LSB INDUSTRIES INC
Form 10-K
February 28, 2012

Table of Contents

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

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2011
or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____
Commission File Number: 1-7677
LSB INDUSTRIES, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware	73-1015226
(State of 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:

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

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. o Yes þ No
Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. o Yes þ No
Indicate by check mark whether the Registrant (1) has filed all reports required by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for the shorter period that the Registrant has had to file the reports), and (2) has been subject to the filing requirements for the past 90 days. þ Yes o No
Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). þ Yes o 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. o

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

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o
		(Do not check if a smaller reporting company)	

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

The aggregate market value of the Registrant s voting common equity held by non-affiliates of the Registrant, computed by reference to the price at which the voting common stock was last sold as of June 30, 2011, was approximately $796 million. As a result, the Registrant is a large accelerated filer as of December 31, 2011. For purposes of this computation, shares of the Registrant s common stock beneficially owned by each executive officer and director of the Registrant were deemed to be owned by affiliates of the Registrant as of June 30, 2011. Such determination should not be deemed an admission that such executive officers and directors of our common stock are, in fact, affiliates of the Registrant or affiliates as of the date of this Form 10-K.

As of February 15, 2012, the Registrant had 22,318,223 shares of common stock outstanding (excluding 4,320,462 shares of common stock held as treasury stock).

FORM 10-K OF LSB INDUSTRIES, INC.
TABLE OF CONTENTS

Table of Contents

PART I

ITEM 1. BUSINESS

General

LSB Industries, Inc. (LSB or Registrant) was formed in 1968 as an Oklahoma corporation and became a Delaware corporation in 1977. LSB is a diversified holding company involved in manufacturing and marketing operations through its subsidiaries. LSB and its wholly-owned subsidiaries (the Company , We , Us , or Our) own the follow core businesses:

- Climate Control Business manufactures and sells a broad range of heating, ventilation and air conditioning (HVAC) products in the niche markets we serve consisting of geothermal and water source heat pumps, hydronic fan coils, large custom air handlers, modular geothermal and other chillers and other related products used to control the environment in various structures. Our markets include commercial/institutional and residential new building construction, renovation of existing buildings and replacement of existing systems.
- Chemical Business manufactures and sells nitrogen-based chemical products produced from four facilities located in El Dorado, Arkansas (the El Dorado Facility); Cherokee, Alabama (the Cherokee Facility); Pryor, Oklahoma (the Pryor Facility); and Baytown, Texas (the Baytown Facility) for the agricultural industrial, and mining markets. Our products include high purity and commercial grade anhydrous ammonia for industrial and agricultural applications, industrial and fertilizer grade ammonium nitrate (AN), urea ammonium nitrate (UAN), sulfuric acids, nitric acids in various concentrations, nitrogen solutions, diesel exhaust fluid (DEF) and various other products.

We believe our Climate Control Business has developed leadership positions in certain niche markets by offering extensive product lines, customized products and improved technologies. Under this focused strategy, we have developed what we believe to be the most extensive line of geothermal and water source heat pumps and hydronic fan coils in the United States (U.S.). Further, we believe that we were a pioneer in the use of geothermal technology in the climate control industry and we have used it to create what we believe to be the most energy efficient climate control systems commercially available today. We employ highly flexible production capabilities that allow us to custom design units for new construction as well as the retrofit and replacement markets. This flexibility positions us well for an eventual recovery in commercial/institutional and residential construction markets.

In recent years, we have put heavy emphasis on our geothermal heating and air conditioning products, which are considered green technology and a form of renewable energy. We believe our geothermal systems are among the most energy efficient systems available in the market for heating and cooling applications in commercial/institutional and single family new construction as well as replacement and renovation markets. Based upon industry information available to us, we believe we have the leading market share. In addition, even though the general construction level has been lower than some previous years in both the commercial/institutional and residential sectors, we believe we have continued to increase our market share of the growing geothermal heating and cooling market.

Our Chemical Business is a supplier to some of the world s leading chemical and industrial companies. By focusing on specific geographic areas, we have developed freight and distribution advantages over many of our competitors, and we believe our Chemical Business has established leading regional market positions.

We sell most of our industrial and mining products to customers pursuant to contracts containing minimum volumes and/or cost plus a profit provision. These contractual sales stabilize the effect of commodity cost changes and fluctuations in demand for these products due to the cyclicality of the end markets. Periodically we enter into forward sales commitments for agricultural products but we sell most of our agricultural products at the current spot market price in effect at time of shipment.

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

Table of Contents

Current State of the Economy

Since our two core business segments serve several diverse markets, we consider market fundamentals for each market individually as we evaluate economic conditions. From a macro standpoint, we believe the U.S. economy is poised for modest growth if the European sovereign debt issues do not negatively affect the global economy beyond current concerns.

Climate Control Business Sales for 2011 were 12% higher than the same period in 2010, including a 43% increase in hydronic fan coil sales, a 7% increase in geothermal and water source heat pump sales, and a 6% increase in other HVAC sales. From a market sector perspective, the increase is due to a 19% improvement in commercial/institutional product sales partially offset by a 7% decrease in residential product sales. The improvement in commercial/institutional sales was in most major product lines. For 2011, sales and order levels of our commercial/institutional products increased in most major markets (education, multi-family, healthcare, office and hospitality) although sales and order levels of our single-family residential products decreased from 2010 reflecting the slowdown in new residential construction. The latest information available from the Construction Market Forecasting Service provided by McGraw-Hill (CMFS) indicates that in 2012 both the commercial/institutional and residential construction sectors we serve are expected to increase modestly over 2011 levels.

Chemical Business Our Chemical Business primary markets are agricultural, industrial and mining. During 2011, approximately 45% of our Chemical Business sales in 2011 were into the agricultural fertilizer markets to customers that primarily purchase at spot market prices and not pursuant to contractual pricing arrangements. Our agricultural sales volumes and prices depend upon the supply of and the demand for fertilizer, which in turn depends on the market fundamentals for crops including corn, wheat, cotton and forage. The current 2012 outlook according to most market indicators, including reports in Green Markets, Fertilizer Week and the USDA s World Agricultural Supply and Demand Estimates, point to positive supply and demand fundamentals for the types of nitrogen fertilizer products we produce and sell. However, it is possible that the fertilizer outlook could change if there are unanticipated changes in commodity prices, acres planted or unfavorable weather conditions. Our Cherokee and Pryor Facilities produce anhydrous ammonia from natural gas and UAN from ammonia. During 2011, agricultural customer demand for and the selling prices of ammonia and UAN continued to increase while natural gas prices were generally lower compared to 2010. As a result, gross margins increased significantly for these two products. On the other hand, our El Dorado Facility produces agricultural grade AN from purchased ammonia and is at a cost disadvantage compared to competitive product produced from natural gas. During 2011, certain of the mid-south market area for agricultural grade AN was in a drought condition, which could negatively affect customer demand for that product if the drought continues into the spring of 2012. As a result, we are shipping agricultural grade AN to other freight logical markets and are attempting to divert production capacity to other products to help mitigate the negative effects of the drought.

The remaining 55% of our Chemical Business sales were into industrial and mining markets of which approximately 57% of these sales are to customers that have contractual obligations to purchase a minimum quantity and allow us to recover our cost plus a profit, irrespective of the volume of product sold. During 2011, our sales volumes to industrial and mining customers increased 2% and 11%, respectively, as compared to 2010, while sales dollars increased 28% and 34%, respectively. For 2012, we expect slight growth in these markets based on projections from the American Chemistry Council and customer feedback.

See further discussion relating to the economy under various risk factors under Item 1A of this Part 1 and Overview-Economic Conditions of the Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) contained in this report.

Website Access to Company s Reports

Our internet website address is www.lsb-okc.com. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to section 13(a) or 15(d) of the Exchange Act are available free of charge through our website within a reasonable amount of time after they are electronically filed with, or furnished to, the Securities and Exchange Commission (SEC).

Table of Contents

Segment Information and Foreign and Domestic Operations and Export Sales

Schedules of the amounts of net sales, gross profit, operating income and identifiable assets attributable to each of our lines of business and of the amount of our export sales in the aggregate and by major geographic area for each of the last three years appear in Note 18 of the Notes to Consolidated Financial Statements included elsewhere in this report.

Climate Control Business

General

Our Climate Control Business manufactures and sells a broad range of standard and custom designed geothermal and water source heat pumps and hydronic fan coils as well as large custom air handlers and modular chiller systems, including modular geothermal chillers. These products are for use in commercial/institutional and residential HVAC systems. Our products are installed in some of the most recognizable commercial/institutional developments in the U.S., including the Prudential Tower, Rockefeller Plaza, Trump Tower, Time Warner Center and many others. In addition, we have a significant presence in the lodging sector with installations in numerous Hyatt, Marriott, Four Seasons, Starwood, Ritz Carlton and Hilton hotels, among others.

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

	2011	2010	2009
Percentage of net sales of the Climate Control Business:			
Geothermal and water source heat pumps	65%	69%	68%
Hydronic fan coils	19%	15%	17%
Other HVAC products	16%	16%	15%
	100%	100%	100%
Percentage of LSB s consolidated net sales:			
Geothermal and water source heat pumps	23%	28%	34%
Hydronic fan coils	7%	6%	9%
Other HVAC products	5%	7%	7%
	35%	41%	50%

Market Conditions Climate Control Business

As discussed above, CMFS has projected the commercial/institutional and residential construction sectors will rebound somewhat during 2012.

In addition, we believe that tax credits and incentives, and certain planned direct spending by the federal government contained in the American Reinvestment and Recovery Act of 2009, have and could continue to stimulate sales of our geothermal heat pump products, as well as other green products.

Geothermal and Water Source Heat Pumps

We believe our Climate Control Business is a leading provider of geothermal and water source heat pumps to the commercial/institutional construction and renovation markets in the U.S. Water source heat pumps are highly efficient heating and cooling products, which enable individual room climate control through the transfer of heat using a water pipe system connected to a centralized cooling tower or heat injector. Water source heat pumps enjoy a broad range of commercial/institutional applications, particularly in medium to large sized buildings with many small, individually controlled spaces. We believe the market share for commercial/institutional water source heat pumps relative to other types of heating and air-conditioning systems will continue to grow due to the relative efficiency and longevity of such systems, as well as the replacement market for those systems.

Table of Contents

We also provide geothermal heat pumps in residential and commercial/institutional applications. Geothermal systems, which circulate water or a combination of water and antifreeze through an underground heat exchanger, are considered to be the most energy efficient systems currently available in the market. We believe the energy efficiency, longer life, and relatively short payback periods of geothermal systems, as compared with other systems, as well as tax incentives that are available to homeowners and businesses when installing geothermal systems, will increase demand for our geothermal products. Our products are sold to the commercial/institutional markets, as well as single and multi-family residential new construction, renovation and replacements.

Hydronic Fan Coils

We believe that our Climate Control Business is a leading provider of hydronic fan coils targeting commercial and institutional markets. Hydronic fan coils use heated or chilled water provided by a centralized chiller and/or boiler, through a water pipe system, to condition the air and allow individual room control. Hydronic fan coil systems are quieter, have longer lives and lower maintenance costs than other comparable systems used where individual room control is required. Important components of our strategy for competing in the commercial/institutional renovation and replacement markets include the breadth of our product line coupled with customization capability provided by a flexible manufacturing process. Hydronic fan coils enjoy a broad range of commercial/institutional applications, particularly in medium to large sized buildings with many small, individually controlled spaces.

Production, Capital Investments and Backlog Climate Control Business

We manufacture our products in many sizes and configurations, as required by the purchaser, to fit the space and capacity requirements of hotels, motels, schools, hospitals, apartment buildings, office buildings and other commercial/institutional or residential structures. Most customers place their product orders well in advance of required delivery dates.

During 2011, we invested approximately $5.7 million in additional property, plant and equipment (PP&E) primarily relating to the purchase of production equipment and facility upgrades for additional capacity relating to our Climate Control Business.

As of December 31, 2011, we have committed to spend an additional $0.3 million primarily for production equipment and facility upgrades in 2012. In addition, planned spending in 2012 is approximately $12 million although any commitment for any investment will be based on factors including but not limited to: the maintenance, repair, and replacement of existing equipment and facilities; efficiency/productivity improvements; and an increase in our capacity to produce and distribute products as related to expectations for growth in the markets we serve. See discussions under Liquidity and Capital Resources-Capital Expenditures of Item 7 of Part II of this report, including Advanced Manufacturing Energy Credits awarded to two subsidiaries of the Climate Control Business.

The backlog of confirmed customer product orders (purchase orders from customers that have been accepted and received credit approval) for our Climate Control Business was approximately $44.5 million and $47.6 million as of December 31, 2011 and 2010, respectively. The backlog of product orders generally does not include amounts relating to shipping and handling charges, service orders or service contract orders. The backlog also excludes contracts for our construction business due to the relative size of individual projects and, in some cases, extended timeframe for completion beyond a twelve-month period.

Historically, we have not experienced significant cancellations relating to our backlog of confirmed customer product orders. We expect to ship substantially all of these orders within the next twelve months; however, it is possible that some of our customers could cancel a portion of our backlog or extend the shipment terms.

Table of Contents

Distribution Climate Control Business

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

	2011	2010	2009
Net sales to OEMs as a percentage of:			
Net sales of the Climate Control Business	21%	24%	23%
LSB s consolidated net sales	7%	10%	11%

Market Climate Control Business

Our Climate Control Business market includes commercial/institutional and residential new building construction, renovation of existing buildings and replacement of existing systems.

Raw Materials and Components Climate Control Business

Numerous domestic and foreign sources exist for the materials and components used by our Climate Control Business, which include compressors, copper, steel, electric motors, valves and aluminum. Periodically, our Climate Control Business enters into futures contracts for copper. We do not anticipate any difficulties in obtaining necessary materials and components for our Climate Control Business. Although we believe we will be able to pass to our customers the majority of any cost increases in the form of higher prices, the timing of these price increases could lag the increases in the cost of materials and components. While we believe we will have sufficient sources for materials and components, a shortage could impact production of our Climate Control products.

Competition Climate Control Business

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

Continue to Introduce New Products Climate Control Business

Based on business plans and key objectives submitted by subsidiaries within our Climate Control Business, we expect to continue to launch new products and product upgrades in an effort to maintain and increase our current market position and to establish a presence in new markets served by the Climate Control Business.

Chemical Business

General

Our Chemical Business manufactures products for three principal markets:

- anhydrous ammonia, fertilizer grade AN, UAN, and ammonium nitrate ammonia solution for agricultural applications,
- high purity and commercial grade anhydrous ammonia, high purity AN, sulfuric acids, concentrated, blended and regular nitric acid, mixed nitrating acids, and DEF for industrial applications, and
- industrial grade AN and solutions for the mining industry.

Table of Contents

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

	2011	2010	2009
Percentage of net sales of the Chemical Business:			
Agricultural products	45%	39%	41%
Industrial acids and other chemical products	32%	36%	37%
Mining products	23%	25%	22%
	100%	100%	100%
Percentage of LSB s consolidated net sales:			
Agricultural products	29%	22%	20%
Industrial acids and other chemical products	20%	21%	18%
Mining products	15%	15%	11%
	64%	58%	49%

Market Conditions Chemical Business

As discussed above and in more detail below under Overview-Economic Conditions of the MD&A contained in this report, we believe that customer demand for our industrial, mining and agricultural products for 2012 will be sufficiently strong to allow us to run the four chemical plants at optimal production rates, which is an important operating characteristic in chemical process plants. The industrial and mining volumes are driven by general economic conditions as well as contractual arrangements with certain large customers. Fertilizer demand depends upon acres planted of crops requiring fertilizer to enhance yield. The fertilizer outlook could be affected by significant changes in commodity prices, acres planted or weather conditions.

Agricultural Products

Our Chemical Business produces UAN, agricultural grade AN and anhydrous ammonia, all of which are nitrogen-based fertilizers. Farmers and ranchers decide which type of nitrogen-based fertilizer to apply based on the crop planted, soil and weather conditions, regional farming practices and relative nitrogen fertilizer prices. Our agricultural markets include a high concentration of pastureland and row crops, which favor our products. We sell these agricultural products to farmers, ranchers, fertilizer dealers and distributors primarily in the ranch land and grain production markets in the U.S. We develop our market position in these areas by emphasizing high quality products, customer service and technical advice. During the past few years, we have been successful in expanding outside our traditional markets by barging to distributors on the Tennessee and Ohio rivers, and by railing into certain Western States. Our Chemical Business produces a high performance AN fertilizer that, because of its uniform size, is easier to apply than many competing nitrogen-based fertilizer products. Our historical sales of agricultural products are shown in the following table. The sales shown do not reflect amounts used internally, such as ammonia, in the manufacture of other products, or intercompany sales.

	2011		2010		2009	
	Tons	Net Sales	Tons	Net Sales	Tons	Net Sales
			(In Thousands)			
Agricultural Products						
UAN	421	$ 129,507	191	$ 36,794	170	$ 28,109
AN	157	57,703	201	56,758	226	57,182
Ammonia	51	26,392	49	22,430		
Other*		17,997		19,616		19,009

Total	$ 231,599	$ 135,598	$ 104,300

* Includes phosphate and potassium products purchased and sold through our retail and wholesale distribution centers.

Table of Contents

Our Chemical Business establishes long-term relationships with wholesale agricultural distributors and retailers and also sells directly to agricultural end-users through its network of wholesale and retail distribution centers. In addition, our Chemical Business sells at market prices substantially all of the UAN produced at the Pryor Facility pursuant to an agreement. The term of the agreement is through June 2014, but may be terminated earlier by either party pursuant to the terms of the agreement.

Industrial Acids and Other Chemical Products

Our Chemical Business manufactures and sells industrial acids and other chemical products primarily to the polyurethane, paper, fibers, fuel additives, emission control, and electronics industries. We are a major supplier of concentrated nitric acid and mixed nitrating acids, specialty products used in the manufacture of fibers, gaskets, fuel additives, ordnance, and other chemical products. In addition, our Chemical Business produces and sells blended and regular nitric acid. Our Chemical Business is also a niche market supplier of industrial and high purity ammonia for many specialty applications, including the reduction of air emissions from power plants.

We believe the Baytown Facility is one of the largest nitric acid manufacturing units in the U.S., with demonstrated capacity exceeding 1,350 short tons per day. The majority of the Baytown Facility s production is sold to a customer pursuant to a long-term contract (the Bayer Agreement) that provides for a pass-through of certain costs, including the anhydrous ammonia costs, plus a profit. The term of the Bayer Agreement is through June 2014, with certain renewal options.

Our Chemical Business competes based upon service, price, location of production and distribution sites, product quality and performance and provides inventory management as part of the value-added services offered to certain customers.

Mining Products

Our Chemical Business manufactures industrial grade AN and 83% AN solution for the mining industry. Pursuant to a long-term cost-plus supply agreement (the Orica Agreement), our Chemical Business sells to Orica International Pte Ltd. a significant annual volume of industrial grade AN produced at the El Dorado Facility. The term of the agreement is through December 2014.

Major Customer Chemical Business

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

	2011	2010	2009
Net sales to Orica as a percentage of:			
Net sales of the Chemical Business	17%	18%	14%
LSB s consolidated net sales	11%	11%	7%

Raw Materials Chemical Business

The products our Chemical Business manufactures are primarily derived from the following raw material feedstocks: anhydrous ammonia and natural gas. These raw material feedstocks are commodities, subject to price fluctuations.

The El Dorado Facility purchases approximately 200,000 tons of anhydrous ammonia annually and produces and sells approximately 470,000 tons of nitrogen-based products per year. Although anhydrous ammonia is produced from natural gas, the price does not necessarily follow the spot price of natural gas in the U.S. Anhydrous ammonia is an internationally traded commodity and the relative price is set in the world market while natural gas is primarily a nationally traded commodity. The ammonia supply to the El Dorado Facility is transported from the Gulf of Mexico by pipeline. Under an agreement with its principal supplier of anhydrous ammonia, our subsidiary, El Dorado Chemical Company (EDC), purchases a majority of its anhydrous ammonia requirements through December 2012 from this supplier. We believe that we can obtain anhydrous ammonia from other sources in the event of an interruption of service under the above-referenced contract.

Table of Contents

The Cherokee Facility normally consumes 5 to 6 million MMBtu of natural gas to produce and sell approximately 300,000 to 370,000 tons of nitrogen-based products per year. Natural gas is a primary raw material for producing anhydrous ammonia, UAN and other products. Periodically, the Cherokee Facility purchases anhydrous ammonia to supplement its annual production capacity of approximately 175,000 tons. Anhydrous ammonia can be delivered to the Cherokee Facility by truck, rail or barge.

Based on 2011 production rates, the Pryor Facility consumes 5 to 6 million MMBtu of natural gas to produce and sell approximately 300,000 tons of UAN and approximately 35,000 tons of anhydrous ammonia.

The Cherokee and Pryor Facilities natural gas feedstock requirements are generally purchased at spot market price. Periodically, we will enter into firm purchase commitments and/or futures/forward contracts to economically hedge the cost of certain of the natural gas requirements

The Baytown Facility typically consumes more than 100,000 tons of purchased anhydrous ammonia per year; however, the majority of the Baytown Facility s production is sold to a customer pursuant to the Bayer Agreement that provides for a pass-through of certain costs, including the anhydrous ammonia costs, plus a profit.

Spot anhydrous ammonia and natural gas costs have fluctuated dramatically in recent years. The following table shows, for the periods indicated, the high and low published prices for:

- ammonia based upon the low Tampa price per metric ton as published by Fertecon and FMB Ammonia reports and
- natural gas based upon the daily spot price at the Henry Hub pipeline pricing point.

	Ammonia Price Per Metric Ton		Natural Gas Prices Per MMBtu	
	High	Low	High	Low
2011	$ 705	$ 475	$ 4.92	$ 2.80
2010	$ 470	$ 300	$ 7.51	$ 3.18
2009	$ 355	$ 125	$ 6.10	$ 1.85

As of February 15, 2012, the published price, as described above, for ammonia was $400 per metric ton and natural gas was $2.53 per MMBtu.

Sales Strategy Chemical Business

Our Chemical Business has pursued a strategy of developing industrial and mining customers that purchase substantial quantities of products, including contractual obligations to purchase minimum quantities and pricing arrangements that provide for the pass through of raw material and other manufacturing costs. These arrangements help mitigate the volatility risk inherent in the raw material feedstocks and/or the changes in demand for our products. For 2011, approximately 55% of the Chemical Business sales were into industrial and mining markets of which approximately 57% of these sales were pursuant to these types of arrangements. The remaining 45% of our 2011 sales were into agricultural markets primarily at the price in effect at time of shipment. Periodically, we enter into firm purchase commitments and/or futures/forward contracts to economically hedge the cost of natural gas for the purpose of securing the profit margin on a certain portion of our firm sales price commitments in our Chemical Business.

The spot sales prices of our agricultural products may not have a correlation to the anhydrous ammonia and natural gas feedstock costs but rather reflect market conditions for like and competing nitrogen sources. This lack of correlation can compromise our ability to recover our full cost to produce the product in this market. Additionally, the lack of sufficient non-seasonal sales volume to operate our manufacturing facilities at optimum levels can preclude the Chemical Business from reaching full performance potential. Looking forward, we are pursuing profitable growth of our Chemical Business including the potential to increase the output of our existing production facilities. Our strategy also calls for increased emphasis on the agricultural sector, while remaining committed to further developing industrial customers who assume the volatility risk associated with the cost of natural gas and ammonia.

Table of Contents

Seasonality Chemical Business

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

Regulatory Matters Chemical Business

Our Chemical Business is subject to extensive federal, state and local environmental laws, rules and regulations as discussed under Environmental Matters of this Item 1 and various risk factors under Item 1A.

Competition Chemical Business

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

Employees

As of December 31, 2011, we employed 1,841 persons. As of that date, our Climate Control Business employed 1,276 persons, none of whom were represented by a union, and our Chemical Business employed 492 persons, with 149 represented by unions under agreements that expire in July through November of 2013.

Environmental Matters

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

We are obligated to monitor certain discharge water outlets at our Chemical Business facilities. We are also contractually obligated through at least December 2053 to pay a portion of the operating costs of a municipally owned wastewater pipeline currently being constructed, which will serve the El Dorado Facility. Additionally, we have certain facilities in our Chemical Business that contain asbestos insulation around certain piping and heated surfaces, which we plan to maintain or replace, as needed, with non-asbestos insulation through our standard repair and maintenance activities to prevent deterioration.

Table of Contents

1. Discharge Water Matters

The El Dorado Facility owned by EDC generates process wastewater, which includes cooling tower and boiler water quality control streams, contact storm water (rain water inside the facility area which picks up contaminants) and miscellaneous spills and leaks from process equipment. The process water discharge, storm-water runoff and miscellaneous spills and leaks are governed by a state National Pollutant Discharge Elimination System (NPDES) discharge water permit issued by the Arkansas Department of Environmental Quality (ADEQ), which permit is generally required to be renewed every five years. The El Dorado Facility is currently operating under a NPDES discharge water permit, which became effective in 2004 (2004 NPDES permit). In November 2010, a preliminary draft of a discharge water permit renewal, which contains more restrictive ammonia limits, was issued by the ADEQ for EDC s review. EDC submitted comments to the ADEQ on the draft permit in December 2010.

The El Dorado Facility has generally demonstrated its ability to comply with applicable ammonia and nitrate permit limits, but has, from time to time, had difficulty demonstrating consistent compliance with the more restrictive dissolved minerals permit levels. As part of the El Dorado Facility s long-term compliance plan, EDC has pursued a rulemaking and permit modification with the ADEQ. The ADEQ approved a rule change, but on August 31, 2011, the U.S. Environmental Protection Agency (EPA) formally disapproved the rule change. On October 7, 2011, EDC filed a lawsuit against the EPA in the U.S. District Court, El Dorado, Arkansas, appealing the EPA s decision disapproving the rule change. At this time, we do not believe that the occasional noncompliance will have a material adverse impact on EDC. We do not believe this matter regarding the dissolved minerals will be an issue once the pipeline discussed below is operational.

During January 2010, EDC received an Administrative Order from the EPA noting certain violations of the 2004 NPDES permit and requesting EDC to demonstrate compliance with the permit or provide a plan and schedule for returning to compliance. EDC provided a response which states that the El Dorado Facility is now in compliance with the permit, except for an occasional difficulty demonstrating consistent compliance with the more restrictive dissolved minerals permit limits; that the El Dorado Facility expects to be able to maintain compliance and that a majority of the alleged violations were resolved through a consent administrative order with the ADEQ. In June 2011, EDC received an Administrative Complaint from the EPA reciting past violations of the 2004 NPDES permit that had not been addressed by previous ADEQ Consent Administrative Orders and seeking a penalty of $124,000. EDC has met with EPA to discuss the Administrative Complaint and EDC s plans for addressing the occasional noncompliance with the NPDES Permit, as discussed above. EDC has met, and continues to meet, with the EPA to explain its objections against the proposed penalty. In December 2011, EDC was notified by the EPA that the matter has been taken over by the United States Department of Justice (DOJ), the current Administrative Complaint will be withdrawn, and the EPA and DOJ will handle this as a joint enforcement matter. On January 11, 2012, EPA filed a motion requesting authorization to withdraw the Administrative Complaint so that it could proceed with a judicial enforcement proceeding against EDC and certain other companies in the El Dorado, Arkansas, area that have also agreed to use the pipeline discussed below, all of whom have alleged outstanding NPDES permit violations. It is anticipated that EPA s motions will be granted. A liability of $124,000 has been established at December 31, 2011 relating to this matter.

The city of El Dorado, Arkansas (the City) received approval to construct a pipeline for disposal of wastewater generated by the City and by certain companies in the El Dorado area. However, in November 2011, opponents of the pipeline filed a lawsuit against the City and the pipeline consultants for alleged violations of the Freedom of Information Act. We do not believe that this lawsuit will affect the City s approval, or the City s construction, of the pipeline. The companies intending to use the pipeline will contribute to the cost of construction and operation of the pipeline. Although EDC believes it can comply with the more restrictive permit limits without the pipeline, EDC will participate in the construction of the pipeline that will be owned by the City in order to ensure that EDC will be able to comply with future permit limits. During April 2011, certain companies, including EDC, and the City entered into a funding agreement and operating agreement, pursuant to which each party to the agreements has agreed to contribute to the cost of construction and the annual operating costs of the pipeline for the right to use the pipeline to dispose its wastewater. EDC anticipates its capital cost in connection with the construction of the pipeline will be approximately $4.0 million, of which $0.5 million has been capitalized as of December 31, 2011. The City plans to complete the construction of the pipeline by mid-2014. Once the pipeline is completed, EDC s estimated share of the annual

operating costs is to be $100,000 to $150,000. The initial term of the operating agreement is through December 2053.

Table of Contents

In addition, the El Dorado Facility is currently operating under a consent administrative order (2006 CAO) that recognizes the presence of nitrate contamination in the shallow groundwater. The 2006 CAO required EDC to continue semi-annual groundwater monitoring, to continue operation of a groundwater recovery system and to submit a human health and ecological risk assessment to the ADEQ relating to the El Dorado Facility. The final remedy for shallow groundwater contamination, should any remediation be required, will be selected pursuant to a new consent administrative order and based upon the risk assessment. The cost of any additional remediation that may be required will be determined based on the results of the investigation and risk assessment, which costs (or range of costs) cannot currently be reasonably estimated. Therefore, no liability has been established at December 31, 2011, in connection with this matter.

2. Air Matters

The EPA has sent information requests to most, if not all, of the operators of nitric acid plants in the U.S., including our El Dorado and Cherokee Facilities and the Baytown Facility operated by El Dorado Nitric Company and it subsidiaries (EDN) under Section 114 of the Clean Air Act as to construction and modification activities at each of these facilities over a period of years. These information requests will enable the EPA to determine whether these facilities are in compliance with certain provisions of the Clean Air Act. In connection with a review by our Chemical Business of these facilities in obtaining information for the EPA pursuant to the EPA s request, our Chemical Business management believes, subject to further review, investigation and discussion with the EPA, that certain facilities within our Chemical Business may be required to make certain capital improvements to certain emission equipment in order to comply with the requirements of the Clean Air Act. If changes to the production equipment at these facilities are required in order to bring this equipment into compliance with the Clean Air Act, the type of emission control equipment that might be required is unknown and, as a result, the amount of capital expenditures necessary in order to bring the equipment into compliance is unknown at this time but could be substantial.

Further, if it is determined that the equipment at any of our chemical facilities has not met the requirements of the Clean Air Act, our Chemical Business could be subject to penalties in an amount not to exceed $27,500 per day as to each facility not in compliance and be required to retrofit each facility with the best available control technology.

Our Chemical Business has provided to the EPA a proposed settlement offer in connection with this matter. While the total capital cost to achieve the emission rates being proposed by our Chemical Business in the settlement offer has not been determined, the total capital cost could be significant and involving up to nine of our affected nitric acid plants. Our Chemical Business proposed settlement offer did not provide an amount of any proposed civil penalty, if any, but we anticipate that the EPA will require a civil penalty. Therefore a liability of $100,000 has been established at December 31, 2011, in connection with this matter.

3. Other Environmental Matters

In 2002, two subsidiaries within our Chemical Business, sold substantially all of their operating assets relating to a Kansas chemical facility (Hallowell Facility) but retained ownership of the real property. At December 31, 2002, even though we continued to own the real property, we did not assess our continuing involvement with our former Hallowell Facility to be significant and therefore accounted for the sale as discontinued operations. In connection with this sale, our subsidiary leased the real property to the buyer under a triple net long-term lease agreement. However, our subsidiary retained the obligation to be responsible for, and perform the activities under, a previously executed consent order to investigate the surface and subsurface contamination at the real property and a corrective action strategy based on the investigation. In addition, certain of our subsidiaries agreed to indemnify the buyer of such assets for these environmental matters. Based on the assessment discussed above, we account for transactions associated with the Hallowell Facility as discontinued operations.

The successor (Chevron) of a prior owner of the Hallowell Facility has agreed in writing, within certain limitations, to pay and has been paying one-half of the costs of the interim measures relating to this matter as approved by the Kansas Department of Environmental Quality, subject to reallocation.

Table of Contents

Our subsidiary and Chevron are pursuing with the state of Kansas a course of long-term surface and groundwater monitoring to track the natural decline in contamination. Currently, our subsidiary and Chevron are in the process of performing additional surface and groundwater testing. We have accrued for our allocable portion of costs for the additional testing, monitoring and risk assessments that could be reasonably estimated.

In addition, the Kansas Department of Health and Environment (KDHE) notified our subsidiary and Chevron that the Hallowell Facility has been referred to the KDHE s Natural Resources Trustee, who is to consider and recommend restoration, replacement and/or whether to seek compensation. KDHE will consider the recommendations in their evaluation.

Currently, it is unknown what damages, if any, the KDHE would claim, if any. The ultimate required remediation, if any, is unknown. The nature and extent of a portion of the requirements are not currently defined and the associated costs (or range of costs) are not reasonably estimable.

At December 31, 2011, our estimated allocable portion of the total estimated liability (which is included in current accrued and other liabilities) related to the Hallowell Facility is $105,000. The estimated amount is not discounted to its present value. It is reasonably possible that a change in the estimate of our liability could occur in the near term.

ITEM 1A. RISK FACTORS

Risks Related to Us and Our Business

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

Our Climate Control Business can be affected by cyclical factors, such as interest rates, inflation and economic downturns. Our Climate Control Business depends on sales to customers in the construction and renovation industries, which are particularly sensitive to these factors. Due to the recession, we have experienced and could continue to experience a decline in both commercial/institutional and residential construction and, therefore, demand for our Climate Control Business products. A decline in the economic activity in the United States has in the past, and could in the future, have a material adverse effect on us and our customers in the construction and renovation industries in which our Climate Control Business sells a substantial amount of its products. Such a decline could result in a decrease in revenues and profits, and an increase in bad debts, in our Climate Control Business and could have a material adverse effect on our operating results, financial condition and liquidity.

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

Weather conditions adversely affect our Chemical Business.

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

Table of Contents

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

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

Environmental and regulatory matters entail significant risk for us.

Our businesses are subject to numerous environmental laws and regulations, primarily relating to our Chemical Business. The manufacture and distribution of chemical products are activities, which entail environmental risks and impose obligations under environmental laws and regulations, many of which provide for substantial fines and potential criminal sanctions for violations. Although we have established processes to monitor, review and manage our businesses to comply with the numerous environmental laws and regulations, our Chemical Business has in the past, and may in the future, be subject to fines, penalties and sanctions for violations and substantial expenditures for cleanup costs and other liabilities relating to the handling, manufacture, use, emission, discharge or disposal of effluents at or from the Chemical Business facilities. Further, a number of our Chemical Business facilities are dependent on environmental permits to operate, the loss or modification of which could have a material adverse effect on their operations and our financial condition.

If changes to the production equipment at our chemical facilities are required in order to comply with environmental regulations, the amount of capital expenditures necessary to bring the equipment into compliance is unknown at this time and could be substantial.

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

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

In order to comply with the Secure Handling of Ammonium Nitrate Act of 2007 as enacted by the United States Congress, the U.S. Department of Homeland Security (DHS) has published in the August 3, 2011