Thousands, Except Per Share Amounts)

	Three months ended			
	March 31	June 30	September 30	December 31
2002				
Net sales	$ 67,920	$ 80,873	$ 69,443	$ 65,575
Gross profit	$ 12,015	$ 13,412	$ 10,714	$ 9,556
Income (loss) from continuing operations before cumulative effect of accounting change	$ (25)	$ 751	$ (683)	$ 2,657
Income (loss) from discontinued operations, net	(1,059)	(1,424)	(2,027)	1,049
Cumulative effect of accounting change	860	-	-	-
Net income (loss)	$ (224)	$ (673)	$ (2,710)	$ 3,706
Net income (loss) applicable to common stock	$ (791)	$ (1,240)	$ (3,277)	$ 3,080
Income (loss) per common share:				
Basic:				
Income (loss) from continuing operations before cumulative effect of accounting change	$ (.05)	$ ..02	$ (.10)	$ ..16
Income (loss) from discontinued operations, net	(.09)	(.12)	(.17)	.09
Cumulative effect of accounting change	.07	-	-	-
Net income (loss) applicable to common stock	$ (.07)	$ (.10)	$ (.27)	$ .25
Diluted:				
Income (loss) from continuing operations before cumulative effect of accounting change	$ (.05)	$ ..02	$ (.10)	$ ..16
Income (loss) from discontinued operation, net	(.09)	(.12)	(.17)	.06
Cumulative effect of accounting change	.07	-	-	-
Net income (loss) applicable to common stock	$ (.07)	$ (.10)	$ (.27)	$ .22
2001				
Net sales	$ 81,432	$ 92,253	$ 71,348	$ 69,909
Gross profit	$ 13,061	$ 17,327	$ 8,861	$ 11,525
Income (loss) from continuing operations	$ (1,265)	$ 4,675	$ 409	$ 3,511
Income from discontinued operations, net	172	558	324	173
Net income (loss)	$ (1,093)	$ 5,233	$ 733	$ 3,684
Net income (loss) applicable to common stock	$ (1,660)	$ 4,666	$ 166	$ 3,118

Income (loss) per common share:								
Basic:								
Income (loss) from continuing operations	$	(.15)	$	.34	$	(.02)	$	.25
Income from discontinued operations, net		.01		.05		.03		.01
Net income (loss) applicable to common stock	$	(.14)	$	.39	$	.01	$	.26
Diluted:								
Income (loss) from continuing operations	$	(.15)	$	.29	$	(.02)	$	.22
Income from discontinued operations, net		.01		.04		.03		.01
Net income (loss) applicable to common stock	$	(.14)	$	.33	$	.01	$	.23

LSB Industries, Inc.

Supplementary Financial Data

Quarterly Financial Data (Unaudited) (continued)

In the first quarter of 2002, we adopted SFAS 142 and recognized $.9 million of negative goodwill as a cumulative effect of accounting change.

We recorded a benefit from termination of firm purchase commitments of $.2 million and $.1 million in the first and second quarters of 2002, respectively, compared to $2.3 million and $.4 million in the second and fourth quarters of 2001, respectively. We also recorded a provision for loss on firm sales commitments of $.7 million in the fourth quarter of 2002.

During the second quarter of 2002, we received approximately $.5 million from a supplier of anhydrous ammonia relating to excess pipeline charges previously billed to us compared to $1.2 million from another supplier during the fourth quarter of 2001. These amounts are classified as reductions of cost of sales.

During the third quarter of 2002, we wrote down the carrying value of certain nitrate-based inventories by approximately $.9 million compared to $.7 million during the third quarter of 2001.

During the second quarter of 2002, we repurchased certain Senior Unsecured Notes using the proceeds from a Financing Agreement which was accounted for as a voluntary debt restructuring. As a result, all future interest expense associated with the Financing Agreement indebtedness was recognized against the implied gain on the transaction.

During the second quarter of 2002, due to certain alleged violations of explosives storage and related regulations, the government regulator, the Bureau of Alcohol, Tabacco and Firearms ("BATF"), issued an order revoking the manufacturing license of one of our subsidiaries Slurry Explosive Corporation ("SEC") for its Hallowell, Kansas Facility to produce certain mining products and confiscated certain high explosives inventory. SEC continued to manufacture certain non-explosive products. At the end of the third quarter of 2002, another subsidiary of the ours ("UTeC") obtained a manufacturing license from the BATF for the Hallowell, Kansas Facility. The manufacturing of certain mining products resumed in the fourth quarter of 2002 until the sale of all of the operating assets of SEC and UTeC in December 2002 by which we recognized a gain on disposal of $1.6 million. The operations of SEC and UTeC are reflected as discontinued operations for all periods presented.

On April 8, 2002, a portion of our subsidiary's chemical plant complex in El Dorado, Arkansas experienced damage from high winds and a likely tornado. Plant management and engineers surveyed the damage which affected the production facilities for ammonium nitrate, certain acid plants, a large cooling tower, and other equipment. During the repair time, we were not able to produce industrial grade ammonium nitrate until the middle of May 2002. Production of our other products, agricultural grade ammonium nitrate and industrial acids, continued without

F-65

material interruption. Our property insurance covering the chemical plant entitles us to receive approximate replacement value for the damaged property less an aggregate $1 million deductible. We also had a thirty-day waiting period before our business interruption insurance coverage became effective. During the fourth quarter of 2002, a final settlement of $2.5 million, net of the $1 million deductible, was reached for the property and business interruption insurance claims. The net proceeds relating to our property insurance claim exceeded the cash expenditures for repairs and the depreciated value of the damaged assets. As a result, a net gain relating to property damage of approximately $1.4 million is classified as other income and a business interruption insurance recovery of approximately $.3 million is classified as a reduction of cost of sales.

During the fourth quarter of 2002, approximately $3.5 million of the sales proceeds of SEC and UTeC's assets as discussed above were used as a prepayment on borrowings under a Financing Agreement discussed above. Due to this prepayment, we recognized a gain on extinguishment of debt of $1.5 million. During the third quarter of 2001, we repurchased $4.5 million of Senior Unsecured Notes and recognized a gain of $2.6 million.

In the third quarter of 2001, we sold certain property and equipment including a chemical plant site located at Crystal City, Missouri and recognized a gain of approximately $3.3 million. In the fourth quarter of 2001, we also sold certain property and equipment including a significant portion of our distribution business of mining products and recognized a gain of approximately $2.7 million.

F-66

LSB Industries, Inc.

Schedule II - Valuation and Qualifying Accounts

Years ended December 31, 2002, 2001 and 2000

(Dollars in Thousands)

Description	Balance at Beginning of Year	Additions Charges (Recoveries) to Costs and Expenses	Deductions Write-offs/ Costs Incurred	Balance at End of Year
Accounts receivable - allowance for doubtful accounts (1):				
2002	$ 1,980	$ 618	$ 193	$ 2,405
2001	$ 2,469	$ 128	$ 617	$ 1,980
2000	$ 1,132	$ 1,947	$ 610	$ 2,469
Inventory-reserve for slow-moving items (1):				
2002	$ 1,232	$ 350	$ 321	$ 1,261
2001	$ 1,291	$ 60	$ 119	$ 1,232
2000	$ 1,450	$ -	$ 159	$ 1,291
Notes receivable-allowance for doubtful accounts (1):				
2002	$ 13,655	$ -	$ -	$ 13,655
2001	$ 13,787	$ -	$ 132	$ 13,655

2000	$ 15,414	$ 1,001 (2)	$ 2,628	$ 13,787

LSB Industries, Inc.

Schedule II - Valuation and Qualifying Accounts (continued)

Years ended December 31, 2002, 2001 and 2000

(Dollars in Thousands)

Description	Balance at Beginning of Year	Additions Charges (Recoveries) to Costs and Expenses	Deductions Write-offs/ Costs Incurred	Balance at End of Year
Accrual for plant turnaround:				
2002	$ 1,742	$ 2,861	$ 2,717	$ 1,886
2001	$ 1,848	$ 2,946	$ 3,052	$ 1,742
2000	$ 1,299	$ 1,922	$ 1,373	$ 1,848

(1) Deducted in the balance sheet from the related assets to which the reserve applies.

(2) Amount includes $2.6 million in allowance for the notes received from DLT related to the debt guarantees that we were required to fund and is included in loss on discontinued operations.

Other valuation and qualifying accounts are detailed in our notes to consolidated Financial statements.

(a)(3) Exhibits

2.1. Stock Purchase Agreement and Stock Pledge Agreement between Dr. Hauri AG, a Swiss Corporation, and LSB Chemical Corp., which the Company hereby incorporates by reference from Exhibit 2.2 to the Company's Form 10-K for fiscal year ended December 31, 1994.

3.1. Restated Certificate of Incorporation, the Certificate of Designation dated February 17, 1989, and certificate of Elimination dated April 30, 1993, which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Registration Statement, No. 33-61640; Certificate of Designation for the Company's $3.25 Convertible Exchangeable Class C Preferred Stock, Series 2, which the Company hereby incorporates by reference from Exhibit 4.6 to the Company's Registration Statement, No. 33-61640.

3.2. Bylaws, as amended, which the Company hereby incorporates by reference from Exhibit 3(ii) to the Company's Form 10-Q for the quarter ended June 30, 1998.

4.1. Specimen Certificate for the Company's Non-cumulative Preferred Stock, having a par value of $100 per share, which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 10-Q for the quarter ended June 30, 1983.

4.2. Specimen Certificate for the Company's Series B Preferred Stock, having a par value of $100 per share, which the Company hereby incorporates by reference from Exhibit 4.27 to the Company's Registration Statement No. 33-9848.

4.3. Specimen Certificate for the Company's Series 2 Preferred, which the Company hereby incorporates by reference from Exhibit 4.5 to the Company's Registration Statement No. 33-61640.

4.4. Specimen Certificate for the Company's Common Stock, which the Company incorporates by reference from Exhibit 4.4 to the Company's Registration Statement No. 33-61640.

4.5. Renewed Rights Agreement, dated January 6, 1999, between the Company and Bank One, N.A., which the Company hereby incorporates by reference from Exhibit No. 1 to the Company's Form 8-A Registration Statement, dated January 27, 1999.

4.6. Indenture, dated as of November 26, 1997, by and among ClimaChem, Inc., the Subsidiary Guarantors and Bank One, NA, as trustee, which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 8-K, dated November 26, 1997.

4.7. Form of 10 3/4% Series B Senior Notes due 2007 which the Company hereby incorporates by reference from Exhibit 4.3 to the ClimaChem Registration Statement, No. 333-44905.

4.8. First Supplemental Indenture, dated February 8, 1999, by and among ClimaChem, Inc., the Guarantors, and Bank One N.A., which the Company hereby incorporates by reference from Exhibit 4.19 to the Company's Form 10-K for the year ended December 31, 1998.

F-69

4.9. Second Amended and Restated Loan and Security Agreement dated May 10, 1999, by and between Bank of America National Trust and Savings Association and LSB Industries, Inc., Summit Machine Tool Manufacturing Corp., and Morey Machinery Manufacturing Corporation, which the Company hereby incorporates by reference from Exhibit 4.2 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1999.

4.10. Specimen of Certificate of Series D 6% Cumulative, Convertible Class C Preferred Stock which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2001.

4.11. Second Amendment to Loan and Security Agreement, dated May 24, 2002, by and among the Company, LSB, certain subsidiaries of the Company, Foothill Capital Corporation ("Foothill") and Congress Financial Corporation (Southwest), which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 8-K, dated May 24, 2002. Omitted are exhibits and schedules attached thereto. The Agreement contains a list of such exhibits and schedules, which the Company agrees to file with the Commission supplementally upon the Commission's request.

4.12. Securities Purchase Agreement, dated May 24, 2002 ("Agreement"), which the Company hereby incorporates by reference from Exhibit 4.2 to the Company's Form 8-K, dated May 24, 2002. Omitted are exhibits and schedules attached thereto. The Agreement contains a list of such exhibits and schedules, which the Company agrees to file with the Commission supplementally upon the Commission's request.

4.13. Fifth Supplemental Indenture, dated May 24, 2002, among the Company, the Guarantors, and Bank One, N.A, which the Company hereby incorporates by reference from Exhibit 4.3 to the Company's Form 8-K, dated May 24, 2002.

4.14. Promissory Note, dated May 24, 2002, granted by the Company in favor of one of the Lenders in the original principal amount of $7,786,927, which the Company hereby incorporates by reference from Exhibit 4.4 to the

Company's Form 8-K, dated May 24, 2002. Substantially similar Promissory Notes, dated May 24, 2002, were granted by the Company to each of the other Lenders in the original principal amount indicated: (a) a Promissory Note granted in favor of one Lender in the original principal amount of $3,478,410, (b) two Promissory Notes granted in favor of a Lender in the original aggregate principal amount of $20,000,000, (c) a Promissory Note granted in favor of a Lender in the original principal amount of $3,734,663. Copies of these Promissory Notes will be provided to the Commission upon request.

4.15. Letter, dated July 10, 2002, to document certain items not reflected in the Securities Purchase Agreement which the Company hereby incorporates by reference from Exhibit 4.5 to the Company's Form 10-Q for the fiscal quarter ended June 30, 2002.

4.16. Third Amendment, dated as of November 18, 2002, to the Loan and Security Agreement dated as of April 13, 2001, as amended by the First Amendment dated as of August 3, 2001 and the second Amendment dated as of May 24, 2002, by and among LSB Industries, Inc., ClimaChem, Inc., and certain subsidiaries of ClimaChem, Congress Financial Corporation

(Southwest) and Foothill Capital Corporation which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2002.

4.17. Second Amendment to Securities Purchase Agreement, dated February 28, 2003 by and among ClimaChem, Inc. and certain of its subsidiaries, the Purchasers and Guggenheim Investment Management, LLC.

4.18. Fourth Amendment, dated as of March 3, 2003, to the Loan and Security Agreement dated as of April 13, 2001, as amended by the First, Second, and Third Amendments, by and among LSB Industries, Inc., ClimaChem, Inc., and certain subsidiaries of ClimaChem, Inc., Congress Financial Corporation (Southwest) and Foothill Capital Corporation.

4.19 Letter, dated March 3, 2003, to document the consent to increase capital expenditures, as defined in the Securities Purchase Agreement.

10.1. Form of Death Benefit Plan Agreement between the Company and the employees covered under the plan, which the Company hereby incorporates by reference from Exhibit 10(c) (1) to the Company's Form 10-K for the year ended December 31, 1980.

10.2. The Company's 1993 Stock Option and Incentive Plan which the Company hereby incorporates by reference from Exhibit 10.6 to the Company's Form 10-K for the fiscal year ended December 31, 1993.

10.3. The Company's 1993 Non-employee Director Stock Option Plan which the Company hereby incorporates by reference from Exhibit 10.7 to the Company's Form 10-K for the fiscal year ended December 31, 1993.

10.4. Limited Partnership Agreement dated as of May 4, 1995, between the general partner, and LSB Holdings, Inc., an Oklahoma Corporation, as limited partner which the Company hereby incorporates by reference from Exhibit 10.11 to the Company's Form 10-K for the fiscal year ended December 31, 1995.

10.5. Severance Agreement, dated January 17, 1989, between the Company and Jack E. Golsen, which the Company hereby incorporates by reference from Exhibit 10.48 to the Company's Form 10-K for fiscal year ended December 31, 1988. The Company also entered into identical agreements with Tony M. Shelby, David R. Goss, Barry H. Golsen, David M. Shear, and Jim D. Jones and the Company will provide copies thereof to the Commission upon request.

10.6. Employment Agreement and Amendment to Severance Agreement dated January 12, 1989 between the Company and Jack E. Golsen, dated March 21, 1996 which the Company hereby incorporates by reference from Exhibit 10.15 to the Company's Form 10-K for fiscal year ended December 31, 1995.

10.7. First Amendment to Non-Qualified Stock Option Agreement, dated March 2, 1994, and Second Amendment to Stock Option Agreement, dated April 3, 1995, each between the

Company and Jack E. Golsen, which the Company hereby incorporates by reference from Exhibit 10.1 to the Company's Form 10-Q for the fiscal quarter ended March 31, 1995.

10.8. Baytown Nitric Acid Project and Supply Agreement dated June 27, 1997, by and among El Dorado Nitrogen Company, El Dorado Chemical Company and Bayer Corporation which the Company hereby incorporates by reference from Exhibit 10.2 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #5551, DATED SEPTEMBER 25, 1997, GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.

10.9. First Amendment to Baytown Nitric Acid Project and Supply Agreement, dated February 1, 1999, between El Dorado Nitrogen Company and Bayer Corporation, which the Company hereby incorporates by reference from Exhibit 10.30 to the Company's Form 10-K for the year ended December 31, 1998. CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #7927, DATED JUNE 9, 1999, GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.

10.10. Service Agreement, dated June 27, 1997, between Bayer Corporation and El Dorado Nitrogen Company which the0 Company hereby incorporates by reference from Exhibit 10.3 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #5551, DATED SEPTEMBER 25, 1997, GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.

10.11. Ground Lease dated June 27, 1997, between Bayer Corporation and El Dorado Nitrogen Company which the Companyhereby incorporates by reference from Exhibit 10.4 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #5551, DATED SEPTEMBER 25, 1997, GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.

10.12. Participation Agreement, dated as of June 27, 1997, among El Dorado Nitrogen Company, Boatmen's Trust Company of Texas as Owner Trustee, Security Pacific Leasing Corporation, as Owner Participant and a Construction Lender, Wilmington Trust Company, Bayerische Landes Bank, New York Branch, as a Construction Lender and the Note Purchaser, and Bank of America National Trust and Savings Association, as Construction Loan Agent which the Company hereby incorporates by reference from Exhibit 10.5 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #5551, DATED SEPTEMBER 25, 1997, GRANTING A REQUEST FOR CONFIDENTIAL

TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.

10.13. Lease Agreement, dated as of June 27, 1997, between Boatmen's Trust Company of Texas as Owner Trustee and El Dorado Nitrogen Company which the Company hereby incorporates by reference from Exhibit 10.6 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997.

10.14. Security Agreement and Collateral Assignment of Construction Documents, dated as of June 27, 1997, made by El Dorado Nitrogen Company which the Company hereby incorporates by reference from Exhibit 10.7 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997.

10.15. Security Agreement and Collateral Assignment of Facility Documents, dated as of June 27, 1997, made by El Dorado Nitrogen Company and consented to by Bayer Corporation which the Company hereby incorporates by reference from Exhibit 10.8 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997.

10.16. Non-Qualified Stock Option Agreement, dated April 22, 1998, between the Company and Robert C. Brown, M.D. The Company entered into substantially identical agreements with Bernard G. Ille, Raymond B. Ackerman, Horace G. Rhodes, and Donald W. Munson. The Company will provide copies of these agreements to the Commission upon request.

10.17. The Company's 1998 Stock Option and Incentive Plan, which the Company hereby incorporates by reference from Exhibit 10.44 to the Company's Form 10-K for the year ended December 31, 1998.

10.18. Letter Agreement, dated March 12, 1999, between Kestrel Aircraft Company and LSB Industries, Inc., Prime Financial Corporation, Herman Meinders, Carlan K. Yates, Larry H. Lemon, Co-Trustee Larry H. Lemon Living Trust, which the Company hereby incorporates by reference from Exhibit 10.45 to the Company's Form 10-K for the year ended December 31, 1998.

10.19. LSB Industries, Inc. 1998 Stock Option and Incentive Plan which the Company hereby incorporates by reference from Exhibit "B" to the LSB Proxy Statement, dated May 24, 1999, for Annual Meeting of Stockholders.

10.20. LSB Industries, Inc. Outside Directors Stock Option Plan which the Company hereby incorporates by reference from Exhibit "C" to the LSB Proxy Statement, dated May 24, 1999, for Annual Meeting of Stockholders.

10.21. First Amendment to Second Amended and Restated Loan and Security Agreement, dated January 1, 2000, by and between Bank of America, N.A. and LSB Industries, Inc., Summit Machine Tool Manufacturing Corp., and Morey Machinery Manufacturing Corporation, which the Company hereby incorporates by reference from Exhibit 10.3 to the Company's Form 8-K dated December 30, 1999.

10.22. Second Amendment to Second Amended and Restated Loan and Security Agreement, dated March 1, 2000 by and between Bank of America, N.A. and LSB Industries Inc., Summit Machine Tool Manufacturing Corp., and Morey Machinery Manufacturing Corporation, which the Company hereby incorporates by reference from Exhibit 10.3 to the Company's Form 8-K dated March 1, 2000.

10.23. Third Amendment to Second Amended and Restated Loan and Security Agreement, dated March 31, 2000 by and between Bank of America, N.A. and LSB Industries Inc., Summit Machine Tool Manufacturing Corp., and Morey Machinery Manufacturing Corporation, which the Company hereby incorporates by reference from Exhibit 10.14 to the Company's Form 10-Q for the fiscal quarter ended March 31, 2000.

10.24. Loan Agreement dated December 23, 1999 between Climate Craft, Inc. and the City of Oklahoma City, which the Company hereby incorporates by reference from Exhibit 10.49 to the Company's Amendment No. 2 to its 1999 Form 10-K.

10.25. Letter, dated April 1, 2000, executed by SBL to Prime amending the Promissory Note, which the Company incorporates by reference from Exhibit 10.52 to the Company's Amendment No. 2 to its 1999 Form 10-K.

10.26. Fourth Amendment to Second Amended and Restated Loan and Security Agreement dated October 10, 2000 by and between Bank of America, N.A. and LSB Industries, Inc., Summit Machine Tool Manufacturing Corp., and Morey Machinery Manufacturing Corporation, which the Company hereby incorporates by reference from Exhibit 10.2 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2000.

10.27. Letter Agreement, dated August 23, 2000, between LSB Chemical Corp. and Orica USA, Inc., which the Company hereby incorporates by reference from Exhibit 10.4 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2000. CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #10714, DATED FEBRUARY 21, 2001 GRANTING A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.

10.28. Agreement, dated October 31, 2000, between Orica Nitrogen, L.L.C., Orica USA, Inc., and LSB Chemical Corp., which the Company hereby incorporates by reference from Exhibit 10.5 to the Company's Form 10-Q for the fiscal quarter ended September 20, 2000. CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #10714, DATED FEBRUARY 21, 2001 GRANTING A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.

10.29. Letter, dated April 1, 2001, executed by SBL to Prime amending the Promissory Note, which the Company hereby incorporates by reference from Exhibit 10.55 to the Company's Form 10-K for the fiscal year ended December 31, 2000.

F-74

10.30. Agreement, dated April 2, 2001, between Crystal City Nitrogen Company and River Cement Company, which the Company hereby incorporates by reference from Exhibit 10.57 to the Company's Form 10-K for the fiscal year ended December 31, 2000.

10.31. Assignment, dated May 8, 2001, between Climate Master, Inc. and Prime Financial Corporation, which the Company hereby incorporates by reference from Exhibit 10.2 to the Company's Form 10-Q for the fiscal quarter ended March 31, 2001.

10.32. Agreement for Purchase and Sale, dated April 10, 2001, by and between Prime Financial Corporation and Raptor Master, L.L.C. which the Company hereby incorporates by reference from Exhibit 10.3 to the Company's Form 10-Q for the fiscal quarter ended March 31, 2001.

10.33. Amended and Restated Lease Agreement, dated May 8, 2001, between Raptor Master, L.L.C. and Climate Master, Inc. which the Company hereby incorporates by reference from Exhibit 10.4 to the Company's Form 10-Q for the fiscal quarter ended March 31, 2001.

10.34. Option Agreement, dated May 8, 2001, between Raptor Master, L.L.C.and Climate Master, Inc., which the Company hereby incorporates by reference from Exhibit 10.5 to the Company's Form 10-Q for the fiscal quarter ended March 31, 2001.

10.35. Stock Purchase Agreement, dated September 30, 2001, by and between Summit Machinery Company and SBL Corporation, which the Company hereby incorporates by reference from Exhibit 10.1 to the Company' Form 10-Q for the fiscal quarter ended September 30, 2001.

10.36. Agreement, dated October 18, 2001, by and between LSB Industries, Inc., Prime Financial Corporation, and SBL Corporation, which the Company hereby incorporates by reference from Exhibit 10.2 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2001.

10.37. Certificate of Designations of LSB Industries, Inc., relating to the issuance of a new series of Class C Preferred Stock, which the Company hereby incorporates by reference form Exhibit 10.3 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2001.

10.38. Asset Purchase Agreement, dated October 22, 2001, between Orica USA, Inc. and El Dorado Chemical Company and Northwest Financial Corporation, which the Company hereby incorporates by reference from Exhibit 99.1 to the Company's Form 8-K dated December 28, 2001. CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST.

10.39. AN Supply Agreement, dated November 1, 2001, between Orica USA, Inc. and El Dorado Company, which the Company hereby incorporates by reference from Exhibit 99.2 to the

Company's Form 8-K dated December 28, 2001. CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST.

10.40. Ammonium Nitrate Sales Agreement between Nelson Brothers, L.L.C. and Cherokee Nitrogen Company, which the Company hereby incorporates by reference from Exhibit 99.3 to the Company's Form 8-K dated December 28, 2001. CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST.

10.41 Loan and Security Agreement, dated April 13, 2001 by and among LSB Industries, Inc., ClimaChem and each of its Subsidiaries that are Signatories, the Lenders that are Signatories and Foothill Capital Corporation, which the Company hereby incorporates by reference from Exhibit 10.51 to ClimaChem, Inc.'s amendment No. 1 to Form 10-K for the year ended December 31, 2000.

10.42. Agreement, dated August 4, 2001, between El Dorado Chemical Company and Paper, Allied-Industrial, Chemical and Energy Workers International Union AFL-C10 and its Local 5-434, which the Company hereby incorporates by reference from Exhibit 10.65 to the Company's Form 10-K for the year ended December 31, 2001.

10.43. Agreement, dated October 16, 2001, between El Dorado Chemical Company and International Association of Machinists and Aerospace Workers, AFL-C10 Local No. 224, which the Company hereby incorporates by reference from Exhibit 10.66 to the Company's Form 10-K for the year ended December 31, 2001.

10.44. First Amendment to Third Amended and Restated Loan and Security Agreement, dated March 29, 2002, entered into by and between Bank of America, N.A. and Summit Machine Tool Manufacturing Corp, which the Company hereby incorporates by reference from Exhibit 10.67 to the Company's Form 10-K for the year ended December 31, 2001.

10.45. Warrant, dated May 24, 2002, granted by the Company to a Lender for the right to purchase up to 132,508 shares of the Company's common stock at an exercise price of $0.10 per share, which the Company hereby incorporates by reference from Exhibit 99.1 to the Company's Form 8-K, dated May 24, 2002. Four substantially similar Warrants, dated May 24, 2002, for the purchase of an aggregate additional 463,077 shares at an exercise price of $0.10 were issued. Copies of these Warrants will be provided to the Commission upon request.

10.46. Intercreditor Agreement, which the Company hereby incorporates by reference from Exhibit 99.2 to the Company's Form 8-K, dated May 24, 2002.

10.47. 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, which the Company hereby incorporates by reference from Exhibit 2.1 to the Company's Form 8-K, dated December 12, 2002. The asset purchase agreement contains a brief list identifying all schedules and exhibits to the asset purchase agreement. Such schedules and exhibits are not filed herewith, and the Registrant agrees to furnish supplementally a copy of the omitted schedules and exhibits to the commission upon request.

10.48. Anhydrous Ammonia Sales Agreement, dated December 9, 2002, between Koch Nitrogen Company and El Dorado Chemical Company. CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST.

10.49. Registration Rights Agreement, dated March 25, 2003, among LSB Industries, Inc., Kent C. McCarthy, Jayhawk Capital management, L.L.C., Jayhawk Investments, L.P. and Jayhawk Institutioal Partners, L.P.

10.50. Subscription Agreement, dated March 25, 2003, by and between LSB Industries, Inc. and Jayhawk Institutional Partners, L.P.

10.51. Warrant Agreement, dated March 25, 2003, between LSB Industries, Inc. and Jayhawk Institutional Partners, L.P.

21.1 Subsidiaries of the Company.

23.1. Consent of Independent Auditors.

99.1 Certification of Jack E. Golsen, Chief Executive Officer, pursuant to 18 U.S.C. Section 1350. A signed original of this written statement required by Section 906 has been provided to LSB Industries, Inc. and will be retained by LSB Industries, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

99.2 Certification of Tony M. Shelby, Chief Financial Officer pursuant to 18 U.S.C. Section 1350. A signed original of this written statement required by Section 906 has been provided to LSB Industries, Inc. and will be retained by LSB Industries, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

(b) REPORTS ON FORM 8-K. The Company filed the following report on Form 8-K during the fourth quarter of 2002.

F-77

(i) Form 8-K, dated December 27, 2002. (date of earliest event: December 12, 2002). The item reported was Item 2, "Acquisition or Disposition of Assets", discussing the sale of all of the operating assets of Slurry Explosive Corporation and Universal Tech Corporation to four wholly owned subsidiaries of Energetic Systems Inc., LLC pursuant to the terms of an Asset Purchase Agreement, dated December 6, 2002.

F-78

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K/A
AMENDMENT NO. 1

(Mark One)

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

For the fiscal year ended: December 31, 2002

or

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (NO FEE REQUIRED)

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 Incorporation)	(I.R.S. Employer identification No.)

16 South Pennsylvania Avenue
Oklahoma City, Oklahoma 73107
(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: None

Securities Registered Pursuant to Section 12(g) of the Act: Preferred Share Purchase Rights, $3.25 Convertible Exchangeable Class C Preferred Stock, Series 2 and

Title of Each Class	Name of Each Exchange On Which Registered
Common Stock, Par Value $.10	Over-the-Counter Bulletin Board

(Facing Sheet Continued)

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).
YES ___ No X

The aggregate market value of the Registrant's voting common equity held by non-affiliates of the Registrant, based on the last average bid and asked price of the common stock on June 28, 2002, as reported on the Over-the-Counter Bulletin Board, was approximately $23.3 million. For purposes of this computation, shares of the Registrant's common stock beneficially owned by each officer and director and Jayhawk Capital Management, L.L.C. and its affiliates are deemed to be affiliates. Such determination should not be deemed an admission that such officers, directors and such other beneficial owners of our common stock are, in fact, affiliates of the Registrant. In addition, this computation does not include the 1,204 shares of voting Convertible Non-Cumulative Preferred Stock (the "Non-Cumulative Preferred Stock") held by non-affiliates of the Company. An active trading market does not exist for the shares of Non-Cumulative Preferred Stock.

As of March 31, 2003, the Registrant had 12,420,688 shares of common stock outstanding (excluding 3,272,426 shares of common stock held as treasury stock).

Explanatory Note

This Form 10-K/A is being filed as Amendment No. 1 to the Form 10-K of LSB Industries, Inc., filed with the Securities and Exchange Commission on April 2, 2003, for the purpose of providing the information required under Part III, Items 10, 11, 12, and 13, and to correct and update the list of exhibits set forth in Part IV, Item 15. As required by the rules of the Securities and Exchange Commission, this Amendment No. 1 also includes currently dated exhibits 99.1 and 99.2.

-1-

PART III

Item 10.

Directors and Executive Officers of the Company

Directors The Certificate of Incorporation and By-laws of the Company provide for the division of the Board of Directors into three classes, each class consisting as nearly as possible of one-third of the whole. The term of office of one class of directors expires each year, with each class of directors elected for a term of three years and until the shareholders elect their qualified successors.

The Company's By-laws provide that the Board of Directors, by resolution from time to time, may fix the number of directors that shall constitute the whole Board of Directors. The By-laws presently provide that the number of directors may consist of not less than 3 nor more than 12. As of the date of this report, the Board of Directors currently has set the number of directors at 12.

The By-laws of the Company further provide that only persons nominated by or at the direction of: (a) the Board of Directors of the Company, or (b) any stockholder of the Company entitled to vote for the election of the directors that complies with certain notice procedures, shall be eligible for election as a director of the Company. Any stockholder desiring to nominate any person as a director of the Company must give written notice to the Secretary of the Company at the Company's principal executive office not less than 50 days prior to the date of the meeting of stockholders to elect directors; except, if less than 60 day's notice or prior disclosure of the date of such meeting is given to the stockholders, then written notice by the stockholder must be received by the Secretary of the Company not later than the close of business on the 10th day following the day on which such notice of the date of the meeting was mailed or such public disclosure was made. In addition, if the stockholder proposes to nominate any person, the stockholder's written notice to the Company must provide all information relating to such person that the stockholder desires to nominate that is required to be disclosed in solicitation of proxies pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended.

The terms of the $3.25 Convertible Exchangeable Class C Preferred Stock, Series 2 ("Series 2 Preferred") provide that whenever dividends on the Series 2 Preferred are in arrears and unpaid in an amount equal to at least six quarterly dividends: (a) the number of members of the Board of Directors of the Company shall be increased by two effective as of the time of election of such directors; (b) the Company shall, upon the written request of the record holder of 10% of the shares of Series 2 Preferred, call a special meeting of the Preferred Stockholders for the purpose of electing such two additional directors; and (c) the Preferred Stockholders have the exclusive right to vote for and elect such two additional directors.

At the request of Jayhawk Capital Management, L.L.C., a special meeting of the holders of the Series 2 Preferred was held on March 11, 2002 for the purpose of electing the two additional directors to the Company's Board of Directors. At this special meeting, the holders of the Company's Series 2 Preferred elected two new members of the Company's Board of Directors, Dr. Allen Ford and Mr. Grant Donovan, as permitted pursuant to the terms of the Series 2 Preferred. The election of Dr. Ford and Mr. Donovan increased the number of directors from 10 to 12.

-2-

The following table sets forth the name, principal occupation, age, year in which the individual first became a director, and year in which the director's term will expire.

Name and Principal Occupation	First Became a Director	Annual Meeting at which Term Expires	Age
Barry H. Golsen (1) Vice Chairman of the Board of Directors of the Company and President of the Climate Control Business of the Company	1981	2003	52
David R. Goss (2) Senior Vice President of Operations of the Company	1971	2003	62
Robert C. Brown, M.D. (3) President of Northwest Internal Medicine Associates, Inc.	1969	2004	72
Charles A. Burtch (4) Investments	1999	2004	68
Jack E. Golsen (5) President, Chief Executive Officer and Chairman of the Board of Directors of the Company	1969	2004	74
Horace G. Rhodes (6) President/Managing Partner, Kerr, Irvine, Rhodes and Ables	1996	2004	75
Raymond B. Ackerman (7) Chairman Emeritus of Ackerman McQueen, Inc.	1993	2005	80
Bernard G. Ille (8) Investments	1971	2005	76
Donald W. Munson (9) Consultant	1997	2005	70
Tony M. Shelby (10) Senior Vice President of Finance and Chief Financial Officer of the Company	1971	2005	61

Grant J. Donovan (11) President and Founder of Galehead, Inc.	2002	(13)	46

Dr. N. Allen Ford (12) Professor of Accounting at the University of Kansas	2002	(13)	60

(1) Mr. Golsen, L.L.B., has served as Vice Chairman of the Board of the Company since August 1994, and for more than five (5) years has been the President of the Company's Climate Control Business. Mr. Golsen has both his undergraduate and law degrees from the University of Oklahoma.

(2) Mr. Goss, a certified public accountant, is Senior Vice President - Operations of the Company and has served in substantially the same capacity for more than five years. Mr. Goss is a graduate of Rutgers University.

(3) Dr. Brown has practiced medicine for many years and is Vice President and Treasurer of Plaza Medical Group, P.C. Dr. Brown is a graduate of Tufts University and received his medical degree from Tufts University.

(4) Mr. Burtch was formerly Executive Vice-President and West Division Manager of BankAmerica, where he managed BankAmerica's asset-based lending division for the western third of the United States. Mr. Burtch retired in 1998 and has since been engaged as a private investor. He is a graduate of Arizona State University.

(5) Mr. Golsen, founder of the Company, is Chairman of the Board and President of the Company and has served in that capacity since the inception of the Company in 1969. During 1996, Mr. Golsen was inducted into the Oklahoma Commerce and Industry Hall of Honor as one of Oklahoma's leading industrialists. Mr. Golsen has a degree from the University of New Mexico in Biochemistry.

(6) Mr. Rhodes is the Chairman of the law firm of Kerr, Irvine, Rhodes & Ables and has served in such or similar capacity and has practiced law for more than five years. From 1972 until 2001, Mr. Rhodes served as Executive Vice President and General Counsel for the Association of Oklahoma Life Insurance Companies and since 1982 has served as Executive Vice President and General Counsel for the Oklahoma Life and Health Insurance Guaranty Association. Mr. Rhodes received his undergraduate and law degrees from the University of Oklahoma.

(7) From 1972 until his retirement in 1992, Mr. Ackerman served as Chairman of the Board and President of Ackerman, McQueen, Inc., the largest advertising and public relations firm headquartered in Oklahoma. Mr. Ackerman currently serves as Chairman Emeritus of Ackerman, McQueen, Inc. Mr. Ackerman retired as a Rear Admiral from the United States Naval Reserves. Mr. Ackerman is a graduate of Oklahoma City University, and in 1996, he was awarded an honorary doctorate from Oklahoma City University. He was elected to the Oklahoma Hall of Fame in 1993.

(8) Mr. Ille served as President and Chief Executive Officer of First Life Assurance Company from May 1988, until it was acquired by another company in March 1994. For more than five years prior to joining First Life, Mr. Ille served as President of United Founders Life Insurance Company. Mr. Ille is a director of Landmark Land Company, Inc., which was parent company of First Life. Mr. Ille is also a director for Quail Creek Bank, N.A. Mr. Ille is currently President of BML Consultants and a private investor. He is a graduate of the University of Oklahoma.

(9)

From January 1988, until his retirement in August 1992, Mr. Munson served as President and Chief Operating Officer of Lennox Industries. Prior to his election as President and Chief Operating Officer of Lennox Industries, Mr. Munson served as Executive Vice President of Lennox Industries' Division Operations, President of Lennox Canada and Managing Director of Lennox Industries' European Operations. Prior to joining Lennox Industries, Mr. Munson served in various capacities with the Howden Group, a company located in England, and The Trane Company, including serving as the managing director of various companies within the Howden Group and Vice President Europe for The Trane Company. Mr. Munson is currently a consultant and international distributor for the Ducane Company, an equipment manufacturer, and is serving as a member of the Board of Directors of Multi Clima SA, a French manufacturer of air conditioning - heating equipment, which a subsidiary of the Company has an option to acquire. Mr. Munson is a resident of England. Mr. Munson has degrees in mechanical engineering and business administration from the University of Minnesota.

(10) Mr. Shelby, a certified public accountant, is Senior Vice President and Chief Financial Officer of the Company, a position he has held for more than five years. Prior to becoming Senior Vice President and Chief Financial Officer of the Company, Mr. Shelby served as Chief Financial Officer of a subsidiary of the Company and was with the accounting firm of Arthur Young & Co., a predecessor to Ernst & Young, L.L.P. Mr. Shelby is a graduate of Oklahoma City University.

(11) Mr. Donovan, is President and founder of Galehead, Inc. a company specializing on the collections of accounts receivable in the international maritime trade business. Prior to forming Galehead, Inc., Mr. Donovan was a partner in a real estate development firm specializing in revitalizing functionally obsolete industrial buildings. Mr. Donovan received his MBA from Stanford University and his undergraduate degree in Civil Engineering from the University of Vermont. He currently is on the board of directors of EngenderHealth, a 50 year old international aid organization focused on improving women's healthcare.

(12) Dr. Ford joined the University of Kansas in 1976. He received his Ph.D. in Accounting from the University of Arkansas. Dr. Ford's teaching and research duties focus mainly on taxation. At the University of Kansas, Professor Ford has won several teaching awards and is the Larry D. Horner/KPMG Peat Marwick Distinguished Professor of Accounting. Dr. Ford teaches the following courses in taxation: individual, corporate, partnership, S corporation, gift and estate tax. He is active in professional organizations such as the American Taxation Association and the American Accounting Association.

-5-

(13) Mr. Donovan's and Dr. Ford's service as directors began March 11, 2002 upon their election by the holders of the Series 2 Preferred. The terms of the Series 2 Preferred provide that (a) the right of the holders of the Series 2 Preferred to vote for such two additional directors shall terminate, subject to re-vesting in the event of a subsequent similar arrearage, when all cumulative and unpaid dividends on the Series 2 Preferred have been declared and set apart for payment; and (b) pursuant to the terms of the Series 2 Preferred, the term of office will terminate immediately upon the termination of the right of the Series 2 Preferred holders to vote for such two additional directors, subject to the requirements of Delaware law. The Series 2 Preferred holders have the right to remove without cause at any time and replace either of the two directors that the Series 2 Preferred holders have elected.

Family Relationships

Jack E. Golsen is the father of Barry H. Golsen and the brother-in-law of Robert C. Brown, M.D. Robert C. Brown, M.D. is the uncle of Barry H. Golsen.

Executive Officers Certain information with respect to the executive officers of the Company is set forth under Item 4A of Part I hereof.

Section 16(a) Beneficial Ownership Reporting Compliance Based solely on a review of copies of the Forms 3, 4 and 5 and amendments thereto furnished to the Company with respect to 2002, or written representations that no such reports were required to be filed with the Securities and Exchange Commission, the Company believes that during 2002 all directors and officers of the Company and beneficial owners of more than 10% of any class of equity securities of the Company registered pursuant to Section 12 of the Exchange Act filed their required Forms 3, 4, or 5, as required by Section 16(a) of the Securities Exchange Act of 1934, as amended, on a timely basis, except (a) Jayhawk Investments, L.P. filed one late Form 5 to report two transactions during 2002 and one late Form 5 to report 8 transactions during 2001, and (b) Jayhawk Institutional Partners, L.P. filed one late Form 5 to report 11 transactions during 2002.

Item 11. Executive Compensation.

The following table shows the aggregate cash compensation which the Company and its subsidiaries paid or accrued to the Chief Executive Officer and each of the other four most highly-paid executive officers of the Company (which includes the Vice Chairman of the Board who also serves as President of the Company's Climate Control Business). The table includes cash distributed for services rendered during 2002, plus any cash distributed during 2002 for services rendered in a prior year, less any amount relating to those services previously included in the cash compensation table for a prior year.

Summary Compensation Table

		Annual Compensation		Long-term Compensation Awards
Name and Position	Year	Salary ($)	Bonus ($) (1)	Securities Underlying Stock Options
Jack E. Golsen,				
Chairman of the Board,	2002	477,400	-	-
President and Chief	2001	477,400	-	-
Executive Officer	2000	477,400	-	-
Barry H. Golsen	2002	326,600	85,000	-
Vice Chairman of the	2001	326,600	60,000	20,000
Board of Directors	2000	226,600	-	-
And President of the				
Climate Control Business				
David R. Goss,	2002	190,500	75,000	-
Senior Vice	2001	190,500	50,000	15,000
President - Operations	2000	190,500	-	-

Tony M. Shelby	2002	190,500	85,000	-
Senior Vice President/	2001	190,500	100,000	15,000
Chief Financial Officer	2000	190,500	-	-
David M. Shear,	2002	165,000	50,000	-
Vice President/	2001	165,000	50,000	15,000
General Counsel	2000	165,000	-	-

(1) Bonuses are for services rendered for the prior fiscal year.

-7-

Certain Option Grants in 2002

There were no individual grants of stock options made to any of the named executive officers in the above Summary Compensation table during 2002.

Aggregated Option Exercises in 2002
and Fiscal Year End Option Values

The following table sets forth information concerning the number and value of unexercised options held by each of the named executive officers during 2002 and the year-end value of unexercised options.

Name	Shares Acquired On Exercise	Value Realized	Number of Securities Underlying Unexercised Options at FY End (1) Exercisable/Unexercisable	Value of Unexercised In-the-Money Options at Fiscal Year End (1) (2) Exercisable/Unexercisable
Jack E. Golsen	-	-	185,500 / 79,500	$ 279,781 / $119,906
Barry H. Golsen	-	-	112,500 / 62,500	$ 159,583 / $ 68,955
David R. Goss	(3)	$ 2,200	158,000 / 42,000	$ 108 710 / $ 47,340
Tony M. Shelby	(4)	$ 2,200	158,000 / 42,000	$ 108,710 / $ 47,340
David M. Shear	(5)	$ 2,318	137,000 / 42,000	$ 108,710 / $ 47,340

(1) The stock options granted under the Company's stock option plans become exercisable 20% after one year from date of grant, an additional 20% after two years, an additional 30% after three years, and the remaining 30% after four years.

(2) The values are based on the difference between the price of the Company's Common Stock on the Over-the-Counter Bulletin Board at the close of trading on December 31, 2002 of $2.80 per share and the exercise price of such option. The actual value realized by a named executive officer on the exercise of these options depends

on the market value of the Company's Common Stock on the date of exercise.

(3) Mr. Goss exercised his right to purchase shares of the Company's common stock under the Company's stock option plans by acquiring 8,000 shares at an aggregate purchase price of $25,000. These 8,000 shares were acquired at an option price per share of $3.125 under the incentive stock options ("ISO") granted to Mr. Goss on June 1, 1992. As consideration for the acquisition of such shares, Mr. Goss transferred to the Company 7,353 shares of the Company's common stock owned by him, having a value of $3.40 on May 31, 2002, the date of such exercise, for an aggregate fair market value of $25,000.

(4) Mr. Shelby exercised his right to purchase shares of the Company's common stock under the Company's stock option plans by acquiring 8,000 shares at an aggregate purchase price of $25,000. These 8,000 shares were acquired at an option price per share of $3.125 under the ISO granted to Mr. Shelby on June 1, 1992. As consideration for the acquisition of such shares, Mr. Shelby transferred to the Company 7,353 shares of the Company's common stock owned by him, having a value of $3.40 on May 31, 2002, the date of such exercise, for an aggregate fair market value of $25,000.

-8-

(5) Mr. Shear exercised his right to purchase shares of the Company's common stock under the Company's stock option plans by acquiring 7,600 shares at an aggregate price of $23,750. These 7,600 shares were acquired at an exercised price per share of $3.125 under the ISO granted to Mr. Shear on June 1, 1992. As consideration for the acquisition of such shares, Mr. Shear's spouse, Heidi Brown Shear, transferred to the Company as a bona fide gift to her spouse 6,846 shares of the Company's common stock owned by her, having a value of $3.43 per share on May 29, 2002, the day the 6,846 shares were delivered, for an aggregate fair market value of $23,482. Mr. Shear paid an additional $268 to the Company.

Other Plans The Board of Directors has adopted an LSB Industries, Inc., Employee Savings Plan (the "401(k) Plan") for the employees (including executive officers) of the Company and its subsidiaries, excluding certain (but not all) employees covered under union agreements. The 401(k) Plan is an employee contribution plan, and the Company and its subsidiaries make no contributions (with limited matching exceptions at two certain locations) to the 401(k) Plan. The amount that an employee may contribute to the 401(k) Plan equals a certain percentage of the employee's compensation, with the percentage based on the employee's income and certain other criteria as required under Section 401(k) of the Internal Revenue Code. The Company or subsidiary deducts the amounts contributed to the 401(k) Plan from the employee's compensation each pay period, in accordance with the employee's instructions, and pays the amount into the 401(k) Plan for the employee's benefit. The Summary Compensation Table set forth above includes any amount contributed and deferred during the 2002, 2001, and 2000 fiscal years pursuant to the 401(k) Plan by the named executive officers of the Company.

The Company has a death benefit plan for certain key employees which is in the process of being revised. Under the existing plan, the designated beneficiary of an employee covered by the plan will receive a monthly benefit for a period of 10 years if the employee dies while in the employment of the Company or a wholly-owned subsidiary of the Company. The agreement with each employee provides, in addition to being subject to other terms and conditions set forth in the agreement, that the Company may terminate the agreement as to any employee at anytime prior to the employee's death. The Company has purchased life insurance on the life of each employee covered under the plan to provide, in large part, a source of funds for the Company's obligations under the plan. The Company also will fund a portion of the benefits by investing the proceeds of such insurance policy received by the Company upon the employee's death. The Company is the owner and sole beneficiary of the insurance policy, with the proceeds payable to the Company upon the death of the employee. The following table sets forth the amounts of annual benefits payable to the designated beneficiary or beneficiaries of the executive officers named in the Summary Compensation Table set forth above under the above-described death benefits plan.

Name of Individual	Amount of Annual Payment
Jack E. Golsen	$ 175,000
Barry H. Golsen	$ 30,000
David R. Goss	$ 35,000
Tony M. Shelby	$ 35,000
David M. Shear	$ N/A

-9-

In addition to the above-described plans, during 1991 the Company entered into a non-qualified arrangement with certain key employees of the Company and its subsidiaries to provide compensation to such individuals in the event that they are employed by the Company or a subsidiary of the Company at age 65. This arrangement is also in the process of being revised. Under the plan, the employee will be eligible to receive for the life of such employee, a designated benefit as set forth in the plan. In addition, if prior to attaining the age 65 the employee dies while in the employment of the Company or a subsidiary of the Company, the designated beneficiary of the employee will receive a monthly benefit for a period of 10 years. The agreement with each employee provides, in addition to being subject to other terms and conditions set forth in the agreement, that the Company may terminate the agreement as to any employee at any time prior to the employee's death. The Company has purchased insurance on the life of each employee covered under the plan where the Company is the owner and sole beneficiary of the insurance policy, with the proceeds payable to the Company to provide a source of funds for the Company's obligations under the plan. The Company may also fund a portion of the benefits by investing the proceeds of such insurance policies. Under the terms of the plan, if the employee becomes disabled while in the employment of the Company or a wholly-owned subsidiary of the Company, the employee may request the Company to cash-in any life insurance on the life of such employee purchased to fund the Company's obligations under the plan. Jack E. Golsen does not participate in the plan. The following table sets forth the amounts of annual benefits payable to the executive officers named in the Summary Compensation Table set forth above under such retirement plan.

Name of Individual	Amount of Annual Payment
Barry H. Golsen	$ 17,480
David R. Goss	$ 17,403
Tony M. Shelby	$ 15,605
David M. Shear	$ 17,822

The two plans set forth above are in the process of being revised into a single program which would provide a combined benefit. The details of the revised program which will replace the death benefit plan and the non-qualified arrangement described above are being finalized. The revised plan may be materially altered prior to such finalization. It provides for a non-qualified arrangement with certain key employees of the Company and its subsidiaries to provide compensation to such individuals in the event that they are employed by the Company or a subsidiary of the Company at age 65 (and participate in the plan for 10 years). Under the plan the employee will be eligible to receive a designated benefit as set forth in the plan for 10 years. In addition, if prior to attaining age 65 the employee dies while in the employment of the Company or a subsidiary of the Company, the designated beneficiary of the employee will receive a monthly benefit for a period of 10 years. The agreement with each employee provides, in addition to being subject to other terms and conditions set forth in the agreement, that the Company may terminate the agreement as to any employee at any time prior to the employee's death. The Company has purchased insurance on the life of each employee covered under the plan where the Company is the owner and sole beneficiary of the insurance policy, with the proceeds payable to the Company to provide a source of funds for the Company's obligations under the plan. The Company may also fund a portion of the benefits by investing the proceeds of such insurance policies. Under the terms of the plan, if the employee becomes disabled while in the employment of the Company or a wholly-owned

-10-

subsidiary of the Company, the employee may request the Company to cash-in any life insurance on the life of such employee purchased to fund the Company's obligations under the plan. Jack E. Golsen participates only in the death benefit aspect of the plan. The following table sets forth the amounts of annual benefits payable to the beneficiaries of the employee or to the executive officers named in the Summary Compensation Table set forth above under such retirement plan.

Name of Individual	Death Benefit Amount of Annual Payment	Maximum Salary Continuation Amount of Payment (1) (2)
Jack E. Golsen	$ 120,050	$ -
Barry H. Golsen	$ 97,213	$ 97,213
David R. Goss	$ 60,363	$ 60,363
Tony M. Shelby	$ 72,888	$ 72,888
David M. Shear	$ 37,500	$ 37,500

(1) If employee attains age 65 and completes 10 years participation in the plan.
(2) Employees who reach age 65 prior to 10 years participation in the plan will receive a reduced benefit depending on years of participation.

Compensation of Directors In 2002, the Company compensated six non-employee directors $1,125 each and two non-employee directors $800 each for their services as directors on the Company's Board. Certain non-employee directors also served on the Board of Directors of the Company's subsidiary, ClimaChem, Inc. and received additional fees of $3,375 each for their services. The non-employee directors of the Company also received $500 for every meeting of the Board of Directors attended during 2002. Mr. Ackerman received an additional $20,500 for his services on the Audit and Public Relations and Marketing Committees in 2002. Mr. Ille received an additional $20,500 for his services on the Audit, Public Relations and Marketing, and Executive Salary Review Committees in 2002. Messrs. Burtch and Rhodes received an additional $20,000 each for their services on the Audit Committee in 2002. Dr. Brown received an additional $20,000 for his services on the Executive Salary Review Committees in 2002. During 2002, Mr. Munson was paid $32,780 for consulting services in connection with developing the Company's European business.

As fully discussed in Item 12 "Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters", in 1993 and 1999, the Company adopted the 1993 Non-Employee Director Stock Option Plan and the Outside Directors Stock Purchase Plan, respectively. The Company did not grant options under these plans during 2002, 2001, and 2000.

Employment Contracts and Termination of Employment and Change in Control Arrangements

a) Termination of Employment and Change in Control Agreements The Company has entered into severance agreements with Jack E. Golsen, Barry H. Golsen, Tony M. Shelby, David R. Goss, David M. Shear, and certain other officers of the Company and subsidiaries of the Company.

Each severance agreement provides (among other things) that if, within 24 months after the occurrence of a change in control (as defined) of the

Company, the Company terminates the officer's employment other than for cause (as defined), or the officer terminates his employment for good reason (as defined), the Company must pay the officer an amount equal to 2.9 times the officer's base amount (as defined). The phrase "base amount" means the average annual gross compensation paid by the Company to the officer and includable in the officer's gross income during the period consisting of the most recent five year period immediately preceding the change in control. If the officer has been employed by the Company for less than five years, the base amount is calculated with respect to the most recent number of taxable years ending before the change in control that the officer worked for the Company.

The severance agreements provide that a "change in control" means a change in control of the Company of a nature that would require the filing of a Form 8-K with the Securities and Exchange Commission and, in any event, would mean when: (a) any individual, firm, corporation, entity, or group (as defined in Section 13(d)(3) of the Securities Exchange Act of 1934, as mended) becomes the beneficial owner, directly or indirectly, of 30% or more of the combined voting power of the Company's outstanding voting securities having the right to vote for the election of directors, except acquisitions by (i) any person, firm, corporation, entity, or group which, as of the date of the severance agreement, has that ownership, or (ii) Jack E. Golsen, his wife; his children and the spouses of his children; his estate; executor or administrator of any estate, guardian or custodian for Jack E. Golsen, his wife, his children, or the spouses of his children, any corporation, trust, partnership, or other entity of which Jack E. Golsen, his wife, children, or the spouses of his children own at least 80% of the outstanding beneficial voting or equity interests, directly or indirectly, either by any one or more of the above-described persons, entities, or estates; and certain affiliates and associates of any of the above-described persons, entities, or estates; (b) individuals who, as of the date of the severance agreement, constitute the Board of Directors of the Company (the "Incumbent Board") and who cease for any reason to constitute a majority of the Board of Directors except that any person becoming a director subsequent to the date of the severance agreement, whose election or nomination for election is approved by a majority of the Incumbent Board (with certain limited exceptions), will constitute a member of the Incumbent Board; or (c) the sale by the Company of all or substantially all of its assets.

Except for the severance agreement with Jack E. Golsen, the termination of an officer's employment with the Company "for cause" means termination because of: (a) the mental or physical disability from performing the officer's duties for a period of 120 consecutive days or one hundred eighty days (even though not consecutive) within a 360 day period; (b) the conviction of a felony; (c) the embezzlement by the officer of Company assets resulting in substantial personal enrichment of the officer at the expense of the Company; or (d) the willful failure (when not mentally or physically disabled) to follow a direct written order from the Company's Board of Directors within the reasonable scope of the officer's duties performed during the 60 day period prior to the change in control. The definition of "Cause" contained in the severance agreement with Jack E. Golsen means termination because of: (a) the conviction of Mr. Golsen of a felony involving moral turpitude after all appeals have been completed; or (b) if due to Mr. Golsen's serious, willful, gross misconduct or willful, gross neglect of his duties has resulted in material damages to the Company and its subsidiaries, taken as a whole, provided that (i) no action or failure to act by Mr. Golsen will constitute a reason for termination if he believed, in

-12-

good faith, that such action or failure to act was in the Company's or its subsidiaries' best interest, and (ii) failure of Mr. Golsen to perform his duties hereunder due to disability shall not be considered willful, gross misconduct or willful, gross negligence of his duties for any purpose.

The termination of an officer's employment with the Company for "good reason" means termination because of (a) the assignment to the officer of duties inconsistent with the officer's position, authority, duties, or responsibilities during the 60 day period immediately preceding the change in control of the Company or any other action which results in the diminishment of those duties, position, authority, or responsibilities; (b) the relocation of the officer; (c) any purported termination by the Company of the officer's employment with the Company otherwise than as permitted by the severance agreement; or (d) in the event of a change in control of the Company, the failure of the successor or parent company to agree, in form and substance satisfactory to the officer, to assume (as to a successor) or guarantee (as to a parent) the severance agreement as of no change in control had occurred.

Except for the severance agreement with Jack E. Golsen, each severance agreement runs until the earlier of: (a) three years after the date of the severance agreement, or (b) the officer's normal retirement date from the Company; however, beginning on the first anniversary of the severance agreement and on each annual anniversary thereafter, the term of the severance agreement automatically extends for an additional one-year period, unless the Company gives notice otherwise at least 60 days prior to the anniversary date. The severance agreement with Jack E. Golsen is effective for a period of three years from the date of the severance agreement; except that, commencing on the date one year after the date of such severance agreement and on each annual anniversary thereafter, the term of such severance agreement shall be automatically extended so as to terminate three years from such renewal date, unless the Company gives notices otherwise at least one year prior to the renewal date.

(b) Employment Agreement The Company has an employment agreement with Jack E. Golsen, the Chairman of the Board and President of the Company, which requires the Company to employ Mr. Golsen as an executive officer of the Company. The current term of the employment agreement will expire March 21, 2005; however, pursuant to an amendment to the employment agreement approved by the Board of Directors, the term will be automatically renewed for up to three additional three-year periods. The employment agreement may be terminated by either party by written notice at least one year prior to the expiration of the then current term. Under the terms of such employment agreement, Mr. Golsen shall be paid (a) an annual base salary at his 1995 base rate, as adjusted from time to time by the Compensation Committee, but such shall never be adjusted to an amount less than Mr. Golsen's 1995 base salary, (b) an annual bonus in an amount as determined by the Compensation Committee, and (c) receive from the Company certain other fringe benefits.

The employment agreement provides that Mr. Golsen's employment may not be terminated, except (a) upon conviction of a felony involving moral turpitude after all appeals have been exhausted, (b) Mr. Golsen's serious, willful, gross misconduct or willful, gross negligence of duties resulting in material damage to the Company and its subsidiaries, taken as a whole, unless Mr. Golsen believed, in good faith, that such action or failure to act was in the Company's or its subsidiaries' best interest, and (c) Mr. Golsen's death. However, no such termination under (a) or (b) above may occur unless and until the Company has delivered to Mr. Golsen a resolution duly adopted by an

-13-

affirmative vote of three-fourths of the entire membership of the Board of Directors at a meeting called for such purpose after reasonable notice given to Mr. Golsen finding, in good faith, that Mr. Golsen violated (a) or (b) above.

If Mr. Golsen's employment is terminated in breach of the employment agreement, then he shall, in addition to his other rights and remedies, receive and the Company shall pay to Mr. Golsen (a) in a lump sum cash payment, on the date of termination, a sum equal to the amount of Mr. Golsen's annual base salary at the time of such termination and the amount of the last bonus paid to Mr. Golsen prior to such termination times the number of years remaining under the then current term of the employment agreement and (b) provide to Mr. Golsen all of the fringe benefits that the Company was obligated to provide during his employment under the employment agreement for the remainder of the term of the employment agreement.

If there is a change in control (as defined in the severance agreement between Mr. Golsen and the Company) and within 24 months after such change in control Mr. Golsen is terminated, other than for Cause (as defined in the severance agreement), then in such event, the severance agreement between Mr. Golsen and the Company shall be controlling.

In the event Mr. Golsen becomes disabled and is not able to perform his duties under the employment agreement as a result thereof for a period of 12 consecutive months within any two year period, the Company shall pay Mr. Golsen his full salary for the remainder of the term of the employment agreement and thereafter 60% of such salary until Mr. Golsen's death.

Compensation Committee Interlocks and Insider Participation The Company's Executive Salary Review Committee has the authority to set the compensation of all officers of the Company. This Committee generally considers and approves the recommendations of the President. The members of the Executive Salary Review Committee are the following non-employee directors: Robert C. Brown, M.D., and Bernard G. Ille. During 2002, the Executive Salary Review Committee had 3 meetings.

See "Compensation of Directors" for information concerning compensation paid to non-employee directors of the Company during 2002 for services as a director to the Company, and Item 13 "Certain Relationships and Related Transactions" for information concerning compensation paid to an affiliate of Mr. Brown.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The following table sets forth the information concerning the number of securities to be issued upon the exercise of outstanding stock options, the weighted-average exercise price and the number of securities remaining available under equity compensation plans approved and not approved by security holders at December 31, 2002.

-14-

Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders (1)	1,529,600	$ 2.26	851,300
Equity compensation plans not approved by security holders (2)	1,243,000	$ 2.44	-
Total	2,772,600	$ 2.34	851,300

(1) Stockholder Approved Plans. The Company's equity compensation plans which are approved by the Company's stockholders are the following:

- 1986 Incentive Stock Option Plan (the "1986 Plan"). As of December 31, 2002, 10,000 shares are issuable under outstanding options granted under the 1986 Plan and no additional shares are available for future issuance.

- 1993 Stock Option and Incentive Plan (the "1993 Plan"). As of December 31, 2002, 492,000 shares are issuable under outstanding options granted under the 1993 Plan and 355,800 additional shares are available for future issuance.

- 1998 Stock Option Plan (the "1998 Plan"). As of December 31, 2002, 922,600 shares are issuable under outstanding options granted under the 1998 Plan and 50,500 additional shares are available for future issuance.

- Outside Directors Stock Option Plan (the "Outside Directors Plan"), as of December 31, 2002, 105,000 shares are issuable under outstanding options granted under the Outside Directors Plan and 295,000 additional shares are available for future issuance. The Outside Directors Plan authorizes the Company to grant options to purchase common stock to each member of our Board of Directors who is not an officer or employee of the Company or its subsidiaries. These options become fully exercisable after six months and one day from the date of grant and lapse at the end of ten years. The exercise price of options granted under the Outside Directors Plan is equal to the market value of our common stock at the date of grant.

- 1993 Non-Employee Directors Stock Option Plan (the "1993 Directors Plan"). As of December 31, 2002, no shares have been granted under the 1993 Directors Plan and 150,000 shares are available for future issuance. The 1993 Directors Plan authorizes the grant of nonqualified stock options to each member of our Board of Directors who is not an officer or employee of the Company or its subsidiaries. Options granted to non-employee Directors of the Company become fully exercisable after six months from the date of grant. Pursuant to the terms of the 1993 Directors Plan, each outside director receives an option to acquire 5,000 shares of our common stock on April 30 following

the end of each year in which the Company realizes net income of $9.2 million or more for such year. The exercise price for these options is the fair market value of the shares of common stock at the time of grant. Each option granted under this plan expires upon the earlier of the termination as a member of our Board of Directors or the fifth anniversary of the date such option was granted.

The 1986 Plan, 1993 Plan, and 1998 Plan each authorize the Company to grant options to purchase common stock to our employees. All outstanding options granted to employees under these plans have a term of 10 years and become exercisable as to 20% of the underlying shares after one year from date of grant, 40% after two years, 70% after three years, and 100% after four years. The exercise price of outstanding options granted under these plans is equal to the market value of the Company's common stock at the date of grant. However, with respect to participants who own 10% or more of our common stock at the date of grant, the options have a term of five years, and the exercise price is 110% of the market value at the date of grant.

(2) Non-Stockholder Approval Plans. From time to time, our Board of Directors has approved the grants of certain nonqualified stock options as the Board has determined to be in the best interest of the Company to compensate directors, officers, or employees for service to the Company. Unless otherwise indicated below, (a) the price of each such option is equal to the market value of our common stock at the date of grant, (b) the options become exercisable as to 20% of the underlying shares after one year from the date of grant, 40% after two years, 70% after three years, and 100% after four years, and (c) each option expires 10 years from the grant date. The Company's equity compensation plans which have not been approved by the stockholders are the following:

- Effective December 1, 2002, the Company granted nonqualified options to purchase up to an aggregate 112,000 shares of common stock to former employees of two former subsidiaries. These options were part of the employees' severance compensation arising from the sale of the former subsidiaries' assets. Each recipient of a grant received options for the same number of shares and having the same exercise price as under the recipient's vested incentive stock options which expired upon the sale. Each nonqualified option was exercisable as of the date of grant and has a term of 10 years from the original date of grant. Of the 112,000 shares issuable under the options, 4,000 shares have an exercise price of $9.00 per share and expired March 19, 2003, 34,000 have an exercise price of $4.188 per share and expire from August 18, 2004 through April 22, 2008, 34,000 have an exercise price of $2.37 per share and expire November 21, 2011, and 40,000 have an exercise price of $1.25 and expire July 8, 2009.

- On November 7, 2002, the Company granted to an employee of the Company a nonqualified stock option to acquire 50,000 shares of common stock at an exercise price of $2.62 per share in consideration of services rendered to the Company.

- On April 25, 2002, the Company granted to an employee of the Company a nonqualified stock option to acquire 3,000 shares of common stock at an exercise price of $4.188 per share in consideration of services to the Company.

-16-

- On November 29, 2001, the Company granted to employees of the Company nonqualified stock options to acquire 102,500 shares of common stock at an exercise price of $2.73 in consideration of services to the Company.

- On July 20, 2000, the Company granted nonqualified options to a former employee of the Company to acquire 185,000 shares of common stock in consideration of services to the Company. The following are the exercise prices per share for these options: 5,000 shares at $5.362; 80,000 shares at $4.538; 60,000 shares at $1.375; and 40,000 shares at $1.25. These options were for the same number of shares and the same exercise prices as under the stock options held by the former employee prior to leaving the Company. These options were fully vested at the date of grant and expire, as to 100,000 shares, nine years from the date of grant and as to the remaining 85,000 shares, seven years from the date of grant.

- On July 8, 1999, in consideration of services to the Company, the Company granted nonqualified stock options to acquire 266,500 shares of common stock at an exercise price of $1.25 per share to Jack E. Golsen (176,500 shares), Barry H. Golsen (55,000 shares) and Steven J. Golsen (35,000 shares), David R. Goss (35,000 shares), Tony M. Shelby (35,000 shares), David M. Shear (35,000 shares) and granted to certain other employees nonqualified stock options to acquire a total of 165,000 shares of common stock at an exercise price of $1.25 per share in consideration of services to the Company.

- On April 22, 1998, the Company granted to certain employees and to each member of our Board of Directors who was not an officer or employee of the Company or its subsidiaries nonqualified stock options to acquire shares of common stock at an exercise price of $4.1875 per share in consideration of services to the Company. As of December 31, 2002, 229,000 shares are issuable under outstanding options under these agreements.

- On December 18, 1997, the Company granted to an employee nonqualified stock options to acquire 25,000 shares of common stock at an exercise price of $4.125 per share. The options became exercisable as to 30% of the underlying shares after two years from the date of grant, 60% after three years, and 100% after four years.

Security Ownership of Certain Beneficial Owners

The following table shows the total number and percentage of the outstanding shares of the Company's voting Common Stock and voting Preferred Stock beneficially owned as of the close of business on April 14, 2003, with respect to each person (including any "group" as used in Section 13(d)(3) of the Securities Act of 1934, as amended) that the Company knows to have beneficial ownership of more than 5% of the Company's voting Common Stock and voting Preferred Stock. A person is deemed to be the beneficial owner of voting shares of Common Stock of the Company which he or she could acquire within 60 days of April 14, 2003.

Because of the requirements of the Securities and Exchange Commission as to the method of determining the amount of shares an individual or entity may beneficially own, the amounts shown below for an individual or entity may include shares also considered beneficially owned by others.

-17-

Name and Address of Beneficial Owner	Title of Class	Amounts of Shares Beneficially owned (1)				Percent of Class
Jack E. Golsen and members of his family (2)	Common	4,798,990	(3)	(5)	(6)	34.5 %
	Voting Preferred	1,020,000	(4)	(6)		99.9 %
Kent C. McCarthy & affiliates	Common	2,762,081	(7)			19.8 %
Paul J. Denby	Common	900,556	(8)			7.1 %
James W. Sight	Common	805,938	(9)			6.4 %

(1) The Company based the information with respect to beneficial ownership on information furnished by the above-named individuals or entities or contained in filings made with the Securities and Exchange Commission or the Company's records.

(2) Includes Jack E. Golsen and the following members of his family: wife, Sylvia H. Golsen; son, Barry H. Golsen (a Director, Vice Chairman of the Board of Directors, and President of the Climate Control Business of the Company); son, Steven J. Golsen (Executive officer of several subsidiaries of the Company); and daughter, Linda F. Rappaport. The address of Jack E. Golsen, Sylvia H. Golsen, Barry H. Golsen, and Linda F. Rappaport is 16 South Pennsylvania Avenue, Oklahoma City, Oklahoma 73107; and Steven J. Golsen's address is 7300 SW 44th Street, Oklahoma City, Oklahoma 73179.

(3) Includes (a) the following shares over which Jack E. Golsen ("J. Golsen") has the sole voting and dispositive power: (i) 40,000 shares that he owns of record, (ii) 4,000 shares that he has the right to acquire upon conversion of a promissory note, (iii) 133,333 shares that he has the right to acquire upon the conversion of 4,000 shares of the Company's Series B 12% Cumulative Convertible Preferred Stock (the "Series B Preferred") owned of record by a trust, of which he is the sole trustee, (iv) 22,090 shares owned of record by the MG Trust, of which he is the sole trustee, (v) 69,029 shares owned of record by a trust, of which he is the sole trustee, and (vi) 185,500 shares that he has the right to acquire within the next 60 days under the Company's stock option plans; (b) 643,290 shares owned of record by Sylvia H. Golsen, and 284,915 shares owned of record by a trust, of which Sylvia H. Golsen is the sole trustee, over which she and her husband, J. Golsen share voting and dispositive power; (c) 246,616 shares over which Barry H. ("B. Golsen") has the sole voting and dispositive power, 533 shares owned of record by B. Golsen's wife, over which he shares the voting and dispositive power, and 112,500 shares that he has the right to acquire within the

next 60 days under the Company's stock option plans; (d) 206,987 shares over which Steven J. Golsen ("S. Golsen") has the sole voting and dispositive power and 74,000 shares that he has the right to acquire within the next 60 days under the Company's stock option plans; (e) 271,511 shares held in trust for the grandchildren and great grandchild of J. Golsen and Sylvia H. Golsen of which B. Golsen, S. Golsen and Linda F. Rappaport ("L. Rappaport") jointly

share voting and dispositive power; (f) 82,552 shares owned of record by L. Rappaport over which she has sole voting and dispositive power; (g) 1,336,199 shares owned of record by SBL Corporation ("SBL"), 39,177 shares that SBL has the right to acquire upon conversion of 9,050 shares of the Company's non-voting $3.25 Convertible Exchangeable Class C Preferred Stock, Series 2 (the "Series 2 Preferred"), 400,000 shares that SBL has the right to acquire upon conversion of 12,000 shares of Series B Preferred owned of record by SBL, and 250,000 shares that SBL has to right to acquire upon conversion of 1,000,000 shares of the Company's Series D 6% cumulative, convertible Class C preferred stock ("Series D Preferred") owned of record by SBL and (h) 88,100 shares owned of record by Golsen Petroleum Corporation ("GPC"), which is a wholly-owned subsidiary of SBL, 133,333 shares that GPC has the right to acquire upon conversion of 4,000 shares of Series B Preferred owned of record by GPC and 175,325 shares that GPC has the right to acquire upon conversion of 40,500 shares of Series 2 Preferred owned of record by GPC. SBL is wholly-owned by Sylvia H. Golsen (40% owner), B. Golsen (20% owner), S. Golsen (20% owner), and L. Rappaport (20% owner) and, as a result, SBL, J. Golsen, Sylvia H. Golsen, B. Golsen, S. Golsen, and L. Rappaport share the voting and dispositive power of the shares beneficially owned by SBL. SBL's address is 16 South Pennsylvania Avenue, Oklahoma City, Oklahoma 73107.

(4) Includes: (a) 4,000 shares of Series B Preferred owned of record by a trust, of which J. Golsen is the sole trustee, over which he has the sole voting and dispositive power; (b) 12,000 shares of Series B Preferred owned of record by SBL; (c) 4,000 shares Series B Preferred owned of record by SBL's wholly-owned subsidiary, GPC, over which SBL, J. Golsen, Sylvia H. Golsen, B. Golsen, S. Golsen, and L. Rappaport share the voting and dispositive power and (d) 1,000,000 shares of Series D Preferred owned of record by SBL.

(5) Does not include 176,850 shares of Common Stock that L. Rappaport's husband owns of record and 185,000 shares which he has the right to acquire within the next 60 days under the Company's stock option plans, all of which L. Rappaport disclaims beneficial ownership. Does not include 255,520 shares of Common Stock owned of record by certain trusts for the benefit of B. Golsen, S. Golsen, and L. Rappaport over which B. Golsen, S. Golsen and L. Rappaport have no voting or dispositive power. Heidi Brown Shear, an officer of the Company and the niece of J. Golsen, is the Trustee of each of these trusts.

(6) J. Golsen disclaims beneficial ownership of the shares that B. Golsen, S. Golsen, and L. Rappaport each have the sole voting and investment power over as noted in footnote (3) above. B. Golsen, S. Golsen, and L. Rappaport disclaim beneficial ownership of the shares that J. Golsen has the sole voting and investment power over as noted in footnotes (3) and (4) and the shares owned of record by Sylvia H. Golsen. Sylvia H. Golsen disclaims beneficial ownership of the shares that J. Golsen has the sole voting and dispositive power over as noted in footnotes (3) and (4) above.

(7) Kent C. McCarthy, manager of Jayhawk Capital Management, L.L.C. ("Jayhawk"), a Delaware limited liability company and investment advisor, is deemed to beneficially own 2,762,081 shares of the Company's Common Stock (which includes 1,401,081 shares of Common Stock receivable upon conversion of 323,650 shares of Series 2 Preferred and 112,500 shares of Common Stock that may be acquired upon exercise of warrants exercisable within 60 days of March 27, 2003). This number of shares includes the shares Mr. McCarthy personally owns, as well as the shares he controls as manager and sole member

of Jayhawk. As manager and sole member of Jayhawk, Mr. McCarthy has sole voting and dispositive power over the Common Stock beneficially owned by Jayhawk. Jayhawk is deemed to have beneficial ownership of 2,458,050 shares of the Company's Common Stock (which includes 1,298,050 shares of Common Stock receivable upon conversion of 299,850 shares of Series 2 Preferred and 112,500 shares of Common Stock that may be acquired upon exercise of warrants), all of which shares are held in portfolios of (a) Jayhawk Institutional Partners, L.P. ("Jayhawk Institutional"), a Delaware limited partnership, (1,850,692 shares of Common Stock which includes 690,692 shares of Common Stock receivable upon conversion of 159,550 shares of Series 2 Preferred and 112,500 shares of Common Stock that may be acquired upon exercise of warrants), (b) Jayhawk Investments, L.P. ("Jayhawk Investments"), a Delaware limited partnership, (370,562 shares of Common Stock receivable upon conversion of 85,600 shares of Series 2 Preferred), and (c) Lucky Henry, L.P., ("Lucky Henry"), a Delaware limited partnership. Jayhawk is the general partner and manager of Jayhawk Institutional, Jayhawk Investments, and Lucky Henry and, as such, has sole voting and dispositive power over these shares. Mr. McCarthy disclaims beneficial ownership of all such shares other than his personal holdings. Mr. McCarthy's address is 8201 Mission Road, Suite 110, Prairie Village, Kansas 66208. Information set forth in this footnote is based upon Amendment No. 2 to Schedule 13-D filed on March 27, 2003, by McCarthy, Jayhawk, Jayhawk Institutional, and Jayhawk Investments. See "Item 13. Certain Relationships and Related Transactions."

(8) Paul J. Denby advised the Company that he has voting and dispositive power over 900,556 shares of Common Stock (which includes 230,256 shares of Common Stock receivable upon conversion of 53,300 shares of Series 2 Preferred). This number of shares includes 23,776 shares beneficially owned by Mr. Denby's spouse over which Mr. Denby shares voting and dispositive power. Mr. Denby's address is 4613 Redwood Court, Irving, Texas 75038.

(9) James W. Sight has sole voting and dispositive power over 805,938 shares of Common Stock (which includes 173,785 shares of Common Stock receivable upon conversion of 40,228 shares of Series 2 Preferred). Mr. Sight's address is 8500 College Boulevard, Overland Park, Kansas 66210.

Security Ownership of Management The following table sets forth information obtained from the directors of the Company and the directors and executive officers of the Company as a group as to their beneficial ownership of the Company's voting Common Stock and voting Preferred Stock as of April 14, 2003.

Because of the requirements of the Securities and Exchange Commission as to the method of determining the amount of shares an individual or entity may own beneficially, the amount shown below for an individual may include shares also considered beneficially owned by others. Any shares of stock which a person does not own, but which he or she has the right to acquire within 60 days of April 14, 2003, are deemed to be outstanding for the purpose of computing the percentage of outstanding stock of the class owned by such person but are not deemed to be outstanding for the purpose of computing the percentage of the class owned by any other person.

-20-

Name of Beneficial Owner	Title of Class	Amounts of Shares Beneficially Owned (1)		Percent of Class
Raymond B. Ackerman	Common	36,000	(2)	*
Robert C. Brown, M.D.	Common	238,329	(3)	1.9 %
Charles A. Burtch	Common	15,000	(4)	*
Grant J. Donovan	Common	44,169	(5)	*

Dr. N. Allen Ford	Common	432	(6)	*
Barry H. Golsen	Common	3,046,294	(7)	22.5 %
	Voting Preferred	1,016,000	(7)	99.5 %
Jack E. Golsen	Common	3,804,291	(8)	27.7 %
	Voting Preferred	1,020,000	(8)	99.9 %
David R. Goss	Common	281,272	(9)	2.2 %
Bernard G. Ille	Common	90,000	(10)	*
Donald W. Munson	Common	31,432	(11)	*
Horace G. Rhodes	Common	35,000	(12)	*
Tony M. Shelby	Common	348,229	(13)	2.8 %
Directors and Executive Officers as a group number (14 persons)	Common	5,919,672	(14)	40.4 %
	Voting Preferred	1,020,000		99.9 %

* Less than 1%.

(1) The Company based the information, with respect to beneficial ownership, on information furnished by each director or officer, contained in filings made with the Securities and Exchange Commission, or contained in the Company's records.

(2) This amount includes the following shares over which Mr. Ackerman shares voting and dispositive power: (a) 2,000 shares held by Mr. Ackerman's trust, and (b) 4,000 shares held by the trust of Mr. Ackerman's wife. The remaining 30,000 shares of Common Stock included herein are shares that Mr. Ackerman may acquire pursuant to currently exercisable non-qualified stock options granted to him by the Company.

(3) The amount shown includes 30,000 shares of Common Stock that Dr. Brown may acquire pursuant to currently exercisable non-qualified stock options granted to him by the Company. The shares, with respect to which Dr. Brown shares the voting and dispositive power, consists of 122,516 shares owned by Dr. Brown's wife, 15,000 shares held jointly by Dr. Brown and his wife, 50,727 shares owned by Robert C. Brown, M.D., Inc., a corporation wholly-owned by Dr. Brown, and 20,086 shares held by the Robert C. Brown M.D., Inc.

-21-

Employee Profit Sharing Plan, of which Dr. Brown serves as the trustee. The amount shown does not include 50,380 shares owned directly, or through trusts, by the children of Dr. Brown, all of which Dr. Brown disclaims beneficial ownership.

(4) Mr. Burtch has sole voting and dispositive power over these shares, which may be acquired by Mr. Burtch pursuant to currently exercisable non-qualified stock options granted to him by the Company.

(5) Mr. Donovan has sole voting and dispositive power over these shares, which include 13,000 shares of Common Stock and 31,169 shares of Common Stock that Mr. Donovan has the right to acquire upon conversion of 7,200 shares of Series 2 Preferred.

(6) Dr. Ford has sole voting and dispositive power over these 432 shares of Common Stock that Dr. Ford has the right to acquire upon conversion of 100 shares of Series 2 Preferred.

(7) See footnotes (3), (4), and (6) of the table under "Security Ownership of Certain Beneficial Owners" of this item for a description of the amount and nature of the shares beneficially owned by B. Golsen, including shares he has the right to acquire within 60 days.

(8) See footnotes (3), (4), and (6) of the table under "Security Ownership of Certain Beneficial Owners" of this item for a description of the amount and nature of the shares beneficially owned by J. Golsen, including the shares he has the right to acquire within 60 days.

(9) Mr. Goss has the sole voting and dispositive power over these shares, which include 158,000 shares that Mr. Goss has the right to acquire within 60 days pursuant to options granted under the Company's stock option plans.

(10) The amount includes (a) 30,000 shares that Mr. Ille may purchase pursuant to currently exercisable non-qualified stock options, over which Mr. Ille has the sole voting and dispositive power, and (b) 50,000 shares owned of record by Mr. Ille's wife, voting and dispositive power of which are shared by Mr. Ille and his wife.

(11) Mr. Munson has the sole voting and dispositive power over these shares, which include (a) 432 shares of Common Stock that Mr. Munson has the right to acquire upon conversion of 100 shares of Series 2 Preferred and (b) 30,000 shares that Mr. Munson may purchase pursuant to currently exercisable non-qualified stock options.

(12) Mr. Rhodes has sole voting and dispositive power over these shares, which include 30,000 shares that may be acquired by Mr. Rhodes pursuant to currently exercisable non-qualified stock options granted to him by the Company.

(13) Mr. Shelby has the sole voting and dispositive power over these shares, which include 158,000 shares that Mr. Shelby has the right to acquire within 60 days pursuant to options granted under the Company's stock option plans and 15,151 shares that Mr. Shelby has the right to acquire upon conversion of 3,500 shares of Series 2 Preferred.

(14) The amount shown includes 1,053,000 shares of Common Stock that executive officers, directors, or entities controlled by executive officers and directors of the Company have the right to acquire within 60 days.

Item 13. Certain Relationships and Related Transactions

A subsidiary of the Company, Hercules Energy Mfg. Corporation ("Hercules"), leased land and a building in Oklahoma City, Oklahoma from Mac Venture, Ltd. ("Mac Venture"), a limited partnership. GPC (a wholly owned subsidiary of SBL) serves as the general partner of Mac Venture. The limited partners of Mac Venture include GPC and the three children of Jack E. Golsen. See "Security Ownership of Certain Beneficial Owners" and "Security Ownership of Management" above for a discussion of the stock ownership of SBL. The warehouse and shop space leased by Hercules from Mac Venture consists of a total of 30,000 square feet. Hercules leased the property from Mac Venture for $3,750 per month under a month-to-month triple net lease extension which ended in October 2002.

Northwest Internal Medicine Associates ("Northwest"), a division of Plaza Medical Group, P.C., has an agreement with the Company to perform medical examinations of the management and supervisory personnel of the Company and its subsidiaries. Under such agreement, Northwest is paid $2,000 a month to perform all such examinations. Dr. Robert C. Brown (a director of the Company) is Vice President and Treasurer of Plaza Medical Group, P.C.

In 1983, LSB Chemical Corp. ("LSB Chemical"), a subsidiary of the Company, acquired all of the outstanding stock of El Dorado Chemical Company ("EDC") from its then four stockholders ("Ex-Stockholders"). A substantial portion of the purchase price consisted of an earnout based primarily on the annual after-tax earnings of EDC for a ten-year period. During 1989, two of the Ex-Stockholders received LSB Chemical promissory notes for a portion of their earnout, in lieu of cash, totaling approximately $896,000, payable $496,000 in January 1990, and $400,000 in May, 1994. LSB Chemical agreed to a buyout of the balance of the earnout from the four Ex-Stockholders for an aggregate purchase amount of $1,231,000. LSB Chemical purchased for cash the earnout from two of the Ex-Stockholders and issued multi-year promissory notes totaling $676,000 to the other two Ex-Stockholders. Jack E. Golsen guaranteed LSB Chemical's payment obligation under the promissory notes. The unpaid balance of these notes at March 31, 2003, was $400,000.

At October 15, 2001, Prime Financial Corporation ("Prime"), a subsidiary of the Company, had a note with an outstanding principal balance of $1,350,000 (the "Prime Note") owed to SBL Corporation ("SBL"), a corporation wholly owned by the spouse and children of Jack E. Golsen, Chairman of the Board and President of the Company. The Prime Note was issued in connection with a loan from SBL to Prime of funds borrowed by SBL from SBL's lender. In order to obtain the loan from SBL, Prime was required to (a) issue to SBL's lender a limited guaranty of the lender's loan to SBL, and (b) pledge to SBL's lender 1,973,461 shares of the Company's common stock owned by Prime as security for the limited guaranty.

On October 18, 2001, the Company, Prime, and SBL entered into an agreement (the "Agreement") whereby the Company issued to SBL 1,000,000 shares of a newly created series of Series D Convertible Preferred Stock in the Company ("Series D Preferred Stock"). In consideration of the issuance of the Series D Preferred stock, SBL (a) reduced the principal amount of the Prime Note by $1,000,000, (b) caused Prime's limited guaranty to be reduced to an amount

-23-

not to exceed $350,000, and (c) caused the shares of LSB common stock pledged by Prime to SBL's lender to be reduced by 1,000,000 shares. In February 2003, SBL's lender terminated Prime's limited guaranty and released all shares of LSB common stock pledged by Prime to secure the limited guaranty. At March 31, 2003, $150,000 remains outstanding under the Prime Note which is payable on demand.

Each share of Series D Preferred Stock issued to SBL has, among other things, ..875 votes and the right to vote as a class with the Company's common stock, a liquidation preference of $1.00 per share, cumulative dividends at the rate of 6% per annum, and is convertible into LSB common stock on the basis of four shares of Preferred Stock into one share of common stock. Dividends on the Series D Preferred Stock issued to SBL will be paid only after accrued and unpaid dividends are paid on the Company's Series 2 Preferred. At March 31, 2003, there was $7.6 million in accrued but unpaid dividends due on the Series 2 Preferred.

Effective March 25, 2003, the Company completed a private placement to Jayhawk Institutional Partners, L.P. ("Jayhawk Institutional") of 450,000 shares of the Company's common stock and a five year warrant to purchase up to 112,500 share of the Company's common stock at an exercise price of $3.49 per share, subject to anti-dilution adjustments under certain conditions. The total price paid by Jayhawk to the Company for the shares of common stock and the warrant was $1,570,500. The average closing price of the Company's common stock over the 30 day period prior to the transaction was $3.49. Jayhawk has certain registration rights. See "Security Ownership of Certain Beneficial Owners" for a description of the beneficial ownership of our common stock by Kent C. McCarthy and affiliates, including Jayhawk Institutional.

-24-

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) (1) Financial Statements

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

(a) (2) Financial Statement Schedule

The Company has included the following schedule in this report:

II - Valuation and Qualifying Accounts F-67 to F-68

* These financial statements are included in the original Form 10-K for the year ended December 31, 2002, filed with the Securities and Exchange Commission on April 2, 2003.

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

2.1. Stock Purchase Agreement and Stock Pledge Agreement between Dr. Hauri AG, a Swiss Corporation, and LSB Chemical Corp., which the Company hereby incorporates by reference from Exhibit 2.2 to the Company's Form 10-K for fiscal year ended December 31, 1994.

3.1. Restated Certificate of Incorporation, the Certificate of Designation dated February 17, 1989, and certificate of Elimination dated April 30, 1993, which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Registration Statement, No. 33-61640; Certificate of Designation for the Company's $3.25 Convertible Exchangeable Class C Preferred Stock, Series 2, which the Company hereby incorporates by reference from Exhibit 4.6 to the Company's Registration Statement, No. 33-61640.

3.2. Bylaws, as amended, which the Company hereby incorporates by reference from Exhibit 3(ii) to the Company's Form 10-Q for the quarter ended June 30, 1998.

3.3 Certificate of Designations of LSB Industries, Inc., relating to the issuance of a new series of Class C Preferred Stock, which the Company hereby incorporates by reference form Exhibit 10.3 to the Company's Form

10-Q for the fiscal quarter ended September 30, 2001.

4.1. Specimen Certificate for the Company's Non-cumulative Preferred Stock, having a par value of $100 per share, which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 10-Q for the quarter ended June 30, 1983.

4.2. Specimen Certificate for the Company's Series B Preferred Stock, having a par value of $100 per share, which the Company hereby incorporates by reference from Exhibit 4.27 to the Company's Registration Statement No. 33-9848.

4.3. Specimen Certificate for the Company's Series 2 Preferred, which the Company hereby incorporates by reference from Exhibit 4.5 to the Company's Registration Statement No. 33-61640.

4.4. Specimen Certificate for the Company's Common Stock, which the Company incorporates by reference from Exhibit 4.4 to the Company's Registration Statement No. 33-61640.

4.5. Renewed Rights Agreement, dated January 6, 1999, between the Company and Bank One, N.A., which the Company hereby incorporates by reference from Exhibit No. 1 to the Company's Form 8-A Registration Statement, dated January 27, 1999.

4.6. Indenture, dated as of November 26, 1997, by and among ClimaChem, Inc., the Subsidiary Guarantors and Bank One, NA, as trustee, which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 8-K, dated November 26, 1997.

4.7. Form of 10 3/4% Series B Senior Notes due 2007 which the Company hereby incorporates by reference from Exhibit 4.3 to the ClimaChem Registration Statement, No. 333-44905.

4.8. First Supplemental Indenture, dated February 8, 1999, by and among ClimaChem, Inc., the Guarantors, and Bank One N.A., which the Company hereby incorporates by reference from Exhibit 4.19 to the Company's Form 10-K for the year ended December 31, 1998.

4.9. Second Amended and Restated Loan and Security Agreement dated May 10, 1999, by and between Bank of America National Trust and Savings Association and LSB Industries, Inc., Summit Machine Tool Manufacturing Corp., and Morey Machinery Manufacturing Corporation, which the Company hereby incorporates by reference from Exhibit 4.2 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1999.

4.10. Specimen of Certificate of Series D 6% Cumulative, Convertible Class C Preferred Stock which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2001.

4.11. Second Amendment to Loan and Security Agreement, dated May 24, 2002, by and among the Company, LSB, certain subsidiaries of the Company, Foothill Capital Corporation ("Foothill") and Congress Financial Corporation (Southwest), which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 8-K, dated May 24, 2002. Omitted are exhibits and schedules attached thereto. The Agreement contains a list of such exhibits and schedules, which the Company agrees to file with the Commission supplementally upon the Commission's request.

4.12. Securities Purchase Agreement, dated May 24, 2002 ("Agreement"), which the Company hereby incorporates by reference from Exhibit 4.2 to the Company's Form 8-K, dated May 24, 2002. Omitted are exhibits and schedules attached thereto. The Agreement contains a list of such exhibits and schedules, which the Company agrees to file with the Commission supplementally upon the Commission's request.

4.13. Fifth Supplemental Indenture, dated May 24, 2002, among the Company, the Guarantors, and Bank One, N.A, which the Company hereby incorporates by reference from Exhibit 4.3 to the Company's Form 8-K, dated May 24, 2002.

4.14. Promissory Note, dated May 24, 2002, granted by the Company in favor of one of the Lenders in the original principal amount of $7,786,927, which the Company hereby incorporates by reference from Exhibit 4.4 to the Company's Form 8-K, dated May 24, 2002. Substantially similar Promissory Notes, dated May 24, 2002, were granted by the Company to each of the other Lenders in the original principal amount indicated: (a) a Promissory Note granted in favor of one Lender in the original principal amount of $3,478,410, (b) two Promissory Notes granted in favor of a Lender in the original aggregate principal amount of $20,000,000, (c) a Promissory Note granted in favor of a Lender in the original principal amount of $3,734,663. Copies of these Promissory Notes will be provided to the Commission upon request.

4.15. Letter, dated July 10, 2002, to document certain items not reflected in the Securities Purchase Agreement which the Company hereby incorporates by reference from Exhibit 4.5 to the Company's Form 10-Q for the fiscal quarter ended June 30, 2002.

4.16. Third Amendment, dated as of November 18, 2002, to the Loan and Security Agreement dated as of April 13, 2001, as amended by the First

Amendment dated as of August 3, 2001 and the second Amendment dated as of May 24, 2002, by and among LSB Industries, Inc., ClimaChem, Inc., and certain subsidiaries of ClimaChem, Congress Financial Corporation (Southwest) and Foothill Capital Corporation which the Company hereby incorporates by reference from Exhibit 4.1 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2002.

4.17. Second Amendment to Securities Purchase Agreement, dated February 28, 2003 by and among ClimaChem, Inc. and certain of its subsidiaries, the Purchasers and Guggenheim Investment Management, LLC. which the Company hereby incorporates by reference from Exhibit 4.17 to the Company's Form 10-K for the year ended December 31, 2002.

4.18. Fourth Amendment, dated as of March 3, 2003, to the Loan and Security Agreement dated as of April 13, 2001, as amended by the First, Second, and Third Amendments, by and among LSB Industries, Inc., ClimaChem, Inc., and certain subsidiaries of ClimaChem, Inc., Congress Financial Corporation (Southwest) and Foothill Capital Corporation which the Company hereby incorporates by reference from Exhibit 4.18 to the Company's Form 10-K for the year ended December 31, 2002.

4.19 Letter, dated March 3, 2003, to document the consent to increase capital expenditures, as defined in the Securities Purchase Agreement which the Company hereby incorporates by reference from Exhibit 4.19 to the Company's Form 10-K for the year ended December 31, 2002.

10.1. Form of Death Benefit Plan Agreement between the Company and the employees covered under the plan, which the Company hereby incorporates by reference from Exhibit 10(c) (1) to the Company's Form 10-K for the year ended December 31, 1980.

10.2. The Company's 1993 Stock Option and Incentive Plan which the Company hereby incorporates by reference from Exhibit 10.6 to the Company's Form 10-K for the fiscal year ended December 31, 1993.

10.3. The Company's 1993 Non-employee Director Stock Option Plan which the Company hereby incorporates by reference from Exhibit 10.7 to the Company's Form 10-K for the fiscal year ended December 31, 1993.

10.4. Limited Partnership Agreement dated as of May 4, 1995, between the general partner, and LSB Holdings, Inc., an Oklahoma Corporation, as limited partner which the Company hereby incorporates by reference from Exhibit 10.11 to the Company's Form 10-K for the fiscal year ended December 31, 1995.

10.5. Severance Agreement, dated January 17, 1989, between the Company and Jack E. Golsen, which the Company hereby incorporates by reference from Exhibit 10.48 to the Company's Form 10-K for fiscal year ended December 31, 1988. The Company also entered into identical agreements with Tony M. Shelby, David R. Goss, Barry H. Golsen, David M. Shear, and Jim D. Jones and the Company will provide copies thereof to the Commission upon request.

10.6. Employment Agreement and Amendment to Severance Agreement dated January 12, 1989 between the Company and Jack E. Golsen, dated March 21, 1996 which the Company hereby incorporates by reference from Exhibit 10.15 to the Company's Form 10-K for fiscal year ended December 31, 1995.

10.7. Omitted

-28-

10.8. Baytown Nitric Acid Project and Supply Agreement dated June 27, 1997, by and among El Dorado Nitrogen Company, El Dorado Chemical Company and Bayer Corporation which the Company hereby incorporates by reference from Exhibit 10.2 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #5551, DATED SEPTEMBER 25, 1997, GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.**

10.9. First Amendment to Baytown Nitric Acid Project and Supply Agreement, dated February 1, 1999, between El Dorado Nitrogen Company and Bayer Corporation, which the Company hereby incorporates by reference from Exhibit 10.30 to the Company's Form 10-K for the year ended December 31, 1998. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #7927, DATED JUNE 9, 1999, GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.**

10.10. Service Agreement, dated June 27, 1997, between Bayer Corporation and El Dorado Nitrogen Company which the Company hereby incorporates by reference from Exhibit 10.3 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #5551, DATED SEPTEMBER 25, 1997, GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.**

10.11. Ground Lease dated June 27, 1997, between Bayer Corporation and El Dorado Nitrogen Company which the Company hereby incorporates by reference from Exhibit 10.4 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #5551, DATED SEPTEMBER 25, 1997, GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.**

10.12. Participation Agreement, dated as of June 27, 1997, among El Dorado Nitrogen Company, Boatmen's Trust Company of Texas as Owner Trustee, Security Pacific Leasing Corporation, as Owner Participant and a Construction

Lender, Wilmington Trust Company, Bayerische Landes Bank, New York Branch, as a Construction Lender and the Note Purchaser, and Bank of America National Trust and Savings Association, as Construction Loan Agent which the Company hereby incorporates by reference from Exhibit 10.5 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #5551, DATED SEPTEMBER 25, 1997, GRANTING A REQUEST FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.**

10.13. Lease Agreement, dated as of June 27, 1997, between Boatmen's Trust Company of Texas as Owner Trustee and El Dorado Nitrogen Company which the Company hereby incorporates by reference from Exhibit 10.6 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997.

10.14. Security Agreement and Collateral Assignment of Construction Documents, dated as of June 27, 1997, made by El Dorado Nitrogen Company which the Company hereby incorporates by reference from Exhibit 10.7 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997.

-29-

10.15. Security Agreement and Collateral Assignment of Facility Documents, dated as of June 27, 1997, made by El Dorado Nitrogen Company and consented to by Bayer Corporation which the Company hereby incorporates by reference from Exhibit 10.8 to the Company's Form 10-Q for the fiscal quarter ended June 30, 1997.

10.16. Non-Qualified Stock Option Agreement, dated April 22, 1998, between the Company and Robert C. Brown, M.D. The Company entered into substantially identical agreements with Bernard G. Ille, Raymond B. Ackerman, Horace G. Rhodes, and Donald W. Munson. The Company will provide copies of these agreements to the Commission upon request.

10.17. The Company's 1998 Stock Option and Incentive Plan, which the Company hereby incorporates by reference from Exhibit 10.44 to the Company's Form 10-K for the year ended December 31, 1998.

10.18. Letter Agreement, dated March 12, 1999, between Kestrel Aircraft Company and LSB Industries, Inc., Prime Financial Corporation, Herman Meinders, Carlan K. Yates, Larry H. Lemon, Co-Trustee Larry H. Lemon Living Trust, which the Company hereby incorporates by reference from Exhibit 10.45 to the Company's Form 10-K for the year ended December 31, 1998.

10.19. LSB Industries, Inc. 1998 Stock Option and Incentive Plan which the Company hereby incorporates by reference from Exhibit "B" to the LSB Proxy Statement, dated May 24, 1999, for Annual Meeting of Stockholders.

10.20. LSB Industries, Inc. Outside Directors Stock Option Plan which the Company hereby incorporates by reference from Exhibit "C" to the LSB Proxy Statement, dated May 24, 1999, for Annual Meeting of Stockholders.

10.21. First Amendment to Second Amended and Restated Loan and Security Agreement, dated January 1, 2000, by and between Bank of America, N.A. and LSB Industries, Inc., Summit Machine Tool Manufacturing Corp., and Morey Machinery Manufacturing Corporation, which the Company hereby incorporates by reference from Exhibit 10.3 to the Company's Form 8-K dated December 30, 1999.

10.22. Second Amendment to Second Amended and Restated Loan and Security Agreement, dated March 1, 2000 by and between Bank of America, N.A. and LSB Industries Inc., Summit Machine Tool Manufacturing Corp., and Morey Machinery Manufacturing Corporation, which the Company hereby incorporates by reference from Exhibit 10.3 to the Company's Form 8-K dated March 1, 2000.

10.23. Third Amendment to Second Amended and Restated Loan and Security Agreement, dated March 31, 2000 by and between Bank of America, N.A. and LSB Industries Inc., Summit Machine Tool Manufacturing Corp., and Morey Machinery Manufacturing Corporation, which the Company hereby incorporates by reference from Exhibit 10.14 to the Company's Form 10-Q for the fiscal quarter ended March 31, 2000.

10.24. Loan Agreement dated December 23, 1999 between Climate Craft, Inc. and the City of Oklahoma City, which the Company hereby incorporates by reference from Exhibit 10.49 to the Company's Amendment No. 2 to its 1999 Form 10-K.

10.25. Letter, dated April 1, 2000, executed by SBL to Prime amending the Promissory Note, which the Company incorporates by reference from Exhibit

-30-

10.52 to the Company's Amendment No. 2 to its 1999 Form 10-K.

10.26. Fourth Amendment to Second Amended and Restated Loan and Security Agreement dated October 10, 2000 by and between Bank of America, N.A. and LSB Industries, Inc., Summit Machine Tool Manufacturing Corp., and Morey Machinery Manufacturing Corporation, which the Company hereby incorporates by reference from Exhibit 10.2 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2000.

10.27. Letter Agreement, dated August 23, 2000, between LSB Chemical Corp. and Orica USA, Inc., which the Company hereby incorporates by reference from Exhibit 10.4 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2000.

CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #10714, DATED FEBRUARY 21, 2001 GRANTING A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.

10.28. Agreement, dated October 31, 2000, between Orica Nitrogen, L.L.C., Orica USA, Inc., and LSB Chemical Corp., which the Company hereby incorporates by reference from Exhibit 10.5 to the Company's Form 10-Q for the fiscal quarter ended September 20, 2000. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF COMMISSION ORDER CF #10714, DATED FEBRUARY 21, 2001 GRANTING A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT UNDER THE FREEDOM OF INFORMATION ACT AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.**

10.29. Letter, dated April 1, 2001, executed by SBL to Prime amending the Promissory Note, which the Company hereby incorporates by reference from Exhibit 10.55 to the Company's Form 10-K for the fiscal year ended December 31, 2000.

10.30. Agreement, dated April 2, 2001, between Crystal City Nitrogen Company and River Cement Company, which the Company hereby incorporates by reference from Exhibit 10.57 to the Company's Form 10-K for the fiscal year ended December 31, 2000.

10.31. Assignment, dated May 8, 2001, between Climate Master, Inc. and Prime Financial Corporation, which the Company hereby incorporates by reference from Exhibit 10.2 to the Company's Form 10-Q for the fiscal quarter ended March 31, 2001.

10.32. Agreement for Purchase and Sale, dated April 10, 2001, by and between Prime Financial Corporation and Raptor Master, L.L.C. which the Company hereby incorporates by reference from Exhibit 10.3 to the Company's Form 10-Q for the fiscal quarter ended March 31, 2001.

10.33. Amended and Restated Lease Agreement, dated May 8, 2001, between Raptor Master, L.L.C. and Climate Master, Inc. which the Company hereby incorporates by reference from Exhibit 10.4 to the Company's Form 10-Q for the fiscal quarter ended March 31, 2001.

10.34. Option Agreement, dated May 8, 2001, between Raptor Master, L.L.C.and Climate Master, Inc., which the Company hereby incorporates by reference from Exhibit 10.5 to the Company's Form 10-Q for the fiscal quarter ended March 31, 2001.

10.35. Stock Purchase Agreement, dated September 30, 2001, by and between Summit Machinery Company and SBL Corporation, which the Company hereby incorporates by reference from Exhibit 10.1 to the Company' Form 10-Q for the fiscal quarter ended September 30, 2001.

10.36. Agreement, dated October 18, 2001, by and between LSB Industries, Inc., Prime Financial Corporation, and SBL Corporation, which the Company hereby incorporates by reference from Exhibit 10.2 to the Company's Form 10-Q for the fiscal quarter ended September 30, 2001.

10.37. Omitted

10.38. Asset Purchase Agreement, dated October 22, 2001, between Orica USA, Inc. and El Dorado Chemical Company and Northwest Financial Corporation, which the Company hereby incorporates by reference from Exhibit 99.1 to the Company's Form 8-K dated December 28, 2001. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST.**

10.39. AN Supply Agreement, dated November 1, 2001, between Orica USA, Inc. and El Dorado Company, which the Company hereby incorporates by reference from Exhibit 99.2 to the Company's Form 8-K dated December 28, 2001. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST.**

10.40. Ammonium Nitrate Sales Agreement between Nelson Brothers, L.L.C. and Cherokee Nitrogen Company, which the Company hereby incorporates by reference from Exhibit 99.3 to the Company's Form 8-K dated December 28, 2001. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST.**

10.41 Loan and Security Agreement, dated April 13, 2001 by and among LSB Industries, Inc., ClimaChem and each of its Subsidiaries that are Signatories, the Lenders that are Signatories and Foothill Capital Corporation, which the Company hereby incorporates by reference from Exhibit 10.51 to ClimaChem, Inc.'s amendment No. 1 to Form 10-K for the year ended December 31, 2000.

10.42. Agreement, dated August 4, 2001, between El Dorado Chemical Company and Paper, Allied-Industrial, Chemical and Energy Workers International Union AFL-C10 and its Local 5-434, which the Company hereby incorporates by reference from Exhibit 10.65 to the Company's Form 10-K for the year ended December 31, 2001.

10.43. Agreement, dated October 16, 2001, between El Dorado Chemical Company and International Association of Machinists and Aerospace Workers, AFL-C10 Local No. 224, which the Company hereby incorporates by reference from Exhibit 10.66 to the Company's Form 10-K for the year ended December 31,

2001.

10.44. First Amendment to Third Amended and Restated Loan and Security Agreement, dated March 29, 2002, entered into by and between Bank of America, N.A. and Summit Machine Tool Manufacturing Corp, which the Company hereby incorporates by reference from Exhibit 10.67 to the Company's Form 10-K for the year ended December 31, 2001.

10.45. Warrant, dated May 24, 2002, granted by the Company to a Lender for the right to purchase up to 132,508 shares of the Company's common stock at an exercise price of $0.10 per share, which the Company hereby incorporates by reference from Exhibit 99.1 to the Company's Form 8-K, dated May 24, 2002. Four substantially similar Warrants, dated May 24, 2002, for the purchase of an aggregate additional 463,077 shares at an exercise price of $0.10 were issued. Copies of these Warrants will be provided to the Commission upon request.

10.46. Intercreditor Agreement, which the Company hereby incorporates by reference from Exhibit 99.2 to the Company's Form 8-K, dated May 24, 2002.

10.47. 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, which the Company hereby incorporates by reference from Exhibit 2.1 to the Company's Form 8-K, dated December 12, 2002. The asset purchase agreement contains a brief list identifying all schedules and exhibits to the asset purchase agreement. Such schedules and exhibits are not filed herewith, and the Registrant agrees to furnish supplementally a copy of the omitted schedules and exhibits to the commission upon request.

10.48 Anhydrous Ammonia Sales Agreement, dated December 9, 2002, between Koch Nitrogen Company and El Dorado Chemical Company which the Company hereby incorporates by reference from Exhibit 10.48 to the Company's Form 10-K for the year ended December 31, 2002. **CERTAIN INFORMATION WITHIN THIS EXHIBIT HAS BEEN OMITTED AS IT IS THE SUBJECT OF A REQUEST BY THE COMPANY FOR CONFIDENTIAL TREATMENT BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FREEDOM OF INFORMATION ACT. THE OMITTED INFORMATION HAS BEEN FILED SEPARATELY WITH THE SECRETARY OF THE SECURITIES AND EXCHANGE COMMISSION FOR PURPOSES OF SUCH REQUEST.**

10.49. Registration Rights Agreement, dated March 25, 2003, among LSB Industries, Inc., Kent C. McCarthy, Jayhawk Capital management, L.L.C., Jayhawk Investments, L.P. and Jayhawk Institutioal Partners, L.P. which the Company hereby incorporates by reference from Exhibit 10.49 to the Company's Form 10-K for the year ended December 31, 2002.

10.50. Subscription Agreement, dated March 25, 2003, by and between LSB Industries, Inc. and Jayhawk Institutional Partners, L.P. which the Company hereby incorporates by reference from Exhibit 10.50 to the Company's Form 10-K for the year ended December 31, 2002.

10.51. Warrant Agreement, dated March 25, 2003, between LSB Industries, Inc. and Jayhawk Institutional Partners, L.P. which the Company hereby incorporates by reference from Exhibit 10.51 to the Company's Form 10-K for the year ended December 31, 2002.

-33-

10.52 First Amendment to Employment Agreement, dated April 29, 2003, between the Company and Jack E. Golsen.

10.53 Release, dated February 11, 2003, by Stillwater National Bank and Trust Company in favor of Prime Financial Corporation.

10.54 Nonqualified Stock Option, dated December 1, 2002, between the Company and William Manion. The Company entered into substantially identical nonqualified stock option agreements with three other former employees for the purchase of 34,000 shares at an exercise price of $2.73 per share, expiring on November 21, 2011, 40,000 shares at an exercise price of $1.25 per share, expiring on July 8, 2009, 31,000 shares at an exercise price of $4.188 per share, expiring on August 18, 2004 through April 22, 2008 and 4,000 shares at an exercise price of $9.00 per share, expired on March 19, 2003, copies of which will be provided to the Commission upon request.

10.55 Nonqualified Stock Option Agreement, dated November 7, 2002, between the Company and John J. Bailey Jr.

10.56 Nonqualified Stock Option Agreement, dated November 29, 2001, between the Company and Dan Ellis.

10.57 Nonqualified Stock Option Agreement, dated July 20, 2000, between the Company and Claude Rappaport for the purchase of 80,000 shares of common stock. Substantially similar nonqualified stock option agreements were entered into with Mr. Rappaport (40,000 shares at an exercise price of $1.25 per share, expiring on July 20, 2009), (5,000 shares at an exercise price of $5.362 per share, expiring on July 20, 2007), and (60,000 shares at an exercise price of $1.375 per share, expiring on July 20, 2009), copies of which will be provided to the Commission upon request.

10.58 Nonqualified Stock Option Agreement, dated July 8, 1999, between the Company and Jack E. Golsen. Substantially similar nonqualified stock options were granted to Barry Golsen (55,000 shares), Stephen J. Golsen (35,000 shares), David R. Goss (35,000 shares), Tony M. Shelby (35,000 shares), David M. Shear (35,000 shares) and five other employees (165,000 shares), copies of which will be provided to the Commission upon request.

10.59 Nonqualified Stock Option Agreement, dated December 18, 1997, between the Company and Dan Ellis.

21.1 Subsidiaries of the Company which the Company hereby incorporates by reference from Exhibit 21.1 to the Company's Form 10-K for the year ended December 31, 2002.

23.1. Consent of Independent Auditors which the Company hereby incorporates by reference from Exhibit 23.1 to the Company's Form 10-K for the year ended December 31, 2002.

99.1 Certification of Jack E. Golsen, Chief Executive Officer, pursuant to 18 U.S.C. Section 1350. A signed original of this written statement required by Section 906 has been provided to LSB Industries, Inc. and will be retained by LSB Industries, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

99.2 Certification of Tony M. Shelby, Chief Financial Officer pursuant to 18 U.S.C. Section 1350. A signed original of this written statement required by Section 906 has been provided to LSB Industries, Inc. and will be retained

-34-

by LSB Industries, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

(b) REPORTS ON FORM 8-K. We filed the following report on Form 8-K during the fourth quarter of 2002.

(i) Form 8-K, dated December 27, 2002. (date of earliest event: December 12, 2002). The item reported was Item 2, "Acquisition or Disposition of Assets", discussing the sale of all of the operating assets of Slurry Explosive Corporation and Universal Tech Corporation to four wholly owned subsidiaries of Energetic Systems Inc., LLC pursuant to the terms of an Asset Purchase Agreement, dated December 6, 2002.

-35-

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Company has caused the undersigned, duly-authorized, to sign this Amendment No.1 to the report on its behalf on this 29th day of April 2003.

LSB INDUSTRIES, INC.

By:

/s/ Jack E. Golsen

Jack E. Golsen
Chairman of the Board and President
(Principal Executive Officer)

By:

/s/ Tony M. Shelby

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

By:

/s/ Jim D. Jones

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

-36-

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the undersigned have signed this report on behalf of the Company, in the capacities and on the dates indicated.

Dated: April 29, 2003	By: /s/ Jack E. Golsen Jack E. Golsen, Director
Dated: April 29, 2003	By: /s/ Tony M. Shelby Tony M. Shelby, Director
Dated: April 29, 2003	By: /s/ David R. Goss David R. Goss, Director
Dated: April 29, 2003	By: /s/ Barry H. Golsen Barry H. Golsen, Director
Dated: April 29, 2003	By: /s/ Robert C. Brown Robert C. Brown, Director
Dated: April 29, 2003	By: /s/ Bernard G. Ille Bernard G. Ille, Director
Dated: April 29, 2003	By: /s/ Raymond B. Ackerman Raymond B. Ackerman, Director
Dated: April 29, 2003	By: /s/ Horace G. Rhodes Horace G. Rhodes, Director
Dated: April 29, 2003	By: /s/ Donald W. Munson Donald W. Munson, Director
Dated: April 29, 2003	By: /s/ Charles A. Burtch Charles A. Burtch, Director
Dated: April 29, 2003	By: /s/ Grant J. Donovan, Director
Dated: April 29, 2003	By: /s/ Dr. N. Allen Ford Dr. N. Allen Ford, Director

-37-

CERTIFICATION

I, Jack E. Golsen, President and Chief Executive Officer, certify that:

1. I have reviewed this annual report on Form 10-K, as amended by this Form 10K/A Amendment No. 1 of LSB

Industries, Inc.;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

- designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

- evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

- presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

- all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

- any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: April 29, 2003 /s/ Jack E. Golsen

Jack E. Golsen
President
(Principal Executive Officer)

-38

CERTIFICATION

I, Tony M. Shelby, Senior Vice President and Chief Financial Officer, certify that:

1. I have reviewed this annual report on Form 10-K, as amended by this Form 10K/A Amendment No. 1 of LSB Industries, Inc.;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state

a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

- designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

- evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

- presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

- all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

- any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: April 29, 2003

/s/ Tony M. Shelby
Tony M. Shelby
Senior Vice President
(Principal Financial Officer)

-39

DIRECTORS

LSB CORPORATE, SUBSIDIARY AND OPERATING UNIT EXECUTIVE OFFICERS (OTHER THAN DIRECTORS) AS OF YEAR 2003

RAYMOND B. ACKERMAN

Chairman Emeritus
of Ackerman McQueen, Inc.

ROBERT C. BROWN, M.D.
President and CEO
N.W. Internal Medicine Associates

CHARLES (CHUCK) A. BURTCH
Former Executive Vice President
and West Division Manager
of Bank America

GRANT DONOVAN
President
Galehead, Inc.

DR. ALLEN FORD, PH.D
Professor
University of Kansas

JACK E. GOLSEN
Chairman of Board, CEO

BARRY H. GOLSEN
J.D., Vice Chairman of Board, COO
President
Climate Control Business

DAVID R. GOSS
C.P.A., Senior Vice President,
Operations

BERNARD G. ILLE
Former CEO and
Board Chairman
First Life Assurance Company

DONALD W. MUNSON
Former President of Lennox Corp.
Consultant to and
International Distributor for
The Ducane Company

HORACE G. RHODES
Chairman
Kerr, Irvine, Rhodes and Ables
Law Firm

TONY M. SHELBY
C.P.A., Senior Vice President, CFO

MICHAEL G. ADAMS
C.P.A., Vice President, Internal Audit

HEIDI L. BROWN
J.D., L.L.M., Vice President
Managing Counsel

JUDI BURNETT
Assistant Vice President,
Risk Manager

JOHN CARVER
Vice President
Safety & Environmental Compliance
ClimaChem, Inc.

DAN ELLIS
President
ClmateMaster, Inc.

LARRY FITZWATER
Vice President,
Operations
LSB Chemical Group

STEVE J. GOLSEN
Co-Chairman, CEO
ClimateMaster, Inc.

PHIL GOUGH
Senior Vice President,
Agricultural Products
EL Dorado Chemical Company

BRIAN HAGGART
President
The Climate Control Group. Inc.

LARRY L. JEWELL
President
International Environmental Corporation

JIM D. JONES
C.P.A., Vice President, Controller
and Treasurer

WARREN JONES
Vice President,
Administration
El Dorado Chemical Company

WALTER P. MECOZZI
President
ClimateCraft, Inc.

ANN MUISE-MILLER
J.D., Assistant Vice President,
Associate General Counsel

JAMES W.M. MURRAY, III
J.D., Vice President
Senior Associate General Counsel

ANN RENDON
President
El Dorado Nitric Company

PAUL RYDLUND
Senior Vice President,
Industrial Products
El Dorado Chemical Company

DAVID M. SHEAR
J.D., Vice President
General Counsel and Secretary

MIKE TEPPER
Senior Vice President
International Operations

JAMES L. WEWERS
President
LSB Chemical Group

MIKE WOLFE
Vice President,
Retail & Wholesale Ag Centers
El Dorado Chemical Company

DOUG WONNACOTT
President
El Dorado Chemical Company

CHEMICAL FACILITIES LOCATIONS

CORPORATE OFFICE:
Oklahoma City, Ok.

SALES AND MARKETING OFFICES:
Oklahoma City, OK
Rockwall, TX
St. Louis, MO

PRODUCTION FACILITIES:
Baytown, TX
El Dorado, AR
Wilmington, NC
Cherokee, AL

AGRICULTURAL PRODUCTS FACILITIES:
Annona, TX
Athens, TX
Bells, TN
Bryan, TX

Cooper, TX
Corsicana, TX
Dublin, TX
Greenville, TX
Itasca, TX
Kennett, Mo
Marquez, TX
McKinney, TX
Newbern, TN
Pittsburg, TX
Terrell, TX
Trinity, TX
Tyler, TX
Waxahachie, TX
Whitewright, TX

CLIMATE CONTROL MARKETS

Argentina	Jordan
Aruba	Kenya
Australia	Korea
Austria	Kuwait
Bahamas	Lebanon
Botswana	Malaysia
Belgium	Mexico
Belize	New Zealand
Bermuda	Nigeria
Canada	Norway
Chile	Oman
China	Pakistan
Colombia	Peru
Costa Rica	Philippines
Cuba	Puerto Rico
Curacao	Qatar
Dominican Republic	Saudi Arabia
	Scotland
Ecuador	Russia
Egypt	Spain
England	Sweden
Finland	Taiwan
France	Thailand
Germany	Turkey
Greece	United Arab Emirates
Guam	
Hungary	Unites States
India	Uruguay
Indonesia	Venezuela
Israel	Virgin Islands
Italy	Yemen
Japan	

TRANSFER AGENT & REGISTRAR:
UMB Bank, N.A.
Securities Transfer Division
P.O. Box 410064

Kansas City, Missouri 64141-0064
816-860-7786

STOCK LISTED:
Common stock
Ticker Symbol: LSBD
Series 2, $3.25 convertible exchangeable
Class C Preferred Stock
Ticker Symbol: LSBDP

AUDITORS:

Ernst & Young LLP
Oklahoma City, Oklahoma

LSB INDUSTRIES CORPORATION OFFICES:
16 South Pennsylvania Avenue
Oklahoma City, Oklahoma 73107
405-235-4546
405-235-5067 fax
www.lsb-okc.com