

**Activist Investors...
Friends or Foes?**

September 29, 2016

Panelists:



Today's Panel



Kyle Cerminara -
CEO, Co-Founder &
Partner,
Fundamental Global
Investors; a well
known investor and
activist



Ann Yerger -
Executive Director at
EY's Center for Board
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Lex Suvanto –
Global Managing
Director, Financial
Communications &
Capital Markets at
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Chris Gyves -
Partner, Womble
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Rice, LLP; Corporate
Board Advisor

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Material Available to NACD Members

Director Essentials: Preparing the Board for Shareholder Activism

Published April 21, 2016

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**Recommendations from the Board Briefing – Notes from September, 19, 2016 NACD Global Board Leaders Summit
Panel: Activism and the Rise of Highly Engaged Shareowners**

What should our Board be doing proactively?

- Regularly review peer data and analyst reports

- Stay informed on the company’s investors, especially the 10 largest shareholders, and their positions on key issues (including governance)
- Ensure management is clearly communicating key considerations—such as company strategy, performance and value drivers—to investors
- Engage in conversations on company vulnerabilities; consider including an external partner as may be appropriate to stimulate the conversation
- Listen to ideas on improving shareholder value, regardless of source

What if a “Highly Engaged Shareowner” contacts management or our Board?

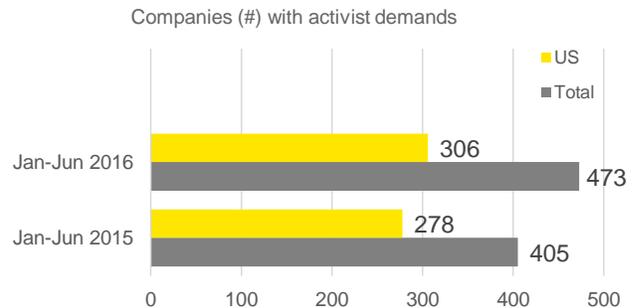
- Ignoring them does not work
- Talk with others who may have worked with the shareowner; consider engaging outside expertise including those with insights on the highly engaged shareowner and its leadership team
- Prepare for meetings with the highly engaged shareowner and other investors
- Ensure appropriate advisors (including financial advisor and/or banker, legal counsel, public relations/investor relations and proxy solicitor) are engaged in the communication/response plan

Activism at a glance

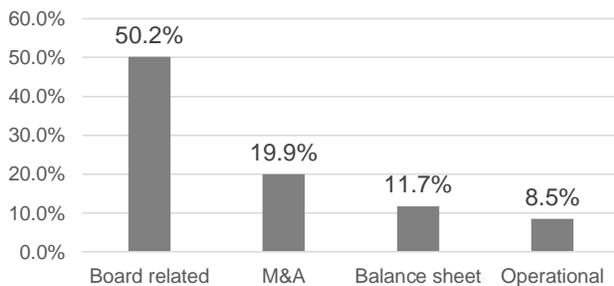
Global activist AUM growing, but very small piece of institutional AUM



Activism is global, but US activity dominates



Global activism concentrated in four areas



Pressure for board seats rarely ends in a proxy contest

	2014	2015
Companies where activists sought board seats	120	157
Settlements	102	112
Proxy contests that went to a vote	19	23
Board seats gained	213	184
Success rate in contests that went to a vote (at least 1 board seat)	68%	48%

Data from Activist Insight



Recent activism has occurred across numerous industries with service companies, financials, basic minerals and technology leading the pack. The important thing to remember is that no industry is immune.

SAMPLE ACTIVIST INVESTOR LETTER

Engine Capital Letter to LSB Industries Board – December 30, 2013

Dear Board Members:

Engine Capital LP, together with its affiliates (“Engine”), is a shareholder of LSB Industries, Inc. (“LSB” or “LXU” or the “Company”). LSB represents a significant investment for Engine. We invested in LSB because we think that the Company is significantly undervalued and there are opportunities within the control of management and the Board to increase shareholder value substantially. In particular, we think that the Board would be significantly strengthened by adding a number of new members with relevant backgrounds in chemical asset operations, climate control, and corporate finance, and with no ties to the Golsen family. We also urge the Company to establish a special committee of truly independent directors to analyze the Company’s strategic alternatives to maximize value, including separating the climate control business from the chemical assets and converting certain of the chemical assets into an MLP structure.

As you probably know, over the last few weeks, we have had discussions with your President and Chief Operating Officer, Mr. Barry Golsen, and your Chief Financial Officer, Mr. Tony Shelby, about different topics, including board representation and corporate structure. As mentioned to Mr. Golsen, it was our hope and desire to work cooperatively and behind the scenes with the Board to effectuate positive change. Unfortunately, during our last conversation, Mr. Golsen made it clear that he had no interest in discussing the ideas we raised and that the Company had no interest in discussing board representation. We have therefore decided to make this letter public to encourage dialogue among the Company, its shareholders, and the analyst community.

As stated above, we believe LXU’s stock is significantly undervalued. At the current price, the enterprise value of LXU is around \$850 million (taking into account the insurance claims that were paid after September 30, 2013). In our opinion, the best way to value the company is through a “sum of the parts,” given the very different financial characteristics of the climate control business and the chemical assets.

Climate Control Business: We think that this business is worth at least 9x normalized EBITDA based on where its public peers trade. We think the business could be worth considerably more to synergistic buyers based on M&A multiples. We therefore think that a conservative value for the climate control business is around \$300 to \$350 million.

Chemical Plants: We think that the chemical plants are worth north of \$1.2 billion based on the following considerations:

- Replacement value of Pryor around \$675 million, as per Barry Golsen’s comments during the Q3 earnings call (“... you’re looking at a plant that if we had to replicate it, would be somewhere between \$600 million and \$750 million ...”)
- Replacement value of Cherokee of at least \$400 million, based on its production capacity and product mix compared to Pryor.
- Replacement value of El Dorado’s current assets between \$100 and \$200 million, based on the construction cost of around \$120 million to build another 360,000 ton-per-year nitric-acid plant and a 40,000 ton-per-year nitric-acid concentrator.
- Pryor and Cherokee combined have production capacity that is approximately 50% higher than the production capacity of Rentech Nitrogen Partners’ East Dubuque facility. Based on the current enterprise value of Rentech Nitrogen Partners (NYSE: RNF) and the price RNF paid for a recent acquisition, we estimate that the market

values the East Dubuque facility at around \$750 million, implying a value for Pryor and Cherokee of around \$1.125 billion.

- LXU's chemical assets have a production capacity that is superior to CVR Partners (NYSE: UAN) production capacity. CVR Partners has an enterprise value of \$1.25 billion. We realize that UAN produces nitrogen products from pet coke and sells a higher percentage of its production to the agricultural market, but we think that directionally the valuation is relevant (and highlights the higher valuation that could be achieved through an MLP structure).
- We have not attributed any value to the Bayton, TX, facility, which is very conservative.
- LXU's current chemical assets have a normalized EBITDA between \$150 and \$200 million. Our valuation therefore implies a 6x to 8x EBITDA multiple, which we think is reasonable in light of where peers trade.

We therefore think that LSB's total inherent value is at least \$1.5 billion, implying a stock price between \$65 and \$75 per share, compared to LXU's stock price of around \$39 per share as of the time of this writing. We think that this significant value gap is caused by the Company's poor governance structure, poor corporate structure, history of poor communication with shareholders, and a recent history of over-promising and under-delivering on operational matters.

Governance - Board Composition

We think that the Board could be significantly strengthened by adding a number of new board members with relevant backgrounds in chemical plant operations, climate control, and corporate finance, and with no ties to the Golsen family. Given the size of the Board (which, at 14, in our opinion is already too large for a company of this size), we would also expect a number of the current Board members to step down. The current makeup of the Board is highly unusual and probably quite unique in corporate America (unfortunately, not in a positive way). Here are just a few examples that highlight our concerns:

- Six out of the fourteen board members are either related to the Golsen family or are insiders of the Company. Most companies have only one non-independent member on their board of directors. At LXU, in addition to the CEO Jack Golsen, the following family members or insiders sit on the Board:
 - Barry Golsen – President and Chief Operating Officer
 - Steve Golsen – Chief Operating Officer of the Climate Control Business
 - Tony Shelby – Executive Vice President of Finance and Chief Financial Officer
 - David Gross – Executive Vice President of Operations
 - Robert Brown – brother-in-law of Jack Golsen (and with no relevant business experience)
- Another three board members (of the eight that are technically considered independent) have either current or past dealings with the Golsen family or the Company that in our opinion compromise their independence.
 - John Shelley – Former President of Equity Bank for Savings, a savings and loan that was owned by LSB before 1994. In other words, John Shelley used to report to Jack Golsen.
 - Robert Henry - President and Chief Executive Officer of Oklahoma City University. Jack Golsen serves as trustee of Oklahoma City University, and his family has made charitable contributions to the University.
 - Webster Benham – Former Senior Vice President of SAIC. LSB is going to spend hundreds of millions of dollars in capital expenditures using SAIC as a contractor.
- Except for Mr. Donald Munson (who was a former COO of Lennox but retired more than 22 years ago!), none of the other seven (technically) independent board members have relevant backgrounds in chemical asset operations, climate control, or corporate finance.

- The Board is staggered and the role of the CEO and Chairman is combined.

How can the Board members oversee, help, or challenge management when they either have no relevant experience or are conflicted because of their ties to the Golsen family? We think that the recent operational and financial challenges of the Company as well as the antiquated corporate structure that we highlight below are a direct consequence of this poor governance structure.

Corporate Structure

LSB is currently a holding company with two very different businesses: (1) four chemical plants, and (2) a climate control business. There are no synergies between these two businesses. We think that the market currently ascribes very little value to the climate business, which is dwarfed by the chemical assets. We frankly question whether LSB is the best owner of the climate control business or whether the business could be worth a lot more as a separate entity or in the hands of a synergistic buyer. Depending on the tax basis of the business (the CFO was unable or unwilling to provide an answer to that question), the best course of action may be a sale or a spinoff of the business. We think that the analyst community and investors in general focus on the chemical assets and value the Company using chemical assets multiples, therefore undervaluing the higher quality climate control business that deserves a higher multiple (climate control peers trade at significantly higher multiples than chemical peers). In light of the recent operational challenges at a number of the Company's chemical plants, we also think it would be positive to have LSB management exclusively focused and incented on optimizing the chemical assets.

Within the chemical division, LSB has an opportunity to improve the tax efficiency of its corporate structure by converting its agricultural-related assets into a publicly traded Master Limited Partnership ("MLP"). Because of the tax advantages of the MLP structure and the yield it provides to unitholders, MLPs trade at higher multiples than regular corporations. As an example, among the Company's peers, RNF trades at 7.5x 2014 EBITDA, UAN trades at 9x 2014 EBITDA and CF Industries (NYSE: CF) trades at 6.4x 2014 EBITDA. Both RNF and UAN are MLPs (note the higher multiple) while CF just announced that they were looking at utilizing an MLP as a financing vehicle. If it makes sense for these companies to be MLPs, why doesn't make it sense for LXU?

We think that the Board should establish a special committee consisting of only truly independent directors with a strong corporate finance background to analyze the Company's options. This special committee should be assisted by a leading investment bank and a leading law firm. The value creation potential is significant, as evidenced by the market reaction of CF Industries' stock when it announced that it was working with two leading investment banks to look at specific opportunities for utilizing the MLP structure as a potential financing vehicle.

Capital Allocation / Communication with Shareholders

One of the most important roles of the Board is to allocate capital appropriately. LSB has announced a 3-year capital expenditure ("capex") program of around \$600 million. This is extremely significant for a company of LSB's size, and we question whether it is wise to start such a significant capex program and lever up the Company ahead of significant new production supply of ammonia coming on the market. When we asked Mr. Shelby to quantify the expected returns on the capex related to the expansion of the El Dorado Facility into an ammonia producer, he simply told us that the Company believes it makes sense to integrate and produce from natural gas instead of buying ammonia on the market no matter what the returns were. We disagree with this thinking, and it is quite possible that instead of leveraging up the Company and engaging in this capex program, shareholders would have been better served by a large repurchase of undervalued stock. The reality is that as shareholders, it is very difficult to evaluate the merits of this capex program because the Company refuses to share its assumptions and the implied returns on investment. Compare this situation with the way CF Industries thinks about return on capital and communicates this metric with its shareholders: On slide 15 of its most recent presentation at the Citigroup 6th Annual Basic Materials Conference, CF Industries shares its IRR projections for the Donaldsonville and Port Neal expansion projects under different assumptions for natural gas costs and urea pricing. This slide highlights how CF Industries thinks about capital allocation and how clearly it communicates

capital allocation decisions with its shareholders. Having a Board with relevant experience in capital allocation that is focused on maximizing returns on capital opportunistically and communicating its thought process to shareholders in a thoughtful manner would go a long way to improve the market perception of this Company and help close the value gap.

Operations

Unfortunately, the recent operational challenges at the Company are too numerous to detail in this letter. Even though we understand that chemical plants are complex operations, we are particularly concerned by (1) the frequency of problems at a number of the chemical plants (Pryor, Cherokee, and El Dorado), and (2) management's pattern of over-promising and under-delivering when it comes to fixing these operational issues. For example, during the 2012 Q4 earnings call on February 28, 2013, management stated, "We expect to resume production [of the Pryor facility] during early in March. It takes a few days for warming up the catalyst when we start production," and "...but as far as Pryor is concerned, they are all hooked up and ready to go, they are warming up the catalyst now." Despite these comments, the Pryor facility was not started up until late April. In October 2013, the Pryor facility again was taken offline. The Company disclosed the issue only the following month during the 2013 Q3 earning call on November 6, 2013. During that call, management stated, "We expect to have the facility back in operation during November." On December 3, 2013, management issued a press release stating that the plant was now anticipated to start up in December. It is now December 30, 2013, and shareholders have still not heard about the Pryor facility resuming production. A Board with more relevant operational experience would be helpful in assisting management through these issues.

In conclusion, we think that LSB Industries is significantly undervalued. In this letter, we have highlighted a number of concerns with the current situation and have suggested steps that the Company should take to close the significant value gap between where the stock trades and what the Company is worth. Engine Capital has significant M&A, corporate finance, capital allocation, and board experience. We continue to think that the best step forward is to work with you cooperatively for the benefit of all the shareholders, and we hope to continue our discussion with you in the coming weeks. However, if significant progress is not achieved promptly, we are fully prepared to nominate five directors by the January 23, 2014, deadline.

Very truly yours,

Arnaud Ajdler
Managing Partner
Engine Capital
