

STERLING CHEMICALS INC

Form 10-Q

August 11, 2009

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

**Form 10-Q**

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

**For the quarterly period ended June 30, 2009**

**OR**

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

**For the transition period from           to  
Commission File Number 000-50132**

**Sterling Chemicals, Inc.**  
*(Exact name of registrant as specified in its charter)*

**Delaware**  
*(State or other jurisdiction of  
Incorporation or organization)*

**76-0502785**  
*(IRS Employer Identification No.)*

**333 Clay Street, Suite 3600  
Houston, Texas 77002-4109**  
*(Address of principal executive offices)*

**(713) 650-3700**  
*(Registrant's telephone number,  
including area code)*

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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

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

As of July 31, 2009, Sterling Chemicals, Inc. had 2,828,460 shares of common stock outstanding.

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**IMPORTANT INFORMATION REGARDING THIS FORM 10-Q**

Unless otherwise indicated, references to we, us, our and ours in this Form 10-Q refer collectively to Sterling Chemicals, Inc. and its wholly-owned subsidiaries.

Readers should consider the following information as they review this Form 10-Q:

**Forward-Looking Statements**

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the United States Securities Exchange Act of 1934, as amended, or the Exchange Act. Forward-looking statements give our current expectations or forecasts of future events. All statements other than statements of historical fact are, or may be deemed to be, forward-looking statements. Forward-looking statements include, without limitation, any statement that may project, indicate or imply future results, events, performance or achievements, and may contain or be identified by the words expect, intend, plan, predict, anticipate, estimate, believe, should, could, may, might, will, will be, will continue, forecast, budget and similar expressions. Statements in this report that contain forward-looking statements include, but are not limited to, information concerning our possible or assumed future results of operations. While our management considers these expectations and assumptions to be reasonable, they are inherently subject to significant business, economic, competitive, regulatory and other risks, contingencies and uncertainties, most of which are difficult to predict and many of which are beyond our control.

Other sections of this Form 10-Q and our other filings with the Securities and Exchange Commission, or the SEC, including, without limitation, our Annual Report on Form 10-K for the fiscal year ended December 31, 2008, or our Annual Report, include additional factors that could adversely affect our business, results of operations or financial performance. See Risk Factors contained in Item 1A of Part I of our Annual Report. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements. Forward-looking statements included in this Form 10-Q are made only as of the date of this Form 10-Q and are not guarantees of future performance. Although we believe that the expectations reflected in these forward-looking statements are reasonable, such expectations may prove to be incorrect. All written or oral forward-looking statements attributable to us, or persons acting on our behalf, are expressly qualified in their entirety by these cautionary statements.

**Document Summaries**

Descriptions of documents and agreements contained in this Form 10-Q are provided in summary form only, and such summaries are qualified in their entirety by reference to the actual documents and agreements filed as exhibits to our Annual Report, other periodic reports we file with the SEC or this Form 10-Q.

**Access to Filings**

Access to our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to those reports, filed with or furnished to the SEC pursuant to Section 13(a) of the Exchange Act, as well as reports filed electronically pursuant to Section 16(a) of the Exchange Act, may be obtained through our website (<http://www.sterlingchemicals.com>), at no cost, as soon as reasonably practicable after we have electronically filed such material with the SEC. The contents of our website (or the third-party websites accessible through the various hyperlinks) are not, and shall not be deemed to be, incorporated into this Form 10-Q.

**STERLING CHEMICALS, INC.  
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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of Sterling Chemicals, Inc.:

We have reviewed the accompanying condensed consolidated balance sheet of Sterling Chemicals, Inc. and its subsidiaries (the Company) as of June 30, 2009, and the related condensed consolidated statements of operations for the three and six month periods ended June 30, 2009 and 2008 and cash flows for the six months ended June 30, 2009. These interim financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying condensed consolidated financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

GRANT THORNTON LLP

Houston, Texas

August 11, 2009

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**PART I.**  
**FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**STERLING CHEMICALS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(Unaudited)**  
**(Dollars in Thousands, Except Share Data)**

|   | Three months ended June |             | Six months ended June |             |
|---|-------------------------|-------------|-----------------------|-------------|
|   | 30,                     |             | 30,                   |             |
|   | 2009                    | 2008        | 2009                  | 2008        |
| Revenues  | \$ 26,941               | \$ 47,837   | \$ 58,318             | \$ 86,095   |
| Cost of goods sold  | 25,773                  | 38,040      | 51,582                | 71,925      |
| Gross profit  | 1,168                   | 9,797       | 6,736                 | 14,170      |
| Selling, general and administrative expenses  | 3,344                   | 3,787       | 7,227                 | 6,205       |
| Impairment of long-lived assets   |                         | 6,649       |                       | 6,649       |
| Interest and debt related expenses  | 3,968                   | 4,719       | 7,971                 | 8,931       |
| Interest income   | (212)                   | (1,107)     | (596)                 | (2,432)     |
| Other income  | (1,544)                 |             | (2,689)               |             |
| Loss from continuing operations before income tax   | (4,388)                 | (4,251)     | (5,177)               | (5,183)     |
| Benefit for income taxes  | (1,022)                 |             | (1,217)               |             |
| Loss from continuing operations   | \$ (3,366)              | \$ (4,251)  | \$ (3,960)            | \$ (5,183)  |
| Income (loss) from discontinued operations, net of tax of \$1,043, zero, \$1,912 and zero, respectively | 1,928                   | (1,603)     | 3,550                 | (7,857)     |
| Net loss  | \$ (1,438)              | \$ (5,854)  | \$ (410)              | \$ (13,040) |
| Preferred stock dividends   | 3,894                   | 4,422       | 8,041                 | 8,693       |
| Net loss attributable to common stockholders  | \$ (5,332)              | \$ (10,276) | \$ (8,451)            | \$ (21,733) |
| Income (loss) per share of common stock attributable to common stockholders, basic and diluted:         |                         |             |                       |             |
| Loss from continuing operations   | \$ (2.57)               | \$ (3.06)   | \$ (4.25)             | \$ (4.91)   |
| Income (loss) from discontinued operations, net of tax  | 0.68                    | (0.57)      | 1.26                  | (2.77)      |
| Basic and diluted loss per share  | \$ (1.89)               | \$ (3.63)   | \$ (2.99)             | \$ (7.68)   |
| Weighted average shares outstanding:  |                         |             |                       |             |
| Basic and diluted   | 2,828,460               | 2,828,460   | 2,828,460             | 2,828,460   |

The accompanying notes are an integral part of the condensed consolidated financial statements.

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**STERLING CHEMICALS, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(Unaudited)**  
**(Dollars in Thousands, Except Share Data)**

|  | <b>June 30,<br/>2009</b> | <b>December<br/>31,<br/>2008</b> |
|--|--------------------------|----------------------------------|
| <b>ASSETS</b>  |                          |                                  |
| Current assets:  |                          |                                  |
| Cash and cash equivalents  | \$ 150,786               | \$ 156,126                       |
| Accounts receivable, net of allowance of \$18 and \$18, respectively                                   | 15,060                   | 23,163                           |
| Inventories, net   | 5,692                    | 5,221                            |
| Prepaid expenses and other current assets  | 1,257                    | 2,704                            |
| Assets of discontinued operations  | 100                      | 166                              |
| <br>Total current assets   | <br>172,895              | <br>187,380                      |
| Property, plant and equipment, net   | 71,073                   | 67,811                           |
| Other assets, net  | 7,232                    | 7,838                            |
| <br>Total assets   | <br>\$ 251,200           | <br>\$ 263,029                   |
| <br><b>LIABILITIES AND STOCKHOLDERS DEFICIENCY IN ASSETS</b>   |                          |                                  |
| Current liabilities:   |                          |                                  |
| Accounts payable   | \$ 8,469                 | \$ 8,915                         |
| Accrued liabilities  | 13,146                   | 20,008                           |
| Liabilities of discontinued operations   | 14,310                   | 12,444                           |
| <br>Total current liabilities  | <br>35,925               | <br>41,367                       |
| Long-term debt   | 150,000                  | 150,000                          |
| Deferred credits and other liabilities   | 59,130                   | 59,103                           |
| Long-term liabilities of discontinued operations   | 29,201                   | 35,394                           |
| Commitments and contingencies (Note 4)   |                          |                                  |
| Redeemable preferred stock   | 125,648                  | 117,607                          |
| Stockholders' equity:  |                          |                                  |
| Common stock, \$.01 par value (shares authorized 100,000,000; shares issued and outstanding 2,828,460) | 28                       | 28                               |
| Additional paid-in capital   | 115,888                  | 123,740                          |
| Accumulated deficit  | (240,233)                | (239,823)                        |
| Accumulated other comprehensive loss   | (24,387)                 | (24,387)                         |
| <br>Total stockholders' deficiency in assets   | <br>(148,704)            | <br>(140,442)                    |
| <br>Total liabilities and stockholders' deficiency in assets   | <br>\$ 251,200           | <br>\$ 263,029                   |



The accompanying notes are an integral part of the condensed consolidated financial statements.

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**STERLING CHEMICALS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**  
**(Dollars in Thousands)**

|   | <b>Six months ended June 30,</b> |                |
|---|----------------------------------|----------------|
|   | <b>2009</b>                      | <b>2008</b>    |
| Cash flows from operating activities:   |                                  |                |
| Net loss  | \$ (410)                         | \$ (13,040)    |
| Adjustments to reconcile net loss to net cash provided by operating activities: |                                  |                |
| Stock compensation expense  | 189                              | 46             |
| Bad debt expense  |                                  | 10             |
| Depreciation and amortization   | 4,547                            | 5,082          |
| Interest amortization   | 553                              | 810            |
| Unearned income amortization  | (7,274)                          | (5,744)        |
| Impairment of long-lived assets   |                                  | 6,649          |
| Gain on disposal of property, plant and equipment                               | (305)                            |                |
| Other   |                                  | 2              |
| Change in assets/liabilities:   |                                  |                |
| Accounts and other receivables  | 8,169                            | 60,295         |
| Inventories   | (471)                            | 15,010         |
| Prepaid expenses and other current assets                                       | 1,447                            | 2,620          |
| Other assets  | (422)                            | (126)          |
| Accounts payable  | (1,400)                          | 1,846          |
| Accrued liabilities   | (4,996)                          | (6,533)        |
| Other liabilities   | 1,108                            | (3,862)        |
| <br>Net cash provided by operating activities                                   | <br>\$ 735                       | <br>\$ 63,065  |
| <br>Cash flows used in investing activities:                                    |                                  |                |
| Capital expenditures for property, plant and equipment                          | (6,380)                          | (2,757)        |
| Net proceeds from the sale of property, plant and equipment                     | 305                              |                |
| <br>Net cash used in investing activities                                       | <br>(6,075)                      | <br>(2,757)    |
| <br>Cash flows provided by financing activities:                                |                                  |                |
| Net cash provided by financing activities                                       |                                  |                |
| <br>Net increase (decrease) in cash:  | <br>(5,340)                      | <br>60,308     |
| Cash and cash equivalents beginning of year                                     | 156,126                          | 100,183        |
| <br>Cash and cash equivalents end of period                                     | <br>\$ 150,786                   | <br>\$ 160,491 |
| <br>Supplemental disclosures of cash flow information:                          |                                  |                |

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|                            |    |       |    |       |
|----------------------------|----|-------|----|-------|
| Interest paid              | \$ | 8,358 | \$ | 8,039 |
| Interest income received   |    | 596   |    | 2,433 |
| Cash paid for income taxes |    |       |    | 404   |

The accompanying notes are an integral part of the condensed consolidated financial statements.

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**STERLING CHEMICALS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**1. Basis of Presentation**

The accompanying unaudited interim condensed consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP, and reflect all adjustments (including normal recurring accruals) which, in our opinion, are considered necessary for the fair presentation of the results for the periods presented. The results of operations and cash flows for the periods presented are not necessarily indicative of the results to be expected for the full year. These statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report.

*Reclassifications and Revisions:*

During the quarter ended March 31, 2009, we determined we had incorrectly accounted for certain utility allocations at our Texas City facility, specifically accounting for the flow of water throughout our facility. In accordance with Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements, we evaluated the materiality of the misstatement from qualitative and quantitative perspectives and concluded that although the misstatement was immaterial to all prior year financial statements, its correction in the quarter ended March 31, 2009 would be material. Therefore, we are revising the condensed consolidated statement of operation and statement of cash flows for the three and six-month periods ended June 30, 2008, and the condensed consolidated balance sheet as of December 31, 2008, to correct the utility allocation misstatement.

The following table summarizes the effects of the revision on the applicable periods:

|  | <b>Three Months Ended</b>     |           | <b>Six Months Ended</b>       |           |
|--|-------------------------------|-----------|-------------------------------|-----------|
|  | <b>June 30, 2008</b>          |           | <b>June 30, 2008</b>          |           |
|  | <b>(Dollars in Thousands)</b> |           | <b>(Dollars in Thousands)</b> |           |
|  | Previously                    | As        | Previously                    | As        |
|  | Reported                      | Revised   | Reported                      | Revised   |
| <b>Statement of Operations:</b>  |                               |           |                               |           |
| Revenues   | \$ 47,795                     | \$ 47,837 | \$ 85,995                     | \$ 86,095 |
| Cost of goods sold   | 37,969                        | 38,040    | 71,767                        | 71,925    |
| Gross profit   | 9,826                         | 9,797     | 14,228                        | 14,170    |
| Loss from continuing operations before income tax                                      | (4,222)                       | (4,251)   | (5,125)                       | (5,183)   |
| Loss from continuing operations  | (4,222)                       | (4,251)   | (5,125)                       | (5,183)   |
| Loss from discontinued operations, net of tax of zero                                  | (1,588)                       | (1,603)   | (7,813)                       | (7,857)   |
| Net loss   | (5,810)                       | (5,854)   | (12,938)                      | (13,040)  |
| Net loss attributable to common stockholders   | (10,232)                      | (10,276)  | (21,631)                      | (21,733)  |
| Loss per share of common stock attributable to common stockholders, basic and diluted: |                               |           |                               |           |
| Loss from continuing operations  | \$ (3.06)                     | \$ (3.06) | \$ (4.89)                     | \$ (4.91) |
| Loss from discontinued operations, net of tax  | (0.56)                        | (0.57)    | (2.76)                        | (2.77)    |
| Basic and diluted loss per share   | \$ (3.62)                     | \$ (3.63) | \$ (7.65)                     | \$ (7.68) |

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**STERLING CHEMICALS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)**

|  | <b>Six Months Ended<br/>June 30, 2008<br/>(Dollars in Thousands)</b> |             |
|--|--|-------------|
|  | Previously<br>Reported   | As Revised  |
| <b>Statement of Cash Flows:</b>          |  |             |
| Net loss                                 | \$ (12,938)  | \$ (13,040) |
| Change in accounts and other receivables | 60,193   | 60,295      |

|  | <b>As of December 31, 2008<br/>(Dollars in Thousands)</b> |            |
|--|---|------------|
|  | Previously<br>Reported                                    | As Revised |
| <b>Balance Sheet:</b>                                    |   |            |
| Accounts and other receivables, net of allowance         | \$ 22,080   | \$ 23,163  |
| Total current assets                                     | 186,297   | 187,380    |
| Total assets   | 261,946   | 263,029    |
| Accumulated deficit                                      | (240,906)   | (239,823)  |
| Total stockholders' deficiency in assets                 | (141,525)   | (140,442)  |
| Total liabilities and stockholders' deficiency in assets | 261,946   | 263,029    |

In addition to the above, our valuation allowance as of December 31, 2008 decreased from \$52.5 million, as previously reported, to \$52.0 million.

**Disclosures about Fair Value of Financial Instruments**

In preparing disclosures about the fair value of financial instruments, we have concluded that the carrying amount approximates fair value for cash and cash equivalents, accounts receivable, accounts payable and certain accrued liabilities due to the short maturities of these instruments. The fair values of long-term debt instruments are estimated based upon broker quotes for private transactions or on the current interest rates available to us for debt with similar terms and remaining maturities.

**Subsequent Events**

In accordance with the Statement of Financial Accounting Standards, or SFAS, No. 165, Subsequent Events, or SFAS No. 165, we determined there were no subsequent events that should be disclosed or recognized in the financial statements. This evaluation was performed through August 11, 2009, the date of issuance of this Form 10-Q.

**2. Discontinued Operations**

On September 17, 2007, we entered into a long-term exclusive styrene supply agreement and a related railcar purchase and sale agreement with NOVA Chemicals Inc., or NOVA. Under this supply agreement, NOVA had the exclusive right to purchase 100% of our styrene production (subject to existing contractual commitments), the amount of styrene supplied in any particular period being at NOVA's option. In November 2007, this supply agreement, which was subsequently assigned by NOVA to INEOS NOVA, LLC, or INEOS NOVA, received clearance under the Hart-Scott-Rodino Act. This clearance caused the supply agreement and the railcar agreement to become effective and triggered a \$60 million payment to us from INEOS NOVA. In accordance with the terms of the supply agreement, INEOS NOVA assumed substantially all of our contractual obligations for future styrene deliveries. After the supply agreement became effective, INEOS NOVA nominated zero pounds of styrene under the supply agreement for the balance of 2007 and, in response, we exercised our right to terminate the supply agreement and permanently shut down our styrene facility. Under the supply agreement, we were responsible for the closure costs of our styrene facility and are also restricted from reentering the styrene business until November 2012. The restricted period of time

was initially eight years. However, effective April 1, 2008, INEOS NOVA unilaterally reduced the restricted period to five years.

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We operated our styrene facility through early December 2007, as we completed our production of inventory and exhausted our raw materials and purchase requirements. We sold substantially all of our remaining inventory during the first quarter of 2008. The decommissioning process was completed by the end of 2008, and the associated costs incurred for 2008 were \$18.9 million.

In accordance with SFAS No. 144, Accounting for the Impairment and Disposal of Long Lived Assets, we have reported the operating results of this business as discontinued operations in our condensed consolidated financial statements. The carrying amounts of assets and liabilities related to discontinued operations as of June 30, 2009 and December 31, 2008 were as follows:

|   | <b>June<br/>30,<br/>2009</b>  | <b>December<br/>31,<br/>2008</b> |
|---|-------------------------------|----------------------------------|
|   | <b>(Dollars in Thousands)</b> |                                  |
| <b>Assets of discontinued operations:</b>             |                               |                                  |
| Accounts receivable, net                              | \$ 100                        | \$ 166                           |
| <b>Liabilities of discontinued operations:</b>        |                               |                                  |
| Accrued liabilities <sup>(1)</sup>                    | \$ 14,310                     | \$ 12,444                        |
| Deferred credits and other liabilities <sup>(1)</sup> | 29,201                        | 35,394                           |
| Total   | \$ 43,511                     | \$ 47,838                        |

<sup>(1)</sup> As of June 30, 2009, represents deferred income for the NOVA supply agreement that is being amortized over the contractual non-compete period of five years using the straight-line method. Accrued liabilities include the current portion of \$12.4 million and deferred credits and other liabilities include the long-term

portion of the  
deferred income  
of  
\$29.2 million.

Revenue and pre-tax losses from discontinued operations for the three and six-month periods ended June 30, 2009 and 2008 are presented below:

|                                   | <b>Three months ended<br/>June 30,</b> |             | <b>Six months ended June<br/>30,</b> |             |
|-----------------------------------|--|-------------|--------------------------------------|-------------|
|                                   | <b>2009</b>                            | <b>2008</b> | <b>2009</b>                          | <b>2008</b> |
|                                   | <b>(Dollars in Thousands)</b>          |             |                                      |             |
| Revenues                          | \$3,311                                | \$ 611      | \$6,406                              | \$15,208    |
| Income (loss) before income taxes | 2,971                                  | (1,603)     | 5,462                                | (7,857)     |

### **3. Long-Term Debt**

On March 29, 2007, we completed a private offering of \$150 million aggregate principal amount of unregistered 10<sup>1</sup>/<sub>4</sub>% Senior Secured Notes due 2015, or our Secured Notes, pursuant to a Purchase Agreement among us, Sterling Chemicals Energy, Inc., or Sterling Energy, one of our former wholly-owned subsidiaries, and Jefferies & Company, Inc. and CIBC World Markets Corp., as initial purchasers. In connection with that offering, we entered into an indenture, dated March 29, 2007, among us, Sterling Energy, as guarantor, and U. S. Bank National Association, as trustee and collateral agent. On May 6, 2008, Sterling Energy was merged with and into us. Upon consummation of the merger, Sterling Energy no longer had independent existence and, consequently, our Secured Notes are no longer guaranteed by Sterling Energy. Pursuant to a registration rights agreement among us, Sterling Energy and the initial purchasers, we agreed to exchange our unregistered Secured Notes for a new issue of substantially identical debt securities registered under the Securities Act, to cause the registration statement for the exchange offer to become effective by December 24, 2007, and to complete the exchange offer within 50 days of the effective date of the registration statement. On August 30, 2007, we made an initial filing of the exchange offer registration statement. However, the registration statement was not declared effective by December 24, 2007, and, as a result, the interest rate on our Secured Notes increased by 0.25% per annum on each of December 25, 2007, March 24, 2008 and June 22, 2008. The registration statement was declared effective on August 13, 2008, and the



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exchange offer was closed on September 19, 2008. As a result, the interest rate on our Secured Notes reverted back to the face amount of 10<sup>1</sup>/<sub>4</sub>% per annum when the exchange offer closed. The additional interest incurred from December 25, 2007 through the closing of the exchange offer was approximately \$0.5 million and was paid on April 1 and October 1, 2008.

Our indenture contains affirmative and negative covenants and customary events of default, including payment defaults, breaches of covenants and certain events of bankruptcy, insolvency and reorganization. If an event of default occurs and is continuing, other than an event of default triggered upon certain bankruptcy events, the trustee under our indenture or the holders of at least 25% in principal amount of our outstanding Secured Notes may declare our Secured Notes to be due and payable immediately. Upon an event of default, the trustee may also take actions to foreclose on the collateral securing our outstanding Secured Notes, subject to the terms of an intercreditor agreement dated March 29, 2007, among us, Sterling Energy, the trustee and The CIT Group/Business Credit, Inc. Our indenture does not require us to maintain any financial ratios or satisfy any financial maintenance tests. We are currently in compliance with all of the covenants contained in our indenture.

Interest is due on our outstanding Secured Notes on April 1 and October 1 of each year. Our outstanding Secured Notes, which mature on April 1, 2015, are senior secured obligations and rank equally in right of payment with all of our existing and future senior indebtedness. Subject to specified permitted liens, our outstanding Secured Notes are secured (i) on a first priority basis by all of our fixed assets and certain related assets, including, without limitation, all property, plant and equipment and (ii) on a second priority basis by our other assets, including, without limitation, accounts receivable, inventory, capital stock of our domestic restricted subsidiaries, intellectual property, deposit accounts and investment property.

On December 19, 2002, we entered into a Revolving Credit Agreement, or our revolving credit facility, with The CIT Group/Business Credit, Inc., as administrative agent and a lender, and certain other lenders. Under our revolving credit facility, we and Sterling Energy were co-borrowers and were jointly and severally liable for any indebtedness thereunder. After the merger of Sterling Energy with and into us, Sterling Energy ceased to be a co-borrower under our revolving credit facility. Our revolving credit facility is secured by first priority liens on all of our accounts receivable, inventory and other specified assets. On March 29, 2007, we amended and restated our revolving credit facility to, among other things, extend the term of our revolving credit facility until March 29, 2012, reduce the maximum commitment thereunder to \$50 million, make certain changes to the calculation of the borrowing base and lower the interest rates and fees charged thereunder. Borrowings under our revolving credit facility bear interest, at our option, at an annual rate of a base rate plus 0.0% to 0.50% or the LIBOR rate plus 1.50% to 2.25%, depending on our borrowing availability at the time. We are also required to pay an aggregate commitment fee of 0.375% per year (payable monthly) on any unused portion of our revolving credit facility. Available credit under our revolving credit facility is subject to a monthly borrowing base of 70% of eligible accounts receivable plus 65% of eligible inventory. In response to the expected continued lower levels of accounts receivable and inventory, as well as our lesser need for a working capital facility, we reduced our commitment under our revolving credit facility to \$25 million on June 30, 2008. On November 7, 2008, we further amended our revolving credit facility to substantially reduce restrictions, subject to minimum liquidity requirements, on investment of cash and other assets, payment of cash dividends, repurchase of debt and equity securities, modification of preferred stock terms, entry into affiliated transactions, disposition of assets and engagement in certain business activities. We paid the administrative agent an amendment fee plus expenses totaling approximately \$0.1 million in connection with this amendment.

As of June 30, 2009, total credit available under our revolving credit facility was \$9.1 million, there were no loans outstanding and we had \$3.5 million in letters of credit outstanding, resulting in borrowing availability of \$5.6 million. Pursuant to Emerging Issues Task Force Issue No. 95-22, Balance Sheet Classification of Borrowings under Revolving Credit Agreements That Include both a Subjective Acceleration Clause and a Lock-Box Arrangement, any balances outstanding under our revolving credit facility would be classified as a current portion of long-term debt.

Our revolving credit facility contains numerous covenants and conditions, including, but not limited to, restrictions on our ability to incur indebtedness, create liens, sell assets, make investments of cash and other assets,



**Table of Contents****STERLING CHEMICALS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)**

make capital expenditures, engage in mergers and acquisitions and pay cash dividends. Our revolving credit facility also includes various circumstances and conditions that would, upon their occurrence and subject in certain cases to notice and grace periods, create an event of default thereunder. Our revolving credit facility does not require us to maintain any financial ratios or satisfy any financial maintenance tests. We are currently in compliance with all of the covenants contained in our revolving credit facility.

**4. Commitments and Contingencies***Product Contracts:*

We have long-term agreements which provide for the dedication of 100% of our production of acetic acid and plasticizers, each to one customer. See Note 7 for more information.

*Environmental Regulations:*

Our operations involve the handling, production, transportation, treatment and disposal of materials that are classified as hazardous or toxic and that are extensively regulated by environmental and health and safety laws, regulations and permit requirements. Environmental permits required for our operations are subject to periodic renewal and may be revoked or modified for cause or when new or revised environmental requirements are implemented. Changing and increasingly strict environmental requirements can affect the manufacturing, handling, processing, distribution and use of our chemical products and, if so affected, our business and operations may be materially and adversely affected. In addition, changes in environmental requirements may cause us to incur substantial costs in upgrading or redesigning our facilities and processes, including our waste treatment, storage, disposal and other waste handling practices and equipment.

A business risk inherent in chemical operations is the potential for personal injury and property damage claims from employees, contractors and their employees and nearby landowners and occupants. While we believe our business operations and facilities generally are operated in compliance with all applicable environmental and health and safety requirements in all material respects, we cannot be sure that past practices or future operations will not result in material claims or regulatory action, require material environmental expenditures or result in exposure or injury claims by employees, contractors or their employees or the public. Some risk of environmental costs and liabilities is inherent in our operations and products, as it is with other companies engaged in similar businesses.

In light of our historical expenditures and expected future results of operations and sources of liquidity, we believe we will have adequate resources to conduct our operations in compliance with applicable environmental, health and safety requirements. Nevertheless, we may be required to make significant site and operational modifications that are not currently contemplated in order to comply with changing facility permitting requirements and regulatory standards. Additionally, we have incurred, and may continue to incur, a liability for investigation and cleanup of waste or contamination at our own facilities or at facilities operated by third parties where we have disposed of waste. We continually review all estimates of potential environmental liabilities, but we may not have identified or fully assessed all potential liabilities arising out of our past or present operations or the amount necessary to investigate and remediate any conditions that may be significant to us. Based on information available at this time and reviews undertaken to identify potential exposure, we believe any amount reserved for environmental matters is adequate to cover our potential exposure for clean-up costs.

On December 13, 2007, the Texas Commission for Environmental Quality, or TCEQ, issued an agreed order requiring us to remove all process wastewater from the North Ditch Holding Pond in order to prevent outfall violations during heavy rain events. This project has been constructed and will be operational prior to September 2, 2009.

Air emissions from our manufacturing facility in Texas City, Texas, or our Texas City facility, are subject to certain permit requirements and self-implementing emission limitations and standards under state and federal laws. Our Texas City facility is subject to the federal government's June 1997 National Ambient Air Quality Standards, or NAAQS, which lowered the ozone and particulate matter concentration thresholds for attainment. Our Texas City

**Table of Contents****STERLING CHEMICALS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)**

facility is located in an area that the Environmental Protection Agency, or EPA, has classified as not having achieved attainment under the NAAQS for ozone, either on a 1-hour or an 8-hour basis. Ozone is typically controlled by reduction of emissions of volatile organic compounds, or VOCs, and nitrogen oxide, or NOx. TCEQ has imposed strict requirements on regulated facilities, including our Texas City facility, to ensure that the air quality control region will achieve attainment under the NAAQS for ozone. Local authorities may also impose new ozone and particulate matter standards. Compliance with these stricter standards may substantially increase our future control costs for emissions of NOx, VOCs and particulate matter, the amount and full impact of which cannot be determined at this time.

In 2002, the TCEQ adopted a revised State Implementation Plan, or SIP, in order to achieve compliance with the 1-hour ozone standard under the Clean Air Act by 2007. The EPA approved this 1-hour SIP, which required an 80% reduction of NOx emissions and extensive monitoring of emissions of highly reactive VOCs, or HRVOCs, such as ethylene, in the Houston-Galveston-Brazoria area, or the HGB area. We are in full compliance with these regulations. However, the HGB area failed to attain compliance with the 1-hour ozone standard, and Section 185 of the Clean Air Act requires implementation of a program of emissions-based fees until the standard is attained. These Section 185 fees will be assessed on all NOx and VOC emissions in 2008 and beyond in the HGB area which are in excess of 80% of the baseline year. The method for calculating baseline emissions, as well as other details of the program, has not yet been developed. At the present time, we do not expect to be assessed any fees for our emissions for 2008, primarily due to the reduction in emissions from our Texas City facility following the closure of our styrene facility. The rules for administering this fee system are currently under development, and are expected to become effective in 2010. At the present time, we do not expect to be assessed any fees for our emissions for 2008 or 2009, due to the reduction in emissions from our Texas City facility following the closure of the styrene facility.

In April 2004, the HGB area was designated a moderate non-attainment area with respect to the 8-hour ozone standard of the Clean Air Act. However, in response to a request from the Governor of Texas, the EPA has now reclassified the HGB area as a severe non-attainment area, effective October 31, 2008. As a result, the new mandated compliance date for attainment of the 8-hour ozone standard is June 15, 2019. A revised 8-hour SIP to address the HGB area's severe non-attainment designation will now have to be submitted to the EPA by April 10, 2010. The content of the revised 8-hour SIP is unknown at this time making it difficult to predict our final cost of compliance with these regulations. However, given the permanent shutdown of our phthalic anhydride and styrene facilities, we do not anticipate incurring any further cost of compliance in connection with the revised 8-hour SIP.

To reduce the risk of offsite consequences from unanticipated events, we participate in a regional air monitoring network to monitor ambient air quality in the Texas City community.

*Legal Proceedings:*

On July 5, 2005, Patrick B. McCarthy, an employee of Kinder-Morgan, Inc., or Kinder-Morgan, was seriously injured at Kinder-Morgan's facilities near Cincinnati, Ohio, while attempting to offload a railcar containing one of our plasticizers products. On October 28, 2005, Mr. McCarthy and his family filed a suit in the Court of Common Pleas, Hamilton County, Ohio (Case No. A0509 144) against us and six other defendants. Since that time, five of the other defendants were dismissed from the case. The plaintiffs sought in excess of \$42 million in alleged compensatory and punitive damages from the defendants in the aggregate. On May 7, 2009, the jury found that we had not been negligent in connection with the incident and rendered a take nothing verdict in favor of the defendants. On June 24, 2009, the plaintiffs filed a motion for judgment notwithstanding the verdict or, in the alternative, a new trial. A hearing on plaintiffs' motion is currently scheduled for late August 2009. At this time, it is impossible to determine whether the plaintiffs will appeal the verdict. We believe that all, or substantially all, of any liability imposed upon us as a result of this suit and our related out-of-pocket costs and expenses will be covered by our insurance policies, subject to a \$1 million deductible, which was met in January 2008. We do not believe that this incident will have a material adverse effect on our business, financial condition, results of operations or cash flows, although we cannot guarantee that a material adverse effect will not occur.



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**STERLING CHEMICALS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)**

On February 21, 2007, we received a summons naming us, several benefit plans and the plan administrators for those plans as defendants in a class action suit, Case No. H-07-0625 filed in the United States District Court, Southern District of Texas, Houston Division. The plaintiffs are seeking to represent a proposed class of retired employees of Sterling Fibers, Inc., one of our former subsidiaries that we sold in connection with our emergence from bankruptcy in 2002. The plaintiffs are alleging that we were not permitted to increase their premiums for retiree medical insurance based on a provision contained in the asset purchase agreement between us and Cytec Industries Inc. and certain of its affiliates governing our purchase of our former acrylic fibers business in 1997. During our bankruptcy case, we specifically rejected this asset purchase agreement and the bankruptcy court approved that rejection. The plaintiffs are claiming that we violated the terms of the benefit plans and breached fiduciary duties governed by the Employee Retirement Income Security Act and are seeking damages, declaratory relief, punitive damages and attorneys' fees. Trial for this matter is currently scheduled for September 2009. We are vigorously defending this action and are unable to state at this time if a loss is probable or remote and are unable to determine the possible range of loss related to this matter, if any.

On February 4, 2008, we filed a Petition for Declaratory Judgment in the 212th District Court of Galveston County, Texas (Case #08CV0108) against Marathon Petroleum Company LLC, or Marathon, in connection with a dispute between Marathon and us under a Purchase Agreement for FCC Off-Gas, or the Off-Gas Purchase Agreement. Under the Off-Gas Purchase Agreement, we purchase an amount of off-gas each month from Marathon within a stated range at Marathon's option. Following the closure of certain production units at our Texas City facility, our demand for off-gas has been below the low-end of the stated range. On July 31, 2007, and again on November 19, 2007, we invoked the contract's undue economic hardship clause and requested that Marathon enter into good faith negotiations to modify the terms of the Off-Gas Purchase Agreement. After Marathon disputed the applicability of the economic hardship provision and refused to renegotiate the terms of the Off-Gas Purchase Agreement, we filed a declaratory judgment action to enforce the terms of the economic hardship provision, and Marathon counter-claimed against us for breach of contract. This matter is scheduled for trial in February 2010. At this time, it is not possible to determine what, if any, liability we will have under Marathon's counter-claim, and we are vigorously pursuing our declaratory judgment filing and defending against Marathon's counter-claim. We do not believe that this matter will have a material adverse impact on our business, financial condition, results of operations or cash flows, although we cannot guarantee that a material adverse effect will not occur.

On March 4, 2008, Gulf Hydrogen and Energy, L.L.C., or Gulf Hydrogen, filed suit against us in the 212th District Court of Galveston County, Texas (Cause No. 08CV0220) to enforce the provisions of a Memorandum of Understanding entered into between us and Gulf Hydrogen involving the possible sale of our outstanding equity interests to Gulf Hydrogen for approximately \$390 million. The parties entered into a confidential settlement agreement in March 2009 and the lawsuit was dismissed with prejudice by all parties. This matter did not have a material adverse effect on our business, financial condition, results of operations or cash flows.

We are subject to various other claims and legal actions that arise in the ordinary course of our business. We do not believe that any of these claims and actions, separately or in the aggregate, will have a material adverse effect on our business, financial condition, results of operations or cash flows, although we cannot guarantee that a material adverse effect will not occur.

As we believe the potential for an unfavorable outcome regarding one or more of the matters described above is probable, in accordance with SFAS No. 5, Accounting for Contingencies, we accrued a \$1.0 million litigation reserve during 2008.

As of December 31, 2008, we had a receivable of \$1.3 million due from our insurance carriers for reimbursement of legal costs that exceeded our insurance deductibles and are, therefore, reimbursable through our insurance carriers. For the six months ended June 30, 2009, we incurred \$1.9 million of legal costs and received \$1.3 million of payments, resulting in a receivable balance of \$1.9 million as of June 30, 2009.



**Table of Contents****STERLING CHEMICALS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)****5. Income Taxes**

During the three and six month periods ended June 30, 2009, we recorded a net tax benefit of \$1.0 million and \$1.2 million, respectively, for income taxes from continuing operations. For each of the three and six month periods ended June 30, 2008, we recorded a net tax expense of zero for income taxes from continuing operations. The net tax benefit in the three and six month periods ended June 30, 2009 was generated as a result of utilizing income in discontinued operations to recognize a portion of the benefit from losses generated in continuing operations. Our continuing operations effective tax rate was 23.5% for the six-month period ended June 30, 2009. For the three and six month periods ended June 30, 2009, there was no change in the valuation allowance of \$52.0 million.

**6. Pension Plans and Other Postretirement Benefits**

Net periodic pension costs (benefits) consisted of the following components:

|                                | Three months ended June<br>30, |          | Six months ended June<br>30, |          |
|--------------------------------|--------------------------------|----------|------------------------------|----------|
|                                | 2009                           | 2008     | 2009                         | 2008     |
|                                | (Dollars in Thousands)         |          | (Dollars in Thousands)       |          |
| Interest cost                  | \$ 1,828                       | \$ 1,788 | \$ 3,656                     | \$ 3,576 |
| Expected return on plan assets | (1,513)                        | (2,148)  | (3,026)                      | (4,296)  |
| Amortization                   | 864                            | 2        | 1,728                        | 4        |
| Net pension cost (benefit)     | \$ 1,179                       | \$ (358) | \$ 2,358                     | \$ (716) |

Other postretirement costs (benefits) consisted of the following components:

|                                    | Three months ended June<br>30, |          | Six months ended June<br>30, |          |
|------------------------------------|--------------------------------|----------|------------------------------|----------|
|                                    | 2009                           | 2008     | 2009                         | 2008     |
|                                    | (Dollars in Thousands)         |          | (Dollars in Thousands)       |          |
| Service cost                       | \$ 11                          | \$ 14    | \$ 22                        | \$ 28    |
| Interest cost                      | 121                            | 142      | 242                          | 284      |
| Amortization of unrecognized costs | (541)                          | (541)    | (1,082)                      | (1,082)  |
| Net plan benefit                   | \$ (409)                       | \$ (385) | \$ (818)                     | \$ (770) |

**7. Operating Segment and Sales Information**

We report our operations through two segments: acetic acid and plasticizers. The critical accounting policies for these operating segments are the same as those disclosed in our Annual Report. We use gross profit for reporting the results of our operating segments and this measure includes all operating items related to the businesses. There are no sales between segments. The revenues and gross profit for each of our reportable operating segments are as follows:

|              | Three months ended<br>June 30, |           | Six months ended June<br>30, |           |
|--------------|--------------------------------|-----------|------------------------------|-----------|
|              | 2009                           | 2008      | 2009                         | 2008      |
|              | (Dollars in Thousands)         |           |                              |           |
| Revenues:    |                                |           |                              |           |
| Acetic acid  | \$ 19,796                      | \$ 39,170 | \$ 43,635                    | \$ 68,147 |
| Plasticizers | 6,890                          | 8,498     | 14,173                       | 17,509    |
| Other        | 255                            | 169       | 510                          | 439       |



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|                       |           |           |           |           |
|-----------------------|-----------|-----------|-----------|-----------|
| Total                 | \$ 26,941 | \$ 47,837 | \$ 58,318 | \$ 86,095 |
| Segment gross profit: |           |           |           |           |
| Acetic acid           | \$ (134)  | \$ 9,547  | \$ 4,441  | \$ 13,491 |

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**STERLING CHEMICALS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)**

|   | Three months ended     |            | Six months ended June |            |
|---|------------------------|------------|-----------------------|------------|
|   | June 30,               |            | 30,                   |            |
|   | 2009                   | 2008       | 2009                  | 2008       |
|   | (Dollars in Thousands) |            |                       |            |
| Plasticizers                                      | 1,402                  | 1,166      | 2,724                 | 3,075      |
| Other <sup>(1)</sup>                              | (100)                  | (916)      | (429)                 | (2,396)    |
| Total   | 1,168                  | 9,797      | 6,736                 | 14,170     |
| Selling, general and administrative expense       | 3,344                  | 3,787      | 7,227                 | 6,205      |
| Impairment of long-lived assets                   |                        | 6,649      |                       | 6,649      |
| Interest and debt related expenses                | 3,968                  | 4,719      | 7,971                 | 8,931      |
| Interest income                                   | (212)                  | (1,107)    | (596)                 | (2,432)    |
| Other income                                      | (1,544)                |            | (2,689)               |            |
| Loss from continuing operations before income tax | \$ (4,388)             | \$ (4,251) | \$ (5,177)            | \$ (5,183) |
| Depreciation and amortization expenses:           |                        |            |                       |            |
| Acetic acid                                       | \$ 1,715               | \$ 1,525   | \$ 3,359              | \$ 3,037   |
| Plasticizers                                      | 325                    | 532        | 637                   | 1,064      |
| Other <sup>(2)</sup>                              | 262                    | 390        | 551                   | 981        |
| Total   | \$ 2,302               | \$ 2,447   | \$ 4,547              | \$ 5,082   |
| Capital expenditures:                             |                        |            |                       |            |
| Acetic acid                                       | \$ 2,252               | \$ 348     | \$ 3,707              | \$ 1,142   |
| Other plant infrastructure                        | 1,686                  | 372        | 2,673                 | 1,615      |
| Total   | \$ 3,938               | \$ 720     | \$ 6,380              | \$ 2,757   |

(1) Gross loss for Other includes various unallocated corporate charges and credits.

(2) Includes depreciation and amortization expense of less than

\$0.1 million for discontinued operations for each of the three month periods ended June 30, 2009 and 2008, and less than \$0.1 million and \$0.4 million for the six month periods ended June 30, 2009 and 2008, respectively.

|                      | <b>As of<br/>June<br/>30,<br/>2009</b> | <b>As of<br/>December 31,<br/>2008</b> |
|----------------------|--|--|
|                      | <b>(Dollars in Thousands)</b>          |  |
| Total assets:        |  |  |
| Acetic acid          | \$ 32,497                              | \$ 40,707                              |
| Plasticizers         | 5,798                                  | 6,311                                  |
| Other <sup>(3)</sup> | 212,905                                | 216,011                                |
| <b>Total</b>         | <b>\$ 251,200</b>                      | <b>\$ 263,029</b>                      |

<sup>(3)</sup> Components of Other are presented in the table below:

|                                    | <b>As of<br/>June<br/>30,<br/>2009</b> | <b>As of<br/>December 31,<br/>2008</b> |
|------------------------------------|--|--|
|                                    | <b>(Dollars in Thousands)</b>          |  |
| Other:                             |  |  |
| Corporate:                         |  |  |
| Cash                               | \$ 150,786                             | \$ 156,126                             |
| Other                              | 16,422                                 | 17,989                                 |
| Plant infrastructure:              |  |  |
| Property, plant and equipment, net | 45,597                                 | 41,730                                 |
| Assets of discontinued operations  | 100                                    | 166                                    |
| <b>Total</b>                       | <b>\$ 212,905</b>                      | <b>\$ 216,011</b>                      |

**Table of Contents****STERLING CHEMICALS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)****8. New Accounting Standards***Adoption of Accounting Standards:*

In December 2007, the Financial Accounting Standards Board, or FASB, issued SFAS No. 141 (revised 2007), Business Combinations, or SFAS No. 141R. SFAS No. 141R broadens the guidance of SFAS No. 141, Business Combinations, extending its applicability to all transactions and other events in which one entity obtains control over one or more other businesses. SFAS No. 141R broadens the fair value measurement and recognition of assets acquired, liabilities assumed and interests transferred as a result of business combinations, and expands on required disclosures to improve the statement users' abilities to evaluate the nature and financial effects of business combinations. We implemented SFAS No. 141R effective January 1, 2009, and it had no impact on our condensed consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements; an Amendment of ARB No. 51, or SFAS No. 160. SFAS No. 160 establishes the accounting and reporting standards for a noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary and clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS No. 160 requires retroactive adoption of the presentation and disclosure requirements for existing minority interests and applies prospectively to business combinations for fiscal years beginning after December 15, 2008. We implemented SFAS No. 160 effective January 1, 2009, and it had no impact on our condensed consolidated financial statements.

In December 2007, the FASB issued Emerging Issues Task Force, or EITF, 07-1 Accounting for Collaborative Arrangements, or EITF 07-1. EITF 07-1 defines collaborative arrangements and establishes reporting requirements for transactions between participants in a collaborative arrangement and between participants in the arrangement and third parties. EITF 07-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years and shall be applied retrospectively to all prior periods presented for all collaborative arrangements existing as of the effective date. We implemented EITF 07-1 effective June 30, 2009, and it had no impact on our condensed consolidated financial statements.

In February 2008, the FASB issued SFAS No. 157-2, Effective Date of FASB Statement No. 157, which defers the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years, for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). An entity that has issued interim or annual financial statements reflecting the application of the measurement and disclosure provisions of SFAS No. 157 prior to February 12, 2008 must continue to apply all provisions of SFAS No. 157. We implemented SFAS No. 157-2 effective January 1, 2009, and it had no impact on our condensed consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, Disclosures About Derivative Instruments and Hedging Activities, or SFAS No. 161. SFAS No. 161 requires enhanced disclosures about an entity's derivative and hedging activities, with the intent to provide users of financial statements with an enhanced understanding of (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and its related interpretations and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. We implemented SFAS No. 161 effective January 1, 2009, and it had no impact on our condensed consolidated financial statements.

In April 2009, the FASB issued FASB Staff Position SFAS No. 141(R)-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination that Arise from Contingencies, or FSP No. 141(R)-1. FSP No. 141(R)-1 applies to all assets acquired and all liabilities assumed in a business combination that arise from contingencies. FSP No. 141(R)-1 requires the acquirer to recognize such an asset or liability if the acquisition-date fair value of that asset or liability can be determined during the measurement period. If it cannot be determined during the measurement period, then the asset or liability should be recognized at the acquisition date if, consistent



**Table of Contents****STERLING CHEMICALS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)**

with SFAS No. 5, Accounting for Contingencies, information available before the end of the measurement period indicates that it is probable that an asset existed or that a liability had been incurred at the acquisition date, and the amount of the asset or liability can be reasonably estimated. We implemented FSP No. 141(R)-1 effective January 1, 2009, and it had no impact on our condensed consolidated financial statements.

In April 2009, the FASB issued FASB Staff Position SFAS No. 107-1 and Accounting Principles Board No. 28-1, Interim Disclosures about Fair Value of Financial Instruments, or FSP No. 107-1. FSP No. 107-1 requires the disclosure of the fair value of financial instruments for interim reporting periods of publicly traded companies as well as in the annual financial statements. FSP No. 107-1 is effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. We implemented FSP No. 107-1 for the period ending June 30, 2009, and it had no impact on our condensed consolidated financial statements.

In April 2009, the FASB issued FASB Staff Position SFAS No. 115-2 and SFAS No. 124-2, Recognition and Presentation of Other-Than-Temporary Impairments, or FSP Nos. 115-2 and 124-2, which provide new guidance on the recognition of other-than-temporary impairments of investments in debt securities and provide new presentation and disclosure requirements for other-than-temporary impairments of investments in debt and equity securities. FSP Nos. 115-2 and 124-2 are effective for our quarter ending June 30, 2009. We implemented FSP Nos. 115-2 and 124-2 for the period ending June 30, 2009, and it had no impact on our condensed consolidated financial statements.

In April 2009, the FASB issued FASB Staff Position SFAS No. 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly, or FSP No. 157-4. FSP No. 157-4 provides additional guidance for estimating fair value in accordance with SFAS No. 157, Fair Value Measurements, when the volume and level of activity for the asset or liability have significantly decreased. This FASB Staff Position also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP No. 157-4 is effective for our quarter ending June 30, 2009. We implemented FSP No. 157-4 effective June 30, 2009, and it had no impact on our condensed consolidated financial statements.

In May 2009, the FASB issued SFAS No. 165, Subsequent Events, or SFAS No. 165. SFAS No. 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. In particular, SFAS No. 165 sets forth:

- the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements;
- the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and
- the disclosures that an entity should make about events or transactions that occurred after the balance sheet date.

SFAS No. 165 is effective for interim or annual financial periods ending after June 15, 2009, and shall be applied prospectively. We implemented SFAS No. 165 for the period ending June 30, 2009, and it had no impact on our condensed consolidated financial statements.

*Future Adoption of Accounting Standards:*

In December 2008, the FASB issued FASB Staff Position SFAS No. 132(R)-1, Employers Disclosures about Pensions and Other Postretirement Benefits, or FSP No. 132R-1. FSP No. 132R-1 requires enhanced disclosures about the plan assets of defined benefit pension and other postretirement plans. The enhanced disclosures required by FSP No. 132R-1 are intended to provide users of financial statements with a greater understanding of (a) how investment allocation decisions are made, including the factors that are pertinent to an understanding of investment policies and strategies, (b) the major categories of plan assets, (c) the inputs and valuation techniques used to measure the fair value of plan assets, (d) the effect of fair value measurements using significant unobservable inputs

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**STERLING CHEMICALS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)**

(Level 3) on changes in plan assets for the period and (e) significant concentrations of risk within plan assets. FSP No. 132R-1 is effective for the year ending December 31, 2009. We do not believe the implementation of FSP No. 132R-1 will have a material impact on our consolidated financial statements.

In June 2009, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R), or SFAS No. 167. SFAS No. 167 amends certain requirements of FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities, to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. SFAS No. 167 is effective as of the beginning of the first annual reporting period that begins after November 15, 2009 and for interim periods within that first annual reporting period. We do not believe the implementation of SFAS No. 167 will have a material impact on our consolidated financial statements.

In June 2009, The FASB issued SFAS No. 168, FASB Accounting Standards Codification<sup>TM</sup> and the Hierarchy of Generally Accepted Accounting Principles, or SFAS No. 168. SFAS No. 168 establishes the FASB Accounting Standards Codification<sup>TM</sup>, or Codification, as the single source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission, or SEC, under authority of federal securities laws are also sources of authoritative U.S. GAAP for SEC registrants. SFAS No. 168 and the Codification are effective for financial statements issued for interim and annual periods ending after September 15, 2009. Upon implementation, we will follow the guidance of SFAS No. 168 and the Codification in applying U.S. GAAP.

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

The following discussion should be read in conjunction with our condensed consolidated financial statements (including the Notes thereto) included in Item 1, Part I of this report.

**Business Overview**

We are a North American producer of selected petrochemicals used to manufacture a wide array of consumer goods and industrial products. We currently operate in two segments: acetic acid and plasticizers. Each segment has a single customer.

Our acetic acid is used primarily to manufacture vinyl acetate monomer, which is used in a variety of products, including adhesives and surface coatings. Pursuant to our 2008 Amended and Restated Production Agreement, or our Acetic Acid Production Agreement, that extends to 2031, all of our acetic acid production is sold to BP Amoco Chemicals Company, or BP Chemicals. We are BP Chemicals' sole source of acetic acid production in the Americas. BP Chemicals markets all of the acetic acid that we produce and pays us, among other amounts, a portion of the profits derived from its sales of our acetic acid. In addition, BP Chemicals reimburses us for 100% of our fixed and variable costs of production, other than specified indirect costs. We also jointly invest with BP Chemicals in capital expenditures related to our acetic acid facility in the same percentage as the profits from the business we receive from BP Chemicals.

We own and operate one of the lowest cost acetic acid facilities in the world. Our acetic acid facility utilizes BP Chemicals' proprietary Cativa carbonylation technology, which we believe offers several advantages over competing production methods, including lower energy requirements and lower fixed and variable costs. Acetic acid production has two major raw material requirements, methanol and carbon monoxide. BP Chemicals, a producer of methanol, supplies 100% of our methanol requirements related to our production of acetic acid. All of our requirements for carbon monoxide are supplied by Praxair Hydrogen Supply, Inc., or Praxair, from a partial oxidation unit constructed by Praxair on land leased from us at our site in Texas City, Texas, or our Texas City facility.

Although recent slowdowns in the housing and automotive markets have reduced short-term global demand for vinyl acetate monomer, the largest derivative of acetic acid, annual global production of vinyl acetate monomer is expected to increase from 10.4 billion pounds in 2005 to 12.2 billion pounds in 2010. The North American acetic acid industry tends to sell most of its products through long-term sales agreements having cost plus pricing mechanisms, eliminating much of the volatility seen in other petrochemicals products and resulting in more stable and predictable earnings and profit margins.

All of our plasticizers, which are used to make flexible plastics, such as shower curtains, floor coverings, automotive parts and construction materials, are sold to BASF Corporation, or BASF, pursuant to a long-term production agreement that extends until 2013, subject to some early termination rights held by BASF that begin in 2010. Under our agreement with BASF, or our Plasticizers Production Agreement, BASF provides us with most of the required raw materials, markets the plasticizers that we produce and is obligated to make certain fixed quarterly payments to us while reimbursing us monthly for our actual production costs and capital expenditures relating to our plasticizers facility. Due to the terms of our Plasticizers Production Agreement, we are not exposed to fluctuations in costs or market conditions. Our Plasticizers Production Agreement was amended in May 2008, after BASF nominated zero pounds of phthalic anhydride, or PA, under the prior version of the agreement due to deteriorating market conditions, which ultimately resulted in the closure of our PA unit.

On September 17, 2007, we entered into a long-term exclusive styrene supply agreement and a related railcar purchase and sale agreement with NOVA Chemicals Inc., which was subsequently assigned to INEOS NOVA, LLC, or INEOS NOVA. After the supply agreement became effective, INEOS NOVA nominated zero pounds of styrene under the supply agreement for the balance of 2007 and, in response, we exercised our right to terminate the supply agreement and permanently shut down our styrene facility. Under the supply agreement, we were responsible for the closure costs of our styrene facility and are also restricted from reentering the styrene business until November 2012. The restricted period was initially eight years; however, INEOS NOVA unilaterally reduced the restricted period to five years on April 1, 2008.



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We sold substantially all remaining styrene inventory during the first quarter of 2008. The decommissioning process was completed by the end of 2008, and the associated costs incurred for 2007 and 2008 were \$0.7 million and \$18.9 million, respectively. In July 2008, we announced a reduction in work force in order to reduce our staffing to a level appropriate for our existing operations and site development projects. As a result, we reduced our salaried work force by 19 people and our hourly work force by 15 people. In accordance with Statement of Financial Accounting Standards, or SFAS, No. 146, Accounting for Costs Associated with Exit or Disposal Activities, we recognized and paid \$1.4 million of severance costs in 2008. Additionally, as a result of our work force reduction, we recorded a curtailment loss of \$1.2 million for our benefit plans in accordance with SFAS No. 88, Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits, in 2008.

We own the acetic acid and plasticizers manufacturing units located at our Texas City facility. We lease a portion of our Texas City facility to Praxair, who constructed a partial oxidation unit on that land. We also lease a portion of our Texas City facility to S&L Cogeneration Company, a 50/50 joint venture between us and Praxair Energy Resources, Inc., or Praxair Energy, who constructed a cogeneration facility on that land. However, because our strategic initiatives under consideration do not require utilization of the steam produced by the cogeneration facility, we and Praxair Energy elected to terminate the joint venture and have amended the joint venture agreement governing S&L Cogeneration Company to extend its term until the later of November 30, 2009 or upon completion of all final audits, and to address several matters related to the sale of the cogeneration facility, the distribution of the joint venture's assets and the termination and winding-up of its affairs. We lease space for our principal offices located in Houston, Texas. We operate in two segments: acetic acid and plasticizers.

**Recent Developments**

On June 4, 2009 our acetic acid plant was shut down for 42 days for a scheduled turnaround to coincide with the required maintenance shutdown of our carbon monoxide supplier. Capital projects installed in the acetic acid plant during the shutdown included replacement of the acetic acid product column, two exchangers and the distributive control systems, as well as consolidation of two cooling towers and several smaller projects. Sterling's portion of the capital cost of these projects totaled \$5.5 million, of which \$1.8 million was incurred during the second quarter of 2009, with the balance incurred previously. Maintenance work in the acetic acid and utilities departments during the shutdown totaled \$3.0 million and included the cleaning, inspection and repair of a large number of columns, exchangers, control and block valves, instruments and other miscellaneous repairs. As a result of the shutdown, the maximum sustainable annual production rate of our acetic acid plant has increased from approximately 1.2 billion pounds per year to approximately 1.3 billion pounds per year, and we will be able to extend the unit turnaround interval.

**Results of Operations*****Three Months Ended June 30, 2009 Compared to Three Months Ended June 30, 2008****Revenues and loss from continuing operations*

Our revenues were \$26.9 million for the second quarter of 2009, a 44% decrease from the \$47.8 million in revenues we recorded for the second quarter of 2008. We had a net loss from continuing operations of \$3.4 million for the second quarter of 2009, compared to a net loss from continuing operations of \$4.3 million in the second quarter of 2008.

Revenues from our acetic acid operations were \$19.8 million in the second quarter of 2009, a 49% decrease from the \$39.2 million in revenues from these operations in the second quarter of 2008. This decrease in acetic acid revenues in the second quarter of 2009 was primarily due to reduced profit-sharing revenue of approximately \$9.0 million as a result of reduced margins and slightly lower sales volumes compared to the second quarter of 2008. Additionally, reimbursement of variable costs for the second quarter of 2009 was lower by approximately \$11.0 million due to the shutdown of our acetic acid unit in June 2009 for scheduled maintenance work. Gross loss for our acetic acid operations was \$0.1 million for the second quarter of 2009 compared to gross profit of \$9.5 million for the second quarter of 2008. This decrease in gross profit was primarily due to the reduced profit-sharing revenue discussed above.

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Revenues from our plasticizers operations were \$6.9 million in the second quarter of 2009, a 19% decrease from the \$8.5 million in revenues from these operations in the second quarter of 2008. Our higher revenues for the second quarter of 2008 were primarily due to a \$1.9 million reimbursement of costs during the quarter related to the closure of the phthalic anhydride, or PA, unit. Gross profit from our plasticizers operations was \$1.4 million for the second quarter of 2009 compared to \$1.2 million for the second quarter of 2008.

*Selling, general and administrative expenses*

Our selling, general and administrative expenses were \$3.3 million for the second quarter of 2009 compared to \$3.8 million for the second quarter of 2008. This decrease was primarily due to decreased legal fees resulting from the resolution of various lawsuits in the second quarter of 2009. These figures exclude insurance reimbursements of \$1.2 million which are recorded in other income.

*Impairment of long-lived assets*

We recorded zero and \$6.6 million for impairment of long-lived assets for the three months ended June 30, 2009 and 2008, respectively. The \$6.6 million impairment in the second quarter of 2008 was for the write-down of the phthalic anhydride, or PA, assets to zero as a result of the shutdown of the PA unit.

*Interest and debt related expenses*

We recorded \$4.0 million and \$4.7 million of interest and debt related expenses for the three months ended June 30, 2009 and 2008, respectively. The decrease for the three months ended June 30, 2009, compared to the three months ended June 30, 2008, was primarily due to \$0.3 million write-off of debt fees resulting from the reduction of our commitment under our revolving credit facility in the second quarter of 2008. The remaining decrease was due to increased capitalized interest and reduced credit facility fees for the second quarter of 2009 compared to the second quarter of 2008.

*Interest income*

We recorded \$0.2 million of interest income in the second quarter of 2009 compared to \$1.1 million in the second quarter of 2008. This decrease was due to lower interest rates earned on our cash investments in 2009 compared to 2008.

*Other income*

Our other income was \$1.5 million for the second quarter of 2009 compared to zero for the second quarter of 2008. This increase in other income was primarily due to the receipt of a previously disputed contractual payment and the reimbursement from insurers of legal fees related to various lawsuits during the second quarter of 2009.

*Benefit for income taxes*

During the second quarter of 2009, we recorded a net tax benefit of \$1.0 million for income taxes from continuing operations, compared to a net tax expense of zero for income taxes from continuing operations for the second quarter of 2008. The net tax benefit in the second quarter of 2009 was generated as a result of utilizing income in discontinued operations to recognize a portion of the benefit from losses generated in continuing operations. Our continuing operations effective tax rate was 23.3% for the three month period ended June 30, 2009 compared to an effective tax rate of zero for the period ended June 30, 2008; and there was no change to the valuation allowance of \$52.0 million.

**Table of Contents***Income (loss) from discontinued operations, net of tax*

During the second quarter of 2009, net income from discontinued operations, net of tax was \$1.9 million compared to a net loss of \$1.6 million for the second quarter of 2008. This improvement was primarily due to costs incurred for completing the decommissioning of our styrene facility in 2008.

***Six Months Ended June 30, 2009 Compared to Six Months Ended June 30, 2008****Revenues and loss from continuing operations*

Our revenues were \$58.3 million for the six-month period ended June 30, 2009, a 32% decrease from the \$86.1 million in revenues we recorded for the six-month period ended June 30, 2008. We had a net loss from continuing operations of \$4.0 million in the first six months of 2009, compared to a net loss from continuing operations of \$5.2 million in the first six months of 2008.

Revenues from our acetic acid operations were approximately \$43.6 million for the six-month period ended June 30, 2009, a 36% decrease from the \$68.1 million in revenues from these operations for the six-month period ended June 30, 2008. This decrease in acetic acid revenues in the first six months of 2009 was primarily due to reduced profit-sharing revenue of approximately \$8.0 million as a result of lower sales volumes and reduced margins compared to the first six months of 2008. Additionally, reimbursement of variable costs for the first six months of 2009 was lower by approximately \$17.0 million due to the shutdown of our acetic acid unit in June 2009 for scheduled maintenance. Gross profit from our acetic acid operations was \$4.4 million for the first six months of 2009 compared to \$13.5 million for the first six months of 2008. The decrease in gross profit was primarily due to the reduced profit-sharing revenue discussed above.

Revenues from our plasticizers operations were approximately \$14.2 million for the six-month period ended June 30, 2009, a 19% decrease from the \$17.5 million in revenues from these operations for the six-month period ended June 30, 2008. Our higher revenues for the six-month period ended June 30, 2008 is primarily due to a \$3.7 million reimbursement of costs in the first six months of 2008 related to the closure of our PA unit. Gross profit from our plasticizers operations was \$2.7 million for the first six months of 2009 compared to \$3.1 million for the first six months of 2008.

*Selling, general and administrative expenses*

Our selling, general and administrative expenses were \$7.2 million for the six-month period ended June 30, 2009, compared to \$6.2 million for the six-month period ended June 30, 2008. This increase in 2009 was primarily due to increased legal fees related to various lawsuits. These figures exclude insurance reimbursements of \$1.3 million which are recorded in other income.

*Impairment of long-lived assets*

We recorded zero and \$6.6 million for impairment of long-lived assets for the six months ended June 30, 2009 and 2008, respectively. The \$6.6 million impairment in the second quarter of 2008 was for the write-down of PA assets to zero as a result of the shutdown of the PA unit.

*Interest and debt related expenses*

We recorded \$8.0 million and \$8.9 million of interest and debt related expenses for the six months ended June 30, 2009 and 2008, respectively. The decrease for the six months ended June 30, 2009, compared to the six months ended June 30, 2008, was primarily due to \$0.3 million write-off of debt fees resulting from the reduction of our commitment under our revolving credit facility in the second quarter of 2008. The remaining decrease was due to increased capitalized interest and reduced credit facility fees for first six months of 2009 compared to the first six months of 2008.

**Table of Contents***Interest income*

We recorded \$0.6 million of interest income for the first six months of 2009 compared to \$2.4 million in the first six months of 2008. This decrease was due to lower interest rates earned on our cash investments in 2009 compared to 2008.

*Other income*

Our other income was \$2.7 million for the first six months of 2009 compared to zero for the first six months of 2008. This increase in other income was primarily due to the receipt of a previously disputed contractual payment and the reimbursement of legal fees related to various lawsuits during the first six months of 2009.

*Benefit for income taxes*

During the six month periods ended June 30, 2009 and 2008, we recorded net tax benefit of \$1.2 million and zero, respectively, for income taxes from continuing operations. The net tax benefit in the six-month period ended June 30, 2009, was generated as a result of utilizing income in discontinued operations to recognize a portion of the benefit from losses generated in continuing operations. Our continuing operations effective tax rate was 23.5% for the six month period ended June 30, 2009, compared to an effective tax rate of zero for the six month period ended June 30, 2008. For the six months ended June 30, 2009, there was no change to our valuation allowance of \$52.0 million.

*Income (loss) from discontinued operations, net of tax*

During the first six months of 2009, net income from discontinued operations, net of tax was \$3.6 million compared to a net loss of \$7.9 million for the first six months of 2008. This improvement was primarily due to costs incurred for completing the decommissioning of our styrene facility in 2008.

**Liquidity and Capital Resources**

On March 29, 2007, we completed a private offering of \$150 million aggregate principal amount of unregistered 10<sup>1</sup>/<sub>4</sub>% Senior Secured Notes due 2015, or our Secured Notes, pursuant to a Purchase Agreement among us, Sterling Chemicals Energy, Inc., or Sterling Energy, one of our former wholly-owned subsidiaries, and Jefferies & Company, Inc. and CIBC World Markets Corp., as initial purchasers. In connection with that offering, we entered into an indenture, dated March 29, 2007, among us, Sterling Energy, as guarantor, and U. S. Bank National Association, as trustee and collateral agent. On May 6, 2008, Sterling Energy was merged with and into us. Upon consummation of the merger, Sterling Energy no longer had independent existence and, consequently, our Secured Notes are no longer guaranteed by Sterling Energy. Pursuant to a registration rights agreement among us, Sterling Energy and the initial purchasers, we agreed to exchange our unregistered Secured Notes for a new issue of substantially identical debt securities registered under the Securities Act, to cause the registration statement for the exchange offer to become effective by December 24, 2007, and to complete the exchange offer within 50 days of the effective date of the registration statement. On August 30, 2007, we made an initial filing of the exchange offer registration statement. However, the registration statement was not declared effective by December 24, 2007, and, as a result, the interest rate on our Secured Notes increased by 0.25% per annum on each of December 25, 2007, March 24, 2008 and June 22, 2008. The registration statement was declared effective on August 13, 2008, and the exchange offer was closed on September 19, 2008. As a result, the interest rate on our Secured Notes reverted back to the face amount of 10<sup>1</sup>/<sub>4</sub>% per annum when the exchange offer closed. The additional interest incurred from December 25, 2007 through the closing of the exchange offer was approximately \$0.5 million and was paid on April 1 and October 1, 2008.

Our indenture contains affirmative and negative covenants and customary events of default, including payment defaults, breaches of covenants and certain events of bankruptcy, insolvency and reorganization. If an event of default occurs and is continuing, other than an event of default triggered upon certain bankruptcy events, the trustee under our indenture or the holders of at least 25% in principal amount of our outstanding Secured Notes may declare our Secured Notes to be due and payable immediately. Upon an event of default, the trustee may also take actions to foreclose on the collateral securing our outstanding Secured Notes, subject to the terms of an intercreditor agreement

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dated March 29, 2007, among us, Sterling Energy, the trustee and The CIT Group/Business Credit, Inc. Our indenture does not require us to maintain any financial ratios or satisfy any financial maintenance tests. We are currently in compliance with all of the covenants contained in our indenture.

Interest is due on our outstanding Secured Notes on April 1 and October 1 of each year. Our outstanding Secured Notes, which mature on April 1, 2015, are senior secured obligations and rank equally in right of payment with all of our existing and future senior indebtedness. Subject to specified permitted liens, our outstanding Secured Notes are secured (i) on a first priority basis by all of our fixed assets and certain related assets, including, without limitation, all property, plant and equipment and (ii) on a second priority basis by our other assets, including, without limitation, accounts receivable, inventory, capital stock of our domestic restricted subsidiaries, intellectual property, deposit accounts and investment property.

On December 19, 2002, we entered into a Revolving Credit Agreement, or our revolving credit facility, with The CIT Group/Business Credit, Inc., as administrative agent and a lender, and certain other lenders. Under our revolving credit facility, we and Sterling Energy were co-borrowers and were jointly and severally liable for any indebtedness thereunder. After the merger of Sterling Energy with and into us, Sterling Energy ceased to be a co-borrower under our revolving credit facility. Our revolving credit facility is secured by first priority liens on all of our accounts receivable, inventory and other specified assets. On March 29, 2007, we amended and restated our revolving credit facility to, among other things, extend the term of our revolving credit facility until March 29, 2012, reduce the maximum commitment thereunder to \$50 million, make certain changes to the calculation of the borrowing base and lower the interest rates and fees charged thereunder. Borrowings under our revolving credit facility bear interest, at our option, at an annual rate of a base rate plus 0.0% to 0.50% or the LIBOR rate plus 1.50% to 2.25%, depending on our borrowing availability at the time. We are also required to pay an aggregate commitment fee of 0.375% per year (payable monthly) on any unused portion of our revolving credit facility. Available credit under our revolving credit facility is subject to a monthly borrowing base of 70% of eligible accounts receivable plus 65% of eligible inventory. In response to the expected continued lower levels of accounts receivable and inventory, as well as our lesser need for a working capital facility, we reduced our commitment under our revolving credit facility to \$25 million on June 30, 2008. On November 7, 2008, we further amended our revolving credit facility to substantially reduce restrictions, subject to minimum liquidity requirements, on investment of cash and other assets, payment of cash dividends, repurchase of debt and equity securities, modification of preferred stock terms, entry into affiliated transactions, disposition of assets and engagement in certain business activities. We paid the administrative agent an amendment fee plus expenses totaling approximately \$0.1 million in connection with this amendment.

CIT Group, Inc., the administrative agent and a lender under our revolving credit facility, has incurred significant rating downgrades due to liquidity concerns. The bank recently announced that it had entered into a \$3 billion loan facility provided by a group of its major bondholders and that it intends to commence a comprehensive restructuring of its liabilities to provide additional liquidity and further strengthen its capital position. We are closely monitoring this situation; we do not believe it will have a material impact on our financial condition or our ability to fund operations.

As of June 30, 2009, total credit available under our revolving credit facility was \$9.1 million, there were no loans outstanding and we had \$3.5 million in letters of credit outstanding, resulting in borrowing availability of \$5.6 million. Pursuant to Emerging Issues Task Force Issue No. 95-22, Balance Sheet Classification of Borrowings under Revolving Credit Agreements That Include both a Subjective Acceleration Clause and a Lock-Box Arrangement, any balances outstanding under our revolving credit facility would be classified as a current portion of long-term debt.

Our revolving credit facility contains numerous covenants and conditions, including, but not limited to, restrictions on our ability to incur indebtedness, create liens, sell assets, make investments of cash and other assets, make capital expenditures, engage in mergers and acquisitions and pay cash dividends. Our revolving credit facility also includes various circumstances and conditions that would, upon their occurrence and subject in certain cases to notice and grace periods, create an event of default thereunder. Our revolving credit facility does not require us to maintain any financial ratios or satisfy any financial maintenance tests. We are currently in compliance with all of the covenants contained in our revolving credit facility.



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Our liquidity (*i.e.*, cash and cash equivalents plus total credit available under our revolving credit facility) was \$156.4 million at June 30, 2009, a decrease of \$10.8 million compared to our liquidity at December 31, 2008. This decrease was primarily due to a \$5.9 million decrease in our borrowing base as a result of the reduction in accounts receivable from December 31, 2008, and \$6.4 million for capital expenditures during the first six months of 2009.

Distress in the financial markets during 2008 and 2009 has had an adverse impact on financial market activities including, among other things, volatility in security prices, diminished liquidity and credit availability, rating downgrades of certain investments and declining valuations of others. We have assessed the implications of these factors on our current business and determined that there has not been a significant impact to our financial condition, results of operations or liquidity during the second quarter of 2009. Our cash is invested in highly rated money market funds, which are guaranteed by the US Department of Treasury under its Temporary Guarantee Program for Money Market Funds. We believe that our cash on hand and cash generated from continuing operations, along with credit available under our revolving credit facility, will be sufficient to meet our short-term and long-term liquidity needs for the reasonably foreseeable future.

***Working Capital***

Our working capital was \$137.0 million as of June 30, 2009, a decrease of \$9.0 million from our working capital of \$146.0 million as of December 31, 2008. This decrease was primarily due to a \$7.7 million accrual for interest related to our Secured Notes, capital expenditures of \$6.4 million, shutdown costs of \$2.7 million, a variable compensation accrual of \$1.0 million and property tax accrual of \$0.9 million, offset by a \$9.8 million increase in the profit sharing accrual.

***Cash Flow***

Net cash provided by operations was \$0.7 million for the first six months of 2009, compared to \$63.1 million during the first six months of 2008. This decrease in net cash flow provided by operations during the first six months of 2009 was primarily due to the monetization of our styrene working capital of approximately \$67.0 million in 2008. Net cash flow used in investing activities was \$6.1 million during the first six months of 2009, compared to \$2.8 million for the first six months of 2008. This increase was primarily due to increased capital expenditures. There was no cash flow provided by financing activities in the first six months of 2009 or 2008.

***Capital Expenditures***

Our capital expenditures were \$6.4 million during the first six months of 2009 compared to \$2.8 million during the first six months of 2008. Capital expenditures during the first six months of 2009 were \$3.7 million for our portion of acetic acid related projects, including construction of an acetic acid pipeline and other replacement and debottlenecking projects and \$1.8 million for the capital project to prevent the discharge of process wastewater during periods of heavy rain at our Texas City facility. Costs incurred for routine safety, environmental, replacement capital and profit improvement projects decreased \$0.9 million for the first six months of 2009 compared to the first six months of 2008.

We expect our capital expenditures for the remainder of 2009 to be approximately \$7.4 million, including \$0.6 million for our portion of acetic acid related projects and \$0.2 million for the capital project to prevent the discharge of process wastewater during periods of heavy rain at our Texas City facility. The remaining \$6.6 million is primarily for routine safety, environmental, replacement capital and profit improvement projects.

***Contractual Cash Obligations***

As of June 30, 2009, there have been no significant changes to the contractual obligations disclosed in our Annual Report.

**Table of Contents****Critical Accounting Policies, Use of Estimates and Assumptions**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and related notes. Actual results could differ from those estimates. On an ongoing basis, we review our estimates, including those related to the allowance for doubtful accounts, recoverability of long-lived assets, deferred tax asset valuation allowance, litigation, environmental liabilities, pension and post-retirement benefits, preferred stock dividends and various other operating allowances and accruals, based on currently available information. Changes in facts and circumstances may alter such estimates and affect our results of operations and financial position in future periods. There have been no material changes or developments in our evaluation of the accounting estimates or the underlying assumptions or methodologies that we believe to be critical accounting policies disclosed in our Annual Report.

**New Accounting Standards***Adoption of Accounting Standards:*

In December 2007, the Financial Accounting Standards Board, or FASB, issued SFAS No. 141 (revised 2007), Business Combinations, or SFAS No. 141R. SFAS No. 141R broadens the guidance of SFAS No. 141, Business Combinations, extending its applicability to all transactions and other events in which one entity obtains control over one or more other businesses. SFAS No. 141R broadens the fair value measurement and recognition of assets acquired, liabilities assumed and interests transferred as a result of business combinations, and expands on required disclosures to improve the statement users' abilities to evaluate the nature and financial effects of business combinations. We implemented SFAS No. 141R effective January 1, 2009, and it had no impact on our condensed consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements; an Amendment of ARB No. 51, or SFAS No. 160. SFAS No. 160 establishes the accounting and reporting standards for a noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary and clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS No. 160 requires retroactive adoption of the presentation and disclosure requirements for existing minority interests and applies prospectively to business combinations for fiscal years beginning after December 15, 2008. We implemented SFAS No. 160 effective January 1, 2009, and it had no impact on our condensed consolidated financial statements.

In December 2007, the FASB issued Emerging Issues Task Force, or EITF, 07-1 Accounting for Collaborative Arrangements, or EITF 07-1. EITF 07-1 defines collaborative arrangements and establishes reporting requirements for transactions between participants in a collaborative arrangement and between participants in the arrangement and third parties. EITF 07-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years and shall be applied retrospectively to all prior periods presented for all collaborative arrangements existing as of the effective date. We implemented EITF 07-1 effective June 30, 2009, and it had no impact on our condensed consolidated financial statements.

In February 2008, the FASB issued SFAS No. 157-2, Effective Date of FASB Statement No. 157, which defers the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years, for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). An entity that has issued interim or annual financial statements reflecting the application of the measurement and disclosure provisions of SFAS No. 157 prior to February 12, 2008 must continue to apply all provisions of SFAS No. 157. We implemented SFAS No. 157-2 effective January 1, 2009, and it had no impact on our condensed consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, Disclosures About Derivative Instruments and Hedging Activities, or SFAS No. 161. SFAS No. 161 requires enhanced disclosures about an entity's derivative and hedging activities, with the intent to provide users of financial statements with an enhanced understanding of (a)



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how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and its related interpretations and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. We implemented SFAS No. 161 effective January 1, 2009, and it had no impact on our condensed consolidated financial statements.

In April 2009, the FASB issued FASB Staff Position SFAS No. 141(R)-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination that Arise from Contingencies, or FSP No. 141(R)-1. FSP No. 141(R)-1 applies to all assets acquired and all liabilities assumed in a business combination that arise from contingencies. FSP No. 141(R)-1 requires the acquirer to recognize such an asset or liability if the acquisition-date fair value of that asset or liability can be determined during the measurement period. If it cannot be determined during the measurement period, then the asset or liability should be recognized at the acquisition date if, consistent with SFAS No. 5, Accounting for Contingencies, information available before the end of the measurement period indicates that it is probable that an asset existed or that a liability had been incurred at the acquisition date, and the amount of the asset or liability can be reasonably estimated. We implemented FSP No. 141(R)-1 effective January 1, 2009, and it had no impact on our condensed consolidated financial statements.

In April 2009, the FASB issued FASB Staff Position SFAS No. 107-1 and Accounting Principles Board No. 28-1, Interim Disclosures about Fair Value of Financial Instruments, or FSP No. 107-1. FSP No. 107-1 requires the disclosure of the fair value of financial instruments for interim reporting periods of publicly traded companies as well as in the annual financial statements. FSP No. 107-1 is effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. We implemented FSP No. 107-1 for the period ending June 30, 2009, and it had no impact on our condensed consolidated financial statements.

In April 2009, the FASB issued FASB Staff Position SFAS No. 115-2 and SFAS No. 124-2, Recognition and Presentation of Other-Than-Temporary Impairments, or FSP Nos. 115-2 and 124-2, which provide new guidance on the recognition of other-than-temporary impairments of investments in debt securities and provide new presentation and disclosure requirements for other-than-temporary impairments of investments in debt and equity securities. FSP Nos. 115-2 and 124-2 are effective for our quarter ending June 30, 2009. We implemented FSP Nos. 115-2 and 124-2 for the period ending June 30, 2009, and it had no impact on our condensed consolidated financial statements.

In April 2009, the FASB issued FASB Staff Position SFAS No. 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly, or FSP No. 157-4. FSP No. 157-4 provides additional guidance for estimating fair value in accordance with SFAS No. 157, Fair Value Measurements, when the volume and level of activity for the asset or liability have significantly decreased. This FASB Staff Position also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP No. 157-4 is effective for our quarter ending June 30, 2009. We implemented FSP No. 157-4 effective June 30, 2009, and it had no impact on our condensed consolidated financial statements.

In May 2009, the FASB issued SFAS No. 165, Subsequent Events, or SFAS No. 165. SFAS No. 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. In particular, SFAS No. 165 sets forth:

the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements;

the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and

the disclosures that an entity should make about events or transactions that occurred after the balance sheet date.

SFAS No. 165 is effective for interim or annual financial periods ending after June 15, 2009, and shall be applied prospectively. We implemented SFAS No. 165 for the period ending June 30, 2009, and it had no impact on our condensed consolidated financial statements.



**Table of Contents***Future Adoption of Accounting Standards:*

In December 2008, the FASB issued FASB Staff Position SFAS No. 132(R)-1, Employers' Disclosures about Pensions and Other Postretirement Benefits, or FSP No. 132R-1. FSP No. 132R-1 requires enhanced disclosures about the plan assets of defined benefit pension and other postretirement plans. The enhanced disclosures required by FSP No. 132R-1 are intended to provide users of financial statements with a greater understanding of (a) how investment allocation decisions are made, including the factors that are pertinent to an understanding of investment policies and strategies, (b) the major categories of plan assets, (c) the inputs and valuation techniques used to measure the fair value of plan assets, (d) the effect of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets for the period and (e) significant concentrations of risk within plan assets. FSP No. 132R-1 is effective for the year ending December 31, 2009. We do not believe the implementation of FSP No. 132R-1 will have a material impact on our consolidated financial statements.

In June 2009, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R), or SFAS No. 167. SFAS No. 167 amends certain requirements of FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities, to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. SFAS No. 167 is effective as of the beginning of the first annual reporting period that begins after November 15, 2009 and for interim periods within that first annual reporting period. We do not believe the implementation of SFAS No. 167 will have a material impact on our consolidated financial statements.

In June 2009, The FASB issued SFAS No. 168, FASB Accounting Standards Codification<sup>TM</sup> and the Hierarchy of Generally Accepted Accounting Principles, or SFAS No. 168. SFAS No. 168 establishes the FASB Accounting Standards Codification<sup>TM</sup>, or Codification, as the single source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission, or SEC, under authority of federal securities laws are also sources of authoritative U.S. GAAP for SEC registrants. SFAS No. 168 and the Codification are effective for financial statements issued for interim and annual periods ending after September 15, 2009. Upon implementation, we will follow the guidance of SFAS No. 168 and the Codification in applying U.S. GAAP.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Our \$150 million of Secured Notes bear interest at an annual rate of 10<sup>1</sup>/<sub>4</sub>%, payable semi-annually on April 1 and October 1 of each year. The fair value of our Secured Notes is based on their quoted price, which may vary in response to changing interest rates. As of June 30, 2009, the fair value of our Secured Notes was approximately \$136.5 million.

**Item 4T. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures.* We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act) designed to provide reasonable assurance that the information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms. These include controls and procedures designed to ensure that this information is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance of achieving their control objectives.

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2009. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures were not effective as of June 30, 2009, due to the identification of a control deficiency in the first quarter of 2009 that represents a material weakness in our internal control over financial reporting. This material weakness

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resulted from a lack of effective controls over the accounting for utilities at our Texas City facility, specifically accounting for the flow of water throughout our facility. Management has taken steps to remedy the material weakness by implementing three additional controls:

- § management review and annual approval of the pre-established allocation percentages and any changes to the allocation;
- § management review and approval of the methodology used to address the allocation limitations in our general ledger system; and
- § management review and approval of the volume data from the meter to our general ledger system, including formulas used to correct the volume data.

Although these controls were implemented in the second quarter of 2009, they were not in effect for a sufficient period of time and therefore have not been tested. As a result, our principal executive officer and principal financial officer concluded that, as of June 30, 2009, our disclosure controls and procedures were not effective pursuant to Exchange Act Rules 13a-15(f) and 15d-15(f).

Management is in the process of completing the remediation and testing of the new controls. We anticipate that the new implemented controls will be tested by the end of the third quarter of 2009.

Notwithstanding our assessment that our internal controls over financial reporting were not effective and our identification of the above-described material weakness, we believe that our financial statements contained in this report on Form 10-Q for the three and six months ended June 30, 2009, accurately present our financial condition, results of operations and cash flows in all material respects.

*Changes in Internal Control over Financial Reporting.* Other than the identified changes discussed above, there have been no changes in our internal control over financial reporting for the quarter ended June 30, 2009, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II.  
OTHER INFORMATION**

**Item 1. *Legal Proceedings***

The information under *Legal Proceedings* in Note 4 to the condensed consolidated financial statements included in Item 1 of Part I of this report is hereby incorporated by reference.

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

Our Annual Meeting of Stockholders for 2009, or our Annual Meeting, was held on April 30, 2009. At our Annual Meeting:

seven of our incumbent directors were re-elected;

the appointment of Grant Thornton LLP as our independent registered accounting firm for the fiscal year ending December 31, 2009 was ratified and approved;

our Amended and Restated 2002 Stock Plan was ratified and approved;

our Second Amended and Restated Certificate of Incorporation which increases the number of our total authorized shares of Common Stock from 20,000,000 to 100,000,000 was approved.

Under the Restated Certificate of Designations, Preferences, Rights and Limitations of our Series A Convertible Preferred Stock, or our Preferred Stock, the holders of our Preferred Stock, voting separately as a class, are entitled

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to elect a percentage of our directors determined by the aggregate amount of shares of our Preferred Stock and our common stock beneficially owned by Resurgence Asset Management, L.L.C. and certain permitted transferees. Currently, the holders of our Preferred Stock are entitled to elect a majority of our directors. All of our other directors are elected by the holders of our Preferred Stock and the holders of our common stock, voting together as a single class. For purposes of class voting, each share of our Preferred Stock has the right to one vote for each share of our common stock into which such share is convertible on the record date for such vote, which was 1,000 shares on the record date for our Annual Meeting. At our Annual Meeting, three of our directors were elected by the holders of our Preferred Stock and four of our directors were elected by the holders of our Preferred Stock and the holders of our common stock, voting together as a single class. The voting results for the re-election of our seven incumbent directors are set forth below:

Directors elected by the holders of our Preferred Stock:

| Director            | For       | Withheld |
|---------------------|-----------|----------|
| Byron J. Haney      | 5,601,280 | 0        |
| Philip M. Sivin     | 5,601,280 | 0        |
| Karl W. Schwarzfeld | 5,601,280 | 0        |

Directors elected by the holders of our Preferred Stock and the holders of our common stock, voting together as a single class:

| Director              | For       | Withheld |
|-----------------------|-----------|----------|
| Richard K. Crump      | 8,232,436 | 82,566   |
| John V. Genova        | 8,231,539 | 83,463   |
| John W. Gildea        | 8,232,436 | 82,566   |
| Dr. Peter Ting Kai Wu | 8,314,970 | 32       |

Holders of our Preferred Stock and holders of our common stock voted together as a single class on the ratification and approval of the appointment of Grant Thornton LLP as our independent registered accounting firm for the fiscal year ending December 31, 2009. For purposes of class voting, each share of our Preferred Stock has the right to one vote for each share of our common stock into which such share is convertible on the record date for such vote, which was 1,000 shares on the record date for our Annual Meeting. The voting results for the ratification and approval of the appointment of Grant Thornton LLP as our independent registered accounting firm for the fiscal year ending December 31, 2009 are set forth below:

| For       | Against | Abstain |
|-----------|---------|---------|
| 8,359,088 | 58      | 51      |

Holders of our Preferred Stock and holders of our common stock voted together as a single class on the proposal to amend and restate our Amended and Restated 2002 Stock Plan. For purposes of class voting, each share of our Preferred Stock has the right to one vote for each share of our common stock into which such share is convertible on the record date for such vote, which was 1,000 shares on the record date for our Annual Meeting. The voting results for the proposal to amend and restate our Amended and Restated 2002 Stock Plan are set forth below:

| For       | Against | Abstain |
|-----------|---------|---------|
| 7,581,466 | 333,246 | 84      |

Holders of our Preferred Stock and holders of our common stock voted together as a single class on the proposal to amend and restate our Amended and Restated Certificate of Incorporation. For purposes of class voting, each share of our Preferred Stock has the right to one vote for each share of our common stock into which such share is convertible on the record date for such vote, which was 1,000 shares on the record date for our Annual Meeting. The voting results for the proposal to amend and restate our Amended and Restated Certificate of Incorporation are set forth below:



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|           |         |         |
|-----------|---------|---------|
| For       | Against | Abstain |
| 8,022,163 | 336,979 | 55      |

There were no broker non-votes on any matter voted on at our Annual Meeting.

**Item 5. Other Information**

On August 7, 2009, our Board of Directors adopted the Long-Term Incentive Plan, or our LTI Plan. Our LTI Plan provides for the issuance of performance awards to our Chief Executive Officer and President, our Senior Vice Presidents and other key employees. The purpose of the LTI Plan is to provide an incentive to our executive officers and other designated employees to contribute to our growth and profitability, to increase stockholder value and to retain such employees.

Performance awards under our LTI Plan may be payable in the form of cash or other property, and are payable upon the satisfaction of pre-determined performance goals over performance periods; *provided*, that the recipient remains employed by us on the last day of the performance period for which such recipient is receiving the award. Performance goals, for purposes of the LTI Plan, include any of the following business criteria: revenue; earnings before interest, taxes, depreciation and amortization, or EBITDA (as may be adjusted for certain non-recurring and other items as described in the LTI Plan); free cash flow; funds from operations; funds from operations per share; operating income (loss); pre or after tax income (loss); cash available for distribution; cash available for distribution per share; cash and/or cash equivalents available for operations; net earnings (loss); earnings (loss) per share; return on equity; return on assets; share price performance; improvements in our attainment of expense levels; implementation or completion of critical projects, including, without limitation, implementation of strategic plan(s), improvement in investor relations, marketing and manufacturing of key products, improvement in cash-flow (before or after tax), development of critical projects or product development; or progress relating to research and development. The terms of a participant's performance award will be established by the compensation committee of our Board of Directors and may be set forth in an award agreement.

On August 7, 2009, each of our named executive officers, John V. Genova, President and Chief Executive Officer; John R. Beaver, Senior Vice President Finance and Chief Financial Officer; Kenneth M. Hale, Senior Vice President, General Counsel and Corporate Secretary; Paul C. Rostek, Senior Vice President Commercial; and Walter B. Treybig, Senior Vice President Manufacturing, was awarded performance units under the LTI Plan, having a redemption value of \$1,000 per unit, based on our achievement of the following cumulative free cash flow benchmarks for the period commencing on July 1, 2009 and ending on December 31, 2011, or the Performance Period:

|           | <b>Cumulative Free Cash Flow<sup>(1)</sup></b> |              |
|-----------|--|--------------|
| Threshold |  | \$27,600,000 |
| Target    |  | \$33,900,000 |
| Maximum   |  | \$54,200,000 |

(1) Free Cash Flow means operating cash flow (from the cash flow statement), *plus* out-of-pocket cash used for project development activities (*i.e.*, cash used to explore or implement new strategic initiatives (not

involving existing businesses) aimed to improve future free cash flow such as gasification, mergers and acquisitions, terminalling and sale of utilities to new customers), *plus* net proceeds from equipment sales *plus* \$15.4 million (interest on our Secured Notes without reduction for paydowns/purchases), *plus* insurance proceeds related to plant, property and equipment, *plus* LTI Plan cash payments, *minus* sustaining (non-return) capital.

The number of performance units granted, which is dependent on the cumulative Free Cash Flow achieved (Threshold, Target or Maximum) during the Performance Period, is as follows:

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| Named Executive Officer | Cumulative Free Cash Flow |              |              |
|-------------------------|---------------------------|--------------|--------------|
|                         | Threshold                 | Target       | Maximum      |
|                         | \$27,600,000              | \$33,900,000 | \$54,220,000 |
|                         | 310                       |              |              |
| John V. Genova          | Units                     | 620 Units    | 1,240 Units  |
|                         | 123                       |              |              |
| John R. Beaver          | Units                     | 245 Units    | 490 Units    |
|                         | 130                       |              |              |
| Kenneth M. Hale         | Units                     | 260 Units    | 520 Units    |
|                         | 120                       |              |              |
| Paul C. Rostek          | Units                     | 240 Units    | 480 Units    |
|                         | 110                       |              |              |
| Walter B. Treybig       | Units                     | 220 Units    | 440 Units    |

Assuming we meet at least the Threshold level of performance (as certified by the compensation committee in writing), the actual amount of performance units earned and payable will be prorated between the Threshold, Target and Maximum levels of performance, based on the actual cumulative Free Cash Flow earned by us during the Performance Period. The payment of performance units is contingent on the participant's employment through the end of the Performance Period; however, in the event a participant retires or his employment is terminated without Cause or for Good Reason (as such terms are defined in the LTI Plan) he will be entitled to a pro rata cash portion of his award based on the level of performance achieved during the Performance Period measured as of the end of such period.

Upon a participant's death or Disability (as such term is defined in the LTI Plan), any incomplete performance periods applicable to a performance award will end at such time and will require a payment of the applicable award as provided at the time of grant. In the case of awards made on August 7, 2009, each recipient of an award would be deemed to have earned the number of performance units set forth opposite his name under the column Target \$33,900,000 in the table above and we would redeem those performance units for \$1,000 each in cash.

In the event that a participant's employment with us is terminated without Cause or for Good Reason, as such terms are defined in the LTI Plan, such participant will be deemed to have earned the number of performance units set forth opposite his name under the column \$33,900,000 in the table above multiplied by a fraction, the numerator of which is the number of days in the Performance Period during which such participant was employed by us and the denominator of which is 913, and we will redeem those performance units for \$1,000 each in cash on or before March 14 of the calendar year immediately following the calendar year in which such participant's employment with us was so terminated.

Upon a Change in Control, as such term is defined in the LTI Plan, if a Transaction Fee (as defined in that certain Amended and Restated Employment Agreement dated as of June 16, 2009 between us and John V. Genova) is paid to any participant pursuant to the transaction resulting in such Change in Control, all outstanding performance units granted on August 6, 2009 that are held by each of the participants will automatically lapse and be canceled upon the consummation of such transaction. However, if no Transaction Fee is paid to any participant pursuant to the transaction resulting in such Change in Control, each participant will be deemed to have earned the number of performance units set forth opposite his name under the column \$33,900,000 in the table above and we will redeem those performance units for \$1,000 each in cash.

**Item 6. Exhibits**

The following are filed or furnished as part of this Form 10-Q:

| Exhibit Number | Description of Exhibit |
|----------------|------------------------|
|----------------|------------------------|

|     |  |
|-----|--|
| 3.1 |  |
|-----|--|

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Certificate of Amendment to the Second Amended and Restated Certificate of Incorporation of Sterling Chemicals, Inc. (incorporated by reference to Exhibit 3.1 to our Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2009).

- +10.1 Amended and Restated Employment Agreement dated June 16, 2009 between Sterling Chemicals, Inc. and John V. Genova (incorporated by reference to Exhibit 10.1 to our current report on Form 8-K filed June 16, 2009).
- \*+10.2 Long-Term Incentive Plan.
- \*15.1 Letter of Grant Thornton LLP regarding unaudited interim financial information.
- \*31.1 Rule 13a-14(a) Certification of the Chief Executive Officer.
- \*31.2 Rule 13a-14(a) Certification of the Chief Financial Officer.

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| <b>Exhibit<br/>Number</b>   | <b>Description of Exhibit</b>                              |
|---|--|
| *32.1   | Section 1350 Certification of the Chief Executive Officer. |
| *32.2   | Section 1350 Certification of the Chief Financial Officer. |
| * Filed or<br>furnished<br>herewith                                   |  |
| + Management<br>contract or<br>compensatory<br>plan or<br>arrangement |  |

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**SIGNATURES**

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

STERLING CHEMICALS, INC.  
(Registrant)

Date: August 11, 2009

By /s/ JOHN V. GENOVA  
John V. Genova  
*President and Chief Executive Officer*

Date: August 11, 2009

By /s/ JOHN R. BEAVER  
John R. Beaver  
*Senior Vice President-Finance and  
Chief Financial Officer  
(Principal Financial Officer)*

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**EXHIBIT INDEX**

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| *31.2                     | Rule 13a-14(a) Certification of the Chief Financial Officer.  |
| *32.1                     | Section 1350 Certification of the Chief Executive Officer.  |
| *32.2                     | Section 1350 Certification of the Chief Financial Officer.  |
| *<br>*                    | Filed or<br>furnished<br>herewith   |
| +<br>+                    | Management<br>contract or<br>compensatory<br>plan or<br>arrangement   |