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STERLING CHEMICALS INC
Form 10-Q
November 13, 2003

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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, 2003

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)

76-0502
(IRS EMPLOYER IDENTIFICATION NUMBER)

1200 SMITH STREET, SUITE 1900
HOUSTON, TEXAS 77002-4312
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

(713) 650-
(REGISTRANT'S TELEPHONE NUMBER)

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

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

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

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

As of October 31, 2003, Sterling Chemicals, Inc. had 2,825,000 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

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 Securities Act of 1933, as amended, and Section 21E of the 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 be," "will continue," "will likely result," "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:

- o the cyclicity of the petrochemicals industry;
- o current and future industry conditions;
- o the potential effects of market and industry conditions and cyclicity on our business strategy, results of operations or financial position;
- o the adequacy of our liquidity;
- o our environmental management programs and safety initiatives;
- o our market sensitive financial instruments;
- o future uses of and requirements for financial resources;
- o future contractual obligations;
- o business strategy;
- o growth opportunities;
- o competitive position;
- o expected financial position;
- o future cash flows;

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- o future dividends;
- o financing plans;
- o budgets for capital and other expenditures;
- o plans and objectives of management;
- o outcomes of legal proceedings;
- o compliance with applicable laws; and
- o adequacy of insurance or indemnification.

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 forward-looking statements. Such risks and uncertainties include, among others, the following:

- o the timing and extent of changes in commodity prices;
 - o petrochemicals industry production capacity and operating rates;
 - o market conditions in the petrochemicals industry, including the supply-demand balance for our products;
 - o competition, including competitive products and pricing pressures;
 - o obsolescence of product lines;
 - o the timing and extent of changes in global economic and business conditions;
 - o increases in raw materials and energy costs, including the cost of natural gas;
 - o our ability to obtain raw materials and energy at acceptable prices, in a timely manner and on acceptable terms;
 - o regulatory initiatives and compliance with governmental regulations;
 - o compliance with environmental laws and regulations;
 - o customer preferences;
 - o the availability of skilled personnel;
 - o our ability to attract or retain high quality employees;
- i-
- o operating hazards attendant to the petrochemicals industry;
 - o casualty losses;

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- o changes in foreign, political, social and economic conditions;
- o risks of war, military operations, other armed hostilities, terrorist acts and embargoes;
- o changes in technology, which could require significant capital expenditures in order to maintain competitiveness;
- o effects of litigation;
- o cost, availability and adequacy of insurance;
- o adequacy of our sources of liquidity; and
- o 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 September 30, 2002 (our "Annual Report"), include additional factors that could adversely affect our business, results of operations and financial performance. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Certain Known Events, Trends, Uncertainties and Risk Factors" contained in our Annual Report. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements. Forward-looking statements included in this report speak only as of the date of this report and are not guarantees of future performance. Although we believe that the expectations reflected in the forward-looking statements are reasonable, no assurances can be given that such expectations will prove to have been correct. 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 forward-looking statement to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any forward-looking statement is based. 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 12, 2003, unless those statements are expressly made as of another date. We disclaim any responsibility for the correctness 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 12, 2003 or by the passage of time after such date and, except as required by applicable securities laws, we do not intend to update such information.

DOCUMENT SUMMARIES

Statements contained in this Form 10-Q describing documents and agreements 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.

AVAILABLE INFORMATION

Access to our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, amendments to those reports, and effective June 30, 2003, any beneficial ownership reports that have been electronically

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filed by our directors, officers and stockholders that own at least 10% of our capital securities, filed with or furnished to the Securities and Exchange Commission pursuant to Section 13(a) and 16(a) of the Exchange Act, may be obtained through our website (<http://www.sterlingchemicals.com>). Our website provides a hyperlink to a third-party website where these reports may be viewed and printed at no cost as soon as reasonably practicable after such materials have been electronically filed or furnished. The contents of our website are not, and shall not be deemed to be, incorporated into this report.

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STERLING CHEMICALS, INC.

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STERLING CHEMICALS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

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| | REORGANIZED STERLING | PRED STE |
|--|--|--------------------------------------|
| | ----- THREE MONTHS ENDED SEPTEMBER 30, 2003 ----- | ----- THREE M SEPTEMB ----- |
| Revenues | \$ 160,110 | \$ |
| Cost of goods sold | 153,050 | |
| | ----- | ----- |
| Gross profit | 7,060 | |
| Selling, general and administrative expenses | 3,373 | |
| Other expense (income) | 1 | |
| Reorganization items | -- | |
| Interest and debt related expenses, net of interest income (1) | 2,225 | |
| | ----- | ----- |
| Income (loss) from continuing operations before income taxes..... | 1,461 | |
| Benefit for income taxes | (74) | |
| | ----- | ----- |
| Income (loss) from continuing operations | 1,535 | |
| Loss from discontinued operations, net of tax expense | -- | |
| | ----- | ----- |
| Net income (loss) | \$ 1,535 | \$ |
| Preferred stock dividends | 1,305 | |
| | ----- | ----- |
| Net income (loss) attributable to common stockholders | \$ 230 | \$ |
| | ===== | ===== |
| Net income per share attributable to common stockholders, basic and diluted:..... | \$ 0.08 | \$ |
| | ===== | ===== |
| Weighted average shares of common stock outstanding: | | |
| Basic | 2,825 | |
| Diluted | 5,161 | |

(1) Contractual interest for the three-month period ended September 30, 2002 totaled \$29,506.

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

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| | REORGANIZED STERLING | PRE ST |
|---|---|--------------------------------------|
| | ----- NINE MONTHS ENDED SEPTEMBER 30, 2003 ----- | ----- NINE MO SEPTEMB ----- |
| Revenues | \$ 403,088 | \$ |
| Cost of goods sold | 407,452 | |
| | ----- | ----- |
| Gross profit (loss) | (4,364) | |
| Selling, general and administrative expenses | 11,966 | |
| Other income | (3,520) | |
| Reorganization items | -- | |
| Interest and debt related expenses, net of interest income (1) | 6,069 | |
| | ----- | ----- |
| Loss from continuing operations before income taxes | (18,879) | |
| Provision (benefit) for income taxes | (7,099) | |
| | ----- | ----- |
| Loss from continuing operations | (11,780) | |
| Income (loss) from discontinued operations, net of tax expense | (976) | |
| | ----- | ----- |
| Net loss | (12,756) | |
| Preferred stock dividends | 3,767 | |
| | ----- | ----- |
| Net loss attributable to common stockholders | \$ (16,523) | \$ |
| | ===== | ===== |
| Net loss per share attributable to common stockholders, basic and diluted: | \$ (5.85) | \$ |
| | ===== | ===== |
| Weighted average shares of common stock outstanding: | | |
| Basic and diluted | 2,825 | |

(1) Contractual interest for the nine-month period ended September 30, 2002 totaled \$75,617.

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

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| | REORGANIZED STERLING CHEMICALS INC | |
|---|--------------------------------------|----------------------------|
| | ----- SEPTEMBER 30, 2003 ----- | DECEMBER 31, 2002 ----- |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 38,356 | \$ |
| Accounts receivable, net | 84,076 | |
| Inventories | 50,815 | |
| Prepaid expenses | 3,918 | |
| Deferred tax asset | 12,343 | |
| Assets held for sale | -- | |
| | ----- | ----- |
| Total current assets | 189,508 | |
| Property, plant and equipment, net | 275,854 | |
| Goodwill | 48,463 | |
| Other assets | 21,191 | |
| | ----- | ----- |
| Total assets | \$ 535,016 | \$ |
| | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 44,523 | \$ |
| Accrued liabilities | 22,907 | |
| Current portion of long-term debt | -- | |
| Liabilities related to discontinued operations | -- | |
| | ----- | ----- |
| Total current liabilities | 67,430 | |
| Pre-petition liabilities - subject to compromise | -- | |
| Pre-petition liabilities - not subject to compromise | -- | |
| Long-term debt | 94,275 | |
| Deferred tax liability | 52,808 | |
| Deferred credits and other liabilities | 94,077 | |
| Redeemable preferred stock | 33,937 | |
| Commitments and contingencies (Note 7) | | |
| Stockholders' equity (deficiency in assets): | | |
| Common stock, \$.01 par value | 28 | |
| Additional paid-in capital | 206,760 | |
| Accumulated deficit | (14,299) | |
| Accumulated other comprehensive income | -- | |
| | ----- | ----- |
| Total stockholders' equity (deficiency in assets) | 192,489 | |
| | ----- | ----- |
| Total liabilities and stockholders' equity (deficiency in assets) | \$ 535,016 | \$ |
| | ===== | ===== |

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

STERLING CHEMICALS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(AMOUNTS IN THOUSANDS)
(UNAUDITED)

| | REORGANIZED STERLING |
|--|---|
| | NINE MONTHS ENDED SEPTEMBER 30, 2003 |
| Cash flows from operating activities: | |
| Net loss from continuing operations | \$ (11,780) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | |
| Depreciation and amortization | 20,224 |
| Interest amortization | 281 |
| Deferred tax benefit | (7,144) |
| Other | -- |
| Change in assets/liabilities: | |
| Accounts receivable | (42,262) |
| Inventories | (19,804) |
| Prepaid expenses | 643 |
| Other assets | (537) |
| Accounts payable | 13,310 |
| Accrued liabilities | (3,728) |
| Other liabilities | 945 |
| | ----- |
| Net cash provided by (used in) operating activities | (49,852) |
| | ----- |
| Cash flows used in investing activities: | |
| Capital expenditures | (10,634) |
| Cash flows from financing activities: | |
| Net borrowings under DIP Facility | -- |
| Net increase (decrease) in cash and cash equivalents from continuing operations | (60,486) |
| Net increase in cash and cash equivalents from discontinued operations | (976) |
| Cash and cash equivalents - beginning of period | 99,818 |
| | ----- |
| Cash and cash equivalents - end of period | \$ 38,356 |
| | ===== |
| Supplemental disclosures of cash flow information: | |
| Net interest paid | \$ 3,744 |
| Cash paid for reorganization items | 13,115 |

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

STERLING CHEMICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. BASIS OF PRESENTATION

Overview:

On July 16, 2001, Sterling Chemicals Holdings, Inc. ("Holdings"), Sterling Chemicals, Inc. and most of their U.S. subsidiaries (collectively, the "Debtors") filed voluntary petitions for reorganization under Chapter 11 ("Chapter 11") of the United States Bankruptcy Code in the U.S. Bankruptcy Court for the Southern District of Texas (the "Bankruptcy Court"). A plan of reorganization (as modified, the "Plan of Reorganization") was filed with the Bankruptcy Court on May 14, 2002 and was confirmed on November 20, 2002. On December 19, 2002, the Plan of Reorganization became effective and the Debtors emerged from bankruptcy pursuant to the terms of the Plan of Reorganization. During the period from July 16, 2001 through December 19, 2002, the Debtors operated their respective businesses as debtors-in-possession pursuant to the United States Bankruptcy Code, and the financial statements covered by this period have been presented in conformity with the American Institute of Certified Public Accountants ("AICPA")'s Statement of Position 90-7, "Financial Reporting By Entities In Reorganization Under the Bankruptcy Code" ("SOP 90-7"). In this Form 10-Q, we are referred to as "Predecessor Sterling" for periods on or before December 19, 2002 and as "Reorganized Sterling" for periods after December 19, 2002.

The filing of the Chapter 11 petitions was driven by the Debtors' inability to meet their funded debt obligations over the long-term, largely brought about by weak demand for petrochemicals products caused by declines in general worldwide economic conditions, the relative strength of the U.S. dollar (which caused their export sales to be at a competitive disadvantage) and higher raw materials and energy costs. As a result of these conditions, the Debtors incurred significant operating losses. The reorganization, effected through the bankruptcy filings, permitted the Debtors to preserve cash and gave them the opportunity to restructure their debt. As the market for our petrochemicals products remains highly cyclical, the capital structure of Reorganized Sterling has been designed with the goal of ensuring that we have sufficient liquidity during cyclical downturns in the markets for our petrochemicals products, although we cannot give any assurances that our new capital structure will provide us with sufficient liquidity over any specific period.

On December 6, 2002, Holdings was merged with and into Predecessor Sterling. Under the terms of the merger and the Plan of Reorganization, all equity interests in Holdings were cancelled upon consummation of the merger and we issued 65,000 shares of Reorganized Sterling common stock to the holders of Holdings' 13 1/2% Senior Secured Discount Notes in full payment of their claims. Upon the effectiveness of the Plan of Reorganization, Resurgence Asset Management, L.L.C., on behalf of itself and certain of its and its affiliates' managed funds and accounts (collectively, the "Investor"), paid \$30 million for certain shares of Reorganized Sterling's Series A Convertible Preferred Stock. An additional \$30 million was contributed to Reorganized Sterling at the effectiveness of the Plan of Reorganization in exchange for 2,175,000 shares of Reorganized Sterling's common stock pursuant to a rights offering made available

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to the Debtors' unsecured creditors (other than unsecured creditors of Holdings), which offering was underwritten by the Investor. In addition, upon the effectiveness of the Plan of Reorganization, the unsecured creditors of the Debtors (other than unsecured creditors of Holdings), which included holders of Predecessor Sterling's 11 1/4% Senior Subordinated Notes and 11 3/4% Senior Subordinated Notes, received pro rata shares of 11.7% of Reorganized Sterling's common stock (on a fully diluted basis assuming the conversion of all shares of Reorganized Sterling's Series A Convertible Preferred Stock into shares of Reorganized Sterling's common stock) and warrants to acquire 949,367 shares of Reorganized Sterling's common stock at an exercise price of \$52 per share (subject to adjustment).

Pursuant to the Plan of Reorganization, on December 19, 2002, the Debtors' pulp chemicals business was sold to Superior Propane, Inc. ("Superior Propane") for approximately \$373 million and the Debtors' acrylic fibers business was sold to local management of that business for nominal consideration. Approximately \$80 million of the net proceeds from the sale of the Debtors' pulp chemicals business remained with Reorganized Sterling, which continues to own and operate the Debtors' core petrochemicals business. The remaining net proceeds from the sale were paid to the holders of Predecessor Sterling's 12 3/8% Senior Secured Notes (the "12 3/8% Notes"), who also received approximately \$94.3 million in principal amount of new 10% Senior Secured Notes due 2007 issued by Reorganized Sterling (the "New Notes") in satisfaction of their claims. In addition, on December 19, 2002, Reorganized Sterling established a new revolving credit facility providing up to \$100 million in revolving credit loans (subject to borrowing base limitations) with The CIT Group/Business Credit, Inc., as administrative agent and a lender, and certain other lenders (the "New Revolver"). As of September 30, 2003, we had not borrowed any money under the New Revolver, although we had approximately \$1.3 million in letters of credit outstanding.

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For financial reporting purposes, the "Effective Date" of the Plan of Reorganization is considered to have been the close of business on December 19, 2002. Due to the Debtors' emergence from Chapter 11 and the implementation of fresh-start accounting (see Note 3), our financial results have been separately presented under the heading "Predecessor Sterling" for periods on or before December 19, 2002 and under the heading "Reorganized Sterling" for periods after December 19, 2002. Our financial statements as of and for the three and nine-month periods ended September 30, 2003 are not comparable to those of Predecessor Sterling for the same periods ended September 30, 2002. Additionally, in December 2002, we changed our fiscal year-end from September 30 to December 31.

Interim Financial Information:

In our opinion, the accompanying unaudited condensed consolidated financial statements reflect all adjustments necessary to present fairly our consolidated financial position and consolidated results of operations and cash flows for the applicable three and nine-month periods ended September 30, 2003 and September 30, 2002. All such adjustments are of a normal and recurring nature. 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. Certain amounts reported in the financial statements for the prior periods have been reclassified to conform with the current financial statement presentation with no effect on net loss or stockholders' equity (deficiency in assets).

The accompanying unaudited condensed consolidated financial statements

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should be, and are assumed to have been, read in conjunction with the consolidated financial statements and notes included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2002 (our "Annual Report"), and with the transition report on Form 10-Q/A for the three-month period ended December 31, 2002 (our "Transition Report"). The accompanying condensed consolidated balance sheet as of September 30, 2002 has been derived from the audited consolidated balance sheet as of September 30, 2002 included in our Annual Report, and the accompanying condensed consolidated balance sheet as of December 31, 2002 has been derived from the consolidated balance sheet as of December 31, 2002 included in our Transition Report. The accompanying condensed consolidated financial statements, as of September 30, 2003 and for the three and nine-month periods ended September 30, 2003 and September 30, 2002, have been reviewed by Deloitte & Touche LLP, our independent public accountants, whose report is included herein.

Recent Developments:

On November 3, 2003, a barge delivering a raw material owned by a third party capsized near the docks at our Texas City, Texas facilities. The United States Coast Guard took over responsibility for directing appropriate actions to safely address the situation. After the initial incident, the barge was secured to our docks. On November 11, 2003, the barge was righted and is currently being unloaded. Prior to being righted, the barge precluded access to our main docks, and we curtailed production of a variety of our products. Once the barge was righted, the barge was moved to a location at our facilities that permits full access to the affected docks. Due to the nature of the barge incident and the control asserted by the Coast Guard, we are unable at this time to determine whether our main docks will be closed again in connection with this incident. The barge incident may have a negative impact on our business, financial position, results of operations and cash flows if we are unable to recover our losses from the responsible parties, but we do not believe that the effect will be material. However, if access to our main docks is again restricted for an extended period, the impact on our business, financial position, results of operations and cash flows could become material.

On October 13, 2003, David G. Elkins resigned from our Board of Directors.

2. STOCK-BASED COMPENSATION PLAN

In connection with the implementation of the Plan of Reorganization, we adopted our 2002 Stock Plan. 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. Our 2002 Stock Plan may be amended or modified from time to time by our Board of Directors in accordance with its terms. We have reserved 379,747 shares of our common stock for issuance under our 2002 Stock Plan (subject to adjustment). On February 11, 2003, we granted options to purchase 348,500 shares of our common stock under our 2002 Stock Plan at an exercise price of \$31.60 per share.

We account for our stock-based compensation arrangements using the intrinsic value method in accordance with the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), and related interpretations. Under APB 25, if the exercise price of employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized. All stock options issued under our 2002 Stock Plan were granted with exercise prices at estimated fair value at the time of grant. Therefore, no compensation expense has been recognized under APB 25.

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The following table illustrates the effect on net loss and earnings per share assuming that compensation costs for stock options issued under our 2002 Stock Plan had been determined using the estimated market value at the grant dates amortized on a pro rata basis over the vesting period if calculated pursuant to Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation," for the three and nine-month periods ended September 30, 2003. There were no options outstanding under our 2002 Stock Plan prior to February 11, 2003.

| | THREE MONTHS ENDED SEPTEMBER 30, 2003 |
|---|---|
| | ----- (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) |
| Net income (loss) attributable to common stockholders, as reported | \$ 230 |
| Add: Stock-based employee compensation expense included in reported net income (loss), net of related tax effects | -- |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | 594 |
| Pro forma net loss | \$ (364) ===== |
| Earnings (loss) per share attributable to common stockholders as reported, basic and diluted:..... | \$ 0.08 |
| Pro forma loss per share attributable to common stockholders, basic and diluted: | \$ (0.13) |

3. FRESH-START ACCOUNTING

Upon our emergence from bankruptcy on December 19, 2002, we implemented fresh-start accounting under the provisions of SOP 90-7 and became a new reporting entity. Under SOP 90-7, our reorganization value was allocated to our assets and liabilities, our accumulated deficit was eliminated and new preferred and common equity was issued pursuant to the Plan of Reorganization. In connection with our Plan of Reorganization, our financial advisor, Greenhill & Co., LLC ("Greenhill") prepared a valuation of our business. In preparing its valuation, Greenhill considered a number of factors, including valuations by other parties and the application of various valuation methods, including discounted cash flow analysis, comparable company analysis and precedent transaction analysis. Based on Greenhill's valuation, the estimated reorganization value was allocated as follows (dollars in thousands):

| | |
|----------------------------|-----------|
| Long-term debt | \$ 94,275 |
| Redeemable preferred stock | 30,000 |

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| | |
|---------------------|------------|
| Stockholders'equity | 210,725 |
| | ----- |
| Total | \$ 335,000 |
| | ===== |

In connection with the cancellation of certain debt of Holdings and Predecessor Sterling pursuant to the Plan of Reorganization, on December 19, 2002 we recorded a \$457.8 million gain related to the cancellation of that debt. Also in connection with fresh-start accounting, we changed our method of accounting for periodic turnaround maintenance for our manufacturing units. We previously accrued the cost of these turnarounds in advance, but we now expense all costs for turnarounds as they are incurred. A one-time credit to reverse a \$5.2 million existing accrual for turnaround expenses was recorded as part of our fresh-start accounting transactions. A reconciliation of the adjustments recorded in connection with our debt restructuring, the adoption of fresh-start accounting and the accounting for discontinued operations at December 19, 2002 is presented below:

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| | PREDECESSOR STERLING DECEMBER 19, 2002 | DISCONTINUED OPERATIONS | REORGANIZATION ADJUSTMENTS |
|---|--|----------------------------|-------------------------------|
| | ----- | ----- | ----- |
| ASSETS | | | (dollars in thousands, u |
| Current assets: | | | |
| Cash and cash equivalents | \$ 5,839 | \$ 358,108 | \$ (274,120) |
| Accounts receivable, net | 87,435 | (35,771) | 2,226 |
| Inventories | 44,832 | (17,852) | 91 |
| Prepaid expenses | 6,658 | (1,388) | - |
| | ----- | ----- | ----- |
| Deferred tax asset | - | - | - |
| | ----- | ----- | ----- |
| Total current assets | 144,764 | 303,097 | (271,803) |
| Property, plant and equipment, net | 253,875 | (139,940) | - |
| Goodwill | - | - | - |
| Other assets | 45,212 | (6,039) | (3,027) |
| | ----- | ----- | ----- |
| Total assets | \$ 443,851 | \$ 157,118 | \$ (274,830) |
| | ===== | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | |
| Current liabilities: | | | |
| Accounts payable | \$ 45,976 | \$ (16,684) | \$ 343 |
| Accrued liabilities | 31,860 | (7,240) | 791 |
| Current portion of long-term debt | 52,327 | (10,127) | (42,200) |
| | ----- | ----- | ----- |
| Total current liabilities | 130,163 | (34,051) | (41,066) |
| Pre-petition liabilities subject to compromise | 512,760 | (2,159) | (510,601) |

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| | | | |
|---|------------|------------|--------------|
| Pre-petition liabilities not subject to compromise | 372,326 | - | (372,326) |
| Long-term debt | - | - | 94,275 |
| Deferred tax liability | 13,835 | (13,835) | - |
| Deferred credits and other liabilities | 39,189 | (15,011) | 45,970 |
| Commitments and contingencies | | | |
| Redeemable preferred stock | - | - | 30,000 |
| Stockholders' equity (deficiency in assets): | | | |
| Common stock, \$.01 par value | - | - | - |
| Additional paid-in capital | (141,786) | - | 30,000 |
| Retained earnings (accumulated deficit) | (434,465) | 188,891 | 448,918 |
| Accumulated other comprehensive income | (48,171) | 33,283 | - |
| | ----- | ----- | ----- |
| Total stockholders' equity (deficiency in assets) | (624,422) | 222,174 | 478,918 |
| | ----- | ----- | ----- |
| Total liabilities and stockholders' equity (deficiency in assets) | \$ 443,851 | \$ 157,118 | \$ (274,830) |
| | ===== | ===== | ===== |

Reorganization adjustments reflect the forgiveness of debt, including related accrued interest and certain pre-petition liabilities, in consideration for new debt and new common stock, resulting in a gain from debt restructuring of \$457.8 million, partially offset by an expense of approximately \$8.9 million for professional fees incurred in connection with the reorganization. Fresh-start adjustments primarily reflect the recording of property, plant and equipment at fair market value, the recording of a net deferred tax liability arising out of the difference between the book and tax basis of certain assets and liabilities (along with the resulting amount of goodwill recorded) and the recognition of previously unrecognized pension and other post-employment benefits liabilities.

4. DISPOSAL OF LONG LIVED ASSETS

Pursuant to the Plan of Reorganization, on December 19, 2002, the Debtors' pulp chemicals business was sold to Superior Propane for approximately \$373 million and the Debtors' acrylic fibers business was sold to local management of that business for nominal consideration. 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 the consolidated statement of operations and cash flows for Predecessor Sterling, and the assets and liabilities of these businesses have been presented separately as assets held for sale and liabilities related to discontinued operations in Predecessor Sterling's consolidated balance sheet.

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The carrying amounts of the major classes of assets held for sale and liabilities related to discontinued operations as of September 30, 2002 were as follows:

PREDECESSOR STERLING
SEPTEMBER 30, 2002
(Dollars in Thousands)

PULP CHEMICALS BUSINESS ACRYLIC FIBERS BUSINESS

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| ASSETS HELD FOR SALE: | | | |
|---|----|---------|-----------|
| Current assets | \$ | 59,109 | \$ 11,429 |
| Property, plant and equipment, net | | 138,614 | -- |
| Other assets | | 4,890 | 1,136 |
| Total | \$ | 202,613 | \$ 12,565 |
| LIABILITIES RELATED TO DISCONTINUED OPERATIONS: | | | |
| Current liabilities | | 32,080 | 2,385 |
| Deferred credits and other liabilities | | 42,390 | 13,255 |
| Total | \$ | 74,470 | \$ 15,640 |

For the three and nine-month periods ended September 30, 2002, the amount of revenue and net income (loss) (including gains or losses recorded on the sales) attributable to the discontinued operations were as follows:

| | | PREDECESSOR |
|------------------------------|----|--|
| | | THREE MONTHS ENDED SEPTEMBER 30, 2002 |
| | | (Dollar) |
| REVENUES: | | |
| Pulp chemicals business..... | \$ | 57,825 |
| Acrylic fibers business..... | | 4,782 |
| Total | \$ | 62,607 |
| NET INCOME (LOSS): | | |
| Pulp chemicals business..... | | (267) |
| Acrylic fibers business..... | | (6,514) |
| Total | \$ | (6,781) |

5. INVENTORIES

| | REORGANIZED STERLING | |
|------------------------|------------------------|-------------------|
| | SEPTEMBER 30, 2003 | DECEMBER 31, 2002 |
| | (Dollars in Thousands) | |
| Finished products..... | \$ 31,445 | \$ 12,228 |
| Raw materials..... | 14,270 | 12,259 |

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| | | |
|--|-----------|-----------|
| Inventories under exchange agreements..... | (655) | 550 |
| Stores and supplies..... | 5,755 | 5,974 |
| | \$ 50,815 | \$ 31,011 |
| | ===== | ===== |

6. LONG-TERM DEBT

Pursuant to the Plan of Reorganization, on December 19, 2002, we issued approximately \$94.3 million in principal amount of New Notes to the holders of Predecessor Sterling's 12 3/8% Notes. The New 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. The New Notes are guaranteed by Sterling Chemicals Energy, Inc. ("Sterling

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Energy"), one of our wholly owned subsidiaries. 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. The New Notes are secured by a first priority lien on our production facilities and related assets.

The New Notes bear interest at an annual rate of 10%, payable semi-annually on June 15 and December 15 of each year. Under certain circumstances, for any interest period ending on or before December 19, 2004, we may elect to pay interest on the New Notes through the issuance of additional New Notes rather than the payment of cash. However, if we pay interest through the issuance of additional New Notes rather than the payment of cash, the interest rate for the relevant period is increased to 13 3/8%. We made our first interest payment on the New Notes, in cash, during June 2003. In November 2003, we made the decision to pay the December 15, 2003 interest payment through the issuance of additional New Notes. Subject to compliance with the terms of the New Revolver, we may redeem the New Notes at any time at a redemption price of 100% of the outstanding principal amount thereof plus accrued and unpaid interest. 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 the New Notes at 101% of the outstanding principal amount thereof plus accrued and unpaid interest. We are also required to offer to repurchase the New Notes at 100% of the outstanding principal amount thereof plus accrued and unpaid interest in the event of certain other sales of assets.

The indenture governing the New 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 established the New Revolver with The CIT Group/Business Credit, Inc., as administrative agent and a lender, and certain other lenders, which provides up to \$100 million in revolving credit loans. The

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New Revolver has an initial term ending on September 19, 2007. Under the New Revolver, Reorganized Sterling and Sterling Energy are co-borrowers and are jointly and severally liable for any indebtedness thereunder. The New Revolver is secured by first priority liens on all accounts receivable, inventory and other specified assets owned by Reorganized Sterling or Sterling Energy, as well as all of the issued and outstanding capital stock of Sterling Energy.

Borrowings under the New 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 the New 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 the New Revolver). Under the New Revolver, we are also required to pay an aggregate commitment fee of 0.50% per year (payable monthly) on any unused portion of the New Revolver. Available credit under the New 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 the New Revolver must exceed outstanding borrowings thereunder by \$8 million at all times. As of September 30, 2003, total credit available under the New Revolver was limited to \$67.1 million due to these borrowing base limitations. As of September 30, 2003, we had not borrowed any money under the New Revolver, although we had approximately \$1.3 million in letters of credit outstanding, leaving unused borrowing capacity under the New Revolver of approximately \$65.8 million.

The New 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. The New Revolver also contains a covenant that requires us to earn a specified amount of earnings before interest, income taxes, depreciation and amortization on a monthly basis if, for 15 consecutive days, unused availability under the New Revolver plus cash on hand is less than \$20 million. The New 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.

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, plasticizers, sodium cyanide, disodium iminodiacetic acid ("DSIDA") and methanol, each to one customer. We also have various sales and conversion agreements that dedicate significant portions of our production of styrene and acrylonitrile to certain customers. Some of these agreements provide for cost recovery plus an agreed profit margin based upon market prices.

We are currently litigating in the Bankruptcy Court the assumption of our contracts with Monsanto Company ("Monsanto") governing the production of DSIDA and related cure costs. Until this litigation is completed, we cannot determine whether we will assume these contracts and restart the DSIDA unit or reject these contracts. In addition, Monsanto has indicated that it may seek to terminate the DSIDA contracts in the event that we assume the DSIDA contracts. As a result, we filed a motion with the

Bankruptcy Court seeking to include the issue of whether Monsanto has the right

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to terminate the DSIDA contracts following assumption. On March 26, 2003, the Bankruptcy Court held a hearing on our motion and on May 1, 2003, the Bankruptcy Court denied our motion on non-justiciability grounds. The rejection or termination of the DSIDA contracts would have a negative impact on our business, financial position, results of operations and cash flows compared to those that would be achieved if we assumed the DSIDA contracts, although we do not expect that impact to be material.

On April 24, 2003, BASF Corporation and Sunoco, Inc. announced that they had signed a letter of intent related to a proposed sale by Sunoco of its plasticizer operations in Pasadena, Texas to BASF. The proposed transaction is subject to satisfaction of certain conditions, including regulatory approval. Since 1986, we have sold all of our plasticizers production to BASF pursuant to a product sales agreement that expires at the end of 2007. We are currently evaluating the impact that this acquisition would have on our plasticizers relationship with BASF and exploring various alternatives that may be available to us related to our plasticizer operations should the transaction between BASF and Sunoco ultimately be consummated. Under certain circumstances, the BASF-Sunoco transaction could have negative effects under our product sales agreement with BASF. However, we do not believe that any such negative effects would have a material impact on our business, financial position, results of operations or cash flows.

On July 1, 2000, we, in conjunction with BP, entered into a multiyear contract with Methanex for the purchase of our respective methanol requirements from Methanex. At that time, we granted Methanex the exclusive right to acquire the output of our methanol plant, which we continue to own. Under this agreement, Methanex chose to discontinue production at our methanol plant on July 1, 2000, and to provide our methanol requirements with methanol produced in countries that have a significant advantage in the cost of natural gas, the primary raw material in the production of methanol. The initial term of these agreements expires December 31, 2003 and Methanex has elected not to renew these agreements. We are currently analyzing various alternatives for our methanol plant, however we do not expect this to have a material adverse impact on our results of operations or financial position.

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, 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 manufacturing, handling, processing, distribution and use of our products and the raw materials used to produce our products and, if so affected, our business, financial position, results of operations and cash flows may be materially and adversely affected. In addition, changes in environmental requirements can cause us to incur substantial costs in upgrading or redesigning our facility and processes, including our emission producing practices and equipment and our waste treatment, storage, disposal and other waste handling practices and equipment.

We conduct environmental management programs designed to maintain compliance with applicable environmental requirements. We routinely conduct inspection and surveillance programs designed to detect and respond to leaks or spills of regulated hazardous substances and to correct identified regulatory deficiencies. We continue to participate in Responsible Care(R) initiatives as a part of our membership in several trade groups, which are partner associations in the American Chemistry Council. Notwithstanding our efforts and beliefs, a business risk inherent with chemical operations is the potential for personal

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injury and property damage claims from employees, contractors and their employees and nearby landowners and occupants. While we believe that our business operations and facility are operated in compliance, in all material respects, with all applicable environmental, health and safety requirements, 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 or the public. Some risk of environmental costs and liabilities is inherent in our operations and products, as it is with other companies engaged in similar businesses.

In light of our historical expenditures and expected future results of operations and sources of liquidity, we believe we will have adequate resources to conduct our operations in compliance with applicable environmental and health and safety requirements. Nevertheless, we may be required to make significant site and operational modifications that are not currently contemplated in order to comply with changing facility permitting requirements and regulatory standards. Additionally, we have incurred and may continue to incur liability for investigation and cleanup of waste or contamination at our own facility or at facilities operated by third parties where we have disposed of waste. We continually review all estimates of potential environmental liabilities but can give no assurances that all potential liabilities arising out of our past or present operations have been identified or fully assessed or that the amount necessary to investigate and remediate such conditions will not be significant to us. It is our policy to make safety, environmental and replacement capital expenditures a priority in order to assist us in ensuring adequate safety and compliance at all times.

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On December 13, 2002, the Texas Commission for Environmental Quality adopted a revised State Implementation Plan (the "SIP") for compliance with the ozone provisions of the Clean Air Act. The SIP is currently being reviewed by the Environmental Protection Agency ("EPA"), which is expected to make further revisions to these rules this fall. Under the current SIP, we would be required to reduce emissions of nitrogen oxide at our Texas City, Texas facility by approximately 80%. The current rule also requires monitoring of emissions of highly reactive volatile organic carbons ("HRVOCs"), such as ethylene and propylene, by the end of 2004, and imposes a site-wide cap on emissions of HRVOCs in 2006. However, revisions to the rule are expected in the near future which would delay the monitoring requirement until the end of 2005. We believe that we would need to make between \$20 million and \$30 million in capital improvements in order to comply with these new regulations. We anticipate that the majority of these capital expenditures and other expenses would need to be incurred over a four-year period beginning January 1, 2004.

Legal Proceedings:

As previously discussed, the Debtors filed voluntary petitions for reorganization under Chapter 11 on July 16, 2001. As a result of the commencement of the Chapter 11 cases, an automatic stay was imposed against the commencement or continuation of legal proceedings against the Debtors outside of the Bankruptcy Court. Claimants with alleged claims against the Debtors were required to assert their claims in the Chapter 11 cases by timely filing a proof of claim, to which the Debtors were allowed to file an objection and seek a determination from the Bankruptcy Court as to whether such claims were allowable. Claimants who desired to liquidate their claims in legal proceedings outside of the Bankruptcy Court were required to obtain relief from the automatic stay by order of the Bankruptcy Court before doing so. If such relief was granted, the automatic stay remained in effect with respect to the

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collection of liquidated claim amounts. As a general rule, all claims against the Debtors that sought a recovery from assets of the Debtors' estates have been addressed in the Chapter 11 cases and have been or will be paid only pursuant to the terms of the Plan of Reorganization or negotiated settlements.

A number of issues remain outstanding before the Bankruptcy Court, including the allowability and classification of certain claims, the amount of rejection damages payable to some parties whose contracts were rejected in the bankruptcy proceedings and similar matters. We do not believe that the outcome of any of these issues will have a material adverse effect on our business, financial position, results of operations or cash flows, although we cannot give any assurances to that effect. In addition, as mentioned above, we are currently litigating in the Bankruptcy Court the assumption of our contracts with Monsanto governing the production of DSIDA and related cure costs.

Ethylbenzene Release. A description of this release can be found under "Legal Proceedings" in Note 9 of the "Notes to Consolidated Financial Statements" contained in our Annual Report. The two lawsuits listed below and one intervention currently involve two plaintiffs (excluding the Bobbie Adams, et al. case, which was settled), and were filed based on this release alleging personal injury, property damage and nuisance claims:

- o Zabrina Alexander, et al. v. Sterling Chemicals Holdings, Inc., et al.; Case No. 00-CV0217; In the 10th Judicial District Court of Galveston County, Texas;
- o Bobbie Adams, et al. v. Sterling Chemicals International, Inc., et al.; Case No. 00-CV0311; In the 212th Judicial District Court of Galveston County, Texas; and
- o Olivia Ellis v. Sterling Chemicals, Inc.; Case No. JC5000305; In Justice Court No. 5 of Galveston County, Texas.

The Bankruptcy Court, with our support, lifted the automatic stay for all known claims arising out of the Zabrina Alexander, et al. and Bobbie Adams, et al. cases, allowing the plaintiffs to proceed against our liability insurance policies. As a condition to the lifting of the automatic stay, these plaintiffs waived their right to seek any recoveries against us directly and must look solely to insurance proceeds to satisfy their claims. On August 18, 2003, the Bobbie Adams et al. case was settled through mediation, and an order dismissing the case was entered on September 29, 2003. We have also settled the Olivia Ellis case but still need to obtain approval of the settlement from the Bankruptcy Court, which is expected in the near future. Neither of these settlements will have a material impact on our financial statements. A Motion to Dismiss has been filed on behalf of the plaintiff in the Zabrina Alexander, et al. case, which is expected to be approved by the judge in that case in the near future.

We believe that all or substantially all of our future out-of-pocket costs and expenses relating to these lawsuits and the intervention, including settlement payments and judgments, will be covered by our liability insurance policies. We do not believe that the claims and litigation arising out of these lawsuits and the intervention will have a material adverse effect on our business, financial position, results of operations or cash flows, although we cannot give any assurances to that effect. To the extent that the lawsuits or intervention seek a recovery from assets of the Debtors' estates, the claims have been addressed in the Chapter 11 cases and have been or will be paid only pursuant to the terms of the Plan of Reorganization or a negotiated settlement.

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Other Claims:

We are subject to various other claims and legal actions that arise in the ordinary course of our business. Claims and legal actions against the Debtors that existed as of the Chapter 11 filing date are subject to the discharge injunction provided for in the Plan of Reorganization, and recoveries sought thereon from assets of the Debtors are subject to the terms of the Plan of Reorganization.

8. NEW ACCOUNTING STANDARDS

In May 2003, the Financial Accounting Standards Board (the "FASB") issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 is intended to result in more consistent reporting of contracts as either freestanding derivative instruments subject to SFAS No. 133 in its entirety, or as hybrid instruments with debt host contracts and embedded derivative features. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003. The adoption of SFAS No. 149 did not have an impact on our financial statements.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." SFAS No. 150 requires certain financial instruments that embody obligations of the issuer and have characteristics of both liabilities and equity to be classified as liabilities. SFAS No. 150 is effective for all financial instruments created or modified after May 31, 2003 and to other instruments at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 did not have an impact on our financial statements.

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INDEPENDENT ACCOUNTANTS' REPORT

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 subsidiaries (the "Company") as of September 30, 2003 (Successor Company balance sheet), and the related condensed consolidated statements of operations and cash flows for the three and nine-month periods ended September 30, 2003 (Successor Company operations) and for the three and nine-month periods ended September 30, 2002 (Predecessor Company operations). These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. 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 auditing standards generally accepted in the United States of America, 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.

As discussed in Note 1 to the financial statements, on November 20, 2002, the Bankruptcy Court entered an order confirming the plan of reorganization which became effective after the close of business on December 19, 2002. Accordingly, the accompanying financial statements have been prepared in conformity with

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AICPA Statement of Position 90-7, "Financial Reporting for Entities in Reorganization Under the Bankruptcy Code," for the Successor Company as a new entity with assets, liabilities, and a capital structure having carrying values not comparable with prior periods as described in Notes 1 and 3.

Based on our review, 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 auditing standards generally accepted in the United States of America, the consolidated balance sheets of the Company as of September 30, 2002 (Predecessor Company balance sheet), and the related consolidated statements of operations, stockholders' equity (deficiency in assets), and cash flows for the year then ended (not presented herein) (Predecessor Company operations); and in our report dated December 13, 2002, we expressed an unqualified opinion on those consolidated financial statements and included an explanatory paragraph concerning matters that raise substantial doubt about the Company's ability to continue as a going concern. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of September 30, 2002 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 12, 2003

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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.

OVERVIEW

On July 16, 2001, Sterling Chemicals Holdings, Inc. ("Holdings"), Sterling Chemicals, Inc. and most of their U.S. subsidiaries (collectively, the "Debtors") filed voluntary petitions for reorganization under Chapter 11 ("Chapter 11") of the United States Bankruptcy Code in the U.S. Bankruptcy Court for the Southern District of Texas (the "Bankruptcy Court"). A plan of reorganization (as modified, the "Plan of Reorganization") was filed with the Bankruptcy Court on May 14, 2002 and was confirmed on November 20, 2002. On December 19, 2002, the Plan of Reorganization became effective and the Debtors emerged from bankruptcy pursuant to the terms of the Plan of Reorganization. During the period from July 16, 2001 through December 19, 2002, the Debtors operated their respective businesses as debtors-in-possession pursuant to the United States Bankruptcy Code, and the financial statements covered by this period have been presented in conformity with the American Institute of Certified Public Accountants ("AICPA")'s Statement of Position 90-7, "Financial Reporting By Entities In Reorganization Under the Bankruptcy Code" ("SOP 90-7"). In this Form 10-Q, we are referred to as "Predecessor Sterling" for periods on or before December 19, 2002 and as "Reorganized Sterling" for periods after December 19, 2002.

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The filing of the Chapter 11 petitions was driven by the Debtors' inability to meet their funded debt obligations over the long-term, largely brought about by weak demand for petrochemicals products caused by declines in general worldwide economic conditions, the relative strength of the U.S. dollar (which caused their export sales to be at a competitive disadvantage) and higher raw materials and energy costs. As a result of these conditions, the Debtors incurred significant operating losses. The reorganization, effected through the bankruptcy filings, permitted the Debtors to preserve cash and gave them the opportunity to restructure their debt. As the market for our petrochemicals products remains highly cyclical, the capital structure of Reorganized Sterling has been designed with the goal of ensuring that we have sufficient liquidity during cyclical downturns in the markets for our petrochemicals products, although we cannot give any assurances that our new capital structure will provide us with sufficient liquidity over any specific period.

On December 6, 2002, Holdings was merged with and into Predecessor Sterling. Under the terms of the merger and the Plan of Reorganization, all equity interests in Holdings were cancelled upon consummation of the merger and we issued 65,000 shares of Reorganized Sterling common stock to the holders of Holdings' 13 1/2% Senior Secured Discount Notes in full payment of their claims. Upon the effectiveness of the Plan of Reorganization, Resurgence Asset Management, L.L.C., on behalf of itself and certain of its and its affiliates' managed funds and accounts (collectively, the "Investor"), paid \$30 million for certain shares of Reorganized Sterling's Series A Convertible Preferred Stock. An additional \$30 million was contributed to Reorganized Sterling at the effectiveness of the Plan of Reorganization in exchange for 2,175,000 shares of Reorganized Sterling's common stock pursuant to a rights offering made available to the Debtors' unsecured creditors (other than unsecured creditors of Holdings), which offering was underwritten by the Investor. In addition, upon the effectiveness of the Plan of Reorganization, the unsecured creditors of the Debtors (other than unsecured creditors of Holdings), which included holders of Predecessor Sterling's 11 1/4% Senior Subordinated Notes and 11 3/4% Senior Subordinated Notes, received pro rata shares of 11.7% of Reorganized Sterling's common stock (on a fully diluted basis assuming the conversion of all shares of Reorganized Sterling's Series A Convertible Preferred Stock into shares of Reorganized Sterling's common stock) and warrants to acquire 949,367 shares of Reorganized Sterling's common stock at an exercise price of \$52 per share (subject to adjustment).

Pursuant to the Plan of Reorganization, on December 19, 2002 the Debtors' pulp chemicals business was sold to Superior Propane, Inc. ("Superior Propane") for approximately \$373 million and the Debtors' acrylic fibers business was sold to local management of that business for nominal consideration. In accordance with Statement of Financial Accounting Standards ("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 the condensed consolidated statements of operations and cash flows for Predecessor Sterling, and the assets and liabilities of these businesses have been presented separately as assets held for sale and liabilities related to discontinued operations in Predecessor Sterling's condensed consolidated balance sheet. Approximately \$80 million of the net proceeds from the sale of the Debtors' pulp chemicals business remained with Reorganized Sterling, which continues to own and operate the Debtors' core petrochemicals business. The remaining net proceeds from the sale were paid to the holders of Predecessor Sterling's 12 3/8% Senior Secured Notes (the "12 3/8% Notes"), who also received approximately \$94.3 million in principal amount of new 10% Senior Secured Notes due 2007 issued by Reorganized Sterling (the "New Notes") in satisfaction of their claims. In addition, on December 19, 2002, Reorganized Sterling established a new revolving credit facility providing up to \$100 million in revolving credit loans (subject to borrowing base limitations) with The CIT Group/Business Credit, Inc., as administrative agent and a lender, and certain other lenders (the "New Revolver"). As of September 30, 2003, we had

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not borrowed any money under the New Revolver, although we had approximately \$1.3 million in letters of credit outstanding.

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For financial reporting purposes, the "Effective Date" of the Plan of Reorganization is considered to have been the close of business on December 19, 2002. Due to the Debtors' emergence from Chapter 11 and the implementation of fresh-start accounting (see Note 3 to the condensed consolidated financial statements included in Item 1 of Part 1 of this report), our financial results have been separately presented under the heading "Predecessor Sterling" for periods on or before December 19, 2002 and under the heading "Reorganized Sterling" for periods after December 19, 2002. Our financial statements for the three and nine-month periods ended September 30, 2003 are not comparable to those of Predecessor Sterling for the same periods ended September 30, 2002. Additionally, in December 2002, we changed our fiscal year-end from September 30 to December 31.

RECENT DEVELOPMENTS

In June 2003, we began the process of restarting the acrylonitrile unit at our Texas City facility, which had been shut down since February 2001. We completed the restart of two of the three reactors of the acrylonitrile unit in July 2003, and completed the restart of the third reactor in August 2003. In addition, in June 2003, we entered into an expanded acrylonitrile relationship agreement with BP Chemicals Inc. ("BP"). Our acrylonitrile relationship with BP is governed by a variety of documents, including a Production Agreement, under which BP has the right, but not the obligation, to purchase acrylonitrile from us up to a specified percentage of our annual rated production capacity, and a Joint Venture Agreement, pursuant to which we and BP formed ANEXCO, LLC, a 50/50 joint venture that markets all of the parties' respective sales of acrylonitrile everywhere in the world other than the United States, Canada, Mexico, Turkey and the European Union. Under the Production Agreement, BP furnishes the necessary raw materials and pays us a conversion fee for any acrylonitrile it elects to purchase, and reimburses us for a specified portion of our fixed costs related to acrylonitrile production irrespective of whether BP purchases any acrylonitrile under the Production Agreement. Under the expanded acrylonitrile relationship agreement, BP's right to purchase acrylonitrile from us under the Production Agreement was significantly increased and the Joint Venture Agreement was modified in a manner that, together with the modifications to the Production Agreement, is intended to provide us with the ability to operate our acrylonitrile facility at optimal three-reactor rates throughout the acrylonitrile market cycles.

In addition, in July 2003, we entered into a new sodium cyanide supply agreement with E.I. du Pont de Nemours and Company ("DuPont") which allows us to enhance the value of hydrogen cyanide produced as a by-product from our acrylonitrile operations. The sodium cyanide plant, which is located at our Texas City facility but is owned by DuPont, was restarted in August 2003. The sodium cyanide plant had been shut down since February 2001.

On April 24, 2003, BASF Corporation and Sunoco, Inc. ("Sunoco") announced that they had signed a letter of intent related to a proposed sale by Sunoco of its plasticizer operations in Pasadena, Texas to BASF. The proposed transaction is subject to satisfaction of certain conditions, including regulatory approval. Since 1986, we have sold all of our plasticizers production to BASF pursuant to a product sales agreement that expires at the end of 2007. We are currently evaluating the impact that this acquisition would have on our plasticizers relationship with BASF and exploring various alternatives that may be available to us related to our plasticizer operations should the transaction between BASF and Sunoco ultimately be consummated. Under certain circumstances,

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the BASF-Sunoco transaction could have negative effects under our product sales agreement with BASF. However, we do not believe that any such negative effects would have a material impact on our business, financial position, results of operations or cash flows.

On November 3, 2003, a barge delivering a raw material owned by a third party capsized near the docks at our Texas City, Texas facilities. The United States Coast Guard took over responsibility for directing appropriate actions to safely address the situation. After the initial incident, the barge was secured to our docks. On November 11, 2003, the barge was righted and is currently being unloaded. Prior to being righted, the barge precluded access to our main docks, and we curtailed production of a variety of our products. Once the barge was righted, the barge was moved to a location at our facilities that permits full access to the affected docks. Due to the nature of the barge incident and the control asserted by the Coast Guard, we are unable at this time to determine whether our main docks will be closed again in connection with this incident. The barge incident may have a negative impact on our business, financial position, results of operations and cash flows if we are unable to recover our losses from the responsible parties, but we do not believe that the effect will be material. However, if access to our main docks is again restricted for an extended period, the impact on our business, financial position, results of operations and cash flows could become material.

On October 13, 2003, David G. Elkins resigned from our Board of Directors.

RESULTS OF OPERATIONS

THREE MONTHS ENDED SEPTEMBER 30, 2003 COMPARED TO THREE MONTHS ENDED SEPTEMBER 30, 2002

Revenues, Cost of Goods Sold and Net Loss

Our revenues were approximately \$160.1 million for the three-month period ended September 30, 2003, compared to Predecessor Sterling's approximately \$117.8 million in revenues for the three-month period ended September 30, 2002. This

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increase in revenues was primarily due to the restart of our acrylonitrile facility at the end of the second quarter of 2003 and increased revenues from our styrene operations. We recorded net income attributable to common stockholders of approximately \$0.2 million for the three-month period ended September 30, 2003, compared to a net loss attributable to common stockholders of approximately \$12.9 million that Predecessor Sterling recorded for the same period in 2002. This improvement in net earnings was primarily due to the exclusion in the quarter ending September 30, 2003 of reorganization items associated with Predecessor Sterling's bankruptcy proceedings and a reduction in interest expense due to our significantly lower long-term indebtedness following our emergence from bankruptcy.

Revenues from our styrene operations were approximately \$110.0 million for the quarter ended September 30, 2003, or an increase of approximately 18% from Predecessor Sterling's approximately \$93.1 million in revenues from these operations for the quarter ended September 30, 2002. This increase in revenues from our styrene operations resulted primarily from increased sales of ethylbenzene, an intermediate product we produce from ethylene and benzene and then typically convert into styrene. Our total sales volumes of styrene for the quarter ended September 30, 2003 decreased approximately 3% from those realized by Predecessor Sterling during the quarter ended September 30, 2002. Direct

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sales prices for styrene during the quarter ended September 30, 2003 remained consistent with those realized during the quarter ended September 30, 2002. During the quarter ended September 30, 2003, the prices we paid for benzene and ethylene, the two primary raw materials required for styrene, both increased approximately 12% from the prices we paid for these products in the quarter ended September 30, 2002. The average price we paid for natural gas for the quarter ended September 30, 2003 increased approximately 54% compared to the average price we paid for natural gas during the quarter ended September 30, 2002. With the continued rise of raw material and natural gas prices, margins on our styrene sales for the quarter ended September 30, 2003 decreased from those realized by Predecessor Sterling during the quarter ended September 30, 2002.

Our acrylonitrile unit is now operational and we are producing at planned rates. Revenues from the acrylonitrile unit were \$21.2 million in the third quarter ended September 30, 2003 compared to the \$1.5 million in revenues earned in the quarter ended September 30, 2002 when our unit was shut down.

Revenues from our other petrochemicals operations, including acetic acid, plasticizers and methanol, were approximately \$28.9 million for the quarter ended September 30, 2003, an increase of approximately 19% from the approximately \$24.3 million in revenues received by Predecessor Sterling from these operations during the quarter ended September 30, 2002. This increase in revenues resulted primarily from higher prices for acetic acid and plasticizers.

Selling, General and Administrative ("SG&A") Expenses

Our SG&A expenses for the three-month period ended September 30, 2003 were approximately \$3.4 million compared to Predecessor Sterling's approximately \$4.9 million in SG&A expenses for the three-month period ended September 30, 2002. This decrease was largely due to our successful cost reduction efforts.

Reorganization Items

We did not incur any reorganization items during the three-month period ended September 30, 2003, because we emerged from bankruptcy prior to the beginning of the year. In the three-month period ended September 30, 2002, we recorded \$4.1 million in reorganization items, which consisted primarily of professional fees incurred in connection with the Debtors' Chapter 11 proceedings.

Interest Expense

Our total interest expense of approximately \$2.2 million for the quarter ended September 30, 2003 was substantially lower than the approximately \$16.2 million in interest expense we recorded for the quarter ended September 30, 2002, primarily due to the cancellation of our pre-existing senior secured debt upon our emergence from bankruptcy.

NINE MONTHS ENDED SEPTEMBER 30, 2003 COMPARED TO NINE MONTHS ENDED SEPTEMBER 30, 2002

Revenues, Cost of Goods Sold and Net Loss

Our revenues were approximately \$403.1 million for the nine-month period ended September 30, 2003, compared to Predecessor Sterling's approximately \$316.2 million in revenues during the nine-month period ended September 30, 2002. This increase in revenues resulted primarily from the restart of our acrylonitrile facility during 2003 and an increase in styrene sales prices. We recorded a net loss attributable to common stockholders of approximately \$16.5 million for the nine-month period ended September 30, 2003, compared to the net loss attributable to common stockholders of approximately \$21.3 million that Predecessor Sterling recorded for the same period in 2002.

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This improvement in net earnings was primarily due to the absence of

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reorganization items associated with Predecessor Sterling's bankruptcy proceedings during the nine-month period ending September 30, 2003 and a reduction in interest expense due to our significantly lower long-term indebtedness following our emergence from bankruptcy.

Revenues from our styrene operations were approximately \$289.5 million for the nine-month period ended September 30, 2003, an increase of approximately 23% from Predecessor Sterling's approximately \$235.6 million in revenues from these operations for the same period ended September 30, 2002. This increase in revenues from our styrene operations was primarily due to higher sales prices during the first nine months of 2003 compared to those realized during the first nine months of 2002. Our total sales volumes for styrene during the nine-month period ended September 30, 2003 decreased approximately 24% from those realized by Predecessor Sterling during the nine-month period ended September 30, 2002, primarily due to reduced overall demand in the styrene market. Direct sales prices for styrene in the nine-month period ended September 30, 2003 increased approximately 28% compared to those realized during the nine-month period ended September 30, 2002. During the nine-month period ended September 30, 2003, prices for benzene and ethylene, the two primary raw materials required for styrene, also increased approximately 35% and 26%, respectively, from the prices paid for these products in the nine-month period ended September 30, 2002. The average price we paid for natural gas for the nine-month period ended September 30, 2003 increased approximately 87% compared to the average price we paid for natural gas during the nine-month period ended September 30, 2002. Margins on our styrene sales for the nine-month period ended September 30, 2003 decreased from those realized by Predecessor Sterling during the nine-month period ended September 30, 2002, as the higher costs for benzene, ethylene and natural gas more than offset the increase in direct sales prices.

Our acrylonitrile unit is now operational and we are producing at planned rates. Revenues from the acrylonitrile unit were \$25.8 million in the nine months ended September 30, 2003, primarily in the third quarter of 2003, compared to the \$5.1 million in revenues earned during the nine-month period ended September 30, 2002 when our acrylonitrile unit was shut down.

Revenues from our other petrochemicals operations, including acetic acid, plasticizers and methanol, were approximately \$87.8 million for the nine-month period ended September 30, 2003, an increase of approximately 15% from the approximately \$76.5 million in revenues received by Predecessor Sterling from these operations during the nine-month period ended September 30, 2002. This increase in revenues was primarily due to higher prices for acetic acid and increased revenues from our methanol relationship with Methanex Corporation, which expires at the end of 2003.

SG&A Expenses

Our SG&A expenses for the nine-month period ended September 30, 2003 were approximately \$12.0 million, whereas Predecessor Sterling's SG&A expenses for the nine-month period ended September 30, 2003 were approximately \$10.6 million. This increase in SG&A expenses was primarily due to the inclusion in the current period of bankruptcy related professional fees that were classified as reorganization items during the nine-month period ended September 30, 2002 pursuant to SOP 90-7, and ongoing matters related to our recent emergence from bankruptcy, including litigation related to the possible assumption of our DSIDA contracts with Monsanto, final determinations as to the classification and

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allowed amount of disputed claims, final determinations of the amount of rejection damages assessed for contracts we rejected in our bankruptcy proceedings and continuing filing obligations with the Bankruptcy Court (see Note 7 to the consolidated financial statements included in Item 1 of Part 1 of this report).

Other Income

Our other income for the nine-month period ended September 30, 2003 was approximately \$3.5 million, consisting of a Texas sales tax refund of approximately \$3.7 million which was offset by other expense of \$0.2 million.

Reorganization Items

We did not incur any reorganization items during the nine-month period ended September 30, 2003, because we emerged from bankruptcy prior to the beginning of the year and items previously recorded as reorganization items were included in SG&A. In the nine-month period ended September 30, 2002, we recorded \$13.4 million in reorganization items, which consisted primarily of professional fees incurred in connection with the Debtors' Chapter 11 proceedings.

Interest Expense

Our total interest expense of approximately \$6.1 million for the nine-month period ended September 30, 2003 was substantially lower than the approximately \$38.7 million in interest expense we recorded for the same period ended September 30, 2002, primarily due to the cancellation of our pre-existing senior secured debt upon our emergence from bankruptcy.

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Provision (Benefit) for Income Taxes

During the nine-month period ended September 30, 2003, we recorded an approximate \$7.1 million benefit for income taxes compared to a less than \$0.1 million provision for income taxes for the nine-month period ended September 30, 2002. In 2003 we recorded a benefit for tax losses versus the full valuation allowance that was recorded in 2002.

LIQUIDITY AND CAPITAL RESOURCES

Pursuant to the Plan of Reorganization, on December 19, 2002, we issued approximately \$94.3 million in principal amount of New Notes to the holders of Predecessor Sterling's 12 3/8% Notes. The New 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. The New Notes are guaranteed by Sterling Chemicals Energy, Inc. ("Sterling Energy"), one of our wholly owned subsidiaries. Sterling Energy's guaranty ranks equally in right of payment with all its existing and future senior indebtedness and senior in right of payment to all of its existing and future subordinated indebtedness. The New Notes and Sterling Energy's guaranty are secured by a first priority lien on all of our production facilities and related assets.

The New Notes bear interest at an annual rate of 10%, payable semi-annually on June 15 and December 15 of each year. Under certain circumstances, for any interest period ending on or before December 19, 2004, we may elect to pay interest on the New Notes through the issuance of additional New Notes rather than the payment of cash. However, if we pay interest through the issuance of additional New Notes rather than the payment of cash, the

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interest rate for the relevant period is increased to 13 3/8%. We made our first interest payment on the New Notes, in cash, during June 2003. In November 2003, we made the decision to pay the December 15, 2003 interest payment through the issuance of additional New Notes. Subject to compliance with the terms of the New Revolver, we may redeem the New Notes at any time at a redemption price of 100% of the outstanding principal amount thereof plus accrued and unpaid interest. 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 the New Notes at 101% of the outstanding principal amount thereof plus accrued and unpaid interest. We are also required to offer to repurchase the New Notes at 100% of the outstanding principal amount thereof plus accrued and unpaid interest in the event of certain other sales of assets.

The indenture governing the New 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 established the New Revolver with The CIT Group/Business Credit, Inc., as administrative agent and a lender, and certain other lenders which provides up to \$100 million in revolving credit loans. The New Revolver has an initial term ending on September 19, 2007. Under the New Revolver, Reorganized Sterling and Sterling Energy are co-borrowers and are jointly and severally liable for any indebtedness thereunder. The New Revolver is secured by first priority liens on all accounts receivable, inventory and other specified assets owned by Reorganized Sterling or Sterling Energy, as well as all of the issued and outstanding capital stock of Sterling Energy.

Borrowings under the New 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 the New 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 the New Revolver). Under the New Revolver, we are also required to pay an aggregate commitment fee of 0.50% per year (payable monthly) on any unused portion of the New Revolver. Available credit under the New 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 the New Revolver must exceed outstanding borrowings thereunder by \$8 million at all times. As of September 30, 2003, the total credit available under the New Revolver was \$67.1 million due to borrowing base limitations. As of September 30, 2003, we had not borrowed any money under the New Revolver, although we had approximately \$1.3 million in letters of credit outstanding, leaving unused borrowing capacity under the New Revolver of approximately \$65.8 million.

The New 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. The New Revolver also contains a covenant that requires us to earn a specified amount of earnings before interest, income taxes, depreciation and amortization on a monthly basis if, for 15 consecutive days, unused availability under the New Revolver plus cash on hand is less than \$20 million. The New 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 (which includes cash and cash equivalents plus total credit available under the New Revolver, subject to the conditions to borrowings under the New Revolver) decreased by \$2.1 million to \$104.2 million during the third quarter of 2003. A decrease in cash and cash equivalents during the period was offset by increases in accounts receivable and inventory due primarily to the startup of our acrylonitrile unit which accounted for approximately \$29.4 million. We believe that our cash on hand, together with credit available under the New Revolver and other internally generated funds, will be sufficient to meet our liquidity needs for the reasonably foreseeable future, although we cannot give any assurances to that effect.

Working Capital

Our working capital at September 30, 2003 was approximately \$122.1 million, a decrease from our working capital of approximately \$131.3 million on December 31, 2002. This decrease in working capital was primarily due to a reduction in cash and cash equivalents and accrued liabilities, which was partially offset by increases in accounts receivable, inventories and accounts payable.

Cash Flow

Net cash used in our operations was approximately \$49.9 million during the nine-month period ended September 30, 2003, whereas net cash provided by Predecessor Sterling's operations during the nine-month period ended September 30, 2002 was approximately \$6.0 million. This increase in cash used in our operations was primarily due to an increase in accounts receivable and inventories, partially offset by an increase in accounts payable. Net cash flow used in our investing activities, which primarily relates to capital expenditures, was approximately \$10.6 million during the nine-month period ended September 30, 2003, whereas net cash flow used in Predecessor Sterling's investing activities during the nine-month period ended September 30, 2002 was approximately \$5.4 million. We did not record any cash from financing activities during the nine-month period ended September 30, 2003, whereas Predecessor Sterling recorded net cash from financing activities of approximately \$5.8 million during the nine-month period ended September 30, 2002, which related to borrowings under our debtor-in-possession credit facility during our bankruptcy proceedings.

Capital Expenditures

Our capital expenditures were approximately \$10.6 million during the nine-month period ended September 30, 2003, whereas Predecessor Sterling's capital expenditures during the nine-month period ended September 30, 2002 were approximately \$5.4 million. This increase in capital expenditures in the nine-month period ended September 30, 2003 was primarily related to capital projects associated with the restart of our acrylonitrile facility. During the remainder of 2003, capital expenditures are anticipated to be approximately \$5 to \$10 million, primarily for routine safety, environmental and equipment replacement matters.

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, management reviews its estimates, including those related to the allowance for doubtful accounts, recoverability of

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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.

NEW ACCOUNTING STANDARDS

In May 2003, the Financial Accounting Standards Board (the "FASB") issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 is intended to result in more consistent reporting of contracts as either freestanding derivative instruments subject to Statement 133 in its entirety, or as hybrid instruments with debt host contracts and embedded derivative features. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003. The adoption of SFAS No. 149 did not have an impact on our financial statements.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." SFAS No. 150 requires certain financial instruments that embody obligations of the issuer and have characteristics of both liabilities and equity to be classified as liabilities. SFAS No. 150 is effective for all financial instruments created or modified after May 31, 2003 and to other instruments at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 did not have an impact on our financial statements.

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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. Due to the sale of our pulp chemicals business, which had significant operations in Canada, we are no longer susceptible to market risk exposure related to those operations in the form of currency exchange rate movements. Additionally, we do not currently have exposure to changing U.S. interest rates, as there are no draws outstanding under our New Revolver; however, the fair value of the New Notes may vary in response to changing interest rates.

ITEM 4. CONTROLS AND PROCEDURES

We carried out an evaluation, as of the end of the period covered by this report, 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 (as defined in Exchange Act Rule 13a-15(e)). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are adequate to ensure that information we are required to disclose in reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

In connection with our evaluation, no change was identified in our internal control over financial reporting that occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits: The following exhibits are filed 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 the Company's 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 the Company's Form 8-K filed on November 26, 2002). |
| 2.3 | - First Modification to Amendment to Joint Plan of Reorganization of Sterling Chemicals Holdings, Inc., et al., dated November 18, 2002 (incorporated by reference from Exhibit 2.2 to the Company's Form 8-K filed on November 26, 2002). |
| 3.1 | - Amended and Restated Certificate of Incorporation of Sterling Chemicals, Inc. (incorporated by reference from Exhibit 3.1 to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2002). |
| 3.2 | - Certificate of Designations, Preferences, Rights and Limitations of Series A Convertible Preferred Stock of Sterling Chemicals, Inc. (incorporated by reference from Exhibit 4 to the Company's Registration Statement on Form 8-A filed on December 19, 2002). |
| 3.3 | - Restated Bylaws of Sterling Chemicals, Inc. (incorporated by reference from Exhibit 3.3 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2003). |
| **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 |

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- **32.1 - Section 1350 Certification of the Chief Executive Officer
- **32.2 - Section 1350 Certification of the Chief Financial Officer
- **99.1 - Amended and Restated Audit Committee Charter

** Filed or furnished herewith

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(b) Reports on Form 8-K.

1. On July 7, 2003, we filed a Current Report on Form 8-K reporting Items 5 and 7 related to the restart of our acrylonitrile facility in June 2003.

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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 12, 2003

/s/ RICHARD K. CRUMP

Richard K. Crump
President and
Chief Executive Officer

Date: November 12, 2003

/s/ PAUL G. VANDERHOVEN

Paul G. Vanderhoven
Senior Vice President-Finance
and Chief Financial Officer
(Principal Financial Officer)

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