

TERRA INDUSTRIES INC  
Form 10-Q  
May 03, 2004

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2004

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 1-8520

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**TERRA INDUSTRIES INC.**

(Exact name of registrant as specified in its charter)

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<b>Maryland</b> (State or other jurisdiction of incorporation or organization)	<b>52-1145429</b> (I.R.S. Employer Identification No.)
<b>Terra Centre</b> <b>P.O. Box 6000</b> <b>600 Fourth Street</b>	
<b>Sioux City, Iowa</b> (Address of principal executive offices)	<b>51102-6000</b> (Zip Code)

**Registrant's telephone number, including area code: (712) 277-1340**

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

As of March 31, 2004, the following shares of the registrant's stock were outstanding:

Common Shares, without par value

75,623,647 shares

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## TERRA INDUSTRIES INC.

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(in thousands)

*(unaudited)*

	<u>March 31,</u> <u>2004</u>	<u>December 31,</u> <u>2003</u>	<u>March 31,</u> <u>2003</u>
<b>ASSETS</b>			
Cash and short-term investments	\$ 160,092	\$ 87,334	\$ 14,958
Accounts receivable, less allowance for doubtful accounts of \$580, \$87 and \$151	106,088	133,480	102,176
Inventories	113,986	90,869	128,963
Other current assets	36,656	43,319	40,977
<b>Total current assets</b>	<u>416,822</u>	<u>355,002</u>	<u>287,074</u>
Property, plant and equipment, net	697,741	707,665	778,161
Deferred plant turnaround costs	22,425	28,103	23,919
Other assets	32,596	34,292	32,774
<b>Total assets</b>	<u>\$ 1,169,584</u>	<u>\$ 1,125,062</u>	<u>\$ 1,121,928</u>
<b>LIABILITIES</b>			
Debt due within one year	\$ 154	\$ 153	\$ 147
Accounts payable	77,545	79,563	120,637
Accrued and other liabilities	165,473	142,338	107,685
<b>Total current liabilities</b>	<u>243,172</u>	<u>222,054</u>	<u>228,469</u>
Long-term debt and capital lease obligations	402,164	402,206	400,319
Deferred income taxes	28,736	17,831	54,348
Pension liabilities	63,453	63,453	62,865
Other liabilities	50,444	65,325	46,057
Minority interest	90,842	89,062	95,961
<b>Total liabilities and minority interest</b>	<u>878,811</u>	<u>859,931</u>	<u>888,019</u>
<b>STOCKHOLDERS EQUITY</b>			
Capital stock			
Common Shares, authorized 133,500 shares; outstanding 77,624, 77,563 and 76,853 shares	129,029	128,968	128,888
Paid-in capital	555,604	555,529	555,456
Accumulated other comprehensive loss	(37,320)	(44,596)	(73,804)

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Retained deficit	(356,540)	(374,770)	(376,631)
<b>Total stockholders equity</b>	<b>290,773</b>	<b>265,131</b>	<b>233,909</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 1,169,584</b>	<b>\$ 1,125,062</b>	<b>\$ 1,121,928</b>

See Accompanying Notes to the Consolidated Financial Statements.

## TERRA INDUSTRIES INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per-share amounts)

*(unaudited)*

	Three Months Ended March 31,	
	2004	2003
<b>REVENUES</b>		
Net sales	\$ 360,461	\$ 279,655
Other income, net	568	488
<b>Total revenues</b>	<b>361,029</b>	<b>280,143</b>
<b>COSTS AND EXPENSES</b>		
Cost of sales	323,647	284,074
Recovery of product claim costs	(15,514)	
Selling, general and administrative expense	7,309	9,327
	<b>315,442</b>	<b>293,401</b>
Income (loss) from operations	45,587	(13,258)
Interest income	377	189
Interest expense	(13,501)	(12,552)
Minority interest	(2,933)	1,718
Income (loss) from operations before income taxes	29,530	(23,903)
Income tax (provision) benefit	(11,300)	9,561
<b>NET INCOME (LOSS)</b>	<b>\$ 18,230</b>	<b>\$ (14,342)</b>
Basic and diluted income (loss) per share:		
Basic	\$ 0.24	\$ (0.19)
Diluted	\$ 0.23	\$ (0.19)
Basic and diluted weighted average shares outstanding		
Basic	75,814	75,624
Diluted	77,776	75,624

See Accompanying Notes to the Consolidated Financial Statements.

## TERRA INDUSTRIES INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

*(unaudited)*

	Three Months Ended March 31,	
	2004	2003
<b>OPERATING ACTIVITIES</b>		
Net income (loss)	\$ 18,230	\$ (14,342)
Adjustments to reconcile net income (loss) from operations to net cash flows from operating activities:		
Depreciation and amortization	25,578	27,617
Deferred income taxes	11,323	(11,843)
Minority interest in earnings (loss)	2,933	(1,718)
Recovery of product claim costs	(12,874)	
Changes in current assets and liabilities:		
Accounts receivable	28,588	(908)
Inventories	(22,273)	(39,807)
Other current assets	7,875	(10,168)
Accounts payable	(3,214)	14,392
Accrued and other liabilities	19,713	9,858
Other	(71)	518
Net cash flows from operating activities	<u>75,808</u>	<u>(26,401)</u>
<b>INVESTING ACTIVITIES</b>		
Purchase of property, plant and equipment	(1,075)	(3,578)
Plant turnaround costs	(150)	(12,318)
Other	(861)	(76)
Net cash flows from investing activities	<u>(2,086)</u>	<u>(15,972)</u>
<b>FINANCING ACTIVITIES</b>		
Principal payments on long-term debt and capital lease obligations	(41)	(35)
Stock issuance-net	136	
Distributions to minority interests	(1,153)	(1,153)
Net cash flows from financing activities	<u>(1,058)</u>	<u>(1,188)</u>
Effect of exchange rate changes on cash	94	40
Increase (decrease) to cash and short-term investments	72,758	(43,521)
Cash and short-term investments at beginning of period	87,334	58,479
<b>Cash and short-term investments at end of period</b>	<u>\$ 160,092</u>	<u>\$ 14,958</u>

See Accompanying Notes to the Consolidated Financial Statements.



## TERRA INDUSTRIES INC.

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

THREE MONTHS ENDED MARCH 31, 2004 AND 2003

(in thousands)

*(unaudited)*

	Accumulated				
	Capital Stock	Paid-In Capital	Other Comprehensive Loss	Retained Deficit	Total
Balance at January 1, 2004	\$ 128,968	\$ 555,529	\$ (44,596)	\$ (374,770)	\$ 265,131
Comprehensive income:					
Net income				18,230	18,230
Foreign currency translation adjustment			8,095		8,095
Change in fair value of derivatives, net of taxes of \$(973)			(819)		(819)
Comprehensive income					25,506
Stock issuance	61	75			136
Balance at March 31, 2004	\$ 129,029	\$ 555,604	\$ (37,320)	\$ (356,540)	\$ 290,773
			Accumulated Other Comprehensive Loss		
	Capital Stock	Paid-In Capital	Retained Deficit	Total	
Balance at January 1, 2003	\$ 128,654	\$ 555,167	\$ (63,668)	\$ (362,289)	\$ 257,864
Comprehensive loss:					
Net loss				(14,342)	(14,342)
Foreign currency translation adjustment			(820)		(820)
Change in fair value of derivatives, net of taxes of \$7,801			(8,138)		(8,138)
Minimum pension liability, net of taxes of \$580			(1,178)		(1,178)
Comprehensive loss					(24,478)
Stock incentive plan	234	289			523
Balance at March 31, 2003	\$ 128,888	\$ 555,456	\$ (73,804)	\$ (376,631)	\$ 233,909

See Accompanying Notes to the Consolidated Financial Statements.



## TERRA INDUSTRIES INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*(unaudited)*

1. The accompanying unaudited consolidated financial statements and condensed notes thereto contain all adjustments necessary, in the opinion of management, to summarize fairly the financial position of Terra Industries Inc. and all majority-owned subsidiaries (Terra, we and our) and the results of operations for the periods presented. Because of the seasonal nature of our operations and effects of weather-related conditions in several of its marketing areas, results of any interim reporting period should not be considered as indicative of results for a full year. These statements should be read in conjunction with our 2003 Annual Report to Stockholders.

Basic earnings (loss) per share data are based on the weighted-average number of Common Shares outstanding during the period. Diluted earnings per share data are based on the weighted-average number of Common Shares outstanding and the effect of all dilutive potential common shares including stock options, restricted shares and contingent shares.

Inventories consisted of the following:

<u>(in thousands)</u>	<u>March 31,</u> <u>2004</u>	<u>December 31,</u> <u>2003</u>	<u>March 31,</u> <u>2003</u>
Raw materials	\$ 19,252	\$ 22,937	\$ 27,044
Supplies	26,091	26,058	26,753
Finished goods	68,643	41,874	75,166
<b>Total</b>	<b>\$ 113,986</b>	<b>\$ 90,869</b>	<b>\$ 128,963</b>

Revenue is recognized when title to finished product passes to the customer. Revenue is recognized as the net amount to be received after deducting estimated amounts for discounts and trade allowances. Revenues include amounts paid by customers for shipping and handling.

Realized gains and losses from hedging activities and premiums paid for option contracts are deferred and recognized in the month in which the hedged transactions closed. Swaps, options and other derivative instruments that do not qualify for hedge accounting treatment are marked to fair value each accounting period. Costs associated with settlement of natural gas purchase contracts and costs for shipping and handling are included in cost of sales.

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We account for our employee stock-based compensation plans in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and the related interpretations, which utilize the intrinsic value method. The pro forma impact on net income (loss) and diluted income (loss) per share of accounting for stock-based compensation using the fair value method required by Statement of Financial Accounting Standard No. 123, Accounting for Stock-Based Compensation follows:

(in thousands, except per-share amounts)	Three Months Ended March 31	
	2004	2003
Basic and diluted net income (loss) as reported	\$ 18,230	\$ (14,342)
Basic and diluted net income (loss) pro forma	18,230	(14,342)
Basic net income (loss) per share as reported	\$ 0.24	\$ (0.19)
Basic net income (loss) per share pro forma	0.24	(0.19)
Diluted net income (loss) per share as reported	\$ 0.23	\$ (0.19)
Diluted net income (loss) per share pro forma	0.23	(0.19)

We review our long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the sum of the expected future cash flows expected to result from the use of the asset (undiscounted and without interest charges) is less than the carrying amount of the asset, an impairment loss is recognized based on the difference between the carrying amount and the fair value of the asset.

We commenced a review to determine if the Blytheville facility's carrying value was impaired during the second quarter of 2003. This review led us to conclude that future market conditions may not justify the ongoing investment in maintenance and replacement capital necessary to extend operations for the remainder of the facility's useful life. Accordingly, a \$53.1 million charge was recorded as an Impairment of long-lived assets. Although we resumed production in October 2003, we plan to discontinue production on or about May 31, 2004 and prepare the site for permanent closure. No decision has yet been made regarding the sale or demolition of the facility's production plants. We expect to operate the facility's storage and distribution assets as a terminal for ammonia produced at our Verdigris facility or obtained from other sources. We anticipate \$3.0 to \$4.0 million of spending, primarily for employee severance and decommissioning costs, will be required when the facility is permanently idled.

### 2. Product Claim Costs

Appeals of a Federal court decision ordering our insurer to pay all of our past and future judgments, settlements and other associated costs arising from a 1998 recall of carbonated beverages containing carbon dioxide tainted with benzene were exhausted in our favor during the 2004 first quarter. Accordingly, we recorded the recovery of product claim costs totaling \$15.5 million through the elimination of remaining reserves originally established for these claims and the recognition of a receivable for additional amounts due from the insurer for claims previously paid by us.

We are involved in various other legal actions and claims, including environmental matters, arising from the normal course of business. While it is not feasible to predict with certainty the final outcome of these proceedings, management does not believe that these matters will have a material adverse effect on the results of operations, financial position or net cash flows.

### 3. Derivative Financial Instruments

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Natural gas is the principal raw material used in our production of nitrogen products and methanol. Natural gas prices are volatile and we manage this volatility through the use of derivative commodity instruments. Our current policy is to hedge 20-80% of our natural gas requirements for the upcoming 12 months and up to 50% of the requirements for the following 24-month period, provided that such arrangements would not result in costs greater than expected selling prices for our finished products.

We notify the Board of Directors when we deviate from this policy. The financial derivatives are traded in months forward and settlement dates are scheduled to coincide with gas purchases during those future periods. These contracts reference physical natural gas prices or appropriate NYMEX futures contract prices. Contract prices are frequently based on prices at the most common and financially liquid location of reference for financial derivatives related to natural gas. However, natural gas supplies for our facilities are purchased for each plant at locations other than reference points, which often creates a location basis differential between the contract price and the physical price of natural gas. Accordingly, the use of financial derivatives may not exactly offset the change in the price of physical gas.

We have entered into forward pricing positions for a portion of its natural gas requirements for the remainder of 2004, consistent with its policy. As a result of its policies, we have reduced the potential adverse financial impact of natural gas price increases during the forward pricing period, but conversely, if natural gas prices were to fall, we will incur higher costs. Contracts were in place at March 31, 2004 to cover 21% of natural gas requirements for the succeeding twelve months. We also use basis swaps to manage some of the basis risk.

Unrealized gains from forward pricing positions in North America totaled \$4.4 million as of March 31, 2004. We also had \$.4 million of realized gains on closed North America contracts relating to future periods that have been deferred to the respective period.

For the period ending March 31, 2004, recording the fair value of natural gas derivatives resulted in a \$2.4 million decrease to other current assets, a \$.6 million charge to cost of sales and a \$.8 million decrease, before deferred taxes of \$1.0 million to Accumulated Other Comprehensive Loss, which reflected the effective portion of the derivatives designated as cash flow hedges. The decrease to other current assets was to recognize the value of open natural gas contracts and the increase to other current liabilities was to reclassify deferred gains on closed contracts relating to future periods.

#### 4. Industry Segment Data

We classify our continuing operations into two business segments: nitrogen products and methanol. The nitrogen products business produces and distributes ammonia, urea, nitrogen solutions, ammonium nitrate and other products to farm distributors and industrial users. The methanol business manufactures and distributes methanol which is used in the production of a variety of chemical derivatives and in the production of methyl tertiary butyl ether (MTBE), an oxygenate and an octane enhancer for gasoline. We do not allocate interest, income taxes or infrequent items to continuing business segments. Included in Other are general corporate activities not attributable to a specific industry segment.

The following summarizes operating results by business segment:

(in thousands)	Three Months Ended March 31	
	2004	2003
Revenues - Nitrogen Products	\$ 317,557	\$ 228,541
- Methanol	42,904	51,114
- Other	568	488
<b>Total revenues</b>	<b>\$ 361,029</b>	<b>\$ 280,143</b>
Income (loss) from operations		
- Nitrogen Products	\$ 49,418	\$ (13,558)
- Methanol	(2,046)	1,633
- Other	(1,785)	(1,333)
<b>Total income (loss) from operations</b>	<b>\$ 45,587</b>	<b>\$ (13,258)</b>

5. We maintain defined benefit pension plans that cover substantially all salaried and hourly employees. Benefits are based on a pay formula. The defined benefit plans' assets consist principally of equity securities and corporate and government debt securities. We also have certain non-qualified pension plans covering executives, which are unfunded. We accrue pension costs based upon annual actuarial valuations for each plan and fund these costs in accordance with statutory requirements.

The estimated components of net periodic pension expense for the three months ending March 31 follow:

(in thousands)	2004	2003
Service cost	\$ 502	\$ 1,024
Interest cost	3,754	2,733
Expected return on plan assets	(3,065)	(2,537)
Amortization of prior service cost	7	19
Amortization of actuarial loss	1,191	1,022
Amortization of net assets	(29)	(77)
Termination charge	385	
<b>Pension Expense</b>	<b>\$ 2,361</b>	<b>\$ 2,568</b>

Our cash contributions to the defined benefit pension plans for the quarter ended March 31, 2004 and 2003 were \$1.6 million and \$1.5 million, respectively.

We also sponsor defined contribution savings plans covering most full-time employees. Contributions made by participating employees are matched based on a specified percentage of employee contributions. The cost of our contributions to these plans for the period ending March 31,

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2004 and 2003 totaled \$.8 million and \$.3 million, respectively.

We provide health care benefits for certain U.S. employees who retired on or before January 1, 2002. Participant contributions and co-payments are subject to escalation. The plan pays a stated percentage of most medical expenses reduced for any deductible and payments made by government programs. These costs are funded as paid.

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6. Guarantor Subsidiaries

Condensed consolidating financial statements of Terra Industries Inc. (the Parent), Terra Capital, Inc. (TCAPI), the Guarantor Subsidiaries and subsidiaries of the Parent that are not guarantors of the Senior Secured Notes due 2008 for March 31, 2004, December 31 and March 31, 2003 and condensed statements of operations and cash flows for the three months ended March 31, 2004 and 2003 are presented below for purposes of complying with the reporting requirements of the Guarantor Subsidiaries.

Guarantor subsidiaries include subsidiaries that own the Woodward, Oklahoma, Port Neal, Iowa and Beaumont, Texas plants as well as the corporate headquarters facility in Sioux City, Iowa. All other company facilities are owned by non-guarantor subsidiaries.

Condensed Consolidating Statement of Financial Position as of March 31, 2004:

(in thousands)	Parent	TCAPI	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>Assets</b>						
Cash and short-term investments	\$	\$ 157,680	\$ 589	\$ 1,823	\$	\$ 160,092
Accounts receivable, net		10	29,625	76,453		106,088
Inventories			40,451	73,535		113,986
Other current assets	6,652	9,586	5,069	11,961	3,388	36,656
<b>Total current assets</b>	<b>6,652</b>	<b>167,276</b>	<b>75,734</b>	<b>163,772</b>	<b>3,388</b>	<b>416,822</b>
Property, plant and equipment, net			333,032	366,505	(1,796)	697,741
Investments in and advanced to (from) affiliates	408,856	384,989	1,296,586	119,449	(2,209,880)	
Other assets and deferred plant turnaround costs	(453)	17,602	7,829	29,750	293	55,021
<b>Total assets</b>	<b>\$ 415,055</b>	<b>\$ 569,867</b>	<b>\$ 1,713,181</b>	<b>\$ 679,476</b>	<b>\$ (2,207,995)</b>	<b>\$ 1,169,584</b>
<b>Liabilities</b>						
Debt due within one year	\$	\$	\$ 94	\$ 60	\$	\$ 154
Accounts payable	137		30,285	47,123		77,545
Accrued and other liabilities	(6,881)	39,606	50,161	79,199	3,388	165,473
<b>Total current liabilities</b>	<b>(6,744)</b>	<b>39,606</b>	<b>80,540</b>	<b>126,382</b>	<b>3,388</b>	<b>243,172</b>
Long-term debt and capital lease obligations		402,000	105	59		402,164
Deferred income taxes	41,201			(12,465)		28,736
Pension and other liabilities	89,825	(4,105)	21,946	6,231		113,897
Minority interest		17,769	73,073			90,842
<b>Total liabilities</b>	<b>124,282</b>	<b>455,270</b>	<b>175,664</b>	<b>120,207</b>	<b>3,388</b>	<b>878,811</b>
<b>Stockholders Equity</b>						

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Common stock	129,029		72	49,709	(49,781)	129,029
Paid-in capital	555,604	150,218	1,778,916	685,556	(2,614,690)	555,604
Accumulated other comprehensive income (loss)	(37,320)	(37,320)		17,484	19,836	(37,320)
Retained earnings (deficit)	(356,540)	1,699	(241,471)	(193,480)	433,252	(356,540)
	<u>290,773</u>	<u>114,597</u>	<u>1,537,517</u>	<u>559,269</u>	<u>(2,211,383)</u>	<u>290,773</u>
Total stockholders equity						
Total liabilities and stockholders equity	\$ 415,055	\$ 569,867	\$ 1,713,181	\$ 679,476	\$ (2,207,995)	\$ 1,169,584
	<u>\$ 415,055</u>	<u>\$ 569,867</u>	<u>\$ 1,713,181</u>	<u>\$ 679,476</u>	<u>\$ (2,207,995)</u>	<u>\$ 1,169,584</u>



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Condensed Consolidating Statement of Operations for the three months ended March 31, 2004:

(in thousands)				Non-Guarantor		Consolidated
	Parent	TCAPI	Guarantor Subsidiaries	Subsidiaries	Eliminations	
<b>Revenues</b>						
Net sales	\$	\$	\$ 112,488	\$ 246,309	\$ 1,664	\$ 360,461
Other income, net			2,127	105	(1,664)	568
			<u>114,615</u>	<u>246,414</u>		<u>361,029</u>
<b>Cost and Expenses</b>						
Cost of sales			110,849	212,177	621	323,647
Product claim costs				(15,514)		(15,514)
Selling, general and administrative expenses	906	(491)	4,719	2,600	(425)	7,309
Equity in the (earnings) loss of subsidiaries	(25,669)	(38,112)	(860)		64,641	
	<u>(24,763)</u>	<u>(38,603)</u>	<u>114,708</u>	<u>199,263</u>	<u>64,837</u>	<u>315,442</u>
Income (loss) from operations	24,763	38,603	(93)	47,151	(64,837)	45,587
Interest income		361	972	173	(1,129)	377
Interest expense	(769)	(12,721)	(8)	(1,148)	1,145	(13,501)
Minority interest		(574)	(2,359)			(2,933)
Income (loss) from operations before income taxes	23,994	25,669	(1,488)	46,176	(64,821)	29,530
Income tax benefit (provision)	(5,764)			(5,535)	(1)	(11,300)
Net Income (Loss)	<u>\$ 18,230</u>	<u>\$ 25,669</u>	<u>\$ (1,488)</u>	<u>\$ 40,641</u>	<u>\$ (64,822)</u>	<u>\$ 18,230</u>

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Condensed Consolidating Statement of Cash Flows for the three months ended March 31, 2004:

(in thousands)	Parent	TCAPI	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>Operating Activities</b>						
Net income (loss)	\$ 18,230	\$ 25,669	\$ (1,488)	\$ 40,641	\$ (64,822)	\$ 18,230
Adjustments to reconcile net income (loss) to net cash flows from operating activities:						
Depreciation and amortization		1,048	11,755	12,775		25,578
Deferred income taxes	10,922			(17)	418	11,323
Minority interest in earnings		574	2,359			2,933
Recovery of product claim costs				(12,874)		(12,874)
Equity in earnings (loss) of subsidiaries	25,669	38,112	860		(64,641)	
Change in operating assets and liabilities	(8,238)	8,395	26,405	(9,842)	13,969	30,689
Other				12,874	(71)	(71)
<b>Net Cash Flows from Operating Activities</b>	<b>46,583</b>	<b>73,798</b>	<b>39,891</b>	<b>43,557</b>	<b>(128,021)</b>	<b>75,808</b>
<b>Investing Activities</b>						
Purchase of property, plant and equipment			(80)	(995)		(1,075)
Plant turnaround costs			(3)	(147)		(150)
Other	453	(1)	883	(6,047)	3,851	(861)
<b>Net Cash Flows from Investing Activities</b>	<b>453</b>	<b>(1)</b>	<b>800</b>	<b>(7,189)</b>	<b>3,851</b>	<b>(2,086)</b>
<b>Financing Activities</b>						
Principal payments on long-term debt and capital lease obligations			(26)	(15)		(41)
Change in investments and advances from (to) affiliates	(47,172)	9,477	(44,887)	(41,494)	124,076	
Stock issuance, net	136					136
Distributions to minority interests		(225)	(928)			(1,153)
<b>Net Cash Flows from Financing Activities</b>	<b>(47,036)</b>	<b>9,252</b>	<b>(45,841)</b>	<b>(41,509)</b>	<b>124,076</b>	<b>(1,058)</b>
<b>Effect of Foreign Exchange Rate on Cash</b>						
					94	94
<b>Increase (decrease) in Cash and Short-term Investments</b>		<b>83,049</b>	<b>(5,150)</b>	<b>(5,141)</b>		<b>72,758</b>
<b>Cash and Short-term Investments at Beginning of Year</b>		<b>74,631</b>	<b>5,739</b>	<b>6,964</b>		<b>87,334</b>
	<b>\$</b>	<b>\$ 157,680</b>	<b>\$ 589</b>	<b>\$ 1,823</b>	<b>\$</b>	<b>\$ 160,092</b>

**Cash and Short-term  
Investments at End of Year**



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Condensed Consolidating Statement of Financial Position for the Year Ended December 31, 2003:

(in thousands)				Non-Guarantor		Consolidated
	Parent	TCAPI	Guarantor Subsidiaries	Subsidiaries	Eliminations	
<b>Assets</b>						
Cash and short-term investments	\$	\$ 74,631	\$ 5,739	\$ 6,964	\$	\$ 87,334
Accounts receivable			49,642	83,838		133,480
Inventories			26,337	64,532		90,869
Other current assets	7,541	6,267	16,836	12,221	454	43,319
<b>Total current assets</b>	<b>7,541</b>	<b>80,898</b>	<b>98,554</b>	<b>167,555</b>	<b>454</b>	<b>355,002</b>
Property, plant and equipment, net			343,379	366,321	(2,035)	707,665
Investment in and advanced to (from) affiliates	380,076	425,301	1,257,814	82,676	(2,145,867)	
Other assets and deferred plant turnaround costs		18,650	10,037	34,126	(418)	62,395
<b>Total Assets</b>	<b>\$ 387,617</b>	<b>\$ 524,849</b>	<b>\$ 1,709,784</b>	<b>\$ 650,678</b>	<b>\$ (2,147,866)</b>	<b>\$ 1,125,062</b>
<b>Liabilities</b>						
Debt due within one year	\$	\$	\$ 95	\$ 58	\$	\$ 153
Accounts payable	669		29,426	49,468		79,563
Accrued and other liabilities	851	27,456	41,213	72,818		142,338
<b>Total current liabilities</b>	<b>1,520</b>	<b>27,456</b>	<b>70,734</b>	<b>122,344</b>		<b>222,054</b>
Long-term debt and capital lease obligations		402,000	130	76		402,206
Deferred income taxes	30,279			(12,448)		17,831
Pension and other liabilities	90,687	(3,680)	23,019	18,750	2	128,778
Minority interest		17,421	71,641			89,062
<b>Total liabilities and minority interest</b>	<b>122,486</b>	<b>443,197</b>	<b>165,524</b>	<b>128,722</b>	<b>2</b>	<b>859,931</b>
<b>Stockholders Equity</b>						
Common stock	128,968		72	49,709	(49,781)	128,968
Paid in capital	555,529	150,218	1,819,036	725,546	(2,694,800)	555,529
Accumulated other comprehensive income (loss)	(44,596)	(44,596)		16,090	28,506	(44,596)
Retained earnings (deficit)	(374,770)	(23,970)	(274,848)	(269,389)	568,207	(374,770)
<b>Total stockholders equity</b>	<b>265,131</b>	<b>81,652</b>	<b>1,544,260</b>	<b>521,956</b>	<b>(2,147,868)</b>	<b>265,131</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 387,617</b>	<b>\$ 524,849</b>	<b>\$ 1,709,784</b>	<b>\$ 650,678</b>	<b>\$ (2,147,866)</b>	<b>\$ 1,125,062</b>



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Condensed Consolidating Statement of Financial Position as of March 31, 2003:

(in thousands)	Parent	TCAPI	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>Assets</b>						
Cash	\$	\$ 9,039	\$ 1,132	\$ 4,787	\$	\$ 14,958
Accounts Receivable		(2)	38,818	63,360		102,176
Inventories			46,947	82,016		128,963
Other current assets	4,057	12,193	13,250	11,477		40,977
<b>Total current assets</b>	<b>4,057</b>	<b>21,230</b>	<b>100,147</b>	<b>161,640</b>		<b>287,074</b>
Property, plant and equipment, net			393,049	388,611	(3,499)	778,161
Investments in and advanced to (from) affiliates	596,654	374,004	1,340,320	11,169	(2,322,147)	
Other assets and deferred plant turnaround costs	(479)	13,188	10,241	33,743		56,693
<b>Total assets</b>	<b>\$ 600,232</b>	<b>\$ 408,422</b>	<b>\$ 1,843,757</b>	<b>\$ 595,163</b>	<b>\$ (2,325,646)</b>	<b>\$ 1,121,928</b>
<b>Liabilities</b>						
Debt due within one year	\$	\$	\$ 91	\$ 56	\$	\$ 147
Accounts payable	18		55,171	65,448		120,637
Accrued and other liabilities	35,468	11,455	37,895	34,394		119,212
<b>Total current liabilities</b>	<b>35,486</b>	<b>11,455</b>	<b>93,157</b>	<b>99,898</b>		<b>239,996</b>
Long-term debt	200,000	200,000	200	119		400,319
Deferred income taxes	54,356	19,422		(19,430)		54,348
Pension and other liabilities	76,481	12,865	2,245	5,803	1	97,395
Minority interest		18,770	77,191			95,961
<b>Total liabilities</b>	<b>366,323</b>	<b>262,512</b>	<b>172,793</b>	<b>86,390</b>	<b>1</b>	<b>888,019</b>
<b>Stockholders Equity</b>						
Common stock	128,888		73	49,709	(49,782)	128,888
Paid in capital	555,456	150,218	1,812,918	719,365	(2,682,501)	555,456
Accumulated other comprehensive loss	(73,804)	(41,846)		(21,983)	63,829	(73,804)
Retained earnings (deficit)	(376,631)	37,538	(142,027)	(238,318)	342,807	(376,631)
<b>Total stockholders equity</b>	<b>233,909</b>	<b>145,910</b>	<b>1,670,964</b>	<b>508,773</b>	<b>(2,325,647)</b>	<b>233,909</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 600,232</b>	<b>\$ 408,422</b>	<b>\$ 1,843,757</b>	<b>\$ 595,163</b>	<b>\$ (2,325,646)</b>	<b>\$ 1,121,928</b>

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Condensed Consolidating Statement of Operations for the three months ended March 31, 2003:

(in thousands)	Parent	TCAPI	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>Revenues</b>						
Net sales	\$	\$	\$ 105,852	\$ 172,548	\$ 1,255	\$ 279,655
Other income, net			1,625	118	(1,255)	488
			107,477	172,666		280,143
<b>Cost and Expenses</b>						
Cost of sales			109,853	175,176	(955)	284,074
Selling, general and administrative expenses	1,365	(518)	5,385	2,498	597	9,327
Equity in the (earnings) loss of subsidiaries	16,689	11,465	11,264	(82)	(39,336)	
	18,054	10,947	126,502	177,592	(39,694)	293,401
Loss from operations	(18,054)	(10,947)	(19,025)	(4,926)	39,694	(13,258)
Interest income	14	720	1,001	55	(1,601)	189
Interest expense	(5,740)	(6,798)	(12)	(1,778)	1,776	(12,552)
Minority interest		336	1,382			1,718
Loss from operations before income taxes	(23,780)	(16,689)	(16,654)	(6,649)	39,869	(23,903)
Income tax benefit	9,438			123		9,561
Net loss	\$ (14,342)	\$ (16,689)	\$ (16,654)	\$ (6,526)	\$ 39,869	\$ (14,342)

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Condensed Consolidating Statement of Cash Flows for the three months ended March 31, 2003:

(in thousands)	Parent	TCAPI	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>Operating Activities</b>						
Net income (loss)	\$ (14,342)	\$ (16,689)	\$ (16,654)	\$ (6,526)	\$ 39,869	\$ (14,342)
Adjustments to reconcile net loss to net cash flows from operating activities:						
Depreciation and amortization		697	12,826	14,094		27,617
Deferred income taxes	(15,798)			(2,603)	6,558	(11,843)
Minority interest in earnings		(336)	(1,382)			(1,718)
Equity in earnings (loss) of subsidiaries	16,689	11,465	11,264	(82)	(39,336)	
Change in operating assets and liabilities	15,698	(7,274)	(78,292)	(7,920)	51,155	(26,633)
Other					518	518
<b>Net Cash Flows from Operating Activities</b>	<b>2,247</b>	<b>(12,137)</b>	<b>(72,238)</b>	<b>(3,037)</b>	<b>58,764</b>	<b>(26,401)</b>
<b>Investing Activities</b>						
Purchase of property, plant and equipment			(1,456)	(2,122)		(3,578)
Plant turnaround costs			(5,814)	(6,504)		(12,318)
Other					(76)	(76)
<b>Net Cash Flows from Investing Activities</b>			<b>(7,270)</b>	<b>(8,626)</b>	<b>(76)</b>	<b>(15,972)</b>
<b>Financing Activities</b>						
Principal payments on long-term debt			(22)	(13)		(35)
Change in investments and advances from (to) affiliates	(2,248)	6,013	82,155	(92,282)	6,362	
Distributions to minority interests		(225)	(928)			(1,153)
Other			(565)	(435)	1,000	
<b>Net Cash Flows from Financing Activities</b>	<b>(2,248)</b>	<b>5,788</b>	<b>80,640</b>	<b>(92,730)</b>	<b>7,362</b>	<b>(1,188)</b>
<b>Effect of Foreign Exchange Rate on Cash</b>						
					40	40
<b>Increase (decrease) in Cash and Short-term Investments</b>	<b>(1)</b>	<b>(6,349)</b>	<b>1,132</b>	<b>(104,393)</b>	<b>66,090</b>	<b>(43,521)</b>
<b>Cash and Short-term Investments at Beginning of Year</b>	<b>1</b>	<b>15,388</b>		<b>109,180</b>	<b>(66,090)</b>	<b>58,479</b>
<b>Cash and Short-term Investments at End of Year</b>	<b>\$</b>	<b>\$ 9,039</b>	<b>\$ 1,132</b>	<b>\$ 4,787</b>	<b>\$</b>	<b>\$ 14,958</b>





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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION**

Introduction

We produce and market nitrogen products for agricultural and industrial markets with production facilities located in North America and the United Kingdom. Nitrogen products are commodity chemicals that are sold at prices reflecting global supply and demand conditions. The nitrogen products industry has cycles of oversupply, resulting in lower prices and idled capacity, followed by supply shortages, resulting in high selling prices and higher industry-wide production rates. In order to be viable in this industry, a producer must be among the low-cost suppliers in the markets it serves and have a financial position that can sustain it during periods of oversupply.

Natural gas is the most significant raw material in the production of nitrogen products. North American natural gas costs have increased substantially since 1999. Since we compete with nitrogen products imported from regions with lower natural gas costs, the oversupply situation during most of the three years ending December 31, 2003 did not allow us and other North American producers to increase selling prices to levels necessary to cover the natural gas cost increases. This resulted in curtailments of North American nitrogen production by us and other producers that have contributed to higher nitrogen product prices through reductions to global supplies. Our United Kingdom operations have benefited from higher nitrogen product prices, but incurred natural gas costs lower than those in North America.

Imports, most of which are produced at facilities with access to fixed-price natural gas supplies, account for a significant portion of U.S. nitrogen product supply. Imported products' natural gas costs have been and could continue to be substantially lower than the delivered cost of natural gas to our facilities. Off-shore producers are most competitive in regions close to the point of entry for imports, including the Gulf Coast and East Coast of North America. Our sales volumes depend primarily on our plants' operating rates. We may purchase product from other manufacturers or importers for resale, but gross margins on those volumes are rarely significant. Profitability and cash flows from our nitrogen products business are affected by our ability to manage our costs and expenses (other than natural gas), most of which do not materially change for different levels of production or sales. Other factors affecting our nitrogen products results include the level of planted acres, transportation costs, weather conditions (particularly during the planting season), grain prices and other variables described in Items 1 and 2 Business and Properties section of our most recent Form 10-K filing with the Securities and Exchange Commission.

We also produce methanol in the U.S. Like nitrogen products, methanol is a commodity chemical manufactured from natural gas. Consequently, natural gas costs and the supply/demand balance for methanol significantly affect methanol earnings and cash flows. A significant portion of U.S. methanol demand is met by imports from regions with natural gas costs lower than those available to U.S. producers. Industry analysts have identified approximately 7.0 million metric tonnes of new methanol capacity (20% of current global demand) that should start up from 2004 through 2006 in regions with low natural gas costs. U.S. methanol demand has declined over the past year and is expected to continue to decline due to reduced U.S. consumption of MTBE, a gasoline oxygenate and octane enhancer that uses methanol as a feedstock.

In December 2003, we entered into contracts with the Methanex Corporation (Methanex) assigning it our sales contracts and providing it exclusive rights to all methanol production at the Beaumont facility for five years as more fully described in Items 1 and 2 Business and Properties most recent Form 10-K filing with the Securities and Exchange Commission. Under those contracts, Methanex has the right to terminate Beaumont production and we would be responsible for costs of shutting down the facility, which we estimate at \$5 million to \$7 million.

## Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America for reporting purposes. The preparation of these financial statements requires us to make estimates and judgments that affect the amount of assets, liabilities, revenues and expenses at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that reflect significant judgments and uncertainties, and potentially result in materially different results under different assumptions and conditions. Our critical accounting policies are described below.

### *Impairment of Long-Lived Assets*

We will record impairment losses on long-lived assets used in operations when events and circumstances indicated that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of these items. Our cash flow estimates are based on historical results adjusted to reflect our best estimate of future market and operating conditions. The net carrying value of assets not recoverable is reduced to fair value. Our estimates of fair value represent our best estimate based on industry trends and reference to market rates and transactions. Estimates of future cash flows are subject to significant uncertainties and assumptions. Accordingly, actual results could vary significantly from such estimates.

### *Pension Assets and Liabilities*

Pension assets and liabilities are affected by the estimated market value of plan assets, estimates of the expected return on plan assets and discount rates. Actual changes in the fair market value of plan assets and differences between the actual return on plan assets and the expected return on plan assets will affect the amount of pension expense ultimately recognized.

### *Post-Retirement Benefits*

Post-retirement benefits are determined on an actuarial basis and are affected by assumptions including the discount rate and expected trends in health care costs. Changes in the discount rate and differences between actual and expected health care costs will affect the recorded amount of post-retirement benefits expense ultimately recognized.

### *Revenue Recognition*

Revenue is recognized when title to finished product passes to the customer. Revenue is recognized as the net amount to be received after deducting estimated amounts for discounts and trade allowances. Revenue includes amounts paid by customers for shipping and handling.

*Deferred Income Taxes*

Deferred income tax assets and liabilities reflect (a) differences between financial statement carrying amounts and corresponding tax bases and (b) temporary differences resulting from differing treatment of items for tax and accounting purposes. Deferred tax assets also include the expected benefits of carrying forward our net operating losses. We regularly review deferred tax assets for recoverability and reduce them if we can not sufficiently determine that they will be realized. We base this determination on projected future taxable income and the expected timing of the reversals of existing temporary differences. We do not expect to recognize additional U.S. tax benefits for future losses until we realize

taxable income or generate additional deferred tax liabilities from U.S. operations. If there is a material change in the effective tax rates or time period when temporary difference become taxable or deductible, we may have to additionally reduce all or a significant portion of our deferred tax assets.

#### *Inventory Valuation*

Inventories are stated at the lower of cost and estimated net realizable value. The average cost of inventories is determined by using the first-in, first-out method. The nitrogen and methanol industries are characterized by rapid change in both demand and pricing. Rapid declines in demand could result in temporary or permanent curtailment of production, while rapid declines in price could result in a lower cost or market adjustment.

#### *Derivative and Financial Instruments*

We account for derivatives in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 133 Accounting for Derivative Instruments and Hedging Activities . SFAS No. 133 requires the recognition of derivatives in the balance sheet and the measurement of these instruments at fair value. Changes in the fair value of derivatives are recorded in earnings unless the normal purchase or sale exception applies or hedge accounting is elected.

We enter into derivative instruments including future contracts, swap agreements, and purchased options to cap or fix prices for a portion of natural gas production requirements. Terra has designated, documented and assessed accounting hedge relationships, which mostly resulted in cash flow hedges that require the recording of the derivative assets or liabilities at their fair value on the balance sheet with an offset in other comprehensive income. Amounts are removed from other comprehensive income as the underlying transactions occur and realized gains or losses are recorded.

## **RESULTS OF OPERATIONS**

### **QUARTER ENDED MARCH 31, 2004 COMPARED WITH**

### **QUARTER ENDED MARCH 31, 2003**

#### **Consolidated Results**

We reported net income of \$18.2 million for the 2004 first quarter compared with a 2003 loss from operations of \$14.3 million. The increase in 2004 income was primarily related to higher margins on nitrogen product sales and recovery of product claim costs.

We classify our operations into two business segments: nitrogen products and methanol. The nitrogen products segment represents operations directly related to the wholesale sales of nitrogen products from our ammonia production and upgrading facilities. The methanol segment represents wholesale sales of methanol produced by Terra's two methanol manufacturing plants.



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Total revenues and operating income (loss) by segment for the three-month period ended March 31, 2004 and 2003 follow:

(in thousands)	2004	2003
<b>REVENUES:</b>		
Nitrogen Products	\$ 317,557	\$ 228,541
Methanol	42,904	51,114
Other	568	488
	<u>\$ 361,029</u>	<u>\$ 280,143</u>
<b>OPERATING INCOME (LOSS):</b>		
Nitrogen Products	\$ 49,418	\$ (13,558)
Methanol	(2,046)	1,633
Other income - net	(1,785)	(1,333)
	<u>\$ 45,587</u>	<u>\$ (13,258)</u>

**Nitrogen Products**

Volumes and prices for the three-month periods ended March 31, 2004 and 2003 follow:

**VOLUMES AND PRICES**

(quantities in thousands of tons)	2004		2003	
	Sales Volumes	Average Unit Price*	Sales Volumes	Average Unit Price*
Ammonia	310	\$ 270	277	\$ 210
Nitrogen solutions	877	113	756	86
Urea	157	188	152	157
Ammonium nitrate	247	188	248	126

\* After deducting outbound freight costs

Nitrogen products segment revenues increased \$89.0 million to \$317.6 million in the 2004 first quarter compared with \$228.5 million in the 2003 first quarter primarily as a result of higher sales prices. Sales prices were higher as the result of increased demand and lower supplies caused by curtailments to North American production in response to high natural gas costs.

The nitrogen products segment had operating income of \$49.4 million for the first quarter of 2004 compared with an operating loss of \$13.6 million for the 2003 first quarter. As compared to the 2003 first quarter, higher selling prices contributed almost \$57.2 million to 2004 gross profits. In addition, recovery of product claim costs contributed \$15.5 million to 2004 first quarter operating income. First quarter natural gas

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costs increased about \$ 9.8 million from the 2003 first quarter as unit costs, net of forward pricing gains and losses, were \$5.22/MMBtu during the 2004 first quarter compared to \$4.87/MMBtu during the same 2003 period. As a result of forward price contracts, first quarter 2004 natural gas costs for the nitrogen products segment were \$6.8 million lower than spot prices.

### **Methanol**

For the three months ended March 31, 2004 and 2003 the Methanol segment had revenues of \$42.9 million and \$51.1 million, respectively. Sales volumes declined 5% from prior year levels and selling prices declined from \$.76/gallon in 2003 to \$.65/gallon in 2004. Sales volumes declined in 2004 due to fewer opportunities to profitably sell product purchased from other manufacturers. Selling prices declined in response to increased industry supplies.



The methanol segment had an operating loss of \$2.0 million for the 2004 first quarter compared to operating income of \$1.6 million for the 2003 first quarter. The decrease to operating income reflected lower sales prices that were only partially offset by reduced natural gas costs. Natural gas costs, net of forward pricing gains and losses, were \$5.37/MMBtu during the 2004 first quarter compared to \$5.54/MMBtu during the 2003 period. As a result of forward pricing contracts, first quarter 2004 natural gas costs for the methanol were \$.7 million lower than spot prices.

#### **Other Income - Net**

We had other operating losses of \$1.8 million in the 2004 first quarter compared to \$1.3 million operating loss in the 2003 first quarter. The increase to expenses relates primarily to legal and administrative expenses related to corporate activities not assignable to either business segment.

#### **Interest Expense - Net**

Interest expense, net of interest income, totaled \$13.1 million during the 2004 first quarter compared with \$12.4 million for the prior year period. The increased interest expense primarily related to higher interest rates paid on the 2003 refinancing of Senior Notes.

#### **Minority Interest**

Minority interest represents third-party interests in the earnings of the publicly held common units of Terra Nitrogen Company, L.P. (TNCLP). The 2004 first quarter minority interest charge of \$2.9 million reflected nitrogen earnings for TNCLP, which were included in their entirety in consolidated operating results. Minority interest benefits of \$1.7 million were recorded in the 2003 as the result of TNCLP losses, which were included in their entirety in consolidated operating results. These amounts are directly related to TNCLP earnings and losses.

#### **Income Taxes**

Income taxes for the first quarter 2004 were recorded based on the estimated annual effective tax rate for the individual jurisdictions in which we operate. In addition, the first quarter tax provisions were increased by \$1.6 million to provide a valuation allowance on first quarter losses for U.S. operations.

#### **LIQUIDITY AND CAPITAL RESOURCES**

Our primary uses of funds are to fund our working capital requirements, make payments on our debt and other obligations and make plant turnarounds and capital expenditures. The principle sources of funds will be cash flow from operations and borrowings under available bank facilities.

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During the first three months of 2004, cash and short-term investments increased \$72.8 million, most of which was provided through \$45.2 million from operating activities and \$33.6 million from seasonal reductions to working capital. At March 31, 2004, we had \$80.8 million in customer prepayments that we anticipate will be used during our second quarter.

During the first three months, we funded plant and equipment purchases of \$1.1 million primarily for replacement or stay-in-business capital needs. We expect 2004 plant and equipment purchases to be less than \$20 million consisting primarily of expenditures for replacement of equipment at manufacturing facilities.

Plant turnaround costs represent cash used for the periodic scheduled major maintenance of our continuous process production facilities that is performed at each plant generally every two years. We funded \$.2 million of plant turnaround costs in the first three months of 2004. We estimate 2004 plant turnaround costs will approximate \$30 million.

We have a \$175 million revolving credit facility that expires in June 2005. Borrowing availability under the credit facility is generally based on eligible cash balances, 85% of eligible accounts receivable and 60% of eligible inventory, less outstanding letters of credit. There were no revolving credit borrowings and there were \$31.0 million in outstanding letters of credit, resulting in remaining borrowing availability of approximately \$144.0 million under the facility. We are required to maintain a minimum unused borrowing availability of \$30 million. The credit facility also requires that we adhere to certain limitations on additional debt, capital expenditures, acquisitions, liens, asset sales, investments, prepayments of subordinated indebtedness, changes in lines of business and transactions with affiliates. In addition, if our borrowing availability falls below \$60 million, we are required to have generated \$60 million of operating cash flows, or earnings before interest, income taxes, depreciation, amortization and other non-cash items (as defined in the credit facility) for the preceding four quarters. The amount of operating cash flows to measure credit facility compliance is different than amounts that can be derived from our financial statements. For the 12 months ended March 31, 2004, operating cash flows as defined in the credit facility was \$170.7 million.

Our ability to meet credit facility covenants will depend on future operating cash flows, working capital needs, receipt of customer prepayments and trade credit terms. Failure to meet these covenants could result in additional costs and fees to amend the credit facility or could result in termination of the facility. Access to adequate bank facilities is critical to funding our operating cash needs. Based on current market conditions for our finished products and natural gas, we anticipate that we will be able to meet our covenants through 2004. Nevertheless, if product margins were to be as depressed as during portions of the 2003 first half or if there were to be any adverse changes in the factors discussed above, we may need a waiver of our credit facility covenants and there is no assurance we could receive such waivers.

Our cash contributions to pension plans are estimated at \$20 million in 2004, \$15 million in 2005 and \$7 million in 2006. Actual contributions could vary from these estimates depending on actual returns for plan assets, legislative changes to pension funding requirements and/or plan amendments.

We have a contract with Methanex that provides it with exclusive rights to all methanol production at the Beaumont facility through 2008. During that time, Methanex has the right to terminate Beaumont production and we would be responsible for costs of shutting down the facility, which we estimate at \$5 million to \$7 million.

Distributions paid to the minority TNCLP common unitholders in the first three months of 2004 and 2003 were \$1.2 million. TNCLP distributions are based on Available Cash (as defined in the Partnership Agreement).

Cash balances at March 31, 2004 were \$160.1 million, all of which is unrestricted.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to the risk of loss that may impact our financial position, results of operations or cash flows due to adverse changes in financial and commodity market prices and rates. We use derivative financial instruments to manage risk in the areas of natural gas prices, foreign currency fluctuations and interest rates. For more information about how we manage specific risk exposures, refer to our most recent Annual Report on Form 10-K (which is on file with the Securities and Exchange Commission), Item 7A Quantitative and Qualitative Disclosures about Market Risk and Note 13 Derivative Financial Instruments contained in Item 8.

Our operations are significantly affected by the price of natural gas. We employ derivative commodity instruments related to a portion of our natural gas requirements (primarily futures, swaps and options) for the purpose of managing our exposure to commodity price risk in the purchase of natural gas. Changes in the market value of these derivative instruments have a high correlation to changes in the spot price of natural gas. The volume of natural gas hedged varies from time to time based on management's judgment of market conditions, particularly natural gas prices and prices for nitrogen products and methanol. Contracts were in place at March 31, 2004 to cover 21% of our natural gas requirements for the succeeding twelve months (see Note 3). Our future ability to manage our exposure to commodity price risk in the purchase of natural gas through the use of financial derivatives may be affected by limitations imposed by our bank agreement covenants.

At March 31, 2004, we had no forward positions in any foreign currency.

Our only debt facility with floating rates at March 31, 2004 is borrowings under our bank lines. No borrowings were outstanding at September 30, 2003. There were no interest rate derivatives outstanding at March 31, 2004.

### ITEM 4. CONTROLS AND PROCEDURES

Our Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by the report, that our disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms.

There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### POTENTIAL CHANGE OF CONTROL

Anglo American plc, through its wholly-owned subsidiaries, owns 48.4% of Terra Industries' outstanding shares. Anglo American has made public its intention to dispose of its interest in Terra Industries with the timing based on market and other conditions.

**FORWARD-LOOKING PRECAUTIONS**

Information contained in this report, other than historical information, may be considered forward looking. Forward-looking information reflects management's current views of future events and financial performance that involve a number of risks and uncertainties. The factors that could cause actual results to differ materially include, but are not limited to, the following: changes in financial markets, general economic conditions within the agricultural industry, competitive factors and price changes (principally, sales prices of nitrogen and methanol products and natural gas costs), changes in product mix, changes in the seasonality of demand patterns, changes in weather conditions, changes in agricultural regulations, and other risks detailed in the "Factors that Affect Operating Results" section of our most recent Form 10-K.

**PART II. OTHER INFORMATION**

**ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.**

**(a) Exhibits**

Exhibit 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 31.2 Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32 Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

**(b) Reports on Form 8-K**

Form 8-K dated January 29, 2004 furnishing under Item 12 Terra's fourth quarter 2003 earnings.

Form 8-K dated March 31, 2004 reporting under Item 5 Terra's plan to close its Blytheville, Arkansas manufacturing facility.

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: April 30, 2004

**TERRA INDUSTRIES INC.**

/s/ Francis G. Meyer

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Francis G. Meyer  
*Senior Vice President and Chief Financial*

*Officer and a duly authorized signatory*