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

þ **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

o **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	**76-0502785**
(State or other jurisdiction of incorporation or organization)	*(IRS Employer Identification No.)*
333 Clay Street, Suite 3600 **Houston, Texas 77002-4109**	**(713) 650-3700**
(Address of principal executive offices)	*(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 þ No o.

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 o Accelerated filer o Non-accelerated filer þ

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 þ No o.

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

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 conti 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 cyclicality 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 cyclicality 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;

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

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.

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PART I.
FINANCIAL INFORMATION

Item 1. ***Financial Statements***

STERLING CHEMICALS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

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

	September 30, 2006	December 31, 2005
	(Unaudited)	
	(Dollars in Thousands)	
ASSETS		
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
LIABILITIES AND STOCKHOLDERS EQUITY		
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

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

STERLING CHEMICALS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine months ended September 30,	
	2006	2005
	(Unaudited) (Dollars in Thousands)	
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:

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 Principals 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)

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

	September 30, 2006	December 31, 2005
	(Dollars in Thousands)	
Assets of discontinued operations:		
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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STERLING CHEMICALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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)			
Basic income (loss) per share:				
Income (loss) from continuing operations attributable to common shareholders	$ 7,859	$ (1,671)	$ (3,078)	$ (12,362)
Income (loss) from discontinued operations	625	(9,164)	(1,127)	(13,888)
Net income (loss), net of tax	$ 8,484	$ (10,835)	$ (4,205)	$ (26,250)
Weighted average shares outstanding	2,828,460	2,828,474	2,828,462	2,827,566
Earnings per common share:				
	$ 2.78	$ (0.59)	$ (1.09)	$ (4.37)

Income (loss) from continuing operations attributable to common shareholders								
Income (loss) from discontinued operations		0.22		(3.24)		(0.40)		(4.91)
Net income (loss)	$	3.00	$	(3.83)	$	(1.49)	$	(9.28)

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

	Three months ended September 30,		Nine months ended September 30,	
	2006	**2005**	**2006**	**2005**
Diluted income (loss) per share:				
Income (loss) from continuing operations attributable to common shareholders	$ 7,859	$ (1,671)	$ (3,078)	$ (12,362)
Add: preferred stock dividends	2,090	-	-	-
Income available to common stockholders plus assumed conversions	$ 9,949	$ (1,671)	$ (3,078)	$ (12,362)
Income (loss) from discontinued operations	625	(9,164)	(1,127)	(13,888)
Income (loss) for purposes of computing diluted earnings per share	$ 10,574	$ (10,835)	$ (4,205)	$ (26,250)
Weighted average common shares outstanding	2,828,460	2,828,474	2,828,462	2,827,566
Dilutive impact of preferred stock, if converted	3,787,686	-	-	-
Weighted average common shares outstanding assuming dilution	6,616,146	2,828,474	2,828,462	2,827,566
Earnings per common share assuming dilution:				
Income (loss) from continuing operations attributable to common shareholders	$ 1.50	$ (0.59)	$ (1.09)	$ (4.37)
Income (loss) from discontinued operations	0.10	(3.24)	(0.40)	(4.91)
Net income (loss)	$ 1.60	$ (3.83)	$ (1.49)	$ (9.28)

For the three and nine-months ended September 30, 2005, all outstanding stock options and warrants and conversion of preferred stock are excluded from the computation as they were anti-dilutive.

5. Inventories

	September 30, 2006	December 31, 2005
	(Dollars in Thousands)	
Finished products	$ 34,449	$ 30,162
Raw materials	13,429	7,974

Inventories under exchange agreements	1,778	(2,807)
Stores and supplies, net	3,845	3,765
	$ 53,501	$ 39,094

6. Long-Term Debt

On December 19, 2002, we issued $94.3 million in original principal amount of our 10% Senior Secured Notes due December 2007 (our Secured Notes). Our Secured Notes are senior secured obligations and rank equally in right of payment with all of our other existing and future senior indebtedness, and senior in right of payment to all of our existing and future subordinated indebtedness. Our Secured Notes are guaranteed by Sterling Chemicals Energy, Inc. (Sterling Energy), our only wholly-owned subsidiary. Sterling Energy s guaranty ranks equally in right of payment with all of its existing and future senior indebtedness, and senior in right of payment to all of its existing and future subordinated indebtedness. Our Secured Notes and Sterling Energy s guaranty are secured by a first priority lien on all of our production facilities and related assets.

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

Our Secured Notes bear interest at an annual rate of 10%, payable semi-annually on June 15 and December 15 of each year. Until December 19, 2004, we were permitted under certain circumstances to pay interest on our Secured Notes through the issuance of additional Secured Notes rather than the payment of cash at an interest rate of 13 3/8 % per annum. In December 2003, we made an interest payment on our Secured Notes at the higher rate through the issuance of $6.3 million in original principal amount of additional Secured Notes, increasing the aggregate principal amount of outstanding Secured Notes to $100.6 million. We have made all other interest payments on our Secured Notes in cash.

We may redeem our Secured Notes at any time at a redemption price of 100% of the outstanding principal amount thereof plus accrued and unpaid interest, subject to compliance with the terms of our Revolving Credit Agreement dated December 19, 2002 with The CIT Group/Business Credit, Inc., as administrative agent and a lender, and certain other lenders (our Revolver). In addition, in the event of a specified change of control or the sale of our facility in Texas City, Texas, we are required to offer to repurchase our Secured Notes at 101% of the outstanding principal amount thereof plus accrued and unpaid interest. Under certain circumstances, we are also required to use the proceeds of other asset sales to repurchase those Secured Notes tendered by the holders at a price equal to 100% of the outstanding principal amount thereof plus accrued and unpaid interest.

The indenture governing our Secured Notes contains numerous covenants and conditions, including, but not limited to, restrictions on our ability to incur indebtedness, create liens, sell assets, make investments, make capital expenditures, engage in mergers and acquisitions and pay dividends. The indenture 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. However, the indenture does not require us to satisfy any financial ratios or maintenance tests.

On December 19, 2002, we also established our Revolver, which provides up to $100 million in revolving credit loans, subject to borrowing base limitations. Our Revolver has an initial term ending on September 19, 2007. Under our Revolver, we and Sterling Energy are co-borrowers and are jointly and severally liable for any indebtedness thereunder. Our Revolver is secured by first priority liens on all of our accounts receivable, inventory and other specified assets, as well as all of the issued and outstanding capital stock of Sterling Energy.

Borrowings under our Revolver bear interest, at our option, at an annual rate of either the Alternate Base Rate plus 0.75% or the LIBO Rate (as defined in our Revolver) plus 2.75%. The Alternate Base Rate is equal to the greater of the Base Rate as announced from time to time by JPMorgan Chase Bank in New York, New York or 0.50% per annum above the latest Federal Funds Rate (as defined in our Revolver). The average interest rate for borrowings under our Revolver for the three and nine-month periods ended September 30, 2006 was 9.00% and 8.94%, respectively. Under our Revolver, we are also required to pay an aggregate commitment fee of 0.50% per year (payable monthly) on any unused portion of our Revolver. Available credit under our Revolver is subject to a monthly borrowing base of 85% of eligible accounts receivable plus the lesser of $50 million and 65% of eligible inventory. In addition, the borrowing base for our Revolver must exceed outstanding borrowings thereunder by $8 million at all times. As of September 30, 2006, total credit available under our Revolver was limited to $54 million due to these borrowing base limitations. As of September 30, 2006, there were no loans outstanding under our Revolver, and we had $3 million in outstanding letters of credit issued pursuant to our Revolver. Based on the maturity date of the Revolver, and 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 Revolver are classified as a current portion of long-term debt.

Our Revolver contains numerous covenants and conditions, including, but not limited to, restrictions on our ability to incur indebtedness, create liens, sell assets, make investments, make capital expenditures, engage in mergers and acquisitions and pay dividends. Our Revolver also contains a covenant that requires us to earn a specified amount of earnings before interest, income taxes, depreciation and amortization (as defined in our Revolver) on a monthly basis if, for 15 consecutive days, unused availability under our Revolver plus cash on hand is less than $20 million. Our Revolver 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.

We believe that our cash on hand, together with credit available under our Revolver, will be sufficient to meet our short-term liquidity needs, although our liquidity may not be adequate during any particular period. The stated term of our Revolver ends on September 19, 2007 and our Secured Notes become due on December 19, 2007. We have commenced discussions to renew or replace our Revolver and refinance the indebtedness under our Secured Notes prior to their stated maturities, either on a stand-alone basis or as part of a larger strategic corporate transaction, although we may not be successful in doing so.

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

7. Commitments and Contingencies

Product Contracts:

We have certain long-term agreements that provide for the dedication of 100% of our production of acetic acid and plasticizers, each to one customer. We also have various sales and conversion agreements, which dedicate significant portions of our production of styrene to various customers. Some of these agreements provide for cost recovery plus an agreed profit margin based upon market prices. A significant portion of our existing styrene sales contracts will expire in the next nine months. The stated term of one of these contracts, which represents a significant portion of our current North America committed sales volumes, expires at the end of this year and we do not expect that contract to be renewed. We are currently pursuing renewals of our other contracts that expire in 2007, as well as additional contract volumes with new customers. We may not be successful in renewing these expiring contracts or obtaining new contract customers. If we are unsuccessful, we may lower our styrene production levels or sell more of our styrene production in the spot markets, both domestic and export, which could have a material adverse effect on our financial condition, results of operations and cash flows.

Environmental Regulations:

Our operations involve the handling, production, transportation, treatment and disposal of materials that are classified as hazardous or toxic waste 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 can be revoked or modified for cause or when new or revised environmental requirements are implemented. Changing and increasingly strict environmental requirements can affect the manufacture, handling, processing, distribution and use of our products and, if so affected, our business and operations may be materially and adversely affected. In addition, changes in environmental requirements can 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 and their employees and 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.

We have incurred, and may continue to incur, 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.

Air emissions from 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 located in an area that the Environmental Protection Agency (EPA) has classified as not having attained the ambient air quality standards for ozone, which is controlled by direct regulation of volatile organic compounds and nitrogen oxide (NOx). Our Texas City facility is also subject to the federal government s June 1997 National Ambient Air Quality Standards, which lower the ozone and particulate matter threshold for attainment. The Texas Commission for Environmental Quality (TCEQ) has imposed strict requirements on regulated facilities, including our Texas City facility, to ensure that the air quality control region will achieve the ambient air quality standards for ozone. Local authorities also may impose new ozone and particulate matter standards. Compliance with these stricter standards may substantially increase our future NOx, volatile organic compounds and particulate matter control costs, the amount and full impact of which cannot be determined at this time.

On December 13, 2002, the TCEQ adopted a revised State Implementation Plan (SIP) to achieve compliance with the 1 hour ozone standard of the Clean Air Act. The EPA has recently approved this 1 hour SIP, which calls for reduction of emissions of NOx at our Texas City facility by approximately 80% by the end of 2007. The current SIP also requires monitoring of emissions of highly reactive volatile organic carbons (HRVOCs), such as ethylene. The cost of compliance with the 1 hour SIP at our Texas City facility is estimated to be between $12 million and $14 million. This estimate includes our share of capital

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

expenditures needed to be made by S&L Cogeneration Company, a 50/50 joint venture between us and Praxair Energy Resources, Inc. (Praxair). To date we have spent $9.9 million in capital on NOx reductions and HRVOC monitoring, with $0.6 million of that amount being spent during the first three quarters of 2006. In April 2004, the Houston-Galveston region was designated a moderate non-attainment area with respect to the 8-hour ozone standard of the Clean Air Act, and compliance with this standard is required no later than June 15, 2010. The TCEQ is currently drafting another revision to the SIP in order to achieve compliance with the 8-hour ozone standard. Potential control strategies for this 8-hour SIP are being reviewed by the TCEQ, and adoption of additional regulations is expected in May 2007. These revisions to the SIP are expected to be submitted to the EPA for approval in June 2007, and may require that emissions of NOx be reduced by 90% by January 1, 2009, as well as further reductions or additional monitoring of HRVOC emissions. We estimate that an additional $14 million to $16 million in capital improvements would be required to meet these new requirements. A small portion of these costs may be recovered from the other parties to our production agreements.

Legal Proceedings:

On July 16, 2001, Sterling Chemicals Holdings, Inc., and most of its U.S. subsidiaries, including us (collectively, the Debtors) filed voluntary petitions for reorganization under Chapter 11 of the United States Bankruptcy Code in the U.S. Bankruptcy Court for the Southern District of Texas. The Debtors plan of reorganization (our Plan of Reorganization) was confirmed on November 20, 2002 and, on December 19, 2002, the Debtors emerged from bankruptcy pursuant to the terms of our Plan of Reorganization.

On July 5, 2005, Patrick B. McCarthy, an employee of Kinder-Morgan, Inc., was seriously injured at Kinder-Morgan s facilities near Cincinnati, Ohio, while attempting to offload a railcar containing one of our plasticizers products. The incident is being investigated and the underlying cause of the accident is not yet known. On October 28, 2005, Mr. McCarthy and his family filed a suit in the Court of Common Pleas, Hamilton County, Ohio (Case No. A0509144) against us, BASF Corporation and five other defendants seeking over $0.5 million in damages related to medical expenses and loss of earnings and earnings capacity, among other things, and punitive damages. At this time, it is impossible to determine the extent of, or whether we will have any, liability for this incident and we will vigorously defend the suit. 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. We do not believe that this incident will have a material adverse affect on our business, financial position, results of operations or cash flows, although we cannot guarantee that a material adverse effect will not occur.

On August 17, 2006, we initiated an arbitration proceeding against BP Amoco Chemical Corporation (BP Chemicals) to resolve a dispute involving the interpretation of provisions of our acetic acid production agreement with BP Chemicals. Under the production agreement, BP Chemicals reimburses our manufacturing expenses and pays us a percentage of the profits derived from the sales of the acetic acid we produce. Historically, the costs of manufacturing charged to our acetic acid business, and reimbursed by BP Chemicals, included the amounts we paid Praxair for carbon monoxide, hydrogen and a blend of carbon monoxide and hydrogen commonly referred to as blend gas . Our acetic acid business has always used all of the carbon monoxide produced by Praxair other than the small amount of carbon monoxide included in the blend gas. Until recently, all of the blend gas produced by Praxair was used by the oxo-alcohols plant included in our plasticizers business. During the period when the oxo-alcohols plant was operating, BP Chemicals was compensated for the use of this blend gas by our oxo-alcohols plant through a credit to the amount of our manufacturing expenses reimbursed by BP Chemicals. Effective July 1, 2006, we permanently closed our oxo-alcohols plant. BP Chemicals is now taking the position that it is entitled to continue to deduct a portion of the blend gas credit from the reimbursement of our manufacturing expenses, even though our oxo-alcohols plant has been closed and is no longer taking any blend gas and the Praxair facilities have been modified so that the carbon monoxide previously used in blend gas is now being delivered to our acetic acid operations. Effective as of July 1, 2006, BP Chemicals began short paying our invoices for manufacturing expenses by the portion of the credit that BP Chemicals now claims will continue until July 31, 2016. The disputed portion of the credit is averaging approximately $0.3 million per month during 2006. We are also seeking additional damages from BP Chemicals in the arbitration based on what we believe are breaches of duty by BP Chemicals. A date for the arbitration hearing has not yet been set, although we expect the hearings to occur during the first quarter of 2007. The arbitration process is in its initial stages, with each side having selected their respective neutral arbitrator. We believe that our acetic acid production agreement does not contemplate the continuation of any portion of the blend gas credit under these circumstances and will vigorously pursue our position in the arbitration.

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 position, results of operation 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)

Other:

Our styrene facilities consist of two trains, a north train and a south train. On September 22, 2005, during a shut down of our plant in anticipation of Hurricane Rita, the superheater in the south train of our styrene facilities was significantly damaged in a fire, forcing a closure of the south train until repairs could be completed. In addition, the north train of our styrene facilities sustained internal damage as a result of this incident and, although still capable of producing product, the damage caused significant raw material yield and energy inefficiencies. On January 12, 2006, we shut down the north train of our styrene facilities to make repairs to the reactor and replace the existing catalyst. In February 2006, both the north and south trains were re-started. During the shutdowns, we fully met our supply obligations to our contract styrene customers through the operation of the north train of our styrene facilities, supplemented by open market purchases of styrene. The total cost for these repairs was approximately $11 million. We also filed a claim for approximately $12 million under our business interruption insurance policies. During the second quarter of 2006, we received an advance payment from our insurance companies of $3 million. In August 2006, we settled the claim with our insurance carriers for a total of $15 million, including the $3 million advance payment. We recognized the incremental $12 million claim settlement as income during the third quarter of 2006. Of the $12 million incremental claim settlement, approximately half was received during September 2006, with the remainder received prior to November 2, 2006.

8. Pension Plans and Other Postretirement Benefits

Net periodic pension costs consisted of the following components:

	Three months ended September 30, 2006	Three months ended September 30, 2005	Nine months ended September 30, 2006	Nine months ended September 30, 2005
	(Dollars in Thousands)			
Service cost	$ 162	$ 202	$ 487	$ 606
Interest cost	1,810	1,669	5,425	5,007
Expected return on plan assets	(1,750)	(1,667)	(5,250)	(5,001)
Net pension costs	$ 222	$ 204	$ 662	$ 612

Other postretirement benefits costs consisted of the following components:

	Three months ended September 30, 2006	Three months ended September 30, 2005	Nine months ended September 30, 2006	Nine months ended September 30, 2005
	(Dollars in Thousands)			
Service cost	$ 47	$ 89	$ 141	$ 161
Interest cost	388	650	1,163	1,171
Amortization of unrecognized costs.	(288)	(491)	(864)	(886)
Curtailment gain		(542)		(542)
Plan costs of continuing operations	147	(294)	440	(96)
Curtailment gain from discontinued operations		(1,185)		(1,185)
Net plan costs	$ 147	$ (1,479)	$ 440	$ (1,281)

9. New Accounting Standards

In September 2005, the Financial Accounting Standards Board (the FASB) issued Emerging Issues Task Force Issue No. 04-13, Accounting for Purchases and Sales of Inventory with the Same Counterparty (EITF No. 04-13). EITF No. 04-13 provides that two or more legally separate exchange transactions with the same counterparty should be combined and considered as a single arrangement for purposes of applying Accounting Principles Board Opinion No. 29, Accounting for Nonmonetary Transactions, when the transactions were entered into in contemplation of one another. EITF No. 04-13 contains several indicators to be considered in assessing whether two transactions are entered into in contemplation of one another. If, based on consideration of the indicators and the substance of the arrangement, two transactions are combined and considered a single

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

arrangement, an exchange of finished goods inventory for either raw material inventory or work-in-process inventory should be accounted for at fair value. The provisions of EITF No. 04-13 were effective for transactions beginning April 1, 2006. Adoption of EITF No. 04-13 did not have a material impact on our consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, (FIN 48) to clarify the accounting for uncertain tax positions accounted for in accordance with FASB Statement No. 109, Accounting for Income Taxes. This interpretation prescribes a two-step approach for recognizing and measuring tax benefits and requires explicit disclosure of any uncertain tax position. FIN 48 is effective for us on January 1, 2007. We are currently evaluating what impact, if any, the adoption of FIN 48 will have on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans (SFAS No. 158). SFAS No. 158 requires the recognition of the funded status of pension and other postretirement benefit plans on the balance sheet. The overfunded or underfunded status would be recognized as an asset or liability on the balance sheet with changes occurring during the current year reflected through the comprehensive income portion of equity. SFAS No. 158 will also require the measurement date of the funded status of our defined benefit postretirement plans match the date of our fiscal year-end financial statements, eliminating the use of earlier measurement dates that were previously permissible. We will be required to initially recognize the funded status of our defined benefit postretirement plan and provide the required disclosures as of our fiscal year ending December 31, 2006. The requirement to measure the assets and benefit obligations of our defined benefit postretirement plans as of the date of our fiscal year-end statement of financial position will be effective for our fiscal year ending December 31, 2008.

In September 2006, the Securities and Exchanged Commission issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. We will adopt SAB 108 for our fiscal year ending December 31, 2006 and do not believe that SAB 108 will have a material impact on our consolidated financial statements.

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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 subsidiary (the Company) as of September 30, 2006, and the related condensed consolidated statements of operations for the three and nine-month periods ended September 30, 2006 and 2005, and of cash flows for the nine-month periods ended September 30, 2006 and 2005. These interim financial statements are the responsibility of the Company s management.

We conducted our reviews in accordance with 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 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 such condensed consolidated financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of the Company as of December 31, 2005, and the related consolidated statements of operations, stockholders equity (deficiency in assets), and cash flows for the year then ended (not presented herein); and in our report dated March 16, 2006, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2005 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

DELOITTE & TOUCHE LLP

Houston, Texas
November 10, 2006

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 leading North American producer of selected petrochemicals used to manufacture a wide array of consumer goods and industrial products throughout the world. Our primary products are styrene, acetic acid and plasticizers. Styrene is a commodity chemical used to produce intermediate products such as polystyrene, expandable polystyrene resins and ABS plastics, which are used in a wide variety of products such as household goods, foam cups and containers, disposable food service items, toys, packaging and other consumer and industrial products. Approximately 50% of our styrene capacity is currently committed for sales in North America under long-standing customer relationships. The balance of our capacity is available to produce styrene for sales throughout the world when market conditions warrant. A significant portion of our existing styrene sales contracts will expire in the next nine months. The stated term of one of these contracts, which represents a significant portion of our current North America committed sales volumes, expires at the end of this year and we do not expect that contract to be renewed. We are currently pursuing renewals of our other contracts that expire in 2007, as well as additional contract volumes with new customers. We may not be successful in renewing these expiring contracts or obtaining new contract customers. If we are unsuccessful, we may lower our styrene production levels or sell more of our styrene production in the spot markets, both domestic and export, which could have a material adverse effect on our financial condition, results of operations or cash flows.

Acetic acid is used primarily to produce vinyl acetate monomer, which is used in a variety of products, including adhesives and surface coatings. All of our acetic acid production is sold to BP Amoco Chemical Company (BP Chemicals) pursuant to a long-term contract that extends until 2016, which has provided us with a stable, steadily increasing source of income since the inception of this relationship in 1986. 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 (BASF) pursuant to a long-term production agreement that expires in 2013, subject to some limited early termination rights held by BASF.

We generally sell our petrochemicals products to customers for use in the manufacture of other chemicals and products, which in turn are used in the production of a wide array of consumer goods and industrial products throughout the world. Styrene is a commodity and exhibits wide swings in prices and profit margins based upon current and anticipated levels of supply and demand. The acetic acid industry tends to sell most of its products through long-term sales agreements having cost plus pricing mechanisms, which eliminates much of the volatility seen in other petrochemicals products and results in more stable and predictable earnings and profit margins. Although exceptions occasionally occur, as a general rule, if styrene profit margins are favorable, our overall financial performance is good, but our overall financial performance suffers when styrene margins are unfavorable. The market for styrene roughly follows repetitive cycles, and general trends in the supply and demand balance may be observed over time. However, it is difficult, if not impossible, to definitively predict when market conditions will be favorable or unfavorable.

The financial performance of each of our products is primarily a function of sales prices, the cost of raw materials and energy and sales volumes. While changes in the prices for our products may be tracked through a variety of sources, a change in price does not necessarily result in a corresponding change in our financial performance. When the prices of our products increase or decrease, our overall financial performance may improve, decline or stay roughly the same depending upon the extent and direction of changes in our costs for raw materials and energy and our production rates. For most of our products, the combined cost of raw materials and energy resources is far greater than all other costs of production combined. We use significant amounts of natural gas as fuel in the production of our products, and the producers of most of our raw materials use significant amounts of natural gas in their production. As a result, our production and raw materials costs increase or decrease based upon changes in the price for natural gas. Natural gas and most of our raw materials are commodities and, consequently, are subject to wide fluctuations in prices, which can, and often do, move independently of changes in the prices for our products. Prices for, and the availability of, natural gas and many of our raw materials are largely based on regional factors, which can result in wide disparities in prices in different parts of the world or shortages or unavailability in some regions at the same time when these products are plentiful in other parts of the world. Prices for styrene, on the other hand, tend to be more consistent throughout the world, after taking into account transportation costs. Consequently, changes in prices for natural gas and raw materials tend to impact the margin on our sales rather than the price of our products, with margins increasing when natural gas and raw materials costs decline and vice versa. In addition, many producers in other parts of the world use oil-based processes rather than natural gas-based processes. The relationship between the price of crude oil and the price of natural gas can either increase or decrease our competitiveness depending on their relative values at any particular point in time. Sales volumes influence our overall financial performance in a variety of ways. As a general rule, increases in sales volumes will result in an increase in overall revenues and vice versa, although this is not necessarily the case since the prices for some of our products can change dramatically from month-to-month. More importantly, changes in production rates impact the average cost per pound of the products produced. If more pounds are produced, our fixed costs are spread over a greater number of pounds resulting in a lower average cost to produce each pound. In addition, our production rates influence the overall efficiency of our manufacturing unit and the yields we receive from our raw materials.

Styrene sales prices during the third quarter of 2006 increased significantly compared to the second quarter of 2006, in large part due to increasing benzene prices. The rapidly increasing styrene sales prices during the third quarter of 2006 contributed to positive gross margins in styrene for the period, as a significant amount of our styrene was produced using lower-priced benzene as a raw material and was then sold in the ensuing month when styrene prices had increased. This impact resulted in an increase in gross profit of approximately $5 million during the quarter. Contract benzene prices trended up from January through July 2006 and then decreased somewhat during the rest of the third quarter, as depicted in the chart below:

Source: Chemical Marketing Associates, Inc. (CMAI)

Depending on market conditions, benzene contract prices may be either higher or lower than benzene spot prices. As we purchase a portion of our benzene requirements priced on a contract basis and the remainder priced on a spot basis, the actual prices for our benzene purchases is not exactly the same as shown in the table above. Our actual benzene costs did, however, follow similar trends. As the combined cost of raw materials and energy resources is far greater than the total of all other costs of styrene production, with the cost of benzene having the greatest impact on overall styrene manufacturing costs, high benzene prices have continued to make it difficult for United States styrene producers to realize meaningful margin improvements on their styrene sales.

Over the last five years, China has been the driver for growth in styrene demand, representing around 75% of the world s new styrene demand in that period. Historically, we have positioned ourselves to take advantage of peaks in the Asian styrene markets, with only 50% of our styrene capacity being committed under long-term arrangements. However, over the last two years, relatively high benzene and natural gas prices have significantly limited our ability to sell styrene into the Asian markets, and high styrene prices have reduced styrene global demand growth rates. We expect these dynamics to continue throughout 2006. Further complicating our ability to sell styrene into the Asian markets is the announcement by several of our competitors of their intention to build new styrene production units outside the United States during the late 2006 to 2008 time frame. In 2006, our competitors added approximately 2 billion pounds of new styrene capacity in Asia. Most of the remaining announced construction projects appear likely to start up during 2007 and 2008, although it is not uncommon for announced construction to be delayed. In addition, much of this new capacity is being constructed in politically unstable regions of the world, such as the Middle East, which may impact the start-up of this new capacity. If and when these new units are completed, we would anticipate more difficult market conditions, especially in the export markets, until the additional supply is absorbed by growth in market demand.

Given the market conditions in the Asian markets and the high domestic raw materials and energy costs we have been experiencing, most of our styrene sales over the last two years have been made to customers in NAFTA countries and South America. We expect most our styrene sales over the next three to five years to also be in these geographic regions. Consequently, we are focusing our efforts on increasing market share in these areas, while continuing to make occasional styrene sales in Asia on an opportunistic basis. We may not, however, be successful in increasing our market share in these geographic regions during this period and we cannot guarantee when, or if, market conditions for North American styrene producers will improve in Asia.

Our styrene facilities consist of two trains, a north train and a south train. On September 22, 2005, during a shut down of our plant in anticipation of Hurricane Rita, the superheater in the south train of our styrene facilities was significantly damaged in a fire, forcing a closure of the south train until repairs could be completed. In addition, the north train of our styrene facilities sustained internal damage as a result of this incident and, although still capable of producing product, the damage caused significant raw material yield and energy inefficiencies. On January 12, 2006, we shut down the north train of our styrene facilities to make repairs to the reactor and replace the existing catalyst. In February 2006, both the north and south trains were re-started. During the shutdowns, we fully met our supply obligations to our contract styrene customers through the operation of the north train of our styrene facilities, supplemented by open market purchases of styrene. The total cost for these repairs was approximately $11 million. We also filed a claim for approximately $12 million under our business interruption insurance policies. During the second quarter of 2006, we received an advance payment from our insurance companies of $3 million. In August 2006, we settled the claim with our insurance carriers for a total of $15 million, including the $3 million advance payment. We recognized the incremental $12 million claim settlement as income during the third quarter of 2006. Of the $12 million incremental claim settlement, approximately half was received during September 2006, with the remainder received prior to November 2, 2006.

Margins for acetic acid have grown steadily over the past several years, with this trend continuing for the first nine months of 2006. We also expect demand to remain robust throughout 2007. The North American acetic acid market is mature and well developed, with demand being linked to the demand for vinyl acetate monomer, a key intermediate in the production of a wide array of polymers. Vinyl acetate monomer is the largest derivative of acetic acid, representing over 40% of total demand. From 2005 to 2009, global production of vinyl acetate monomer is expected to increase from 7.3 billion pounds to 8.3 billion pounds. The acetic acid industry tends to sell most of its products through long term sales agreements having cost plus pricing mechanisms, which eliminates much of the volatility seen in other petrochemicals products and results in more stable and predictable earnings and profit margins. All of our acetic acid production is sold to BP Chemicals under a long-term production agreement that extends until at least 2016. Under the production agreement, BP Chemicals markets all of the acetic acid we produce and pays us, among other amounts, a portion of the profits earned from their sales of our acetic acid.

Historically, we have produced linear plasticizers, which typically receive a premium over competing branched propylene-based products for customers that require enhanced performance properties. However, the markets for competing plasticizers can be affected by the cost of the underlying raw materials, especially when the cost of one olefin rises faster than the other, or by the introduction of new products. One of these raw materials for linear plasticizers is a product known as linear alpha olefins. Over the last few years, the price of linear alpha olefins has increased sharply, which has caused many consumers to switch to lower cost branched propylene-based products and C4-based products, despite the loss of some performance properties. Ultimately, we expect branched plasticizers to replace linear plasticizers for most applications over the long-term. As a result, we modified our plasticizers facilities to produce lower cost branched plasticizers products during the third quarter of 2006.

In 2005, BP Chemicals announced the permanent closure of its linear alpha-olefins production facility in Pasadena, Texas, the primary source of linear alpha olefins to the oxo-alcohols production unit of our plasticizers facility. On April 28, 2006, BASF Corporation (BASF) notified us that it was exercising its right under our Second Amended and Restated Plasticizers Production Agreement to terminate its future obligations with respect to the operation of our oxo-alcohols production unit, effective as of July 31, 2006. After pursuing various alternative uses for our oxo-alcohols unit, we were unable to secure an alternative use for this facility. As a result, we permanently shut down our oxo-alcohols production unit on July 30, 2006. This shutdown did not result in any layoffs, as personnel assigned to our oxo-alcohol unit were redeployed to other positions at our Texas City facility. Due to the closure of our oxo-alcohol unit, our phthalate esters unit now uses oxo-alcohols supplied by BASF that have a different chemical composition. We do not expect the closure of our oxo-alcohol unit to have a material effect on our financial condition, results of operation or cash flows. In addition, due to the oxo-alcohols long-lived assets having a book value of zero, no impairment charges were required as a result of this closure.

Results of Operations

Three Months Ended September 30, 2006 Compared to Three Months Ended September 30, 2005

Revenues and Income (Loss) from Continuing Operations

Our revenues were $190 million for the third quarter of 2006, a 28% increase from the $149 million in revenues we recorded for the third quarter of 2005. This increase in revenues was primarily driven by an increase in styrene sales prices and acetic acid sales. We recorded net income from continuing operations of $10 million for the third quarter of 2006, compared to the net income of $0.1 million that we recorded in the third quarter of 2005. Our improved financial performance in the third quarter of 2006 resulted primarily from higher styrene and acetic margins, higher acetic sales volumes and a $12 million gain we recorded from the insurance settlements filed against our property damage and business interruption insurance policies related to the fire that occurred in our styrene unit in September 2005.

Revenues from our styrene operations were $150 million for the third quarter of 2006, an increase of 24% from the $122 million in revenues we received from these operations for the third quarter of 2005. This increase in revenues from our styrene operations was primarily due to higher sales prices. During the third quarter of 2006, the prices we paid for benzene, one of the primary raw materials required for styrene production, increased 28% from the prices we paid for benzene during the third quarter of 2005, and the prices we paid for ethylene, the other primary raw material required for styrene production, increased 23% from the prices we paid for ethylene during the third quarter of 2005. The average price we paid for natural gas for the third quarter of 2006 decreased 23% compared to the average price we paid for natural gas during the third quarter of 2005.

Revenues from acetic acid and plasticizers were $40 million for the third quarter of 2006 compared to the $27 million in revenues we received from these operations during the third quarter of 2005. This increase in revenues was comprised of a 51% increase in acetic acid revenues and a 35% increase in plasticizer revenues. The increase in acetic revenues resulted primarily from increased sales volumes of acetic acid in the third quarter of 2006, in large part due to the lack of production in the third quarter of 2005 due to a maintenance shutdown, as well as higher margins in the 2006 period. Additionally, acetic acid revenues also increased by $2.4 million in the third quarter of 2006 in connection with an adjustment to previously incorrectly billed items. In December 2005, we amended our plasticizers production agreement with BASF to among other things, eliminate the provisions providing for the sharing of profits and losses from this business between us and BASF. The increase in plasticizer revenues in the third quarter of 2006 primarily resulted from the absence of an accrual for the losses from this business we shared with BASF during the third quarter of 2005.

Other Income

We recorded $12 million in other income during the third quarter of 2006, which primarily consisted of recognition of the final settlement of our claims under our insurance policies related to the fire that occurred in our styrene unit in September 2005.

Provision (Benefit) for Income Taxes

During the third quarter of 2006, we recorded a $10 million provision for income taxes from continuing operations compared to a less than $1 million provision for income taxes from continuing operations for the third quarter of 2005. This difference was due to our increased net income and certain return to accrual adjustments in connection with the filing of our 2005 federal income tax return in the third quarter of 2006.

Nine Months Ended September 30, 2006 Compared to Nine Months Ended September 30, 2005

Revenues and Income (Loss) from Continuing Operations

Our revenues were $477 million for the nine-month period ended September 30, 2006, compared to the $492 million in revenues we received during the nine-month period ended September 30, 2005. This 3% decrease in revenues resulted primarily from lower styrene volumes due to the shutdown of our styrene unit in the first quarter of 2006 to repair the damage caused by the September 22, 2005 fire discussed above. We recorded a net income from continuing operations of $3 million for the nine-month period ended September 30, 2006, compared to a net loss of $7 million during the nine-month period ended September 30, 2005.

Revenues from our styrene operations were $366 million for the nine-month period ended September 30, 2006. This represents a decrease of 10% from the $407 million in revenues we received from these operations for the nine-month period ended September 30, 2005. This decrease in revenues from our styrene operations was due to lower production from our styrene production facility during the shutdown of that facility in the first quarter of 2006 to repair the damage caused by the September 22, 2005 fire discussed above. As a part of normal recurring operations, each of our manufacturing units is completely shut down from time to time, for a period typically lasting two to four weeks, to replace catalysts and perform major maintenance work required to sustain long-term production. These periods are commonly referred to as turnarounds or shutdowns. While actual timing is subject to a number of variables, turnarounds of our styrene unit typically occur every two to three years. As our styrene production facility was already shut down in the first quarter of 2006 to repair the damage caused by the September 2005 fire discussed above, we decided to perform our normal recurring styrene turnaround earlier than planned. We expense the costs of turnarounds as the associated expenses are incurred. As expenses for turnarounds, especially for our styrene unit, can be significant, the impact of turnarounds can be material for financial reporting periods during which the turnarounds actually occur. During the first quarter of 2006, we incurred approximately $9 million of expenses associated with this turnaround of our styrene unit. During the first three quarters of 2006, prices for benzene and ethylene, the two primary raw materials required for styrene production, increased 5% and 17%, respectively, from the prices we paid for these products in the first three quarters of 2005. The average price we paid for natural gas for the first three quarters of 2006 decreased 7% from the average price we paid for natural gas during the same period in 2005.

Revenues from acetic acid and plasticizers were $111 million for the nine-month period ended September 30, 2006 and $85 million for the nine-month period ended September 30, 2005. This increase in revenues was comprised of a 27% increase in acetic acid revenues and a 37% increase in plasticizer revenues. The increase in acetic revenues resulted primarily from increased sales volumes of acetic acid in the third quarter of 2006, in large part due to the lack of production in the third quarter of 2005 due to a maintenance shutdown, as well as higher margins in the 2006 period. Additionally, acetic acid revenues also increased by $2.4 million in the third quarter of 2006 in connection with an adjustment to previously incorrectly billed items. In December 2005, we amended our plasticizers production agreement with BASF to among other things, eliminate the provisions providing for the sharing of profits and losses from this business between us and BASF. The increase in plasticizer revenues in the third quarter of 2006 primarily resulted from the absence of an accrual for the losses from this business we shared with BASF during the third quarter of 2005.

Other Income

We recorded $16 million in other income for the nine-month period ended September 30, 2006, which primarily consisted of the recognition of final settlement of our claims under our property damage and business interruption insurance policies related to the fire that occurred in our styrene unit in September 2005.

Provision (Benefit) for Income Taxes

During the nine-months ended September 2006, we recorded a $6 million provision for income taxes from continuing operations compared to a $4 million benefit for income taxes from continuing operations for the third quarter of 2005. This difference was due to our increased net income from continuing operations, in large part due to the insurance settlement mentioned above and certain return to accrual adjustments in connection with the filing of our 2005 federal income tax return during the nine-months ended September 2006.

Liquidity and Capital Resources

On December 19, 2002, we issued $94.3 million in original principal amount of our Secured Notes. Our Secured Notes are senior secured obligations and rank equally in right of payment with all of our other existing and future senior indebtedness, and senior in right of payment to all of our existing and future subordinated indebtedness. Our Secured Notes are guaranteed by Sterling Energy, our only wholly owned subsidiary. Sterling Energy s guaranty ranks equally in right of payment with all of its existing and future senior indebtedness, and senior in right of payment to all of its existing and future subordinated indebtedness. Our Secured Notes and Sterling Energy s guaranty are secured by a first priority lien on all of our production facilities and related assets.

Our Secured Notes bear interest at an annual rate of 10%, payable semi-annually on June 15 and December 15 of each year. Until December 19, 2004, we were permitted under certain circumstances to pay interest on our Secured Notes through the issuance of additional Secured Notes rather than the payment of cash at an interest rate of 13 3 / 8 % per annum. In December 2003, we made an interest payment on our Secured Notes at the higher rate through the issuance of $6.3 million in original principal amount of additional Secured Notes, increasing the aggregate principal amount of outstanding Secured Notes to $100.6 million. We have made all other interest payments on our Secured Notes in cash. We may redeem our Secured Notes at any time at a redemption price of 100% of the outstanding principal amount thereof plus accrued and unpaid interest, subject to compliance with the terms of our Revolver. In addition, in the event of a specified change of control or the sale of our facility in Texas City, Texas, we are required to offer to repurchase our Secured Notes at 101% of the outstanding principal amount thereof plus accrued and unpaid interest. Under certain circumstances, we are also required to use the proceeds of other asset sales to repurchase those Secured Notes tendered by the holders at a price equal to 100% of the outstanding principal amount thereof plus accrued and unpaid interest.

The indenture governing our Secured Notes contains numerous covenants and conditions, including, but not limited to, restrictions on our ability to incur indebtedness, create liens, sell assets, make investments, make capital expenditures, engage in mergers and acquisitions and pay dividends. The indenture 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. However, the indenture does not require us to satisfy any financial ratios or maintenance tests.

On December 19, 2002, we also established our Revolver, which provides up to $100 million in revolving credit loans, subject to borrowing base limitations. Our Revolver has an initial term ending on September 19, 2007. Under our Revolver, we and Sterling Energy are co-borrowers and are jointly and severally liable for any indebtedness thereunder. Our Revolver is secured by first priority liens on all of our accounts receivable, inventory and other specified assets, as well as all of the issued and outstanding capital stock of Sterling Energy.

Borrowings under our Revolver bear interest, at our option, at an annual rate of either the Alternate Base Rate plus 0.75% or the LIBO Rate (as defined in our Revolver) plus 2.75%. The Alternate Base Rate is equal to the greater of the Base Rate as announced from time to time by JPMorgan Chase Bank in New York, New York or 0.50% per annum above the latest Federal Funds Rate (as defined in our Revolver). The average interest rate for borrowings under our Revolver for the three and nine-month periods ended September 30, 2006 was 9.00% and 8.94%, respectively. Under our Revolver, we are also required to pay an aggregate commitment fee of 0.50% per year (payable monthly) on any unused portion. Available credit is subject to a monthly borrowing base of 85% of eligible accounts receivable plus the lesser of $50 million and 65% of eligible inventory. In addition, the borrowing base for our Revolver must exceed outstanding borrowings thereunder by $8 million at all times. As of September 30, 2006, total credit available under our Revolver was limited to $54 million due to these borrowing base limitations. As of September 30, 2006, there were no loans outstanding under our Revolver, and we had $3 million in letters of credit outstanding.

Our Revolver contains numerous covenants and conditions, including, but not limited to, restrictions on our ability to incur indebtedness, create liens, sell assets, make investments, make capital expenditures, engage in mergers and acquisitions and pay dividends. Our Revolver also contains a covenant that requires us to earn a specified amount of earnings before interest, income taxes, depreciation and amortization (as defined in our Revolver) on a monthly basis if, for 15 consecutive days, unused availability under our Revolver plus cash on hand is less than $20 million. Our Revolver 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 liquidity (i.e., cash and cash equivalents plus total credit available under our Revolver) was $79 million at September 30, 2006, a decrease of $8 million compared to our liquidity at December 31, 2005. This decrease primarily resulted from expenses associated with the maintenance turnaround and repairs to our styrene facility performed during the first quarter of 2006. The total cost of this turnaround and the repairs, including maintenance expense, catalyst installation and capital projects, was approximately $15 million. We believe that our cash on hand, together with credit available under our Revolver, will be sufficient to meet our short-term liquidity needs, although our liquidity may not be adequate during any particular period. The stated term of our Revolver ends on September 19, 2007 and our Secured Notes become due on December 19, 2007. We have commenced discussions to renew or replace our Revolver and refinance the indebtedness under our Secured Notes prior to their stated maturities, either on a stand-alone basis or as part of a larger strategic corporate transaction, although we may not be successful in doing so.

Working Capital

Our working capital, excluding assets and liabilities from discontinued operations, was $86 million on September 30, 2006, an increase of $7 million thereof from December 31, 2005. This increase in working capital resulted primarily from a decrease in accounts payable partially offset by a decrease in our cash balances due to expenditures for the shutdown of our styrene unit in the first quarter of 2006.

Cash Flow

Net cash used in our operations was $7 million for the first nine months of 2006, compared to the $58 million in net cash provided by operations during the first nine months of 2005. This decrease in net cash flow in the first nine months of 2006 was primarily driven by the cash outflow associated with the styrene turnaround and repairs to our styrene facility and an increase in inventories. Cash flow during the first nine months of 2005 was also positively impacted by approximately $41 million from the depletion of working capital associated with our closure of our acrylonitrile facility during February 2005. Net cash flow used in our investing activities was $8 million during the first nine months of 2006, whereas we used $6 million of net cash flow in our investing activities during the first nine months of 2005. There were no net repayments under our Revolver during the first nine months of 2006 compared to $18 million of net repayments in the first nine months of 2005.

Capital Expenditures

Our capital expenditures were $10 million during the first nine months of 2006 compared to $5 million during the first nine months of 2005. This increase was due to an assortment of projects completed during the styrene turnaround in the first quarter of 2006. We expect our capital expenditures for the remainder of 2006 to be approximately $3 million, primarily for routine safety, environmental and replacement capital.

Contractual Cash Obligations

The following table summarizes our significant contractual obligations at September 30, 2006, and the effect such obligations are expected to have on our liquidity and cash flows in future periods.

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	Less than 1 year [1]	1-3 years	4-5 years	More than 5 years	Total
			(Dollars in Thousands)		
Long-term debt	$	$100,579	$	$	$100,579
Interest payments on long-term debt	10,142	5,029			15,171
Operating leases	293	879	586	293	2,051
Purchase obligations [2]	74,000	100,000	71,000	149,000	394,000
Pension and other postretirement benefits	10,340	17,856	8,142	30,491	66,829
Contractual obligations of discontinued operations	756				756
Total	$95,531	$224,343	$79,728	$179,784	$579,386

(1) Payment obligations under our Revolver are not presented because there were no outstanding borrowings at September 30, 2006 and interest payments fluctuate depending on the interest rate and outstanding balance under our Revolver at any point in time.

(2) For the purposes of this table, we have considered contractual obligations for the purchase of goods or services as agreements involving more

than $1 million that are enforceable and legally binding and that specify all significant terms, including: fixed or minimum quantities to be purchased, fixed, minimum or variable price provisions and the approximate timing of the transaction. Most of the purchase obligations identified include variable pricing provisions. We have estimated the future prices of these items, utilizing forward curves where available. The pricing estimated for use in this table is subject to market risk.

New Accounting Standards

In September 2005, the Financial Accounting Standards Board (the FASB) issued Emerging Issues Task Force Issue No. 04-13, Accounting for Purchases and Sales of Inventory with the Same Counterparty (EITF No. 04-13). EITF No. 04-13 provides that two or more legally separate exchange transactions with the same counterparty should be combined and considered as a single arrangement for purposes of applying Accounting Principles Board Opinion No. 29, Accounting for Nonmonetary Transactions, when the transactions were entered into in contemplation of one another. EITF No. 04-13 contains several indicators to be considered in assessing whether two transactions are entered into in contemplation of one another. If, based on consideration of the indicators and the substance of the arrangement, two transactions are combined and considered a single arrangement, an exchange of finished goods inventory for either raw material inventory or work-in-process inventory should be accounted for at fair value. The provisions of EITF No. 04-13 were effective for transactions beginning April 1, 2006. Adoption of EITF No. 04-13 did not have a material impact on our consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, (FIN 48) to clarify the accounting for uncertain tax positions accounted for in accordance with FASB Statement No. 109, Accounting for Income Taxes. This interpretation prescribes a two-step approach for recognizing and measuring tax benefits and requires explicit disclosure of any uncertain tax position.

FIN 48 is effective for us on January 1, 2007. We are currently evaluating what impact, if any, the adoption of FIN 48 will have on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans (SFAS No. 158). SFAS No. 158 requires the recognition of the funded status of pension and other postretirement benefit plans on the balance sheet. The overfunded or underfunded status would be recognized as an asset or liability on the balance sheet with changes occurring during the current year reflected through the comprehensive income portion of equity. SFAS No. 158 will also require the measurement date of the funded status of our defined benefit postretirement plans match the date of our fiscal year-end financial statements, eliminating the use of earlier measurement dates that were previously permissible. We will be required to initially recognize the funded status of our defined benefit postretirement plan and provide the required disclosures as of our fiscal year ending December 31, 2006. The requirement to measure the assets and benefit obligations of our defined benefit postretirement plans as of the date of our fiscal year-end statement of financial position will be effective for our fiscal year ending December 31, 2008.

In September 2006, the Securities and Exchanged Commission issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. We will adopt SAB 108 for our fiscal year ending December 31, 2006 and do not believe that SAB 108 will have a material impact on our consolidated financial statements.

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 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 on Form 10-K for the fiscal year ended December 31, 2005.

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

Our financial results can be affected by volatile changes in raw materials, natural gas and finished product sales prices. Borrowings under our Revolver bear interest, at our option, at an annual rate of either the Alternate Base Rate plus 0.75% or the LIBO Rate (as defined in our Revolver) plus 2.75%. The Alternate Base Rate is equal to the greater of the Base Rate as announced from time to time by JPMorgan Chase Bank in New York, New York or 0.50% per annum above the latest Federal Funds Rate (as defined in our Revolver). There were no borrowings under our Revolver during the second quarter of 2006. The fair value of our Revolver is the same as its carrying value due to the short-term nature of this financial instrument. Our Secured Notes bear interest at an annual rate of 10%, payable semi-annually on June 15 and December 15 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 September 30, 2006, the fair value of the Secured Notes was approximately $94.6 million.

Item 4. *Controls and Procedures*

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934, as amended (the Exchange Act), is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Management necessarily applies its judgment in assessing the costs and benefits of such controls and procedures which, by their nature, can provide only reasonable assurance regarding management s control objectives.

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15, as of the end of the fiscal period covered by this report on Form 10-Q. Based upon that evaluation, each of our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to us (including our consolidated subsidiary) that is required to be disclosed in our Exchange Act reports. In connection with our evaluation, no change was identified in our internal controls over financial reporting that occurred during the third quarter of 2006 that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

Under the current rules and regulations promulgated by the Securities and Exchange Commission, beginning with our Annual Report on Form 10-K for 2007, we will be subject to the provisions of Section 404 of the Sarbanes-Oxley Act that require an annual management assessment of our internal controls over financial reporting. Beginning with our Annual Report on Form 10-K for 2008, we will be subject to the related attestation by our independent registered public accounting firm.

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PART II.
OTHER INFORMATION

Item 1. ***Legal Proceedings***

The information under Legal Proceedings in Note 7 to the consolidated financial statements included in Item 1 of Part I of this report is hereby incorporated by reference.

Item 5. ***Other Information***

On November 10, 2006, our Board of Directors increased the number of directors constituting our whole Board from six to seven and appointed Mr. Steve Gidumal to fill the vacancy resulting from the creation of this newly-created directorship. Mr. Gidumal s will serve as one of our directors until our 2007 Annual Meeting of Stockholders and until his successor is duly elected and qualified or until his earlier death or his resignation or removal as one of our directors. Mr. Gidumal was also appointed as a member of the Compensation Committee of our Board of Directors to fill the vacancy created by Mr. Philip M. Sivin s resignation as a member of our Compensation Committee. Resurgence Asset Management, L.L.C. (Resurgence) recommended to our Corporate Governance Committee that Mr. Gidumal be appointed as one of our directors. Our Corporate Governance Committee reviewed Mr. Gidumal s candidacy as a member of our Board of Directors, and recommended to our Board that Mr. Gidumal be appointed as one of our directors. Mr. Gidumal s election to our Board of Directors was not pursuant to any arrangement or understanding with any other persons, except as generally described in the following paragraph.

Mr. Gidumal is a Managing Director and a Co-Chief Investment Officer of Resurgence. Resurgence has beneficial ownership of a substantial majority of the voting power of our equity securities due to its investment and disposition authority over securities owned by its and its affiliates managed funds and accounts. Currently, Resurgence has beneficial ownership of over 98% of our Series A Convertible Preferred Stock and over 60% of our common stock, representing ownership of over 80% of the total voting power of our equity. The holders of our Series A Convertible Preferred Stock are entitled to designate a number of our directors roughly proportionate to their overall equity ownership, but in any event not less than a majority of our directors as long as they hold in the aggregate at least 35% of the total voting power of our equity. As a result, these holders have the ability to control our management, policies and financing decisions, elect a majority of our Board and control the vote on most matters presented to a vote of our stockholders. Pursuant to established policies of Resurgence, all director compensation earned by its employees for service on our Board of Directors is paid to Resurgence. As with our other directors that are employees of Resurgence, any director compensation earned by Mr. Gidumal is expected to be paid to Resurgence pursuant to its established policies. Currently, that would include an annual retainer of $25,000 for his service as a director and meeting attendance fees of $2,500 for each Board meeting held in person and $1,250 for each telephonic Board meeting. It will also include attendance fees of $1,500 for each Compensation Committee meeting held in person and $750 for each telephonic Compensation Committee meeting.

Item 6. ***Exhibits***

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

Exhibit Number		Description of Exhibit
2.1	-	Certificate of Ownership and Merger merging Sterling Chemicals Holdings, Inc. into Sterling Chemicals, Inc. (incorporated by reference from Exhibit 2.1 to our Annual Report on Form 10-K for the fiscal year ended September 30, 2002).
2.2	-	Joint Plan of Reorganization of Sterling Chemicals Holdings, Inc., et al., dated October 14, 2002 (incorporated by reference from Exhibit 2.1 to our Form 8-K filed on November 26, 2002).
2.3	-	First Modification to Joint Plan of Reorganization of Sterling Chemicals Holdings, Inc., et al., dated November 18, 2002 (incorporated by reference from Exhibit 2.2 to our Form 8-K filed on November 26, 2002).

3.1	-	Amended and Restated Certificate of Incorporation of Sterling Chemicals, Inc. (conformed copy) (incorporated by reference from Exhibit 3.1 to our Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2005).
3.2	-	Restated Certificate of Designations, Preferences, Rights and Limitations of Series A Convertible Preferred Stock of Sterling Chemicals, Inc. (incorporated by reference from Exhibit 3.2 to our Annual Report on Form 10-K for the fiscal year ended December 31, 2003).

Exhibit Number		Description of Exhibit
3.3	-	Restated Bylaws of Sterling Chemicals, Inc. (conformed copy) (incorporated by reference from Exhibit 3.3 to our Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2003).
**10.1+	-	Sterling Chemicals, Inc. Amended and Restated 2002 Stock Plan
**10.2+	-	Fifth Amended and Restated Key Employee Protection Plan
**10.3+	-	Sterling Chemicals, Inc. Amended and Restated Salaried Employees Pension Plan
**15.1	-	Letter of Deloitte & Touche 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
**32.1	-	Section 1350 Certification of the Chief Executive Officer
**32.2	-	Section 1350 Certification of the Chief Financial Officer
**99.1	-	Compensation Committee Charter of Sterling Chemicals, Inc.

** Filed or furnished herewith

+ Management contracts or compensatory plans or arrangements.

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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: November 13, 2006	By	/s/ RICHARD K. CRUMP
		Richard K. Crump *President and Chief Executive Officer*
Date: November 13, 2006	By	/s/ PAUL G. VANDERHOVEN
		Paul G. Vanderhoven *Senior Vice President-Finance and Chief Financial Officer* *(Principal Financial Officer)*

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