

STERLING CHEMICALS INC

Form 10-Q

November 09, 2010

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

**Form 10-Q**

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

**For the quarterly period ended September 30, 2010**

**OR**

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

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

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

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

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

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

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

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

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

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

Large accelerated filer       Accelerated filer       Non-accelerated filer       Smaller reporting  
company

(Do not check if a smaller  
reporting company)

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

As of October 31, 2010, Sterling Chemicals, Inc. had 2,828,460 shares of common stock outstanding.

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

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

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

**Forward-Looking Statements**

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

Other sections of this Form 10-Q and our other filings with the Securities and Exchange Commission, or the SEC, including, without limitation, our Annual Report on Form 10-K for the fiscal year ended December 31, 2009, or our Annual Report, include additional factors that could adversely affect our business, results of operations or financial performance. See Risk Factors contained in Item 1A of Part I of our Annual Report. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements. Forward-looking statements included in this Form 10-Q are made only as of the date of this Form 10-Q and are not guarantees of future performance. Although we believe that the expectations reflected in these forward-looking statements are reasonable, such expectations may prove to be incorrect. All written or oral forward-looking statements attributable to us, or persons acting on our behalf, are expressly qualified in their entirety by these cautionary statements.

**Document Summaries**

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

**Access to Filings**

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

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

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

We have reviewed the accompanying condensed consolidated balance sheet of Sterling Chemicals, Inc. and its subsidiaries (the Company) as of September 30, 2010, and the related condensed consolidated statements of operations for the three and nine-month periods ended September 30, 2010 and 2009, and cash flows for the nine months ended September 30, 2010 and 2009. These interim financial statements are the responsibility of the Company's management.

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

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

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the balance sheet of the Company as of December 31, 2009, and the related statements of income, stockholders' equity and cash flows for the year then ended (not presented herein); and in our report dated March 24, 2010, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed balance sheet as of December 31, 2009, is fairly stated, in all material respects, in relation to the balance sheet from which it has been derived.

/s/GRANT THORNTON LLP

Houston, Texas

November 9, 2010

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

**Item 1. Financial Statements**

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

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Revenues	\$ 30,899	\$ 27,179	\$ 93,018	\$ 85,497
Cost of goods sold	26,107	24,932	78,143	76,514
Gross profit	4,792	2,247	14,875	8,983
Selling, general and administrative expenses	2,247	2,916	7,364	10,143
Impairment of long-lived assets			290	
Interest and debt related expenses	3,349	3,984	10,294	11,955
Interest income	(101)	(94)	(226)	(690)
Other income	(102)	(234)	(272)	(2,923)
Loss from continuing operations before income tax	(601)	(4,325)	(2,575)	(9,502)
Benefit for income taxes		(1,316)		(2,533)
Loss from continuing operations	\$ (601)	\$ (3,009)	\$ (2,575)	\$ (6,969)
Income from discontinued operations, net of tax expense of zero, \$972, zero and \$2,884, respectively	3,047	1,805	9,062	5,355
Net income (loss)	\$ 2,446	\$ (1,204)	\$ 6,487	\$ (1,614)
Preferred stock dividends	4,683	4,271	13,643	12,312
Net loss attributable to common stockholders	\$ (2,237)	\$ (5,475)	\$ (7,156)	\$ (13,926)
Income (loss) per share of common stock attributable to common stockholders, basic and diluted:				
Loss from continuing operations	\$ (1.87)	\$ (2.58)	\$ (5.73)	\$ (6.81)
Income from discontinued operations, net of tax	1.08	0.64	3.20	1.89
Basic and diluted loss per share	\$ (0.79)	\$ (1.94)	\$ (2.53)	\$ (4.92)
Weighted average shares outstanding:				
Basic and diluted	2,828,460	2,828,460	2,828,460	2,828,460

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



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

	<b>September 30, 2010</b>	<b>December 31, 2009</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 124,377	\$ 123,778
Accounts receivable, net of allowance of \$58 and \$58, respectively	12,604	14,614
Inventories, net	4,615	5,268
Prepaid expenses and other current assets	2,634	2,656
Assets of discontinued operations		24
Total current assets	144,230	146,340
Property, plant and equipment, net	58,924	68,182
Other assets, net	4,781	5,643
Total assets	\$ 207,935	\$ 220,165
<b>LIABILITIES AND STOCKHOLDERS DEFICIENCY IN ASSETS</b>		
Current liabilities:		
Accounts payable	\$ 8,357	\$ 11,703
Accrued liabilities	22,506	24,416
Liabilities of discontinued operations	12,382	12,384
Total current liabilities	43,245	48,503
Long-term debt	123,000	125,000
Long-term liabilities	38,998	41,084
Long-term liabilities of discontinued operations	13,724	23,010
Commitments and contingencies (Note 4)		
Redeemable preferred stock	148,171	134,528
Stockholders' deficiency in assets:		
Common stock, \$.01 par value (shares authorized 100,000,000; shares issued and outstanding 2,828,460)	28	28
Additional paid-in capital	93,378	106,948
Accumulated deficit	(234,293)	(240,780)
Accumulated other comprehensive loss	(18,316)	(18,156)
Total stockholders' deficiency in assets	(159,203)	(151,960)
Total liabilities and stockholders' deficiency in assets	\$ 207,935	\$ 220,165



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

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

	<b>Nine months ended September</b>	
	<b>30,</b>	
	<b>2010</b>	<b>2009</b>
Cash flows from operating activities:		
Net income (loss)	\$ 6,487	\$ (1,614)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Stock compensation expense	73	284
Bad debt expense	21	
Benefit plan curtailment gain	(115)	
Depreciation and amortization	9,430	7,289
Interest amortization	844	830
Amortization of deferred revenue	(12,839)	(10,911)
Impairment of long-lived assets	290	
Gain on disposal of property, plant and equipment	(96)	(362)
Other	468	(358)
Change in assets/liabilities:		
Accounts receivable	2,013	12,994
Inventories	338	(99)
Prepaid expenses and other current assets	22	(678)
Other assets	(51)	(10)
Accounts payable	(3,116)	(1,003)
Accrued liabilities	(1,912)	(1,880)
Long-term liabilities	1,422	1,441
Net cash provided by operating activities	3,279	5,923
Cash flows used in investing activities:		
Capital expenditures for property, plant and equipment	(857)	(8,972)
Net proceeds from the sale of property, plant and equipment	102	362
Net cash used in investing activities	(755)	(8,610)
Cash flows used in financing activities:		
Purchase of Senior Secured Notes	(1,925)	
Net cash used in financing activities	(1,925)	
Net increase (decrease) in cash	599	(2,687)
Cash and cash equivalents beginning of year	123,778	156,126

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Cash and cash equivalents	end of period	\$ 124,377	\$ 153,439
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Supplemental disclosures of cash flow information:

Interest paid	\$ 6,514	\$ 8,449
Interest income received	226	690
Cash received for income taxes	598	

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 and Accounting Policies**

The accompanying (a) condensed consolidated balance sheet as of December 31, 2009, which was derived from audited financial statements, and (b) the unaudited interim condensed consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP, and reflect all adjustments (including normal recurring accruals) which, in our opinion, are considered necessary for the fair presentation of the results for the periods presented. The results of operations and cash flows for the periods presented are not necessarily indicative of the results to be expected for the full year. These statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report.

*Reclassifications and Revisions*

We have reclassified certain amounts on the condensed consolidated balance sheet between other assets and prepaid expenses and other current assets as of December 31, 2009. We have reclassified amounts on the condensed consolidated statement of cash flows between other assets and prepaid expenses and other current assets, between accounts receivable and accounts payable and between depreciation and amortization, other, inventories and other assets to reconcile net income (loss) to net cash provided by operating activities for the nine month period ended September 30, 2009.

*Property Plant and Equipment Impairment*

In accordance with our policies, an impairment charge of \$0.3 million was recorded in the first quarter of 2010 to reduce the carrying value of one of our turbo generator units which was classified as a spare to its net realizable value of \$0.4 million.

**2. Discontinued Operations**

On September 17, 2007, we entered into a long-term exclusive styrene supply agreement and a related railcar purchase and sale agreement with NOVA Chemicals Inc., or NOVA. Under this supply agreement, NOVA had the exclusive right to purchase 100% of our styrene production (subject to existing contractual commitments), the amount of styrene supplied in any particular period being at NOVA's option. In November 2007, this supply agreement, which was subsequently assigned by NOVA to INEOS NOVA, LLC, or INEOS NOVA, received clearance under the Hart-Scott-Rodino Antitrust Improvements Act. This clearance caused the supply agreement and the railcar agreement to become effective and triggered a \$60.0 million payment to us from INEOS NOVA. In accordance with the terms of the supply agreement, INEOS NOVA assumed substantially all of our contractual obligations for future styrene deliveries. After the supply agreement became effective, INEOS NOVA nominated zero pounds of styrene under the supply agreement for the balance of 2007 and, in response, we exercised our right to terminate the supply agreement and permanently shut down our styrene facility. Under the supply agreement, we were responsible for the closure costs of our styrene facility and are also restricted from reentering the styrene business for a period of time. The restricted period of time was initially through 2015. However, effective April 1, 2008, INEOS NOVA unilaterally reduced the restricted period to five years ending November 2012.

As a result of our styrene facility being permanently shut down, we have no significant continued involvement in the styrene business and have, therefore, reported the operating results of this business as discontinued operations in our condensed consolidated financial statements. The carrying amounts of assets and liabilities related to discontinued operations as of September 30, 2010 and December 31, 2009 were as follows (in thousands):

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

	September 30, 2010	December 31, 2009
<b>Assets of discontinued operations:</b>		
Accounts receivable, net of allowance of \$44 and \$23 respectively	\$	\$ 24
<b>Liabilities of discontinued operations:<sup>(1)</sup></b>		
Current portion of deferred revenue	\$ 12,382	\$ 12,384
Long-term portion of deferred revenue	13,724	23,010
Total	\$ 26,106	\$ 35,394

(1) As of September 30, 2010, amounts represent deferred income from the NOVA supply agreement that is being amortized over the contractual non-compete period of five years using the straight-line method.

Revenues and income before income taxes from discontinued operations for the three and nine-month periods ended September 30, 2010 and 2009 are presented below:

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
	(Dollars in Thousands)			
Revenues	\$ 3,096	\$ 3,096	\$ 9,287	\$ 9,502
Income before income taxes	3,047	2,777	9,062	8,239

**3. Long-Term Debt**

On March 29, 2007, we completed a private offering of \$150.0 million aggregate principal amount of unregistered 10<sup>1</sup>/<sub>4</sub>% Senior Secured Notes due 2015, or our Secured Notes, pursuant to a Purchase Agreement among us, Sterling Chemicals Energy, Inc., or Sterling Energy, one of our former wholly-owned subsidiaries, and Jefferies & Company, Inc. and CIBC World Markets Corp., as initial purchasers. In connection with that offering, we entered into an indenture dated March 29, 2007 among us, Sterling Energy, as guarantor, and U.S. Bank National Association, as trustee and collateral agent. On May 6, 2008, Sterling Energy was merged with and into us. Upon consummation of the merger, Sterling Energy no longer had independent existence and, consequently, our Secured Notes are no longer guaranteed by Sterling Energy.

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

Interest is due on our outstanding Secured Notes on April 1 and October 1 of each year. Our outstanding Secured Notes, which mature on April 1, 2015, are senior secured obligations and rank equally in right of payment with all of our existing and future senior indebtedness. Subject to specified permitted liens, our outstanding Secured Notes are secured (i) on a first priority basis by all of our fixed assets and certain related assets, including, without limitation, all

of our property, plant and equipment and (ii) on a second priority basis by our other assets, including, without limitation, accounts receivable, inventory, capital stock of our domestic restricted subsidiaries, intellectual property, deposit accounts and investment property.

In the fourth quarter of 2009, we purchased \$25.0 million in aggregate principal amount of our Secured Notes in the open market for \$23.8 million in cash, resulting in a \$1.2 million gain. This gain was partially offset by the amortization of a pro rata portion of the related debt issue costs of \$0.9 million. In February 2010, we purchased an additional \$2.0 million in aggregate principal amount of our Secured Notes in the open market for \$1.9 million in

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cash, resulting in a \$0.1 million gain. This gain was partially offset by the amortization of a pro rata portion of the related debt issue costs of less than \$0.1 million.

On December 19, 2002, we entered into a Revolving Credit Agreement, or our revolving credit facility, with The CIT Group/Business Credit, Inc, or CIT, as administrative agent and a lender, and certain other lenders. Under our revolving credit facility, we and Sterling Energy were co-borrowers and were jointly and severally liable for any indebtedness thereunder. On December 10, 2009, we elected to terminate our revolving credit facility effective January 24, 2010, due to our substantial cash reserves and low working capital needs. There were no penalties or termination fees payable by us in connection with the early termination of our revolving credit facility. The remaining associated debt issue costs of \$0.2 million were written off as of the effective termination date.

On January 31, 2010, we entered into a \$5.0 million Revolving Line of Credit for letters of credit, or our LC Facility, with JPMorgan Chase Bank, N.A., or Chase, for the issuance of commercial and standby letters of credit. Our LC Facility initially had a one year term. Under our LC Facility, we pay Chase a fee of 1% per annum of the face amount of each outstanding letter of credit and an issuance fee of \$500 for each letter of credit. Since its inception, our LC Facility has been and continues to be secured by \$5.0 million in cash under an Assignment of Deposit Account Agreement between us and Chase. On September 20, 2010, we amended our LC facility to extend the initial term to April 30, 2011, and concurrently therewith entered into a Security Agreement and a Pledge Agreement with Chase, pursuant to which we granted Chase first priority liens on all of our accounts receivable, inventory and other specified assets to secure our obligations under our LC Facility. As of September 30, 2010, there were \$3.3 million in standby letters of credit issued under our LC facility.

***Debt Maturities***

Our Secured Notes, which had an aggregate principal balance of \$123.0 million outstanding as of September 30, 2010, are due on April 1, 2015.

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

We have agreements, one with each of our two customers, which provide for the dedication of 100% of our production of acetic acid and plasticizers. See Note 7 for more information regarding our acetic acid and plasticizers segments.

***Legal Proceedings:***

On July 5, 2005, Patrick B. McCarthy, an employee of Kinder-Morgan, Inc., or Kinder-Morgan, was seriously injured at Kinder-Morgan's facilities near Cincinnati, Ohio, while attempting to offload a railcar containing one of our plasticizers products. On October 28, 2005, Mr. McCarthy and his family filed a suit in the Court of Common Pleas, Hamilton County, Ohio (Case No. A0509 144) against us and six other defendants. During the case, five of the other defendants were dismissed. The plaintiffs sought in excess of \$42 million in alleged compensatory and punitive damages from the defendants in the aggregate. On May 7, 2009, the jury found that we had not been negligent in connection with the incident and rendered a take nothing verdict in favor of the defendants. On June 24, 2009, the plaintiffs filed a motion for judgment notwithstanding the verdict or, in the alternative, a new trial. On September 4, 2009, the Court denied plaintiffs' motion for judgment notwithstanding the verdict but granted plaintiffs' motion for a new trial. We and the other remaining defendant timely filed notices of appeal of that order, as well as other orders issued during the trial. Oral arguments for this appeal were heard on September 14, 2010, but to date the appellate court has not rendered a decision. 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 \$1.0 million deductible, which was met in January 2008. We do not believe that this incident will have a material adverse effect on our business, financial condition, results of operations or cash flows, although we cannot guarantee that a material adverse effect will not occur.

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On February 21, 2007, three retired employees of Sterling Fibers, Inc., one of our former subsidiaries, sued us, several of our benefit plans and the plan administrators for those plans in a class action suit, Case No. H-07-0625 filed in the United States District Court, Southern District of Texas, Houston Division. The plaintiffs allege that we were not permitted to increase their premiums for retiree medical insurance based on a provision contained in an asset purchase agreement between us, Sterling Fibers, Inc. and Cytec Industries Inc. and certain of its affiliates that governed our purchase of our former acrylic fibers business in 1997. During our bankruptcy case, we specifically rejected this asset purchase agreement and the bankruptcy court approved that rejection. The plaintiffs claimed that we violated the terms of the benefit plans and breached fiduciary duties governed by the Employee Retirement Income Security Act and failed to comply with sections of the Bankruptcy Code dealing with retiree benefits, and sought damages, declaratory relief, punitive damages and attorneys' fees. A trial for this matter was held during the second week of November 2009. On July 1, 2010, the judge ruled for us on the merits and dismissed all of the plaintiffs' claims. The plaintiffs filed an appeal on July 16, 2010. Oral arguments for this appeal have not been scheduled to date. We are vigorously seeking affirmation of the trial judge's rulings. We are unable to state at this time if a loss is probable or remote and are unable to determine the possible range of loss related to this matter, if any.

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

As of December 31, 2009, we had a receivable of \$0.1 million due from our insurance carriers for reimbursement of legal costs that exceeded our insurance deductibles and was, therefore, reimbursable through our insurance carriers. For the nine months ended September 30, 2010, we incurred \$0.2 million of legal costs that are reimbursable under our insurance policies and received \$0.2 million of payments from our insurance carriers, resulting in a receivable balance of \$0.1 million as of September 30, 2010.

**5. Income Taxes**

For each of the three and nine-month periods ended September 30, 2010, we recorded net tax expense of zero for income taxes from continuing operations. During the three and nine-month periods ended September 30, 2009, we recorded net tax benefit of \$1.3 million and \$2.5 million, respectively, for income taxes from continuing operations. Based on our net operating loss position and projections for the year, we expect any tax expense or benefit during 2010 to be fully offset by a related change in the valuation allowance, resulting in an effective tax rate of zero. The net tax benefit during the three and nine-month periods ended September 30, 2009 was generated as a result of utilizing income in our discontinued operations to recognize a portion of the benefit from losses generated in our continuing operations. Our continuing operations effective tax rate was zero for the nine-month period ended September 30, 2010 compared to an effective tax rate of 26.9% for the nine-month period ended September 30, 2009.

**6. Employee Benefits**

Net periodic pension costs consisted of the following components:

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
	<b>(Dollars in Thousands)</b>			
Interest cost	\$ 1,745	\$ 1,828	\$ 5,235	\$ 5,484
Expected return on plan assets	(1,159)	(1,512)	(3,479)	(4,538)
Amortization	191	863	574	2,591
Net pension cost	\$ 777	\$ 1,179	\$ 2,330	\$ 3,537





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Other postretirement benefits consisted of the following components:

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
	<b>(Dollars in Thousands)</b>			
Service cost	\$ 10	\$ 12	\$ 30	\$ 34
Interest cost	93	121	281	363
Amortization of unrecognized costs	(540)	(542)	(1,624)	(1,624)
Curtailment gain			(115)	
Net plan benefit	\$ (437)	\$ (409)	\$ (1,428)	\$ (1,227)

During the first quarter of 2010, we announced and completed a reduction in our work force. In accordance with Accounting Standards Codification, or ASC, Topic 715 Compensation Retirement Benefits, we recorded a curtailment gain of \$0.1 million under our retiree medical plans.

Total contributions of \$4.5 million expected to be paid in 2010 were paid during the nine-month period ended September 30, 2010.

**7. Operating Segment and Sales Information**

As of September 30, 2010, after considering the effects of discontinued operations, we have reported our operations through two segments: acetic acid and plasticizers. The accounting policies are the same as those disclosed in our Annual Report. We use gross profit for reporting the results of our operating segments and this measure includes all operating items related to these businesses. There are no sales between segments. The revenues and gross profit (losses) for each of our reportable operating segments are as follows:

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
	<b>(Dollars in Thousands)</b>			
Revenues:				
Acetic acid	\$ 24,522	\$ 20,892	\$ 73,482	\$ 64,527
Plasticizers	6,122	6,032	18,766	20,205
Other	255	255	770	765
Total	\$ 30,899	\$ 27,179	\$ 93,018	\$ 85,497
Segment gross profit (loss):				
Acetic acid	\$ 3,925	\$ 43	\$ 11,216	\$ 4,484
Plasticizers	1,748	1,511	5,129	4,235
Other	(881)	693	(1,470)	264
Total	4,792	2,247	14,875	8,983
Selling, general and administrative expenses	2,247	2,916	7,364	10,143
Impairment of long-lived assets			290	
Interest and debt related expenses	3,349	3,984	10,294	11,955
Interest income	(101)	(94)	(226)	(690)

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Other income	(102)	(234)	(272)	(2,923)
Loss from continuing operations before income tax	\$ (601)	\$ (4,325)	\$ (2,575)	\$ (9,502)
Depreciation and amortization expenses:				
Acetic acid	\$ 2,029	\$ 2,114	\$ 5,951	\$ 5,473
Plasticizers	874	342	2,466	979
Other <sup>(1)</sup>	342	330	1,013	837
Total	\$ 3,245	\$ 2,786	\$ 9,430	\$ 7,289
Capital expenditures:				
Acetic acid	\$	\$ 1,472	\$ 144	\$ 5,179
Other plant infrastructure	82	1,120	713	3,793
Total	\$ 82	\$ 2,592	\$ 857	\$ 8,972

<sup>(1)</sup> Includes depreciation and amortization expenses for discontinued operations of less than \$0.1 million for each of the three and nine-month periods ended September 30, 2010 and 2009, respectively.

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

	<b>September 30, 2010</b>	<b>December 31, 2009</b>
	<b>(Dollars in Thousands)</b>	
Total assets:		
Acetic acid	\$ 32,956	\$ 35,362
Plasticizers	2,349	5,412
Other <sup>(1)</sup>	172,630	179,391
<b>Total</b>	<b>\$ 207,935</b>	<b>\$ 220,165</b>

<sup>(1)</sup> Components of Other are presented in the table below:

	<b>September 30, 2010</b>	<b>December 31, 2009</b>
	<b>(Dollars in Thousands)</b>	
Other:		
Corporate:		
Cash	\$ 124,377	\$ 123,778
Other	13,422	17,677
Plant infrastructure:		
Property, plant and equipment, net	34,831	37,912
Assets of discontinued operations		24
<b>Total</b>	<b>\$ 172,630</b>	<b>\$ 179,391</b>

**8. Fair Value Measurements*****Fair Value of Financial Instruments***

In accordance with the provisions of the Fair Value Measurements and Disclosures Topic of the ASC, the fair value of our financial instruments has been estimated in accordance with GAAP. The fair value of our fixed rate long-term debt is estimated based on quoted market prices or prices quoted from third-party financial institutions. The carrying and fair values of our long-term debt are as follows:

	<b>September 30, 2010</b>		<b>December 31, 2009</b>	
	<b>Carrying Value</b>	<b>Fair Value</b>	<b>Carrying Value</b>	<b>Fair Value</b>
Secured Notes	\$ 123,000	\$ 120,540	\$ 125,000	\$ 119,400

The fair values of our cash equivalents, trade receivables and trade payables approximate their carrying values due to the short-term nature of these instruments.

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**STERLING CHEMICALS, INC.**

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

***Nonrecurring Fair Value Measurements***

Effective January 1, 2009, fair value measurements were applied with respect to our non-financial assets and liabilities. We measure certain non-financial assets and liabilities, including long-lived assets, at fair value on a non-recurring basis. The fair market value of these assets is determined using Level 3 inputs, which requires management to make estimates about future cash flows. Management estimates the amount and timing of future cash flows based on its experience and knowledge of market factors.

**9. New Accounting Standards**

***Adoption of Accounting Standards:***

In January 2010, the Financial Accounting Standards Board issued Accounting Standards Update No. 2010-06, an amendment to ASC Topic 820-10, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements, or ASU No. 2010-06. ASU No. 2010-06 requires new disclosures and clarifies some existing disclosure requirements with respect to fair value measurement as set forth in Codification Subtopic 820-10. The objective of ASU No. 2010-06 is to improve these disclosures and increase the transparency in financial reporting. Specifically, ASU No. 2010-06 amends ASC Topic 820-10 to require that:

- a reporting entity disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and the reasons for the transfers; and
- a reporting entity present separately information about purchases, sales, issuances and settlements in the reconciliation for fair value measurements using significant unobservable inputs.

In addition, ASU No. 2010-06 provides that:

- for purposes of reporting fair value measurements for each class of assets and liabilities, a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities; and
- a reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements.

ASU No. 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures with respect to purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Early application is permitted. We implemented ASU No. 2010-06 effective January 1, 2010, and have enhanced our disclosures to comply with ASU No. 2010-06.

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

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

**Business Overview**

We were formed in 1986 to acquire a petrochemicals facility located in Texas City, Texas that was previously owned by Monsanto Company. We are a producer of select petrochemicals used to manufacture a wide array of consumer goods and industrial products. Our primary products are acetic acid and plasticizers.

Our site in Texas City, Texas, or our Texas City facility, is strategically located on Galveston Bay and benefits from a deep-water dock capable of handling ships with up to a 40-foot draft, as well as four barge docks and direct access to Union Pacific and Burlington Northern Santa Fe railways. Our Texas City facility also has truck loading racks, weigh scales, stainless and carbon steel storage tanks, three waste deepwells, 160 acres of available land zoned for heavy industrial use, additional land zoned for light industrial use and a supportive political environment for growth. In addition, we are in the heart of one of the largest petrochemical complexes on the Gulf Coast and, as a result, have on-site access to a number of raw material pipelines, as well as close proximity to a number of large refinery complexes. Given our under-utilized infrastructure and our management, operational and engineering expertise, as well as our ample unoccupied land, we believe that there are significant opportunities for further development of our Texas City facility. We are currently pursuing numerous initiatives to attract new manufacturing, distribution or storage related businesses to our Texas City facility. Specifically, we are seeking long-term contractual business arrangements or partnerships that will provide us with the ability to realize the value of our under-utilized assets through profit sharing or other revenue generating arrangements. For development projects that may have significant capital expenditure requirements, we are considering joint ventures or other arrangements where we would contribute certain of our assets and our management and operational expertise to minimize our share of the capital costs. In any case, we expect any new facility constructed at our Texas City facility to lower the amount of overall fixed costs allocated to each of our operating units and provide us with additional profit. We recently entered into a contract involving the terminaling of methanol as a part of our strategy, although we do not expect this transaction to have a material affect on our business, financial results or cash flows.

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

Our rated annual production capacity for acetic acid is among the highest in North America. In mid-2009, we and BP Chemicals implemented an incremental expansion of our acetic acid plant to 1.3 billion pounds of annual capacity, which represents 20% of total North American capacity, making our acetic acid facility the second largest acetic acid production facility in North America. Our acetic acid facility utilizes BP Chemicals' proprietary Cativa methanol carbonylation technology, which we believe offers several advantages over competing production methods, including lower energy requirements and lower fixed and variable costs. Acetic acid production has two major raw material requirements, methanol and carbon monoxide. BP Chemicals, a producer of methanol, supplies 100% of our methanol requirements related to our production of acetic acid. All of our requirements for carbon monoxide are supplied by Praxair Hydrogen Supply, Inc., or Praxair, from a partial oxidation unit constructed by Praxair on land leased from us at our Texas City facility.

All of our plasticizers, which are used to make flexible plastics, such as shower curtains, floor coverings, automotive parts and construction materials, are produced exclusively for BASF Corporation, or BASF. Under our Third Amended and Restated Plasticizers Production Agreement with BASF, or our Plasticizers Production Agreement, BASF provides us with most of the required raw materials, markets the plasticizers that we produce and



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is obligated to make certain fixed quarterly payments to us and reimburse us monthly for our actual production costs and capital expenditures relating to our plasticizers facility.

On November 11, 2009, BASF elected to terminate our Plasticizers Production Agreement, effective December 31, 2010, at which time we will no longer produce plasticizers for BASF. We will not be subject to any early termination penalties in connection with BASF's termination of our Plasticizers Production Agreement, although we will be required to refund a \$1.0 million deposit previously paid by BASF. BASF, on the other hand, will be required to pay us an early termination fee of \$9.8 million on or before December 31, 2010. In addition, if we continue to operate our plasticizers business after the termination of our Plasticizers Production Agreement, we will be required to make payments to BASF for the undepreciated portion of past capital expenditures paid by BASF, determined as of the end of the original term of our Plasticizers Production Agreement, based on a straight line, 8-year life. As of December 31, 2013, we expect the total amount of these undepreciated capital expenditures to be approximately \$2.6 million, with approximately \$1.0 million, \$0.7 million, \$0.6 million and \$0.3 million potentially to be paid in 2011, 2012, 2013 and 2014, respectively. However, if within 90 days after the termination of our Plasticizers Production Agreement, we provide written notice to BASF of our election to permanently close our plasticizers facility, the undepreciated capital expenditures paid by BASF for all capital projects is deemed to be zero, and we will not be required to make any payments to BASF. In the event we discontinue our plasticizers operations, we expect to incur approximately \$1.0 million in shutdown and decontamination costs. The costs and timing for dismantling of our plasticizers facility are unknown at this time but we do not expect these costs to be significant.

We are in the process of exploring and evaluating our commercial options with respect to continuing our plasticizers business after the termination of our Plasticizers Production Agreement with BASF. As we are still in the process of evaluating our commercial options regarding our plasticizers business, we cannot predict the ultimate outcome or the success of continuing our plasticizers business after December 31, 2010. We have, however, developed plans for restructuring our operating costs during the first quarter of 2011, the extent of which will be dependent upon whether we elect to permanently close our plasticizers facility. If we are unable to continue our plasticizers operations through other viable commercial options for our plasticizers business or facility or restructure our operating costs, or are unable to do so at or shortly after December 31, 2010, the termination of our Plasticizers Production Agreement will likely have a material adverse effect on our financial condition, results of operations and cash flows. However, we do not believe that these effects will impact our ability to continue as a going concern. Other than our Plasticizers Production Agreement, we do not have any material relationships with BASF.

In January 2010, we announced and completed a reduction in our work force in order to reduce our staffing to a level appropriate for our existing operations. As a result, we reduced our salaried work force by ten people and our hourly work force by 7 people, and we recognized and paid \$0.9 million of severance costs. Additionally, as a result of our work force reduction, we recorded a curtailment gain of \$0.1 million under our retiree medical plans in the first quarter of 2010.

On May 7, 2010, our Board of Directors authorized us to pursue the acquisition of companies or assets with the goals of materially diversifying our cash flow streams, creating strong long-term growth opportunities and providing a platform for listing our shares of common stock on The NASDAQ Stock Market or the New York Stock Exchange. After an extensive review with our Board of Directors of a wide range of acquisition targets and financing alternatives, we have been focusing our search for acquisition candidates on companies or assets involved in chemical distribution, specialty chemical manufacture or bulk, petroleum or chemical storage or logistics and whose existing business would benefit from our available acreage and infrastructure at our Texas City facility. We anticipate that the structure of the financing for any such acquisition will be determined by, among other things, the characteristics of the acquisition target, and may involve a cash purchase, a merger, an exchange of stock or another financing mechanism, or may involve the formation of a joint venture or other business partnership.



**Table of Contents****Results of Operations*****Three Months Ended September 30, 2010 Compared to Three Months Ended September 30, 2009****Revenues and loss from continuing operations*

Our revenues were \$30.9 million for the third quarter of 2010, a 14% increase from the \$27.2 million in revenues we recorded for the third quarter of 2009. We had a loss from continuing operations of \$0.6 million for the third quarter of 2010, compared to a loss from continuing operations of \$3.0 million for the third quarter of 2009.

Revenues from our acetic acid operations were \$24.5 million in the third quarter of 2010, a 17% increase from the \$20.9 million in revenues we received from these operations in the third quarter of 2009. This increase in acetic acid revenues was primarily due to increased contribution margin and sales volume in the third quarter of 2010 compared to the third quarter of 2009, and the 42 day shutdown of our acetic acid unit beginning in June 2009 for scheduled maintenance work and the lower production volumes and associated variable cost reimbursements resulting from that shutdown, partially offset by increased fixed cost reimbursements for shutdown costs in 2009. Gross profit for our acetic acid operations was \$3.9 million for the third quarter of 2010 compared to less than \$0.1 million for the third quarter of 2009. This increase in gross profit was primarily due to the same factors that caused our increase in acetic acid revenues.

Revenues from our plasticizers operations were \$6.1 million in the third quarter of 2010, a 2% increase from the \$6.0 million in revenues we received from these operations in the third quarter of 2009. This increase in revenues was primarily due to a \$0.6 million increase in the amortization of the payment we received in connection with the previous termination by BASF of its obligations related to our oxo alcohols facilities under our Plasticizers Production Agreement. Due to the termination of our Plasticizers Production Agreement by BASF effective December 31, 2010, the original 8-year life used to amortize this payment was accelerated to coincide with the termination of our Plasticizers Production Agreement. This increase was offset by lower cost reimbursements of \$0.5 million in the third quarter of 2010 primarily due to reimbursement of costs in 2009 for the project to redesign our process wastewater treatment system. Gross profit from our plasticizers operations was \$1.7 million for the third quarter of 2010, compared to \$1.5 million for the third quarter of 2009. This increase was primarily due to the \$0.6 million in increased amortization of the BASF payment discussed above and the impact of \$0.1 million of increased reimbursements for various components of reimbursable costs under our Plasticizers Production Agreement, offset by a \$0.6 million increase in depreciation expense that resulted from the acceleration of depreciation on our plasticizers facility as a result of BASF terminating our Plasticizers Production Agreement effective December 31, 2010.

*Selling, general and administrative expenses*

Our selling, general and administrative expenses were \$2.2 million during the third quarter of 2010, a 24% decrease from the \$2.9 million in selling, general and administrative expenses we incurred during the third quarter of 2009. This decrease was primarily due to a \$0.4 million decrease in engineering costs for strategic initiatives and a \$0.1 million decrease in legal fees.

*Interest and debt related expenses*

We recorded \$3.3 million of interest and debt related expenses during the third quarter of 2010, an 18% decrease from the \$4.0 million of interest and debt related expenses we incurred during the third quarter of 2009. This decrease was primarily due to our purchase of \$27.0 million in aggregate principal amount of our 10<sup>1</sup>/<sub>4</sub>% Senior Secured Notes due 2015, or our Secured Notes, over the period November 2009 through February 2010.

*Other income*

Our other income was \$0.1 million during the third quarter of 2010 and \$0.2 million during the third quarter of 2009. This decrease in other income was primarily due to a \$0.1 million decrease in reimbursement of legal fees.

*Benefit for income taxes*

During the third quarters of 2010 and 2009, we recorded net tax expense of zero and net tax benefit of \$1.3 million, respectively, for income taxes from continuing operations. Based on our net operating loss position and projections for the year, we expect any tax expense or benefit during 2010 to be fully offset by a related change in our valuation allowance, resulting in an effective tax rate of zero. The tax benefit in the third quarter of 2009 was generated as a result of utilizing income in our discontinued operations to recognize a portion of the benefit from



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losses generated in our continuing operations. For the three-month periods ended September 30, 2010, and September 30, 2009, our continuing operations effective tax rate was zero and 31.1%, respectively.

*Income from discontinued operations, net of tax*

Our income from discontinued operations, net of tax, was \$3.0 million during the third quarter of 2010, a 67% increase compared to the \$1.8 million in income from discontinued operations net of tax, we recorded during the third quarter of 2009. This increase was primarily due to our recording \$1.0 million of income tax expense during the third quarter of 2009, whereas we had no income tax expense during the third quarter of 2010.

***Nine Months Ended September 30, 2010 Compared to Nine Months Ended September 30, 2009****Revenues and loss from continuing operations*

Our revenues were \$93.0 million for the first nine months of 2010, a 9% increase from the \$85.5 million in revenues we recorded for the first nine months of 2009. We had a loss from continuing operations of \$2.6 million for the first nine months of 2010, compared to a loss from continuing operations of \$7.0 million for the first nine months of 2009.

Revenues from our acetic acid operations were \$73.5 million for the first nine months of 2010, a 14% increase from the \$64.5 million in revenues we received from these operations for the first nine months of 2009. This increase in acetic acid revenues was primarily due to increased contribution margin and sales volume in the first nine months of 2010 compared to the first nine months of 2009, and the 42 day shutdown of our acetic acid unit beginning in June 2009 for scheduled maintenance work and the lower production volumes, associated variable cost reimbursements resulting from that shutdown, partially offset by increased fixed cost reimbursements for shutdown costs in 2009. Gross profit from our acetic acid operations was \$11.2 million for the first nine months of 2010 compared to \$4.5 million for the first nine months of 2009. The \$6.7 million increase in gross profit was primarily due to the same factors that caused our increase in acetic acid revenues.

Revenues from our plasticizers operations were \$18.8 million for the first nine months of 2010, a 7% decrease from the \$20.2 million in revenues we received from these operations for the first nine months of 2009. This decrease in revenues was primarily due to lower cost reimbursements of \$3.4 million in the first nine months of 2010, compared to the first nine months of 2009, as the 2009 period included reimbursement of costs to redesign our process wastewater treatment system. Partially offsetting this decrease in revenues was a \$1.9 million increase in the amortization of the payment we received in connection with the previous termination by BASF of its obligations related to our oxo alcohols facilities under our Plasticizers Production Agreement. Due to the termination of our Plasticizers Production Agreement by BASF effective December 31, 2010, the original 8-year life used to amortize this payment was accelerated to coincide with the termination of our Plasticizers Production Agreement. Gross profit from our plasticizers operations was \$5.1 million for the first nine months of 2010, compared to \$4.2 million for the first nine months of 2009. This increase was primarily due to the \$1.9 million in increased amortization of the BASF payment discussed above and the impact of \$0.7 million of increased reimbursements for various components of reimbursable costs under our Plasticizers Production Agreement. These favorable variances were offset by a \$1.5 million increase in depreciation that resulted from acceleration of depreciation on our plasticizers facility as a result of BASF terminating our Plasticizers Production Agreement effective December 31, 2010.

*Selling, general and administrative expenses*

Our selling, general and administrative expenses were \$7.4 million during the first nine months of 2010, a 27% decrease from the \$10.1 million of selling, general and administrative expenses we incurred during the first nine months of 2009. This decrease was primarily due to a \$1.9 million decrease in legal fees and a \$0.8 million decrease in engineering costs for strategic initiatives in the first nine months of 2010 compared to the same period in 2009.

**Table of Contents***Impairment of long-lived assets*

We recorded \$0.3 million for the impairment of long-lived assets during the first nine months of 2010 and had no impairments during the first nine months of 2009. In accordance with our policies, the impairment charge of \$0.3 million was recorded to reduce the carrying value of one of our turbo generator units, which we have classified as a spare, to its net realizable value of \$0.4 million in the first quarter of 2010.

*Interest and debt related expenses*

We recorded \$10.3 million of interest and debt related expenses during the first nine months of 2010, a 14% decrease from the \$12.0 million of interest and debt related expenses we incurred during the first nine months of 2009. This decrease was primarily due to our purchase of \$27.0 million in aggregate principal amount of our Secured Notes over the period from November 2009 through February 2010.

*Interest income*

We recorded \$0.2 million of interest income during the first nine months of 2010 and \$0.7 million in the first nine months of 2009. This decrease in interest income was primarily due to lower interest rates for our cash investments and a lower cash balance in the first nine months of 2010 compared to the same period in 2009.

*Other income*

Our other income was \$0.3 million during the first nine months of 2010 and \$2.9 million during the first nine months of 2009. This decrease in other income was primarily due to the receipt of a previously disputed \$1.1 million contractual payment during the second quarter of 2009 and the reimbursement of \$1.5 million of legal fees during the first nine months of 2009.

*Benefit for income taxes*

For the nine-month period ended September 30, 2010, we recorded net tax expense of zero for income taxes from continuing operations compared to a net tax benefit of \$2.5 million for income taxes from continuing operations for the nine-month period ended September 30, 2009. Based on our net operating loss position and projections for the year, we expect any tax expense or benefit during 2010 to be fully offset by a related change in our valuation allowance, resulting in an effective tax rate of zero. The net tax benefit during the nine-month period ended September 30, 2009 was generated as a result of utilizing income in our discontinued operations to recognize a portion of the benefit from losses generated in our continuing operations. Our continuing operations effective tax rate was zero for the nine-month period ended September 30, 2010 compared to an effective tax rate of 26.9% for the nine-month period ended September 30, 2009.

*Income from discontinued operations, net of tax*

Our income from discontinued operations, net of tax, was \$9.1 million during the first nine months of 2010, a 69% increase compared to the \$5.4 million in income from discontinued operations, net of tax, we recorded during the first nine months of 2009. This increase was primarily due to our recording \$2.9 million of income tax expense during the first nine months of 2009, whereas we had no income tax expense in the first nine months of 2010.

**Liquidity and Capital Resources***General*

Our working capital was \$101.0 million as of September 30, 2010, an increase of \$3.2 million from our working capital of \$97.8 million as of December 31, 2009. This increase was primarily due to an \$18.6 million increase in our accrual for profit sharing, a \$3.6 million decrease in our accrual for deferred revenue, the receipt of three fixed quarterly payments from BASF and reclassification of \$1.5 million from short-term pension liability to long-term pension liability. Partially offsetting this increase was \$9.5 million in accrued interest, the purchase of \$2.0 million in aggregate principal amount of our Secured Notes for \$1.9 million, a \$2.7 million decrease in prepaid insurance, a \$2.4 million accrual for variable compensation, \$5.4 million in net benefit payments, capital expenditures of \$0.9 million and a property tax accrual of \$0.9 million.

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Our liquidity was \$124.4 million as of September 30, 2010, a decrease of \$3.4 million from our liquidity of \$127.8 million as of December 31, 2009. This decrease was primarily due to the termination of our revolving credit facility and our purchase of \$2.0 million in aggregate principal amount of our Secured Notes in 2010 for \$1.9 million. We periodically review the balance of our cash on hand in light of our strategic objectives and the restrictions on the use of cash contained in the indenture for our Secured Notes. As opportunities arise, we intend to utilize our cash as circumstances warrant, possibly in material amounts, to fund all or a portion of the purchase price of mergers or acquisitions, engage in project development work, make contributions to our defined benefit plans or purchase our outstanding Secured Notes on the open market, in privately negotiated transactions, or otherwise.

We currently invest our cash in money market funds and certificates of deposit. However, we may invest our cash in other high-quality, highly liquid cash equivalents from time to time.

*Debt*

On March 29, 2007, we completed a private offering of \$150.0 million aggregate principal amount of unregistered Secured Notes pursuant to a Purchase Agreement among us, Sterling Chemicals Energy, Inc., or Sterling Energy, one of our former wholly-owned subsidiaries, and Jefferies & Company, Inc. and CIBC World Markets Corp., as initial purchasers. In connection with that offering, we entered into an indenture dated March 29, 2007 among us, Sterling Energy, as guarantor, and U.S. Bank National Association, as trustee and collateral agent. On May 6, 2008, Sterling Energy was merged with and into us. Upon consummation of the merger, Sterling Energy no longer had independent existence and, consequently, our Secured Notes are no longer guaranteed by Sterling Energy.

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

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

In the fourth quarter of 2009, we purchased \$25.0 million in aggregate principal amount of our Secured Notes in the open market for \$23.8 million in cash, resulting in a \$1.2 million gain. This gain was partially offset by the amortization of a pro rata portion of the related debt issue costs of \$0.9 million. In February 2010, we purchased an additional \$2.0 million in aggregate principal amount of our Secured Notes in the open market for \$1.9 million in cash, resulting in a \$0.1 million gain. This gain was partially offset by the amortization of a pro rata portion of the related debt issue costs of less than \$0.1 million.

On December 19, 2002, we entered into a Revolving Credit Agreement, or our revolving credit facility, with The CIT Group/Business Credit, Inc, or CIT, as administrative agent and a lender, and certain other lenders. Under our revolving credit facility, we and Sterling Energy were co-borrowers and were jointly and severally liable for any indebtedness thereunder. On December 10, 2009, we elected to terminate our revolving credit facility effective January 24, 2010, due to our substantial cash reserves and low working capital needs. There were no penalties or termination fees payable by us in connection with the early termination of our revolving credit facility. The remaining associated debt issue costs of \$0.2 million were written off as of the effective termination date.

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On January 31, 2010, we entered into a \$5.0 million Revolving Line of Credit for letters of credit, or our LC Facility, with JPMorgan Chase Bank, N.A., or Chase, for the issuance of commercial and standby letters of credit. Our LC Facility initially had a one year term. Under our LC Facility, we pay Chase a fee of 1% per annum of the face amount of each outstanding letter of credit and an issuance fee of \$500 for each letter of credit. Since its inception, our LC Facility has been and continues to be secured by \$5.0 million in cash under an Assignment of Deposit Account Agreement between us and Chase. On September 20, 2010, we amended our LC facility to extend the initial term to April 30, 2011, and concurrently therewith entered into a Security Agreement and a Pledge Agreement with Chase, pursuant to which we granted Chase first priority liens on all of our accounts receivable, inventory and other specified assets to secure our obligations under our LC Facility. As of September 30, 2010, there were \$3.3 million in standby letters of credit issued under our LC facility.

As part of our strategic goals, we are seeking to consummate strategic transactions, including, but not limited to, acquisitions of assets or businesses and the formation of joint ventures or other business combinations. Although we do not currently have any commitments with respect to any strategic transactions, we may enter into such commitments in the future, which could result in a material expansion of our existing operations or result in our entering into new lines of business. In addition, a strategic transaction could result in the expenditure of a material amount of our funds or the issuance by us of a material amount of debt or equity securities.

**Cash Flow**

Net cash provided by operations was \$3.3 million during the first nine months of 2010, a 44% decrease from the \$5.9 million in net cash provided by operations we recorded during the first nine months of 2009. This decrease in net cash provided by operations was primarily due to higher acetic acid profit sharing payments in 2009 compared to 2010, due to a higher percentage true-up payment in 2009 under the previous version of our Acetic Acid Production Agreement, offset by higher net income in 2010 compared to 2009. Net cash used in investing activities was \$0.8 million during the first nine months of 2010, a 92% decrease from the \$8.6 million net cash used in investing activities we recorded during the first nine months of 2009. This decrease in net cash used in investing activities was primarily due to higher capital expenditures in 2009 of \$4.4 million for acetic acid related projects and \$1.8 million for a process wastewater treatment system. Net cash used in financing activities was \$1.9 million during the first nine months of 2010 and zero during the first nine months of 2009. This increase in net cash flow used in financing activities was primarily due to our purchase of \$2.0 million in aggregate principal amount of our Secured Notes for \$1.9 million in the first quarter of 2010.

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

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

**Item 4T. Controls and Procedures**

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



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misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance of achieving their control objectives.

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2010. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of September 30, 2010. Although we identified a control deficiency in the fourth quarter of 2009 that represented a material weakness in our internal controls over financial reporting, we believe this control deficiency was remediated as of June 30, 2010.

The material weakness identified by management resulted from a lack of effective controls over the review and approval of non-routine transactions. In particular, the material weakness related to the review and approval of cost allocation billing corrections. We implemented new controls and strengthened our control documentation regarding non-routine transactions during the first quarter of 2010, and we now require all applicable departments to formally review and approve non-routine transactions prior to their finalization.

Although these controls were implemented in the first quarter of 2010, the effectiveness of these controls could not be tested until the second quarter of 2010, when a non-routine transaction occurred. The tests of our controls over non-routine transactions indicated that those controls are operating effectively.

We believe that our financial statements contained in this Form 10-Q accurately present our financial condition, results of operations and cash flows in all material respects.

*Changes in Internal Controls over Financial Reporting.* There have been no changes in our internal controls over financial reporting for the quarter ended September 30, 2010 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.



**Table of Contents****PART II.  
OTHER INFORMATION****Item 1. Legal Proceedings**

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

**Item 6. Exhibits**

Exhibits not incorporated by reference to a prior filing and filed or furnished herewith are designated by an \*. All exhibits not so designated are incorporated herein by reference to a prior filing as indicated.

**Exhibit****Number****Description of Exhibit**

*3.1	Amendment to Line Letter dated as of September 10, 2010 between Sterling Chemicals, Inc. and JPMorgan Chase Bank, N.A.
*3.2	Security Agreement dated as of September 13, 2010 between Sterling Chemicals, Inc. and JPMorgan Chase Bank, N.A.
*3.3	Pledge Agreement dated as of September 13, 2010 between Sterling Chemicals, Inc. and JPMorgan Chase Bank, N.A.
+*10.1	Fifth Amended and Restated Severance Pay Plan.
+*10.2	Sterling Chemicals, Inc. Savings and Investment Plan.
*15.1	Letter of Grant Thornton LLP regarding unaudited interim financial information.
*31.1	Rule 13a-14(a) Certification of the Chief Executive Officer.
*31.2	Rule 13a-14(a) Certification of the Principal Financial Officer.
*32.1	Section 1350 Certification of the Chief Executive Officer.
*32.2	Section 1350 Certification of the Principal Financial Officer.

+ Management contracts or compensatory plans or arrangements

\* Filed or furnished herewith

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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 9, 2010

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

Date: November 9, 2010

By /s/ DAVID J. COLLINS  
David J. Collins  
*Senior Vice President and Chief Financial  
Officer (Principal Financial Officer)*

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**EXHIBIT INDEX**

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