

LSB INDUSTRIES INC
Form POS AM
March 28, 2008
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As filed with the Securities and Exchange Commission on March 28, 2008

Registration No. 333-145721

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Post Effective Amendment No. 1
to
FORM S-1
REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

LSB INDUSTRIES, INC.

(Exact Name of Registrant)

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DELAWARE (State or other jurisdiction of incorporation or organization)	2810 (Primary Standard Industrial Classification Code Number) 16 South Pennsylvania Avenue	73-1015226 (I.R.S. Employer Identification Number)
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Oklahoma City, Oklahoma 73107

(405) 235-4546

(Address, including zip code, and telephone number of registrant's principal executive offices)

David M. Shear, Esq.

Senior Vice President and General Counsel

LSB Industries, Inc.

16 South Pennsylvania Avenue Oklahoma City, Oklahoma 73107

(405) 235-4546

(Name, address, including zip code and telephone number, including area code of Agent for Service)

COPIES TO:

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Oklahoma City, Oklahoma 73102

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Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this Registration Statement.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933 check the following box:

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

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If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

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EXPLANATORY NOTE

This Post-Effective Amendment No. 1 to the Registration Statement, file no. 333-145721, is filed to incorporate by reference the following information that we previously filed with the Securities and Exchange Commission:

Our 2007 Annual Report on Form 10-K, for the fiscal year ended December 31, 2007, filed March 14, 2008, as amended by our Amendment Number 1 to Annual Report on Form 10-K/A, filed March 27, 2008, which includes, without limitation, information with respect to our business, properties, legal proceedings, certain stockholder matters, financial statements, selected financial data, supplementary financial information, management's discussion and analysis of financial condition and results of operations, dividend policy, and quantitative and qualitative disclosures about market risk; and

Our Current Reports on Form 8-K filed on March 14, and March 27, 2008.

Statements contained in the foregoing may be modified by the terms of this Registration Statement. See Incorporation by Reference.

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The information in this prospectus is not complete and may be changed. The selling security holders may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED MARCH 28, 2008

PROSPECTUS

LSB INDUSTRIES, INC.

\$60 million/5.5% Convertible Senior Subordinated Debentures Due 2012

2,296,500 Shares of Common Stock

The debentures and shares of our common stock will be offered and sold by the selling security holders named in this prospectus or in any amendment or supplement to this prospectus. See **Selling Security Holders** beginning on page 35. The shares of common stock included in this prospectus are comprised of the following:

2,184,000 shares issuable upon conversion of \$60 million aggregate principal amount of our debentures based upon the initial conversion rate of 36.4 shares per \$1,000 principal amount of debentures (representing a conversion price of approximately \$27.47 per share). See **Description of Debentures-Conversion of debentures**, and

112,500 shares issued to Jayhawk Institutional Partners, L.P. (**Jayhawk Institutional**) upon the exercise of warrants at an exercise price of \$3.49 per share.

We will not receive any of the proceeds from the sale by the selling security holders of these securities, but did receive \$392,625 in total proceeds upon the exercise of such warrants issued to Jayhawk Institutional. See **Risk Factors** contained herein as to certain matters relating to Jayhawk Institutional.

The debentures bear interest at the rate of 5.5% per year, and interest is payable on July 1 and January 1 of each year, beginning on January 1, 2008. The debentures are convertible in whole or in part at any time prior to their maturity by holders into shares of our common stock at a conversion rate of 36.4 shares per \$1,000 principal amount of debentures, representing a conversion price of \$27.47 per share (subject to adjustment in certain circumstances). The debentures will mature on July 1, 2012, unless earlier converted or repurchased by us.

Our common stock is listed on the American Stock Exchange (**AMEX**) under the symbol **LXU**. The last reported sale price of our common stock on the AMEX on March 24, 2008 was \$15.52 per share. There is no established market for the debentures and we do not intend to apply for listing of the debentures on any securities exchange or for quotation of the debentures through any automated quotation system.

The selling security holders may sell the securities offered by this prospectus from time to time on any exchange on which the securities are listed. They may also sell the securities in private sales or through dealers or agents. The selling security holders may sell the securities at prevailing market prices or at prices negotiated with buyers. The selling security holders will be responsible for any commissions due to brokers, dealers or agents. We will pay all expenses of the registration of the debentures and the common stock and certain other expenses as set forth in the registration rights agreement described in this prospectus.

Investing in the debentures or in our common stock involves risks.

See **Risk Factors** beginning on page 4.

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Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy of this prospectus. Any representation to the contrary is a criminal offense.

The date of this prospectus is [] [], 2008.

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ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we have filed with the Securities and Exchange Commission. The securities described in this prospectus may be offered and sold by the selling security holders using this prospectus from time to time as described in the Plan of Distribution beginning on page 39. You should carefully read this prospectus and the information described under the heading Incorporation by Reference beginning on page 12 and Where You Can Find More Information on page 13.

You should rely only on the information contained in, or incorporated by reference in, this document. We have not authorized anyone to provide you with information that is different. This document may only be used where it is legal to sell these securities. The information in this document may only be accurate on the date of this document.

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PROSPECTUS SUMMARY

This summary highlights certain information concerning our business and this offering. It does not contain all of the information that may be important to you and to your investment decision and is qualified in its entirety by, and should be read in conjunction with, the more detailed information about us and the common stock in this prospectus, including the section entitled Risk Factors, along with our business information, our financial information and other documents incorporated by reference in this prospectus.

LSB Industries, Inc.

LSB Industries, Inc. (the Company, we, us, or our) was formed in 1968 as an Oklahoma corporation, and became a Delaware corporation in 1977. We are a diversified holding company operating through our subsidiaries. Our wholly-owned subsidiary, ThermaClima, Inc. (ThermaClima) through its subsidiaries, owns substantially all of our core businesses consisting of the:

Climate Control Business, which is engaged in the manufacturing and selling of a broad range of heating, ventilation and air conditioning products used in commercial and residential new building construction, renovation of existing buildings and replacement of existing systems; and

Chemical Business, which is engaged in the manufacturing and selling of chemical products produced from three plants in Texas, Arkansas and Alabama for the industrial, mining and agricultural markets.

Private Placement of Debentures

On June 28, 2007, we entered into a purchase agreement pursuant to which we sold \$60.0 million aggregate principal amount of our debentures in a private placement to qualified institutional buyers pursuant to the exemptions from the registration requirements of the Securities Act of 1933, as amended (the Securities Act), afforded by Section 4(2) of the Securities Act and Regulation D promulgated under the Securities Act. The debentures are convertible into a number of shares of our common stock at a conversion rate of 36.4 shares of common stock per \$1,000 principal amount of debentures, which is equivalent to an initial conversion price of approximately \$27.47 per share, subject to adjustment in certain circumstances. See Description of Debentures. The net proceeds received by us in connection with the private placement were approximately \$57 million, after discounts and commissions.

We agreed, pursuant to a registration rights agreement entered into in connection with such transaction, to register for resale by the debenture holders the debentures and shares of common stock issuable upon conversion of the debentures. This prospectus covers the resale by certain holders of such debentures and underlying common stock. See Description of Debentures Registration rights of the debenture holders.

In addition, this prospectus covers the resale of up to 112,500 shares of our common stock by one other selling security holder who exercised its right to participate in this offering pursuant to the time of a registration rights agreement that we have with this selling security holder. See Description of Capital Stock Registration rights.

Company Information

Our executive offices are located at 16 South Pennsylvania Avenue, Oklahoma City, Oklahoma 73107, telephone (405) 235-4546. Our Web site is located at www.lsb-okc.com. The information on our Web site is not part of this prospectus and should not be considered in your decision to invest in the debentures or our common stock.

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THE OFFERING

Issuer	LSB Industries, Inc.
Selling Security Holders	The securities to be offered and sold using this prospectus will be offered and sold by the selling security holders named in this prospectus, or in any amendment or supplement to this prospectus. See Selling Security Holders.
Securities covered by this prospectus	\$60,000,000 aggregate principal amount of 5.5% convertible senior subordinated debentures due 2012.
	2,296,500 shares of common stock, par value \$0.10 per share.
Maturity date of debentures	July 1, 2012
Interest on debentures	5.5% per annum on the principal amount, from June 28, 2007, payable semi-annually in arrears in cash on January 1 and July 1 of each year, beginning January 1, 2008.
Ranking of debentures	The debentures are unsecured and subordinated in right of payment to the prior payment in full of all of our existing and future senior indebtedness. The debentures are also subordinated to all other present or future liabilities, including trade payables, of our subsidiaries. As of December 31, 2007, we had approximately \$120.5 million of senior indebtedness outstanding, including approximately \$60.5 million of indebtedness of our subsidiaries which we have guaranteed, and our subsidiaries had other outstanding liabilities of approximately \$76.4. Therefore, as of December 31, 2007, the debentures are effectively subordinate to a total of approximately \$196.9 million of senior indebtedness, including the liabilities of our subsidiaries. See Risk Factors. Neither we nor our subsidiaries are prohibited from incurring additional debt, including senior indebtedness, under the indenture.
Conversion of debentures	The debentures are convertible by holders in whole or in part into shares of our common stock, at any time prior to their maturity on July 1, 2012. The conversion rate of debentures for holders electing to convert all or any portion of a debenture will be 36.4 shares per \$1,000 principal amount of debentures (representing a conversion price of \$27.47 per share). The conversion rate is subject to adjustment in certain circumstances. If a holder elects to convert its debentures in connection with certain changes in control, as defined herein, which occur prior to the maturity date, the holder will be entitled to receive additional shares of our common stock as a make-whole premium upon conversion under certain circumstances. See Description of Debentures-Conversion of debentures.
Sinking fund as to debentures	None.
Optional redemption of debentures	Beginning July 2, 2010, we may redeem the debentures either in whole or in part, upon at least 30 and not more than 60 days notice, at a redemption price, payable at our option in cash or, subject to certain conditions (see Payment of debentures in shares below), shares of our common stock, equal to 100% of the principal amount of the debentures to be redeemed, plus accrued and unpaid interest thereon to, but excluding, the redemption date, if: (1) the closing sale prices of our common stock for at least 20 of the 30 consecutive trading days ending on the trading day prior to the date we mail a notice of redemption, exceeds 115% of the adjusted conversion price of the debenture; (2) our common stock is listed on The New York Stock Exchange, the American Stock Exchange, The NASDAQ Global Select Market, the NASDAQ Global Market or the NASDAQ Capital Market (each, an Eligible Market), no suspension of trading thereof has occurred and no delisting or suspension of trading thereof is then pending or threatened; and (3) a shelf registration statement covering resales of the debentures and the common stock issuable upon conversion of the debentures is effective and expected to remain effective and available for use during the 30 days following

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the redemption date, unless registration is no longer required, and such shares of common stock may be issued without violating Section 713(a) of the Amex Company Guide or any successor provision thereof or, if our common stock is then traded on another Eligible Market, any similar rule of such market. See Description of Debenture Optional redemption by LSB.

Payment of debentures in shares

We may elect to pay the redemption price in shares of our common stock if, on the date of redemption: (1) our common stock is listed on an Eligible Market; (2) the shares used to pay the redemption price are freely tradeable; and (3) we receive certain required opinions of counsel. Payments made with shares of our common stock will be valued at 95% of the weighted average of the closing sale prices of our common stock for the 20 consecutive trading days ending on the fifth trading day prior to the redemption date. We will publicly announce the number of shares of our common stock to be paid as the redemption price, per each \$1,000 principal amount of debentures to be redeemed, not later than the fourth trading day prior to the redemption date.

We may elect to pay, at maturity, up to 50% of the principal amount of the debentures, plus accrued and unpaid interest due thereon at maturity, in shares of our common stock if, on the maturity date: (1) our common stock continues to be listed on an Eligible Market, (2) the shares used to pay the debentures and any interest thereon are freely tradeable, and (3) we receive certain required opinions of counsel. Payments made with our shares of common stock will be valued at 95% of the weighted average of the closing prices of our common stock for the 20 consecutive trading days ending on the fifth trading day prior to the maturity date. We will publicly announce the number of shares of our common stock to be paid per each \$1,000 principal amount of debentures on the maturity date, not later than the fourth trading day prior to the maturity date.

Repurchase of debentures at the option of the holder upon a designated event

If a designated event (as described under Description of Debentures-Repurchase at option of the Holder upon a designated event) occurs prior to maturity, holders may require us to purchase, in cash, all or part of the holder's debentures at a repurchase price equal to 101% of their principal amount, plus accrued and unpaid interest thereon to, but excluding, the repurchase date.

Make-whole premium of debentures

If a fundamental change occurs on or before June 30, 2010, we will pay a make-whole premium on the debentures converted in connection with the fundamental change, payable in shares of our common stock or the consideration into which our common stock has been converted or exchanged in connection with the fundamental change. The amount of the make-whole premium, if any, will be based on the stock price in the fundamental change transaction and the date of the fundamental change transaction. A description of how the make-whole premium will be determined and a table showing the make-whole premium that would apply at various stock prices and effective dates is set forth under Description of the Debentures Conversion of debentures Make- whole premium.

Use of Proceeds

We will not receive any proceeds from the sale made from time to time under this prospectus by the selling security holders of the debentures or our common stock. However, we received the exercise price of the warrants upon exercise of the warrants held by Jayhawk Institutional, which we will use for general corporate purposes. See Use of Proceeds.

Registration rights

We entered into a registration rights agreement with each selling security holder that originally purchased debentures and have filed a registration statement of which this prospectus is a part with the SEC covering the resale of the debentures and the common stock issuable upon conversion of the debentures. We agreed to use commercially reasonable efforts to have the

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registration statement declared effective and to keep the registration statement effective until July 1, 2010. The registration statement was declared effective on November 19, 2007. This prospectus is part of the registration statement contained in the post-effective amendment no. 1 to the registration statement. See Description of Capital Stock Registration Rights. See Description of Debentures Registration rights of the debenture holders.

Pursuant to a registration rights agreement, dated March 25, 2003, with Jayhawk Institutional and certain of its affiliates, Jayhawk Institutional exercised its piggyback registration rights to include in the registration statement, of which this prospectus is a part, 112,500 issued to Jayhawk Institutional upon exercise of warrants. See Description of Capital Stock Registration rights.

Absence of a Public Market for the Debentures We cannot assure you that any active or liquid market will develop for the debentures. See Plan of Distribution.

Debentures

Trading We do not intend to apply to list the debentures on any national securities exchange or to include the debentures in any automated quotation system. Qualified institutional buyers may trade the debentures in the PORTAL MarketSM. The debentures sold using this prospectus, however, will no longer be eligible for trading in the PORTAL MarketSM.

Trustee, Paying Agent and Custodian UMB Bank, n.a.

Agent for debentures

American Stock Exchange Symbol for our common stock Our common stock is quoted on the AMEX under the symbol LXU.

our common stock

Transfer Agent for our common stock Computershare Trust Company, N.A

Risk Factors You should read the Risk Factors section, beginning on page 4 of this prospectus, to understand the risks associated with an investment in the debentures or our common stock.

RISK FACTORS

An investment in the debentures or our common stock involves a high degree of risk. There are a number of factors associated with our business that could affect your decision to invest in the debentures or any common stock issuable upon conversion of the debentures. The following discussion describes the material risks currently known to us. However, additional risks that we do not know about or that we currently view as immaterial may also impair our business or adversely affect an investment in the debentures or any common stock issuable upon conversion of the debentures. You should carefully consider the risks described below, together with other information contained in, or incorporated by reference into, this prospectus before making a decision to invest in the debentures or any common stock offered under this prospectus by the selling security holders.

Risks related to us and our business

Cost and the lack of availability of raw materials could materially affect our profitability and liquidity.

Our sales and profits are heavily affected by the costs and availability of primary raw materials. These primary raw materials, which are purchased from unrelated third parties, are subject to considerable price volatility. Historically, when there have been rapid increases in the cost of these primary raw materials, we have sometimes been unable to timely increase our sales prices to cover all of the higher costs incurred. While we periodically enter into exchange-traded futures contracts to hedge against price increases in certain of these raw materials, there can be no assurance that we will effectively manage against price fluctuations in those raw materials.

Anhydrous ammonia and natural gas represent the primary raw material feedstocks in the production of most of the products of the Chemical Business. Although our Chemical Business has a program to enter into contracts with certain customers that provide for the pass-through of raw material costs, we have a substantial amount of sales that do not provide for the pass-through of raw material costs. In addition, the Climate

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Control Business depends on raw materials such as copper and steel, which have shown considerable price volatility. As a result, in the future, we may not be able to pass along to all of our customers the full amount of any increases in raw material costs. There can be no assurance that future price fluctuations in our raw materials will not have an adverse effect on our financial condition, liquidity and results of operations.

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Additionally, we depend on certain vendors to deliver the primary raw materials and other key components that are required in the production of our products. Any disruption in the supply of the primary raw materials and other key components could result in lost production or delayed shipments. We have suspended in the past, and could suspend in the future, production at our chemical facilities due to, among other things, the high cost or lack of availability of such primary raw materials. Accordingly, our financial condition, liquidity and results of operations could be materially affected in the future by the lack of availability of primary raw materials and other key components.

Periodically, our Chemical Business may not generate significant positive cash flows.

Due, in part, to extensive capital expenditures, our Chemical Business may not generate significant positive cash flows periodically. Continuing significant cash flow expenditures by this business could have a material adverse effect on our financial condition and liquidity.

Our Climate Control and Chemical Businesses and their customers are sensitive to certain economic cycles.

Our Climate Control Business can be affected by cyclical factors, such as interest rates, inflation and economic downturns. Our Climate Control Business depends on sales to customers in the commercial construction and renovation industries, which are particularly sensitive to these factors. A decline in the economic activity in the United States has in the past, and could in the future, have a material adverse effect on our customers in the commercial construction and renovation industries in which our Climate Control Business sells a substantial amount of its products. Such a decline could result in a decrease in revenues and profits, and an increase in bad debts, in our Climate Control Business.

Our Chemical Business also can be affected by cyclical factors such as inflation, global energy policy and costs, global market conditions and economic downturns in specific industries. Certain sales of our Chemical Business are sensitive to the level of activity in the agricultural, mining, automotive and housing industries. A decline in the activity in these industries in the United States has in the past, and could in the future, have a material adverse effect on the results of our Chemical Business.

Weather conditions adversely affect our Chemical Business.

The agricultural products produced and sold by our Chemical Business have in the past, and could in the future, to be materially affected by adverse weather conditions (such as excessive rains or drought) in the primary markets for our fertilizer and related agricultural products. If any of these unusual weather events occur during the primary seasons for sales of our agricultural products (March-June and September-November), this could have a material adverse effect on the agricultural sales of our Chemical Business and our financial condition and results of operation.

Environmental and regulatory matters entail significant risk for us.

Our Chemical Business is subject to numerous environmental laws and regulations. The manufacture and distribution of chemical products are activities, which entail environmental risks and impose obligations under environmental laws and regulations, many of which provide for substantial fines and potential criminal sanctions for violations. Our Chemical Business has in the past, and may in the future, be subject to fines, penalties and sanctions for violations of environmental laws and substantial expenditures for cleanup costs and other liabilities relating to the handling, manufacture, use, emission, discharge or disposal of effluents at or from the Chemical Business facilities. Further, a number of our Chemical Business facilities are dependent on environmental permits to operate, the loss or modification of which could have a material adverse effect on its operations and our financial condition.

We may be required to expand our security procedures and install additional security equipment for our Chemical Business in order to comply with the Homeland Security Act of 2002 and possible future government regulation.

The chemical industry in general, and producers and distributors of ammonium nitrate specifically, are scrutinized by the government, industry and public on security issues. Under the Homeland Security Act of 2002, as well as current and proposed regulations, we may be required to incur substantial additional costs relating to security at our chemical facilities, distribution centers, and our customers, as well as in the transportation of our products. These costs could have a material impact on our financial condition and results of operation. The cost of such regulatory changes, if significant enough, could lead some of our customers to choose alternate products to ammonium nitrate, which would have a significant impact on our Chemical Business.

A substantial portion of our sales is dependent upon a limited number of customers.

During 2007, four customers of our Chemical Business accounted for 44% of its net sales and 22% of our consolidated sales, and our Climate Control Business had one customer that accounted for 17% of its net sales and 8% of our consolidated sales. The loss of, or a material reduction in purchase levels by, one or more of these customers could have a material adverse effect on our business and our results of operations,

financial condition and liquidity if we are unable to replace a customer on substantially similar terms.

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There is intense competition in the Climate Control and Chemical industries.

Substantially all of the markets in which we participate are highly competitive with respect to product quality, price, design innovations, distribution, service, warranties, reliability and efficiency. We compete with a number of established companies that have greater financial, marketing and other resources. Competitive factors could require us to reduce prices or increase spending on product development, marketing and sales that would have a material adverse effect on our business, results of operation and financial condition.

We are effectively controlled by the Golsen Group.

Jack E. Golsen, our Chairman of the Board and Chief Executive Officer (CEO), members of his immediate family (spouse and children), including Barry H. Golsen, our Vice Chairman and President, entities owned by them and trusts for which they possess voting or dispositive power as trustee (collectively, the Golsen Group) beneficially owned as of February 29, 2008, an aggregate of 3,395,743 shares of our common stock and 1,020,000 shares of our voting preferred stock (1,000,000 of which shares have .875 votes per share, or 875,000 votes), which together votes as a class and represent approximately 19.5% of the voting power of our issued and outstanding voting securities as of that date. In addition, the Golsen Group also beneficially owned options and other convertible securities that allowed its members to acquire an additional 116,500 shares of our common stock within 60 days of February 29, 2008. Thus, the Golsen Group may be considered to effectively control us. As a result, the ability of other stockholders to influence our management and policies could be limited.

Loss of key personnel could negatively affect our business.

We believe that our performance has been and will continue to be dependent upon the efforts of our principal executive officers. We cannot promise you that our principal executive officers will continue to be available. Jack E. Golsen has an employment agreement with us. No other principal executive has an employment agreement with us. The loss of some of our principal executive officers could have a material adverse effect on us. We believe that our future success will depend in large part on our continued ability to attract and retain highly skilled and qualified personnel.

We may have inadequate insurance.

While we maintain liability insurance, including certain coverage for environmental contamination, it is subject to coverage limits and policies may exclude coverage for some types of damages (which may include warranty and product liability claims). Although there may currently be sources from which such coverage may be obtained, it may not continue to be available to us on commercially reasonable terms or the possible types of liabilities that may be incurred by us may not be covered by our insurance. In addition, our insurance carriers may not be able to meet their obligations under the policies or the dollar amount of the liabilities may exceed our policy limits. Even a partially uninsured claim, if successful and of significant magnitude, could have a material adverse effect on our business, results of operations, financial condition and liquidity.

Terrorist attacks and other acts of violence or war, and natural disasters (such as hurricanes, pandemic health crisis, etc.), have and could negatively impact the U.S. and foreign companies, the financial markets, the industries where we operate, our operations and profitability.

Terrorist attacks and natural disasters (such as hurricanes) have in the past, and can in the future, negatively affect our operations. We cannot predict further terrorist attacks and natural disasters in the United States and elsewhere. These attacks or natural disasters have contributed to economic instability in the United States and elsewhere, and further acts of terrorism, violence, war or natural disasters could further affect the industries where we operate, our ability to purchase raw materials, our business, results of operations and financial condition. In addition, terrorist attacks and natural disasters may directly impact our physical facilities, especially our chemical facilities, or those of our suppliers or customers and could impact our sales, our production capability and our ability to deliver products to our customers. In the past, hurricanes affecting the Gulf Coast of the United States have resulted in damages to, or shutdown of, the gas pipeline to the Cherokee Facility, resulting in that facility being shutdown for several weeks. The consequences of any terrorist attacks or hostilities or natural disasters are unpredictable, and we may not be able to foresee events that could have an adverse effect on our operations.

Restatements and amendments to our 2004 audited financial statements and certain matters related to our disclosure controls and procedures may present a risk of future restatements and could in turn lead to legal exposure.

In response to comments from the Securities and Exchange Commission (SEC) to our 2004 Form 10-K, and as a result of changes we made internally, we restated and amended our 2004 audited financial statements and on December 30, 2005, filed a Form 10-K/A (Amendment No. 1) for year ended December 31, 2004. As a result of the restatement and amendments to our 2004 audited financial statements and SEC comments, we also filed on December 30, 2005, an amended Form 10-Q/A for each of the quarters ended March 31, 2005 and June 30, 2005.

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As a result of this restatement to our 2004 financial statements, we also revised our 2004 Form 10-K and first two quarters 2005 Form 10-Qs to provide that our disclosure controls and procedures were not effective as of December 31, 2004, March 31, 2005 and June 30, 2005, in our Form 10-K/A and Forms 10-Q/A, as a result of assessing that the change from the LIFO method to the FIFO method of accounting was not material resulting in the decision at the time of the change not to disclose and not to restate the prior years financial statements. We believe that during December 2005, we corrected the weakness to our disclosure controls and procedures by, among other things, establishing a Disclosure Committee to maintain oversight activities and to examine and reevaluate our policies, procedures and criteria to determine materiality of items relative to our financial statements taken as a whole. Restatements by others have, in some cases, resulted in the filing of class action lawsuits against such companies and their management and further inquiries from the SEC. Any similar lawsuit against us could result in substantial defense and/or liability costs and would likely consume a material amount of management's attention that might otherwise be applied to our business. Under certain circumstances, these costs might not be covered by, or might exceed the limits of, our insurance coverage.

By letter received in August 2006 from the SEC, the SEC has made an informal inquiry of us relating to the change in inventory accounting from LIFO to FIFO resulting in the restatement of our financial statements. Based on an informal conversation with the SEC, this inquiry could:

rise to the level of an investigation or proceeding, or

result in an enforcement action by the SEC.

We are a holding company and depend, in large part, on receiving funds from our subsidiaries to fund our indebtedness.

Because we are a holding company and operations are conducted through our subsidiaries, principally ThermaClime and its subsidiaries, our ability to make scheduled payments of principal and interest on our indebtedness depend on operating performance and cash flows of our subsidiaries and the ability of our subsidiaries to make distributions and pay dividends to us. Under its loan agreements, ThermaClime and its subsidiaries may only make distributions and pay dividends to us under limited circumstances and in limited amounts. If ThermaClime is unable to make distributions or pay dividends to us, or the amounts of such distributions or dividends are not sufficient for us to service our debts, we may not be able to pay the principal or interest, or both, due on our indebtedness.

Our net operating loss carryforwards are subject to certain limitations and have not been audited or approved by the Internal Revenue Service.

Our net operating loss (NOL) carryforwards have resulted from certain historical losses. At December 31, 2006, we had regular NOL carryforwards of approximately \$49.9 million, all of which we have utilized or anticipate utilizing to reduce our federal income tax liability for 2007 and 2008. In future periods, our net income and liquidity will be negatively affected as we recognize and pay income taxes without the benefit of these NOL carryforwards. In addition, the amount of these NOL carryforwards utilized has not been audited or approved by the Internal Revenue Service.

We are subject to a variety of factors that could discourage other parties from attempting to acquire us.

Our certificate of incorporation provides for a staggered board of directors and, except in limited circumstances, a two-thirds vote of outstanding voting shares to approve a merger, consolidation or sale of all, or substantially all, of our assets. In addition, we have entered into severance agreements with our executive officers and some of the executive officers of our subsidiaries that provide, among other things, that if, within a specified period of time after the occurrence of a change in control of our company, these officers are terminated, other than for cause, or the officer terminates his employment for good reason, we must pay such officer an amount equal to 2.9 times the officer's average annual gross salary for the last five years preceding the change in control.

We have authorized and unissued (including shares held in treasury) 53,982,012 shares of common stock and 4,229,415 shares of preferred stock as of December 31, 2007. These unissued shares could be used by our management to make it more difficult, and thereby discourage an attempt to acquire control of us.

We have adopted a preferred share purchase plan, which is designed to ensure that all of our stockholders receive fair and equal treatment in the event of a proposed takeover or abusive tender offer.

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The foregoing provisions and agreements are designed to discourage a third party tender offer or proxy contest for control of us and could have the effect of making it more difficult to remove incumbent management.

Delaware has adopted an anti-takeover law which, among other things, will delay for three years business combinations with acquirers of 15% or more of the outstanding voting stock of publicly-held companies (such as us), unless (a) the acquirer owned at least 85% of the outstanding voting stock of such company prior to commencement of the transaction, or (b) two-thirds of the stockholders, other than the acquirer, vote to approve the business combination after approval thereof by the board of directors, and (c) the stockholders decide to opt out of the statute.

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Risks related to the debentures and common stock:

We have not paid dividends on our outstanding common stock in many years.

We have not paid cash dividends on our outstanding common stock in many years, and we do not currently anticipate paying cash dividends on our outstanding common stock in the foreseeable future. However, our board of directors has not made a definitive decision whether or not to pay such dividends in 2008.

The debentures are contractually subordinated to all of our senior debt and are effectively subordinated to all of our secured debt and to all of the debt and other liabilities of our subsidiaries.

The debentures are our general unsecured obligations and are contractually subordinated to all of our existing and future senior debt, including obligations relating to credit facilities of our subsidiaries that we have guaranteed. As of December 31, 2007, our senior debt, including our subsidiaries' debt which we have guaranteed totaled approximately \$120.5 million. Upon any distribution to our creditors in a bankruptcy, liquidation, reorganization or similar proceeding relating to us or our property, the holders of senior debt will be entitled to be paid in full in cash before any payment may be made with respect to the debentures. In addition, all payments on the debentures will be blocked in the event of a payment default on our senior debt and may be blocked for up to 179 days in the event of certain non-payment defaults on designated senior debt.

The debentures are not secured by any of our assets, and therefore will be effectively subordinated to all of our secured debt. In addition, future debt that we incur, including accounts payable and other liabilities incurred in obtaining goods and services, may be secured by our assets. If we become insolvent or are liquidated, or if payment of any of our secured debt is accelerated, the holders of that secured debt will be entitled to exercise the remedies available to secured lenders under applicable law, including the ability to foreclose on and sell the assets securing such debt to satisfy such debt. In any such case, our remaining assets may be insufficient to repay the debentures.

The debentures are obligations exclusively of LSB Industries, Inc. Since we are a holding company and most of our operations are conducted through our wholly owned subsidiaries, principally ThermaClime and its subsidiaries, the cash flow and the consequent ability to service debt, including the debentures, are dependent upon the earnings of such subsidiaries and the distribution of those earnings to, or upon loans or other payments of funds by, those subsidiaries to us. Our subsidiaries have no obligation to pay any amounts due pursuant to the debentures or to make any funds available therefore. Additionally, under its loan agreements, ThermaClime and its subsidiaries may only make distributions and pay dividends to us under limited circumstances and in limited amounts. If ThermaClime is unable to make distributions or pay dividends to us, or the amounts of such distributions or dividends are not sufficient for us to service our debts, we may not be able to pay the principal or interest, or both, due on our indebtedness, including the debentures.

Any right we have to receive assets of any of our subsidiaries upon their liquidation or reorganization (and the consequent right of the holders of the debentures to participate in those assets) will be effectively subordinated to the claims of that subsidiary's creditors (including trade creditors). There are no restrictions in the indenture on the creation of additional senior indebtedness (or any indebtedness).

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The amounts of our indebtedness and the indebtedness of our subsidiaries as of December 31, 2007, are based on unaudited numbers.

We may be unable to purchase the debentures for cash following a designated event.

Holders of the debentures have the right to require us to repurchase the debentures upon the occurrence of a designated event prior to maturity as described under the heading **Description of Debentures** **Repurchase at option of the holder upon a designated event**. Any of our future debt agreements may contain a similar provision. We may not have sufficient funds to make the required repurchase in cash at such time or the ability to arrange necessary financing on acceptable terms. In addition, our ability to repurchase the debentures may be limited by law or the terms of other agreements relating to our debt outstanding at the time. However, if we fail to repurchase the debentures as required by the indenture, it would constitute an event of default under the indenture governing the debentures which would cause a default in one or more of our senior credit facilities. Important corporate events, such as takeovers, recapitalizations or similar transactions, may not constitute a designated event under the indenture governing the debentures and thus not permit the holders of the debentures to require us to repurchase or redeem the debentures.

There is currently no public market for the debentures, and an active trading market may not develop for the debentures. The failure of a market to develop for the debentures could adversely affect the liquidity and value of the debentures.

The debentures are a new issue of securities, and there is no existing market for the debentures. Although the debentures are eligible for trading in The PORTAL MarketSM, we do not intend to apply for listing of the debentures on any securities exchange or for quotation of the debentures on any automated dealer quotation system. In addition, debentures sold using this prospectus will no longer be eligible for trading in the PORTAL MarketSM. A market may not develop for the debentures, and if a market does develop, it may not be sufficiently liquid for your purposes. If an active, liquid market does not develop for the debentures, the market price and liquidity of the debentures may be adversely affected. Debentures traded after their initial issuance may trade at a discount from their face amount.

The liquidity of the trading market, if any, and future trading prices of the debentures will depend on many factors, including, among other things, the market price of our common stock, our ability to register the resale of the debentures, prevailing interest rates, our operating results, financial performance and prospects, the market for similar securities and the overall securities market, and may be adversely affected by unfavorable changes in these factors. Historically, the market for convertible debt has been subject to disruptions that have caused volatility in prices. The market for the debentures may be subject to disruptions, which could have a negative effect on the holders of the debentures, regardless of our operating results, financial performance or prospects.

Resale of the debentures and the common stock issuable upon conversion of the debentures is subject to significant restrictions.

Although we are required to register the resale by the holders of the debentures and the common stock into which the debentures are convertible, along with 112,500 shares of common stock issued to Jayhawk Institutional upon the exercise of warrants, such registration may not be available at all times. We are not currently eligible to register the resale of the debentures and the common stock included in this prospectus on Form S-3, and, therefore, registered the resale of these securities on Form S-1. As a result, under certain circumstances, we must update the registration statement for the resale of such debentures and common stock by filing post-effective amendments to the registration statement that will not be effective until each is declared effective by the SEC. Between the time it is determined that the registration statement must be updated by a post-effective amendment and the time the SEC declares the applicable post-effective amendment effective, the registration statement will not be available for use and the price of our common stock could decline during that time. The SEC has broad discretion to determine whether any registration statement (including and post-effective amendment) will be declared effective and may delay or deny the effectiveness of any registration statement or post effective amendment filed by us for a variety of reasons. Selling security holders also may be subject to restrictions and potential liability under the Securities Act. See **Description of Debentures** **Registration rights of the debenture holders** and **Description of Capital Stock** **Registration rights**.

The debentures do not restrict our ability to incur additional debt, repurchase our securities or to take other actions that could negatively impact holders of the debentures.

We are not restricted under the terms of the debentures from incurring additional debt, including secured debt, or repurchasing our securities. In addition, the limited covenants applicable to the debentures do not require us to achieve or maintain any minimum financial results relating to our financial position or results of operations. Our ability to recapitalize, incur additional debt and take a number of other actions that are not limited by the terms of the debentures could have the effect of diminishing our ability to make payments on the debentures when due. Certain of our other debt instruments may, however, restrict these and other actions. See **Description of Debentures - Subordination of debentures**.

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Determination of debenture terms

The conversion rate of the debentures is initially 36.4 shares per \$1,000 principal amount of debentures, representing an initial conversion price of \$27.47, subject to adjustment. There can be no assurance that the market price of our common stock will ever reach or exceed the representative price at which the debentures may be converted into shares of common stock. In addition, our right to redeem the debentures or pay the debentures at maturity in our common stock is not conditioned upon the closing sale price of our common stock exceeding the then effective conversion price of the debentures. Because the value of the common stock will be determined before the redemption date, or the maturity date, if we specify that we will make payment of the redemption price or a portion of the principal and accrued interest thereon of the debentures at the maturity date in shares of our common stock, holders of debentures bear the market risk that our common stock will decline in value between the date of such determination and the redemption date or the maturity date, whichever is applicable. In addition, holders will not know the exact number of shares of common stock to be received upon redemption or maturity until the fourth trading day prior to the redemption date or maturity date, whichever is applicable. The conversion price, redemption price and the other terms of the debentures have been determined by negotiation between the placement agent and us. See Description of the Debentures.

The price of our common stock, and therefore of the debentures may fluctuate significantly; and this may make it difficult for you to resell the debentures and/or our common stock when you want or at prices you find attractive.

The price of our common stock on the American Stock Exchange constantly changes. We expect that the market price of our common stock will continue to fluctuate. In addition, because the debentures are convertible into our common stock, volatility or depressed prices for our common stock could have a similar effect on the trading price of the debentures. This may make it difficult for you to resell the debentures and/or our common stock when you want or at prices you find attractive.

Future issuance or potential issuance of our common stock could adversely affect the price of our common stock and the value of the debentures, our ability to raise funds in new stock offerings and dilute your percentage interest in our common stock.

Future sales of substantial amounts of our common stock or equity-related securities in the public market, or the perception that such sales could occur, could adversely affect prevailing trading prices of our common stock and the value of the debentures, and impair our ability to raise capital through future offerings of equity or equity-related securities. No prediction can be made as to the effect, if any, that future issuances or sales of shares of common stock or the availability of shares of common stock for future issuance, will have on the trading price of our common stock or the value of the debentures. Such future issuances could also significantly reduce the percentage ownership of our existing common stockholders.

Resale of shares offered by this prospectus could adversely affect the market price of our common stock and our ability to raise additional equity capital

The sale, or availability for sale, of common stock in the public market pursuant to this prospectus may adversely affect the prevailing market price of our common stock and may impair our ability to raise additional capital by selling equity or equity-related securities. This prospectus includes 2,746,500 shares that will be available for resale (assuming the conversion of all of the debentures and exercise of the warrant for which the underlying shares of common stock are registered). The resale of a substantial number of shares of our common stock in the public market pursuant to this offering, and afterwards, could adversely affect the market price for our common stock and make it more difficult for you to sell our shares at times and prices that you feel are appropriate. Furthermore, we expect that, because there is a large number of shares offered under this prospectus, the selling security holders may continue to offer shares covered by this prospectus for a significant period of time, the precise duration of which we cannot predict. Accordingly, the adverse market and price pressures resulting from this offering may continue for an extended period of time and continued negative pressure on the market price of our common stock could have a material adverse effect on our ability to raise additional equity capital.

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FORWARD-LOOKING STATEMENTS

This prospectus and the documents incorporated by reference into this prospectus contain forward-looking statements. All statements in this prospectus and such incorporated information other than statements of historical fact are forward-looking statements that are subject to known and unknown risks, uncertainties and other factors which could cause actual results and performance of the Company to differ materially from such statements. Such forward-looking statements relate to statements about our business strategies, our expected financial position and operating results, the projected size of our markets and our financing plans and similar matters, including but not limited to, the forward-looking statements described in our Annual Report on Form 10-K for the year ended December 31, 2007, under the heading **Special Note Regarding Forward Looking Statements**, each of which is hereby incorporated herein by reference.

While we believe the expectations reflected in such forward-looking statements are reasonable, we can give no assurance such expectations will prove to have been correct. There are a variety of factors which could cause future outcomes to differ materially from those described in this prospectus, including but not limited to, the factors described in the above sections of our Annual Report on Form 10-K for the year ended December 31, 2007.

The words **believe**, **may**, **will**, **estimate**, **continue**, **anticipate**, **intend**, **expect**, **project** and similar expressions, as they relate to us, management, and our industry are intended to identify forward-looking statements. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends affecting the financial condition of our business. Actual results may differ materially. Some of the risks, uncertainties and assumptions about us that may cause actual results to differ from the results in these forward-looking statements are described in **Risk Factors** contained herein and/or in our Form 10-K for the year ended December 31, 2007, each of which is incorporated by reference herein.

All forward-looking statements attributable to us, or to persons acting on our behalf, are expressly qualified in their entirety by this cautionary statement. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks and uncertainties, the forward-looking events and circumstances discussed in this prospectus might not transpire.

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INCORPORATION BY REFERENCE

We have elected to incorporate by reference certain information into this prospectus. By incorporating by reference, we can disclose important information to you by referring you to another document we have filed separately with the Securities and Exchange Commission. The information incorporated by reference is deemed to be part of this prospectus, except for information incorporated by reference that is superseded by information contained in this prospectus. We incorporate by reference the documents listed below that we previously filed with the SEC:

Our 2007 Annual Report on Form 10-K, for the fiscal year ended December 31, 2007 (2007 10-K), filed March 14, 2008, as amended by our Amendment Number 1 to Annual Report on Form 10-K/A, filed March 27, 2008, which includes, without limitation, information with respect to our business, properties, legal proceedings, certain stockholder matters, financial statements, selected financial data, supplementary financial information, management's discussion and analysis of financial condition and results of operations, dividend policy, and quantitative and qualitative disclosures about market risk; and

Our Current Reports on Form 8-K filed on March 14, and 27, 2008.

These filings have not been included in or delivered with this prospectus. To receive a free copy of any of the documents incorporated by reference in this prospectus, other than exhibits, unless they are specifically incorporated by reference in those documents, call or write to us at the following:

LSB Industries, Inc.

P.O. Box 754

Oklahoma City, Oklahoma 73101-0754

Attention: Secretary

(405) 235-4546

The information relating to us contained in this prospectus does not purport to be comprehensive and should be read together with the information contained in the documents incorporated or deemed to be incorporated by reference in this prospectus.

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WHERE YOU CAN FIND MORE INFORMATION

We filed with the SEC a registration statement on Form S-1 (Registration No. 333-145721) including the exhibits, schedules and amendments to the registration statement under the Securities Act with respect to the debentures and shares of common stock to be sold in this offering. This prospectus, which is part of the registration statement, does not contain all the information set forth in the registration statement. For further information with respect to LSB Industries, the debentures, and shares of common stock to be sold in this offering, reference is made to the registration statement. Statements contained in this prospectus as to the contents of any contract, agreement or other document referred to are not necessarily complete, and in each instance reference is made to the copy of such contract, agreement or other document filed as an exhibit to the registration statement, each such statement being qualified in all respects by such reference.

We are subject to the information and reporting requirements of the Securities Exchange Act of 1934, as amended (the Exchange Act), and file periodic reports, proxy statements and other information with the SEC. You may read and copy all or any portion of the registration statement or any other information LSB Industries files at the SEC's public reference room at 100 F Street, N.E., Washington, DC 20549. You can request copies of these documents, upon payment of a duplicating fee, by writing to the SEC. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference rooms. Our SEC filings, including the registration statement, are also available to you on the SEC's Web site, <http://www.sec.gov>.

Such registration statement and other information filed by us may also be inspected at the American Stock Exchange offices located at 86 Trinity Place, New York, New York 10006-1872 and is available at AMEX's website, <http://www.amex.com>. We furnish our shareholders with annual reports containing audited financial statements and make available quarterly reports for the first three quarters of each year containing unaudited interim financial information.

Our Internet address is www.lsb-okc.com. We make available, free of charge, on www.lsb-okc.com our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after we electronically file such reports with, or furnish them to, the SEC. Except as otherwise specifically incorporated by reference in this prospectus, information contained in, or accessible through, our website is not a part of this prospectus.

Table of Contents**SUMMARY FINANCIAL DATA**

The following summary financial data as of and for the fiscal years ended December 31, 2005, 2006, and 2007, are derived from our audited consolidated financial statements and the related notes, which appear in our Annual Report on Form 10-K for the year ended December 31, 2007. Statement of operations data for periods prior to 2007 have been adjusted for the change in accounting for major maintenance activities as prescribed under FASB Staff Position No. AUG AIR-1. You should read the information set forth below in conjunction with the Selected Financial Data and our financial statements and the related notes, incorporated in this prospectus by reference to our SEC filings.

Consolidated statement of operations data:

(In thousands, except per share data)

	Years ended December 31,		
	2005	2006	2007
Net sales	\$ 397,115	\$ 491,952	\$ 586,407
Gross profit	66,766	90,862	132,593
Operating income	14,853	27,139	59,011
Interest expense	11,407	11,915	12,078
Income from continuing operations	5,634	15,768	46,534
Net income	\$ 4,990	\$ 15,515	\$ 46,882
Net income applicable to common stock	\$ 2,707	\$ 12,885	\$ 41,274
Weighted average common Shares outstanding:			
Basic	13,617	14,332	19,580
Diluted	14,907	20,872	23,496
Income per common share:			
Basic:			
Income from continuing operations	\$ 0.25	\$ 0.92	\$ 2.09
Net income (loss) from discontinued operations	(0.05)	(0.02)	.02
Net income	\$ 0.20	\$)	(3,000,000)
Sale of short term investments	9,500,000	6,550,000	
Issuance of loan receivable	(571,200)		
Note receivable closing costs	(37,586)		
Collections on note receivable	11,093		
Loss on investment in Celsion China, Ltd.	(11,994)		
Purchase of property and equipment	(183,370)	(77,878)	
Net cash (used) provided by investing activities	(3,293,057)	3,472,122	
Cash flows from financing activities:			
Proceeds from loan payable	9,000,000	6,000,000	
Purchase of Celsion common stock (treasury stock)	(2,396)		
Net cash provided by financing activities	8,997,604	6,000,000	
Net (decrease) increase in cash and cash equivalents	(440,552)	2,320,837	
Cash and cash equivalents at beginning of period	2,313,430	1,233,816	
Cash and cash equivalents at end of the period	\$ 1,872,878	\$ 3,554,653	

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CELSION CORPORATION
NOTES TO FINANCIAL STATEMENTS
(UNAUDITED)

For the Three and Nine Months Ended September 30, 2006 and 2005

Note 1. Basis of Presentation

The accompanying unaudited condensed financial statements of Celsion Corporation (which we sometimes refer to as Celsion, the Company, we, us or our) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring accruals considered necessary for a fair presentation, have been included in the accompanying unaudited financial statements. Operating results for the three and nine month periods ended September 30, 2006 are not necessarily indicative of the results that may be expected for any other interim period(s) or for any full year. For further information, refer to the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

Note 2. Common Stock Outstanding and Per Share Information

For the three month and nine month periods ended September 30, 2006 and September 30, 2005, per share data is based on the weighted average number of shares of common stock, par value \$0.01 per share (Common Stock), outstanding during the respective periods. Outstanding warrants and options that can be converted into Common Stock and non-vested common stock are not included, as their effect is anti-dilutive. On February 27, 2006 the Company effected a 15:1 reverse stock split and the 2005 share data has been adjusted accordingly. The total number of outstanding warrants and options for the periods ended September 30, 2006 and September 30, 2005 were 2,230,114 and 2,282,190 respectively. The number of outstanding non-vested common stock for the periods ended September 30, 2006 and September 30, 2005 were 45,854 and none respectively.

Note 3. New Accounting Pronouncements

In November 2004, the Financial Accounting Standard Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 151, *Inventory Costs*. SFAS No. 151 amends Accounting Research Bulletin No. 43, Chapter 4, to clarify that abnormal amounts of idle facility expense, freight, handling costs and wasted materials (spoilage) should be recognized as current-period charges. In addition, SFAS No. 151 requires that allocation of fixed production overhead to inventory be based on the normal capacity of the production facilities. The Company was required to adopt SFAS No. 151 beginning January 1, 2006. SFAS No. 151 has not had a material impact on the Company's results of operations, financial position and cash flow.

On December 16, 2004 the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123(R)), which is a revision of SFAS No. 123, *Accounting for Stock-based Compensation*. SFAS 123(R) supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees* and amends SFAS No. 95, *Statement of Cash Flows*. Generally, the approach in SFAS 123(R) is similar to the approach described in SFAS 123. However, SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the determination of net income based on their fair values. The Company adopted SFAS 123(R) effective January 1, 2006.

SFAS 123(R) permits public companies to adopt its requirements using one of two methods: (1) a modified prospective approach or (2) a modified retrospective approach. Under the modified

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prospective approach, compensation cost is recognized beginning with the effective date based on (a) the requirements of SFAS 123(R) for all share based payments granted after the effective date and (b) the requirements of SFAS 123(R) for all awards granted to employees prior to the effective date of SFAS 123(R) that remain unvested on the effective date. The modified retrospective approach includes the requirements of the modified prospective approach, but also permits entities to restate, based on the amounts previously recognized under SFAS 123 for purposes of pro forma disclosures, either all prior periods presented or prior interim periods of the year of adoption. The Company adopted the modified prospective approach. As permitted by SFAS 123, the Company accounted for share-based payments to employees using APB Opinion No. 25's intrinsic value method, and, as such, generally recognized no compensation cost for employee stock options in fiscal 2005. Accordingly, the adoption of the fair value method will have a significant impact on our results of operations, although it will have no impact on our overall financial position.

The effects of the adoption of SFAS 123(R) on the Company's results of operations and financial position are dependent upon a number of factors, including the number of employee stock options outstanding and unvested, the number of stock-based awards which may be granted in the future, the life and vesting features of stock-based awards which may be granted in the future, the future market value and volatility of the Company's stock, movements in the risk free rate of interest, award exercise and forfeiture patterns, and the valuation model used to estimate the fair value of each award. In addition, the Company intends to utilize non-vested stock units as a component of its ongoing employee incentive-based compensation plan. These awards generally are recorded at fair value, equal to the quoted market price of the Company's common stock on the date of issuance, and this amount is subsequently amortized ratably over the vesting period of the shares of non-vested stock held by the employee. The Company estimates the adoption of SFAS 123(R) will increase compensation expense in the range of \$1.0 to \$1.75 million for the year ending December 31, 2006, of which \$1.0 million represents estimated compensation expense for options issued and outstanding at December 31, 2005 and the remainder represents estimated compensation expense for anticipated option issuances. The fair value accounting of stock options resulted in an expense for the quarter ended September 30, 2006 of \$254,730 and \$812,013 for the nine months ended September 30, 2006.

SFAS 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow. Because the Company does not recognize the benefit of tax deductions in excess of recognized compensation cost due to its net operating loss position, it is expected that this change will have no impact on the Company's consolidated financial statements.

Note 4. Fair Value Accounting for Stock Plans

Employee Stock Options

The Company has long-term compensation plans that permit the granting of incentive awards in the form of stock options. Generally, the terms of these plans require that the exercise price of the options may not be less than the fair market value of Celsion's Common Stock on the date the options are granted. Options generally vest over various time frames or upon milestone accomplishments. Some vest immediately. Others vest over a period between one and five years. The options generally expire ten years from the date of the grant.

2001 Stock Option Plan

The purpose of the 2001 Plan is to promote long-term growth and profitability of Celsion Corporation by providing key associates with incentives to improve stockholder value and to contribute to the growth and financial success of Celsion and to enable the company to attract, retain and reward the best available persons for positions of substantial responsibility. The 2001 Plan permitted the granting of stock options

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(including nonqualified stock options and incentive stock options qualifying under Section 422 of the Internal Revenue Code) and stock appreciation rights or any combination of the foregoing. During the year that ended December 31, 2005, 38,920 options were canceled or expired. During the quarter and nine months ended September 30, 2006, 15,557 and 21,336 options were canceled or expired, respectively. All canceled and expired options under the 2001 Plan become available for issue under the 2004 Plan.

2004 Stock Incentive Plan

The purpose of the 2004 Plan is to promote the long-term growth and financial success of the Company and enable the Company to attract, retain and reward the best available persons for positions of substantial responsibility. The 2004 Plan permits the granting of awards in the form of incentive stock options, restricted stock, restricted stock units, stock appreciation rights, phantom stock, and performance awards, or in any combination of the foregoing. On September 30, 2006 options to purchase 471,185 shares were available from the 737,501 authorized under the 2004 Plan.

During the quarter ended March 31, 2006 the Company issued 48,223 shares of non-vested common stock at a market price of \$4.08. Since the grant of non-vested common stock relates to future service, the total compensation expense of \$196,799 will be recognized ratably over the service period. Since the initial issue some 2,369 share have been cancelled leaving a balance of 45,854 shares. The expense recognized for the nine months ended September 30, 2006 was \$110,424.

Options Issued to Non-Employees for Services

The Company enters into agreements with consultants in which the consultants receive stock options in exchange for services. Generally, the terms of these plans require that the exercise price of the options may not be less than the fair market value of Celsion's Common Stock on the date the options are granted. Options generally vest over various time frames or upon milestone accomplishments. Some vest immediately. Others vest over a period between one and five years. The options generally expire ten years from the date of the grant. There were no options granted to non-employees for the period ended September 30, 2006.

A summary of the Company's Common Stock option activity and related information is as follows:

	Three Months Ended September 30, 2006		Nine Months Ended September 30, 2006	
	Options Outstanding	Weighted Average Exercise Price	Options Outstanding	Weighted Average Exercise Price
Outstanding at beginning of period (1)	1,318,876	\$ 8.56	1,276,793	\$ 8.70
Granted	6,500	2.45	149,134	4.08
Exercised				
Expired/cancelled	(24,449)	13.75	(125,000)	7.57
Outstanding at end of period	1,300,927	\$ 8.41	1,300,927	\$ 8.41
Exercisable at end of period	750,396	10.05	750,396	10.05
Available for grant at end of period	471,185		471,185	

(1) The options outstanding and weighted average exercise price has been adjusted to reflect February 27, 2006 15:1 reverse stock split.

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Following is additional information with respect to options outstanding at September 30, 2006:

	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2006
Risk-free interest rate	4.76 to 4.81%	4.30 to 4.96%
Dividend Yield	0%	0%
Expected volatility	83%	83%
Expected option life in years	6	6

	Exercise Price from \$2.18 to \$6.00	Exercise Price from \$6.01 to \$9.60	Exercise Price from \$9.61 to \$13.80	Exercise Price from \$13.81 to \$22.50
Common Stock Options				
Outstanding at September 30, 2006:				
Number of options	589,960	341,428	218,868	150,671
Weighted average exercise price	\$ 5.26	7.99	11.27	17.63
Weighted average remaining contractual life in years	8.74	6.45	5.47	2.28
Exercisable at September 30, 2006:				
Number of options	126,614	289,761	212,684	121,337
Weighted average exercise price	\$ 5.44	8.11	11.31	17.23
Weighted average remaining contractual life in years	7.96	6.14	5.42	1.34

For all of the Company's stock-based compensation plans, the fair value of each grant was estimated at the date of grant using the Black-Scholes option pricing model. Black-Scholes utilizes assumptions related to volatility, the risk-free interest rate, the dividend yield and employee exercise behavior. Expected volatilities utilized in the model are based on historical volatility of the Company's stock price. The risk free interest rate is derived from values assigned to U.S. Treasury strips as published in the Wall Street Journal in effect at the time of grant. The model incorporates exercise, pre-vesting and post-vesting forfeiture assumptions based on analysis of historical data. The expected life of the fiscal 2006 grants was generated using the simplified method as allowed under Securities and Exchange Commission Staff Accounting Bulletin No. 107.

The Company has long-term compensation plans that permit the granting of incentive awards in the form of stock options. Prior to fiscal 2006, the Company applied the intrinsic value method as outlined in the APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations in accounting for stock options granted. No compensation expense was recognized in the accompanying consolidated financial statements of earnings prior to fiscal 2006. The following table illustrates the effect on net income and earnings per share for periods presented prior to fiscal 2006, if the Company had applied the fair value recognition provisions of SFAS 123 to its stock-based employee plans.

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	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Net loss attributable to common stockholders, as reported	\$ (1,953,865)	\$ (6,561,155)
Adjust for total stock-based employee compensation expense determined using the fair value-based method for all awards	(273,160)	(646,824)
Pro forma net loss	\$ (2,227,025)	\$ (7,207,979)
Loss per share:		
Basic as reported	\$ (0.18)	\$ (0.61)
Basic pro forma	\$ (0.21)	\$ (0.67)
	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Risk free interest rate	3.88 to 4.34%	3.88 to 4.42%
Dividend yield	0%	0%
Expected volatility	87%	87 to 89%
Expected option life in years	6	6

Note 5. Note Receivable and Note Receivable Interest

On January 16, 2006, Celsion contributed to its wholly-owned subsidiary, Celsion (Canada) Limited (Canada), all of the Company's assets relating to its Adaptive Phased Array (APA) technology for the treatment of breast cancer. Also on that date, the Company entered into a Stock Purchase Agreement with the Company's founder and former officer and director, Dr. Augustine Y. Cheung, whereby the Company sold to Dr. Cheung all of the issued and outstanding shares of capital stock of Canada. The Company also agreed to provide certain services to Canada pursuant to a Transition Services Agreement between the Company and Canada.

Under the Stock Purchase Agreement, all of the capital stock of Canada was transferred to Dr. Cheung in exchange for a promissory note made by Dr. Cheung in favor of the Company in the principal amount of \$1,500,000 to be paid over a period of up to 78 months and secured by a pledge of 100,536 shares of Celsion common stock owned by Dr. Cheung and his wife and the commitment of Canada to pay a 5 percent royalty on the net sales of certain products sold by and patent royalties received by Canada and its successors and assigns, of up to \$18,500,000.

The terms of the note receivable only specify an interest charge in the event that scheduled payments are in arrears. The value of the \$1,500,000 note was therefore discounted at the prime rate in effect January 16, 2006 (7.25%) plus 1.0%, or 8.25%, and the calculated net present value of \$1,146,428 was recorded in the financial statements. During the three months ended June 30, 2006 Celsion adjusted the note reducing the net present value from \$1,146,428 to \$1,049,509 and recording a charge against net income of \$96,919. This reduction reflects Dr. Cheung's agreement to forgo a bonus payment due under his employment contract in respect to his employment for 2005. Interest for the nine months ended September 30, 2006 was recorded in the amount of \$60,502. The next scheduled payment is due June 30, 2008 with additional payments due every six months thereafter through December 31, 2010.

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Note 6: Loan Receivable

In conjunction with the sale of Celsion (Canada) Limited, a Transition Services Agreement was entered into whereby Celsion sublet space in the Company's offices for use by Canada to carry on its business, for a period of up to six (6) months from the date of the agreement; provided administrative support services as needed in the operation of Canada's business for the period of the sublease and advanced funds to pay salary and health and dental insurance of each of certain employees of Canada and, in addition, expenses reasonably incurred in connection with the operation of Canada's business up to \$100,000 for the shorter of the period ending June 30, 2006 or the date of closing by Canada of a transaction involving the merger of Canada into a newly created Canadian Capital Pool Company and a simultaneous funding through a private placement of shares under terms approved by the Toronto Stock Exchange (the Canada Transaction). The Canada Transaction did not close by June 30, 2006. Based on discussions with Canada management, Celsion management established that diligent efforts were being made by Canada management to close the Canada Transaction on a timely basis and agreed to extend the due date for repayment of the loan to the earlier of the closing of the Canada Transaction or December 31, 2006. Within ten days after the closing of the Canada Transaction, Canada will pay the Company all amounts due under the Transition Services Agreement. If Canada fails to close the Canada Transaction, Celsion has the right to sell the 100,536 shares of stock being held as collateral.

The Transition Services Agreement was amended on March 28, 2006 to advance Celsion (Canada) Limited an additional \$200,000 to fund reasonable operating expenses. This additional advance is repayable under the same terms as the Transition Services Agreement. However, in the event of default, Dr. Cheung will forgo payments due under a consulting agreement between Celsion Corporation and Dr. Cheung dated January 16, 2006. The cumulative balance advanced under the Transition Services Agreement, as amended, at September 30, 2006 was \$571,200.

Note 7. Investment in Celsion China, Ltd.

On December 15, 2003 the Company announced the formation of a joint venture with Asia Pacific Life Science Group, Ltd., a group of Hong Kong-based investors, to develop our technologies and distribute our products in Greater China. Celsion acquired 45.65% of the equity of Celsion China Ltd for \$200,000 on February 5, 2004.

On January 12, 2006 Celsion acquired a further 25.65% of the equity of Celsion China Ltd. from Asia Pacific Life Science Group, Ltd for \$25,000 increasing Celsion's total equity position to 71.3%.

An additional cash advance in the amount of \$84,123 in the form of a loan was made to Celsion China, Ltd. on January 27, 2006.

Celsion Corporation terminated its interest in Celsion China Ltd. on May 9, 2006, and has recorded the loan write-off, other receivable write-off and final dissolution expenses related to Celsion China, Ltd. as a loss on investment in Celsion China Ltd.

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The financial records of Celsion China, Ltd. as of December 31, 2005 reflected the following:

	December 31, 2005
Cash	\$ 12,754
Inventory	62,500
Prepaid Insurance	6,000
Prepaid expense	17,439
Total current assets	98,693
Fixed assets, net	286
Total assets	\$ 98,979
Due to Celsion Corporation	\$ 68,605
Equity	442,216
Accumulated deficit	(411,842)
Total liabilities and equity	\$ 98,979

Celsion Corporation's balance sheet at December 31, 2005 reflects the investment in Celsion China in the account entitled Investment in Celsion China, Ltd., the components of which are as follows:

	December 31, 2005
Total cash investment	\$ 200,000
Accumulated loss	(188,006)
Net investment carrying value	\$ 11,994

Note 8. Licensing Agreement

The Distribution Agreement dated January 21, 2003 between Celsion Corporation and Boston Scientific Corporation (BSC or Boston Scientific) entitled Celsion to a \$4,000,000 licensing fee, effective upon the occurrence of certain events, in return for granting BSC a seven-year, royalty-free, exclusive right to market, distribute, import, export, use, sell and offer to sell Celsion's Prolieve Thermodilatation® system worldwide, with the exception of China, Taiwan, Hong Kong, Macao, Mexico and Central and South America. All of the conditions were met, and we received cash from BSC during the quarter ended March 31, 2004 in the amount of \$2,000,000. The remaining \$2,000,000 was placed in an escrow account, pursuant to the terms of the Distribution Agreement. The Company is recognizing the licensing fee, at the rate of approximately \$47,600 per month, over the seven-year term of the Distribution Agreement.

The escrow is designed to provide available funds for payment in the event of any legal expenses, settlements, license fees, royalties, damages or judgments incurred by Celsion or Boston Scientific in connection with any patent litigation related to alleged infringement of third party patents occurring during the 36-month term of the escrow. The escrow is held in an interest-bearing account, with interest accruing for the benefit of Celsion, but subject to the escrow. All amounts held in the account at the end of the term of the escrow are payable to Celsion. However, Celsion bears full responsibility for payment of claims subject to the escrow in excess of available escrowed funds.

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Inventory is comprised of Prolieve Thermodilatation system control units, parts inventory and associated disposable treatment kits. Inventory is stated at the lower of cost or market. Inventory on hand at September 30, 2006 and December 31, 2005 was as follows:

	September 30, 2006	December 31, 2005
Components	\$ 61,247	\$ 535,253
Finished Goods	3,013,947	2,830,093
	3,075,194	3,365,346
Less: reserve	29,725	39,706
	\$ 3,045,469	\$ 3,325,640

Note 10. Loan Payable

On August 8, 2005 we entered into a loan agreement with BSC whereby BSC will lend the Company up to \$15 million. The loan, which has a term expiring on February 20, 2009 and bears interest at a rate of prime plus 1 percent, has been disbursed in three installments. The first installment, in the amount of \$6 million, was disbursed on August 17, 2005. The second installment, in the amount of \$4.5 million, was disbursed on February 2, 2006. The third installment, in the amount of \$4.5 million, was disbursed on July 28, 2006. Interest is due on the first to occur of:

- (i) February 20, 2009;
- (ii) upon repayment of the principal amount in full;
- (iii) upon BSC's exercise of its option described in the footnotes, to purchase certain assets and technology; or
- (iv) on conversion of the principal amount plus accrued interest, if any, to shares of the Company's common stock.

The Company has the right to prepay the loan at any time without penalty.

The principal balance of this loan, together with all accrued and unpaid interest, is due and payable in full on February 29, 2009. At September 30, 2006 the accrued and unpaid interest to date was \$923,115.

Note 11. Treasury Stock

On February 27, 2006, the Company affected a 15:1 reverse stock split of the Company's issued and outstanding shares of common stock (the Common Stock). As of that date, each fifteen shares of the Company's issued and outstanding shares of Common Stock were automatically combined, converted and changed into one share of Common Stock of the Company (the Reverse Split). No fractional shares were issued as a result of the Reverse Split. Instead, the Company paid cash in lieu of fractional shares based on the average closing price of the Company's Common Stock for the five trading days prior to the effective date of the Reverse Split. Unless otherwise noted herein, all share numbers and per share financial information in this Quarterly Report on Form 10-Q is provided on a post-reverse stock split basis.

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Note 12. Contingencies

Purchase Commitment

Sanmina-SCI (Sanmina) and Celsion entered into a Medical Product Manufacturing Services Agreement on April 2, 2003 for the production of the Company's Prolieve Thermodilatation control units. It is stipulated in this agreement that Celsion may from time to time require Sanmina to acquire component inventories in excess of current demand. Any such inventory of components purchased and held by Sanmina will be designated as excess inventory; Celsion is responsible to reimburse Sanmina for the delivered cost of those components. As of September 30, 2006 Celsion and Sanmina have valued the excess components at \$255,418. In lieu of payment in full, Celsion, beginning October 1, 2005, is paying a 1.5% monthly inventory carrying charge. The amount paid in the nine months ended September 30, 2006 was \$38,690.

Legal Costs

On April 27, 2006 American Medical Systems, Inc. and AMS Research Corporation (together referred to as AMS) filed suit in the U.S. District Court for the District of Minnesota alleging infringement of two patents of AMS resulting from our manufacture, use and sale of the Prolieve Thermodilatation system. The suit is captioned American Medical Systems, Inc. and AMS Research Corporation vs. Celsion Corporation, Case no. 0:06-cv-01606-JMR-FLN. The complaint seeks injunctive relief against the alleged infringement, unspecified trebled damages, plaintiff costs, expenses and attorney fees. Celsion believes the suit is without merit and will defend its case vigorously.

On September 1, 2006 AMS amended the complaint alleging that Prolieve infringes two additional AMS patents.

The U.S. District Court for the District of Minnesota dismissed the patent infringement lawsuit filed by AMS against Celsion Corporation for lack of personal jurisdiction on September 27, 2006. A new suit was filed on September 28, 2006 against Celsion by AMS in the U.S. District Court for the District of Delaware, where both companies are incorporated, alleging that Celsion's Prolieve Thermodilatation System infringes the patents previously asserted in the Minnesota suit.

Under the licensing agreement with Boston Scientific an escrow account was established during March 2004. The escrow is designed to provide available funds for payment in the event of any legal expenses, settlements, license fees, royalties, damages or judgments incurred by Celsion or Boston Scientific in connection with any patent litigation related to alleged infringement of third party patents occurring during the 36-month term of the escrow. The escrow is held in an interest-bearing account, with interest accruing for the benefit of Celsion, but subject to the escrow. All amounts held in the escrow account at the end of the term (March 2007) are payable to Celsion. However, Celsion bears full responsibility for payment of claims in excess of available escrowed funds.

Legal expenses in the amount of \$543,365 have been incurred for the nine months ended September 30, 2006. The Company and Boston Scientific have requested and received disbursements in the amount of \$115,108 and \$20,865, respectively. Celsion intends to request disbursement for additional costs, as they become due.

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

Forward-Looking Statements

Statements and terms such as expect , anticipate , estimate , plan , believe and words of similar import regarding the Company's expectations of the development and effectiveness of its technologies, the potential demand for our products, and other aspects of our present and future business operations,

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constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Although we believe that our expectations are based on reasonable assumptions within the bounds of our knowledge of our industry, business and operations, we cannot guarantee that actual results will not differ materially from our expectations. In evaluating such forward-looking statements, readers should specifically consider the various factors contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 including, without limitation: the impact of potentially significant expenses to defend the AMS patent infringement lawsuit described in Part II, Item 1 of this Quarterly Report; the possibility that our common stock could be delisted from The American Stock Exchange as a result of the failure to comply with applicable listing standards; unforeseen changes in the course of research and development activities and in clinical trials; possible changes in cost and timing of development and testing, capital structure, and other financial items; changes in approaches to medical treatment; introduction of new products by others; possible acquisitions of other technologies, assets or businesses; and possible actions by customers, suppliers, competitors and regulatory authorities. These and other risks and uncertainties could cause actual results to differ materially from those indicated by such forward-looking statements, including those set forth in Management's Discussion and Analysis of Financial Condition and Results of Operations Risk Factors contained in the Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

The discussion of risks and uncertainties set forth in this Report and in our most recent Annual Report on Form 10-K as well as in other filings with the SEC, is not necessarily a complete or exhaustive list of all risks facing the Company at any particular point in time. We operate in a highly competitive, highly regulated and rapidly changing environment and our business is in a state of evolution. Therefore, it is likely that new risks will emerge, and that the nature and elements of existing risks will change, over time. It is not possible for management to predict all such risk factors or changes therein, or to assess either the impact of all such risk factors on our business or the extent to which any individual risk factor, combination of factors, or new or altered factors, may cause results to differ materially from those contained in any forward-looking statement. We disclaim any obligation to revise or update any forward-looking statement that may be made from time to time by us or on our behalf.

Overview

Celsion is a biotechnology company dedicated to furthering the development and commercialization of oncology drugs including tumor-targeting treatments using focused heat energy in combination with heat activated drug delivery. In 1989, we obtained premarketing approval (PMA) from the FDA to use our microwave-based Microfocus 1000 heat therapy system on surface and subsurface tumors in conjunction with radiation therapy. We marketed this system until 1995. From 1995 until early in 2004 we engaged in research and development of new treatment systems. On February 19, 2004, we obtained a PMA for our Prolieve Thermodilatation system for the treatment of Benign Prostatic Hyperplasia (BPH) and thereafter our marketing partner, Boston Scientific, commenced commercial sales of the Prolieve system. In addition, we are engaged in the development of treatment systems using a combination of heat and ThermoDox™, our proprietary heat activated liposomal encapsulation of doxorubicin, for the treatment of liver cancer and breast cancer.

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Development pipeline

Our pipeline presently consists of the following products, in the indicated stages of development:

Product	Status
<p>Prolieve Thermodilatation system for the treatment of BPH</p>	<p>We received premarketing approval (PMA) for the Prolieve system from the FDA on February 19, 2004. Since that time, we have been commercializing the Prolieve system through Boston Scientific. Boston Scientific has an option to purchase the Prolieve assets (expiring February 2009) for \$60 million.</p>
<p>ThermoDox (Doxorubicin-encapsulated thermo-liposome) plus heat for the treatment of cancer</p>	<p>We are conducting a Phase I clinical trial in collaboration with the National Institutes of Health and Queen Mary's Hospital in Hong Kong using ThermoDox in conjunction with radio frequency ablation (RFA) in the treatment of liver cancer. We are also sponsoring the conduct of an investigator initiated Phase I study of the use of ThermoDox for the treatment of recurrent chest wall (RCW) breast cancer.</p>

We anticipate that, in the near term (up to 12 months), the source of our revenues will be from sales of our Prolieve® system and related disposables. In the longer term (beyond 12 months), we expect to seek to develop new revenue streams from our current work with Duke University in targeted drug delivery systems. We anticipate that revenues will come from the licensing of these technologies to pharmaceutical manufacturers and from eventual sales to major institutional health care providers who would employ these technologies to deliver drug regimens throughout the body or from the sale of one or more of these technologies.

From 1995 to 2004, we generated only minimal revenues and have funded our operations primarily through private placements of our equity securities. During 2004, following FDA premarketing approval of our Prolieve Thermodilatation system, we received a one-time licensing fee of \$4 million under our agreement with Boston Scientific, the distributor of our Prolieve system. Since receipt of the PMA, in February, 2004 sales of Prolieve products generated revenues to us of \$21.6 million. Until such time as we are able to complete development and testing of, and gain necessary regulatory approvals for, one or more of our other products, sales of Prolieve products will represent our only source of revenue. We presently do not have any committed sources of financing. Therefore, we are reliant on revenues from the sale of our Prolieve products and from funds generated through the sale of our securities to fund our ongoing operations.

The Prolieve system consists of a microwave generator and conductors, along with a computer and computer software programs that control the focusing and application of heat (control units), plus a specially designed, single-use catheter kit. We expect to continue to generate revenues from sales of control units and catheter kits to Boston Scientific. Under our agreement with Boston Scientific, we are entitled to receive our costs plus 50% of the profit for each control unit measured as the difference between our costs and Boston Scientific's selling price (determined in accordance with the agreement) for each control unit and 50% of the revenue generated by Boston Scientific from the sale of catheter kits, for which Celsion bears the cost of goods sold. During the introduction of the Prolieve system, we anticipate that sales of both control units and catheter kits will increase. However, over time we expect that sales will level off.

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Our principal costs consist of:

cost of sales, relating to the production and sale of Prolieve control units and catheter kits, which are being marketed by Boston Scientific under a seven-year agreement (expiring in 2011);

research and development costs related to ThermoDox and Prolieve; and

corporate overhead.

Our research and development activities, pre-clinical tests and clinical trials, and the manufacturing, marketing and labeling of each of our products are subject to extensive regulation by the FDA. We may not bring to market any product in the U.S. without approval, in the form of a premarketing approval from the FDA. We received such premarketing approval for our Prolieve system on February 19, 2004. We are currently conducting basic research and development activities, pursuing prototype products through clinical testing and regulatory approval. Our ultimate objective is to commercialize those products to generate a return on investment for our stockholders through one of several means including:

selling products directly to end users;

selling products through a distributor (as is the case with our Prolieve products); and

licensing the technology to third parties and generating income through royalties and milestone payments.

During the quarter ended June 30, 2006, Celsion conducted a voluntary Class II recall related to its disposable catheter kit in order to correct a manufacturing issue that could cause the catheter to fail to reach operating pressure during a treatment. An investigation by the Company of the new catheter kit manufacturer revealed issues in the manufacturing process and in one of the components that resulted in the performance failure. The Company has since corrected both issues and filed a supplement with the FDA to approve the change in the manufacturing process. A Class II recall is a situation in which use of the product in question may cause temporary or medically reversible adverse health consequences or where the probability of serious adverse health consequences is remote. Shipments of disposable catheter kits began again in August 2006.

Recent Events

On September 7, 2006 Lawrence Olanoff, M.D, Ph.D., President and Chief Executive Officer, tendered his resignation effective October 6, 2006. Anthony P. Deasey, Celsion's Executive Vice President, Chief Operating Officer and Chief Financial Officer was named Interim President and Chief Executive Officer of Celsion during the transitional period while a permanent Chief Executive Officer is recruited.

Gary W. Pace, Ph.D. and Kris Venkat, Ph.D., members of Celsion's Board of Directors, will actively assist executive management during the transition period. Both Drs. Pace and Venkat have extensive pharmaceutical development and business expertise to contribute to this effort. As part of the goal of establishing a separate oncology drug development business, and advancing the current drug development program, William Hahne, M.D., who was Vice President Clinical and Medical Affairs, was promoted to the newly established position of Vice President of Research and Development. Anthony P. Deasey also assumed the position of President of the Prolieve Division.

As of October 16, 2006 the Company had enrolled 21 patients in its ThermoDox/RFA liver cancer Phase I study. Celsion is conducting the study in collaboration with the National Institutes of Health (NIH) and Queen Mary's Hospital, Hong Kong, and is aggressively recruiting patients eligible for enrollment in the study both at the NIH and Queen Mary's Hospital. The Company believes this study is close to determining the dose which triggers dose-limiting toxicity as defined in the protocol.

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Celsion has provided a research grant in the amount of \$500,000 to Duke University and is providing clinical supplies of ThermoDox to support a Phase I, open label study of the safety and pharmacokinetics in Recurrent Chest Wall Breast Cancer patients. To date, Duke has enrolled and initiated treatment in six patients.

Results of Operations

Comparison of Three Months Ended September 30, 2006 and Three Months Ended September 30, 2005

	Actual Results		Change	
	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Dollars	Percent
Net Sales	\$ 4,122,908	\$ 3,205,829	917,079	29
Cost of sales	1,903,144	2,186,640	(283,496)	(13)
Gross margin	2,219,764	1,019,189	1,200,575	118
Operating expenses:				
Research and development	2,337,269	2,293,562	43,707	2
General and administrative	849,745	810,244	39,501	5
Total operating expenses	3,187,014	3,103,806	83,208	3
Loss from operations	\$ (967,250)	\$ (2,084,617)	(1,117,367)	(54)
Interest income (expense), net	\$ (167,432)	\$ 10,227	(177,659)	(1,737)
Other income, net	\$ 143,534	\$ 120,525	23,009	19
Net Loss	\$ (991,148)	\$ (1,953,865)	(962,717)	(49)

Net sales for the quarter ended September 30, 2006 were \$4,122,908, an increase of \$917,079 or (29%), compared to \$3,205,829 in the quarter ended September 30, 2005. Product sales consist of sales of our Prolieve products and are comprised of two elements – sales of control units and sales of disposable catheter kits, all to our exclusive distributor, Boston Scientific Corporation. The increase in revenues during the quarter ended September 30, 2006 compared to the quarter ended September 30, 2005, was the result of continued sales growth of the Prolieve product and was achieved despite the fact that the Company was unable to ship product during the period July 1, 2006 to August 10, 2006, as a result of a product recall. Sales in the quarter were positively affected by the impact of sales to Boston Scientific required to re-build its warehouse inventory.

The gross margin for the quarter ended September 30, 2006 was \$2,219,764 or (53.9%) of sales compared to \$1,019,189 or (31.8%) of sales for the quarter ended September 30, 2005. The increase in gross margin percentage is the result of a cost reduction due to transfer of the production of the disposable Prolieve catheter kit to a new supplier.

The increase of \$43,707 or (2%) in research and development expense during the quarter compared to the quarter ended September 30, 2005 was due to a number of factors including:

stock option expense resulting from the Company's adoption of SFAS 123(R) (\$131,000);

clinical trial costs and animal studies (\$26,000); and

patent infringement lawsuit costs (\$326,000).

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These increases were offset by:

a reduction in consulting support and development costs for the Prolieve system (\$140,000);

a reduction in staff (\$186,000); and

reduction in liposome manufacturing costs (\$114,000).

The \$39,501 or (5%) increase in general and administrative expense during the quarter ended September 30, 2006 compared to the comparable period during 2005 was due to a number of factors including:

stock option expense resulting from the Company's adoption of SFAS 123(R) (\$190,000);

increase of director fees (\$21,000);

increased general consulting expenses (\$85,000); and

increased investor relation expenses (\$29,000).

These increases were offset by:

a reduction in legal expenses (unrelated to patent infringement lawsuit) (\$147,000);

a reduction in bad debt expenses (\$62,000);

a reduction in salaries (\$60,000); and

timing of Delaware Franchise taxes (\$16,000).

The increase in the gross profit generated from the sale of Prolieve products (\$1,200,575), offset by an increase in operating expenses of \$83,208, resulted in a decrease in the loss from operations for the three-month period ended September 30, 2006 of \$1,117,367 or 54%, to \$967,250 from \$2,084,617 in the comparable period during the prior fiscal year.

Net interest in the quarter ended September 30, 2006 was an expense of \$167,432 compared to income of \$10,227 for the quarter ended September 30, 2005. This change was due to funding the business with a loan from Boston Scientific which closed on August 8, 2005.

Other income for the quarter ended September 30, 2006 was \$143,534 compared to \$120,525 for the quarter ended September 30, 2005, an increase of \$23,009, primarily due to non-recurrence of a loss in 2005 on the investment in Celsion China Ltd.

The net loss for the quarter ended September 30, 2006 was \$991,148 compared to \$1,953,865 for the quarter ended September 30, 2005 a decrease of \$962,717 principally due to the increase in gross margin.

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Comparison of Nine Months Ended September 30, 2006 and Nine Months Ended September 30, 2005

	Actual Results			
	Nine Months Ended September 30,		Change	
	2006	2005	Dollars	Percent
Net Sales	\$ 6,775,117	\$ 7,972,332	(1,197,215)	(15)
Cost of sales	4,309,519	5,385,196	(1,075,677)	(20)
Gross margin	2,465,598	2,587,136	(121,538)	(5)
Operating expenses:				
Research and development	6,906,888	6,997,480	(90,592)	(1)
General and administrative	2,942,855	2,648,247	294,608	11
Total operating expenses	9,849,743	9,645,727	(204,016)	(2)
Loss from operations	\$ (7,384,145)	\$ (7,058,591)	325,554	5
Interest income (expense), net	\$ (296,792)	\$ 135,466	(432,258)	(319)
Other income, net	\$ 1,183,469	\$ 361,970	821,499	227
Net Loss	\$ (6,497,468)	\$ (6,561,155)	(63,687)	(1)

Net sales for the nine months ended September 30, 2006 were \$6,775,117, a decrease of \$1,197,215 or (15%), compared to \$7,972,332 for the nine months ended September 30, 2005. Product sales consist of sales of our Prolieve products and are comprised of two elements – sales of control units and sales of disposable catheter kits, all to our exclusive distributor, Boston Scientific Corporation. The decrease in revenues in the period was principally due to an interruption in the supply of product caused by a product recall due to manufacturing defects occurring during a change in the manufacturing process due to the transition to a new supplier of our disposable Prolieve catheter kit.

The gross margin for the nine months ended September 30, 2006 was \$2,465,598 or (36.4%) compared to \$2,587,136 or (32.5%) of sales for the nine months ended September 30, 2005. Year to date gross margin as a percentage of sales is lower than the current quarter gross margin due to costs incurred in scrapping returned and recalled product.

The decrease of \$90,592, or (1%) in research and development expense during the nine months ended September 30, 2006 compared to the nine months ended September 30, 2005 was due primarily to a number of factors including:

non-recurrence of a termination fee payable in the second quarter of 2005 in connection with migration of manufacturing of catheter kits to a new supplier (\$350,000);

non-recurrence of costs associated with our breast cancer treatment device and heat activated gene technology which have since been discontinued (\$422,000);

a reduction in consulting support and development costs for the Prolieve system (\$610,000); and

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patent related legal costs (\$264,000).

These decreases were offset by:

stock option expense resulting from the Company's adoption of SFAS 123(R) (\$391,000);

increased clinical trial costs (\$260,000);

additional regulatory and quality assurance consulting support (\$365,000); and

patent infringement lawsuit costs (\$543,000).

The \$294,608 or (11%) increase in general and administrative expense during the nine months ended September 30, 2006 as compared to the comparable period during 2005 was attributable to a number of factors including:

stock option expense resulting from the Company's adoption of SFAS 123(R) (\$479,000);

consulting costs (\$130,000);

timing of director's compensation (\$101,000); and

legal costs incurred as a result of outsourcing legal services (\$57,000).

These increases were offset by:

reduction in staffing and related costs (\$258,000);

reduction in legal expense (unrelated to patent infringement lawsuit) (\$147,000); and

bad debt expense related to Celsion China (\$62,000).

The net increase of \$204,016 in operating expenditures during the nine months ended September 30, 2006 when compared to the nine months ended September 30, 2005, combined with the charges associated with the product recall, resulted in an increase in the loss from operations for the nine month period ended September 30, 2006 of \$325,554 or 5%, to \$7,384,145 from \$7,058,591 in the comparable period during the prior fiscal year.

Net interest in the nine months ended September 30, 2006 was an expense of \$296,792 compared to income of \$135,466 for the nine months ended September 30, 2005. This change was due to funding the business with a loan from Boston Scientific which closed on August 8, 2005.

Other income for the nine months ended September 30, 2006 was \$1,183,469 compared to \$361,970 for the nine months ended September 30, 2005, an increase of \$821,499 principally due to a gain of \$1,011,923 on the sale of the stock of Celsion (Canada) Limited on January 16, 2006.

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The net loss for the nine months ended September 30, 2006 was \$6,497,468 compared to \$6,561,155 for the nine months ended September 30, 2005, a decrease of \$63,687 principally due to the gain on the sale of Celsion (Canada) Limited offset by the increased interest expense on the Boston Scientific loan and costs associated with the product recall.

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Financial Condition, Liquidity and Capital Resources

Celsion's core business activity is the development of products to treat cancer and other diseases and to commercialize those products to generate a return on investment for its stockholders through one of several means including:

selling products directly to end users;

selling product through a distributor (as is the case with its Prolieve products);

licensing its technology to third parties and generating income through royalties and milestone payments; and

outright sale of a technology directly or, ultimately, through the sale of the entire Company.

This business model will generate uneven cash flows, inasmuch as continuing development expenditures will not necessarily be matched by revenues from one of the above sources. In the event that annual development expenditures are not covered by current revenues, funding will be provided from other sources including any cash on hand, revenues provided as above, income generated from licensing agreements and debt or equity funding raised in the capital markets.

Since inception, our expenses have significantly exceeded our revenues, resulting in an accumulated deficit of \$89,400,052 at September 30, 2006. We have incurred negative cash flows from operations since our inception and have funded our operations primarily through the sale of equity securities. As of September 30, 2006, we had total current assets of \$16,586,579, including cash and short term investments of \$10,372,878, compared with current liabilities of \$3,507,832, resulting in a working capital surplus of \$13,078,747. As of December 31, 2005 we had \$8,313,430 in cash and short term investments and total current assets of \$12,841,104 compared with current liabilities of \$3,885,463, which resulted in working capital of \$8,955,641 at the fiscal year end.

Net cash used in the Company's operating activities for the nine months ended September 30, 2006 was \$6,145,099 compared to \$7,151,285 for the nine months ending September 30, 2005. This net cash requirement was funded from cash on hand at the beginning of the year, together with the second and third installments of a loan from Boston Scientific totaling \$9 million. Under the loan agreement, which was effective on August 8, 2005, Boston Scientific agreed to lend the Company up to \$15 million, disbursed in three installments. The first installment, in the amount of \$6 million, was disbursed on August 17, 2005. The second installment of \$4.5 million was disbursed on February 2, 2006 and the third installment of \$4.5 million was disbursed on July 28, 2006. The loan, which has a term expiring on February 20, 2009 and bears interest at a rate of prime plus 1 percent is due on the first to occur of:

February 20, 2009;

upon repayment of the principal amount and accrued interest in full;

upon Boston Scientific's exercise of its option, described below, to purchase certain assets and technology; or

on conversion of the principal amount plus accrued interest, if any, to shares of Company common stock.

The Company has the right to prepay the loan at any time without penalty.

Boston Scientific may at any time convert in whole or in part the outstanding principal plus accrued interest into shares of the Company's common stock at a minimum conversion price of \$9.15 per share. Additionally, Boston Scientific may apply the outstanding principal plus accrued interest toward the option exercise price if Boston Scientific decides to exercise the option granted by the Company. The option granted

by the Company gives Boston Scientific the right to purchase for \$60 million the assets and

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technology relating to the manufacture, marketing, sale, distribution and/or research and development of products using thermal therapy for the treatment of BPH. There can be no assurance when, if ever, Boston Scientific will exercise its right to purchase. In the event that Boston Scientific does exercise its option, the Company will receive an immediate infusion of cash but will cease to receive revenues from the sale of Prolieve systems and related disposables.

In the nine months ended September 30, 2006 total assets and total liabilities and shareholder equity increased by \$3,408,094 to \$19,317,535 compared to \$15,909,441 at December 31, 2005. The increase was due to a number of factors including:

an increase in accounts receivable of \$152,508 due to the higher sales during the quarter ended September 30, 2006;

an increase in cash and cash equivalents and short term investments of \$2,059,448 as detailed in the statement of cash flows;

an increase of \$571,200 in loans receivable related to the sale of Celsion Canada Ltd.; and

a note receivable of \$1,038,416 representing the obligations of Dr. Cheung, our former CEO, relative to the purchase of the stock of Celsion (Canada) Ltd.

The increases were offset by:

a decrease in inventories of \$280,171 due to a decrease in component inventory as a result of discontinuation of a catheter kit supplier and an increase in the inventory reserve also related to the change in suppliers.

The increase in total liabilities and stockholder equity was due to a number of factors including:

the impact of stock related costs of \$922,437 recorded as a result of the adoption of FAS 123(R);

an increase in accrued interest payable of \$745,490 on the loan from Boston Scientific in the nine months ended September 30, 2006; and

the disbursement, on February 6, 2006, by Boston Scientific of the second and on July 28, 2006 the third installment, each of \$4.5 million, increasing the amount of the loan payable by \$9.0 million to \$15.0 million.

These increases were offset by:

a decrease in accounts payable trade and other accrued liabilities of \$372,332;

an increase in the accumulated deficit of \$6,497,468 reflecting the net loss for the nine months ended September 30, 2006; and

a decrease of \$428,572 in the deferred revenue license fee for amortization for the nine months ending September 30, 2006.

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Additionally, the escrow account license fee balance was reclassified from other assets to current assets due to the expiration of the 36 month escrow period set for March, 2007. Costs of \$135,973 have been disbursed from the escrow account during the quarter ended September 30, 2006.

For fiscal year 2006, we expect to expend approximately \$10,000,000 to commercialize our Prolieve system and for clinical testing of liver cancer and breast cancer treatment systems, as well as for corporate

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overhead, all of which we expect to fund from funds on hand and revenues anticipated from the sale of our Prolieve system and related disposables. The foregoing is an estimate, based upon assumptions as to the scheduling of institutional clinical research and testing personnel, the timing of clinical trials and other factors, not all of which are fully predictable.

Item 3. Quantitative and Qualitative Disclosure about Market Risk.

Our loan from Boston Scientific Corporation bears interest at a variable rate; therefore changes in prevailing interest rates would impact the amount owed under such loans. A one percentage point fluctuation in interest rates would not have a material impact.

Item 4. Controls and Procedures

We have carried out an evaluation, under the supervision and with the participation of management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as that term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended. Based on that evaluation, our principal executive officer and principal financial officer concluded that as of September 30, 2006, which is the end of the period covered by this report, our disclosure controls and procedures are effective.

There has been no change in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 of the Securities Exchange Act of 1934, as amended, that occurred during the quarter ended September 30, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II

OTHER INFORMATION

Item 1. Legal Proceedings

As previously disclosed in our Current Report on Form 8-K filed with the SEC on May 3, 2006, and on Quarterly Report on Form 10-Q filed with the SEC on May 11, 2006, on April 27, 2006 American Medical Systems, Inc. and AMS Research Corporation (together referred to as AMS) filed suit in the U.S. District Court for the District of Minnesota alleging infringement of two patents of AMS resulting from our manufacture, use and sale of the Prolieve Thermodilatation system. The suit is captioned American Medical Systems, Inc. and AMS Research Corporation vs. Celsion Corporation, Case no. 0:06-cv-01606-JMR-FLN. The complaint seeks injunctive relief against the alleged infringement, unspecified trebled damages, plaintiff costs, expenses and attorney fees. Celsion believes the suit is without merit and will defend its case vigorously.

On September 1, 2006 AMS amended the complaint alleging that Prolieve infringes two additional AMS patents.

On September 27, 2006, the U.S. District Court for the District of Minnesota dismissed the patent infringement lawsuit filed by American Medical Systems, Inc. (AMS) against us for lack of personal jurisdiction. On September 28, 2006, AMS filed a new suit against us in the U.S. District Court for the District of Delaware, where both companies are incorporated (case no. CA-06-606 (SLR)), alleging that our Prolieve Thermodilatation System infringes the patents previously asserted in the Minnesota suit. The complaint seeks injunctive relief against alleged infringement, unspecified trebled damages, plaintiff costs, expenses and attorney fees.

Item 1A. Risk Factors.

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2005, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

If we fail to regain compliance with AMEX's continued listing standards, our Common Stock may be delisted, which would be likely to have a material adverse effect on the price of our common stock.

On June 15, 2006, we received a letter from the American Stock Exchange (AMEX) notifying us that, based on our Quarterly Report on Form 10-Q for the period ended March 31, 2006, we are not in compliance with the continued listing standards set forth in the AMEX Company Guide in that our shareholder's equity is less than \$4,000,000 and we had losses from continuing operations and/or net losses in three of our four most recent fiscal years and that shareholder's equity was less than \$6,000,000 and losses from continuing operations and/or net losses were incurred in the last five fiscal years. At the request of AMEX, on July 13, 2006, we submitted a plan advising AMEX of actions we have taken, and will take, to bring us into compliance with the continued listing standards within a maximum of 18 months from June 14, 2006.

On August 31, 2006, we received a letter from AMEX notifying us that based upon a review of our Quarterly Report on Form 10-Q for the period ended June 30, 2006, we are not in compliance with an additional continued listing standard in that our shareholders' equity is less than \$2,000,000 and we had losses from continuing operations and/or net losses in two of our three most recent fiscal years. AMEX also notified us on August 31, 2006 that it has accepted our plan of compliance and that our plan makes a

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reasonable demonstration of our ability to regain compliance with the continued listing standards. In connection with the acceptance of our plan, AMEX has granted us an extension until December 14, 2007 to regain compliance with the continued listing standards. AMEX will allow us to maintain our AMEX listing through the plan period, subject to periodic review of our progress by the AMEX staff. If we are not in compliance with the continued listing standards or do not make progress consistent with our plan during the plan period, AMEX may then initiate delisting proceedings. The failure to maintain listing of our Common Stock on AMEX would be likely to have a material adverse effect on the market and the market price for our Common Stock.

Item 6. Exhibits.

- 10.1 Form of Restricted Stock Agreement for Celsion Corporation 2004 Stock Incentive Plan (Filed herewith)
- 10.2 Form of Stock Option Grant Agreement for Celsion Corporation 2004 Stock Incentive Plan (Filed herewith)
- 11 Statement Re: Computation of Earnings Per Share (Filed herewith)
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Filed herewith)
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Filed herewith)
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Furnished herewith)
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Furnished herewith)

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SIGNATURES

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.

November 8, 2006

CELSION CORPORATION

Registrant

By: /s/ Anthony P. Deasey
Anthony P. Deasey
Chief Executive Officer, Chief Operating Officer
and Chief Financial Officer (Principal Financial and
Chief Accounting Officer)

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Exhibit Index

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