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LXU - Q3 2019 LSB Industries Inc Earnings Call

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CORPORATE PARTICIPANTS

Cheryl Maguire *LSB Industries, Inc. - Senior VP & CFO*

Kristy Carver *LSB Industries, Inc. - Senior VP & Treasurer*

Mark T. Behrman *LSB Industries, Inc. - President, CEO & Director*

CONFERENCE CALL PARTICIPANTS

James Philip Geygan *Global Value Investment Corp - VP Advisory*

Joseph Logan Mondillo *Sidoti & Company, LLC - Research Analyst*

Roger Neil Spitz *BofA Merrill Lynch, Research Division - Director and High Yield Research Analyst*

Travis Edwards *Goldman Sachs Group Inc., Research Division - Research Analyst*

PRESENTATION

Operator

Greetings, and welcome to LSB Industries' Third Quarter 2019 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded. It is now my pleasure to turn the conference over to your host, Kristy Carver, Senior Vice President and Treasurer. Thank you. You may begin.

Kristy Carver - *LSB Industries, Inc. - Senior VP & Treasurer*

Thank you, Rob, and good morning, everyone. Joining me today on the call are Mark Behrman, our Chief Executive Officer; and Cheryl Maguire, our Chief Financial Officer.

Please note that today's call will include forward-looking statements and because these statements are based on the company's current intent, expectations and projections, they are not guarantees of future performance, and a variety of factors could cause actual results to differ materially.

As this call will include references to non-GAAP results, please reference the press release in the Investors section of our website, lsbindustries.com, for further information regarding forward-looking statements and reconciliations of non-GAAP results to GAAP results.

At this time, I'd like to go ahead and turn the call over to Mark for opening remarks.

Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

Thank you, Kristy, and good morning, everyone. We're glad that you could participate in our call this morning and appreciate your interest in LSB Industries.

Our financial results were in line with our expectations for the third quarter, which as a reminder is typically our seasonally weakest quarter, given the fertilizer application season slows down after the second quarter once all crop planting occurs. Fertilizer manufacturers generally try to schedule turnarounds during a seasonally slower time of the year, and we follow suit. During the third quarter, as previously announced, we performed scheduled turnarounds on 2 of our facilities that we expect to yield meaningful payoffs in the years to come. More on that in a moment.

Despite lower ammonia prices resulting from the weather issues we've had throughout the Midwest, our third quarter adjusted EBITDA increased from the same period last year, aided by higher selling prices for UAN and HDAN, higher production and lower natural gas prices.



During the third quarter, we began turnarounds at our El Dorado and Pryor facilities. El Dorado was successfully completed in September, and Pryor has completed all of its maintenance work and is in start-up. First, congratulations to both the El Dorado and Pryor teams for getting the work done safely. The safety of our employees and our contractors remains our #1 priority.

The turnaround at Pryor was the most extensive turnaround at that facility in our history. The good news is we didn't have any major finds or discoveries that would have taken us out of production for an extended period of time. We did, however, find some unplanned repair work that needed to be done since the goal of this turnaround was to ensure that we could materially improve the reliability of all the plants at this facility. What's most important is that we believe we have addressed the issues that we identified in support of Pryor's long-term reliability. The extra time we took to fix these issues, combined with a few bad weather days, elongated the turnaround from the estimated 30 days to approximately 50 days. We now feel that we have materially improved our ability to operate the Pryor facility at consistently higher operating rates, allowing us to generate more product for sale with reduced production costs.

Beyond the usual significance of planned maintenance events with respect to efficiency and reliability, these turnarounds were significant in 2 additional aspects. First, we are now on a 3-year turnaround cycles at both our Cherokee and El Dorado facilities, with the next turnaround at Cherokee scheduled for 2021 and in El Dorado for 2022. Our Pryor facility is comfortably on a 2-year turnaround cycle, with its next turnaround scheduled for 2021. Our plan is to not schedule any turnarounds for next year based on our current schedule and feelings about the condition of our plants.

The completion of this work positions us very well to capitalize on what we expect to be a stronger year for the agricultural market, which I'll discuss in further detail later, and the continued growth in our industrial and mining businesses.

Secondly, as part of the turnaround at Pryor, we installed a new urea reactor. This new equipment will enable us to increase daily urea production, allowing us to increase UAN production by as much as 100 tons per day.

Turnarounds are one important element of our overall ongoing initiatives to make our facilities more reliable. I'm pleased to report that for the third quarter of 2019, excluding the periods of planned maintenance at El Dorado and Pryor, our 3 ammonia plants once again averaged an on-stream rate of 94%. That gives us a 94% average on-stream rate for the past 5 quarters, and we expect to continue to operate consistently in future quarters. While we still have room for improvement, as indicated by our stated goal of consistently achieving an average on-stream rate of 96%, I feel comfortable stating that we are well on our way to reaching that goal as a result of the positive impacts of leadership changes, the capital improvements we've made over the last few years and the continued focus on and investment in improving our operating processes and procedures.

Ultimately, our goal is to be a best-in-class chemical manufacturer as measured not only by consistent operating rates but also by a strong environmental health and safety record. Every day, our employees show our commitment to this goal, particularly those at the plant level, and I want to thank them for their dedication and efforts.

Lastly, beginning in the third quarter of 2019, we excluded certain specific legal costs in our calculation of adjusted EBITDA for 2019 and 2018. These costs are related to litigation we brought against Leidos, the general contractor in our El Dorado ammonia plant expansion project, which began in 2013 and concluded in 2016 and which incurred substantial cost overruns. We are seeking more than \$100 million in damages as compensation for Leidos' wrongdoing, which involved breach of contract, fraud, gross negligence, professional negligence and negligence.

Relatedly, in a prior year, we were brought in as a defendant in a case where Global Industrial, a subcontractor involved with the expansion, sought damages from Leidos. We requested indemnifications from Leidos under the terms of our contracts with them, and they did not honor that request. Therefore, we had to incur legal costs to defend ourselves. We will be seeking reimbursement of these legal costs as well.

To date, we have incurred approximately \$10.6 million in legal and expert witness fees for prosecuting our claims against Leidos and defending the claims brought by Global despite our request from Leidos for indemnification, including \$3.3 million in this most recent third quarter. Our trial against Leidos is scheduled to begin in February 2020, and we anticipate that between now and then, we will spend an additional \$1 million per month as we prepare for the impending trial. While we can't guarantee any outcome in litigation or the recovery of any damages, we are vigorously pursuing this matter.



I'll discuss our market outlook for the balance of 2019 and 2020 later in the call. Now Cheryl will go into more detail about our Q3 financial results. Cheryl?

Cheryl Maguire - *LSB Industries, Inc. - Senior VP & CFO*

Thanks, Mark, and good morning, everyone.

Page 5 of the presentation provides a consolidated summary statement of operations for the third quarter of 2019 as compared to the third quarter of 2018. In reviewing our operations for the third quarter, total net sales in Q3 2019 decreased 5% to \$75.5 million from \$79.8 million in Q3 of 2018. Gross profit remained flat to prior year as we were able to offset lower selling prices, particularly for ammonia, with solid ammonia operating rates and lower overall fixed and variable costs. Additionally, natural gas costs were 11% lower than the third quarter last year, and we expect that gap to widen in the fourth quarter.

Adjusted EBITDA for the third quarter of 2019 was higher than last year, and I will bridge EBITDA for you on the next slide.

With respect to legal costs related to our case against Leidos, given the significance of the costs particularly in the third quarter of 2019 and our expectation of ongoing similar costs as we prepare for trial, we have adjusted EBITDA to reflect the add-back of these onetime costs, which we believe is a truer reflection of ongoing operations. Please refer to our reconciliation of non-GAAP measures beginning on Slide 12 for further information on noncash and onetime costs incurred during the period.

Page 6 bridges our consolidated adjusted EBITDA for Q3 2018 of \$10.6 million to adjusted EBITDA for Q3 2019 of \$11.1 million. Our year-over-year improvement reflects higher net selling prices for UAN and HDAN coupled with favorable natural gas feedstock prices and lower overall costs, partially offset by lower selling prices for industrial products due in large part to a decline in the Tampa ammonia benchmark price as the Tampa price declined approximately \$90 per metric ton year-over-year from an approximate price of \$310 per metric ton in the third quarter of 2018 to approximately \$220 per metric ton in the third quarter of 2019.

Turning to Page 7. We have outlined the gross profit margins for each of our market segments. This presentation excludes depreciation, amortization and turnaround expenses and therefore, should represent the true underlying cash margins at each market. We have reconciled this back to gross profit as presented on the financial statements on Slide 13. As Mark pointed out, the third quarter is our seasonally weakest period. Given that, we take the opportunity to perform planned turnarounds, which results in lower production and fixed cost absorption and overall reduced profit margins. The El Dorado ammonia turnaround lasted 18 days in the quarter, and the Pryor facility was in turnaround for 24 days in September, with the balance in October, as Mark mentioned.

While margins are generally lower in the third quarter as a result of lower demand and lower production due to the scheduled maintenance, our ag business gross profit margins increased from 5% to 9% as we realized stronger sales volumes for UAN and ammonia, which increased 26% and 11%, respectively, year-over-year, primarily driven by higher production at Cherokee, which was in turnaround for 35 days in the third quarter of 2018.

Furthermore, agricultural net selling prices improved year-over-year, with HDAN and UAN increasing 13% and 4%, respectively. Partially offsetting these gains were lower HDAN volumes, which decreased 38% quarter-over-quarter as we experienced unusually hot and dry weather in our primary geographic end markets during the third quarter as compared to last year when there was greater rainfall during the quarter creating additional demand. Gross profit margins in our industrial and mining markets were comparable to last year as stronger sales volumes were offset by lower sales prices due to the continued price pressure on Tampa ammonia benchmark price. Overall, industrial margins remain robust despite a very low Tampa environment.

Looking forward to the fourth quarter of 2019, please turn to Page 8. This page illustrates current expected average selling prices based on forward sales of product or current spot market sales prices and the current average natural gas prices we are paying or have hedged. Additionally, as you might recall, in the fourth quarter of 2018, we received a \$4.4 million favorable settlement with a subcontractor. Excluding this recovery, adjusted

EBITDA for Q4 2018 would have been closer to \$19 million, and we expect adjusted EBITDA for the fourth quarter of 2019 to be in line with this level.

Impacting the 2019 fourth quarter are continued headwinds with the current Tampa ammonia pricing at \$90 per metric ton, lower than the fourth quarter of last year, and lower production related to the carryover of the Pryor turnaround into the fourth quarter. On the positive side, we have approximately 70% of our gas needs locked in for Q4 at approximately \$2.40 per MMBtu. This represents a 30% reduction in gas cost as compared to the fourth quarter of last year. Additionally, we continue to expect fourth quarter on-stream rates at our ammonia plants, excluding the turnaround days at our Pryor facility, to be in line with the last 5 quarters at approximately 94% and production rates of other downstream products to improve.

Moving to Page 9, we outline our free cash flow. Cash provided from operations for the first 9 months of 2019 was approximately \$41 million compared to \$38.8 million for the same period of 2018. Capital expenditures predominantly related to reliability and maintenance investments were approximately \$20.5 million for the first 9 months of 2019. Cash CapEx for the fourth quarter is expected to be approximately \$10 million.

Page 10 outlines our capital structure at the end of Q3 2019. We ended the quarter with approximately \$67 million in cash and over \$33 million of availability on our revolving credit facility, giving us total liquidity of approximately \$100 million. Total outstanding debt at quarter end was approximately \$457 million with net debt of approximately \$390 million. We also ended the quarter with outstanding preferred stock of approximately \$235 million, including accrued and unpaid dividends.

Now I'll turn it back over to Mark to wrap up.

Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

Thank you, Cheryl.

The past 12 months has been a historically difficult period for farmers with cold wet weather that not only made soil conditions extremely nonconductive to fertilizer application and planting but also had ripple effects throughout the entire rail, barge and truck distribution system. While thus far the USDA has forecast only minimal -- only a minimal decline in planted and harvested corn acres from the expectations going into the year, we believe that, ultimately, the final assessment will show that both are down significantly from the current USDA forecast 2018 and previous years. More specifically, we believe both the acres harvested and yields per acre will be below the USDA current estimates. The market appears to agree with this point of view as corn prices have risen back to the approximate \$4 per bushel level down from the spike in price over the summer but up from this time 1 year ago.

As a result of these indicators, we anticipate that farmers will plant a significant number of additional acres in the upcoming season as several current estimates call for between 94 million and 95 million acres planted. Based on that expectation, coupled with the depletion of nutrients in the soil after all the heavy wet weather, various industry resources -- various industry sources expect that there will be a heavy fall ammonia application in the coming weeks, conditions permitting. We are already seeing ammonia application in selected parts of the country where the weather has allowed corn to be harvested.

Over the past few months, ammonia pricing has begun to recover, with prices rising about \$50 a metric ton in all markets we sell. Additionally, the Tampa ammonia price was priced at \$260 a metric ton for November, up approximately \$40 a metric ton from its low point during the third quarter. This is a positive sign as it indicates increasing expectations for demand and that excess inventory that has been in the distribution channel has been absorbed by the market. We believe it also reflects optimism about the outlook for the agricultural market, which we believe is warranted.

With respect to UAN pricing, relative to the significant run-up in the fourth quarter of last year, UAN prices are back to more historical pricing behavior. We believe that on-farm and retailer UAN storage is extremely low as the farmers are generally focused on harvesting their crops, which should set up a significant amount of demand at increased prices.

Lastly, with our plants running well and without the need for any turnarounds in 2020, we are optimistic that factors are lining up well for us to deliver significant year-over-year growth in adjusted EBITDA and free cash flow in 2020.



On previous calls, I discussed various business improvement initiatives that we've had underway to enhance our financial results. We're very pleased with the operating performance of our plants and feel confident that they can now run with greater consistency than at any time in the company's history and without extended unplanned downtime events. Our goal remains an on-stream rate of 96% for ammonia plants, which we expect to achieve over the next 12 to 24 months. However, continuing at the 94% on-stream rate that we've averaged over the past 5 quarters, combined with improvements we are executing in other areas of our business, will allow us to continue our growth in EBITDA.

On the commercial side of our business, we are in the final stages of negotiation with a customer to build a gas plant at our El Dorado facility that will use CO₂ generated from our El Dorado ammonia plant. Currently, El Dorado was venting CO₂, so this new arrangement will enable us to generate incremental EBITDA using a product we are already producing. We expect the new gas plant to be completed at the end of next year, at which time we will begin selling product to the customer.

Additionally, we are in discussions with several existing industrial and mining customers to expand our current relationships with them, allowing us to increase sales to those customers. This would utilize additional production capacity and change our product mix to higher-margin products. We hope to provide more color on these efforts next quarter.

We've also talked previously about our efforts in supply chain management. Over the past 2 years, we've taken out approximately \$3.5 million of cost by improving our procurement and logistics capabilities and focus, and we believe there are additional costs that we can reduce over time. Additionally, we are revamping our inventory management processes and expect this effort to lead to a reduction in working capital as we become more efficient.

With respect to our previously announced margin enhancement capital projects, we have approximately \$15 million of capital projects underway. One of these projects is an investment in additional storage capacity for fertilizer product. This new storage will allow us to manufacture product at higher production rates throughout the year, lowering our cost per ton and store that product for future sale at higher demand at times of the year at more favorable prices. We believe that this and the other projects we are planning will generate an additional annual EBITDA of between \$6 million and \$7 million when completed, which we expect will be over the next 15 months. Additionally, we have another \$5 million to \$6 million of capital projects under review that would add additional EBITDA if we elect to proceed with them.

Before I pass the call back to the operator to be -- to begin the Q&A session, I'd like to mention that I will be participating in the Cowen Chemicals, Metals and Mining Summit in New York on November 21, and Cheryl will be attending the BofA Leveraged Finance Conference in Boca Raton on December 4. We hope to see some of you at these events.

That concludes our prepared remarks, and we will now be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Joe Mondillo with Sidoti & Company.

Joseph Logan Mondillo - Sidoti & Company, LLC - Research Analyst

So first, I wanted to just clarify what your expectation is for the fourth quarter. I missed sort of what you anticipate. Usually, you give an EBITDA basis. I thought maybe you said comparable to last year, but could you just clarify what that was?

Cheryl Maguire - LSB Industries, Inc. - Senior VP & CFO

Yes. That's right, Joe. It's comparable to last year after you exclude the settlement that we had in the fourth quarter of \$4.4 million.



Joseph Logan Mondillo - *Sidoti & Company, LLC - Research Analyst*

Okay. And then is that including the turnaround costs at Pryor?

Cheryl Maguire - *LSB Industries, Inc. - Senior VP & CFO*

No. That's adjusted for the turnaround costs. We expect the turnaround at Pryor to be, I don't know, probably about \$1 million in the fourth quarter.

Joseph Logan Mondillo - *Sidoti & Company, LLC - Research Analyst*

Okay. And then, I guess, sticking with Pryor since we're talking -- just mentioned Pryor. Just wanted to try to understand, once this turnaround is complete, which you've characterized in the past as being somewhat substantial in terms of on-stream rates at that plant, how can we look or think about that plant in terms of on-stream rates going forward? How should we see progress? Is it going to be over a week's time, all of a sudden, we're seeing significant improvements in on-stream rates? Or how can we sort of think about the improved productivity at Pryor going forward?

Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

It's a great question. So I think ammonia has actually been running pretty well at Pryor, as evidenced by the average 94% on-stream, right? If it wasn't, obviously, the average would be lower. But I do think we've done a fair amount of work during this turnaround that we can consistently produce at those higher rates because consistency, obviously, is the most important thing here.

What I also believe is that you can see in 2020 some slightly higher rates coming from the ammonia plant. So what I think we really focused on is really our downstream production units and primarily our urea plant. We did have a lot of unplanned downtime in -- over the last 3 years with a very old urea reactor. And that's why we, 2 years ago, we made the decision to purchase a new state of the art urea reactor to really improve the reliability of that plant. Clearly, we want to produce at higher rates with urea so that we can convert that into UAN, which is a higher -- generally a higher-margin product than just selling straight ammonia.

So I think you'll see a shift between ammonia sales and UAN sales. On top of that, as I indicated, we expect that we'll get more production out of this new urea reactor. Could be as much as 100 tons a day so, call it, maybe 25,000, 30,000 tons a year of additional production.

So I think what the goal of this turnaround, since it was very extensive, was to really address numerous of the issues that we had identified, and then you always go in and find discovery work that needs to be taken care of. And so I think we're really comfortable and confident that we can run all of the plants, being the ammonia plant, the urea plant and the nitric acid plants, at significantly higher rates than we've done historically.

Joseph Logan Mondillo - *Sidoti & Company, LLC - Research Analyst*

And the 25,000 to 30,000 tons, I know you're sort of ballparking, but that was related to what, urea or ammonia?

Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

That's related to, ultimately, the UAN production. And quite frankly, we bought a urea reactor that was larger than the previous reactor. That's a ballpark. I mean we won't really know until we're actually producing for a month or so and really see how it produces. You're going to tweak the plant, fine-tune it and ultimately, we'll get to a level that we feel really comfortable with.

Joseph Logan Mondillo - *Sidoti & Company, LLC - Research Analyst*

Okay. Great. And then just in terms of the demand/supply dynamics out there in the market on the fertilizer side of things. Could you talk about supply, first off? I understand sort of the demand dynamics. But just given the weather over the last year or so, could you talk about where supply is generally compared to where it was maybe a year ago at this time?

Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

Well, I mean, I think a year ago, we started to have really poor weather in the fall of last year. So very weak ammonia application season, was really short, truncated. I think there were reports of maybe 500,000 to 700,000 tons of ammonia that was not applied as fertilizer. So you had a lot of buildup in fertilizer -- in ammonia throughout the system, and that persisted throughout the spring as we had a really wet and cold spring. But I think we're at a point now where ammonia is -- somewhat normalized. I don't think we're totally there yet, as evidenced by the pricing, but we are starting to see pricing recover. So I think a lot of that ammonia that was inventoried by ourselves and other producers has really been pushed through the distribution channel.

UAN, I think that's the product that everyone has always talked about, that after the run of expansions here in North America, is a product that's probably balanced. So we are still seeing some UAN imports, particularly after the EU duties that were levied on the United States, Trinidad and Russia. So there is some product coming in here. So I think that's why you've seen UAN prices not really have much of a rise over the last couple of months, and you still might see price -- we'll see price recovery, but it won't be until later on this year or early next year.

And then urea, which is a product we don't sell, but does have a significant impact on the market pricing, still is an importer. And we're still short here in the United States. So urea prices have been coming down globally, as evidenced by a recent Indian -- the recent Indian tenders. But I think sort of pricing has hit somewhat of a floor here. I'm not saying prices are going to increase.

Joseph Logan Mondillo - *Sidoti & Company, LLC - Research Analyst*

Okay. So generally, it sounds like you think supply in the market is generally sort of balanced or close to being more sort of normalized, less balanced. And now it's a little more dependent on demand. So in terms of the fall application season, I've been reading the last week or 2, there have been a couple of storms that have affected things. I understand what you said in your prepared remarks, but any more color that you could provide based on not only the fact that the soil is undersaturated with nutrients but then also, how about the dynamic of being so late in the year of harvesting? Because I think the harvest is quite late relative to normalized years. Is that going to play any effect as the weather gets colder or whatnot? So what are your sort of -- what is the risk here over the -- I guess, we have such a small window over a couple of weeks. How are you thinking about that?

Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

Well, I think you just said it. I mean, clearly, there's going to be a smaller window than we would have liked because of a late harvest. We are starting to see harvest catch up in certain areas. And in areas that -- places like Nebraska, Missouri, Kansas, we're starting to see soil temps -- and generally, soil temps are less than 50 degrees. So you want soil temps as low as possible but not freezing, obviously. So I think harvest is catching up.

What I'd say about the application window is there's a lot of really modern technology out there for applying ammonia, and they can get a lot of ammonia on the ground really quick with a lot of the new technology and sort of the application technology that they have. So I think it's a little too early to call. I think we'll know over the next 2 weeks maybe, maybe stretching 3 weeks, on really how this all plays out. But I think we'll have an ammonia run. We're not sure, as we sit here today, how strong or heavy it might be.

Joseph Logan Mondillo - *Sidoti & Company, LLC - Research Analyst*

Okay. And then just in regard to the productivity improvement projects that you have underway. I just wanted to make sure that I understood your prepared remarks. You have \$15 million of the \$20 million that you announced earlier this year of CapEx projects underway. And within 5 to 6 months, we should start seeing annualized savings of \$6 million to \$7 million? Did I hear that correct?

Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

No. I think that within 15 months. So by the end of next year, we would have completed all the projects. It's not to say that along the way, we won't complete projects and we should see some incremental EBITDA. But by the end of next year, we'll have finished all those projects. And on an annualized basis, we should see \$6 million to \$7 million in EBITDA -- incremental EBITDA.

Joseph Logan Mondillo - *Sidoti & Company, LLC - Research Analyst*

Okay. And that's related to the full \$20 million?

Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

No. That's related to the \$15 million. And if we elect to proceed with additional projects that we're evaluating, that would add incremental EBITDA on top of that.

Joseph Logan Mondillo - *Sidoti & Company, LLC - Research Analyst*

Okay. And then the CO2 venture at El Dorado, is there any other information that you can provide in terms of how big of an opportunity this could be in terms of profits? Or is it too early?

Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

I think I'd probably rather wait until next quarter. Hopefully, we would have completed negotiations and signed a contract moving forward. And so I'll be able to give a little bit more color to that.

Joseph Logan Mondillo - *Sidoti & Company, LLC - Research Analyst*

Okay. And then just 2 last questions. In terms of the Leidos, the legal case there, is there any timing -- I know these things are very difficult and they could be prolonged, and who knows how long it's going to take. But is there any timing estimate of how -- when we think we could see an initial answer to the case itself? Or how long this is going to take? Or not really sure at this point?

Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

Well, as I mentioned, I mean, we have a trial date in February. So that's definite. And we are working hard with our legal counsel and our experts to prepare for that trial, and we will be ready to try the case in February. So whether things happen before then, there's a settlement, not settlement, I mean, our position is and our focus is we will be ready to try the case in February.

Joseph Logan Mondillo - *Sidoti & Company, LLC - Research Analyst*

And do you have any idea of how long of a trial this could be? Is this a few weeks or multiple months?



Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

I'd say it's probably -- the estimate is like 4 weeks.

Joseph Logan Mondillo - *Sidoti & Company, LLC - Research Analyst*

Okay. And then the last question, just in terms of the balance sheet. Just wondering sort of what your thoughts are with this call date coming up in early 2020 and how you've been able to make so much progress with the plants and the on-stream rates, sort of what your thinking is heading into approaching that call date of whether we think we could potentially refinance the debt and potentially maybe take out the preferreds. Just wondering what your updated thoughts on that are.

Cheryl Maguire - *LSB Industries, Inc. - Senior VP & CFO*

Yes, Joe. So you're right, the first call date on the bonds is May of 2020. And as Mark mentioned and as we look forward to 2020, we expect to see improving fertilizer demand, driven by higher corn pricing, depleted nitrogen in the field, strong planting intentions for next year. And all of that combined with we don't have any scheduled turnarounds in 2020. So all that being said, we do expect stronger EBITDA generation in 2020, which will bring more options, we think, to look at our balance sheet. And we'll continue to evaluate those options as we get into 2020.

Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

Joe, I think to add on what Cheryl said, it's really -- once you hit a first call date, at that point, honestly, it becomes a math exercise. What's the call premium -- what's the reduction in rate that we could get versus what's the call premium. And so we'll have to take a -- we'll be in a position to take a look at it. And if it makes sense to do something at or post the first call date, we'll do that, and we'll continue to evaluate it. Second call date, the call premium lowers. And so as I said, it's really -- it's a math exercise at that point.

Joseph Logan Mondillo - *Sidoti & Company, LLC - Research Analyst*

Can you just remind us when the second call date is and what the premium is on that?

Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

Yes. So the call premium on May of 2020 is 107, so it's 7 points of call premium, and then it drops down to 104 in May of '21.

Operator

Our next question is from JP Geygan with Global Value Investment Corporation.

James Philip Geygan - *Global Value Investment Corp - VP Advisory*

I have a few follow-up questions. First, this has been, as you noted, an atypical year for the agricultural segment given weather patterns. You spoke about the ramifications of weather and corn planting and harvesting on the Q4 application -- or fall application. But I'm wondering if you can provide some sort of directional commentary about the ramifications of this year's planting and harvesting into 2020 and 2021, particularly as it pertains to product pricing demand and your adjusted gross margins, which, it looks like, held steady throughout a difficult period, in fact increased.



Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

Well, that was a mouthful. If I'm understanding the question, I mean, I think the industry -- a lot of industry folks have sort of centered around 94 million, 95 million acres planted for the next corn season, right, so '19, '20. And so with that, we should see some strong demand in fertilizer, particularly since we're going to be less than 90 million acres this year. So you should see a lot more demand than we saw this year.

If the logic holds true, that would translate into, weather permitting, a lot more ammonia that goes into the ground this fall, and therefore, they come back in the spring. Farmers will come back in the spring and obviously, put down some more ammonia preplant. And then obviously, we'd have urea and UAN going down and HDAN, in some cases, going down during the planting season.

So I think the expectation is that USDA is high. I think if you talk to a lot of people on the ground, they're seeing something a whole lot different than what the USDA is reporting. We won't know that until sometime next month. I think we'll get a better indication. Hopefully, we'll get a better indication of what's really out in the field. So obviously, both production and spreading out those fixed costs over a larger production base and then pricing has a significant impact on the margins that you're talking about.

Industrial and mining margins have really held steady, so I'm really pleased with that despite a really low Tampa environment. So if we get any pickup in Tampa, you'll see those margins go from, as Cheryl pointed out, 30% EBITDA margins back up to 35% to 37%. We should see that. And then the ag margins, really, we've always said that in mid-market pricing, ammonia north -- I mean, ammonia north of \$300 a ton, Tampa ammonia; UAN, \$180 to \$200 a ton; HDAN, more \$225 to \$240 a ton. I mean we should see our ag margins more in the 30% EBITDA range. So I don't know if that answered the question.

James Philip Geygan - *Global Value Investment Corp - VP Advisory*

Yes, it did very accurately. Moving on, you provided quite a bit of detail around this pipeline of capital projects, particularly your \$15 million worth of projects that are currently underway. I'm wondering if you might address areas outside of these capital projects, where you could grow production by growing sales, particularly with -- or I'm sorry, in the industrial and mining segments, where you might have some additional capacity.

Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

Well, we look at that every day, and I know our sales team is working aggressively to increase sales of AN and AN solution in a pretty difficult market, right? I mean we've got coal declining and utilities talking about continuing closures of coal-fired power plants and really ramping up nat gas power plants. However, the flip side to that is precious metals pricing is actually pretty good. So we're seeing growth out West in precious metals mining. And then the quarry and construction is also still growing.

So I think we've positioned ourselves pretty well to be the -- what I believe to be a preferred supplier of AN and AN solution. And I think the team does a really good job offering a high level of service, which I think is important.

But on the industrial side, nitric acid is a core product for us. We compete with others that might come in and out of the nitric acid market as upgrading that nitric acid to other products slows off and they've got excess nitric acid. We've been in there for 30 years. We're known for it. People know us, that we've got backup plants, so I think that's important. So they've done a really good job in growing the nitric acid business for us, and it's a real focus to continue to do that. And I think you'll see nitric acid sales -- with some of the things we're working on, you should see nitric acid sales have some pretty meaningful growth in 2020 going into 2021. And so yes, we're working hard. We're doing it.

James Philip Geygan - *Global Value Investment Corp - VP Advisory*

Great. The sulphuric acid reactor is, I believe, scheduled to be operational by either late this year or early next year. Is that still on schedule?



Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

Actually, should be in early November, which it should be installed at a turnaround and up and running.

James Philip Geygan - *Global Value Investment Corp - VP Advisory*

And what is the increase in capacity between the old and new facilities?

Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

Well, I think historically, we've been somewhere between 125,000 and 135,000 tons of sales of sulfuric acid. So I would say you should probably see 10,000 to 15,000 tons a year of increased production. So call it 10%, 12% of increased production and sales.

James Philip Geygan - *Global Value Investment Corp - VP Advisory*

Great. You talked about some of the cost savings initiatives or -- I'm sorry, storage initiatives lowering your future working capital requirements. Can you give us an idea of what level of working capital you're comfortable with long term or what you're targeting in terms of working capital?

Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

I don't think I'm in a position to tell you exactly how much yet. I think it's going to -- when you have a project like this, you always find there's pockets of inventory that you're probably in an overinventoried situation, so I think you work down those situations. So I think we'll be in a position next quarter to give at least some range or some idea of what we think working capital generation will be once we complete the inventory management exercise that we're going through.

James Philip Geygan - *Global Value Investment Corp - VP Advisory*

Okay. And my final question is, what is the venue for the Leidos trial?

Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

You mean where is it located?

James Philip Geygan - *Global Value Investment Corp - VP Advisory*

Correct.

Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

It's in El Dorado, Arkansas.

James Philip Geygan - *Global Value Investment Corp - VP Advisory*

Or in which court will that be heard?

Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

State Court.

Operator

Our next question is from Travis Edwards with Goldman Sachs.

Travis Edwards - *Goldman Sachs Group Inc., Research Division - Research Analyst*

Thanks for the time and the detail for the quarter. You guys highlighted a number of projects that you've either started or could potentially start that would add to incremental EBITDA. Have you quantified the total incremental EBITDA, both of the projects that you started like the margin enhancement initiatives as well as the projects that are currently pending?

Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

Well, Travis, I think we talked about \$15 million worth of projects that are underway that would generate an additional \$6 million to \$7 million of EBITDA once fully up and running, which we expect to be no later than the end of next year.

Travis Edwards - *Goldman Sachs Group Inc., Research Division - Research Analyst*

I guess for the other projects, though, have you quantified any of the potential -- I know they're not -- maybe not underway yet, but what the potential add-back could be?

Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

Well, I think I'd probably rather wait until we greenlight the projects. I don't want to get anyone's hopes up here.

Travis Edwards - *Goldman Sachs Group Inc., Research Division - Research Analyst*

Okay. No, that's fine. Separate question, again, on the kind of legal issues. I know in your financial you mentioned that no liability has necessarily been established for the claims by Global Industrial, but are you able to share what that liability might look like just according to what they're claiming if there is, say, an unfavorable ruling for you next year? Or just any more detail on the -- what that determination could look like for you.

Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

Well, first off, I don't believe we have a liability. I mean we didn't get sued. We got brought into the lawsuit. And matter of fact, we have an indemnification agreement with Leidos that they didn't honor. So ultimately, we will seek reimbursement of our legal costs based on the indemnification agreement that has been executed. So we don't have any liability.

Travis Edwards - *Goldman Sachs Group Inc., Research Division - Research Analyst*

Got it. Awesome. And then the last question. I just wanted to confirm that your expected turnaround cost add-back in Q4 '19 will just be approximately \$1 million.



Cheryl Maguire - *LSB Industries, Inc. - Senior VP & CFO*

It'll be \$1 million for Pryor. We also have the sulphuric asset turnaround in the fourth quarter that, Mark just mentioned, is finishing up here in November, where we're installing the new sulfuric acid converter. And the turnaround expense associated with that should be about \$1 million, \$1.5 million.

Operator

Our next question comes from Roger Spitz with Bank of America.

Roger Neil Spitz - *BofA Merrill Lynch, Research Division - Director and High Yield Research Analyst*

Could you -- for the Leidos legal fees, you gave us the Q3 '18 and Q3 '19 as well as 9 months. Is it possible to provide those on a quarterly basis for the quarters we don't have, meaning Q1, Q2 '18, Q4 '18, Q1, Q2 '19, please?

Cheryl Maguire - *LSB Industries, Inc. - Senior VP & CFO*

Sure. No problem. So Q1 of '18, \$500,000; Q2 of '18, \$600,000; Q3, we provided; Q4 of '18, \$1.8 million; Q1 of '19, \$900,000; Q2 of '19, \$1.5 million.

Roger Neil Spitz - *BofA Merrill Lynch, Research Division - Director and High Yield Research Analyst*

Perfect. And that gets to your \$10.6 million. The -- were there any legal fees related to Leidos prior to 2018?

Cheryl Maguire - *LSB Industries, Inc. - Senior VP & CFO*

No, nothing that we can think of.

Roger Neil Spitz - *BofA Merrill Lynch, Research Division - Director and High Yield Research Analyst*

Okay. And in Q4 '18, you took a \$4.4 million vendor settlement benefit. It looks like that was -- that benefit -- your adjusted EBITDA benefited from that \$4.4 million benefit, meaning it wasn't backed out, that benefit. Is that correct?

Cheryl Maguire - *LSB Industries, Inc. - Senior VP & CFO*

That's correct. We didn't adjust for it basically because we had taken the expense in prior periods and hadn't backed out that expense.

Roger Neil Spitz - *BofA Merrill Lynch, Research Division - Director and High Yield Research Analyst*

Okay. Was that vendor Leidos? Or was it something to do with Wilson? Or what was that all -- what was that?

Cheryl Maguire - *LSB Industries, Inc. - Senior VP & CFO*

No. It was -- yes, it wasn't related to Leidos at all.



Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

That was a separate contractor that we had a dispute with it.

Operator

Ladies and gentlemen, we've reached the end of the question-and-answer session. I would now like to turn the call back to Mark Behrman for closing comments.

Mark T. Behrman - *LSB Industries, Inc. - President, CEO & Director*

Well, I want to thank everyone for being on the call, and we appreciate the interest in LSB Industries. And if there are any follow-up calls, feel free to call Cheryl and myself. Thank you.

Operator

This concludes today's conference. You may disconnect your lines at this time, and we thank you for your participation.

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