

TERRA INDUSTRIES INC
Form 10-Q
August 09, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2004

OR

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

For the transition period from _____ to _____

Commission file number: 1-8520

TERRA INDUSTRIES INC.

(Exact name of registrant as specified in its charter)

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| | |
|--|--|
| 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 (Address of principal executive offices) | 51102-6000 (Zip Code) |

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 ☐

As of June 30, 2004, the following shares of the registrant's stock were outstanding:

| | |
|----------------------------------|-------------------|
| Common Shares, without par value | 77,684,014 shares |
|----------------------------------|-------------------|

PART I. FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS**

TERRA INDUSTRIES INC.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(in thousands)

(unaudited)

| | June 30, 2004 | December 31, 2003 | June 30, 2003 |
|--|---------------------|----------------------|---------------------|
| ASSETS | | | |
| Cash and short-term investments | \$ 110,944 | \$ 87,334 | \$ 12,368 |
| Accounts receivable, less allowance for doubtful accounts of \$586, \$87 and \$156 | 129,414 | 133,480 | 123,852 |
| Inventories | 90,015 | 90,869 | 96,501 |
| Other current assets | 36,739 | 43,319 | 21,463 |
| Total current assets | 367,112 | 355,002 | 254,184 |
| Property, plant and equipment, net | 677,268 | 707,665 | 725,297 |
| Deferred plant turnaround costs | 22,114 | 28,103 | 32,006 |
| Other assets | 25,331 | 34,292 | 36,023 |
| Total assets | \$ 1,091,825 | \$ 1,125,062 | \$ 1,047,510 |
| LIABILITIES | | | |
| Debt due within one year | \$ 157 | \$ 153 | \$ 149 |
| Accounts payable | 76,940 | 79,563 | 94,188 |
| Accrued and other liabilities | 72,797 | 142,338 | 66,443 |
| Total current liabilities | 149,894 | 222,054 | 160,780 |
| Long-term debt and capital lease obligations | 402,123 | 402,206 | 437,031 |
| Deferred income taxes | 31,436 | 17,831 | 32,457 |
| Pension liabilities | 63,453 | 63,453 | 62,819 |
| Other liabilities | 52,782 | 65,325 | 46,931 |
| Minority interest | 93,255 | 89,062 | 85,011 |
| Total liabilities and minority interest | 792,943 | 859,931 | 825,029 |
| STOCKHOLDERS' EQUITY | | | |
| Capital stock | | | |
| Common Shares, authorized 133,500 shares; outstanding 77,684, 77,563 and 76,844 shares | 129,094 | 128,968 | 128,908 |
| Paid-in capital | 555,684 | 555,529 | 555,486 |

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| | | | |
|---|---------------------|---------------------|---------------------|
| Accumulated other comprehensive loss | (47,221) | (44,596) | (54,191) |
| Accumulated deficit | (338,675) | (374,770) | (407,722) |
| | <u> </u> | <u> </u> | <u> </u> |
| Total stockholders' equity | 298,882 | 265,131 | 222,481 |
| | <u> </u> | <u> </u> | <u> </u> |
| Total liabilities and stockholders' equity | \$ 1,091,825 | \$ 1,125,062 | \$ 1,047,510 |
| | <u> </u> | <u> </u> | <u> </u> |

TERRA INDUSTRIES INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per-share amounts)

(unaudited)

| | Three Months ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|--------------------|------------------------------|--------------------|
| | 2004 | 2003 | 2004 | 2003 |
| REVENUES | | | | |
| Net sales | \$ 416,264 | \$ 378,597 | \$ 776,725 | \$ 658,252 |
| Other income, net | 504 | 348 | 1,072 | 836 |
| Total revenues | 416,768 | 378,945 | 777,797 | 659,088 |
| COSTS AND EXPENSES | | | | |
| Cost of sales | 370,578 | 362,031 | 694,225 | 646,105 |
| Selling, general and administrative expense | 9,295 | 9,733 | 16,604 | 19,060 |
| Recovery of product claim costs | (2,389) | | (17,903) | |
| Impairment of long-lived assets | | 53,091 | | 53,091 |
| | 377,484 | 424,855 | 692,926 | 718,256 |
| Income (loss) from operations | 39,284 | (45,910) | 84,871 | (59,168) |
| Interest income | 612 | 192 | 989 | 381 |
| Interest expense | (13,440) | (15,283) | (26,941) | (27,835) |
| Minority interest | (3,566) | 10,950 | (6,499) | 12,668 |
| Income (loss) before income taxes | 22,890 | (50,051) | 52,420 | (73,954) |
| Income tax (provision) benefit | (5,025) | 18,960 | (16,325) | 28,521 |
| NET INCOME (LOSS) | \$ 17,865 | \$ (31,091) | \$ 36,095 | \$ (45,433) |
| Basic and diluted income (loss) per share: | | | | |
| Basic | \$ 0.24 | \$ (0.41) | \$ 0.48 | \$ (0.60) |
| Diluted | 0.23 | (0.41) | 0.46 | (0.60) |
| Basic and diluted weighted average shares outstanding: | | | | |
| Basic | 75,898 | 75,715 | 75,769 | 75,539 |
| Diluted | 77,879 | 75,715 | 77,663 | 75,539 |

TERRA INDUSTRIES INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

| | Six Months Ended | |
|---|------------------|-------------|
| | June 30, | |
| | 2004 | 2003 |
| OPERATING ACTIVITIES | | |
| Net income (loss) | \$ 36,095 | \$ (45,433) |
| Adjustments to reconcile net income (loss) to net cash flows from operating activities: | | |
| Impairment of long-lived assets | | 53,091 |
| Depreciation and amortization | 50,484 | 55,548 |
| Deferred income taxes | 16,526 | (33,144) |
| Minority interest in earnings (loss) | 6,499 | (12,668) |
| Recovery of product claim costs | (12,874) | |
| Changes in current assets and liabilities: | | |
| Accounts receivable | 4,126 | (20,455) |
| Inventories | 506 | (8,870) |
| Other current assets | 9,067 | 10,046 |
| Accounts payable | (3,069) | (3,021) |
| Accrued and other liabilities | (75,949) | (41,920) |
| Other | 131 | 345 |
| Net cash flows from operating activities | 31,542 | (46,481) |
| INVESTING ACTIVITIES | | |
| Purchase of property, plant and equipment | (3,425) | (5,861) |
| Plant turnaround costs | (819) | (20,321) |
| Other | (1,426) | (1,122) |
| Net cash flows from investing activities | (5,670) | (27,304) |
| FINANCING ACTIVITIES | | |
| Issuance of long-term debt | | 202,000 |
| Net borrowing on credit facility | | 34,750 |
| Deferred financing costs | | (8,138) |
| Principal payments on long-term debt and capital lease obligations | (79) | (200,071) |
| Stock issuance | 269 | |
| Distributions to minority interests | (2,306) | (1,153) |
| Net cash flows from financing activities | (2,116) | 27,388 |
| Effect of exchange rate changes on cash | (146) | 286 |
| Increase (decrease) to cash and short-term investments | 23,610 | (46,111) |
| Cash and short-term investments at beginning of period | 87,334 | 58,479 |

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| | | |
|--|------------|-----------|
| Cash and short-term investments at end of period | \$ 110,944 | \$ 12,368 |
|--|------------|-----------|

TERRA INDUSTRIES INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

SIX MONTHS ENDED JUNE 30, 2004 AND 2003

(in thousands)

(unaudited)

| | Capital Stock | Paid-In Capital | Accumulated Other Comprehensive Loss | Accumulated Deficit | Total |
|--|------------------|--------------------|---|------------------------|------------|
| Balance at January 1, 2004 | \$ 128,968 | \$ 555,529 | \$ (44,596) | \$ (374,770) | \$ 265,131 |
| Comprehensive income: | | | | | |
| Net income | | | | 36,095 | 36,095 |
| Foreign currency translation adjustment | | | 1,271 | | 1,271 |
| Change in fair value of derivatives, net of taxes of \$3,210 | | | (3,896) | | (3,896) |
| Comprehensive income | | | | | 33,470 |
| Exercise of stock options, net | 123 | 146 | | | 269 |
| Stock incentive plan | 3 | 9 | | | 12 |
| Balance at June 30, 2004 | \$ 129,094 | \$ 555,684 | \$ (47,221) | \$ (338,675) | \$ 298,882 |
| | | | | | |
| | Capital Stock | Paid-In Capital | Accumulated Other Comprehensive Loss | Accumulated Deficit | Total |
| Balance at January 1, 2003 | \$ 128,654 | \$ 555,167 | \$ (63,668) | \$ (362,289) | \$ 257,864 |
| Comprehensive loss: | | | | | |
| Net loss | | | | (45,433) | (45,433) |
| Foreign currency translation adjustment | | | 17,793 | | 17,793 |
| Change in fair value of derivatives, net of taxes of \$4,759 | | | (7,138) | | (7,138) |
| Minimum pension liability, net of taxes of \$580 | | | (1,178) | | (1,178) |
| Comprehensive loss | | | | | (35,956) |
| Exercise of stock options, net | 254 | 319 | | | 573 |
| Balance at June 30, 2003 | \$ 128,908 | \$ 555,486 | \$ (54,191) | \$ (407,722) | \$ 222,481 |

TERRA INDUSTRIES INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

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

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

The following table provides a reconciliation between basic and diluted earnings per share for the three and six months ended June 30, 2004 and 2003:

| (in thousands except per share amounts) | Three Months Ended | | Six Months Ended | |
|---|--------------------|-------------|------------------|-------------|
| | June 30, | | June 30, | |
| | 2004 | 2003 | 2004 | 2003 |
| Net Income (Loss) | \$ 17,865 | \$ (31,091) | \$ 36,095 | \$ (45,433) |
| Weighted average shares outstanding | 75,898 | 75,715 | 75,769 | 75,539 |
| Dilutive effect of stock options | 204 | | 117 | |
| Dilutive effect of restricted stock | 1,777 | | 1,777 | |
| Diluted weighted average shares outstanding | 77,879 | 75,715 | 77,663 | 75,539 |
| Earnings (loss) per share basic | \$ 0.24 | \$ (0.41) | \$ 0.48 | \$ (0.60) |
| Earnings (loss) per share diluted | \$ 0.23 | \$ (0.41) | \$ 0.46 | \$ (0.60) |

Common stock options totaling .1 million shares for the three and six months June 30, 2004 were excluded from the computation of diluted earnings per share because the exercise prices of these options exceeded the average market price of our stock for the respective periods, and the effect of their inclusion would be antidilutive.

Inventories consisted of the following:

| (in thousands) | June 30, 2004 | December 31, 2003 | June 30, 2003 |
|----------------|------------------|----------------------|------------------|
| Raw materials | \$ 23,652 | \$ 22,937 | \$ 16,751 |
| Supplies | 21,900 | 26,058 | 26,308 |
| Finished goods | 44,463 | 41,874 | 53,442 |
| Total | \$ 90,015 | \$ 90,869 | \$ 96,501 |

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

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

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

| (in thousands, except per-share amounts) | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|-------------------------------|-------------|-----------------------------|-------------|
| | 2004 | 2003 | 2004 | 2003 |
| Basic and diluted net income (loss) as reported | \$ 17,865 | \$ (31,091) | \$ 36,095 | \$ (45,433) |
| Basic and diluted net income (loss) pro forma | 17,865 | (31,091) | 36,095 | (45,433) |
| Basic net income (loss) per share as reported | 0.24 | (0.41) | \$ 0.48 | \$ (0.60) |
| Basic net income (loss) per share pro forma | 0.24 | (0.41) | 0.48 | (0.60) |
| Diluted net income (loss) per share as reported | \$ 0.23 | \$ (0.41) | \$ 0.46 | \$ (0.60) |
| Diluted net income (loss) per share pro forma | 0.23 | (0.41) | 0.46 | (0.60) |

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

We commenced a review to determine if the Blytheville facility's carrying value was impaired during the second quarter of 2003. This review led us to conclude that future market conditions would not justify the ongoing investment in maintenance and replacement capital necessary to extend operations for the remainder of the facility's useful life. Accordingly, a \$53.1 million charge was recorded as an Impairment of long-lived assets. Although we resumed production in October 2003, we ceased production on May 27, 2004 and prepared the site for permanent closure. No decision has yet been made regarding the sale or demolition of the facility's production plants. We are continuing to operate the facility's storage and distribution assets as a terminal for ammonia produced at our Verdigris facility or obtained from other sources. During the quarter ending June 30, 2004 we incurred \$1.6 million of costs not related to continuing terminal operations.

2. Product Claim Costs

Appeals of a Federal court decision ordering our insurer to pay all of our past and future judgments, settlements and other associated costs arising from a 1998 recall of carbonated beverages containing carbon dioxide tainted with benzene were exhausted in our favor during the 2004 first quarter. Consequently, we recorded in the 2004 first half recovery of product claim costs totaling \$17.9 million representing elimination of remaining reserves established for these claims of \$12.9 million and cash payments of \$5.1 million by the insurer as final settlement for claims we previously paid.

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

3. Derivative Financial Instruments

Natural gas is the principal raw material used in our production of nitrogen products and methanol. Natural gas prices are volatile and we manage this volatility through the use of derivative commodity instruments. Our current policy is to hedge 20-80% of our natural gas requirements for the upcoming 12 months and up to 50% of the requirements for the following 24-month period, provided that such arrangements would not result in costs greater than expected selling prices for our finished products. We notify the Board of Directors when we deviate from this policy. The financial derivatives are traded in months forward and settlement dates are scheduled to coincide with gas purchases during those future periods. These contracts reference physical natural gas prices or appropriate NYMEX futures contract prices. Contract prices are frequently based on prices at the most common and financially liquid location of reference for financial derivatives related to natural gas. However, natural gas supplies for our facilities are purchased for each plant at locations other than reference points, which often creates a location basis differential between the contract price and the physical price of natural gas. Accordingly, the use of financial derivatives may not exactly offset the change in the price of physical gas.

We have entered into forward pricing positions for a portion of our natural gas requirements for the remainder of 2004, consistent with our policy. As a result of our policies, we have reduced the potential adverse financial impact of natural gas price increases during the forward pricing period, but conversely, if natural gas prices were to fall, we will incur higher costs. Contracts were in place at June 30, 2004 to cover 22% of natural gas requirements for the succeeding twelve months. We also use basis swaps to manage some of the basis risk.

Unrealized losses from forward pricing positions in North America totaled \$.2 million as of June 30, 2004. We also had \$.6 million of realized gains on closed North America contracts relating to future periods that have been deferred to the respective period.

For the period ending June 30, 2004, recording the fair value of natural gas and fertilizer derivatives resulted in a \$6.9 million decrease to other current assets, a \$1.9 million increase to current liabilities, a \$1.7 million charge to cost of sales and a \$7.1 million increase, before deferred taxes of \$3.2 million to Accumulated Other Comprehensive Loss, which reflected the effective portion of the derivatives designated as cash flow hedges. The decrease to other current assets was to recognize the value of open natural gas contracts and the increase to other current liabilities was to reclassify deferred gains on closed contracts relating to future periods.

4. Industry Segment Data

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

The following summarizes operating results by business segment:

| (in thousands) | Three Months Ended | | Six Months Ended | |
|-------------------------------------|--------------------|-------------|------------------|-------------|
| | June 30 | | June 30 | |
| | 2004 | 2003 | 2004 | 2003 |
| Revenues | | | | |
| Nitrogen Products | \$ 362,518 | \$ 315,744 | \$ 680,075 | \$ 544,285 |
| Methanol | 53,746 | 62,853 | 96,650 | 113,967 |
| Other | 504 | 348 | 1,072 | 836 |
| Total revenues | \$ 416,768 | \$ 378,945 | \$ 777,797 | \$ 659,088 |
| Income (loss) from operations | | | | |
| Nitrogen Products | \$ 42,012 | \$ (47,554) | \$ 91,430 | \$ (61,112) |
| Methanol | (924) | 3,109 | (2,970) | 4,742 |
| Other | (1,804) | (1,465) | (3,589) | (2,798) |
| Total income (loss) from operations | \$ 39,284 | \$ (45,910) | \$ 84,871 | \$ (59,168) |

- We maintain defined benefit pension plans that cover substantially all salaried and hourly employees hired prior to January 1, 2004. 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 | | Six Months Ended | |
|------------------------------------|--------------------|----------|------------------|----------|
| | June 30 | | June 30 | |
| | 2004 | 2003 | 2004 | 2003 |
| Service cost | \$ 502 | \$ 1,024 | \$ 1,004 | \$ 2,048 |
| Interest cost | 3,754 | 2,733 | 7,508 | 5,466 |
| Expected return on plan assets | (3,065) | (2,537) | (6,130) | (5,074) |
| Amortization of prior service cost | 7 | 19 | 14 | 38 |
| Amortization of actuarial loss | 1,191 | 1,022 | 2,382 | 2,044 |
| Amortization of net assets | (28) | (77) | (58) | (154) |
| Termination charge | | 384 | | 768 |
| Pension Expense | \$ 2,361 | \$ 2,568 | \$ 4,720 | \$ 5,136 |

Our cash contributions to the defined benefit pension plans for the three month periods ended June 30, 2004 and 2003 were \$4.3 million and \$1.6 million, respectively. Year-to-date contributions were \$5.9 million and \$3.1 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 ending June 30, 2004 and 2003 totaled \$2.6 million and \$.4 million, respectively. Contributions were \$3.4 million and \$.7 million for the six months ended June 30, 2004 and 2003, respectively.

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

In May 2004, the FASB issued FSP FAS 106-2 to provide guidance on accounting for the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act), to the employers that sponsor postretirement health care plans which provide prescription drug benefits. This FSP supersedes FSP FAS 106-1, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003.

FSP FAS 106-2 applies only to sponsors of single-employer defined benefit postretirement health care plans for which (1) the employer has concluded that prescription drug benefits available under the plan to some or all participants, for some or all future years, are actuarially equivalent to Medicare Part D and thus qualify for the subsidy provided by the Act, and (2) the expected subsidy will offset or reduce the employer's share of the cost of the underlying postretirement prescription drug coverage on which the subsidy is based. The FSP provides guidance on measuring the accumulated postretirement benefit obligation (APBO) and net periodic postretirement benefit cost, and the effects of the Act on APBO. In addition, the FSP addresses accounting for plan amendments and requires certain disclosures about the Act and its effects in financial statements.

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This FSP is effective for the first interim or annual period beginning after June 15, 2004.

6. Guarantor Subsidiaries

Condensed consolidating financial statements of Terra Industries Inc. (the Parent), Terra Capital, Inc. (TCAPI), the Guarantor Subsidiaries and subsidiaries of the Parent that are not guarantors of the Senior Secured Notes due 2008 for June 30, 2004, December 31 and June 30, 2003 and condensed statements of operations and cash flows for the six months ended June 30, 2004 and 2003 are presented below for purposes of complying with the reporting requirements of the Guarantor Subsidiaries.

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

Condensed Consolidating Statement of Financial Position as of June 30, 2004:

| (in thousands) | Parent | TCAPI | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|--|------------|------------|---------------------------|-------------------------------|----------------|--------------|
| Assets | | | | | | |
| Cash and short-term investments | \$ | \$ 109,896 | \$ 88 | \$ 960 | \$ | \$ 110,944 |
| Accounts receivable, net | | 15 | 44,487 | 84,912 | | 129,414 |
| Inventories | | | 25,391 | 64,624 | | 90,015 |
| Other current assets | 2,592 | 18,852 | 6,546 | 8,749 | | 36,739 |
| Total current assets | 2,592 | 128,763 | 76,512 | 159,245 | | 367,112 |
| Property, plant and equipment, net | | | 323,076 | 355,993 | (1,801) | 677,268 |
| Investments in and advanced to (from) affiliates | 414,967 | 416,798 | 1,285,102 | 112,133 | (2,229,000) | |
| Other assets and deferred plant turnaround costs | (445) | 16,554 | 5,635 | 24,900 | 801 | 47,445 |
| Total assets | \$ 417,114 | \$ 562,115 | \$ 1,690,325 | \$ 652,271 | \$ (2,230,000) | \$ 1,091,825 |
| Liabilities | | | | | | |
| Debt due within one year | \$ | \$ | \$ 96 | \$ 61 | \$ | \$ 157 |
| Accounts payable | 56 | | 31,365 | 45,519 | | 76,940 |
| Accrued and other liabilities | (15,283) | 21,376 | 24,345 | 42,359 | | 72,797 |
| Total current liabilities | (15,227) | 21,376 | 55,806 | 87,939 | | 149,894 |
| Long-term debt and capital lease obligations | | 402,000 | 79 | 44 | | 402,123 |
| Deferred income taxes | 43,552 | | | (12,116) | | 31,436 |
| Pension and other liabilities | 89,907 | (278) | 21,566 | 5,041 | (1) | 116,235 |
| Minority interest | | 18,241 | 75,014 | | | 93,255 |
| Total liabilities | 118,232 | 441,339 | 152,465 | 80,908 | (1) | 792,943 |
| Stockholders' Equity | | | | | | |

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| | | | | | | |
|-----------------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| Common stock | 129,094 | | 72 | 49,709 | (49,781) | 129,094 |
| Paid-in capital | 555,684 | 150,218 | 1,774,243 | 680,836 | (2,605,297) | 555,684 |
| Accumulated other | | | | | | |
| comprehensive income (loss) | (47,221) | (47,221) | | 11,087 | 36,134 | (47,221) |
| Retained earnings (deficit) | (338,675) | 17,779 | (236,455) | (170,269) | 388,945 | (338,675) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total stockholders' equity | 298,882 | 120,776 | 1,537,860 | 571,363 | (2,229,999) | 298,882 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total liabilities and | | | | | | |
| stockholders' equity | \$ 417,114 | \$ 562,115 | \$ 1,690,325 | \$ 652,271 | \$ (2,230,000) | \$ 1,091,825 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

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Condensed Consolidating Statement of Operations for the three months ended June 30, 2004:

| (in thousands) | Parent | TCAPI | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|-----------|-----------|---------------------------|-------------------------------|--------------|--------------|
| Revenues | | | | | | |
| Net sales | \$ | \$ | \$ 164,520 | \$ 249,338 | \$ 2,406 | \$ 416,264 |
| Other income, net | | | 2,722 | 188 | (2,406) | 504 |
| | | | 167,242 | 249,526 | | 416,768 |
| Cost and Expenses | | | | | | |
| Cost of sales | | | 154,411 | 216,951 | (784) | 370,578 |
| Selling, general and administrative expenses | 925 | (914) | 5,936 | 2,567 | 781 | 9,295 |
| Recovery of product claims costs | | | | (2,389) | | (2,389) |
| Equity in the (earnings) loss of subsidiaries | (16,080) | (28,246) | (1) | | 44,327 | |
| | (15,155) | (29,160) | 160,346 | 217,129 | 44,324 | 377,484 |
| Income from operations | 15,155 | 29,160 | 6,896 | 32,397 | (44,324) | 39,284 |
| Interest income | | 279 | 997 | 415 | (1,079) | 612 |
| Interest expense | (770) | (12,662) | (8) | (1,095) | 1,095 | (13,440) |
| Minority interest | | (697) | (2,869) | | | (3,566) |
| Income before income taxes | 14,385 | 16,080 | 5,016 | 31,717 | (44,308) | 22,890 |
| Income tax provision | 3,480 | | | (8,506) | | (5,025) |
| Net Income (Loss) | \$ 17,865 | \$ 16,080 | \$ 5,016 | \$ 23,211 | \$ (44,307) | \$ 17,865 |

Condensed Consolidating Statement of Operations for the six months ended June 30, 2004:

| (in thousands) | Parent | TCAPI | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|----------|----------|---------------------------|-------------------------------|--------------|--------------|
| Revenues | | | | | | |
| Net sales | \$ | \$ | \$ 277,008 | \$ 495,647 | \$ 4,070 | \$ 776,725 |
| Other income, net | | | 4,849 | 293 | (4,070) | 1,072 |
| | | | 281,857 | 495,940 | | 777,797 |
| Cost and Expenses | | | | | | |
| Cost of sales | | | 265,260 | 429,128 | (163) | 694,225 |
| Selling, general and administrative expenses | 1,831 | (1,405) | 10,655 | 5,167 | 356 | 16,604 |
| Recovery of product claims costs | | | | (17,903) | | (17,903) |
| Equity in the (earnings) loss of subsidiaries | (41,749) | (66,358) | (861) | | 108,968 | |

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| | (39,918) | (67,763) | 275,054 | 416,392 | 109,161 | 692,926 |
|----------------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Income from operations | 39,918 | 67,763 | 6,803 | 79,548 | (109,161) | 84,871 |
| Interest income | | 640 | 1,969 | 588 | (2,208) | 989 |
| Interest expense | (1,539) | (25,383) | (16) | (2,243) | 2,240 | (26,941) |
| Minority interest | | (1,271) | (5,228) | | | (6,499) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Income before income taxes | 38,379 | 41,749 | 3,528 | 77,893 | (109,129) | 52,420 |
| Income tax provision | (2,284) | | | (14,041) | | (16,325) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Net Income | \$ 36,095 | \$ 41,749 | \$ 3,528 | \$ 63,852 | \$ (109,129) | \$ 36,095 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

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Condensed Consolidating Statement of Cash Flows for the six months ended June 30, 2004:

| (in thousands) | Parent | TCAPI | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|--|-----------------|-------------------|---------------------------|-------------------------------|------------------|-------------------|
| Operating Activities | | | | | | |
| Net income | \$ 36,095 | \$ 41,749 | \$ 3,528 | \$ 63,852 | \$ (109,129) | \$ 36,095 |
| Adjustments to reconcile net income to net cash flows from operating activities: | | | | | | |
| Depreciation and amortization | | 2,096 | 23,517 | 24,871 | | 50,484 |
| Deferred income taxes | 13,273 | | | 332 | 2,921 | 16,526 |
| Minority interest in earnings | | 1,271 | 5,228 | | | 6,499 |
| Recovery of product claim costs | | | | (12,874) | | (12,874) |
| Equity in earnings (loss) of subsidiaries | 41,749 | 66,358 | 861 | | (108,968) | |
| Change in operating assets and liabilities | (12,579) | (15,279) | 6,461 | (32,938) | (10,984) | (65,319) |
| Other | | | | | 131 | 131 |
| Net Cash Flows from Operating Activities | 78,538 | 96,195 | 39,595 | 43,243 | (226,029) | 31,542 |
| Investing Activities | | | | | | |
| Purchase of property, plant and equipment | | | (412) | (3,013) | | (3,425) |
| Plant turnaround costs | | | (666) | (153) | | (819) |
| Other | 457 | (1) | (4,186) | (7,154) | 9,458 | (1,426) |
| Net Cash Flows from Investing Activities | 457 | (1) | (5,264) | (10,320) | 9,458 | (5,670) |
| Financing Activities | | | | | | |
| Principal payments on long-term debt and capital lease obligations | | | (50) | (29) | | (79) |
| Change in investments and advances from (to) affiliates | (79,264) | (60,479) | (38,076) | (38,898) | 216,717 | |
| Stock issuance, net | 269 | | | | | 269 |
| Distributions to minority interests | | (450) | (1,856) | | | (2,306) |
| Net Cash Flows from Financing Activities | (78,995) | (60,929) | (39,982) | (38,927) | 216,717 | (2,116) |
| Effect of Foreign Exchange Rate on Cash | | | | | | |
| | | | | | (146) | (146) |
| Increase (decrease) in Cash and Short-term Investments | | 35,265 | (5,651) | (6,004) | | 23,610 |
| Cash and Short-term Investments at Beginning of Year | | 74,631 | 5,739 | 6,964 | | 87,334 |
| Cash and Short-term Investments at End of Year | \$ | \$ 109,896 | \$ 88 | \$ 960 | \$ | \$ 110,944 |

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

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

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Condensed Consolidating Statement of Financial Position as of June 30, 2003:

| (in thousands) | Parent | TCAPI | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|--|------------|------------|---------------------------|-------------------------------|----------------|--------------|
| Assets | | | | | | |
| Cash and short-term investments | \$ | \$ 10,158 | \$ 1,774 | \$ 436 | \$ | \$ 12,368 |
| Accounts receivable, net | | (2) | 50,810 | 73,044 | | 123,852 |
| Inventories | | | 30,968 | 65,533 | | 96,501 |
| Other current assets | 2,925 | 2,965 | 4,809 | 10,764 | | 21,463 |
| Total current assets | 2,925 | 13,121 | 88,361 | 149,777 | | 254,184 |
| Property, plant and equipment, net | | | 364,224 | 370,272 | (9,199) | 725,297 |
| Investments in and advanced to (from) affiliates | 355,344 | 577,273 | 1,324,566 | (1,893) | (2,255,290) | |
| Other assets and deferred plant turnaround costs | (450) | 20,314 | 13,667 | 28,300 | 6,198 | 68,029 |
| Total assets | \$ 357,819 | \$ 610,708 | \$ 1,790,818 | \$ 546,456 | \$ (2,258,291) | \$ 1,047,510 |
| Liabilities | | | | | | |
| Debt due within one year | \$ | \$ | \$ 92 | \$ 57 | \$ | \$ 149 |
| Accounts payable | 26 | | 34,352 | 59,810 | | 94,188 |
| Accrued and other liabilities | 23,399 | 7,670 | 26,243 | 9,131 | | 66,443 |
| Total current liabilities | 23,425 | 7,670 | 60,687 | 68,998 | | 160,780 |
| Long-term debt and capital lease obligations | | 436,750 | 177 | 104 | | 437,031 |
| Deferred income taxes | 35,336 | 19,422 | | (22,302) | 1 | 32,457 |
| Pension and other liabilities | 76,577 | 12,828 | 2,414 | 17,932 | (1) | 109,750 |
| Minority interest | | 16,628 | 68,383 | | | 85,011 |
| Total liabilities | 135,338 | 493,298 | 131,661 | 64,732 | | 825,029 |
| Stockholders' Equity | | | | | | |
| Common stock | 128,908 | | 73 | 49,709 | (49,782) | 128,908 |
| Paid in capital | 555,486 | 150,218 | 1,812,918 | 719,365 | (2,682,501) | 555,486 |
| Accumulated other comprehensive loss | (54,191) | (23,250) | | (12,582) | 35,832 | (54,191) |
| Retained earnings (deficit) | (407,722) | (9,558) | (153,834) | (274,768) | 438,160 | (407,722) |
| Total stockholders' equity | 222,481 | 117,410 | 1,659,157 | 481,724 | (2,258,291) | 222,481 |
| Total liabilities and stockholders' equity | \$ 357,819 | \$ 610,708 | \$ 1,790,818 | \$ 546,456 | \$ (2,258,291) | \$ 1,047,510 |

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Condensed Consolidating Statement of Operations for the three months ended June 30, 2003:

| (in thousands) | Parent | TCAPI | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|-------------|-------------|---------------------------|-------------------------------|--------------|--------------|
| Revenues | | | | | | |
| Net sales | \$ | \$ | \$ 153,931 | \$ 224,423 | \$ 243 | \$ 378,597 |
| Other income, net | | | 448 | 143 | (243) | 348 |
| | | | 154,379 | 224,566 | | 378,945 |
| Cost and Expenses | | | | | | |
| Cost of sales | | | 150,186 | 213,145 | (1,300) | 362,031 |
| Selling, general and administrative expenses | 623 | (229) | 6,700 | 2,508 | 131 | 9,733 |
| Impairment of long-lived assets | | | 12,436 | 40,655 | | 53,091 |
| Equity in the (earnings) loss of subsidiaries | 80,474 | 63,714 | 29,195 | (337) | (173,046) | |
| | 81,097 | 63,485 | 198,517 | 255,971 | (174,215) | 424,855 |
| Income (loss) from operations | (81,097) | (63,485) | (44,138) | (31,405) | 174,215 | (45,910) |
| Interest income | 33 | 1,003 | 1,004 | 35 | (1,883) | 192 |
| Interest expense | (5,582) | (9,686) | (9) | (1,708) | 1,702 | (15,283) |
| Minority interest | | 2,142 | 8,808 | | | 10,950 |
| Income (loss) from operations | (86,646) | (70,026) | (34,335) | (33,078) | 174,034 | (50,051) |
| Income tax (provision) benefit | 22,177 | | | (3,217) | | 18,960 |
| Net income (loss) | \$ (64,469) | \$ (70,026) | \$ (34,335) | \$ (36,295) | \$ 174,034 | \$ (31,091) |

Condensed Consolidating Statement of Operations for the six months ended June 30, 2003:

| (in thousands) | Parent | TCAPI | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|--------|--------|---------------------------|-------------------------------|--------------|--------------|
| Revenues | | | | | | |
| Net sales | \$ | \$ | \$ 259,783 | \$ 396,971 | \$ 1,498 | \$ 658,252 |
| Other income, net | | | 2,073 | 261 | (1,498) | 836 |
| | | | 261,856 | 397,232 | | 659,088 |
| Cost and Expenses | | | | | | |
| Cost of sales | | | 260,039 | 388,321 | (2,255) | 646,105 |
| Selling, general and administrative expenses | 1,988 | (747) | 12,085 | 5,006 | 728 | 19,060 |
| Impairment of long-lived assets | | | 12,436 | 40,655 | | 53,091 |
| Equity in the (earnings) loss of subsidiaries | 63,785 | 52,249 | 17,931 | (255) | (133,710) | |

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| | 65,773 | 51,502 | 302,491 | 433,727 | (135,237) | 718,256 |
|--------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Income (loss) from operations | (65,773) | (51,502) | (40,635) | (36,495) | 135,237 | (59,168) |
| Interest income | 47 | 1,723 | 2,005 | 90 | (3,484) | 381 |
| Interest expense | (11,322) | (16,484) | (21) | (3,486) | 3,478 | (27,835) |
| Minority interest | | 2,478 | 10,190 | | | 12,668 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Income (loss) from operations | (77,048) | (63,785) | (28,461) | (39,891) | 135,231 | (73,954) |
| Income tax (provision) benefit | 31,615 | | | (3,094) | | 28,521 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Net income (loss) | \$ (45,433) | \$ (63,785) | \$ (28,461) | \$ (42,985) | \$ 135,231 | \$ (45,433) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

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Condensed Consolidating Statement of Cash Flows for the six months ended June 30, 2003:

| (in thousands) | Parent | TCAPI | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|--|------------------|------------------|---------------------------|-------------------------------|------------------|-----------------|
| Operating Activities | | | | | | |
| Net income (loss) | \$ (45,433) | \$ (63,785) | \$ (28,461) | \$ (42,985) | \$ 135,231 | \$ (45,433) |
| Adjustments to reconcile net loss to net cash flows from operating activities: | | | | | | |
| Impairment of long-lived assets | | | 12,436 | 40,655 | | 53,091 |
| Depreciation and amortization | | 1,708 | 25,522 | 28,318 | | 55,548 |
| Deferred income taxes | (34,818) | | | (5,474) | 7,148 | (33,144) |
| Minority interest in losses | | (2,478) | (10,190) | | | (12,668) |
| Equity in earnings (loss) of subsidiaries | (63,785) | (52,249) | (17,931) | 255 | 133,710 | |
| Change in operating assets and liabilities | 4,915 | (1,868) | (98,164) | (24,878) | 55,775 | (64,220) |
| Other | | 2 | | | 343 | 345 |
| Net Cash Flows from Operating Activities | (139,121) | (118,670) | (116,788) | (4,109) | 332,207 | (46,481) |
| Investing Activities | | | | | | |
| Purchase of property, plant and equipment | | | (2,098) | (3,763) | | (5,861) |
| Plant turnaround costs | | | (6,316) | (14,005) | | (20,321) |
| Other | | | | | (1,122) | (1,122) |
| Net Cash Flows from Investing Activities | | | (8,414) | (17,768) | (1,122) | (27,304) |
| Financing Activities | | | | | | |
| Issuance of long-term debt | | 236,750 | | | | 236,750 |
| Principal payments on long-term debt and capital lease obligations | (200,000) | | (44) | (27) | | (200,071) |
| Change in investments and advances from (to) affiliates | 339,149 | (114,946) | 127,104 | (79,557) | (271,750) | |
| Deferred financing costs | | (8,138) | | | | (8,138) |
| Distributions to minority interests | | (225) | (928) | | | (1,153) |
| Other | (29) | (1) | 844 | (7,283) | 6,469 | |
| Net Cash Flows from Financing Activities | 139,120 | 113,440 | 126,976 | (86,867) | (265,281) | 27,388 |
| Effect of Foreign Exchange Rate on Cash | | | | | | |
| | | | | | 286 | 286 |
| Increase (decrease) in Cash and Short-term Investments | (1) | (5,230) | 1,774 | (108,744) | 66,090 | (46,111) |
| Cash and Short-term Investments at Beginning of | 1 | 15,388 | | 109,180 | (66,090) | 58,479 |

| Year | | | | | | |
|--|----|-----------|----------|--------|----|-----------|
| Cash and Short-term Investments at End of Year | \$ | \$ 10,158 | \$ 1,174 | \$ 436 | \$ | \$ 12,368 |

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

Introduction

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

Natural gas is the most significant raw material in the production of nitrogen products. North American natural gas costs have increased substantially since 1999. Since we compete with nitrogen products imported from regions with lower natural gas costs, the oversupply situation during most of the three years ended December 31, 2002 did not allow us and other North American producers to increase selling prices to levels necessary to cover the natural gas cost increases. This resulted in curtailments of North American nitrogen production by us and other producers that have contributed to higher nitrogen product prices through reductions to global supplies. Our United Kingdom operations have benefited from higher nitrogen product prices, but generally incurred natural gas costs lower than those in North America.

Imports, most of which are produced at facilities with access to fixed-price natural gas supplies, account for a significant portion of U.S. nitrogen product supply. Imported products' natural gas costs have been and could continue to be substantially lower than the delivered cost of natural gas to our facilities. Off-shore producers are most competitive in regions close to the point of entry for imports, including the Gulf Coast and East Coast of North America.

Our sales volumes depend primarily on our plants' operating rates. We may purchase product from other manufacturers or importers for resale, but gross margins on those volumes are rarely significant. Profitability and cash flows from our nitrogen products business are affected by our ability to manage our costs and expenses (other than natural gas), most of which do not materially change for different levels of production or sales. Other factors affecting our nitrogen products results include the level of planted acres, transportation costs, weather conditions (particularly during the planting season), grain prices and other variables described in Items 1 and 2' Business and Properties' section of our most recent Form 10-K filing with the Securities and Exchange Commission.

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

In December 2003, we entered into contracts with the Methanex Corporation (Methanex) assigning it our sales contracts and providing it exclusive rights to all methanol production at the Beaumont facility for five years as more fully described in Items 1 and 2' Business and Properties' most recent Form 10-K

filing with the Securities and Exchange Commission. Under those contracts, Methanex has the right to terminate Beaumont production and we would be responsible for costs of shutting down the facility, which we estimate at \$5 million to \$7 million.

Critical Accounting Policies

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

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

Impairment of Long-Lived Assets

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

Pension Assets and Liabilities

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

Post-Retirement Benefits

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

Revenue Recognition

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

Deferred Income Taxes

Deferred income tax assets and liabilities reflect (a) differences between financial statement carrying amounts and corresponding tax bases and (b) temporary differences resulting from differing treatment of items for tax and accounting purposes. Deferred tax assets also include the expected benefits of carrying forward our net operating losses. We regularly review deferred tax assets for recoverability and reduce them if we cannot sufficiently determine that they will be realized. We base this determination on

projected future taxable income and the expected timing of the reversals of existing temporary differences. We do not expect to recognize additional U.S. tax benefits for future losses until we realize taxable income or generate additional deferred tax liabilities from U.S. operations. If there is a material change in the effective tax rates or time period when temporary difference become taxable or deductible, we may have to additionally reduce all or a significant portion of our deferred tax assets.

Inventory Valuation

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

Derivative and Financial Instruments

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

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

RESULTS OF OPERATIONS

QUARTER ENDED JUNE 30, 2004 COMPARED WITH QUARTER ENDED JUNE 30, 2003

Consolidated Results

We reported net income of \$17.9 million for the 2004 second quarter compared with a 2003 loss of \$31.1 million. The 2003 net loss included a \$27 million loss for impairment of long-term assets (representing a \$53.1 million charge to operating income, less \$9.9 million allocated to minority interest and \$16.2 million of income tax benefit). The remaining increase in 2004 net income was primarily related to higher margins on nitrogen product sales.

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

represents wholesale sales of methanol produced by Terra's two methanol manufacturing plants.

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Total revenues and operating income (loss) by segment for the three-month period ended June 30, 2004 and 2003 follow:

| (in thousands) | 2004 | 2003 |
|---|-------------------|--------------------|
| REVENUES: | | |
| Nitrogen Products | \$ 362,518 | \$ 315,744 |
| Methanol | 53,746 | 62,853 |
| Other | 504 | 348 |
| | \$ 416,768 | \$ 378,945 |
| OPERATING INCOME (LOSS): | | |
| Nitrogen Products | \$ 42,012 | \$ 5,537 |
| Impairment of long-lived assets (nitrogen products) | | (53,091) |
| Methanol | (924) | 3,109 |
| Other income - net | (1,804) | (1,465) |
| | \$ 39,284 | \$ (45,910) |

Nitrogen Products

Volumes and prices for the three-month periods ended June 30, 2004 and 2003 follow:

| (quantities in thousands of tons) | 2004 | | 2003 | |
|-----------------------------------|---------------|---------------------|---------------|---------------------|
| | Sales Volumes | Average Unit Price* | Sales Volumes | Average Unit Price* |
| Ammonia | 452 | \$ 248 | 400 | \$ 238 |
| Nitrogen solutions | 1,108 | 126 | 1,093 | 104 |
| Urea | 135 | 183 | 172 | 178 |
| Ammonium nitrate | 176 | 173 | 169 | 137 |

* After deducting outbound freight costs

Nitrogen products segment revenues increased \$46.8 million to \$362.5 million in the 2004 second quarter compared with \$315.7 million in the 2003 second quarter primarily as a result of higher sales prices. Sales prices were higher as the result of increased demand and lower supplies caused by curtailments to North American production in response to high natural gas costs.

Excluding 2003 charges for impairment of long-lived assets, the nitrogen products segment had operating income of \$42.1 million for the 2004 second quarter compared with operating income of \$5.5 million for the 2003 period. As compared to last year's second quarter, higher selling prices contributed almost \$36.4 million to 2004 gross profits. In addition, recovery of product claim costs contributed \$2.4 million to 2004 second quarter operating income. Second quarter natural gas costs increased about \$13.5 million from the 2003 second quarter, but much of this was offset by higher operating rates and lower fixed cost spending at production sites. Natural gas unit costs, net of forward pricing gains and losses, were \$5.17/MMBtu during the 2004 second quarter compared to \$4.76/MMBtu during the same 2003 period. As a result of forward price

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contracts, second quarter 2004 natural gas costs for the nitrogen products segment were \$6.3 million lower than spot prices.

Impairment of Long-lived Assets

On June 26, 2003, we suspended production at our Blytheville facility due to expectations that the facility would not cover its cash costs because of continuing high natural gas costs and the seasonal decline in nitrogen fertilizer demand and prices. In response to this action and as required by Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, a \$53.1 million charge was recorded during the 2003 second quarter. On May 26, 2004 the Blytheville production facility was permanently shutdown. During the 2004 second quarter we incurred \$1.6 million of costs not related to continuing terminal operations.

Methanol

For the three months ended June 30, 2004 and 2003 the Methanol segment had revenues of \$53.7 million and \$62.9 million, respectively. Sales volumes declined 9% from prior year levels and selling prices declined from \$.77/gallon in 2003 to \$.70/gallon in 2004. Sales volumes declined in 2004 as we discontinued selling product purchased from other manufacturers. Selling prices declined primarily because of increased industry supplies.

The methanol segment had an operating loss of \$.9 million for the 2004 second quarter compared to operating income of \$3.1 million for the 2003 second quarter. The operating income decrease reflected lower sales prices and increased natural gas costs. Natural gas costs, net of forward pricing gains and losses, were \$5.83/MMBtu during the 2004 second quarter compared to \$5.27/MMBtu during the 2003 period.

Other Income Net

We had other operating losses of \$1.8 million in the 2004 second quarter compared to \$1.5 million operating loss in the 2003 second quarter. The increase to expenses relates primarily to legal and administrative expenses related to corporate activities not assignable to either business segment.

Interest Expense - Net

Interest expense, net of interest income, totaled \$12.8 million during the 2004 second quarter compared with \$15.1 million for the prior year period. The reduction to interest expense reflects \$1.7 million of 2003 interest expense due to the issuance of the new debt.

Minority Interest

Minority interest represents third-party interests in the earnings of the publicly held common units of Terra Nitrogen Company, L.P. (TNCLP). The 2004 and 2003 amounts are directly related to TNCLP earnings and losses.

Income Taxes

Income taxes for the second quarter 2004 were recorded based on the estimated annual effective tax rate for the individual jurisdictions in which we operate.

RESULTS OF OPERATIONS**SIX MONTHS ENDED JUNE 30, 2004 COMPARED WITH SIX MONTHS ENDED JUNE 30, 2003****Consolidated Results**

We reported net income of \$36.1 million for the first six months ending June 30, 2004 compared with a net loss of \$45.4 million for the same period in 2003. The 2003 net loss included a \$27 million loss for impairment of long-term assets (representing a \$53.1 million charge to operating income, less \$9.9 million allocated to minority interest and \$16.2 million of income tax benefit). The remaining increase in 2004 net income was primarily related to higher margins on nitrogen product sales and \$12.2 million as the after-tax value from recovery of product claim costs.

Total revenues and operating income (loss) by segment for the six-month period ended June 30, 2004 and 2003 follow:

| (in thousands) | 2004 | 2003 |
|---|-------------------|--------------------|
| REVENUES: | | |
| Nitrogen Products | \$ 680,075 | \$ 544,285 |
| Methanol | 96,650 | 113,967 |
| Other | 1,072 | 836 |
| | \$ 777,797 | \$ 659,088 |
| OPERATING INCOME (LOSS): | | |
| Nitrogen Products | \$ 91,430 | \$ (8,021) |
| Impairment of long-lived assets (nitrogen products) | | (53,091) |
| Methanol | (2,970) | 4,742 |
| Other income - net | (3,589) | (2,798) |
| | \$ 84,871 | \$ (59,168) |

Nitrogen Products

Volumes and prices for the six-month periods ended June 30, 2004 and 2003 follow:

| | 2004 | | 2003 | |
|--|----------------|--------------------|----------------|--------------------|
| (quantities in thousands of tons) | Sales | Average | Sales | Average |
| | Volumes | Unit Price* | Volumes | Unit Price* |

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| | | | | |
|--------------------|-------|--------|-------|--------|
| Ammonia | 763 | \$ 257 | 678 | \$ 227 |
| Nitrogen solutions | 1,983 | 120 | 1,848 | 96 |
| Urea | 292 | 186 | 324 | 168 |
| Ammonium nitrate | 424 | 182 | 417 | 130 |

* After deducting outbound freight costs

Nitrogen products segment revenues increased \$135.8 million to \$680.1 million in the 2004 first half compared with \$544.3 million in the 2003 first half primarily as a result of higher sales prices and volumes. Sales prices were higher as the result of increased demand and lower supplies caused by curtailments to North American production in response to high natural gas costs. The increased sales volumes reflect higher operating rates during 2004 compared to 2003 when certain of our plants were curtailed in response to high natural gas costs.

Excluding 2003 charges for impairment of long-lived assets, the nitrogen products segment had operating income of \$91.4 million for the first half of 2004 compared with an operating loss of \$8.0 million for the 2003 first half. As compared to the 2003 first half, higher selling prices contributed almost \$97.7 million to 2004 gross profits. In addition, recovery of product claim costs contributed \$17.9 million to 2004 first half operating income. First half natural gas costs increased about \$26.1 million from the same period of 2003 but this was partially offset by higher operating rates and lower fixed cost spending at production sites. Natural gas unit costs, net of forward pricing gains and losses, were \$5.20/MMBtu during the 2004 first half compared to \$4.81/MMBtu during the same 2003 period. As a result of forward price contracts, first half 2004 natural gas costs for the nitrogen products segment were \$12.6 million lower than spot prices.

Impairment of Long-lived Assets

On June 26, 2003, we suspended production at our Blytheville facility due to expectations that the facility would not cover its cash costs because of continuing high natural gas costs and the seasonal decline in nitrogen fertilizer demand and prices. In response to this action and as required by Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, a \$53.1 million charge was recorded during the 2003 second quarter. On May 27, 2004 the Blytheville production facility was permanently shutdown. During the 2004 second quarter we incurred \$1.6 million of costs not related to continuing terminal operations.

Methanol

For the six months ended June 30, 2004 and 2003 the Methanol segment had revenues of \$96.7 million and \$114.0 million, respectively. Sales volumes declined 7% from prior year levels and selling prices declined from prices declined from \$.76/gallon in 2003 to \$.67/gallon in 2004. Sales volumes declined in 2004 as we discontinued selling product purchased from other manufacturers. Selling prices declined in response to increased industry supplies.

The methanol segment had an operating loss of \$3.0 million for the first six months of 2004 compared to operating income of \$4.7 million for the first six months of 2003. The decrease to operating income reflected lower sales prices and increased natural gas costs. Natural gas costs, net of forward pricing gains and losses, were \$5.61/MMBtu during the 2004 first half compared to \$5.39/MMBtu during the 2003 period.

Other Income Net

We had other operating losses of \$3.6 million in the 2004 first half compared to \$2.8 million operating loss in the 2003 first half. The increase to expenses relates primarily to legal and administrative expenses related to corporate activities not assignable to either business segment.

Interest Expense - Net

Interest expense, net of interest income, totaled \$26.0 million during the first six months of 2004 compared with \$27.5 million for the prior year period. The reduction to interest expense included \$1.7 million of 2003 interest expense due to the issuance of the new debt and higher 2004 interest income as the result of increased average cash balances.

Minority Interest

Minority interest represents third-party interests in the earnings of the publicly held common units of Terra Nitrogen Company, L.P. (TNCLP). The 2004 and 2003 amounts are directly related to TNCLP earnings and losses.

Income Taxes

Income taxes for the first half of 2004 were recorded based on the estimated annual effective tax rate for the individual jurisdictions in which we operate.

LIQUIDITY AND CAPITAL RESOURCES

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

Net cash provided from operations in the first six months of 2004 was \$31.5 million, composed of \$96.7 million of cash provided from operating activities, net of \$65.2 million used to fund working capital needs. Working capital needs primarily consisted of product shipments against \$71.9 million in customer prepayments that had been received at year-end.

During the first six months, we funded plant and equipment purchases of \$3.4 million primarily for replacement or stay-in-business capital needs. We expect 2004 plant and equipment purchases to approximate \$20 million consisting primarily of expenditures for replacement of equipment at manufacturing facilities.

Plant turnaround costs represent cash used for the periodic scheduled major maintenance of our continuous process production facilities that is performed at each plant generally every two years. We funded \$.8 million of plant turnaround costs in the first six months of 2004. We estimate 2004 plant turnaround costs will approximate \$30 million.

We have a \$175 million revolving credit facility that expires in June 2005. Borrowing availability under the credit facility is generally based on eligible cash balances, 85% of eligible accounts receivable and 60% of eligible inventory, less outstanding letters of credit. There were no revolving credit borrowings and there were \$31.0 million in outstanding letters of credit under the facility at June 30, 2004. Our remaining borrowing availability under the facility was approximately \$144.0 million. We are required to maintain a minimum unused borrowing availability of \$30 million. The credit facility also requires that we adhere to certain limitations on additional debt, capital expenditures, acquisitions, liens, asset sales, investments, prepayments of subordinated indebtedness, changes in lines of business and transactions with affiliates. In addition, if our borrowing availability falls below \$60 million, we are required to have generated \$60 million of operating cash flows, or earnings before interest, income taxes, depreciation, amortization and other non-cash items (as defined in the credit facility) for the preceding four quarters. The amount of operating cash flows to measure credit facility compliance is different than amounts that can be derived from our financial statements. For the 12 months ended June 30, 2004, operating cash flows as defined in the credit facility was \$203.6 million.

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Our ability to meet credit facility covenants will depend on future operating cash flows, working capital needs, receipt of customer prepayments and trade credit terms. Failure to meet these covenants could result in additional costs and fees to amend the credit facility or could result in termination of the facility. Access to adequate bank facilities is critical to funding our operating cash needs. Based on current market

conditions for our finished products and natural gas, we anticipate that we will be able to meet our covenants through 2004. If there were to be any adverse changes in the factors discussed above, we may need a waiver of our credit facility covenants and there is no assurance we could receive such waivers.

Our cash contributions to pension plans are estimated at \$17 million in 2004, \$15 million in 2005 and \$7 million in 2006. Actual contributions could vary from these estimates depending on actual returns for plan assets, legislative changes to pension funding requirements and/or plan amendments.

Distributions paid to the minority TNCLP common unitholders in the first six months of 2004 and 2003 were \$2.3 million. TNCLP distributions are based on Available Cash (as defined in the Partnership Agreement).

Cash balances at June 30, 2004 were \$110.9 million, all of which is unrestricted.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Our operations are significantly affected by the price of natural gas. We employ derivative commodity instruments related to a portion of our natural gas requirements (primarily futures, swaps and options) for the purpose of managing our exposure to commodity price risk in the purchase of natural gas. Changes in the market value of these derivative instruments have a high correlation to changes in the spot price of natural gas. The volume of natural gas hedged varies from time to time based on management's judgment of market conditions, particularly natural gas prices and prices for nitrogen products and methanol. Contracts were in place at June 30, 2004 to cover 22% of our natural gas requirements for the succeeding twelve months (see Note 3). Our future ability to manage our exposure to commodity price risk in the purchase of natural gas through the use of financial derivatives may be affected by limitations imposed by our bank agreement covenants.

At June 30, 2004, we had no forward positions in any foreign currency.

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

ITEM 4. CONTROLS AND PROCEDURES

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

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

POTENTIAL CHANGE OF CONTROL

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

FORWARD-LOOKING PRECAUTIONS

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

PART II. OTHER INFORMATION

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

The 2004 Annual Meeting of stockholders was held on May 4, 2004, in New York, New York. At the meeting, a total of 77,394,304 votes were cast by stockholders.

The following directors were elected to hold office until the next Annual Meeting or until their successors are duly elected and qualified, and received the votes set forth opposite their respective name:

| NAME | FOR | WITHHELD |
|--------------------|------------|-----------------|
| Philip M. Baum | 72,907,616 | 486,688 |
| Michael L. Bennett | 72,796,057 | 598,247 |
| David E. Fisher | 72,588,937 | 805,367 |
| Dod A. Fraser | 72,681,576 | 712,728 |
| Martha O. Hesse | 72,681,294 | 713,010 |
| Ben L. Keisler | 72,899,766 | 494,538 |
| Henry R. Slack | 72,816,752 | 577,552 |

The stockholders ratified the selection by the Corporation's Board of Directors of Deloitte & Touche, LLP as independent accountants for the Corporation for 2004. The number of votes cast for such proposal was 72,189,969, the number against was 490,662, and the number of abstentions was 713,673.

ITEM 5. OTHER INFORMATION

As announced in a press release filed earlier today as an exhibit to Form 8-K, Terra Industries Inc. and Mississippi Chemical Corporation have reached an agreement under which Terra Industries will acquire all of the outstanding shares of Mississippi Chemical Corporation.

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

(a) Exhibits

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

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

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

(b) Reports on Form 8-K

Form 8-K dated April 29, 2004 furnishing under Item 12 Terra's first quarter 2004 earnings.

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: August 9, 2004

/s/ Francis G. Meyer

Francis G. Meyer
Senior Vice President and Chief Financial

Officer and a duly authorized signatory