

TERRA INDUSTRIES INC
Form 10-Q
July 24, 2009

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

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

**For the quarterly period ended June 30, 2009
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
TERRA INDUSTRIES INC.**

(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of
incorporation or organization)

52-1145429
(I.R.S. Employer
Identification No.)

**Terra Centre
P.O. Box 6000
600 Fourth Street
Sioux City, Iowa**

51102-6000
(Zip Code)

(Address of principal executive offices)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting
company

(Do not check if smaller
reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

At the close of business on July 24, 2009 the following shares of the registrant's stock were outstanding:

Common Shares, without par value

99,786,406 shares

TABLE OF CONTENTS

Part I FINANCIAL INFORMATION

Item 1. Financial Statements

Consolidated Balance Sheets 3

Consolidated Statements of Operations 4

Consolidated Statements of Cash Flows 5

Consolidated Statements of Changes in Equity 7

Notes to Consolidated Financial Statements 8

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations 39

Item 3. Quantitative and Qualitative Disclosures about Market Risk 48

Item 4. Controls and Procedures 48

Part II OTHER INFORMATION

Item 1. Legal Proceedings 50

Item 1A. Risk Factors 50

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds 50

Item 3. Defaults upon Senior Securities 50

Item 4. Submission of Matters to a Vote of Security Holders 50

Item 5. Other Information 50

Item 6. Exhibits 51

Exhibit 31.1

Exhibit 31.2

Exhibit 32.1

Exhibit 32.2

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS**

TERRA INDUSTRIES INC.
CONSOLIDATED BALANCE SHEETS
(in thousands)
(unaudited)

	June 30, 2009	December 31, 2008	June 30, 2008
Assets			
Cash and cash equivalents	\$ 1,001,582	\$ 966,700	\$ 752,008
Accounts receivable, less allowance for doubtful accounts of \$1,373, \$290 and \$300	91,200	130,390	236,112
Inventories, net	128,048	197,091	168,950
Margin deposits with derivative counterparties		36,945	38
Other current assets	48,212	61,338	111,962
Current assets of discontinued operations			45,785
Total current assets	1,269,042	1,392,464	1,314,855
Property, plant and equipment, net	426,495	403,313	386,800
Equity method investments	269,113	270,915	360,805
Deferred plant turnaround costs, net	26,331	23,467	37,116
Other assets	29,995	22,858	30,109
Total assets	\$ 2,020,976	\$ 2,113,017	\$ 2,129,685
Liabilities			
Accounts payable	\$ 68,677	\$ 99,893	\$ 146,846
Customer prepayments	27,846	111,592	91,605
Derivative hedge liabilities	7,821	125,925	10,094
Accrued and other current liabilities	92,236	127,770	120,051
Current liabilities of discontinued operations			3,773
Total current liabilities	196,580	465,180	372,369
Long-term debt	330,000	330,000	330,000
Deferred taxes	83,580	61,443	153,754
Pension liabilities	8,394	9,170	9,251
Other liabilities	78,796	78,553	82,550
Total liabilities	697,350	944,346	947,924
Preferred Shares liquidation value of \$1,600; \$1,600 and \$120,000	1,544	1,544	115,800
Common Stockholders Equity			

Edgar Filing: TERRA INDUSTRIES INC - Form 10-Q

Capital stock			
Common Shares, authorized 133,500 shares; 99,701; 99,330 and 91,836 outstanding	152,481	152,111	144,431
Paid-in capital	581,542	579,164	617,744
Accumulated other comprehensive loss	(112,683)	(175,529)	(6,097)
Retained earnings	598,060	507,299	197,799
Total common stockholders equity	1,219,400	1,063,045	953,877
Noncontrolling interest	102,682	104,082	112,084
Total equity	1,322,082	1,167,127	1,065,961
Total liabilities and equity	\$ 2,020,976	\$ 2,113,017	\$ 2,129,685

See Accompanying Notes to the Consolidated Financial Statements.

Table of Contents

TERRA INDUSTRIES INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per-share amounts)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Revenues				
Product revenues	\$ 452,339	\$ 836,924	\$ 870,701	\$ 1,410,126
Other income	1,164	6,173	2,555	7,675
Total revenues	453,503	843,097	873,256	1,417,801
Cost and Expenses				
Cost of sales	296,690	547,070	639,647	954,059
Selling, general and administrative expense	13,906	27,233	32,474	39,937
Other operating expenses	12,560		14,260	
Equity earnings of North American affiliates	(1,522)	(16,518)	(4,774)	(29,808)
Total cost and expenses	321,634	557,785	681,607	964,188
Income from operations	131,869	285,312	191,649	453,613
Interest income	1,165	5,513	2,975	13,921
Interest expense	(6,757)	(6,756)	(13,485)	(13,814)
Income before income taxes, noncontrolling interest and equity earnings (loss) of GrowHow UK Limited	126,277	284,069	181,139	453,720
Income tax provision	(38,215)	(107,069)	(50,800)	(166,573)
Equity earnings (loss) of GrowHow UK Limited	1,886	37,611	(2,488)	46,895
Income from continuing operations, net of tax	89,948	214,611	127,851	334,042
Income from discontinued operations, net of tax		7,319		7,471
Net income before noncontrolling interest	89,948	221,930	127,851	341,513
Less: Net income attributable to the noncontrolling interest	(9,474)	(18,495)	(17,382)	(36,621)
Net income attributable to Terra Industries Inc.	80,474	203,435	110,469	304,892
Less: Net income attributable to preferred share dividends	(17)	(1,275)	(34)	(2,550)
Income Available to Common Stockholders	\$ 80,457	\$ 202,160	\$ 110,435	\$ 302,342

**Basic income per common share attributable to
Terra Industries Inc.:**

Edgar Filing: TERRA INDUSTRIES INC - Form 10-Q

Continued operations	\$ 0.81	\$ 2.14	\$ 1.11	\$ 3.26
Discontinued operations		0.08		0.08
Basic income per common share	\$ 0.81	\$ 2.22	\$ 1.11	\$ 3.34
Diluted income per common share attributable to Terra Industries Inc.:				
Continuing operations	\$ 0.81	\$ 1.87	\$ 1.11	\$ 2.84
Discontinued operations		0.07		0.07
Diluted income per common share	\$ 0.81	\$ 1.94	\$ 1.11	\$ 2.91
Weighted average shares outstanding:				
Basic	99,318	91,011	99,224	90,588
Diluted	99,710	104,678	99,704	104,652
Amounts attributable to Terra Industries Inc.:				
Income from continuing operations, net of tax	\$ 80,474	\$ 196,116	\$ 110,469	\$ 297,421
Income from discontinued operations, net of tax		7,319		7,471
Net income attributable to Terra Industries Inc.	\$ 80,474	\$ 203,435	\$ 110,469	304,892

See Accompanying Notes to the Consolidated Financial Statements.

Table of Contents

TERRA INDUSTRIES INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Six Months Ended June 30,	
	2009	2008
Operating Activities		
Net income attributable to Terra Industries Inc.	\$ 110,469	\$ 304,892
Income from discontinued operations		7,471
Income from continuing operations	110,469	297,421
Adjustments to reconcile income from continuing operations to net cash flows from operating activities:		
Depreciation of property, plant and equipment and amortization of deferred plant turnaround costs	41,628	39,449
Loss on sale of property, plant and equipment	657	727
Deferred income taxes	(1,393)	48,940
Noncontrolling interest in earnings	17,382	36,621
Distributions in excess of equity earnings of North American affiliates	4,204	3,881
Equity loss (earnings) of GrowHow UK Limited	2,488	(46,895)
Non-cash loss (gain) on derivatives	1,491	(4,954)
Share-based compensation	8,562	9,772
Amortization of intangible and other assets	4,598	4,070
Changes in operating assets and liabilities:		
Accounts receivable	40,261	(65,675)
Inventories	68,436	(36,478)
Accounts payable and customer prepayments	(116,095)	(171,404)
Margin deposits with derivative counterparties	36,945	600
Other assets and liabilities, net	(92,101)	(15,174)
Net cash flows from operating activities continuing operations	127,532	100,901
Net cash flows from operating activities discontinued operations		10,051
Net cash flows from operating activities	127,532	110,952
Investing Activities		
Capital expenditures and plant turnaround expenditures	(65,992)	(35,916)
Proceeds from sale of property, plant and equipment	101	1,632
Distributions received from North American affiliates	11,597	7,196
Contribution settlement received from GrowHow UK Limited		28,055
Balancing consideration and other payments from GrowHow UK Limited	7,893	
Net cash flows from investing activities	(46,401)	967
Financing Activities		
Preferred share dividends paid	(34)	(2,550)
Common stock dividends paid	(19,940)	(9,202)

Edgar Filing: TERRA INDUSTRIES INC - Form 10-Q

Common stock issuances and vestings	(5,334)	(6,842)
Excess tax benefits from equity compensation plans	3,921	7,817
Payments under share repurchase program		(7,500)
Distributions to noncontrolling interests	(23,391)	(39,899)
Net cash flows from financing activities	(44,778)	(58,176)
Effect of exchange rate changes on cash	(1,471)	27
Increase to cash and cash equivalents	34,882	53,770
Cash and cash equivalents at beginning of period	966,700	698,238
Cash and cash equivalents at end of period	\$ 1,001,582	\$ 752,008

Table of Contents**Consolidated Statements of Cash Flows (continued)**

	Six Months ended June 30,	
	2009	2008
Supplemental cash flow information:		
Interest paid	\$ 12,117	\$ 12,140
Income tax refunds received	784	206
Income taxes paid	97,360	92,368
Supplemental schedule of non-cash investing and financing activities:		
Conversion of warrants to common stock	\$	\$ 1,672
Supplemental schedule of unconsolidated affiliates distributions received from GrowHow UK Limited:		
Contribution settlement payments, balancing consideration and other payments received from GrowHow UK Limited	\$ 7,893	\$ 28,055
Supplemental schedule of unconsolidated affiliates distributions received from North America:		
Distributions received from unconsolidated affiliates	\$ 11,597	\$ 7,196
Equity in earnings of unconsolidated affiliates	4,774	29,808
Distribution in excess of equity earnings	4,204	3,881
Total cash distributions received from North American unconsolidated affiliates	\$ 20,575	\$ 40,885

See Accompanying Notes to the Consolidated Financial Statements.

Table of Contents

TERRA INDUSTRIES INC.
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
SIX MONTHS ENDED JUNE 30, 2009 AND 2008
(in thousands)
(unaudited)

	Common Stock	Paid-In Capital	Accumulated Other Comprehensive Loss	Noncontrolling Interest	Retained Earnings	Total	Comprehensive Income
Balance at January 1, 2009	\$ 152,111	\$ 579,164	\$ (175,529)	\$ 104,082	\$ 507,299	\$ 1,167,127	
Comprehensive income (loss):							
Net income				17,382	110,469	127,851	\$ 127,851
Foreign currency translation adjustment			30,267			30,267	30,267
Change in fair value of derivatives, net of taxes of \$23,530			32,579	4,609		37,188	37,188
Comprehensive income before noncontrolling interest							\$ 195,306
Distributions to noncontrolling interest				(23,391)		(23,391)	
Preferred share dividends					(34)	(34)	
Common stock dividends					(19,940)	(19,940)	
Excess tax benefit		3,921				3,921	
Net vested stock	370	(5,704)				(5,334)	
Share-based compensation		4,161				4,161	
Other					266	266	
Balance June 30, 2009	\$ 152,481	\$ 581,542	\$ (112,683)	\$ 102,682	\$ 598,060	\$ 1,322,082	

	Common Stock	Paid-In Capital	Accumulated Other Comprehensive Loss	Noncontrolling Interest	(Accumulated Deficit) Retained Earnings	Total	Comprehensive Income
Balance at January 1, 2008	\$ 142,170	\$ 618,874	\$ (44,180)	\$ 108,581	\$ (95,341)	\$ 730,104	
Comprehensive income (loss):							
Net income				36,621	304,892	341,513	\$ 341,513

Edgar Filing: TERRA INDUSTRIES INC - Form 10-Q

Foreign currency translation adjustment			(1,756)		(1,756)	(1,756)
Change in fair value of derivatives, net of taxes of \$29,145			39,839	6,781	46,620	46,620
Comprehensive income before noncontrolling interest						\$ 386,377
Distributions to noncontrolling interest				(39,899)	(39,899)	
Preferred share dividends				(2,550)	(2,550)	
Common stock dividends				(9,202)	(9,202)	
Shares purchased and retired under the share repurchase program	(190)	(7,310)			(7,500)	
Exercise of stock options	11	23			34	
Net vested stock	303	(9,729)			(9,426)	
Net conversion of warrants	2,137	412			2,549	
Share-based compensation		5,177			5,177	
Excess tax benefit		10,297			10,297	
Balance June 30, 2008	\$ 144,431	\$ 617,744	\$ (6,097)	\$ 112,084	\$ 197,799	\$ 1,065,961

See Accompanying Notes to the Consolidated Financial Statements.

Table of Contents

TERRA INDUSTRIES INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(*unaudited*)

1. Background and Basis of Presentation

Terra Industries Inc. together with its subsidiaries (Terra, we, our, or us) is a leading North American producer and marketer of nitrogen products made from natural gas. We also operate production assets in Trinidad, and the United Kingdom, through joint venture agreements. Our six North American and our international production locations, along with a robust distribution capability, provide us with the ability to effectively serve key agricultural, industrial and environmental markets. Our principal products are anhydrous ammonia (ammonia), ammonium nitrate solutions (UAN), ammonium nitrate (AN), and urea. Our principal customers are national agricultural retail chains, farm cooperatives, independent dealers and industrial customers. We operate in one principal industry segment – Nitrogen Products, which is based upon the guidance provided in Statement of Financial Accounting Standards (SFAS) 131, *Disclosures about Segments of an Enterprise and Related Information* (SFAS 131). As a wholesale nitrogen producer, we do not report industry segments in a separate disclosure because our only reportable industry segment is nitrogen. The accompanying unaudited consolidated financial statements and notes thereto have been prepared in accordance with the requirements of the U.S. Securities and Exchange Commission (SEC) for interim reporting. They do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. Therefore, these financial statements should be read in conjunction with our audited consolidated financial statements and notes thereto for the year ended December 31, 2008, included in our 2008 Annual Report on Form 10-K.

Terra's significant accounting policies are described in the notes to consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2008. Management is responsible for the unaudited consolidated financial statements included in this document. The consolidated financial statements included in this document are unaudited; however, they contain all normal recurring adjustments that, in the opinion of management, are necessary for a fair presentation of Terra's financial position, results of operations and cash flows 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 future quarters or the full year.

2. New Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 141R, *Business Combinations* (SFAS 141R), which changes the way we account for business acquisitions. SFAS 141R requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction and establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed in a business combination. Certain provisions of SFAS 141R will, among other things, impact the determination of acquisition-date fair value of consideration paid in a business combination (including contingent consideration); exclude transaction costs from acquisition accounting; and change accounting practices for acquired contingencies, acquisition-related restructuring costs, in-process research and development, indemnification assets, and tax benefits. SFAS 141R became effective for us on January 1, 2009 and the adoption did not have an impact on our financial statements.

Table of Contents

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, an amendment of ARB No. 51 (SFAS 160). SFAS 160 improves the comparability and transparency of financial statements when reporting minority interest. Entities with a noncontrolling interest are required to clearly identify and present the ownership interest in the consolidated statement of financial position within equity, but separate from the parent's equity. The amount of consolidated net income attributable to the parent and to the noncontrolling interest is identified and presented on the face of the consolidated statement of income. The statement offers further guidance on changes in ownership interest, deconsolidation, and required disclosures. SFAS 160 became effective for us on January 1, 2009. The adoption of SFAS 160 recharacterized minority interest as noncontrolling interest and reclassified minority interest as a component of equity on our financial statements. The adoption also recharacterized a portion of other comprehensive income (loss) by allocating a portion of other comprehensive income (loss) to the noncontrolling interest. Prior year amounts relating to noncontrolling interests have been reclassified to conform to the current year presentation as required by SFAS 160.

In March 2008, the FASB issued SFAS 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161). SFAS 161 is an amendment of SFAS 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133). To address concerns that the existing disclosure requirements of SFAS 133 do not provide adequate information, SFAS 161 requires enhanced disclosures about an entity's derivative and hedging activities and thereby improves the transparency of financial reporting. SFAS 161 became effective for us on January 1, 2009 and we have included the additional disclosure information required by SFAS 161 within Note 6, *Derivative Financial Instruments*, of the Notes to the Consolidated Financial Statements.

In June 2008, the FASB issued FASB Staff Position No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities* (FSP EITF 03-6-1). The FASB decided that unvested share-based payout awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of EPS pursuant to the two-class method under SFAS 128, *Earnings per Share*. FSP EITF 03-6-1 became effective for us on January 1, 2009 and the adoption did not have an impact on our financial statements.

In December 2008, the FASB issued FSP 132(R)-1, *Employers' Disclosures about Postretirement Benefit Plan Assets*, which amends Statement 132(R) to require more detailed disclosures about employers' pension plan assets. New disclosures will include more information on investment strategies, major categories of plan assets, concentrations of risk within plan assets and valuation techniques used to measure the fair value of plan assets. This new standard requires new disclosures only, and will have no impact on our consolidated financial position, results of operations or cash flows. These new disclosures will be required for us beginning in our Form 10-K for the 2009 fiscal year.

In April 2009, the FASB issued FASB Staff Position (FSP) FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*. (FSP FAS 157-4), which provides additional guidance in accordance with FASB No. 157, *Fair Value Measurements*, when the volume and level of activity for the asset or liability has significantly decreased. FSP FAS 157-4 became effective for us on April 1, 2009 and the adoption did not have an impact on our financial statements.

Table of Contents

In April 2009, the FASB issued FASB Staff Position FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP FAS 115-2 and FAS 124-2). This FSP amends the other-than-temporary impairment guidance in U.S. generally accepted accounting principles (U.S. GAAP) for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in a company's financial statements. This FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. FSP FAS 115-2 and FAS 124-2 became effective for us on April 1, 2009 and the adoption did not have an impact on our financial statements.

In April 2009, the FASB issued FASB Staff Position FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (FSP FAS 107-1 and APB 28-1). FSP FAS 107-1 and APB 28-1 enhance consistency in financial reporting by increasing the frequency of fair value disclosures. This FSP relates to fair value disclosures for any financial instruments that are not currently reflected in a company's balance sheet at fair value. Prior to the effective date of this FSP, fair values for these assets and liabilities were only disclosed once a year. This FSP will now require these disclosures to be made on a quarterly basis, providing qualitative and quantitative information about fair value estimates for all those financial instruments not measured on the balance sheet at fair value. FSP FAS 107-1 and APB 28-1 became effective for us on April 1, 2009 and we have included the additional disclosure information required by FSP FAS 107-1 and APB 28-1 within Note 7, *Fair Value Measurements*, of the Notes to the Consolidated Financial Statements.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* (SFAS 165), to be effective for interim or annual financial periods ending after June 15, 2009. SFAS 165 does not materially change the existing guidance but introduces the concept of financial statements being available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, that is, whether the date represents the date the financial statements were issued or were available to be issued. This disclosure is intended to alert all users of financial statements that an entity has not evaluated subsequent events after that date in the set of financial statements being presented. SFAS 165 became effective for us on April 1, 2009 and the adoption did not have an impact on our financial statements. We have evaluated subsequent events through July 24, 2009, which is the date of our Form 10-Q filing.

In June 2009, the FASB issued SFAS No. 166, *Accounting for Transfers of Financial Assets* (SFAS 166), which amends the derecognition guidance in SFAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SFAS 140). SFAS 166 addresses concerns expressed by the SEC, members of Congress, and financial statement users about the accounting and disclosures required by SFAS 140 in the wake of the subprime mortgage crisis and the deterioration of the global credit markets. This guidance is effective for financial asset transfers occurring after the beginning of an entity's first fiscal year that begins after November 15, 2009. We are currently assessing the impact SFAS 166 will have on our financial statements.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)* (SFAS 167), which amends the consolidation guidance applicable to variable interest entities under FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities*. SFAS 167 is intended to improve financial reporting by enterprises involved with variable interest entities. This guidance is effective as of the beginning of the first fiscal year that begins after November 15, 2009. We are currently assessing the impact SFAS 167 will have on our financial statements.

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* (SFAS 168), which amends SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. SFAS 168 will become the source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date, SFAS 168 will supersede all then-existing non-SEC accounting and reporting standards. All other non-grandfathered non-SEC accounting literature not included in SFAS 168 will become nonauthoritative. SFAS 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. We are currently assessing the impact SFAS 168 will have on our financial statements.

Table of Contents

3. Unsolicited Exchange Offer by CF Industries Holdings, Inc.

On January 15, 2009, CF Industries Holdings, Inc. (CF) presented a letter to our Board of Directors proposing CF's acquisition of Terra in an all-stock transaction. Terra's Board rejected the proposal on the grounds that it was not in the best interest of Terra or its stockholders and substantially undervalued the Company. CF subsequently announced that they remained committed to the proposal, and on February 3, 2009, announced that they would nominate three director candidates to Terra's Board and commence an exchange offer for all of Terra's outstanding common shares. On February 23, 2009, CF announced that it had commenced an unsolicited exchange offer to acquire all of the outstanding common shares of Terra at a fixed exchange ratio of 0.4235 CF shares for each Terra common share. In response, Terra's Board of Directors announced on February 23, 2009, that it would review and consider CF's exchange offer and make a formal recommendation to shareholders within ten business days, and further advised Terra's shareholders to take no action pending the review of the proposed exchange offer by Terra's Board. On March 3, 2009, Terra's Board of Directors unanimously concluded that CF's offer did not present a compelling case to create additional value for the stockholders of either Terra or CF, substantially undervalues Terra on an absolute basis and relative to CF and is not in the best interests of Terra and its stockholders.

On March 9, 2009, CF sent a letter to Terra's Board of Directors stating CF would be prepared to enter into a negotiated merger agreement with Terra on the basis of an exchange ratio based on \$27.50 for each Terra common share, with an exchange ratio of not less than 0.4129 of a CF common share and not more than 0.4539 of a CF common share. On March 11, 2009, Terra's Board of Directors unanimously concluded that CF's proposal continues to run counter to Terra's strategic objectives, substantially undervalues Terra both absolutely and relative to CF, and would deliver less value to Terra's stockholders than would owning Terra on a stand-alone basis.

On March 23, 2009, CF sent a letter to Terra's Board of Directors stating CF would be prepared to enter into a negotiated merger agreement with Terra on the basis of an exchange ratio based on \$30.50 for each Terra share, with an exchange ratio of not less than 0.4129 of a CF common share and not more than 0.4539 of a CF common share, the same collar as CF's proposal of March 9, 2009. On March 24, 2009, Terra's Board of Directors unanimously concluded CF's proposal continues to run counter to Terra's strategic objectives, substantially undervalues Terra both absolutely and relative to CF and would deliver less value to Terra's stockholders than would owning Terra on a stand-alone basis.

As of the date of this Form 10-Q, CF's unsolicited exchange offer to acquire all of the outstanding common shares of Terra is still outstanding and is set to expire on August 7, 2009, unless further extended. For the three and six month periods ended June 30, 2009, Terra incurred due diligence defense costs of \$12.6 million and \$14.3 million, respectively, related to CF's unsolicited exchange offer.

Table of Contents

4. Income Per Share

Basic income per share data is based on the weighted-average number of common shares outstanding during the period. Diluted income per share data is based on the weighted-average number of common shares outstanding and the effect of all dilutive potential common shares including stock options, nonvested shares, convertible preferred shares and common stock warrants. Nonvested stock carries dividend and voting rights, but is not included in the weighted average number of common shares outstanding used to compute basic income per share since they are contingently returnable.

The following table provides a reconciliation between basic and diluted income per share attributable to Terra Industries Inc. for the three and six month periods ended June 30, 2009 and 2008:

(in thousands, except per-share amounts)	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Basic income per common share attributable to Terra Industries Inc.:				
Income from continuing operations	\$ 80,474	\$ 196,116	\$ 110,469	\$ 297,421
Less: Preferred share dividends	(17)	(1,275)	(34)	(2,550)
Income from continuing operations available to common stockholders	80,457	194,841	110,435	294,871
Income from discontinued operations available to common stockholders		7,319		7,471
Income available to common stockholders	\$ 80,457	\$ 202,160	\$ 110,435	\$ 302,342
Weighted average shares outstanding	99,318	91,011	99,224	90,588
Income per share continuing operations	\$ 0.81	\$ 2.14	\$ 1.11	\$ 3.26
Income per share discontinued operations		0.08		0.08
Net income per share	\$ 0.81	\$ 2.22	\$ 1.11	\$ 3.34
Diluted income per common share attributable to Terra Industries Inc.:				
Income from continuing operations available to common stockholders	\$ 80,457	\$ 194,841	\$ 110,435	\$ 294,871
Add: Preferred share dividends	17	1,275	34	2,550
Income available to common stockholders and assumed conversions	\$ 80,474	\$ 196,116	\$ 110,469	\$ 297,421
Weighted average shares outstanding	99,318	91,011	99,224	90,588
Add incremental shares from assumed conversions:				
Preferred shares	161	12,048	161	12,048
Non vested stock	231	572	319	590
Common stock warrants		1,047		1,424

Edgar Filing: TERRA INDUSTRIES INC - Form 10-Q

Common stock options					2
Dilutive potential common shares		99,710	104,678	99,704	104,652
Income per share continuing operations	\$	0.81	\$ 1.87	\$ 1.11	\$ 2.84
Income per share discontinued operations			0.07		0.07
Net income per share	\$	0.81	\$ 1.94	\$ 1.11	\$ 2.91

Table of Contents

5. Inventories, net

Inventories consisted of the following:

(in thousands)	June 30, 2009	December 31, 2008	June 30, 2008
Raw materials	\$ 17,523	\$ 17,805	\$ 16,791
Supplies	35,439	33,825	33,702
Finished goods	75,086	145,461	118,457
 Total	 \$ 128,048	 \$ 197,091	 \$ 168,950

Production costs include the cost of direct labor and materials, depreciation and amortization, and overhead costs related to manufacturing activities. We allocate fixed production overhead costs based on the normal capacity of our production facilities and unallocated overhead costs are recognized as expense in the period incurred. We determine the cost of inventories using the first-in, first-out method.

Inventories are stated at the lower of cost or market. Market is defined as current replacement cost, except that market should not exceed the net realizable value and should not be less than net realizable value reduced by an allowance for an approximately normal profit margin. We perform a monthly analysis of our inventory balances to determine if the carrying amount of inventories exceeds our net realizable value. Our determination of estimated net realizable value is based on customer orders, market trends and historical pricing. If the carrying amount exceeds the estimated net realizable value, the carrying amount is reduced to the estimated net realizable value.

We estimate a reserve for obsolescence and excess of our materials and supplies inventory. Inventory is stated net of the reserve.

6. Derivative Financial Instruments

We enter into derivative financial instruments, including swaps, basis swaps, purchased put and call options and sold call options, to manage the effect of changes in natural gas costs and the price of our nitrogen products. We report the fair value of the derivatives on our balance sheet. If the derivative is not designated as a hedging instrument, changes in fair value are recognized in earnings in the period of change. If the derivative is designated as a cash flow hedge, and to the extent such hedge is determined to be effective, changes in fair value are reported as a component of accumulated other comprehensive income (loss) in the period of change, and subsequently recognized in our statement of operations in the period the offsetting hedged transaction occurs. If an instrument or the hedged item is settled early, we evaluate whether the hedged forecasted transaction is still probable of occurring when determining whether to reclassify any gains or losses immediately in cost of sales or wait until the forecasted transaction occurs.

Until our derivatives settle, we test derivatives for ineffectiveness. This includes assessing the correlation of New York Mercantile Exchange (NYMEX) pricing, which is commonly used as an index in natural gas derivatives, to the natural gas pipelines pricing at our manufacturing facilities. This assessment requires management judgment to determine the statistically and industry appropriate analysis of prior operating relationships between the NYMEX prices and the natural gas pipelines prices at our facilities.

Table of Contents

To the extent possible, we base our market value calculations on third party data. Due to multiple types of settlement methods available, not all settlement methods for future period trades are available from third party sources. In the event that a derivative is measured for fair value based on a settlement method that is not readily available, we estimate the fair value based on forward pricing information for similar types of settlement methods.

We manage risk using derivative financial instruments for changes in natural gas supply prices and changes in nitrogen prices. Derivative financial instruments have credit risk and market risk.

To manage credit risk, we enter into derivative transactions only with counter-parties who are currently rated as BBB or better or equivalent as recognized by a national rating agency. We will not enter into transactions with a counter-party if the additional transaction will result in credit exposure exceeding \$20 million. The credit rating of counter-parties may be modified through guarantees, letters of credit or other credit enhancement vehicles. As of June 30, 2009, we did not have any credit risk related contingent features that would require us to settle the derivative instruments or to post collateral upon the occurrence of a credit event.

We classify a derivative financial instrument as a hedge if all of the following conditions are met:

1. The item to be hedged must expose us to currency, interest or price risk;
2. It must be probable that the results of the hedge position substantially offset the effects of currency, interest or price changes on the hedged item (e.g., there is a high correlation between the hedge position and changes in market value of the hedge item); and
3. The derivative financial instrument must be designated as a hedge of the item at the inception of the hedge.

Natural gas supplies to meet production requirements at our North American production facilities are purchased at market prices. Natural gas market prices are volatile and we effectively fix prices for a portion of our natural gas production requirements and inventory through the use of swaps and options. The North American contracts reference physical natural gas prices or appropriate NYMEX futures contract prices. Contract physical prices for North America are frequently based on prices at the Henry Hub in Louisiana, the most common and financially liquid location of reference for financial derivatives related to natural gas. However, natural gas supplies for our North American production facilities are purchased at locations other than Henry Hub, 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. Natural gas derivatives are designated as cash flow hedges, provided that the derivatives meet the conditions discussed above. The contracts are traded in months forward and settlement dates are scheduled to coincide with gas purchases during that future period.

A swap is a contract between us and a third party to exchange cash based on a designated price. Option contracts give the holder the right to either own or sell a futures or swap contract. The option contracts require initial premium payments ranging from 2% to 5% of contract value. Basis swap contracts require payments to or from us for the amount, if any, that monthly published gas prices from the source specified in the contract differ from the prices of NYMEX natural gas futures during a specified period. There are no initial cash requirements related to the swap and basis swap agreements; however, the counterparties require maintenance of cash margin balances generally 10% to 20% of the contract value.

Table of Contents

As of June 30, 2009 and 2008, we had open derivative contracts of 13.8 million MMBtus and 37.3 million MMBtus, respectively, of natural gas.

The following summarizes the gross fair market value of all derivative instruments and their location in our Consolidated Balance Sheet are shown by those in an asset or liability position and are categorized as commodity derivatives.

		Asset Derivatives ^(a)		
Derivative Instrument	Location	June 30, 2009	December 31, 2008	June 30, 2008
Commodity Derivatives	Other current assets	\$ 8,004	\$ 25,773	\$ 83,968

		Liability Derivatives ^(a)		
Derivative Instrument	Location	June 30, 2009	December 31, 2008	June 30, 2008
Commodity Derivatives	Derivative hedge liabilities	\$ (7,821)	\$ (125,925)	\$ (10,094)

(a) Amounts are disclosed at gross fair value in accordance with SFAS 161 requirements. All of our commodity derivatives are designated as cash flow hedging instruments under SFAS 133. See Footnote 1 and 5 of our 2008 Annual Report Form 10-K for additional information on our overall risk management strategies. The deferred taxes related to these commodity derivatives for the periods ended June 30, 2009, December 31, 2008 and

June 30, 2008
were
\$1.7 million,
\$25.2 million
and (\$26.1)
million,
respectively.

Certain derivatives outstanding at June 30, 2009 and 2008, which settled during July 2009 and July 2008, respectively, are included in the position of open natural gas derivatives in the table above. The July 2009 derivatives settled for an approximate \$2.8 million loss compared to the July 2008 derivatives which settled for an approximate \$15.6 million gain. All material open derivatives at June 30, 2009 will settle during the next twelve months.

We are required to maintain certain margin deposits on account with derivative counterparties. At June 30, 2009, we had no margin deposits with derivative counterparties, which are reported as Margin deposits with derivative counterparties on the Consolidated Statements of Financial Position. At December 31, 2008 and June 30, 2008, we had margin deposits with derivative counterparties of \$36.9 million and less than \$0.1 million, respectively.

At June 30, 2009 and 2008, we determined that a portion of certain derivative contracts were ineffective for accounting purposes and, as a result, recorded a \$3.4 million charge and \$6.1 million credit to cost of sales, respectively. At June 30, 2009 and 2008, we excluded a portion of the loss on certain derivative contracts from the effectiveness assessment and, as a result, recorded a \$1.9 million credit and a \$1.3 million charge, respectively, to cost of sales.

The effective portion of gains and losses on derivative contracts that qualify for hedge treatment are carried as accumulated other comprehensive income (loss) and credited or charged to cost of sales in the month in which the hedged transaction settles. Gains and losses on the contracts that do not qualify for hedge treatment are credited or charged to cost of sales based on the positions fair value. The risk and reward of outstanding natural gas positions are directly related to increases or decreases in natural gas prices in relation to the underlying NYMEX natural gas contract prices.

Table of Contents

All of our commodity derivatives are designated as cash flow hedging instruments under SFAS 133. See footnote 1 and 5 of our 2008 Annual Report Form 10-K for additional information on our overall risk management strategies. The following table presents the effect of our commodity derivative instruments on the Consolidated Statement of Operations for the three and six months ended June 30, 2009 and 2008.

Amount of Gain (Loss)		Location of Gain	Three Months Ended		Location of Gain (Loss) Recognized in Income (b)	Amount of Gain (Loss) Recognized in Income (b)	
			Reclassified from AOCI	Amount of Gain (Loss)		June 30,	June 30,
Recognized in OCI		(Loss) Reclassified	into Income			June 30,	June 30,
June 30,	June 30,	from AOCI into	June 30,	June 30,	Recognized in Income (b)	June 30,	June 30,
2009	2008	Income (a)	2009	2008	Cost of Sales	2009	2008
\$ (4,439)	\$ 77,085	Cost of Sales	\$ (25,135)	\$ 36,570	Cost of Sales	\$ (1,492)	\$ 4,846

Amount of Gain (Loss)		Location of Gain	Six Months Ended		Location of Gain (Loss) Recognized in Income (b)	Amount of Gain (Loss) Recognized in Income (b)	
			Reclassified from AOCI	Amount of Gain (Loss)		June 30,	June 30,
Recognized in OCI		(Loss) Reclassified	into Income			June 30,	June 30,
June 30,	June 30,	from AOCI into	June 30,	June 30,	Recognized in Income (b)	June 30,	June 30,
2009	2008	Income (a)	2009	2008	Cost of Sales	2009	2008
\$ (37,309)	\$ 119,832	Cost of Sales	\$ (98,026)	\$ 44,067	Cost of Sales	\$ (1,492)	\$ 4,846

(a) Effective portion of gain (loss)

(b) The amount of gain or (loss) recognized in income represents (\$3.4) million and \$6.1 million related to the ineffective portion of the hedging

relationships and
\$1.9 million and
(\$1.3) million
related to the
amount excluded
from the
assessment of
hedge
effectiveness.

Approximately \$4.6 million of the net accumulated loss at June 30, 2009 will be reclassified into earnings during the next twelve months as compared to \$67.1 million of the net accumulated income at June 30, 2008.

At times, we also use forward derivative instruments, such as nitrogen solution contracts, to fix or set floor prices for a portion of our nitrogen sales volumes. At June 30, 2009, we had open nitrogen solution contracts. When outstanding, the nitrogen solution contracts do not qualify for hedge treatment due to inadequate trading history to demonstrate effectiveness. Consequently, these contracts are marked-to-market and unrealized gains or losses are reflected in revenue in the statement of operations. For both the three and six month periods ending June 30, 2009, we recognized a gain of \$0.1 million on nitrogen forward derivative instruments. For the three and six month periods ending June 30, 2008, there were no gains or losses on nitrogen forward derivative instruments.

7. Fair Value Measurements

SFAS 157 establishes a three level hierarchal disclosure framework that prioritizes and ranks the level of market price observability used in measuring assets and liabilities at fair value. Market price observability is impacted by a number of factors, including the type of asset or liability and its characteristics. Assets and liabilities with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value.

Table of Contents

The three levels are defined as follows:

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement.

We evaluated our assets and liabilities to determine which items should be disclosed according to SFAS 157. We currently measure our derivative contracts on a recurring basis at fair value. The inputs included in the fair value measurement of our derivative contracts use adjusted quoted prices from an active market, which are classified as level 2 as a significant other observable input in the disclosure hierarchy framework as defined by SFAS 157. Our gas derivative contracts, which are classified as a level 2 input, are comprised of swaps, basis swaps and options. The valuation techniques for these contracts are observable market data for inputs, including prices quoted on the NYMEX, prices quoted in spot markets and commonly referenced industry publications and prices quoted by market makers. There have been no changes in valuation techniques during the quarter ended June 30, 2009.

The following table summarizes the valuation of our assets and liabilities in accordance with SFAS 157 fair value hierarchy levels as of June 30, 2009:

(in thousands)	Quoted Market Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets			
Derivative contracts	\$	\$ 8,004	\$
Total	\$	\$ 8,004	\$
Liabilities			
Derivative contracts	\$	\$ (7,821)	\$
Total	\$	\$ (7,821)	\$

The following table summarized the valuation of our assets and liabilities in accordance with SFAS 157 fair value hierarchy levels of December 31, 2008:

(in thousands)	Quoted Market Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets			
Derivative contracts	\$	\$ 25,773	\$

Total	\$	\$	25,773	\$
Liabilities				
Derivative contracts	\$	\$	(125,925)	\$
Total	\$	\$	(125,925)	\$

Table of Contents

The following table summarized the valuation of our assets and liabilities in accordance with SFAS 157 fair value hierarchy levels of June 30, 2008:

(in thousands)	Quoted Market Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets			
Derivative contracts	\$	\$ 83,968	\$
Total	\$	\$ 83,968	\$
Liabilities			
Derivative contracts	\$	\$ (10,094)	\$
Total	\$	\$ (10,094)	\$

The following table represents the carrying amounts and estimated fair values of Terra's financial instruments as of June 30, 2009 and 2008.

(in millions)	June 30, 2009		June 30, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial Assets				
Cash and cash equivalents	\$ 1,001.6	\$ 1,001.6	\$ 752.0	\$ 752.0
Financial Liabilities				
Long-term debt	330.0	301.5	330.0	323.4
Preferred shares	1.5	3.8	115.8	564.2

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

Cash and receivables: The carrying amounts approximate fair value because of the short maturity of those instruments.

Long-term debt: The fair value of our long-term debt is estimated by discounting expected cash flows at the rates currently offered for debt of the same remaining maturities.

Preferred shares: Preferred shares are valued on the basis of market quotes, when available, and management estimates based on comparisons with similar instruments that are publicly traded.

Concentration of Credit Risk: We are subject to credit risk through trade receivables and short-term investments. Although a substantial portion of our debtors' ability to pay depends upon the agribusiness economic sector, credit risk with respect to trade receivables generally is minimized due to its geographic dispersion. Short-term cash investments are placed in short duration corporate and government debt securities funds with well-capitalized, high quality financial institutions.

Financial Instruments: At June 30, 2009, we had letters of credit outstanding totaling \$8.0 million, which guarantees various insurance and financing activities.

Table of Contents

8. Preferred Shares

The components of preferred shares outstanding at June 30, 2009 and 2008:

(in thousands)	June 30, 2009		June 30, 2008	
	Number of shares	Carrying Value	Number of shares	Carrying Value

Series A Preferred Shares (120,000 shares authorized, \$1,000 per share liquidation value)	1,600	\$ 1,544	120,000	\$ 115,800
--	-------	----------	---------	------------

We had 1,600 shares of cumulative convertible perpetual Series A Preferred Shares with a liquidation value of \$1,000 per share outstanding at June 30, 2009 and 120,000 shares with a liquidation value of \$1,000 per share at June 30, 2008. Cumulative dividends of \$10.625 per share are payable quarterly. The Series A Preferred Shares are not redeemable, but are convertible into our common stock at the option of the holder for a conversion price of \$9.96 per common share. The Series A shares may automatically be converted to common shares after December 20, 2009 if the closing price for our common shares exceeds 140% of the conversion price for twenty days within a consecutive thirty day period prior to such conversion. Upon the occurrence of a fundamental change to our capital structure, including a change of control, merger, or sale of Terra, holders of the Series A Preferred Shares may require us to purchase any or all of their shares at a price equal to their liquidation value plus any accumulated, but unpaid, dividends. We also have the right, under certain conditions, to require holders of the Series A Preferred Shares to exchange their shares for convertible subordinated debentures with similar terms.

In September 2008 we commenced offers (the inducement offers) to pay a cash premium to holders of the Series A Preferred Shares who elected to convert their Series A Preferred Shares into shares of Terra common stock. A total of 118,400 shares or 99% of the outstanding shares of Series A Preferred Shares were surrendered and converted as part of the inducement offers. The former holders of the Series A Preferred Shares received, in the aggregate, the following:

11,887,550 shares of Terra Industries common stock; and

A cash premium of approximately \$5.3 million

The \$5.3 million represents the difference between the fair value of all securities and other consideration transferred in the transaction to the preferred stockholders and the fair value of securities issuable pursuant to the original conversion terms of the Series A Preferred Shares less the costs related to the inducement offers.

9. Turnaround Costs

The following represents a summary of the deferred plant turnaround costs for the six months ended June 30, 2009 and 2008:

(in thousands)	Beginning Balance	Turnaround Costs Capitalized	Turnaround Amortization	Currency Translation Adjustments	Ending Balance
Period ended:					
June 30, 2009	\$ 23,467	\$ 15,058	\$ (12,372)	\$ 178	\$ 26,331
June 30, 2008	42,190	10,225	(14,875)	(424)	37,116

Table of Contents

10. Accrued and Other Current Liabilities

Accrued and other current liabilities consisted of the following:

(in thousands)	June 30, 2009	December 31, 2008	June 30, 2008
Income taxes payable	\$ 25,559	\$ 63,999	\$ 51,042
Payroll and benefit costs	13,940	27,104	18,662
Accrued CF defense costs	13,028		
Accrued interest	9,747	9,748	9,745
Current accrued phantom shares	4,867	4,341	10,685
Deferred revenue	3,346	3,346	1,375
Accrued property taxes	3,160	3,291	3,212
Other	18,589	15,941	25,330
	\$ 92,236	\$ 127,770	\$ 120,051

11. Other Liabilities

Other liabilities consisted of the following:

(in thousands)	June 30, 2009	December 31, 2008	June 30, 2008
Unrecognized tax benefit	\$ 37,124	\$ 35,949	\$ 33,560
Long-term medical and closed facility reserve	23,835	23,887	24,405
Long-term deferred revenue	9,739	10,488	10,313
Accrued phantom shares	2,262	2,430	7,613
Other	5,836	5,799	6,659
	\$ 78,796	\$ 78,553	\$ 82,550

12. Equity Investments

North America

Our investment in North American companies that are accounted for on the equity method of accounting and included in operations consist of the following: (1) 50% ownership interest in Point Lisas Nitrogen Limited (PLNL), which operates an ammonia production plant in Trinidad, (2) 50% interest in an ammonia storage joint venture located in Houston, Texas and (3) 50% interest in a joint venture in Oklahoma CO₂ at our Verdigris nitrogen plant. These investments were \$118.3 million and \$137.1 million at June 30, 2009 and 2008, respectively. We include the net earnings of these investments as an element of income from operations because the investees' operations provide additional capacity to our operations.

Table of Contents

The combined results of operations and financial position of our North American equity method investments are summarized below:

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Condensed income statement information:				
Net sales	\$ 41,436	\$ 83,993	\$ 79,415	\$ 182,528
Net income	\$ 11,051	\$ 31,640	\$ 19,058	\$ 62,921
Terra's equity in earnings of unconsolidated affiliates	\$ 1,522	\$ 16,518	\$ 4,774	\$ 29,808

(in thousands)	June 30, 2009	June 30, 2008
Condensed balance sheet information:		
Current assets	\$ 42,754	\$ 57,166
Long-term assets	165,559	182,320
Total assets	\$ 208,313	\$ 239,486
Current liabilities	\$ 22,926	\$ 40,557
Long-term liabilities	21,073	13,020
Equity	164,314	185,909
Total liabilities and equity	\$ 208,313	\$ 239,486

The carrying value of these investments at June 30, 2009 was \$36.2 million more than our share of the affiliates' book value. The excess is attributable primarily to the step-up in basis for fixed asset values, which is being depreciated over a period of approximately fifteen years. Our equity in earnings of unconsolidated subsidiaries is different than our ownership interest in income reported by the unconsolidated subsidiaries due to deferred profits on intergroup transactions and amortization of basis differences.

We have transactions in the normal course of business with PLNL whereby we are obliged to purchase 50% of the ammonia produced by PLNL at current market prices. During the six month period ended June 30, 2009, we purchased approximately \$37.0 million of ammonia from PLNL. During the six month period ended June 30, 2008, we purchased approximately \$77.4 million of ammonia from PLNL.

We received \$20.6 million and \$40.9 million in distributions from our North American equity investments in the six month periods ended June 30, 2009 and 2008, respectively.

United Kingdom

On September 14, 2007, we completed the formation of GrowHow UK Limited (GrowHow), a joint venture between Terra and Kemira GrowHow Oyj (Kemira). Pursuant to the joint venture agreement, we contributed our United Kingdom subsidiary Terra Nitrogen (UK) Limited to the joint venture for a 50% interest. Subsequent to the formation, we have accounted for our investment in GrowHow as a non-operating equity method investment. We do not include the net earnings of this investment as an element of income from operations since the investees' operations do not

provide additional capacity to us, nor are its operations integrated with our supply chain in North America. The GrowHow joint venture includes the Kemira site at Ince and our former Teeside and Severnside sites.

Table of Contents

In January 2008 GrowHow closed the Severnside manufacturing facility. Pursuant to the agreement with Kemira, we are responsible for any remediation costs required to prepare the Severnside site for disposal. As of June 30, 2009, we have incurred remediation costs of \$7.6 million. We anticipate total remediation costs to not exceed \$10.0 million. We have an option to purchase the Severnside land for a nominal amount at any time prior to sale. If we elect not to exercise this option, we are still entitled to receive the sales proceeds. We anticipate that the proceeds related to the sale of the Severnside land will exceed the total cost of reclamation of the site.

The Joint Venture Contribution Agreement specifies that we are entitled to receive a minimum balancing consideration payment of up to £60 million based on GrowHow's operating results for fiscal 2008 to 2010. Pursuant to agreements with Kemira, we received minimum balancing consideration and other payments totaling £5.3 million (\$7.9 million) during the first half of 2009. For the six months ended June 30, 2008, we did not receive any balancing consideration payments. We also received \$28.1 million from GrowHow during the first half of 2008 for the refund of working capital contributions in excess of amounts specified in the Joint Venture Contribution Agreement. The carrying value of this equity method investment was \$150.8 million and \$223.7 million at June 30, 2009 and 2008, respectively.

The results of operations and financial position of our equity method investment in GrowHow are summarized below:

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Condensed income statement information:				
Net sales	\$ 108,892	\$ 279,206	\$ 216,552	\$ 546,033
Net income (loss)	\$ 5,111	\$ 76,733	\$ (2,744)	\$ 98,099
Terra's equity in earnings (loss) of unconsolidated affiliates	\$ 1,886	\$ 37,611	\$ (2,488)	\$ 46,895

(in thousands)	June 30, 2009	June 30, 2008
Condensed balance sheet information:		
Current assets	\$ 279,515	\$ 335,197
Long-term assets	182,212	257,849
Total assets	\$ 461,727	\$ 593,046
Current liabilities	\$ 66,533	\$ 135,371
Long-term liabilities	146,492	175,707
Equity	248,702	281,968
Total liabilities and equity	\$ 461,727	\$ 593,046

The carrying value of this investment at June 30, 2009 was \$26.4 million more than our share of GrowHow's book value. The excess is attributable primarily to the step-up in basis for fixed asset values, which is being depreciated over a period of approximately twelve years. Our equity earnings of GrowHow are different than our ownership interest in GrowHow's net income due to the amortization of basis differences.

Table of Contents

13. Long-term Debt

Long-term debt consisted of the following:

(in thousands)	June 30, 2009	December 31, 2008	June 30, 2008
Unsecured Senior Notes, 7.0% due 2017	\$ 330,000	\$ 330,000	\$ 330,000
Total long-term debt	330,000	330,000	330,000
Less current maturities			
Total long-term debt	\$ 330,000	\$ 330,000	\$ 330,000

In 2007, Terra Capital, Inc., (TCAPI) a subsidiary of Terra Industries Inc., issued \$330 million of 7.0% Senior Notes due 2017 (notes). The notes are unconditionally guaranteed by Terra and certain of its U.S. subsidiaries (the Guarantor Subsidiaries); see Note 17, *Guarantor Subsidiaries*, of the Notes to the Consolidated Financial Statements. These notes and guarantees are unsecured and will rank equal in right of payment with any existing and future senior obligations of such guarantors.

The Indenture governing the notes contains covenants that limit, among other things, our ability to: incur additional debt, pay dividends on common stock of Terra or repurchase shares of such common stock, make certain investments, sell any of our principal production facilities or sell other assets outside the ordinary course of business, enter into transactions with affiliates, limit dividends or other payments by our restricted subsidiaries, enter into sale and leaseback transactions, engage in other businesses, sell all or substantially all of our assets or merge with or into other companies, and reduce our insurance coverage.

We are obligated to offer to repurchase these notes upon a Change of Control (as defined in the Indenture) at a cash price equal to 101% of the aggregate principal amount outstanding at that time, plus accrued and unpaid interest to the date of purchase. The Indenture governing these notes contains events of default and remedies customary for a financing of this type.

The \$200 million revolving credit facilities (the facilities) due 2012 are secured by substantially all of our working capital. Borrowing availability is generally based on 100% of eligible cash balances, 85% of eligible accounts receivable, 60% of eligible finished goods inventory and is reduced by outstanding letters of credit. These facilities include \$50 million available only for the use of Terra Nitrogen Company, L.P. (TNCLP), one of our consolidated subsidiaries. Borrowings under the revolving credit facilities will bear interest at a floating rate plus an applicable margin, which can be either a base rate, or, at our option, a London Interbank Offered Rate (LIBOR). At June 30, 2009, the LIBOR rate was 0.32%. The base rate is the highest of (1) Citibank, N.A.'s base rate (2) the federal funds effective rate, plus one-half percent (0.50%) per annum and (3) the base three month certificate of deposit rate, plus one-half percent (0.50%) per annum, plus an applicable margin in each case. LIBOR loans will bear interest at LIBOR plus an applicable margin. The applicable margins for base rate loans and LIBOR loans were 0.50% and 1.75%, respectively, at June 30, 2009. The revolving facilities require an initial one-half percent (0.50%) commitment fee on the difference between committed amounts and amounts actually borrowed.

The facilities and the Indenture governing the notes also require that there be no change of control related to Terra, such that no individual or group (within the meaning of the Securities Exchange Act of 1934, as amended) beneficially owns more than 35% of the outstanding voting shares of Terra. Such a change of control would constitute an event of default under the facilities and would require TCAPI to offer to repurchase the notes at 101% of the principal amount thereof, including any accrued but unpaid interest. On February 23, 2009, CF Industries Holdings, Inc. (CF) commenced an exchange offer to acquire all of the outstanding Terra common stock. Such a business combination, if consummated, would constitute a change of control under both the facilities and the Indenture governing the notes. See Note 3, *Unsolicited Exchange Offer by CF Industries Holdings, Inc.*, of the Notes to the Consolidated Financial Statements for additional information with respect to CF's unsolicited proposal.

Table of Contents

At June 30, 2009, we had no outstanding revolving credit borrowings and \$8.0 million in outstanding letters of credit. The \$8.0 million in outstanding letters of credit reduced our borrowing availability to \$192.0 at June 30, 2009. The facilities require 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. Under the \$150 million facility, if our consolidated borrowing availability falls below \$60 million, we are required to have achieved minimum operating cash flows or earnings before interest, income taxes, depreciation, amortization and other non-cash items (EBITDA) of \$60 million during the most recent four quarters. Under the \$50 million TNCLP facility, if our borrowing availability as computed for that facility falls below \$10 million, we are required to achieve EBITDA at TNCLP of \$25 million during the most recent four quarters. A default under the \$50 million facility results in a cross default to the \$150 million facility.

14. Pension Plans

We maintain defined benefit and defined contribution 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 follow:

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Service cost	\$ 733	\$ 778	\$ 1,466	\$ 1,556
Interest cost	4,648	4,412	9,296	8,824
Expected return on plan assets	(4,701)	(4,516)	(9,402)	(9,032)
Amortization of prior service cost	(9)	(9)	(18)	(18)
Amortization of actuarial loss	162	468	324	936
Pension expense	\$ 833	\$ 1,133	\$ 1,666	\$ 2,266

Cash contributions to the defined benefit pension plans for the three months ended June 30, 2009 and 2008 were \$0.4 million and \$0.6 million, respectively. Cash contributions to the defined benefit pension plans for the six months ended June 30, 2009 and 2008 were \$0.8 million and \$0.9 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 three month periods ended June 30, 2009 and 2008 were \$1.1 million and \$0.9 million, respectively. Contributions to these plans for the six month periods ended June 30, 2009 and 2008 were \$2.3 million and \$2.0 million, respectively.

Table of Contents

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.

15. Comprehensive Income

Comprehensive income attributable to Terra Industries Inc. and its components, net of tax, were as follows:

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Net income before noncontrolling interest	\$ 89,948	\$ 221,930	\$ 127,851	\$ 341,513
Changes in cumulative foreign currency translation adjustment	48,126	1,130	30,267	(1,756)
Changes in market value of derivative financial instruments classified as cash flow hedges, net of tax	12,700	23,707	37,188	46,620
Comprehensive income before noncontrolling interest	150,774	246,767	195,306	386,377
Comprehensive income attributable to noncontrolling interest	(10,918)	(21,022)	(21,991)	(43,402)
Comprehensive income attributable to Terra Industries Inc.	\$ 139,856	\$ 225,745	\$ 173,315	\$ 342,975

The adoption of SFAS 160 has resulted in the reclassification of amounts previously attributable to minority interest (now referred to as noncontrolling interest) to a separate component of equity on the accompanying Consolidated Balance Sheet. Additionally, net income attributable to noncontrolling interests is shown separately from net income in the Consolidated Statements of Operations. Refer to Note 2, *New Accounting Pronouncements*, of the Notes to the Consolidated Financial Statements, on this Form 10-Q for additional information on the adoption of SFAS 160.

Prior year amounts related to noncontrolling interest (previously referred to as minority interest) have been reclassified to conform to the current year presentation as required by SFAS 160. The following table reconciles equity attributable to noncontrolling interest:

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Noncontrolling interest, beginning of period	\$ 101,450	\$ 110,435	\$ 104,082	\$ 108,581
Net income attributable to noncontrolling interest	9,474	18,495	17,382	36,621
Distributions to noncontrolling interests	(9,686)	(19,373)	(23,391)	(39,899)
Changes in market value of derivative financial instruments classified as cash flow hedges, net of tax, attributable to the noncontrolling interest	1,444	2,527	4,609	6,781
Noncontrolling interest, end of period	\$ 102,682	\$ 112,084	\$ 102,682	\$ 112,084

Table of Contents

16. Common Stockholders Equity

Terra allocates \$1.00 per share upon the issuance of common shares to the common share capital account. The common shares have no par value. On July 23, 2009, we declared a dividend of \$0.10 per common share, payable September 10, 2009 to shareholders of record as of August 20, 2009. Future dividends are necessarily dependent upon future earnings, capital requirements, general financial condition, general business conditions, approval from our Board of Directors, compliance with covenants in our debt agreements and other factors.

On May 6, 2008, the Board of Directors adopted a resolution for the repurchase of 12,841,717 shares representing 14 percent of our then outstanding common stock. The stock buyback program commenced on May 7, 2008 and has been and will be conducted on the open market, in private transactions or otherwise at such times prior to June 30, 2010, and at such prices as we determine to be appropriate. Purchases may be commenced or suspended at any time without notice. As of June 30, 2009 there are 7,448,662 shares available to be repurchased under the plan. There were no share repurchase during the second quarter of 2009.

17. Guarantor Subsidiaries

Terra Industries Inc., excluding all majority owned subsidiaries (Parent), files a consolidated United States federal income tax return. Beginning in 1995, the Parent adopted the tax sharing agreements, under which all domestic operating subsidiaries provide for and remit income taxes to the Parent based on their pretax accounting income, adjusted for permanent differences between pretax accounting income and taxable income. The tax sharing agreements allocated the benefits of operating losses and temporary differences between financial reporting and tax basis income to the Parent.

Condensed consolidating financial information regarding the Parent, Terra Capital, Inc. (TCAPI), the Guarantor Subsidiaries and the subsidiaries of the Parent that are not guarantors of the Senior Unsecured Notes (the Non-Guarantor Subsidiaries) (see Note 13, *Long-term Debt*, of the Notes to Consolidated Financial Statements) for June 30, 2009; December 31, 2008; and June 30, 2008 are presented below for purposes of complying with the reporting requirements of the Guarantor Subsidiaries. The guarantees of the Guarantor Subsidiaries are full and unconditional. The Subsidiary issuer and the Guarantor Subsidiaries guarantees are joint and several with the Parent.

Guarantor Subsidiaries include: subsidiaries that own the Woodward, Oklahoma; Port Neal, Iowa; Yazoo City, Mississippi; and Beaumont, Texas plants; Terra Environmental Technologies; Terra Global Holding Company Inc., Terra Investment Fund I LLC, Terra Investment Fund II LLC, Terra (U.K.) Holdings Inc., and the corporate headquarters facility in Sioux City, Iowa. All Guarantor Subsidiaries are wholly owned by the Parent. All other company facilities are owned by Non-Guarantor Subsidiaries. In 2008, we declared the Beaumont, Texas facility as a discontinued operation and classified the facility as held for sale pursuant to SFAS 144. In December 2008, the Beaumont, Texas facility was sold; see Note 18, *Discontinued Operations*, of the Notes to the Consolidated Financial Statements.

Table of Contents

Condensed Consolidating Balance Sheet as of June 30, 2009:

(in thousands)	Parent	TCAPI	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Assets						
Cash and cash equivalents	\$	\$ 457,226	\$ 252,402	\$ 291,954	\$	\$ 1,001,582
Accounts receivable, net			46,076	45,124		91,200
Inventories			84,374	43,674		128,048
Other current assets	23,803	4,223	3,683	16,503		48,212
Total current assets	23,803	461,449	386,535	397,255		1,269,042
Property, plant and equipment, net		6,037	307,568	112,890		426,495
Equity method investments			9,603	259,510		269,113
Intangible assets, other assets and deferred plant turnaround costs	1,816	6,567	37,950	9,993		56,326
Investments in and (from) affiliates	1,393,645	127,059	2,947,544	424,119	(4,892,367)	
Total assets	\$ 1,419,264	\$ 601,112	\$ 3,689,200	\$ 1,203,767	\$ (4,892,367)	\$ 2,020,976
Liabilities						
Accounts payable	\$ 138	\$	\$ 50,107	\$ 18,432	\$	\$ 68,677
Customer prepayments			13,047	14,799		27,846
Derivative hedge liabilities	4,850	277	345	2,349		7,821
Accrued and other current liabilities	44,102	8,907	32,557	6,670		92,236
Total current liabilities	49,090	9,184	96,056	42,250		196,580
Long-term debt		330,000				330,000
Deferred taxes	73,617			9,963		83,580
Pension and other liabilities	75,613	(346)	10,306	1,617		87,190
Total liabilities	198,320	338,838	106,362	53,830		697,350
Preferred Shares liquidation value of \$1,600	1,544					1,544

**Common Stockholders
Equity**

Common stock	152,481		73	92,262	(92,335)	152,481
Paid-in capital	581,542	150,218	2,024,501	808,705	(2,983,424)	581,542
Accumulated other comprehensive income (loss)	(112,683)			(118,926)	118,926	(112,683)
Retained earnings (accumulated deficit)	598,060	92,012	1,475,626	367,896	(1,935,534)	598,060
Total stockholders equity	1,219,400	242,230	3,500,200	1,149,937	(4,892,367)	1,219,400
Noncontrolling interest		20,044	82,638			102,682
Total equity	1,219,400	262,274	3,582,838	1,149,937	(4,892,367)	1,322,082
Total liabilities and equity	\$ 1,419,264	\$ 601,112	\$ 3,689,200	\$ 1,203,767	\$ (4,892,367)	\$ 2,020,976

Table of Contents

Consolidating Statement of Operations for the three months ended June 30, 2009:

(in thousands)	Parent	TCAPI	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Revenues						
Product revenues	\$	\$	\$ 251,043	\$ 201,296	\$	\$ 452,339
Other income			790	374		1,164
Total revenues			251,833	201,670		453,503
Cost and Expenses						
Cost of sales		83	169,514	127,093		296,690
Selling, general and administrative expenses	13,376	(2,466)	6,934	8,622		26,466
Equity earnings of North American affiliates			(161)	(1,361)		(1,522)
Total cost and expenses	13,376	(2,383)	176,287	134,354		321,634
Income (loss) from operations	(13,376)	2,383	75,546	67,316		131,869
Interest income		599	309	257		1,165
Interest expense	(465)	(6,209)	25,534	(25,617)		(6,757)
Income (loss) before income taxes and noncontrolling interest	(13,841)	(3,227)	101,389	41,956		126,277
Income tax benefit (provision)	4,373	(6,909)	(34,260)	(1,419)		(38,215)
Equity earnings (loss) of unconsolidated affiliates	89,942	101,907		1,886	(191,849)	1,886
Income from continuing operations net of tax	80,474	91,771	67,129	42,423	(191,849)	89,948
Income from discontinued operations net of tax						
Net income before noncontrolling interest	80,474	91,771	67,129	42,423	(191,849)	89,948
Less: Net income attributable to the noncontrolling interest		(1,829)	(7,645)			(9,474)
Net income (loss) attributable to Terra Industries Inc.	\$ 80,474	\$ 89,942	\$ 59,484	\$ 42,423	\$ (191,849)	\$ 80,474

Table of Contents

Consolidating Statement of Operations for the six months ended June 30, 2009:

(in thousands)	Parent	TCAPI	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Revenues						
Product revenues	\$	\$	\$ 460,910	\$ 409,791	\$	\$ 870,701
Other income			1,893	662		2,555
Total revenues			462,803	410,453		873,256
Cost and Expenses						
Cost of sales		166	351,659	287,822		639,647
Selling, general and administrative expenses	15,615	(4,625)	18,100	17,644		46,734
Equity earnings of North American affiliates			(860)	(3,914)		(4,774)
Total cost and expenses	15,615	(4,459)	368,899	301,552		681,607
Income (loss) from operations	(15,615)	4,459	93,904	108,901		191,649
Interest income		1,405	808	762		2,975
Interest expense	(930)	(12,391)	48,993	(49,157)		(13,485)
Income (loss) before income taxes and noncontrolling interest	(16,545)	(6,527)	143,705	60,506		181,139
Income tax benefit (provision)	4,908	(13,267)	(42,632)	191		(50,800)
Equity earnings (loss) of unconsolidated affiliates	122,106	145,255		(2,488)	(267,361)	(2,488)
Income from continuing operations net of tax	110,469	125,461	101,073	58,209	(267,361)	127,851
Income from discontinued operations net of tax						
Net income before noncontrolling interest	110,469	125,461	101,073	58,209	(267,361)	127,851
Less: Net income attributable to the noncontrolling interest		(3,355)	(14,027)			(17,382)
Net income (loss) attributable to Terra Industries Inc.	\$ 110,469	\$ 122,106	\$ 87,046	\$ 58,209	\$ (267,361)	\$ 110,469

Table of Contents

Consolidating Statement of Cash Flows for the six months ended June 30, 2009:

(in thousands)	Parent	TCAPI	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Operating Activities						
Net income attributable to Terra Industries Inc.	\$ 110,469	\$ 122,106	\$ 87,046	\$ 58,209	\$ (267,361)	\$ 110,469
Income from discontinued operations						
Income from continuing operations	110,469	122,106	87,046	58,209	(267,361)	110,469
Adjustments to reconcile income from continuing operations to net cash flows from operating activities:						
Depreciation and amortization			26,991	14,637		41,628
Loss on sale of property, plant and equipment			657			657
Deferred income taxes	(1,393)					(1,393)
Noncontrolling interest in earnings		3,355	14,027			17,382
Distributions in excess of (less than) equity earnings	(122,106)	(145,255)	130	4,074	267,361	4,204
Equity earnings						
GrowHow UK Limited				2,488		2,488
Non-cash gain on derivatives	1,491					1,491
Share-based compensation	8,562					8,562
Amortization of intangible and other assets			3,556	1,042		4,598
Change in operating assets and liabilities	47,069	36,339	(62,856)	(83,106)		(62,554)
Net cash flows from operating activities continuing operations	44,092	16,545	69,551	(2,656)		127,532
Net cash flows from operating activities discontinued operations						
Net Cash Flows from Operating Activities	44,092	16,545	69,551	(2,656)		127,532
Investing Activities						
Capital expenditures and plant turnaround			(55,739)	(10,253)		(65,992)

expenditures			
Proceeds from the sale of property, plant and equipment	101		101
Distributions received from unconsolidated affiliate	385	11,212	11,597
Balancing consideration and other payments received from GrowHow UK Limited		7,893	7,893
Net cash flows from investing activities continuing operations	(55,253)	8,852	(46,401)
Net cash flows from investing activities discontinued operations			
Net Cash Flows from Investing Activities	(55,253)	8,852	(46,401)

Table of Contents**Consolidating Statement of Cash Flows (continued)**

(in thousands)	Parent	TCAPI	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Financing Activities						
Preferred share dividends paid	(34)					(34)
Common stock dividends paid	(19,940)					(19,940)
Common stock issuances and vestings	(5,334)					(5,334)
Change in investments and advances from (to) affiliates	(22,705)	113,481	(27,677)	(63,099)		
Excess tax benefits from equity compensation plans	3,921					3,921
Distributions to noncontrolling interests		(4,514)	(18,877)			(23,391)
Net cash flows from financing activities continuing operations	(44,092)	108,967	(46,554)	(63,099)		(44,778)
Net cash flows from financing activities discontinued operations						
Net Cash Flows from Financing Activities	(44,092)	108,967	(46,554)	(63,099)		(44,778)
Effect of Exchange Rate Changes on Cash				(1,471)		(1,471)
Increase (decrease) in Cash and Cash Equivalents		125,512	(32,256)	(58,374)		34,882
Cash and Cash Equivalents at Beginning of Period		331,714	284,658	350,328		966,700
Cash and Cash Equivalents at End of Period	\$	\$ 457,226	\$ 252,402	\$ 291,954	\$	\$ 1,001,582

Table of Contents

Condensed Consolidating Balance Sheet as of December 31, 2008:

(in thousands)	Parent	TCAPI	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Assets						
Cash and cash equivalents	\$	\$ 331,714	\$ 284,658	\$ 350,328	\$	\$ 966,700
Accounts receivable, net	9	74	73,358	56,949		130,390
Inventories			111,295	85,796		197,091
Margin deposits with derivative counterparties		36,945				36,945
Other current assets	23,807	10,440	13,596	13,495		61,338
Current assets held for sale discontinued operations						
Total current assets	23,816	379,173	482,907	506,568		1,392,464
Property, plant and equipment, net		6,037	288,449	108,827		403,313
Equity method investments			10,117	260,798		270,915
Deferred plant turnaround costs, intangible and other assets	2,230	7,156	21,146	15,793		46,325
Investments in and advances to (from) affiliates	1,252,608	94,331	3,103,568	588,172	(5,038,679)	
Total assets	\$ 1,278,654	\$ 486,697	\$ 3,906,187	\$ 1,480,158	\$ (5,038,679)	\$ 2,113,017
Liabilities						
Accounts payable	\$ 205	\$ 62	\$ 70,473	\$ 29,153	\$	\$ 99,893
Customer prepayments			58,922	52,670		111,592
Derivative hedge liabilities	35,254	7,476	39,880	43,315		125,925
Accrued and other current liabilities	51,861	8,947	42,261	24,701		127,770
Current liabilities held for sale discontinued operations						
Total current liabilities	87,320	16,485	211,536	149,839		465,180
Long-term debt		330,000				330,000
Deferred taxes	51,770			9,673		61,443
	74,975		10,983	1,765		87,723

Pension and other liabilities

Total liabilities	214,065	346,485	222,519	161,277		944,346
-------------------	---------	---------	---------	---------	--	---------

Preferred Shares

liquidation value of \$1,600

1,544

1,544

Common Stockholders Equity

Common stock	152,111		73	83,332	(83,405)	152,111
Paid-in capital	579,164	150,218	2,201,646	963,435	(3,315,299)	579,164
Accumulated other comprehensive income (loss)	(175,529)			(170,574)	170,574	(175,529)
Retained earnings (accumulated deficit)	507,299	(30,094)	1,397,955	442,688	(1,810,549)	507,299
Total stockholders equity	1,063,045	120,124	3,599,674	1,318,881	(5,038,679)	1,063,045
Noncontrolling interest		20,088	83,994			104,082
Total equity	1,063,045	140,212	3,683,668	1,318,881	(5,038,679)	1,167,127
Total liabilities and equity	\$ 1,278,654	\$ 486,697	\$ 3,906,187	\$ 1,480,158	\$ (5,038,679)	\$ 2,113,017

Table of Contents

Consolidating Balance Sheet as of June 30, 2008:

(in thousands)	Parent	TCAPI	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Assets						
Cash and cash equivalents	\$	\$ 45,342	\$ 382,642	\$ 817,198	\$ (493,174)	\$ 752,008
Accounts receivable, net		5,848	146,935	89,177	(5,848)	236,112
Inventories	1		116,451	52,498		168,950
Other current assets	43,022	1,935	20,611	46,432		112,000
Current assets held for sale discontinued operations			45,785			45,785
Total current assets	43,023	53,125	712,424	1,005,305	(499,022)	1,314,855
Property, plant and equipment, net			266,936	119,864		386,800
Equity method investments			10,567	350,238		360,805
Intangible assets, other assets and deferred plant turnaround costs	6,732	7,744	24,611	33,481	(5,343)	67,225
Investments in and advances to (from) affiliates	953,877	395,671	2,135,047	130,179	(3,614,774)	
Total assets	\$ 1,003,632	\$ 456,540	\$ 3,149,585	\$ 1,639,067	\$ (4,119,139)	\$ 2,129,685
Liabilities						
Accounts payable	\$ 279	\$	\$ 94,954	\$ 57,461	\$ (5,848)	\$ 146,846
Customer prepayments			49,138	42,467		91,605
Derivative hedge liabilities	3,026		1,522	5,546		10,094
Accrued and other current liabilities	54,982	9,187	34,162	21,720		120,051
Current liabilities held for sale discontinued operations			3,773			3,773
Total current liabilities	58,287	9,187	183,549	127,194	(5,848)	372,369
Long-term debt		330,000				330,000
Deferred taxes	136,706			13,583	3,465	153,754
Pension and other liabilities	78,526	(340)	11,067	2,224	324	91,801
Total liabilities	273,519	338,847	194,616	143,001	(2,059)	947,924

Preferred Shares

liquidation value of \$120,000	115,800					115,800
-----------------------------------	---------	--	--	--	--	---------

Common Stockholders**Equity**

Common stock	144,431		73	32,458	(32,531)	144,431
Paid-in capital	617,744	150,218	1,944,959	1,168,302	(3,263,479)	617,744
Accumulated other comprehensive income (loss)	(17,949)			236,083	(224,231)	(6,097)
Retained earnings (accumulated deficit)	(129,913)	(54,383)	919,711	59,223	(596,839)	197,799
Total stockholders' equity	614,313	95,835	2,864,743	1,496,066	(4,117,080)	953,877
Noncontrolling interest		21,858	90,226			112,084
Total equity	614,313	117,693	2,954,969	1,496,066	(4,117,080)	1,065,961
Total liabilities and equity	\$ 1,003,632	\$ 456,540	\$ 3,149,585	\$ 1,639,067	\$ (4,119,139)	\$ 2,129,685

Table of Contents

Consolidating Statement of Operations for the three months ended June 30, 2008:

(in thousands)	Parent	TCAPI	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Revenues						
Product revenues	\$	\$	\$ 478,835	\$ 358,089	\$	\$ 836,924
Other revenues			5,120	1,053		6,173
Total revenues			483,955	359,142		843,097
Cost and Expenses						
Cost of sales		83	363,813	183,174		547,070
Selling, general and administrative expenses	901	(4,055)	13,431	16,956		27,233
Equity earnings of North America affiliates			(16,518)			(16,518)
Total cost and expenses	901	(3,972)	360,726	200,130		557,785
Income (loss) from operations	(901)	3,972	123,229	159,012		285,312
Interest income		2,286	1,983	1,244		5,513
Interest expense	(465)	(6,207)	(1)	(83)		(6,756)
Foreign currency gain (loss)			(6)	6		
Income (loss) before income taxes and noncontrolling interest	(1,366)	51	125,205	160,179		284,069
Income tax benefit (provision)	598	(42,635)	(54,420)	(10,612)		(107,069)
Equity earnings (loss) of unconsolidated affiliates	204,203	250,357		37,611	(454,560)	37,611
Income from continuing operations net of tax	203,435	207,773	70,785	187,178	(454,560)	214,611
Income from discontinued operations net of tax			7,319			7,319
Net income before noncontrolling interest	\$ 203,435	\$ 207,773	\$ 78,104	\$ 187,178	\$ (454,560)	\$ 221,930
Less: Net income attributable to the noncontrolling interest		(3,570)	(14,925)			(18,495)
Net income (loss) attributable to Terra Industries Inc.	\$ 203,435	\$ 204,203	\$ 63,179	\$ 187,178	\$ (454,560)	\$ 203,435

Table of Contents

Consolidating Statement of Operations for the six months ended June 30, 2008:

(in thousands)	Parent	TCAPI	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Revenues						
Product revenues	\$	\$	\$ 834,569	\$ 575,557	\$	\$ 1,410,126
Other revenues			6,065	1,610		7,675
Total revenues			840,634	577,167		1,417,801
Cost and Expenses						
Cost of sales		166	650,157	303,157		954,059
Selling, general and administrative expenses	1,410	(6,090)	20,109	24,508		39,937
Equity earnings of North America affiliates			(29,808)			(29,808)
Total cost and expenses	1,410	(5,924)	640,458	328,244		964,188
Income (loss) from operations	(1,410)	5,924	200,176	248,923		453,613
Interest income		5,923	1,983	6,015		13,921
Interest expense	(930)	(12,426)	(3)	(455)		(13,814)
Income (loss) before income taxes and noncontrolling interest	(2,340)	(579)	202,156	254,483		453,720
Income tax benefit (provision)	974	(66,116)	(84,135)	(17,296)		(166,573)
Equity earnings (loss) of unconsolidated affiliates	306,258	380,021		46,895	(686,279)	46,895
Income from continuing operations net of tax	304,892	313,326	118,021	284,082	(686,279)	334,042
Income from discontinued operations net of tax			7,471			7,471
Net income before noncontrolling interest	\$ 304,892	\$ 313,326	\$ 125,492	\$ 284,082	\$ (686,279)	\$ 341,513
Less: Net income attributable to the noncontrolling interest		(7,068)	(29,553)			(36,621)
Net income (loss) attributable to Terra Industries Inc.	\$ 304,892	\$ 306,258	\$ 95,939	\$ 284,082	\$ (686,279)	\$ 304,892

Table of Contents

Consolidating Statement of Cash Flows for the six months ended June 30, 2008:

(in thousands)	Parent	TCAPI	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Operating Activities						
Net income attributable to Terra Industries Inc.	\$ 304,892	\$ 306,258	\$ 95,939	\$ 284,082	\$ (686,279)	\$ 304,892
Income from discontinued operations			7,471			7,471
Income from continuing operations	304,892	306,258	88,468	284,082	(686,279)	297,421
Adjustments to reconcile income from continuing operations to net cash flows from operating activities:						
Depreciation and amortization			20,733	18,716		39,449
(Gain) loss on sale of property, plant and equipment			920	(193)		727
Deferred income taxes	48,940					48,940
Noncontrolling interest in earnings		(633)	37,254			36,621
Distributions less than equity earnings	(339,136)	(28,822)	(29,808)	(60,791)	462,438	3,881
Equity earnings - GrowHow UK Limited				(46,895)		(46,895)
Non-cash gain on derivatives	(4,954)					(4,954)
Share-based compensation	9,772					9,772
Amortization of intangible and other assets			2,433	1,637		4,070
Change in operating assets and liabilities	13,046	(6,876)	(140,882)	(232,439)	79,020	(288,131)
Net cash flows from operating activities - continuing operations	32,560	269,927	(20,882)	(35,883)	(144,821)	100,901
Net cash flows from operating activities - discontinued operations			10,051			10,051
Net Cash Flows from Operating Activities	32,560	269,927	(10,831)	(35,883)	(144,821)	110,952
Investing Activities						
Capital expenditures and plant turnaround expenditures			(30,826)	(5,090)		(35,916)
Distributions received from unconsolidated affiliate			7,196			7,196
				28,055		28,055

Contribution settlement received from GrowHow UK Limited			
Proceeds from the sale of property, plant and equipment	1,242	390	1,632
Net cash flows from investing activities continuing operations	(22,388)	23,355	967
Net cash flows from investing activities discontinued operations			
Net Cash Flows from Investing Activities	(22,388)	23,355	967

Table of Contents**Consolidating Statement of Cash Flows (continued)**

(in thousands)	Parent	TCAPI	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Financing Activities						
Preferred share dividends paid	(2,550)					(2,550)
Common stock dividends paid	(9,202)					(9,202)
Common stock issuances and vestings	(6,842)					(6,842)
Change in investments and advances from (to) affiliates	(14,283)	(280,442)	188,615	(77,053)	183,163	
Excess tax benefits from equity compensation plans	7,817					7,817
Payments under share repurchase	(7,500)					(7,500)
Distributions to noncontrolling interests			(39,899)			(39,899)
Net cash flows from financing activities continuing operations	(32,560)	(280,442)	148,716	(77,053)	183,163	(58,176)
Net cash flows from financing activities discontinued operations						
Net Cash Flows from Financing Activities	(32,560)	(280,442)	148,716	(77,053)	183,163	(58,176)
Effect of Exchange Rate Changes on Cash				27		27
Increase (decrease) in Cash and Cash Equivalents		(10,515)	115,497	(89,554)	38,342	53,770
Cash and Cash Equivalents at Beginning of Period		55,857	267,145	906,752	(531,516)	698,238
Cash and Cash Equivalents at End of Period	\$	\$ 45,342	\$ 382,642	\$ 817,198	\$ (493,174)	\$ 752,008

18. Discontinued Operations

On December 31, 2008, pursuant to a 2007 agreement, we sold our Beaumont, Texas assets, including the methanol and ammonia production facilities, to Eastman Chemical Company (Eastman). Consideration received, including cash and a Promissory Note from Eastman of \$5.2 million, approximated this facility's carrying value. The Promissory Note

is due on December 31, 2009 bearing interest at a rate of 3.0% per annum.

Pursuant to the requirements of FASB Statement No. 144 (SFAS 144), *Accounting for the Impairment or Disposal of Long-Lived Assts*, we classified and accounted for the Beaumont assets and liabilities as held for sale in the statements of financial position and the results of operations on a net of tax basis in the statement of operations. SFAS 144 requires that assets held for sale are valued on an asset-by-asset basis at the lower of carrying amount or fair value less costs to sell. In applying those provisions, we considered cash flow analyses, and offers related to those assets. In accordance with the provisions of SFAS 144, assets for sale are not depreciated.

Table of Contents*Summarized Financial Results of Discontinued Operations*

(in thousands)	Three Months Ended		Six Months Ended	
	June 30,	June 30,	June 30,	June 30,
	2009	2008	2009	2008
Operating revenue	\$	\$ 13,224	\$	\$ 14,645
Operating and other expenses		(1,027)		(2,214)
Pretax income from operations of discontinued components		12,197		12,431
Income tax expense		(4,878)		(4,960)
Income from discontinued operations	\$	\$ 7,319	\$	\$ 7,471

The major classes of assets and liabilities held for sale and related to discontinued operations as of June 30, 2009, December 31, 2008 and June 30, 2008 are as follows:

(in thousands)	June 30,	December 31,	June 30,
	2009	2008	2008
Trade receivables	\$	\$	\$ 470
Inventory			2,203
Other current assets			43,112
Current assets	\$	\$	\$ 45,785
Accounts payable	\$	\$	\$ 279
Other current liabilities			3,494
Current liabilities	\$	\$	\$ 3,773

Table of Contents

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

OVERVIEW

You should read the following discussion and analysis in conjunction with our Unaudited Consolidated Financial Statements and the related Notes thereto contained in Part I, Item 1, of this report. The information contained in this Quarterly Report on Form 10-Q is not a complete description of our business or the risks associated with an investment in our common shares. We urge you to carefully review and consider the various disclosures made by us in this report and in our other reports filed with the SEC, including our Annual Report on Form 10-K for the year ended December 31, 2008 and subsequent reports on Form 8-K, which discuss our business in greater detail.

The section entitled "Risk Factors" contained in Part II, Item 1A of this report, and similar discussions in our other SEC filings, describe some of the important risk factors that may affect our business, financial condition, results of operations and/or liquidity. You should carefully consider those risks, in addition to the other information in this report and in our other filings with the SEC.

INTRODUCTION

In this discussion and analysis, we explain our business in the following areas:

- Business Strategy;
- Recent Business Environment;
- Results of Operations;
- Liquidity and Capital Resources; and
- Various Quantitative and Qualitative Disclosures.

BUSINESS STRATEGY

We are a leading North American producer and marketer of nitrogen products made from natural gas. Terra is the largest producer of ammonia in the United States and the second largest producer in North America. We also operate production assets in Trinidad and the United Kingdom through joint venture agreements. Our six North American and our international production locations, along with a robust distribution capability, provide us with the ability to effectively serve key agricultural, industrial and environmental markets. Terra has an extensive history of operating as a public entity and managing complex corporate structures including master limited partnerships, joint ventures and corporate alliances. In fact, since the 1980's, Terra has successfully integrated numerous large-scale value enhancing acquisitions that have contributed to our track record of strong cash flows over the business cycle.

Regarding the business cycle, the nitrogen products industry in which Terra operates has periods of oversupply during industry downturns that lead to capacity shutdowns or curtailments at the least cost-effective plants or at major import points such as the Gulf Coast. These shutdowns may be followed by supply shortages that result in higher selling prices and higher industry-wide production rates during any subsequent industry upturns. Higher selling prices can encourage capacity additions that ultimately lead to an oversupply of product, and the cycle repeats.

Successful companies in cyclical businesses, like nitrogen products, pursue conservative capital management and investment strategies. This enables them to weather industry downturns and continue to effectively serve their target markets cost-effectively throughout the business cycle.

Table of Contents

Our business strategy seeks to pursue profitable growth in the core, nitrogen-based agricultural products business as a scale operator in North America. We also seek to leverage our current business and manufacturing strength outside the core business in closely-adjacent market segments that help to assure long-term cash flow growth and tend to reduce volatility in earnings. Elements of this strategy include:

- Development of products and markets for upgraded products made from ammonia such as UAN, our primary nitrogen fertilizer product, and TerraCair[®], a liquid product for the treatment of diesel exhaust in automotive applications;
- Seeking opportunities to expand our existing asset base to take advantage of logistical or feedstock advantages both domestically and internationally;
- Management of North American and international assets to realize a rate of return that meets or exceeds our cost of capital throughout the business cycle;
- Maintenance of our facilities to be safe, reliable and environmentally compliant, cultivation of relationships with natural customers who, due to their physical location, can receive our product most economically, and close management of the supply chain to keep storage, transportation and other costs at an appropriate level; and
- Continued evaluation of business opportunities in nitrogen markets and businesses that leverage Terra's core competencies in chemical manufacturing, distribution and product application.

RECENT BUSINESS ENVIRONMENT

Demand

Short term demand for nitrogen products may remain constrained into the fall as retailers are anticipated to maintain low inventory levels. Dealers appear to be returning to the pre-2007 practice of utilizing all available inventory and clearing on-site material by the end of the planting season. Estimated ending corn stock levels as of the end of the 2009 planting season support an expected strong demand for corn in the spring of 2010. In addition, nitrogen demand is expected to benefit from the enactment of the 2010 Emission Standards of the 1990 Amendments to the Clean Air Act which requires diesel powered vehicles to achieve near-zero emissions of nitrogen oxides on January 1, 2010. In preparation of the new emission standard, truck manufacturing customers will utilize TerraCair Ultrapure[®] Diesel Exhaust Fluid (TerraCair DEF) for their Selective Catalytic Reduction (SCR) equipped vehicles during the second half of 2009.

An expected increase in long term demand for nitrogen products is supported by the global grain supply. The ending corn stock ratio for the 2009 planting season was estimated to be 15.8% by the USDA World Agriculture Supply and Demand Estimates (WASDE) June 2009 report, which is the second lowest level in 35 years. Historically, the corn ending stock ratio is approximately 30%. Pursuant to its June 2009 report, WASDE expects corn prices for 2009-2010 to increase to \$3.90 - \$4.70 per bushel, from \$4.10 - \$4.30 per bushel in 2008-2009. The expected increased demand for corn is supported by the expected increased demand for food, seed and industrial markets, increased ethanol demand and higher expected exports.

Supply

In an effort to maintain nitrogen inventory at acceptable levels, certain North American production has been curtailed. Imports have declined as a result of the sluggish demand due to poor import economics during the second quarter of 2009, removing 1.2 million tons of nitrogen from the U.S. supply system.

Table of Contents**Natural Gas Costs**

As a result of the economic slowdown, natural gas consumption has declined in the utility and industrial sectors, driving near term prices below \$4 per MMBtu as of June 30, 2009.

The following is an average NYMEX forward natural gas price for the succeeding twelve month period noted for the respective dates:

(in \$ per MMBtu)	June 30, 2008	September 30, 2008	December 31, 2008	March 31, 2009	June 30, 2009
	\$ 13.22	\$ 7.90	\$ 6.09	\$ 4.69	\$ 5.09

During the second quarter of 2009, natural gas prices decreased 61% from June 30, 2008. Generally, as customers place advance orders we secure the prices for the natural gas required to produce the inventory to satisfy these orders.

RESULTS OF OPERATIONS**Consolidated Results**

We reported for the first half of 2009 net income of \$110.5 million on revenues of \$873.3 million compared with 2008 first half net income of \$304.9 million on revenues of \$1,417.8 million. The decrease in net income and revenue for the first half of 2009 is due to lower overall nitrogen prices, lower ammonia and UAN sales volumes, as well as lower equity earnings. Diluted income per share for the six months ended June 30, 2009 was \$1.11 compared with \$2.91 for the six months ended June 30, 2008.

Table of Contents

The following table shows the results of operations for the three and six months ended June 30, 2009 and 2008 (certain percentages that are not considered to be meaningful are represented by NM):

(in millions except per share data)	Three Months Ended		Quarter to Date		Six Months Ended		Year to Date	
	June 30,		2009-2008		June 30,		2009-2008	
	2009	2008	Change	Percent	2009	2008	Change	Percent
Net sales	\$ 453.5	\$ 843.1	\$ (389.6)	-46%	\$ 873.3	\$ 1,417.8	\$ (544.5)	-38%
Cost of goods sold	296.7	547.1	(250.4)	-46%	639.6	954.1	(314.5)	-33%
Gross margin	156.8	296.0	(139.2)	-47%	233.7	463.7	(230.0)	-50%
Gross margin percentage	34.6%	35.1%	-0.5%	-2%	26.8%	32.7%	-5.9%	-18%
Selling, general and administrative expenses	13.9	27.2	(13.3)	-49%	32.5	39.9	(7.4)	-19%
Other operating expenses	12.6		12.6	100%	14.3		14.3	100%
Equity in earnings of North American affiliates	(1.5)	(16.5)	15.0	-91%	(4.8)	(29.8)	25.0	-84%
Income from operations	131.8	285.3	(153.5)	-54%	191.7	453.6	(261.9)	-58%
Interest income (expense), net	(5.6)	(1.2)	(4.4)	NM	(10.5)	0.1	(10.6)	NM
Income before income taxes, noncontrolling interest and equity earnings (loss) of GrowHow UK Limited	126.2	284.1	(157.9)	-56%	181.2	453.7	(272.5)	-60%
Income tax provision	(38.2)	(107.1)	68.9	-64%	(50.8)	(166.6)	115.8	-70%
Equity earnings (loss) of GrowHow UK Limited	1.9	37.6	(35.7)	NM	(2.5)	46.9	(49.4)	NM
Income from continuing operations, net of tax	89.9	214.6	(124.7)	-58%	127.9	334.0	(206.1)	-62%
Income from discontinued operations, net of tax		7.3	(7.3)	NM		7.5	(7.5)	NM
Net income before noncontrolling interest	89.9	221.9	(132.0)	-59%	127.9	341.5	(213.6)	-63%
Net income attributable to noncontrolling interest	(9.5)	(18.5)	9.0	-49%	(17.4)	(36.6)	19.2	-52%
Net income attributable to Terra Industries Inc.	\$ 80.4	\$ 203.4	\$ (123.0)	-60%	\$ 110.5	\$ 304.9	\$ (194.4)	-64%
Diluted earnings per share	\$ 0.81	\$ 1.94	(1.13)	-58%	\$ 1.11	\$ 2.91	(1.80)	-62%
Weighted average diluted shares outstanding	99,710	104,678	(4,968)	-5%	99,704	104,652	(4,948)	-5%

The following table shows sales volumes and prices and natural gas cost for the three months ended June 30, 2009 and 2008:

	2009		2008	
	Sales	Average	Sales	Average

Edgar Filing: TERRA INDUSTRIES INC - Form 10-Q

(quantities in thousands of tons)	Volumes	Unit Price ⁽¹⁾	Volumes	Unit Price ⁽¹⁾
Ammonia	384	\$ 367	547	\$ 530
UAN 32% basis	808	\$ 243	1,099	\$ 338
Urea ⁽²⁾	75	\$ 304	76	\$ 450
Ammonium nitrate ⁽³⁾	241	\$ 193	269	\$ 301
Natural gas cost ⁽⁴⁾		\$ 4.30		\$ 8.77

(1) After deducting \$35.6 million and \$45.2 million outbound freight costs for 2009 and 2008, respectively.

(2) Urea sales volumes and prices include granular urea and urea solutions data.

(3) Ammonium nitrate sales volumes and prices include agricultural grade AN, industrial grade AN and ammonium nitrate solution (ANS).

(4) Per MMBtu. Includes all transportation and other logistical costs and any gains or losses on financial derivatives related to North American natural gas purchases. Net costs of derivatives for the second

quarter of 2009
were
\$25.1 million.
Excluding the
impact of 2009
hedge costs,
natural gas cost
was \$3.39 per
MMBtu for the
2009 second
quarter. The net
benefit of
derivatives for
the second
quarter of 2008
were
\$36.6 million.

Table of Contents

The following table shows sales volumes and prices and natural gas costs for the six months ended June 30, 2009 and 2008:

(quantities in thousands of tons)	2009		2008	
	Sales Volumes	Average Unit Price ⁽¹⁾	Sales Volumes	Average Unit Price ⁽¹⁾
Ammonia	765	\$ 352	911	\$ 503
UAN 32% basis	1,434	\$ 260	2,016	\$ 314
Urea ⁽²⁾	152	\$ 313	135	\$ 439
Ammonium nitrate ⁽³⁾	408	\$ 223	510	\$ 288
Natural gas cost ⁽⁴⁾		\$ 5.68		\$ 8.16

(1) After deducting \$70.3 million and \$79.0 million outbound freight costs for 2009 and 2008, respectively.

(2) Urea sales volumes and prices include granular urea and urea solutions data.

(3) Ammonium nitrate sales volumes and prices include agricultural grade AN, industrial grade AN and ammonium nitrate solution (ANS).

(4) Per MMBtu. Includes all transportation and other logistical costs and any gains or losses on financial derivatives

related to North American natural gas purchases. Net costs of derivatives for the first half of 2009 were \$98.0 million. Excluding the impact of 2009 hedge costs, natural gas cost was \$3.73 per MMBtu for the 2009 first half. The net benefit of derivatives for the first half of 2008 were \$44.1 million.

RESULTS OF OPERATIONS QUARTER ENDED JUNE 30, 2009 COMPARED WITH QUARTER ENDED JUNE 30, 2008

Our net sales for the second quarter of 2009 were \$453.5 million, a decline of \$389.6 million or 46% from the second quarter of 2008 net sales of \$843.1 million. The decline was primarily due to an overall decline in product price of approximately 30% (\$182.3 million) and a decline in UAN and ammonia sales volumes of 26% and 30% (aggregate \$207.3 million), respectively. During the second quarter of 2009 growers faced inclement weather early in the quarter which limited pre-plant fertilizer application. Demand recovered for side-dressing ammonia application at the end of the quarter. The supply channel also maintained the carryover of inventory from purchases made in the prior year. The significant decrease in volumes as compared to the second quarter of 2008 is also partially due to dealers purchasing for application and future fill during the second quarter of 2008. As the market has corrected for this, the sales volumes decreased in the current quarter.

As a result of decreased demand in the second quarter, aggregate production rates were reduced to 90% and a planned curtailment of the Donaldsonville, Louisiana facility started July 1, 2009. During the second quarter of 2009 our Woodward, Oklahoma facility was in turnaround, which was extended due to mechanical issues. The fixed costs associated with the facility being offline were \$4.9 million during the second quarter of 2009.

Our gross margin was \$156.8 million in the second quarter of 2009 compared to \$296.0 million in the second quarter of 2008. Gross margin decreased slightly as a percentage of sales to 34.6% from 35.1%. The gross margin percentage includes a 51% decrease in natural gas costs for the second quarter of 2009. The second quarter natural gas unit costs, net of forward pricing gains and losses, declined from \$8.77 per MMBtu in 2008 to \$4.30 per MMBtu in 2009. The decrease in natural gas cost was offset by aggregate reductions in product pricing of \$182.3 million and a margin impact of \$36.6 million due to the decrease in sales volumes.

We enter into forward sales commitments by utilizing forward pricing and prepayment programs with customers. We use derivative instruments to hedge a portion of our natural gas requirements. The use of these derivative instruments is designed to hedge exposure to natural gas price fluctuations for production required for forward sales estimates. The net cost of derivatives for the second quarter of 2009 was \$25.1 million as compared to the net benefit of derivatives for the second quarter of 2008 of \$36.6 million. Excluding the impact of the hedge cost, natural gas cost was \$3.39 per MMBtu in the second quarter of 2009.

Table of Contents

Selling, General and Administrative Costs and Other Operating Expenses

Selling, general and administrative (SG&A) costs decreased \$13.3 million in the second quarter of 2009 compared to the second quarter of 2008 primarily due to a decrease in short- and long-term performance based incentive compensation expense and a decrease in contracted services. Other operating expenses of \$12.6 million represents costs associated with the unsolicited exchange offer by CF.

Equity Earnings of Unconsolidated Affiliates North America

We recorded income of \$1.5 million from our North American equity investments in the second quarter of 2009 as compared to \$16.5 million in the second quarter of 2008. In addition, we also received cash distributions of \$12.4 million from our North American equity investments in 2009 as compared to \$21.0 million in 2008. The decrease in the second quarter results is primarily due to the decrease in Gulf ammonia pricing which affects the results of our Point Lisas facility, as compared to the second quarter of 2008.

Equity Earnings of Unconsolidated Affiliates GrowHow

We recorded income of \$1.9 million from GrowHow for the second quarter ended June 30, 2009 as compared to income of \$37.6 million for the quarter ended June 30, 2008. The decrease was attributed to a decrease in sales volumes and prices of 36% and 27%, respectively. As a result of the decrease in agricultural and industrial demand, during the second quarter of 2009, GrowHow operated its ammonia plants on a reduced schedule. During the second quarter of 2009, we received balancing consideration and other payments from GrowHow of \$2.7 million.

Noncontrolling Interests

Noncontrolling interest represents third-party interests in the earnings of the publicly held common units of TNCLP. The 2009 and 2008 amounts are directly related to TNCLP earnings and losses. During the first quarter of 2008, the cumulative shortfall of the Minimum Quarterly Distribution was satisfied which entitled us to increased income allocations as provided for in the TNCLP Partnership Agreement. The current quarter noncontrolling interest balance reflects the impact of these adjusted income allocations. Our increased income allocation attributed to our General Partner interest was \$5.5 million for the quarter ended June 30, 2009, as compared to \$13.6 million for the quarter ended June 30, 2008.

Income Taxes

Our income tax expense for the second quarter of 2009 and 2008 was \$38.2 million and \$107.1 million, respectively, and was based on the estimated effective tax rate for the individual jurisdictions in which we operate. The estimated annual effective tax rates were 32.2% and 35.3% in the quarters ended June 30, 2009 and 2008, respectively. The 2009 estimated annual effective tax rate reflects benefits related to the reorganization of Terra's subsidiary ownership structure for its international operations during the fourth quarter 2008, and expected utilization of state and federal tax credits.

Table of Contents**RESULTS OF OPERATIONS SIX MONTHS ENDED JUNE 30, 2009 COMPARED WITH SIX MONTHS ENDED JUNE 30, 2008**

Our net sales for the first six months of 2009 were \$873.3 million, a decline of \$544.5 million or 38% from the first six months of 2008 net sales of \$1,417.8 million. The decline was primarily due to a 29% and 16% decline in UAN and ammonia sales volumes (aggregate \$310.0 million), respectively, and the decrease of 17% and 30% in UAN and ammonia sales prices (aggregate \$234.5 million), respectively.

Our gross margin was \$233.7 million in the first half of 2009 compared to \$463.7 million in the first half of 2008, and decreased as a percentage of sales to 26.8% from 32.7%. The gross margin percentage movement reflects a 31% decrease in natural gas costs. The first half of 2009 natural gas unit costs, net of forward pricing gains and losses, decreased from \$8.16 per MMBtu in 2008 to \$5.68 per MMBtu in 2009. The decrease in natural gas cost was offset by aggregate reductions in product pricing of \$234.5 million and a margin impact of \$51.0 million due to the decrease in sales volumes.

We enter into forward sales commitments by utilizing forward pricing and prepayment programs with customers. We use derivative instruments to hedge a portion of our natural gas requirements. The use of these derivative instruments is designed to hedge exposure to natural gas price fluctuations for production required for forward sales estimates. The net cost of derivatives for the first half of 2009 was \$98.0 million as compared to the net benefit of derivatives for the first half of 2008 of \$44.1 million. Excluding the impact of the hedge cost, natural gas cost was \$3.73 per MMBtu in the first half of 2009.

Selling, General and Administrative Costs and Other Operating Expenses

Selling, general and administrative costs decreased \$7.4 million in the first six months of 2009 compared to the first six months of 2008 primarily due to a decrease in short-term performance based incentive compensation expense, long-term share-based compensation expense, contracted services and a reduction in self-insurance costs. Other operating expenses of \$14.3 million represents costs associated with the unsolicited exchange offer by CF, of which \$1.7 million was previously reported in SG&A in the first quarter of 2009.

Equity Earnings of Unconsolidated Affiliates North America

We recorded income of \$4.8 million from our North American equity investments in the first six months of 2009 as compared to \$29.8 million in the first six months of 2008. In addition, we also received cash distributions of \$20.6 million from our North American equity investments in 2009 as compared to \$40.9 in 2008. The decrease in the first half results is primarily due to the decrease in Gulf ammonia pricing which affects the results of our Point Lisas facility, as compared to the first half of 2008.

Equity Earnings of Unconsolidated Affiliates GrowHow

We recorded a loss of \$2.5 million from GrowHow for the first half ended June 30, 2009 as compared to income of \$46.9 million for the first half ended June 30, 2008. The decrease is primarily due to a 54% decrease in sales volumes, partially offset by a 51% decrease in natural gas cost and a 12% increase in sales price in the first half of 2009 compared to the first half of 2008. During the first half of 2009, we received balancing consideration and other payments from GrowHow of \$7.9 million in the first half of 2009.

Table of Contents**Noncontrolling Interests**

Noncontrolling interest represents third-party interests in the earnings of the publicly held common units of TNCLP. The 2009 and 2008 amounts are directly related to TNCLP earnings and losses. During the first half of 2008, the cumulative shortfall of the Minimum Quarterly Distribution was satisfied which entitled us to increased income allocations as provided for in the TNCLP Partnership Agreement. The current half noncontrolling interest balance reflects the impact of these adjusted income allocations. Our increased income allocation attributed to our General Partner interest was \$9.4 million for the six months ended June 30, 2009, as compared to \$15.6 million for the six months ended June 30, 2008.

Income Taxes

Our income tax expense for the first half of 2009 and 2008 was \$50.8 million and \$166.6 million, respectively, and was based on the estimated effective tax rate for the individual jurisdictions in which we operate. The estimated annual effective tax rates were 31.5% and 35.9% in the six months ended June 30, 2009 and 2008, respectively. The 2009 estimated annual effective tax rate reflects benefits related to the reorganization of Terra's subsidiary ownership structure for its international operations during the fourth quarter 2008, and expected utilization of state and federal tax credits.

LIQUIDITY AND CAPITAL RESOURCES

Our primary uses of cash and cash equivalents were to fund our working capital requirements, make payments for plant turnarounds and capital expenditures, common stock dividends and make distributions to noncontrolling interests. The principal sources of funds were cash flows from operations and funds received from GrowHow, our 50% owned joint venture, and distributions received from our North American equity investments. Cash and cash equivalents were \$1,002 million at June 30, 2009. During the first half of 2009 cash and cash equivalents increased \$34.9 million.

Cash Flows

The following table summarized our cash flows from operating, investing and financing activities for the six month period ended June 30, 2009 and 2008:

(\$in millions)	Six Months Ended June 30,	
	2009	2008
Operating activities	\$ 127.5	\$ 111.0
Investing activities	(46.4)	1.0
Financing activities	(44.8)	(58.2)
Effect of exchange rate changes on cash	(1.4)	
Increase in cash and cash equivalents	\$ 34.9	\$ 53.8

Operating Activities

Our cash flows from operating activities were \$127.5 million during the first half of 2009. The \$127.5 million is comprised of \$190.1 million from operations offset by \$62.6 million from changes in our working capital accounts. The \$190.1 million includes \$110.5 million of net income, adjusted for non-cash expenses. The significant non-cash expenses incurred include \$41.6 million of depreciation of property, plant and equipment and amortization of deferred plant turnaround costs, \$8.6 million of share-based compensation, and \$17.4 million of noncontrolling interest in earnings.

Table of Contents

Included in the June 30, 2009 cash and cash equivalents balance of \$1,002 million is \$27.8 million of customer prepayments for the selling price and delivery costs of products that we expect to ship during the second half of 2009, as compared to the June 30, 2008 cash and cash equivalents balance of \$752.0 million which included \$91.6 million of customer prepayments.

Investing Activities

Our investing activities used cash of \$46.4 million during the first half of 2009. The primary use of cash was related to \$50.9 million of property, plant and equipment purchases for our operations and \$15.1 million for turnaround activities. The primary sources of cash were related to the \$7.9 million balancing consideration and other payments received from GrowHow. We also received \$11.6 million in distributions from our North American equity investments above the equity earnings.

Financing Activities

Our financing activities used cash of \$44.8 million during the first half of 2009. The primary use of cash related to \$23.4 of distributions to the noncontrolling interest holders of TNCLP and common stock dividends of \$19.9 million.

Long-term Debt and Revolving Credit Facilities

During 2007, we completed a debt refinancing whereby we issued \$330 million of 7% unsecured senior notes due 2017. These proceeds were used to redeem \$200.0 million of 12 7/8% senior secured notes and \$131.3 million of 11 1/2% second priority senior secured notes due 2010.

In connection with the debt refinancing, we extended the terms of our revolving credit facilities (facilities) through 2012. Borrowing availability under the facilities is generally based on eligible cash balances, 85% of eligible accounts receivable and 60% of eligible inventory, less outstanding letters of credit. These facilities include \$50 million solely dedicated for the use of TNCLP, one of our consolidated subsidiaries.

At June 30, 2009, there were no outstanding revolving credit borrowings and there were \$8.0 million in outstanding letters of credit, resulting in borrowing availability of approximately \$192.0 million under the facilities. We are required to maintain a combined minimum unused borrowing availability of \$30 million. The facilities also require 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 a combined \$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 facilities) for the preceding four quarters. The facilities also require that there be no change of control related to Terra, such that no individual or group acquires more than 35% of the outstanding voting shares of Terra. Such change of control would constitute an event of default under the facilities.

Our ability to meet facilities 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 facilities or could result in termination of the facilities. Access to adequate bank facilities may be required to fund our need to build inventories during the second half of the year in order to ensure product availability during the peak sales season. We believe that our facilities are adequate for expected 2009 sales levels.

Table of Contents

In addition, our 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 our ability to obtain sufficient credit terms. For additional information regarding commodity price risk, see Item 3, *Quantitative and Qualitative Disclosures about Market Risk*.

Based on our June 30, 2009 financial position and the current market conditions for our financial products and for natural gas, we anticipate that we will be able to comply with our covenants through 2009.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risks relating to our operations result primarily from interest rates, foreign exchange rates, natural gas prices and nitrogen prices. We manage our exposure to these and other market risks through regular operating and financing activities and through the use of derivative financial instruments. We intend to use derivative financial instruments as risk management tools and not for speculative investment purposes. Item 7A, *Quantitative and Qualitative Disclosures about Market Risk*, of Terra's Annual Report on Form 10-K for the year ended December 31, 2008 provides more information as to the types of practices and instruments used to manage risk. There were no material changes in our use of financial instruments during the quarter ended June 30, 2009.

Natural gas is the principal raw material used to manufacture nitrogen and methanol. Natural gas prices are volatile and we mitigate some of this volatility through the use of derivative commodity instruments. Our current policy is to hedge natural gas provided that such arrangements would not result in costs greater than expected selling prices for our finished products. Estimated North American natural gas requirements for 2009 are approximately 113 billion cubic feet (BCF). We have hedged 15% of our expected North American requirements for the next twelve months. The fair value of these instruments is estimated based, in part, on quoted market prices from brokers, realized gains or losses and our computations. These instruments and other natural gas positions fixed natural gas prices at \$6.1 million (including \$4.6 million included in accumulated other comprehensive loss) more than published prices for June 30, 2009 forward markets.

There were no material changes outside the ordinary course of business to Terra's contractual obligations, critical accounting policies or off-balance sheet arrangements presented in Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations* of the Annual Report on Form 10-K for the period ended December 31, 2008.

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 this 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 significant changes in our internal control over financial reporting that occurred during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

FORWARD-LOOKING INFORMATION IS SUBJECT TO RISK AND UNCERTAINTY

Certain statements in this report may constitute forward-looking statements within the meaning of the Private Litigation Reform Act of 1995. Forward-looking statements are based upon the assumptions as to future events that may not prove to be accurate. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Actual outcomes and results may differ materially from what is expressed or forecasted in these forward-looking statements. As a result, these statements speak only as of the date they were made and we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as otherwise required by law.

Words such as expects, intends, plans, projects, believes, estimates, and similar expressions are used to identify forward-looking statements. These include, among others, statements relating to:

- changes in financial markets,
- general economic conditions within the agricultural industry,
- competitive factors and price changes (principally, sales prices of nitrogen products and natural gas costs),
- changes in product mix,
- changes in the seasonality of demand patterns,
- changes in weather conditions,
- changes in environmental and other government regulations,
- changes in agricultural regulations, and
- other risks detailed in Risk Factors in our 2008 Annual Report.

Additional information as to these factors can be found in our 2008 Annual Report on Form 10-K in the sections entitled Business, Legal Proceedings, and Management's Discussion and Analysis of Financial Condition and Results of Operations and in the Notes to our consolidated financial statements included as part of this report.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we are involved in various claims, disputes, administrative proceedings and legal actions arising in the ordinary course of business. We do not believe that the matters in which we are currently involved, either individually or in the aggregate, will have a material adverse effect on our consolidated financial position, results of operations or liquidity.

ITEM 1A. RISK FACTORS

There were no significant changes in our risk factors during the first six months of 2009 as compared to the risk factors identified in our 2008 Form 10-K.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

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

None

ITEM 5. OTHER INFORMATION

None

Table of Contents

ITEM 6. EXHIBITS

(a) Exhibits

- Exhibit 3.1 Amendment No. 1 to the Amended and Restated Bylaws of Terra Industries Inc., filed as Exhibit 3.1 to Terra Industries Inc.'s Form 8-K dated April 14, 2009, is incorporated herein by reference.
- 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 32.1* Certification of the Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- Exhibit 32.2* Certification of the Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Filed herewith

Table of Contents

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.

TERRA INDUSTRIES INC.

Date: July 24, 2009

/s/ Daniel D. Greenwell

Daniel D. Greenwell
*Senior Vice President and Chief Financial
Officer
and a duly authorized signatory
(Principal Financial Officer and
Principal Accounting Officer)*

52

Table of Contents

EXHIBIT INDEX

Exhibit Number	Description
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 32.1*	Certification of the Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 32.2*	Certification of the Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Filed herewith