



**PHOSPHATE HOLDINGS, INC. AND SUBSIDIARIES**

Consolidated Financial Statements

December 31, 2011, 2010, and 2009

(With Independent Auditors' Report Thereon)

# PHOSPHATE HOLDINGS, INC. AND SUBSIDIARIES

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**KPMG LLP**  
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## **Independent Auditors' Report**

The Board of Directors  
Phosphate Holdings, Inc.:

We have audited the accompanying consolidated balance sheets of Phosphate Holdings, Inc. and Subsidiaries (the Company) as of December 31, 2011 and 2010, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2011. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Phosphate Holdings, Inc. and Subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

**KPMG LLP**

Jackson, Mississippi  
April 6, 2012

**PHOSPHATE HOLDINGS, INC. AND SUBSIDIARIES**

Consolidated Balance Sheets

December 31, 2011 and 2010

(In thousands, except share data)

<b>Assets</b>	<b>2011</b>	<b>2010</b>
Current assets:		
Cash and cash equivalents	\$ 3,024	2,261
Trade accounts receivable	14,871	11,414
Other receivables	57	11
Inventories	25,075	26,141
Prepaid expenses and other	13,338	8,329
Deferred income taxes	841	336
Total current assets	<u>57,206</u>	<u>48,492</u>
Freight deposits	3,947	5,636
Restricted investments held in trust, at fair value	6,318	5,657
Property, plant and equipment, net	63,650	61,402
Other	477	553
Total assets	<u>\$ 131,598</u>	<u>121,740</u>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 3,376	1,804
Accrued expenses	32,313	29,783
Short-term financing obligations	2,965	3,492
Revolving credit agreement	15,000	9,000
Total current liabilities	<u>53,654</u>	<u>44,079</u>
Asset retirement obligations	17,627	16,307
Deferred income taxes	1,607	1,836
Total liabilities	<u>72,888</u>	<u>62,222</u>
Stockholders' equity:		
Common stock (\$0.01 par; 30,000,000 shares authorized; 8,411,308 shares issued and outstanding)	84	84
Additional paid-in capital	35,660	35,660
Retained earnings	22,966	23,774
Total stockholders' equity	<u>58,710</u>	<u>59,518</u>
Commitments and contingencies (Notes 18 and 20)		
Total liabilities and stockholders' equity	<u>\$ 131,598</u>	<u>121,740</u>

See accompanying notes to consolidated financial statements.

**PHOSPHATE HOLDINGS, INC. AND SUBSIDIARIES**

Consolidated Statements of Operations

Years ended December 31, 2011, 2010, and 2009

(In thousands, except per share data)

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Net sales:			
DAP	\$ 348,283	257,233	182,780
Other	4,050	3,863	3,531
Total net sales	<u>352,333</u>	<u>261,096</u>	<u>186,311</u>
Cost of sales	<u>345,299</u>	<u>249,931</u>	<u>205,501</u>
Gross profit (loss)	7,034	11,165	(19,190)
Selling, general and administrative expenses	7,722	6,858	5,843
Environmental remediation	159	4,028	1,330
Litigation recoveries, net	—	(2,053)	(2,821)
Insurance recoveries	—	—	(1,615)
Reduction in asset retirement obligations	—	—	(190)
Operating income (loss)	<u>(847)</u>	<u>2,332</u>	<u>(21,737)</u>
Other income (expense):			
Interest, net	(1,045)	(1,107)	(596)
Other, net	(82)	534	670
Total other income (expense)	<u>(1,127)</u>	<u>(573)</u>	<u>74</u>
Income (loss) before income taxes	<u>(1,974)</u>	<u>1,759</u>	<u>(21,663)</u>
Income tax expense (benefit)	<u>(1,166)</u>	695	(8,110)
Net income (loss)	<u>\$ (808)</u>	<u>1,064</u>	<u>(13,553)</u>
Earnings (loss) per share – basic	\$ (0.10)	0.13	(1.76)
Earnings (loss) per share – diluted	(0.10)	0.13	(1.76)
Weighted average common shares outstanding – basic	8,411	8,411	7,713
Weighted average common shares outstanding – diluted	8,411	8,411	7,713

See accompanying notes to consolidated financial statements.

**PHOSPHATE HOLDINGS, INC. AND SUBSIDIARIES**

Consolidated Statements of Stockholders' Equity

Years ended December 31, 2011, 2010, and 2009

(In thousands, except share data)

	<b>Common stock</b>		<b>Additional paid-in capital</b>	<b>Retained earnings</b>	<b>Total</b>
	<b>Shares</b>	<b>Par value</b>			
Balance, December 31, 2008	7,654,290	\$ 77	33,880	36,263	70,220
Net loss	—	—	—	(13,553)	(13,553)
Exercise of stock options	757,018	7	1,780	—	1,787
Balance, December 31, 2009	8,411,308	84	35,660	22,710	58,454
Net income	—	—	—	1,064	1,064
Balance, December 31, 2010	8,411,308	84	35,660	23,774	59,518
Net loss	—	—	—	(808)	(808)
Balance, December 31, 2011	8,411,308	\$ 84	35,660	22,966	58,710

See accompanying notes to consolidated financial statements.

**PHOSPHATE HOLDINGS, INC. AND SUBSIDIARIES**

Consolidated Statements of Cash Flows

Years ended December 2011, 2010, and 2009

(In thousands)

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Cash flows from operating activities:			
Net income (loss)	\$ (808)	1,064	(13,553)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation of property, plant and equipment	10,656	7,571	6,779
Amortization of prepaid maintenance turnaround costs	5,265	3,967	2,912
Accretion of asset retirement obligation	906	659	477
Deferred loan cost amortization	74	229	72
Unrealized restricted investment (gain) loss	139	(507)	(560)
Share-based compensation	12	697	328
Deferred income taxes	(734)	670	(7,683)
Reduction in asset retirement obligation	—	—	(190)
Other	2	8	15
Changes in operating assets and liabilities:			
Trade and other accounts receivable	(3,503)	(8,361)	6,199
Income taxes receivable	—	574	20,840
Inventories	1,066	(8,554)	5,458
Prepaid expenses and other	(10,274)	(7,442)	(2,687)
Freight deposits	1,689	(5,636)	—
Accounts payable and accrued expenses	4,090	18,276	(2,149)
Net cash provided by operating activities	<u>8,580</u>	<u>3,215</u>	<u>16,258</u>
Cash flows from investing activities:			
Purchases of restricted investments held in trust	(800)	(800)	(800)
Purchases of property, plant and equipment	(12,490)	(9,702)	(4,937)
Net cash used in investing activities	<u>(13,290)</u>	<u>(10,502)</u>	<u>(5,737)</u>
Cash flows from financing activities:			
Net borrowings (payments) on revolving credit agreement	6,000	9,000	(11,494)
Proceeds from financing obligations	2,965	4,836	3,248
Payments on financing obligations	(3,492)	(3,333)	(3,440)
Payment of deferred loan costs	—	(622)	(108)
Payments on term loan	—	(2,400)	(600)
Capital contributions from exercise of stock options	—	—	1,787
Net cash provided by (used in) financing activities	<u>5,473</u>	<u>7,481</u>	<u>(10,607)</u>
Net increase (decrease) in cash and cash equivalents	763	194	(86)
Cash and cash equivalents at beginning of year	<u>2,261</u>	<u>2,067</u>	<u>2,153</u>
Cash and cash equivalents at end of year	<u>\$ 3,024</u>	<u>2,261</u>	<u>2,067</u>

See accompanying notes to consolidated financial statements.

## PHOSPHATE HOLDINGS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2011, 2010, and 2009

(Dollars in thousands unless otherwise indicated)

### (1) Nature of Business and Significant Accounting Policies

#### (a) *Nature of Business*

Phosphate Holdings, Inc. (PHI) and its wholly owned subsidiary, Mississippi Phosphates Corporation (MPC), produces diammonium phosphate (DAP) fertilizer at its production facility in Pascagoula, Mississippi. In May 2010, MPC formed two new wholly owned subsidiaries, Ammonia Tank Subsidiary, Inc., and Sulfuric Acid Tanks Subsidiary, Inc. MPC transferred its ammonia terminaling assets to Ammonia Tank Subsidiary, Inc., and its sulfuric acid terminaling assets to Sulfuric Acid Tanks Subsidiary, Inc. PHI, MPC, and MPC's wholly owned subsidiaries are referred to collectively as "the Company." The Company is organized and managed internally based on one reportable segment, phosphates, which includes the production and sale of DAP.

#### (b) *Organization*

PHI was incorporated on December 17, 2004, under the laws of the state of Delaware and owns all of the outstanding common stock of MPC. MPC was incorporated on October 29, 1990, under the laws of the state of Delaware and owns all of the outstanding common stock of Ammonia Tank Subsidiary, Inc., and Sulfuric Acid Tanks Subsidiary, Inc., which were both incorporated on May 4, 2010 under the laws of the state of Delaware.

#### (c) *Principles of Consolidation*

The consolidated financial statements include the accounts of PHI, MPC, and MPC's wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

#### (d) *Reclassifications*

The Company has reclassified certain prior-year information to conform to the current year's presentation.

#### (e) *Use of Estimates*

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment, which management believes to be reasonable under the circumstances. Management adjusts such estimates and assumptions when facts and circumstances dictate. As future events and their effects cannot be determined with precision, actual results could differ from the estimates and assumptions used by management in the preparation of the accompanying consolidated financial statements and such differences could be significant. Changes in those estimates resulting from continuing changes in the economic environment will be reflected in the consolidated financial statements in future periods.



## PHOSPHATE HOLDINGS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2011, 2010, and 2009

(Dollars in thousands unless otherwise indicated)

**(f) Inventories**

Inventories are valued at the lower of cost or net realizable value on a moving average cost basis. Finished goods and intermediary products include material costs, labor costs, and manufacturing overhead.

**(g) Replacement Parts**

The Company maintains replacement parts at its production facility in order to minimize disruption in production in the event of part failures. Replacement parts, which are considered expendable, are included in inventories and are charged to cost of sales as they are placed in service. Replacement parts, which are repairable, are reported as a component of property, plant and equipment and are depreciated over their estimated useful lives.

**(h) Allowances for Doubtful Accounts**

The Company is subject to credit risk in connection with the collection of its accounts receivable and, accordingly, makes estimates related to the ultimate collection of accounts receivable. Specifically, the Company analyzes accounts receivable, bad debt experience, customer concentrations, customer creditworthiness, and current economic and market conditions, when evaluating the adequacy of the allowance for doubtful accounts. The Company's business is primarily with a small number of customers and the collection history with these customers has been favorable. All accounts receivable balances outstanding as of December 31, 2011 and 2010 were collected subsequent to year end.

**(i) Restricted Investments Held in Trust**

In conjunction with producing DAP, the Company is required to maintain a phosphogypsum disposal facility (gypsum disposal facility) for waste by-products. The Company has developed a financial assurance mechanism with the Mississippi Department of Environmental Quality (MDEQ) to provide funds to cover the estimated costs related to the closure, post-closure care and related water treatment of the Company's gypsum disposal facilities when they reach capacity levels. Quarterly payments in the amount of \$200 are made into a restricted trust fund managed by a third-party trustee. The investments held within this trust fund represent debt and equity securities, which are classified as trading securities in accordance with ASC 320, *Investments – Debt and Equity Securities*. The Company recognizes realized and unrealized gains or losses on these securities in the period incurred. The Company's investments comprised exchange-traded securities and investment funds, which are recorded at fair value based upon daily quoted closing prices. Unrealized gains (losses) for the years ended December 31, 2011, 2010, and 2009 were \$(139), \$507, and \$560, respectively, and are recorded as a component of other income (expense) in the Company's consolidated statements of operations.

## PHOSPHATE HOLDINGS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2011, 2010, and 2009

(Dollars in thousands unless otherwise indicated)

(j) ***Property, Plant, and Equipment***

Property, plant, and equipment are stated at cost, less accumulated depreciation. Expenditures for major improvements are capitalized; expenditures for normal maintenance and repairs are charged to expense as incurred. Depreciation expense is computed using the straight-line method over the estimated useful lives of the assets as follows:

Buildings	6 to 40 years
Site improvements	5 to 20 years
Phosphogypsum disposal facility	23 years
Machinery and equipment	2 to 10 years
Replacement parts	10 years

(k) ***Impairment of Long-Lived Assets***

Long-lived assets, such as property, plant, and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If circumstances require that a long-lived asset be tested for possible impairment, the Company first compares undiscounted cash flows expected to be generated by an asset to the carrying value of the asset. If the carrying value of the long-lived asset is not recoverable on an undiscounted cash flow basis, an impairment is recognized to the extent that the carrying value of the asset exceeds its fair value. Fair value is determined through various valuation techniques, including discounted cash flow models, quoted market values and third-party independent appraisals, as considered necessary.

During 2011 and 2010, there were no events or changes in circumstances which warranted any detailed impairment testing by the Company.

(l) ***Income Taxes***

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. As required by ASC 740, *Income Taxes*, the Company recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Company reports tax-related interest and penalties as a component of income tax expense. At December 31, 2010, the Company had accrued in its consolidated balance sheet approximately \$432 of interest and penalties related to uncertain tax positions. In the third quarter of 2011, this accrual

## PHOSPHATE HOLDINGS, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2011, 2010, and 2009

(Dollars in thousands unless otherwise indicated)

was reversed and income tax expense reduced on the underlying tax positions that gave rise to the liability which has statutorily expired.

**(m) Environmental Costs**

Environmental expenditures that relate to existing conditions caused by past operations, and that do not contribute to current or future revenue generation, are expensed. Environmental costs are capitalized if the costs extend the life of the property, increase its capacity or mitigate or prevent contamination from future operations. Liabilities are recorded when environmental assessments and/or remedial efforts are probable and the costs can be reasonably estimated.

**(n) Asset Retirement Obligations**

The Company's asset retirement obligations are legal obligations of the Company to incur future costs associated with the closure, post-closure care and related water treatment of its East gypsum disposal facility. In conjunction with producing DAP, the Company is required to maintain a disposal facility for its by-product, phosphogypsum. Under an agreement with the MDEQ, the Company is obligated to incur future costs associated with closure, post-closure care and related water treatment of the gypsum disposal facility. The Company develops estimates for these costs pursuant to the guidance set forth in ASC 410, *Asset Retirement and Environmental Obligations*. The costs are adjusted for inflation and discounted based on a credit adjusted, risk-free rate. Over time, the related asset is depreciated and the liability is accreted to its present value. Depreciation and accretion expense is included as a component of cost of sales in the accompanying consolidated statements of operations.

**(o) Revenue Recognition**

Revenue is recognized when the earnings process is completed. The Company considers the earnings process to be complete when the risk of ownership and title passes to the customer, collection of the related receivable is probable, evidence of an arrangement exists and the sales price is fixed or determinable. Title passes to the customer at the point of delivery, which can be FOB shipping point, FOB destination, or at other points of delivery as specified by an individual customer's sales contract. Effective October 1, 2009, the Company entered into a DAP sales agreement with a third party, whereby sales are recorded by the Company at the time product passes the delivery point, which is the point where the Company's plant conveyor belts enter the Company's warehouses. Base prices for the Company's product are set pursuant to sales contracts based on agreed-to published price indexes, or upon negotiated short-term prices with the customer. Shipping and handling costs incurred by the Company are included in cost of sales.

**(p) Maintenance Turnaround Costs**

The Pascagoula facility schedules periodic maintenance turnarounds for the various plants within the facility. The associated costs of these turnarounds are capitalized and then amortized as part of cost of sales over the expected benefit period.

## PHOSPHATE HOLDINGS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2011, 2010, and 2009

(Dollars in thousands unless otherwise indicated)

### (q) *Share-Based Compensation*

The Company accounts for share-based compensation in accordance with ASC 718, *Compensation—Stock Compensation*, which requires the measurement and recognition of compensation expense for all equity classified share-based payment awards to be made based on estimated grant date fair values. Under the fair value recognition provisions, share-based compensation cost is measured at the grant date based on the fair value of the award, and is recognized as expense on a straight-line basis over the requisite service period, which is the vesting period. The fair value of share-based payment awards on the date of grant is determined using an option-pricing model which is affected by assumptions regarding a number of complex and subjective variables, that include the expected life of the award, the expected stock price volatility over the expected life of the awards, expected dividend yield, and the risk-free interest rate.

The Company accounts for stock appreciation rights (SARs) as liability awards as they are settled with a cash payment. Compensation costs are measured as of the end of each reporting period based on the then-current fair value of the SARs.

### (r) *Fair Value of Financial Instruments*

Pursuant to ASC 820, *Fair Value Measurements and Disclosures*, and ASC 825, *Financial Instruments*, an entity is required to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. ASC 820 established a fair value hierarchy based on the level of independent, objective evidence surrounding the inputs used to measure fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. ASC 820 prioritizes the inputs into three levels that may be used to measure fair value:

- Level 1 inputs are quoted prices in active markets for identical assets or liabilities;
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability, which are valued based on management's estimates of assumptions that market participants would use in pricing the asset or liability.

The Company's trade and other receivables, accounts payable, accrued expenses and short-term financing obligations are carried at cost, which approximates its fair value due to the short-term nature of the instruments. The Company's restricted investments held in trust at December 31, 2011 and 2010 were \$6,318 and \$5,657, respectively, and are recorded at fair value on a recurring basis based upon Level 1 inputs. The Company had no Level 2 or Level 3 investments as of or during the years ended December 31, 2011 and 2010. At December 31, 2011, the Company's outstanding borrowings under its revolving credit agreement executed in May 2010, were \$15,000 and its estimated fair value based on Level 3 inputs was \$15,000. The Company had no transfers into or out of Level 1, Level 2 or Level 3 during the year ended December 31, 2011.

## PHOSPHATE HOLDINGS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2011, 2010, and 2009

(Dollars in thousands unless otherwise indicated)

(s) ***Subsequent Events***

The Company evaluates events or transactions for potential recognition or disclosure which occur after the balance sheet date but before the financial statements are issued in accordance with ASC 855-10, *Subsequent Events*. The Company's management has evaluated the period from January 1, 2012, through April 6, 2012, the date the consolidated financial statements herein were issued, and no material subsequent events were identified that have not been disclosed elsewhere herein.

(t) ***Recent Accounting Pronouncements***

In January 2010, the FASB issued ASU No. 2010-06, *Fair Value Measurements and Disclosures: Improving Disclosures about Fair Value Measurements (Topic 820)*. ASU No. 2010-06 amends ASC 820 and clarifies and provides additional disclosure requirements on the transfers of assets and liabilities between Level 1 (quoted prices in active market for identical assets or liabilities) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy, including the reasons for and the timing of the transfers. Additionally, the guidance requires a roll forward of activities on purchases, sales, issuance, and settlements of the assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements). The Company has adopted all portions of this statement and it did not have a material impact on the Company's consolidated financial statements.

(2) **Current Market Conditions**

The Company's operating results are highly dependent upon: business and economic conditions and policies affecting fertilizer demand and prices as well as the agricultural industry in general; DAP price and demand volatility resulting from imbalances of supply and demand; and raw material price volatility and availability. The Company has entered into certain raw material supply and sales agreements. These agreements are anticipated to reduce the Company's exposure to DAP and raw material price volatility provided that the Company achieves targeted production levels.

During 2011, the Company had an operating loss of \$847. As a result of this operating loss, the Company continues to assess its operating cash flow needs and ability to fund necessary capital expenditures, environmental expenditures and debt service requirements. During May 2010, the Company entered into a new credit facility to address its working capital needs. While there can be no assurances, management believes the Company's operating results and available credit facilities should be adequate to meet its operating and other cash flow needs for the next 12 months.

## PHOSPHATE HOLDINGS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2011, 2010, and 2009

(Dollars in thousands unless otherwise indicated)

### (3) Inventories

Inventories consisted of the following:

	December 31	
	2011	2010
Raw materials	\$ 15,391	15,416
Intermediary products	3,071	3,576
Finished goods	636	1,506
Replacement parts	5,977	5,643
	<u>\$ 25,075</u>	<u>26,141</u>

Inventories are valued at the lower of cost or net realizable value on a moving average cost basis. As a result of declines in the market prices for the Company's raw materials and finished goods, during 2011 and 2009, the Company recorded inventory valuation write-downs totaling \$852 and \$10,445, respectively, to reduce its raw materials and finished goods to their estimated net realizable values. These write-downs are included as a component of cost of sales in the Company's consolidated statement of operations for 2011 and 2009, respectively.

At December 31, 2011 and 2010, the Company had unsold finished goods in off-site barges of \$636 and \$1,506, respectively (see note 13).

Phosphate rock is a primary raw material in the manufacture of DAP. On August 27, 2009, the Company and OCP S.A. (OCP), located in Morocco, entered into a phosphate rock supply agreement, which was effective as of July 3, 2009 (the Supply Agreement). Under the Supply Agreement, the Company agrees to purchase from OCP, on a take-or-pay basis, the phosphate rock requirements of its Pascagoula, Mississippi plant. The price of the phosphate rock is determined quarterly based on a negotiated formula that is based, in part, on related market prices. The Supply Agreement expires on June 30, 2012. The Company anticipates beginning negotiations with OCP prior to the expiration of the Supply Agreement and believes it will be able to secure its future phosphate rock requirements from OCP. During the first half of 2009, the Company and OCP entered into short-term supply arrangements for the supply of phosphate rock.

**PHOSPHATE HOLDINGS, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2011, 2010, and 2009

(Dollars in thousands unless otherwise indicated)

**(4) Prepaid Expenses and Other**

Prepaid expenses and other consisted of the following:

	<b>December 31</b>	
	<b>2011</b>	<b>2010</b>
Prepaid insurance	\$ 3,392	3,938
Prepaid maintenance turnaround costs	3,672	3,268
Freight deposits	4,170	—
Other	2,104	1,123
	<b>\$ 13,338</b>	<b>8,329</b>

Amortization expense related to maintenance turnaround costs was \$5,265, \$3,967, and \$2,912, for the years ended December 31, 2011, 2010, and 2009, respectively. These expenses are included as a component of cost of sales.

**(5) Freight Deposits**

In February 2009, the Company entered into a four-year affreightment contract with a third-party shipping company. In November 2011, this contract was amended to extend its term through June 30, 2013. Freight rates are fixed throughout the term of the contract, however, for certain shipments made under the contract, if published DAP prices exceed an agreed-to DAP price, the Company will pay rates above the fixed contract rate up to an agreed maximum rate. During 2010, and portions of 2011, the Company paid \$8,117 in excess of the fixed contract rate. These deposits will be refunded to the Company beginning in 2012 as shipments occur. Accordingly, short-term deposits of \$4,170 are reflected as a component of prepaid expenses and other and long-term freight deposits of \$3,947 are reflected as freight deposits on the Company's December 31, 2011 consolidated balance sheet. Freight payments in 2009 equaled the fixed contract rate and, therefore, no refundable deposits were recorded on those shipments.

**PHOSPHATE HOLDINGS, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

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(Dollars in thousands unless otherwise indicated)

**(6) Property, Plant and Equipment, Net**

Property, plant, and equipment consisted of the following:

	<b>December 31</b>	
	<b>2011</b>	<b>2010</b>
Buildings	\$ 5,119	5,119
Site improvements	5,107	5,107
Phosphogypsum disposal facility	10,934	10,520
Machinery and equipment	68,349	61,990
Replacement parts	3,246	2,910
Construction in progress	4,130	2,477
	<u>96,885</u>	<u>88,123</u>
Less accumulated depreciation	33,235	26,721
Property, plant and equipment, net	<u>\$ 63,650</u>	<u>61,402</u>

Depreciation expense totaled \$10,656, \$7,571, and \$6,779, for the years ended December 31, 2011, 2010, and 2009, respectively. Construction in progress includes projects which are expected to be completed in 2012 and 2013. As of December 31, 2011, the total anticipated cash outlays to complete the projects were approximately \$8,160. These projects are expected to be funded through cash generated from operations.

**(7) Accrued Expenses**

Accrued expenses consisted of the following:

	<b>December 31</b>	
	<b>2011</b>	<b>2010</b>
Accrued raw material purchases	\$ 26,669	23,026
Accrued environmental remediation expenses	490	1,366
Accrued compensation	1,565	1,426
Accrued utilities	650	623
Accrued property taxes	694	607
Accrued self-insurance claims	723	594
Other	1,522	2,141
	<u>\$ 32,313</u>	<u>29,783</u>

**(8) Short-term Financing Obligation**

The Company has financed its property and liability insurance premiums for its policy period December 2011 through December 2012. The premiums are financed at an interest rate of 1.98%. The note is payable in monthly installments and matures in November 2012.



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### (9) Credit Facilities

On May 6, 2010, the Company executed a new financing arrangement (Credit Facility) for up to \$25,000 from the Company's largest customer. The Credit Facility provides up to \$10,000 in letters of credit and a \$15,000 revolving loan feature. During the initial two years of the Credit Facility, or in certain cases at the borrower's option up to the initial four years, amounts borrowed under the Credit Facility serve as a revolving credit arrangement. After this initial period, any amounts outstanding under the Credit Facility amortize ratably over eight years, or if the revolving feature is extended for an additional two years, amortize ratably over six years. If the revolving feature of the Credit Facility is extended, amounts available under the revolving loan feature are limited to \$10,000. Amounts borrowed under the Credit Facility bear interest at the three-month LIBOR rate, plus 6.00%. Outstanding letters of credit bear an all-in cost of 3.50% per annum. Additionally, the Credit Facility requires an annual fee of \$50 during the revolving period of the arrangement and a \$35 annual fee thereafter. The Credit Facility is secured by a lien and security interest on the Company's ammonia and sulfuric acid terminal assets, the Company's real property underlying its plant site and the Company's personal property.

The Credit Facility contains customary provisions and covenants, including a fixed charge coverage ratio of 1.2 to 1, a current ratio, as defined, of 1.3 to 1, a minimum tangible net worth of \$45,000, plus 50% of current-year net income (determined annually), limitations on capital expenditures and dividend payments and other covenants customary for loans of this type. Additionally, if the Chief Executive Officer of MPC were to cease being an executive officer or director of MPC (other than as a result of his disability or death), the lender is under no obligation to make additional advances or issue letters of credit under the Credit Facility. A change of control, as defined, in the Company is also considered an event of default under the Credit Facility.

The Credit Facility replaced the Company's lending arrangement with PNC Bank, National Association (PNC). In connection therewith, the Company incurred an early termination fee of \$99, and had unamortized deferred loan cost of \$135, both of which were expensed in the Company's 2010 consolidated statement of operations.

At December 31, 2011 and 2010, the Company had \$15,000 and \$9,000, respectively, outstanding under the revolving loan feature and letters of credit outstanding in the amount of \$6,600 for both 2011 and 2010.

Prior to entering into the Credit Facility, the Company had a revolving credit agreement with PNC, which provided for revolving advances based on specified percentages of accounts receivable and inventories. The borrowings were collateralized by receivables, inventories, equipment, and other personal property and had maximum borrowings of \$17,000. Through May 6, 2010, the Company also had a term loan outstanding with PNC, which funded the construction cost of its storm protection levee completed in 2007. The outstanding balance of \$2,150 was paid off in May 2010, when the Company executed the Credit Facility.

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### (10) Asset Retirement Obligations

The Company's asset retirement obligations are legal obligations of the Company to incur future costs associated with the closure, post-closure care and related water treatment of its East gypsum disposal facility. In conjunction with producing DAP, the Company is required to maintain a gypsum disposal facility for its waste by-products. The Company's East gypsum disposal facility became fully operational during 2003. Prior to 2003, the Company maintained a West gypsum disposal facility for its waste by-products. The closure of the West gypsum disposal facility was completed in 2005. There is no asset retirement obligation recorded for the West gypsum disposal facility, as the closure is complete and the related water leachate is being used by the Company in production. The Company has recorded the estimated fair value of its asset retirement obligation in accordance with ASC 410, *Asset Retirement and Environmental Obligations*. The liability was initially measured at fair value and subsequently is adjusted for accretion expense and changes in the amount or timing of the estimated cash flows. The liability for the East gypsum disposal facility includes costs for closure, post-closure care and related water treatment. The actual amounts to be spent will depend on factors such as the timing of activities, refinements in scope, technological developments, cost inflation, changes in regulations, as well as the Company's business plans. It is possible that these factors could change and that such changes could have a significant impact on the estimates included in the accompanying consolidated financial statements. Closure expenditures for the East gypsum disposal facility are currently estimated to occur in the 2034 to 2036 timeframe.

The balance of the Company's asset retirement obligations and changes thereto are summarized below. Accretion expense is reported in cost of sales in the accompanying consolidated statements of operations.

Obligations at December 31, 2008	\$	4,841
Change in estimate		(190)
Accretion expense		477
		<hr/>
Obligations at December 31, 2009		5,128
Change in estimate		10,520
Accretion expense		659
		<hr/>
Obligations at December 31, 2010		16,307
Change in estimate		414
Accretion expense		906
		<hr/>
Obligations at December 31, 2011	\$	<u>17,627</u>

Each year, the Company reassesses its future costs for closure of its East gypsum disposal facility. The 2011 change in estimate resulted primarily from changes in prior cash flow estimates. The 2010 change in estimate resulted primarily from changes in cash flow estimates and the incorporation of proposed regulatory changes which included, among other things, changes in the order and timing of closure activities and duration of post-closure care. Accordingly, the present value of the future costs for closure, post-closure care and related water treatment costs increased by \$414 in 2011 and \$10,520 in 2010. In accordance with ASC 410, the Company recorded long-lived assets of \$414 in 2011 and \$10,520 in 2010

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and increased the asset retirement obligations by \$414 in 2011 and \$10,520 in 2010. Over time, the asset will be depreciated and the liability will be accreted to its present value.

During 2009, the Company reassessed its future costs of closure, post-closure care and related water treatment costs of its East gypsum disposal facility. Based upon this assessment, the Company determined that the present value of the future costs would be lower by \$190 and, accordingly, reduced its asset retirement obligation liability in accordance with ASC 410. The original retirement asset associated with this obligation was reduced to zero in conjunction with the allocation of the Company's enterprise value upon emergence from bankruptcy in 2004, pursuant to ASC 852, *Reorganizations*. Accordingly, the reduction of the asset retirement obligation is reflected as a separate component of operating income (loss) in the accompanying 2009 consolidated statement of operations.

As described in note 1, the Company has developed a financial assurance mechanism with the MDEQ to provide funds to satisfy the Company's asset retirement obligations. Quarterly payments in the amount of \$200 are made into a trust fund managed by a third-party trustee and will be used to fund closure, post-closure care and related water treatment costs of the East gypsum disposal facility. As stated in note 20, the U.S. Environmental Protection Agency is seeking adjustments to the financial assurance mechanism currently in place to fund the closure, post-closure care and related water treatment costs of the Company's East gypsum disposal facility. The impact of the adjustments, while not yet determinable, could materially impact the Company's future funding requirements.

#### **(11) Stockholders' Equity**

In December 2007, the Board of Directors of the Company adopted a stockholders' rights plan whereby the Company declared a dividend of one common stock purchase right for each share of the Company's common stock outstanding pursuant to certain conditions. The stockholders' rights plan expired on December 31, 2009.

#### **(12) Earnings (Loss) Per Share**

The Company reports basic and diluted earnings (loss) per share as required by ASC 260, *Earnings Per Share*. Basic earnings (loss) per share is calculated based on the weighted average shares of common stock outstanding during the period. Diluted earnings (loss) per share is calculated to include any dilutive effect of common stock equivalents. The Company's common stock equivalents consist of stock options. The dilutive effect of the stock options is calculated using the treasury stock method.

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The weighted average number of common shares outstanding for the purpose of computing basic and diluted earnings (loss) per share is as follows (in thousands):

	<b>Years ended December 31</b>		
	<b>2011</b>	<b>2010</b>	<b>2009</b>
Weighted average number of common shares outstanding – basic	8,411	8,411	7,713
Common stock equivalents	—	—	—
Weighted average number of common shares outstanding – diluted	<u>8,411</u>	<u>8,411</u>	<u>7,713</u>

Common stock equivalents totaling 310 have been excluded from the computation of diluted net loss per share for the year ended December 31, 2009, because their inclusion would have reduced the reported net loss per share. The Company did not have any common stock equivalents in 2010 or 2011.

**(13) Concentration of Business**

Through September 30, 2009, all of the Company’s sales of DAP into international markets were made through a single global commodity trader and all domestic sales of DAP were made through the Company’s internal sales staff. Effective October 1, 2009, the Company entered into a DAP sales contract with the same commodity trader, whereby the commodity trader agreed to purchase the entire output of product produced by the Company, up to 716,000 short tons per contract year. In addition, the commodity trader has the right to purchase any excess tonnage produced by the Company. The price of product sold to the commodity trader is determined quarterly and is based on the ultimate destination of the product and prevailing published market prices. The contract also provides for a limited sharing of profits in excess of a stated threshold realized by the commodity trader in its sales of the Company’s product. Title and risk of ownership pass to the commodity trader at the delivery point, defined as the point where the Company’s plant conveyor belts enter the Company’s warehouses located at its Pascagoula, Mississippi facility. The Company has the option to receive up to eight barges of DAP per month from the commodity trader to meet the demands of the Company’s domestic customers. This contract will expire on December 31, 2012, but will automatically renew for additional periods of one year each commencing each January 1, unless canceled by either party on or before June 30, of the current contract year.

Approximately 49%, 31%, and 67% of the Company’s DAP sales were made into international markets in 2011, 2010, and 2009, respectively.

The Company’s customers that accounted for over 10% of total net sales are shown below:

	<b>2011</b>		<b>2010</b>		<b>2009</b>	
	<b>Sales amount</b>	<b>Percent of total</b>	<b>Sales amount</b>	<b>Percent of total</b>	<b>Sales amount</b>	<b>Percent of total</b>
Customer A	\$ 284,949	82%	\$ 209,777	82%	\$ 148,577	80%
Customer B	44,701	13	—	—	—	—

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Customers that account for over 10% of trade accounts receivable are shown below:

	2011		2010	
	<u>Outstanding receivables</u>	<u>Percent of total</u>	<u>Outstanding receivables</u>	<u>Percent of total</u>
Customer A	\$ 11,982	81%	\$ 9,112	99%

### (14) Litigation and Insurance Recoveries

In July 2007, the internals of the boiler in one of the Company's two sulfuric acid plants reached the end of their useful lives. The Company hired a contractor to disassemble the internals and to rebuild the boiler. After the contractor tendered the project to the Company as complete, the boiler required a number of repairs and the Company suffered unexpected downtime at the sulfuric acid plant. In the fourth quarter of 2007, the Company filed a lawsuit against the contractor and its subcontractor seeking in excess of \$17,000 in damages. The contractor counterclaimed against the Company for amounts allegedly owed by the Company for work performed.

On September 26, 2009, the Company entered into a settlement agreement with the contractor and the contractor's primary insurer. The terms of the agreement required, as consideration of the Company's covenant not to execute any judgment against the contractor and a release of the contractor's primary insurer from any liability arising out of work performed by the contractor for the Company in connection with the boiler, the contractor's primary insurer to pay the Company \$4,100, and the contractor to pay the Company \$100 in October 2009. In addition, the contractor agreed to dismiss with prejudice its counterclaim against the Company for amounts allegedly owed by the Company for work performed. In August 2010, the Company entered into a settlement agreement with the contractor's excess insurance carrier. The excess insurance carrier paid the Company \$1,000 in September 2010 to dismiss all claims outstanding among the parties.

In October 2009, the Company's lawsuit against the subcontractor went to trial. The jury ruled in favor of the Company and awarded damages of \$3,101, the full amount of damages sought by the Company. The jury allocated the damages 60% (\$1,861) to the contractor (which were released in the earlier settlement) and 40% (\$1,240) to the subcontractor. The subcontractor appealed this judgment. On October 15, 2010, the United States Fifth Circuit Court of Appeals affirmed the rulings of the Southern District Court of Mississippi. In November 2010, the subcontractor paid the Company \$1,334 for damages, plus accrued interest.

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As a result of these settlement agreements, the Company has recorded net litigation recoveries in its consolidated statements of operations, as follows:

	<u>2010</u>	<u>2009</u>
Settlement proceeds	\$ 2,334	4,200
Forgiveness of amounts owed to contractor	—	408
Litigation and related expenses	<u>(281)</u>	<u>(1,787)</u>
Litigation recoveries, net	<u>\$ 2,053</u>	<u>2,821</u>

In addition, during 2009, the Company settled with, and received, \$1,500 from its business interruption insurance carrier related to this equipment failure and \$115 in other unrelated insurance recoveries. These settlement proceeds were recorded as insurance recoveries in the Company's 2009 consolidated statement of operations.

The Company had no litigation or insurance recoveries during 2011.

**(15) Interest, Net**

Interest, net, consisted of the following for the years ended December 31:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Interest expense	\$ (1,045)	(1,107)	(599)
Interest income	—	—	3
Net interest expense	<u>\$ (1,045)</u>	<u>(1,107)</u>	<u>(596)</u>

**(16) Income Tax Expense (Benefit)**

Income tax expense (benefit) consisted of the following for the years ended December 31:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Current:			
Federal	\$ (432)	25	177
State	—	—	—
Deferred:			
Federal	(653)	565	(7,207)
State	<u>(81)</u>	<u>105</u>	<u>(1,080)</u>
Total income tax expense (benefit)	<u>\$ (1,166)</u>	<u>695</u>	<u>(8,110)</u>

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The differences between income tax expense at the federal statutory rate of 35% and reported income tax expense were as follows for the years ended December 31:

	2011		2010		2009	
	Amount	Percent of pre-tax income	Amount	Percent of pre-tax income	Amount	Percent of pre-tax income
Expected income tax expense (benefit)	\$ (691)	(35.0)%	\$ 616	35.0%	\$ (7,582)	(35.0)%
State income tax expense (benefit)	(63)	(3.2)	68	3.9	(701)	(3.2)
Increase (decrease) for uncertain tax position	(432)	(21.9)	25	1.4	162	0.7
Other, net	20	1.0	(14)	(0.8)	11	0.1
Total income tax expense (benefit)	<u>\$ (1,166)</u>	<u>(59.1)%</u>	<u>\$ 695</u>	<u>39.5%</u>	<u>\$ (8,110)</u>	<u>(37.4)%</u>

Deferred income tax assets and liabilities consisted of the following at December 31:

	2011	2010
Deferred tax liabilities:		
Property, plant and equipment	\$ 13,350	11,111
Gain on involuntary conversion	3,342	7,359
Prepaid and other assets	1,209	413
Total deferred tax liabilities	17,901	18,883
Deferred tax assets:		
Net operating loss carryforwards	12,966	13,424
Tax credit carryforwards	769	769
Asset retirement obligation	2,770	2,252
Accrued expenses and other liabilities	447	392
Other	183	546
Total deferred tax assets	17,135	17,383
Net deferred tax liabilities	<u>\$ 766</u>	<u>1,500</u>

As of December 31, the net deferred tax liabilities are presented in the accompanying consolidated balance sheets as follows:

	2011	2010
Current deferred income tax assets	\$ (841)	(336)
Long-term deferred income tax liabilities	1,607	1,836
	<u>\$ 766</u>	<u>1,500</u>

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As of December 31, 2011, the Company had federal net operating loss carryforwards totaling approximately \$4,979, which are subject to annual utilization federal limitations pursuant to Internal Revenue Code Section 382. Approximately \$453 can be utilized each year through 2022. As of December 31, 2011, the Company had post-bankruptcy federal net operating loss carryforwards of approximately \$28,849, which expire between years 2028 and 2029.

The Company records uncertain tax positions in accordance with ASC Subtopic 740-10. Interest and penalties incurred related to uncertain tax positions are recognized in income tax expense. Tax periods for all years after 2007 remain open for examination by the federal taxing jurisdictions to which the Company is subject and tax periods for all years after 2007 remain open for examination by the state taxing jurisdictions to which the Company is subject. The following table is a reconciliation of the unrecognized tax benefits, including interest and penalties. These unrecognized tax benefits are recorded as a component of accrued expenses in the Company's 2010 and 2009 consolidated balance sheets. As of December 31, 2011, the statute of limitations related to the unrecognized tax benefits lapsed. In accordance with ASC Subtopic 740-10, the Company recognized the lapse as a discrete item for the year ended December 31, 2011.

Amounts of unrecognized tax benefits at December 31, 2009	\$ 407
Increases as a result of interest and penalties	<u>25</u>
Amounts of unrecognized tax benefits at December 31, 2010	432
Decreases as a result of lapse of statute of limitations	<u>(432)</u>
Amounts of unrecognized tax benefits at December 31, 2011	<u><u>\$ —</u></u>

#### (17) Thrift Plan

The Company has a contributory thrift plan that covers substantially all regular full-time employees who have elected to participate in the plan. The Company matches a certain percentage of each employee's contributions to the plan up to a maximum percentage of the employee's base compensation. The Company's expense related to this plan totaled approximately \$291, \$311, and \$318 for the years ended December 31, 2011, 2010, and 2009, respectively.

#### (18) Commitments

##### (a) Operating Leases

The Company has commitments under operating leases for equipment. As of December 31, 2011, future minimum rental payments required under operating leases having noncancelable lease terms in excess of one year as of the respective lease's inception were \$18 and \$15 and \$8 for the years ended December 31, 2012, 2013 and 2014, respectively.

Rental expense for all operating leases was \$501, \$501, and \$409 for the years ended December 31, 2011, 2010, and 2009, respectively.



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### (b) *Raw Material Purchase Commitments*

As of December 31, 2011, the Company's future raw material purchase commitments and related affreightment commitments (both subject to force majeure provisions and based on minimum contracted quantities and pricing) were as follows:

	<u>Amount</u>
Years ending December 31:	
2012	\$ 37,164
2013	5,450

## (19) Share-based Compensation

### (a) *Stock Options*

In December 2009, two of the Company's executive employees exercised options covering a total of 757,018 shares. The Company received cash proceeds of \$1,787 related to the exercise, which was recorded as a component of common stock and additional paid-in capital in the Company's 2009 consolidated statement of stockholders' equity. As of December 31, 2011, the Company had not recognized the excess income tax benefit of \$1,054 associated with the stock option exercises. Such benefit will be recognized as additional paid-in capital when realized. Tax benefits related to the share-based compensation expense were recorded using a blended federal and state income tax rate of 38.25%.

The intrinsic value of options exercised during the year ended December 31, 2009 was \$2,756. The Company had no options outstanding at December 31, 2011, 2010 or 2009, as there were no new options granted by the Company.

### (b) *Stock Appreciation Rights (SARs)*

In April 2008, the Company's Board of Directors approved the adoption of an incentive plan to provide grants of stock appreciation rights (SARs) to its nonemployee directors (2008 Directors Plan). As of December 31, 2011, the 2008 Directors Plan had 99,314 shares outstanding and 41,257 shares available for future grants. The SARs have a grant date value equal to such director's cash compensation for the ensuing year.

In February 2009, the Company's Board of Directors approved the adoption of an incentive plan to provide grants of SARs to key employees and certain service providers of the Company (2009 Incentive Plan). The 2009 Incentive Plan provides for the granting of up to 688,860 SARs in the aggregate over a five-year period. As of December 31, 2011, the 2009 Incentive Plan had 343,624 shares available for future grants.

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Under both plans, the SARs are to be settled with a cash payment equal to the intrinsic value of the SARs as of the exercise date. One-third of the SARs vest on each of the first three anniversary dates following the grant date and expire on the fifth anniversary of the grant date. All SARs are accounted for as liability awards with compensation cost measured as of the end of each reporting period based on the then-current fair value of the SARs. Compensation costs recognized in the accompanying consolidated statements of operations related to the SARs were \$12, \$697, and \$328 for the years ended December 31, 2011, 2010, and 2009, respectively.

Below is a summary of the Company's SARs activity related to its 2008 Directors Plan and its 2009 Incentive Plan.

	<b>2008 Directors Plan</b>	<b>2009 Incentive Plan</b>	<b>Total</b>
Balance December 31, 2008	\$ 21,703	—	21,703
Granted	43,396	225,236	268,632
Exercised	—	—	—
Forfeited or expired	—	—	—
Balance December 31, 2009	65,099	225,236	290,335
Granted	58,743	120,000	178,743
Exercised	(24,528)	(34,166)	(58,694)
Forfeited or expired	—	(10,000)	(10,000)
Balance December 31, 2010	99,314	301,070	400,384
Granted	—	—	—
Exercised	—	(87,499)	(87,499)
Forfeited or expired	—	—	—
Balance December 31, 2011	\$ 99,314	213,571	312,885

In May 2008, the Company also granted 25,000 SARs to a key employee under a separate employment agreement. These SARs vested in May 2010 and expired unexercised as a result of having no intrinsic value on the vesting date.

**(20) Contingencies**

**(a) Phosphate Industry Investigation**

In 2003, the U.S. Environmental Protection Agency (EPA) announced a nationwide review of all mineral processing facilities. As a result, the EPA selected the mineral processing industry as a National Enforcement and Compliance Priority. One focus of this initiative is to examine the scope of applicability of the Bevill Amendment, which exempts waste generated during phosphate mining beneficiation and processing activities from regulation under the Resource Conservation Recovery Act (RCRA). As a part of the EPA initiative, between 2005 and 2007, the EPA visited all phosphoric

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acid production facilities in the United States. In January and March 2005, the EPA conducted site visits of the Company's facility in Pascagoula, Mississippi. In September 2005, the EPA issued a Notice of Violation (NOV) to the Company alleging that the reuse of low pH process water as DAP scrubber water and other uses within the facility was not protected by the Beville Amendment and therefore violated RCRA.

The Company believes that it has meritorious defenses against the allegations of the NOV, including prior written guidance and interpretations from the EPA inconsistent with its assertions in the NOV. The EPA has issued similar NOV's to other U.S. phosphate producers. The Company has entered into a Joint Defense Agreement with certain other phosphate producers with respect to this EPA initiative.

The Company, the EPA and the MDEQ are engaged in negotiations toward a resolution of the NOV. In these negotiations, the EPA is urging the Company to implement certain changes in its handling and use of process water. The EPA and the Company are also discussing monetary penalties in conjunction with the NOV. At this time, the Company cannot predict the cost of any potential process changes or the amount or nature of any ultimate monetary penalty. The Company intends to cooperate with the EPA and to work toward a negotiated resolution of this matter. If no resolution is achieved, the Company intends to aggressively defend the issues raised in the NOV.

The EPA is also seeking adjustments to the financial assurance mechanism currently in place to fund the closure, post-closure care and related water treatment of the Company's gypsum disposal facility. The EPA is proposing that the Company meet certain financial tests (which the Company does not currently meet) and/or contribute cash to a trust fund (or provide other financial assurance mechanisms in the form of letters of credit, surety arrangements or insurance) in amounts sufficient to fund closure, post-closure care and related water treatment of our gypsum disposal facility. Management is assessing the impact of the EPA's proposal and evaluating funding alternatives. The eventual outcome of these matters could materially impact the Company's future funding requirements (see note 10).

**(b) RCRA 3013 Consent Order**

On June 8, 2007, the Company and the EPA entered into a RCRA 3013 Consent Order which required the Company to prepare a plan for groundwater and surface water sampling around the facility. The 3013 Consent Order is part of the Phosphate Industry Investigation, pursuant to which the EPA is requiring all of the phosphoric acid production facilities to conduct groundwater and surface water sampling. In February 2010, the Company submitted its 3013 Report to the EPA. The report found no impacts to offsite groundwater, or to the sediments and surface water of Bayou Casotte, a body of water adjacent to the Company's plant. Since a majority of the sampling is currently being conducted by the Company, the cost for complying with the 3013 Consent Order is not material.

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In January 2011, the Company discovered, and promptly reported, wet soils immediately outside the West gypsum disposal facility outer dike. The Company retained engineering firms to determine the source of the moisture and any corrective action that might be required, as well as the safety and stability of the outer dike. The engineering evaluation determined that the wet soils were caused by leachate percolating through a very shallow sand lens under the outer dike, and that the leachate had not impacted Bayou Casotte. The evaluation recommended that the Company install several groundwater recovery wells to maintain control of the leachate. The evaluation also determined that the outer dike is stable and safe for continued use. On February 16, 2012, the Company and the EPA executed a RCRA 7003 Order on Consent (7003 Order on Consent). The 7003 Order on Consent requires the Company to continue to monitor the area where wet soils were detected while the EPA evaluates the Company's proposal to address the leachate. The Company currently estimates that the future capital cost for these groundwater recovery wells will be approximately \$450 to \$650. Any future capital cost will be recorded when incurred.

**(c) *TMDL and NPDES Permit Renewal***

On April 16, 2007, the EPA issued final Total Maximum Daily Load (TMDL) for Bayou Casotte, which established a concentration limit on discharges of free un-ionized ammonia into Bayou Casotte. The Company cannot meet the concentration limits under current operating conditions. The Company's National Pollutant Discharge Elimination System (NPDES) permit requires the Company to be in compliance with the newly established concentration limits by November 12, 2012. To satisfy the new concentration permit limits, the Company has proposed the relocation of its NPDES discharge location from the shoreline to a point further out into Bayou Casotte where there is a greater area for mixing upon final discharge. The Company retained a third-party consultant to conduct a Mixing Zone Study to demonstrate that the relocation of the Company's outfall would meet the EPA water quality standards and satisfy permit requirements. The study was completed and submitted to the MDEQ and the EPA. The Company is currently completing the conceptual engineering of the new system and estimates that the cost to relocate the outfall will be less than \$1,000. The company expects that the new system will be operational by November 2012 as required.

**(d) *Hazardous Air Pollutants Notice of Potential Violation***

On May 8, 2008, the EPA issued a Notice of Potential Violation, or NOPV, to the Company, alleging potential violations under the National Emission Standards for Hazardous Air Pollutants for Phosphoric Acid Manufacturing Plants and National Emission Standards for Hazardous Air Pollutants for Phosphate Fertilizer Production Plants.

According to the EPA's compliance guidelines for related field activities, a NOPV does not constitute a compliance order, a penalty assessment or any other administrative or judicial enforcement action. Although the EPA routinely monitors the compliance of regulated entities and issues NOV's for documented violations of applicable environmental regulations, the NOPV that the Company received merely alleges potential violations of regulations that may ultimately be deemed inapplicable to the Company.

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The EPA based the NOPV on the premise that the Company is a “major source” for emission of a single hazardous air pollutant, hydrogen fluoride, in excess of 10 tons per year. The EPA concedes that it has relied exclusively on its own calculations to support its contention that all known phosphate fertilizer and phosphoric acid plants are major sources of hydrogen fluoride. The Company has produced records to the EPA and to the MDEQ as part of their Title V Air Operating permit, which indicate a maximum potential emission of 5.6 tons of hydrogen fluoride per year, and actual emissions that have never exceeded 3 tons per year.

During November 2008, the Company conducted testing for hydrogen fluoride emissions, in accordance with the most recent EPA protocol. The results of the testing have been submitted to the EPA showing that the Company is not a major source for hydrogen fluoride emissions. The Company intends to cooperate with the EPA and intends to aggressively defend the issues raised in the NOPV. The Company is presently unable to predict the future costs or impact of this EPA initiative.

*(e) BART and HAZE Rule for Air Emissions*

The Clean Air Act regulations requires all facilities that have the potential to impact air quality within Class 1 national refuge sites to conduct a Haze (visual impairment) analysis. In October 2008, the Company submitted a permit application for a major construction project to upgrade the facility’s sulfuric acid plants which would satisfy the requirements of the Haze Rule. Under the permit application, the Company agreed to replace the existing vanadium catalyst with cesium catalyst in its two sulfuric acid plants by 2015. On November 9, 2010, the MDEQ issued the PSD Construction permit. The Company estimates that the catalyst replacement will cost approximately \$1,500. The actual cost of the catalyst replacement will be reflected in the Company’s accompanying consolidated financial statements as incurred.

*(f) August 2009 EPA/MDEQ Site Investigation*

On August 11 and 12, 2009, the EPA and the MDEQ conducted a site investigation of the Pascagoula facility. During the site investigation, the EPA and the MDEQ alleged the existence of certain violations of the Clean Water Act and RCRA, primarily attributable to the Company’s handling of leaks and spills of acidic wastewater within the facility. Immediately after the inspection, the Company began the implementation of measures to address issues raised by the EPA and the MDEQ. Subsequently, on September 23, 2009, the MDEQ issued a NOV (the MDEQ NOV) with respect to the alleged Clean Water Act violations and, on September 24, 2009, the EPA issued an Administrative Order (the EPA Order) with respect to the alleged RCRA violations.

**1. MDEQ NOV**

The MDEQ NOV principally alleges violations of the facility’s wastewater discharge permit related to the Company’s handling of low pH water.

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During its review of matters cited in the MDEQ NOV and the EPA Order, the Company determined that certain excess air emission reports filed during prior years, pursuant to its Title V Air Operating Permit with the MDEQ, contained inaccuracies. Corrected reports were filed with the MDEQ.

On March 4, 2011, the Company and the MDEQ executed an agreed order (the Agreed Order) that settles all matters asserted in the MDEQ NOV as well as any other NPDES permit violations from February 1, 2008 through February 28, 2011, not specifically identified in the NOV. Further, the Agreed Order discharged any violations related to previously filed inaccurate air emissions reports. While the Company neither admitted nor denied any liability arising out of the allegations of the MDEQ NOV or Title V Air Emission Report filings, the Company agreed to pay a civil penalty of \$297 to the MDEQ. The civil penalty of \$297 was expensed in the Company's December 31, 2010 consolidated financial statements.

### 2. EPA Order

The EPA Order issued under Section 7003(a) of RCRA alleges, principally, that the Company has contaminated soil, surface water and groundwater by allowing low pH water to escape from containment areas. The EPA Order directs the Company to take specified actions and contains a schedule for compliance with the directives. The Company is complying with the EPA Order in a timely manner.

Since the issuance of the EPA Order, the Company has conducted sampling to identify the nature and scope of the groundwater contamination. The test results confirm that the groundwater contamination is limited to a relatively small portion of the facility. There is no evidence of offsite impacts. The low pH groundwater facilitates the mobility of naturally occurring metals, which are readily leached from the soils into the groundwater upon contact with the low pH groundwater. Remediation of the low pH groundwater will permit the metals to return to the naturally occurring state. The Company has also conducted air monitoring to ensure that there is no imminent risk to employees or to visitors of the facility.

On May 4 and 5, 2010, the EPA conducted a site visit to inspect actions taken by the Company to comply with the EPA Order. The EPA found that the Company has completed many of the required elements of the EPA Order. Of the remaining elements, the EPA has approved all plans submitted thus far, including authorization to initiate the second round of soil and groundwater investigation and to install two shallow groundwater remediation test wells. The Company has completed the Soil and Groundwater Work Plan as approved by the EPA. The Company has prepared and submitted a Remediation Plan to the EPA to address the shallow onsite soil and groundwater issues. There is no evidence of offsite impact.

On February 16, 2012, the Company and the EPA executed the 7003 Order on Consent which superseded and took the place of the EPA Order issued on September 24, 2009. The 7003 Order on Consent was negotiated between the EPA and the Company. The 7003 Order on Consent confirms that specific items required under the EPA Order have been completed by the Company. The 7003 Order on Consent also provides a schedule for completion of other

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projects that the Company has agreed to conduct, primarily focusing on soil and groundwater remediation. The Company estimates that future capital costs for the proposed groundwater remediation will approximate \$550 and will be recorded when incurred.

The EPA is seeking to impose monetary penalties on the Company; however, discussions with regard to these penalties have been temporarily suspended. At this time, the Company cannot predict the amount or nature of any ultimate penalty.

During 2011, 2010 and 2009, the Company expensed \$159, \$4,028 and \$1,330, respectively, in connection with the two 7003 Orders and the MDEQ NOV. Additionally, the Company has accrued environmental remediation costs of \$490 at December 31, 2011, related to these matters.

**(g) Environmental Costs**

The costs to be incurred in connection with the Company's various environmental matters are difficult to predict, and the actual costs could differ from current estimates. These differences could be material to the Company's consolidated financial statements.

**(h) Other**

Additionally, the Company, in the ordinary course of its business, is the subject of, or party to, various pending or threatened legal actions. The Company believes that any ultimate liability arising from these actions will not have a material impact on the financial position or operating results of the Company.

**(21) Supplemental Cash Flow Information**

Supplemental cash flow information consisted of the following for the years ended December 31:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Cash payments for interest	\$ 873	947	527
Cash payments (refunds) of income taxes	—	(574)	(21,429)

During 2011 and 2010, the Company reassessed its future costs of closure, post-closure care and related water treatment costs of its East gypsum disposal facility. As a result of these assessments, the Company recorded on its consolidated balance sheets long-lived assets of \$414 in 2011 and \$10,520 in 2010 and increased its asset retirement obligation by \$414 in 2011 and \$10,520 in 2010. These noncash transactions have been excluded from the consolidated statements of cash flows for the years ended December 31, 2011 and 2010.

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The Company's 2008 consolidated balance sheet (not presented herein) included a current liability of \$24,600 for deposits received related to DAP inventory to be delivered to a customer under a deposit arrangement. During 2009, the Company delivered the DAP inventory in settlement of the outstanding deposit liability related to the deposit arrangement. This noncash transaction has been excluded from the consolidated statement of cash flows for the year ended December 31, 2009.