

STERLING CHEMICALS INC

Form 10-Q

November 14, 2006

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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 September 30, 2006**

**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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

**APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE  
PRECEDING FIVE YEARS:**

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes  No .

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 October 31, 2006, Sterling Chemicals, Inc. had 2,828,460 shares of common stock, par value \$.01 per share, 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 subsidiary.

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

**Forward-Looking Statements**

Certain written and oral statements made or incorporated by reference from time to time by us or our representatives are forward-looking statements within the meaning of Section 27A of the United States Securities Act of 1933, as amended, and Section 21E of the United States Securities Exchange Act of 1934, as amended (the

Exchange Act ). 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, project, 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 and statements about the following subjects:

the cyclical nature of the petrochemicals industry;

current and future industry conditions;

the extent and timing of expansions of production capacity of our products, by us or by our competitors;

the potential effects of market and industry conditions and cyclical nature on our business strategy, results of operations or financial position;

the level of expected savings from our cost reduction initiatives;

the adequacy of our liquidity;

our environmental management programs and safety initiatives;

our market sensitive financial instruments;

future uses of and requirements for financial resources;

future contractual obligations;

future amendments or renewals of existing contractual relationships;

business strategies;

growth opportunities;

competitive position;

expected financial position;

future cash flows;

future dividends;

financing plans;

budgets for capital and other expenditures;

plans and objectives of management;

outcomes of legal proceedings;

compliance with applicable laws; and

adequacy of insurance coverage or indemnification rights.

Such statements are based upon current information and expectations and inherently are subject to a variety of risks and uncertainties that could cause actual results to differ materially from those expected or expressed in the forward-looking statements. Such risks and uncertainties include, among others, the following:

the timing and extent of changes in commodity prices for our products and for raw materials;

petrochemicals industry production capacity and operating rates;

market conditions in the petrochemicals industry, including the supply-demand balance for our products and regional differences in the costs of raw materials and energy;

competition, including competitive products, pricing pressures and regional variations in manufacturing costs;

our ability to maintain adequate quantities of sales under our contracts;

obsolescence of product lines and manufacturing processes;

the timing and extent of changes in global economic and business conditions;

increases in raw materials and energy costs, including the cost of natural gas;

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our ability to obtain raw materials, energy and ocean-going vessels at competitive prices, in a timely manner and on acceptable terms;

regulatory initiatives and compliance with governmental regulations;

compliance with environmental laws and regulations;

customer preferences;

our ability to attract or retain high quality employees;

operating hazards attendant to the petrochemicals industry;

casualty losses, including those resulting from weather related events;

changes in foreign, political, social and economic conditions;

risks of war, military operations, other armed hostilities, terrorist acts and embargoes;

changes in technology, which could require significant capital expenditures in order to maintain competitiveness or cause existing manufacturing processes to become obsolete;

effects of litigation;

cost, availability and adequacy of insurance;

adequacy of our sources of liquidity; and

various other matters, many of which are beyond our control.

The risks included here are not exhaustive. Other sections of this report and our other filings with the Securities and Exchange Commission, including, without limitation, our Annual Report on Form 10-K for the fiscal year ended December 31, 2005 (our Annual Report ), include additional factors that could adversely affect our business, results of operations and financial condition and 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 speak 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 the forward-looking statements are reasonable, such expectations may prove to have been incorrect. All subsequent written and oral forward-looking statements attributable to us, or persons acting on our behalf, are expressly qualified in their entirety by these cautionary statements.

**Subsequent Events**

All statements contained in this Form 10-Q, including the forward-looking statements discussed above, are made as of November 13, 2006, unless those statements are expressly made as of another date. We disclaim any responsibility for the accuracy of any information contained in this Form 10-Q to the extent such information is affected or impacted by events, circumstances or developments occurring after November 13, 2006, or by the passage of time after such date. Except to the extent required by applicable securities laws, we expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any statement or information contained in this Form 10-Q, including the forward-looking statements discussed above, to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any statement or information is based.

**Document Summaries**

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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 Securities and Exchange Commission 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 Securities and Exchange Commission 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>). Our website provides a hyperlink to the website of the Securities and Exchange Commission, where these reports may be viewed and printed at no cost as soon as reasonably practicable after we have electronically filed such reports with the Securities and Exchange Commission. The contents of our website are not, and shall not be deemed to be, incorporated into this report.

**STERLING CHEMICALS, INC.  
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**PART I.**  
**FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**STERLING CHEMICALS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

	<b>Three months ended</b>		<b>Nine months ended September</b>	
	<b>September 30,</b>		<b>30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	<b>(Unaudited)</b>			
	<b>(Dollars in Thousands, Except Share Data)</b>			
Revenues	\$ 189,916	\$ 148,733	\$ 476,972	\$ 492,455
Cost of goods sold	176,582	143,879	470,008	490,445
Gross profit	13,334	4,854	6,964	2,010
Selling, general and administrative expenses	2,562	2,338	6,342	5,540
Other (income) expense	(12,000)		(15,724)	
Interest and debt related expenses, net of interest income	2,663	2,376	7,566	7,874
Income (loss) from continuing operations before income tax	20,109	140	8,780	(11,404)
Provision (benefit) for income taxes	10,160	25	5,827	(4,198)
Income (loss) from continuing operations	\$ 9,949	\$ 115	\$ 2,953	\$ (7,206)
Income (loss) from discontinued operations (net of tax benefit of \$1,139, \$5,290, \$2,223 and \$8,018, respectively)	625	(9,164)	(1,127)	(13,888)
Net income (loss)	\$ 10,574	\$ (9,049)	\$ 1,826	\$ (21,094)
Preferred stock dividends	2,090	1,786	6,031	5,156
Net income (loss) attributable to common stockholders	\$ 8,484	\$ (10,835)	\$ (4,205)	\$ (26,250)
Income (loss) per share of common stock:				
Basic earnings per share:				
Income (loss) from continuing operations	\$ 2.78	\$ (0.59)	\$ (1.09)	\$ (4.37)
Income (loss) from discontinued operations, net of tax	0.22	(3.24)	(0.40)	(4.91)
Basic earnings per share	\$ 3.00	\$ (3.83)	\$ (1.49)	\$ (9.28)



Diluted earnings per share:

Income (loss) from continuing operations	\$ 1.50	\$ (0.59)	\$ (1.09)	\$ (4.37)
Income (loss) from discontinued operations, net of tax	0.10	(3.24)	(0.40)	(4.91)
Diluted earnings per share	\$ 1.60	\$ (3.83)	\$ (1.49)	\$ (9.28)

Weighted average shares outstanding:

Basic :	2,828,460	2,828,474	2,828,462	2,827,566
Diluted :	6,616,146	2,828,474	2,828,462	2,827,566

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

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**STERLING CHEMICALS, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>September 30, 2006</b>	<b>December 31, 2005</b>
	<b>(Unaudited)</b>	
	<b>(Dollars in Thousands)</b>	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 27,370	\$ 42,197
Accounts receivable, net of allowance of \$1,279 and \$953, respectively	42,447	57,261
Accounts receivable, other	6,120	
Inventories, net	53,501	39,094
Prepaid expenses	10,456	4,888
Deferred tax asset	2,861	2,802
Assets of discontinued operations	684	1,791
 Total current assets	 143,439	 148,033
Property, plant and equipment, net	216,410	230,018
Other assets, net	9,070	8,543
 Total assets	 \$ 368,919	 \$ 386,594
 <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 34,548	\$ 43,912
Accrued liabilities	22,010	23,690
Liabilities of discontinued operations	756	3,826
 Total current liabilities	 57,314	 71,428
Long-term debt	100,579	100,579
Deferred tax liability	11,799	8,196
Deferred credits and other liabilities	68,674	77,804
Redeemable preferred stock	54,334	48,302
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Common stock, \$.01 par value	28	28
Additional paid-in capital	186,659	192,551
Accumulated deficit	(106,129)	(107,955)
Accumulated other comprehensive loss	(4,339)	(4,339)
 Total stockholders' equity	 76,219	 80,285

Total liabilities and stockholders' equity	\$ 368,919	\$ 386,594
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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**

	<b>Nine months ended September 30,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(Unaudited)</b>	
	<b>(Dollars in Thousands)</b>	
Cash flows from operating activities:		
Net income (loss)	\$ 1,826	\$ (21,094)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	23,517	25,824
Interest amortization	300	300
Deferred tax expense (benefit)	3,544	(12,274)
Gain on disposal of property, plant and equipment	(1,960)	
Other	140	157
Change in assets/liabilities:		
Accounts receivable	9,651	58,222
Inventories	(14,709)	34,885
Prepaid expenses	(5,568)	(1,527)
Other assets	(1,944)	(1,183)
Accounts payable	(7,668)	(26,002)
Accrued liabilities	(4,639)	6,423
Other liabilities	(9,130)	(5,887)
Net cash provided by (used in) operating activities	(6,640)	57,844
Cash flows provided by (used in) investing activities:		
Capital expenditures	(10,036)	(5,155)
Insurance proceeds relating to property, plant and equipment	1,960	
Cash used for methanol dismantling	(111)	(591)
Net cash used in investing activities	(8,187)	(5,746)
Cash flows from financing activities:		
Net repayments on the Revolver		(17,684)
Net increase (decrease) in cash	(14,827)	34,414
Cash and cash equivalents beginning of year	42,197	1,901
Cash and cash equivalents end of period	\$ 27,370	\$ 36,315
Supplemental disclosures of cash flow information:		

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Interest paid, net of interest income received	\$	5,428	\$	5,864
Cash paid for income taxes		60		59

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 ( 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 on Form 10-K for the year ended December 31, 2005. The accompanying unaudited interim condensed consolidated financial statements have been reviewed by Deloitte & Touche LLP, our independent registered public accounting firm, whose report is included herein.

***Reclassification***

Certain amounts reported in the consolidated financial statements for the prior periods have been reclassified to conform to the current consolidated financial statement presentation with no effect on net income (loss) or stockholders' equity.

**2. Stock-Based Compensation**

On December 19, 2002, we adopted our 2002 Stock Plan and reserved 379,747 shares of our common stock for issuance under the plan (subject to adjustment). Under our 2002 Stock Plan, officers and key employees, as designated by our Board of Directors, may be issued stock options, stock awards, stock appreciation rights or stock units. There are currently options to purchase a total of 278,500 shares of our common stock outstanding under our 2002 Stock Plan, all at an exercise price of \$31.60, and an additional 85,414 shares of common stock available for issuance under our 2002 Stock Plan.

On January 1, 2006, we adopted Statement of Financial Accounting Standards ( SFAS ) No. 123-Revised 2004, Share-Based Payments ( SFAS No. 123(R) ), using the modified prospective method. SFAS No. 123(R) is a revision of SFAS No. 123, Accounting for Stock-Based Compensation ( SFAS No. 123 ), and supersedes Accounting Principles Board No. 25, Accounting for Stock Issued to Employees ( APB No. 25 ). Under SFAS No. 123(R), the cost of employee services received in exchange for a stock-based award is determined based on the grant-date fair value (with limited exceptions). That cost is then recognized over the period during which the employee is required to provide services in exchange for the award (usually the vesting period). We currently use an option pricing model to estimate the grant date fair value of stock-based awards. Excess tax benefits, as defined in SFAS No. 123(R), are recognized as an addition to paid-in capital.

On January 1, 2006, using the modified prospective method under SFAS No. 123(R), we began recognizing expense on any unvested awards under our 2002 Stock Plan that were granted prior to that time and are expected to vest over their respective remaining vesting periods. Any awards granted under our 2002 Stock Plan after December 31, 2005 will be expensed over the vesting period of the award. Stock based compensation expense was \$25,000 and \$139,000 for the three and nine-month periods ended September 30, 2006, respectively.

Prior to January 1, 2006, we had adopted the disclosure-only provisions of SFAS No. 123 and accounted for substantially all of our stock-based compensation using the intrinsic value method prescribed in APB No. 25. Under APB No. 25, no compensation expense was recognized for any of our stock option grants because all of the stock options issued under our 2002 Stock Plan were granted with exercise prices at estimated fair value at the time of grant. During March 2005, we issued 3,474 shares of our common stock pursuant to the exercise of stock options by two of our former employees and, through the use of net

exercise elections, an additional 12,359 shares subject to the stock options held by these two former employees were used to pay the exercise price and withholding taxes related to the option exercises. The net exercise elections required variable accounting and resulted in compensation expense of \$0.2 million during the first quarter of 2005.

The following table illustrates the pro forma effect on our net income and income per share attributable to common stockholders for the three and nine-month periods ended September 30, 2005:



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

	<b>Three months ended September 30, 2005</b>	<b>Nine months ended September 30, 2005</b>
	<b>(Dollars in Thousands, Except Share Data)</b>	
Net loss attributable to common stockholders, as reported	\$ (10,835)	\$ (26,250)
Add: Stock-based employee compensation expense included in reported net income (loss), net of related tax effects		128
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(110)	(350)
Pro forma net loss	\$ (10,945)	\$ (26,472)
Basic and diluted loss per share attributable to common stockholders:		
As reported	\$ (3.83)	\$ (9.28)
Pro forma	(3.87)	(9.36)

**3. Discontinued Operations**

On September 16, 2005, we announced that we were exiting the acrylonitrile business and related derivative operations, which included sodium cyanide and disodium iminodiacetic acid ( DSIDA ). Our decision was based on a history of operating losses incurred by our acrylonitrile and derivatives businesses, and was made after a full review and analysis of our strategic alternatives. Our acrylonitrile and derivatives businesses sustained losses in recent years and had been shut down since February of 2005.

In accordance with SFAS No. 144, Accounting for the Impairment and Disposal of Long Lived Assets, we have reported the operating results of these businesses as discontinued operations in our consolidated statement of operations and cash flows, and we have presented the assets and liabilities of these businesses separately in our consolidated balance sheet.

The carrying amounts of the major classes of assets and liabilities related to discontinued operations as of September 30, 2006 and December 31, 2005 were as follows:

	<b>September 30, 2006</b>	<b>December 31, 2005</b>
	<b>(Dollars in Thousands)</b>	
<b>Assets of discontinued operations:</b>		
Accounts receivable, net	\$ 6	\$ 963
Inventories	678	376
Other assets		452
Total	\$ 684	\$ 1,791



**Liabilities of discontinued operations:**

Accrued liabilities		\$ 756	\$	3,826
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Revenues and pre-tax losses from discontinued operations for the three and nine-month periods ended September 30, 2006 and 2005 are presented below:

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
	(Dollars in Thousands)			
Revenues	\$ 103	\$ 4,582	\$ 1,108	\$ 40,545
Loss before income taxes	514	14,454	3,350	21,906

We expect to incur total costs of \$10 million related to our exit from the acrylonitrile and derivatives businesses, of which approximately \$9 million has been spent through September 30, 2006. Changes in the accrued exit costs are detailed below (in thousands):

	Accrued as of December 31, 2005	Additional accruals	Cash payments	Other	Accrued as of September 30, 2006
Severance accrual	\$ 477	\$ 367	\$ (646)	\$	\$ 198
DSIDA contractual obligation	2,853	147	(3,000)		
DSIDA dismantling costs	496	62			558
Product payable			(228)	228	
Totals	\$ 3,826	\$ 576	\$ (3,874)	\$ 228	\$ 756

**4. Earnings Per Share**

Basic earnings (loss) per share ( EPS ) is calculated by dividing net income (loss) attributable to common shareholders by the weighted average number of common shares outstanding for the period. Diluted EPS is calculated by dividing net income (loss) by the weighted average number of common shares outstanding, plus the assumed exercise of all dilutive securities using the treasury stock method or the if converted method, as appropriate. The following table provides a reconciliation of basic and diluted EPS:

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
	(Dollars in Thousands, Except Share Data)			