LSB INDUSTRIES INC
Form ARS
June 10, 2003

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LSB INDUSTRIES
2002
Annual Report

LSB INDUSTRIES, INC.

is a manufacturing and marketing company. Its core businesses manufacture and sell climate control products and chemicals. It also provides machinery and related chemical and industrial engineering services worldwide.

The Company's major business groups consisting of multiple, separate subsidiaries are referred to as "Businesses." LSB's Businesses are market leaders in specific segments of the fertilizer, explosives, industrial acids and climate control markets.

LSB's corporate offices are based in Oklahoma City, Oklahoma, U.S.A. The Company was formed in 1968 as an Oklahoma corporation. It became a Delaware corporation in 1977.

THE CLIMATE CONTROL BUSINESS

manufactures and sells a broad range of fan coils, air-handling, air-conditioning, heating, water source heat pumps, geothermal heat pumps, dehumidification, and air purification products targeted to commercial and residential new-building construction, renovation of existing buildings, and replacement of existing systems. It currently has operations in the United States and Western Europe and markets its products worldwide.

THE CHEMICAL BUSINESS

manufactures and sells prilled ammonium nitrate products, liquid fertilizers and high-grade specialty acids to the industrial, commercial explosives, and agricultural markets. It manufactures packaged explosives and also develops and tests new commercial explosives for the explosive industry worldwide. It markets and licenses a number of proprietary explosive products in the United States, North America and foreign countries.

ENGINEERED PRODUCTS AND SERVICES

The Company markets other industrial products and designs, engineers, tools, specifies and installs world-class chemical and industrial manufacturing facilities for international clients.

PRESIDENT'S LETTER

To our shareholders,

During 2002, sales were $283.8 million with a net profit of $99 thousand compared to sales of $314.9 million with a net profit of $8.6 million in 2001. Both sales and profits were adversely affected by the performance of our Chemical Business, which will be discussed in more detail later. Our Climate Control Business's sales were lower than 2001, but its profits were up. Over all, we were disappointed with results. The best that can be said is that we have sustained a profit for the last three years.

During 2002, we continued to pursue the long-term objectives we have outlined for you in the past: for our Chemical Business to expand its market area and reduce cost risks by entering into cost based contracts, and for our Climate Control Business to continue to develop strong niche positions within the HVAC industry.

Although it is not my intention to discuss the detailed results in this letter, I will highlight certain key numbers, reiterate our goals for the future, and discuss some of the industry and market changes that could affect our Chemical Business going forward. This will require some history to understand where we are.

Background

After experiencing large losses in several years prior to 2001, (mainly from the automotive parts manufacturing business and our Australian explosive manufacturing plants which were sold) we determined that in order to return to profitability we had to narrow our focus and concentrate on our core businesses, the Climate Control and Chemical Businesses. We set out to liquidate other non-core assets and have been doing so when we can realize reasonable value. While doing this, our financial position raised many practical everyday operating problems. Through all of this we have met all of our obligations, and have continued to reduce our debt.

After improved results in 2000 and 2001, at the outset of 2002 we expected an improved year to come. However, as the year progressed our Chemical Business incurred one significant event after another. Some of these will be discussed in the section below dealing with this business.

Chemical Business

Sales during 2002 were $151.1 million with an operating profit of $500,000, compared to sales of $170 million with an operating profit of $3.7 million during 2001. Although actual tonnage sold during 2002 was higher than 2001, market conditions caused the per ton selling price to be lower, impacting revenues negatively. At the same time, costs of the basic raw materials required to produce were higher. This disconnect between selling prices and costs caused our margins to be lower.

During the first week of February 2002 the BATF (Bureau of Alcohol, Tobacco, Firearms) branch of our government, which oversees the explosive industry, cancelled our license to manufacture certain products at our Slurry Explosives ("Slurry") plant in Hallowell, Kansas. During this period of partial shut-down, we lost $3.5 million at Slurry while we sought to sell it. Slurry, which was not considered by us to be core to our primary Chemical Business, was sold in December 2002 and as a result, is reported as a discontinued operation in our financial statements.

In April 2002, El Dorado Chemical's main plant located in Arkansas was damaged by high winds of a suspected tornado. The plant's operations were severely curtailed for a forty-five day period. We lost production and sales. Our insurance coverage on the property damage had a deductible and our business interruption policy had a forty-five day waiting period before it came into effect, resulting in further losses.

In the last few years, there has not been correlation between costs and selling prices of our agricultural chemical products, which account for approximately 40% of our chemical sales. During this period we have seen other fertilizer manufacturers, including Mississippi Chemical, LaRoche Industries, Nitram and Farmland Industries, file bankruptcy. We have also seen other nitrogen producers suffer heavy losses. In general, the nitrogen chemical industry has sustained substantial losses for some time because of the disconnect between costs and selling prices.

In addition, the cost of our primary raw material feed stocks, anhydrous ammonia and natural gas, increased substantially during the third and fourth quarters of 2002. The market price of our agricultural products, which are sold at spot market prices, did not increase sufficiently to recover the full amount of the increases, resulting in lower gross profit.

From a positive standpoint, our two-pronged strategy (i) to expand the market area in which we sell Agricultural Products, and (ii) to enter into cost-based contracts with our customers wherever possible for industrial products, such as anhydrous ammonia, acids and low density ammonium nitrate, has worked. As a result, we have increased our market share and sold more tonnage. This helped cover some of our fixed costs and reduce our earnings volatility.

Although there is no clear path at this time, we believe that the nitrogen chemical industry is ready for a major consolidation, and we are studying ways to take part in it. To prepare for this, we have repositioned our Chemical Management to strengthen the team. Our Chemical Management will undertake the job of pursuing some of these industry-wide opportunities. It is our goal to attempt to take advantage of those opportunities that we have the resources to pursue.

Climate Control Business

Operating profit of Climate Control Business was $14.7 million in 2002 compared to $12.5 million in 2001. Sales were $128.1 million in 2002 compared to $138.4 million in 2001.

During 2002 our Climate Control Business achieved record earnings. The reported earnings included three relatively new operations which incurred losses. We believe that these have good potential which will add to our profit in the future. However, their development in the current economy has been slower than we anticipated.

Immediately following September 11, 2001, we expected to see a drop in our Climate Control Business as new construction paused. At that time, there was a slow-down of new order intake which very quickly recovered. Then during the second half of 2002, we started to see projects postponed because of lack of insurance against terrorism that affected financing of larger construction projects. This became a trend which was intensified by the general economic slowdown and the talk leading up to the Iraq war. For one example, although we had a record year for profit in 2002, our export sales were down from the prior year. We think that the above factors contributed to the drop in export sales. We believe that we recovered some of the lost volume by capturing a larger share of the USA market.

We are continuing the strategy of our Climate Control Business which is to develop proprietary products for niche markets where we think we can achieve significant market share.

The management team of the Climate Control Business is strong. We believe that in the future it will meet the rapidly changing market conditions as they occur.

FUTURE OUTLOOK

During the last few years we have reduced the debt on our balance sheet. We still have non-core assets which we intend to sell under the right circumstances to further deleverage our balance sheet.

In March 2003, we completed a small private placement of our common stock. The purchaser was an existing shareholder of LSB.

Even though there are many factors which affect our business such as the economy, interest rates, product prices and the volume of competitive imported chemical products, our sales groups in both of our core businesses are increasing marketing efforts in order to offset the negative forces at work in our economy. Our team is working hard to put us on the track that leads to future success.

We thank the Shareholders' who have invested in our Company and the employees, business partners and customers who have helped and continue to help us build the Company.

Sincerely,

/s/ Jack E. Golsen
Jack E. Golsen
Chairman of Board, CEO

May 16, 2003

This letter contains certain "Forward-Looking Statements" All estimates and other statements (other than statements of historical facts) contained in this letter are Forward-Looking Statements, such as "consolidation in the Chemical Business", "pursuing some of the industry wide opportunities" and "sell unneeded chemical asset." Please read "Special Note Regarding Forward-Looking Statement" contained in the Form 10-K for a discussion of a variety of factors which could cause the future outcome to differ materially from Forward-Looking Statements contained herein.

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

(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

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(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 February 28, 2003, the Registrant had 11,970,688 shares of common stock outstanding (excluding 3,272,426 shares of common stock held as treasury stock).

Certain information required by Part III of this Form 10-K is incorporated by reference from the registrant's proxy statement for the 2003 annual meeting of stockholders.

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FORM 10-K OF LSB INDUSTRIES, INC.

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PART I

ITEM 1. BUSINESS

General

LSB Industries, Inc. (the "Company", "We", "Us", or "Our") was formed in 1968 as an Oklahoma corporation, and in 1977 became a Delaware corporation. We are a diversified holding company which engages, through our subsidiaries, in (i) the manufacture and sale of chemical products for the agricultural, mining and industrial acids markets (the "Chemical Business") and (ii) the manufacture and sale of a broad range of hydronic fan coils and water source heat pumps as well as other products including large custom air handlers used in commercial and residential air conditioning systems (the "Climate Control Business").

Our Chemical Business is attempting to (i) be a low cost producer, (ii) focus on a specific geographic area where it can develop a freight and distribution advantage and establish a leading regional presence, (iii) provide value-added services as a means of building customer loyalty, and (iv) continue to expand and modify the product mix towards higher margin products. For example, in the agricultural products market, we have developed a geographic advantage in the Texas, Oklahoma, Missouri, Alabama and Tennessee markets by establishing an extensive network of wholesale and retail distribution centers for nitrogen-based fertilizer tailored for regional farming practices and providing value-added services.

Our Climate Control Business seeks to establish leadership positions in niche markets by offering extensive product lines, custom tailored products and proprietary new technologies. Under this focused strategy, we have developed the most extensive line of hydronic fan coils and water source heat pumps in the United States. We have developed flexible production to allow us to custom design units for the growing retrofit and replacement markets. Products developed by our Climate Control Business include large custom air handlers, modular chillers and ultraviolet light units for bacteria removal. Our Climate Control Business is a pioneer in the use of geothermal water source heat pumps in residential and commercial applications. We believe that an aging installed base of residential HVAC systems, coupled with relatively short payback periods of geothermal systems, will continue to increase demand for our geothermal products in the residential replacement market. See "Special Note Regarding Forward-Looking Statements."

We finance our working capital requirements for our wholly-owned subsidiary ClimaChem, Inc. ("ClimaChem") and its wholly-owned subsidiaries through borrowings under a $50 million credit facility with a lender (the "Working Capital Revolver Loan") maturing in April 2005. See Notes 3 and 7 of Notes to Consolidated Financial Statements.

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 Slurry Explosive Corporation ("SEC"), a subsidiary of the Company, for its Hallowell, Kansas Facility ("Hallowell Facility") to produce certain mining products and confiscated certain high explosives inventory. Following February 2002, SEC continued to manufacture certain non-explosive products at its Hallowell Facility. See discussion in Item 3 "Legal Proceedings" and Item 7 "Management's Discussion and Analysis of Financial Condition and

Results of Operations-Overview-Chemical Business."

Another subsidiary of the Company ("UTeC") obtained a license in September 2002 to manufacture at the Hallowell Facility these mining products previously manufactured by SEC at the same facility. Manufacturing was resumed until we sold all of the operating assets of SEC and UTeC in December 2002. See discussion in Item 7 "Management's Discussion and Analysis of Financial Condition and Results of

Operations-Overview-Chemical Business."

In April 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 have been completed; however, 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 entitles the Company 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. See discussion in Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations-Overview-Chemical Business."

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"). 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.

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. 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 as long-term debt. All future interest payments on the Loans will be charged

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against the debt balance presently accrued on the balance sheet. See discussion in Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations-Overview-General" and "Liquidity and Capital Resources-Loan Agreement-Terms and Conditions."

In December 2002, one of our subsidiaries, El Dorado Chemical Company ("EDC") reached an agreement with its then supplier of anhydrous ammonia to purchase 100% of its requirements of purchased ammonia pursuant to a formula-based market price plus transportation to the manufacturing facility in El Dorado, Arkansas through December 31, 2004. Anhydrous ammonia is a principal raw material used by the Chemical Business to manufacture its products.

Segment information and Foreign and Domestic Operations and Export Sales

Schedules of the amounts of net sales, gross profit, operating profit (loss), and identifiable assets attributable to each of our lines of business and of the amount of our export sales in the aggregate and by major geographic area for each of the last three years appear in Note 19 of the Notes to Consolidated Financial Statements included elsewhere in this report.

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 the Notes to the Consolidated Financial Statements.

Chemical Business

General

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 ("UAN") for the agricultural industry, (2) industrial grade ammonium nitrate and solutions for the mining industry and (3) concentrated, blended and regular nitric acid, metallurgical grade ammonia and sulfuric acid for commercial and industrial applications. Our Chemical Business' principal manufacturing facilities are located in El Dorado, Arkansas ("El Dorado Facility"), Cherokee, Alabama, ("Cherokee Facility") and Baytown, Texas ("Baytown Facility"). We also operate an acids blending facility in Wilmington, North Carolina. The following discussion relates to our continuing operations and accordingly excludes the discontinued operations of SEC and UTeC which were sold in 2002.

For each of the years 2002, 2001 and 2000, approximately 38%, 36% and 31% of the respective net sales of our Chemical Business consisted of sales of fertilizer and related chemical products for agricultural purposes, which represented approximately 20%, 19% and 15% of our consolidated net sales for each respective year. For each of the years 2002, 2001, and 2000, approximately 25%, 32% and 26% of the respective net sales of our Chemical Business consisted of sales of industrial grade ammonium nitrate and other products for the mining industry, which represented approximately 13%, 18% and 12% of our 2002, 2001, and 2000 consolidated net sales, respectively. For each of the years 2002, 2001, and 2000, approximately 37%, 32% and 43% of the respective net sales of our Chemical Business consisted of the industrial acids for sale in the polyurethane, paper, chemical and electronics industries, which represented approximately 20%, 17% and 21% of our 2002, 2001, and 2000 consolidated net sales, respectively. Net sales of our Chemical Business accounted for approximately 53%, 54% and 48% of our 2002,

2001 and 2000 consolidated net sales, respectively. For 2002 and 2001, agricultural and mining product sales include sales associated with our Cherokee Facility which we acquired on October 31, 2000.

Agricultural Products

Our Chemical Business produces agricultural grade ammonium nitrate, a nitrogen-based fertilizer, at the El Dorado Facility and the Cherokee Facility and produces UAN and anhydrous ammonia at the Cherokee Facility. Ammonium nitrate and UAN are two of several forms of nitrogen-based fertilizers which are derived from anhydrous ammonia. Although, to some extent, the various forms of nitrogen-based fertilizers are interchangeable, each has its own characteristics which produce agronomic preferences among end users. Farmers 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. We sell these agricultural products to farmers, fertilizer dealers and distributors located primarily in the South Central and Southeastern United States.

Our Chemical Business' agricultural markets are in close proximity to its El Dorado, Arkansas and Cherokee, Alabama facilities and include a high concentration of pasture land and row crops which favor our products. We develop our market position in these areas by emphasizing high quality products, customer service and technical advice. Using a proprietary prilling process, our El Dorado Facility produces a high performance ammonium nitrate fertilizer that, because of its uniform size, is easier to apply than many competing nitrogen-based fertilizer products. We believe that our "E-2" brand ammonium nitrate fertilizer is recognized as a premium product within our primary market. See "Special Note Regarding Forward - Looking Statements." In addition, our El Dorado Facility establishes long-term relationships with end users through its network of 21 wholesale and retail distribution centers and our Cherokee Facility sells directly to agricultural cooperative customers.

Mining Products

Our Chemical Business manufactures industrial grade ammonium nitrate and 83% ammonium nitrate solution for the mining industry. One of our subsidiaries, El Dorado Chemical Company ("EDC") is a party to a long-term cost-plus supply agreement with one of its customers. Under this supply agreement, EDC will supply this customer with approximately 200,000 tons of industrial grade ammonium nitrate per year for a term through at least November 2006.

Another of our subsidiaries Cherokee Nitrogen Company ("CNC") is party to a long-term cost-plus supply agreement with one of its customers. Under this supply agreement, CNC will supply this customer its requirements of 83% ammonium nitrate solution for a term through at least October 2006.

Industrial Acids

Our Chemical Business manufactures and sells industrial acids, primarily to the polyurethane, paper, chemical and electronics industries. We are a major supplier of concentrated nitric acid, a special grade of nitric acid used in the manufacture of plastics, herbicides, explosives, and other chemical products. In addition, we produce and sell blended and regular nitric acid, metallurgical grade ammonia and sulfuric acid. We compete on the basis of price and service, including on-time reliability and distribution capabilities. We provide inventory management as part of the value-added services we offer to our customers.

The Baytown Facility is one of the two largest single train nitric acid manufacturing units in the United States, with name-plate capacity of 443,000 short tons per year. Subsidiaries within our Chemical Business entered into a series of agreements with Bayer Corporation ("Bayer") (collectively, the "Bayer Agreement"). Under the Bayer Agreement, El Dorado Nitric Company ("EDNC") operates the Baytown Facility at Bayer's Baytown, Texas operation. Under the terms of the Bayer Agreement, Bayer will purchase from EDNC all of its requirements for nitric acid at its Baytown operation for an initial ten-year term ending May 2009. EDNC will purchase from Bayer certain of its requirements for materials, utilities and services for the manufacture of nitric acid.

Upon expiration of the initial ten-year term, 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.

EDNC and Bayer may terminate the Bayer Agreement upon the occurrence of certain events of default if not cured. Bayer retains the right of first refusal with respect to any bona fide third-party offer to purchase any voting stock of EDNC or any portion of the EDNC Baytown Plant.

Major Customer

For each of the years 2002, 2001 and 2000, net sales to one customer, Bayer, of our Chemical Business segment represented approximately 19%, 18% and 29% of the respective net sales of our Chemical Business and approximately 10%, 10%, and 14% of our consolidated net sales for each respective year. As discussed above, 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 its Baytown, Texas facility for an initial ten-year term ending May 2009.

Net sales to another customer of our Chemical Business segment represented approximately 16% of the net sales of our Chemical Business and approximately 8% of our consolidated net sales for 2002. The sales to this customer are based on long-term cost-plus supply agreement for a term through at least November 2006.

Raw Materials

Anhydrous ammonia and natural gas represents the primary component in the production of most of the products of our Chemical Business. See Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations."

In December 2002, EDC reached an agreement with its supplier of anhydrous ammonia whereby the former long-term purchase commitment was terminated effective October 31, 2002, and a new agreement was entered into. 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 manufacturing facility in El Dorado, Arkansas through December 31, 2004. We believe that we could obtain anhydrous ammonia from other sources in the

event of a termination or interruption of service under the above-referenced contract. Our Chemical Business natural gas feedstock requirements are generally purchased at spot market price for delivery at our Cherokee Facility. Periodically, our Chemical Business enters into fixed-price natural gas contracts. See "Special Note Regarding Forward-Looking Statements."

Seasonality

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

Sales to the agricultural markets depend upon weather conditions and other circumstances beyond our control. The agricultural markets serviced by our Chemical Business sustained a drought resulting in a lack of demand for our Chemical Business' fertilizer products during the 2000 spring and fall planting seasons, which had a material adverse effect on the Company.

Regulatory Matters

Our Chemical Business is subject to extensive federal, state and local environmental laws, rules and regulations. See "Environmental Matters" and "Legal Proceedings".

Competition

Our Chemical Business competes with other chemical companies in its markets, many of whom have greater financial and other resources than the Company. We believe that competition within the markets served by our Chemical Business is primarily based upon price, location of production and distribution sites, service and product performance.

Climate Control Business

General

Our Climate Control Business manufactures and sells a broad range of standard and custom designed hydronic fan coils and water source heat pumps as well as other niche products for use in commercial and residential heating ventilation and air conditioning ("HVAC") systems. The construction of commercial, institutional and residential buildings, the renovation of existing buildings and the replacement of existing systems drive the demand for our Climate Control Business' products. Our Climate Control Business' commercial products are used in a wide variety of buildings, such as: hotels, motels, office buildings, schools, universities, apartments, condominiums, hospitals, nursing homes, extended care facilities, industrial and high tech manufacturing facilities, food and chemical processing facilities, and pharmaceutical manufacturing facilities. We target many of our products to meet increasingly stringent indoor air quality and energy efficiency standards.

For each of the years 2002, 2001 and 2000, approximately 44%, 44% and 47% of the respective net sales of our Climate Control Business consisted of sales of hydronic fan coil products, which represented approximately 20%, 20% and 22% of our consolidated net sales for each respective year. For each of the years 2002, 2001, and 2000, approximately 45%, 44% and 41% of the respective net sales of our Climate Control Business consisted of sales of water source heat pump products, which represented approximately 20%, 19% and 20% of our 2002, 2001, and 2000 consolidated net sales, respectively. For each of the years 2002, 2001, and 2000, approximately 11%, 12% and 12% of the respective net sales of our Climate Control Business consisted of other HVAC products, which represented approximately 5%, 5% and 6% of our 2002, 2001, and 2000 consolidated net sales, respectively. Sales of our Climate Control Business accounted for approximately 45%, 44% and 48% of our 2002, 2001 and 2000 consolidated net sales, respectively.

Hydronic Fan Coils

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

Water Source Heat Pumps

We are the leading United States provider of water source heat pumps to the commercial construction and renovation markets. These highly efficient heating and cooling products enable individual room climate control through the transfer of heat through a water pipe system which is connected to a centralized cooling tower or heat injector. Water source heat pumps enjoy a broad range of commercial applications, particularly in medium to large sized buildings with many small, individually controlled spaces. We believe the market for commercial water source heat pumps will continue to grow due to the relative efficiency and long life of such systems as compared to other air conditioning and heating systems, as well as to the emergence of the replacement market for those systems. See "Special Note Regarding Forward-Looking Statements".

Our Climate Control Business has also pioneered the use of geothermal water source heat pumps in residential and commercial applications. Geothermal systems, which circulate water or antifreeze through an underground heat exchanger, are among the most energy efficient systems available. We believe the longer life, lower cost to operate, and relatively short payback periods of geothermal systems, as compared with air-to-air systems, will continue to increase demand for our geothermal products. We specifically target new residential construction of homes exceeding $200,000 in value. See "Special Note Regarding Forward-Looking Statements."

Hydronic Fan Coil and Water Source Heat Pump Market

We pursue a strategy of specializing in hydronic fan coils and water source heat pump products. The annual United States market for hydronic fan

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coils and water source heat pumps is in excess of $280 million. Levels of repair, replacement, and new construction activity generally drive demand in these markets. The United States market for fan coils and water source heat pump products has grown on average 7% per year over the last 5 years. This growth is primarily a result of new construction, the aging of the installed base of units, the introduction of new energy efficient systems, upgrades to central air conditioning and increased governmental regulations restricting the use of ozone depleting refrigerants in HVAC systems.

Production and Backlog

Most of our Climate Control Business production of the above-described products occurs on a specific order basis. We manufacture the units in many sizes and configurations, as required by the purchaser, to fit the space and capacity requirements of hotels, motels, schools, hospitals, apartment buildings, office buildings and other commercial or residential structures. 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. A customer generally has the right to cancel an order prior to the order being released to production. Past experience indicates that customers generally do not cancel orders after we receive them. 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 the 2003 calendar year. See "Special Note Regarding Forward-Looking Statements."

Marketing and Distribution

Distribution

Our Climate Control Business sells its products to mechanical contractors, original equipment manufacturers and distributors. Our sales to mechanical contractors primarily occur through independent manufacturers' representatives, who also represent complementary product lines not manufactured by us. Original equipment manufacturers 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. Sales to original equipment manufacturers accounted for approximately 22% of the net sales of our Climate Control Business in 2002 and approximately 10% of our 2002 consolidated net sales.

Market

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

Raw Materials

Numerous domestic and foreign sources exist for the materials used by our Climate Control Business, which materials include compressors, steel, electric motors, valves and copper. Periodically, our Climate Control

Business enters into fixed-price copper and steel contracts. We do not expect to have any difficulties in obtaining any necessary materials for our Climate Control Business. See "Special Note Regarding Forward-Looking Statements."

Competition

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

Employees

As of December 31, 2002, we employed 1,487 persons. As of that date, (i) our Chemical Business employed 506 persons, with 133 represented by unions under agreements expiring in July and October of 2004 and (ii) our Climate Control Business employed 845 persons, none of whom are represented by a union.

Research and Development

We incurred approximately $125,000 in 2002, $147,000 in 2001, and $132,000 in 2000 of research and development costs relating to the development of new products or the improvement of existing products. We expensed all expenditures for research and development related to the development of new products and improvements.

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 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 Facility and the 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 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 2001 and 2000, EDC's net sales from the El Dorado Facility were approximately $104.9 million and $94.4 million, respectively.

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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 declined to plead to a misdemeanor violation. EDC is engaging in discussions with the AUSA in an attempt to resolve the above concerns.

Consent Order for the Hallowell, Kansas Facility

In April 2002, SEC entered into a consent administrative order ("Slurry Consent Order") with the Kansas Department of Health and Environment ("KDHE"), regarding the 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 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 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. At this time, the cost of additional emission controls is unknown, however, it is not expected to be material. 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.

ITEM 2. PROPERTIES

Chemical Business

Our Chemical Business primarily conducts manufacturing operations (i) on 150 acres of a 1,400 acre tract of land located at the El Dorado Facility, (ii) on 120 acres of a 1,300 acre tract of land located at the Cherokee Facility, (iii) in a mixed acid plant in Wilmington, North Carolina ("Wilmington Plant"), and (iv) in a nitric acid plant at the Baytown Facility. Our Chemical Business owns all of its manufacturing facilities except the Baytown Facility. The Baytown Facility is being leased pursuant to a leveraged lease from an unrelated third party. As discussed in Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations - Loan Agreements - Terms and Conditions", the El Dorado Facility (excluding the DSN Plant and other exceptions) and the Cherokee Facility are being used to secure loans under a financing agreement. As of December 31, 2002, the El Dorado Facility and Cherokee Facility were utilized at approximately 71% and 56% of capacity, respectively, based on continuous operation.

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Our Chemical Business distributes its agricultural products through 21 distribution centers, with 16 of the centers located in Texas (13 of which the Company owns and 3 of which it leases); 2 centers located in Missouri (1 of which the Company owns and 1 of which it leases); 2 centers located in Tennessee (owned); and 1 center located in Illinois (leased).

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

Climate Control Business

Our Climate Control Business conducts its fan coil manufacturing operations in a facility located in Oklahoma City, Oklahoma, consisting of approximately 265,000 square feet. We own this facility subject to a mortgage. As of December 31, 2002, our Climate Control Business was using 90% of the productive capacity, based on one eight-hour shift per day and a five-day week.

Our Climate Control Business manufactures most of its heat pump products in a 270,000 square foot facility ("Building") in Oklahoma City, Oklahoma. We lease the Building with an option to buy through May 2016, with options to renew for three additional five-year periods. As of December 31, 2002, 68% of the productive capacity of this manufacturing operation was being utilized, based on two ten-hour shifts per day and a four-day week in one department and one ten-hour shift per day and a four-day week in all other departments.

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

ITEM 3. LEGAL PROCEEDINGS

Draining of Equalization Pond at the El Dorado, Arkansas Plant

As fully discussed in Item 1 "Business-Environmental Matters", 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. 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 is engaging in discussions with the AUSA in an attempt to resolve the above concerns.

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.

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 lawsuit is pending in the United State District Court, Western District of Arkansas, El Dorado Division. 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. The lawsuit is pending in United States District Court in El Dorado, Arkansas. See "Business - Environmental Matters" for a discussion as to consent agreements with the ADEQ relating to EDC and with the KDHE relating to SEC, at pages 12-16 above.

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

No matters were submitted to a vote of our shareholders during the fourth quarter of 2002.

ITEM 4A. EXECUTIVE OFFICERS OF THE COMPANY

Identification of Executive Officers

The following table identifies our executive officers.

Name	Age	Position and Offices with the Company	Served as an Officer from
Jack E. Golsen	74	Board Chairman and President	December 1968
Barry H. Golsen	52	Board Vice Chairman and President of the Climate Control Business	August 1981
David R. Goss	62	Senior Vice President of Operations and Director	March 1969
Tony M. Shelby	61	Senior Vice President - Chief Financial Officer, and Director	March 1969

Jim D. Jones	61	Vice President - Treasurer and Corporate Controller	April 1977
David M. Shear	43	Vice President and General Counsel	March 1990

Our officers serve one-year terms, renewable on an annual basis by the Board of Directors. All of the individuals listed above have served in substantially the same capacity with the Company and/or its subsidiaries for the last five years. In March 1996, we executed an employment agreement (the "Agreement") with Jack E. Golsen for an initial term of three years followed by two additional three-year terms. The Agreement automatically renews for each successive three-year term unless terminated by either the Company or Jack E. Golsen giving written notice at least one year prior to the expiration of the then three-year term.

Family Relationships

The only family relationship that exists among our executive officers is that Jack E. Golsen is the father of Barry H. Golsen.

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PART II

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

Market Information

Currently our Common Stock trades on the Over-the-Counter Bulletin Board ("OTC"). The following table shows, for the periods indicated, the high and low bid information for our Common Stock which reflects inter-dealer prices, without retail markup, markdown or commission, and may not represent actual transactions.

	Fiscal Year Ended December 31,			
	2002		2001	
Quarter	High	Low	High	Low
First	3.40	2.55	3.56	2.06
Second	3.60	3.20	3.85	3.15
Third	3.35	2.26	3.75	2.65
Fourth	2.90	2.35	3.10	2.40

Stockholders

As of February 28, 2003, we had 866 record holders of our Common Stock.

Dividends

We are a holding company and, accordingly, our ability to pay cash dividends on our Preferred Stock and our

Common Stock depends in large part on our ability to obtain funds from our subsidiaries. The ability of ClimaChem (which owns substantially all of the companies comprising the Chemical Business and the Climate Control Business) and its wholly-owned subsidiaries to pay dividends and to make distributions to us is restricted by certain covenants contained in the Working Capital Revolver Loan to which they are parties.

Under the terms of the Working Capital Revolver Loan, ClimaChem cannot transfer funds to us in the form of cash dividends or other distributions or advances, except for (i) the amount of income taxes that ClimaChem would be required to pay if they were not consolidated with us and (ii) an amount not to exceed fifty percent (50%) of ClimaChem's cumulative net income from January 1, 1998 through the end of the period for which the calculation is made for the purpose of proposing a payment, and (iii) the amount of direct and indirect costs and expenses incurred by us on behalf of ClimaChem pursuant to a certain services agreement and a certain management agreement between us and ClimaChem. See Note 7 of Notes to Consolidated Financial Statements and Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations".

Holders of our Common Stock are entitled to receive dividends only when, as and if declared by our Board of Directors. No cash dividends may be paid on our Common Stock until all required dividends are paid on the outstanding shares of our Preferred Stock, or declared and amounts set apart for the current period, and, if cumulative, prior periods.

As of December 31, 2002, we have issued and outstanding, 623,550 shares of $3.25 Convertible Exchangeable Class C Preferred Stock, Series 2 ("Series 2 Preferred"), 1,000,000 shares of Series D Cumulative Convertible Class C Preferred Stock ("Series D Preferred"), 1,167 shares of a series of Convertible Non Cumulative Preferred Stock ("Non Cumulative Preferred Stock") and 20,000 shares of Series B 12% Convertible, Cumulative Preferred Stock ("Series B Preferred"). Each share of Preferred Stock is entitled to receive an annual dividend, if, as and when declared by our Board of Directors, payable as follows: (i) Series 2 Preferred at the annual rate of $3.25 a share payable quarterly in arrears on March 15, June 15, September 15 and December 15, which dividend is cumulative, (ii) Series D Preferred at the rate of $.06 a share payable on October 9, which dividend is cumulative but will be paid only after accrued and unpaid dividends are paid on the Series 2 Preferred, (iii) Non Cumulative Preferred Stock at the rate of $10.00 a share payable April 1, which are non-cumulative and (iv) Series B Preferred at the rate of $12.00 a share payable January 1, which dividend is cumulative.

Due to our previous operating losses and our subsidiaries limited borrowing ability under the credit facility then in effect, our Board of Directors discontinued payment of cash dividends on our Common Stock for periods subsequent to January 1, 1999, until our Board of Directors determines otherwise. Also due to our previous operating losses and our liquidity position, we have not declared or paid the regular quarterly dividends of $.8125 on our outstanding Series 2 Preferred since June 15, 1999. In addition, we did not declare or pay the regular annual dividend of $12.00 on the Series B Preferred since 1999.

No dividends or other distributions, other than dividends payable in Common Stock, shall be declared or paid, and no purchase, redemption or other acquisition shall be made, by us in connection with any shares of Common Stock until all cumulative and unpaid dividends on the Series 2 Preferred, Series D Preferred and Series B Preferred shall have been paid. As of December 31, 2002, the aggregate amount of unpaid dividends in arrears on our Series 2 Preferred, Series D Preferred and Series B Preferred totaled approximately $7.1 million, $.1 million and $.7 million, respectively. We do not anticipate having funds available to pay dividends on our stock (Common or Preferred) for the foreseeable future. See Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources" for further discussion of our payment of cash dividends. Also see Notes 3, 7, 9, 10 and 11 of Notes to Consolidated Financial Statements.

Sale of Unregistered Securities

Effective December 1, 2002, we granted nonqualified options to purchase up to an aggregate 112,000 shares of common stock to former employees of our former subsidiaries, SEC and UTeC. These options were part of the employees' severance compensation arising from the sale of SEC and UTeC. 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 of SEC and UTeC. Each nonqualified option became exercisable on the date of grant and has a term of 10 years. Of the 112,000 shares issuable under the options, 4,000 shares have an exercise price of $9.00 per share, 34,000 have an exercise price of $4.188 per share, 34,000 have a exercise price of $2.37 per share, and 40,000 have an exercise price of $1.25.

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On March 7, 2002, the Company granted to an employee of the Company a 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 26, 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.

Based on the representations and warranties of the recipients, as contained in the nonqualified option agreements, the cash grant of the nonqualified options discussed above was exempt from registration under the Securities Act 1933, as amended (the "Act") pursuant to section 4 (2) of the Act as a private offering.

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ITEM 6. SELECTED FINANCIAL DATA

	Years ended December 31,				
	2002	2001	2000	1999	1998
	(Dollars in Thousands, except per share data)				
Selected Statement of Operations Data (1):					
Net sales (2)	$283,811	$ 314,942	$272,668	$ 237,369	$239,929
Interest expense (4)	$ 7,590	$ 13,338	$ 14,707	$ 14,497	$ 13,842
Income (loss) from continuing operations before cumulative effect of accounting change (3)	$ 2,700	$ 7,330	$ 7,969	$ (32,863)	$ 1,766
Net income (loss)	$ 99	$ 8,557	$ 6,195	$ (49,767)	$ (1,920)
Net income (loss) applicable to common stock	$ (2,228)	$ 6,290	$ 3,424	$ (52,995)	$ (5,149)
Income (loss) per common share applicable to common stock:					
Basic:					
Income (loss) from continuing operations before cumulative effect of accounting change	$ ..03	$ ..43	$ ..44	$ (3.05)	$ (.12)

Income (loss) from discontinued operations, net	$ (.29)	$ ..10	$ (.15)	$ (1.43)	$ (.30)
Net income (loss)	$ (.19)	$ .53	$ .29	$ (4.48)	$ (.42)
Diluted:					
Income (loss) from continuing operations before cumulative effect of accounting change	$ ..03	$ ..41	$ ..43	$ (3.05)	$ (.12)
Income (loss) from discontinued operations, net	$ (.29)	$ ..09	$ (.14)	$ (1.43)	$ (.30)
Net income (loss)	$ (.19)	$ .50	$ .29	$ (4.48)	$ (.42)

- Amounts are shown excluding balances related to businesses disposed of and discontinued operations.
- Net sales for 2002, 2001 and 2000 include $33.4 million, $35.9 million and $7.1 million, respectively, associated with a subsidiary's operation of the Cherokee Facility acquired in October 2000.
- Income (loss) from continuing operations before cumulative effect of accounting change includes gains on sales of property and equipment of $6.6 million for 2001 and gains on extinguishment of debt of $1.5 million, $2.6 million and $20.1 million for 2002, 2001 and 2000 respectively.
- In the second quarter of 2002, the repurchase of Senior Unsecured 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.

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ITEM 6. SELECTED FINANCIAL DATA (CONTINUED)

	Years ended December 31,		
	2002	2001	2000