

SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **1994-05-13** | Period of Report: **1994-03-31**  
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FILER

**STERLING CHEMICALS INC**

CIK: **795662** | IRS No.: **760185186** | State of Incorpor.: **DE** | Fiscal Year End: **0930**  
Type: **10-Q** | Act: **34** | File No.: **001-10059** | Film No.: **94527899**  
SIC: **2860** Industrial organic chemicals

Business Address  
1200 SMITH ST, SUITE 1900  
HOUSTON TX 77002-4312  
7136503700

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

(Mark One)

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

For the quarterly period ended March 31, 1994

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 1-10059

STERLING CHEMICALS, INC.

-----  
(Exact name of registrant as specified in its charter)

Delaware

76-0185186

-----  
(State or other jurisdiction of  
incorporation or organization)

-----  
(I.R.S. Employer  
Identification Number)

1200 Smith Street, Suite 1900, Houston, Texas

77002-4312

-----  
(Address of Principal Executive Offices)

-----  
(Zip Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No  /

As of May 3, 1994, the number of shares of common stock outstanding was 55,659,958.

Page 1 of \_\_\_\_

## Part I. - FINANCIAL INFORMATION

## Item 1. - FINANCIAL STATEMENTS

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&lt;TABLE&gt;

&lt;CAPTION&gt;

STERLING CHEMICALS, INC.

CONDENSED CONSOLIDATED BALANCE SHEET

(In Thousands Except Per Share Data)

(Unaudited)

	March 31, 1994	September 30, 1993
	----- <C>	----- <C>
 <S>		
ASSETS		
-----		
Current assets:		
Cash and cash equivalents	\$ 108	\$ 1,352
Accounts receivable	111,999	74,553
Inventories	58,960	60,328
Prepaid expenses	3,392	4,632
Deferred income taxes	4,152	3,856
	-----	-----
Total current assets	178,611	144,721
Property, plant and equipment, net	297,457	314,315
Other assets	77,333	80,669
	-----	-----
Total assets	\$553,401	\$539,705
	=====	=====

## LIABILITIES AND STOCKHOLDERS' EQUITY

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Current liabilities:

Accounts payable	\$ 59,707	\$ 42,241
Accrued liabilities	41,055	43,513
Current portion of long-term debt	29,300	28,015
	-----	-----

Total current liabilities	130,062	113,769
---------------------------	---------	---------

Long-term debt	250,845	256,845
Deferred income taxes	43,673	36,098
Deferred credits and other liabilities	63,942	62,657

Commitments and contingencies

Stockholders' equity:

Common stock, \$.01 par value		
150,000 shares authorized,		
60,327 and 60,325 shares issued		
and 55,637 and 55,435 shares		

outstanding, respectively	603	603
Additional paid-in capital	33,355	34,708
Retained earnings	104,211	105,871
Pension adjustment	(1,297)	(1,297)
Accumulated translation adjustment	(20,872)	(16,184)
Deferred compensation	(102)	(164)
	-----	-----
	115,898	123,537
Treasury stock at cost, 4,690 and 4,891 shares, respectively	(51,019)	(53,201)
	-----	-----
Total stockholders' equity	64,879	70,336
	-----	-----
Total liabilities and stockholders' equity	\$553,401	\$539,705
	=====	=====

<FN>

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

</TABLE>

<TABLE>

<CAPTION>

STERLING CHEMICALS, INC.

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS

(In Thousands Except Per Share Data)

(Unaudited)

	Three Months Ended March 31,		Six Months Ended March 31,	
	-----	-----	-----	-----
	1994	1993	1994	1993
	-----	-----	-----	-----
	<C>	<C>	<C>	<C>
<S> Revenues	\$154,754	\$113,045	\$285,313	\$250,834
Cost of goods sold	139,948	104,426	267,537	229,090
	-----	-----	-----	-----
Gross profit	14,806	8,619	17,776	21,744
Selling, general and administrative expenses	6,996	6,955	12,197	13,153
Interest and debt related expenses, net of interest income	5,394	5,725	10,605	11,361

Other income	-	-	2,606	-
	-----	-----	-----	-----
Income (loss) before income taxes	2,416	(4,061)	(2,420)	(2,770)
Provision (benefit) for income taxes	587	(1,475)	(760)	(263)
	-----	-----	-----	-----
Net income (loss)	\$ 1,829	\$ (2,586)	\$ (1,660)	\$ (2,507)
	=====	=====	=====	=====
Per share data:				
Net income (loss)	\$ .03	\$ (.05)	\$ (.03)	\$ (.05)
	=====	=====	=====	=====
Dividends declared per share	\$ -	\$ .02	\$ -	\$ .04
	=====	=====	=====	=====
Weighted average shares outstanding	55,605	55,248	55,553	55,170
	=====	=====	=====	=====

<FN>

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

</TABLE>

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<CAPTION>

STERLING CHEMICALS, INC.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(In Thousands)

(Unaudited)

	Six Months Ended March 31,	
	1994	1993
	-----	-----
	<C>	<C>
<S>		
Cash flows from operating activities:		
Cash received from customers	\$281,936	\$269,839
Miscellaneous cash receipts	4,542	3,162
Cash paid to suppliers and employees	(279,183)	(252,869)
Interest paid	(9,310)	(10,752)
Interest received	12	45
Income taxes paid	(147)	-

Net cash provided by (used in) operating activities	(2,150)	9,425
Cash flows from investing activities:		
Capital expenditures	(4,124)	(7,868)
Retirement of fixed assets	(363)	(1,050)
Proceeds from joint venture distribution	1,350	1,545
Proceeds from sale of assets	2,606	-
Net cash used in investing activities	(531)	(7,373)
Cash flows from financing activities:		
Net change in revolving debt	16,152	8,793
Scheduled payments on long-term debt	(14,831)	(8,302)
Proceeds from sale of common stock	-	203
Dividends paid	-	(2,207)
Other	106	(119)
Net cash provided by (used in) financing activities	1,427	(1,632)
Effect of exchange rate on cash	10	(55)
Net increase (decrease) in cash and cash equivalents	(1,244)	365
Cash and cash equivalents - beginning of period	1,352	2,625
Cash and cash equivalents - end of period	\$ 108	\$ 2,990

(continued)

<FN>

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

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STERLING CHEMICALS, INC.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS, Continued

(In Thousands)

(Unaudited)

RECONCILIATION OF NET INCOME (LOSS) TO CASH  
 PROVIDED BY (USED IN) OPERATING ACTIVITIES

	Six Months Ended March 31,	
	1994	1993
<S>		
Net income (loss)	\$(1,660)	\$(2,507)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	20,161	19,131
Loss on retirement of fixed assets	576	2,370
Gain on sale of assets	(2,606)	-
Deferred tax expense	5,373	630
Deferred compensation	62	115
Treasury stock issued to ESOP	823	-
Change in:		
Accounts receivable	(37,911)	(7,272)
Inventories	1,152	1,752
Prepaid expenses	385	(1,026)
Other assets	(2,977)	(3,176)
Accounts payable	10,957	5,019
Accrued liabilities	(2,724)	(2,594)
Interest payable	209	(394)
Taxes payable	833	761
Other liabilities	5,197	(3,384)
Cash provided by (used in) operating activities	\$(2,150)	\$ 9,425

<FN>

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

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STERLING CHEMICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In Thousands Except Per Share Data)

1. Basis of Presentation:

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In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all normal and recurring adjustments necessary to present fairly the consolidated financial position of Sterling Chemicals, Inc. and its subsidiaries (the "Company") as of March 31, 1994 and the consolidated results of their operations and their cash flows for the periods ended March 31, 1994 and 1993. The results of operations for the periods presented are not necessarily indicative of the results to be expected for the full year. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company's Annual Report for the fiscal year ended September 30, 1993. The condensed consolidated financial statements included herein have been subjected to a review by Coopers & Lybrand, the Company's independent accountants, whose report is included herein.

2. Inventories:

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Inventories consisted of the following:

<TABLE>

<CAPTION>

	March 31, 1994	September 30, 1993
	-----	-----
	<C>	<C>
<S>		
Inventories:		
Finished products	\$33,275	\$27,024
Work in process	3,350	2,794
Raw materials	13,756	16,598
	-----	-----
Inventories at FIFO cost	50,381	46,416
Inventories under exchange agreements	(2,425)	2,684
Stores and supplies	11,004	11,228
	-----	-----
	\$58,960	\$60,328
	=====	=====

</TABLE>

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<CAPTION>

STERLING CHEMICALS, INC.



NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued  
(Unaudited)  
(In Thousands Except Per Share Data)

3. Long-Term Debt:

-----  
Long-term debt consisted of the following:

	March 31, 1994	September 30, 1993
	-----	-----
	<C>	<C>
<S>		
Revolving credit facilities	\$ 62,100	\$ 53,692
Term loan	38,250	39,563
Subsidiary term facility	121,975	130,900
Subordinated note	44,268	44,268
Project loan	19,895	23,486
	-----	-----
Total debt outstanding	286,488	291,909
Less:		
Current maturities	(29,300)	(28,015)
Unamortized debt issue costs	(6,343)	(7,049)
	-----	-----
Total long-term debt	\$250,845	\$256,845
	=====	=====

</TABLE>

The Company has a credit agreement with a syndicate of banks ("Credit Agreement"). The Credit Agreement provides for a revolving credit facility of up to \$80,000 (\$58,000 outstanding at March 31, 1994), the availability of which is reduced by outstanding letters of credit (\$2,307 at March 31, 1994), provides for the outstanding project loan of \$19,895 at March 31, 1994 and provides for the outstanding term loan of \$38,250 at March 31, 1994. The Credit Agreement also allows for up to \$20,000 of additional borrowings from other lenders (\$4,100 outstanding at March 31, 1994). The revolving credit facility matures in August 1996, at which time any outstanding principal and interest are due. The term loan matures in August 1999 and provides for scheduled quarterly payments and for mandatory prepayments of certain percentages of the Company's Excess Cash Flow (as defined in the Credit Agreement). The project loan provides for monthly principal payments and matures in July 1996. The average interest rates on the term loan, the revolving credit line and the \$4,100 of additional borrowings at March 31, 1994 and September 30, 1993 (including all associated interest rate swaps) were 5.5% and 5.1%, respectively.

[CAPTION]

STERLING CHEMICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENT, Continued

(Unaudited)

(In Thousands Except Per Share Data)

The Credit Agreement contains a number of financial and other covenants which were based upon estimates of the Company's future financial performance provided by the Company at the time the Credit Agreement was negotiated in August 1992. Starting in late calendar year 1992, the styrene market became more depressed than the Company had anticipated in August 1992, and that market is just beginning to return to the levels projected by the Company at the time the Credit Agreement was entered into. Further, the disruption in the acrylonitrile market caused by the relatively unstable nature of the Chinese market in recent years was not foreseen by the Company in 1992. As a result primarily of these events, the Company's results of operations for fiscal 1993 and the first quarter of fiscal 1994 were significantly lower than it anticipated when the Credit Agreement was negotiated in 1992. Consequently, the Company would have failed to meet several of the financial covenants in the Credit Agreement at the end of the second quarter of fiscal 1994. Accordingly, in anticipation of such failure, the Company obtained waivers of these covenants through April 30, 1994, while a longer term solution to the financial covenant issue was being negotiated. The Company recently finalized an amendment to the Credit Agreement modifying the financial covenants in a manner that is expected to allow the Company to remain in compliance through the term of the Credit Agreement.

The acquisition of the pulp chemicals business ("Sterling Canada") during the fourth quarter of fiscal 1992 was financed through additional debt, and in connection therewith, the Company obtained a separate stand-alone credit facility for Sterling Canada, which also issued an unsecured \$44,268 subordinated note to the seller. The Sterling Canada credit facility includes a term loan to Sterling Canada (\$121,975 outstanding at March 31, 1994), and an additional Cdn. \$20,000 denominated revolving credit line (\$0 outstanding at March 31, 1994), the availability of which is reduced by outstanding letters of credit (\$2,180 at March 31, 1994) and outstanding bank overdrafts (Cdn. \$9,366 at March 31, 1994). The Sterling Canada term loan, which matures in August 1999, provides for scheduled quarterly payments and additionally provides for mandatory prepayments of certain percentages of the Excess Cash Flow (as defined in the Sterling Canada Credit Facility) of Sterling Canada and its subsidiaries.

The Sterling Canada revolving credit line expires in August 1997, at which time any outstanding principal and interest are due. The interest rate on the term loan and revolving credit line at

March 31, 1994 and September 30, 1993 were 6.2% and 5.7%, respectively. The unsecured \$44,268 subordinated note matures in December 1999 and provides for mandatory prepayments of a certain percentage of Sterling Canada's Excess Cash Flow (as defined in the credit facility). The interest rates on the subordinated note at March 31, 1994 and September 30, 1993 were 6.9% and 6.7%, respectively.

4. Income Taxes:

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The Company adopted the provisions of Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS 109"), effective October 1, 1993. Under SFAS 109, deferred income taxes are provided for temporary differences in recognition of income and expenses for tax and financial reporting purposes. The temporary differences which give rise to significant portions of the Company's deferred tax assets and liabilities are the excess of tax depreciation, amortization and pension expenses over such book expenses. The adoption of this statement did not have an effect on the Company's results of operations. Upon adoption of SFAS 109, the Company's current deferred tax asset and deferred tax liability each increased \$1,609.

The provision for income taxes was computed using effective tax rates of 31.4% and 9.5% for the six month periods ended March 31, 1994 and 1993, respectively. The effective tax rate during the first half of fiscal 1993 was affected by the accrual of the earned surplus portion of the Texas Franchise Tax in addition to an adjustment for certain foreign taxes payable.

5. Commitments and Contingencies:

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FEDERAL INCOME TAXES. During 1991, the Internal Revenue Service ("IRS") completed its examination of the Company's federal income tax returns for fiscal years 1987, 1988, 1989 and 1990. The IRS issued a notice of deficiency in June 1992 with respect to fiscal year 1987, in which it proposed various adjustments, resulting in a tax deficiency of \$16,570, plus interest. The Company filed a petition for redetermination of this deficiency with the United States Tax Court. The IRS also has issued notices of proposed deficiency with respect to fiscal years 1988, 1989 and 1990, proposing primarily the same adjustments as for fiscal year 1987, with a proposed tax deficiency for the three-year period of \$19,378, plus interest. The Company filed protests with the IRS contesting these proposed adjustments.

In October 1993, the Company and the IRS agreed upon a basis for

settlement of the adjustments proposed for fiscal years 1987 through 1990. This settlement will result in a tax refund of \$3,407 plus interest. Resulting adjustments to its fiscal year 1991 and 1992 federal income returns will result in additional taxes owed of approximately \$1,525 plus interest. In addition, the Company's deferred tax liability for future years will increase by approximately \$3,965. During fiscal year 1992, the Company accrued \$2,000 in anticipation of this settlement. These adjustments resulted in an additional \$83 in tax expense during the first quarter of fiscal 1994.

ACETIC ACID PATENT INFRINGEMENT. In January 1993, Hoeschst Celanese Corporation ("HCC") filed suit against BP Chemicals Limited ("BP") and the Company alleging patent infringement in connection with the use of an ion exchange resin in a guard bed installed in the Company's acetic acid production facility in Texas City. The suit sought unspecified damages and issuance of an injunction against BP and the Company to enjoin further infringement. The trial commenced on January 10, 1994 and on January 19, 1994, the jury rendered its verdict that BP and the Company had willfully infringed HCC's patent and were liable to HCC for a reasonable royalty of .6 cents per pound (\$.006/lb) for the acetic acid produced by the Company during the infringing period. On March 8, 1994, the court entered a final judgment upholding the jury verdict and awarding the following sums to HCC: \$5,592 as lost royalties; \$5,592 as enhancement damages; \$186 as prejudgment interest through March 8, 1994; and \$25 as HCC's costs. In addition, the court entered a permanent injunction against BP and the Company prohibiting any activities that constitute infringement or inducement of infringement of HCC's patent. On March 22, 1994, the court entered an order staying the final judgment pending a final decision of any appeal to the Court of Appeals for the Federal Circuit affirming the validity and infringement of HCC's patent and the award of damages. The order was based upon a stipulation of the parties waiving the condition of a supersedeas bond. Subject to the expected denial of a motion for new trial, BP and the Company intend to prosecute an appeal.

Under the terms of the Lease and Production Agreement between the Company and BP Chemicals, Inc. ("BPC"), a U.S. subsidiary of British Petroleum Company plc, BPC has undertaken the defense of the Company and will indemnify the Company against all damages incurred as a result of the suit. Regardless of the final outcome, the Company does not anticipate final resolution of this matter to have a material impact on the Company's financial position or results of operations. In addition, future operations of the acetic acid production facility are not expected to be materially impacted by the final resolution of this matter.

AMMONIA RELEASE. On May 8, 1994, an ammonia release occurred at the Company's Texas City facility when a reactor in the acrylonitrile unit was being restarted after a shutdown for routine maintenance. The Company estimates that approximately 3,000 pounds of ammonia were emitted into the atmosphere. Over one thousand residents of the Texas City area were examined at local hospitals as a result of alleged exposure to the ammonia. Fewer than 10 individuals were admitted for further observation and it appears that there are no serious injuries. Nevertheless, the Company anticipates that there is a substantial likelihood that litigation against the Company involving personal injury and property damage claims will ensue. On May 10, 1994, the Company presented the results of its preliminary investigation into the cause of the incident to the Occupational Safety and Health Administration and production from the affected reactor was resumed. The Company believes that final resolution of these matters will not have a material adverse effect on the financial position, liquidity or results of operations of the Company.

CHLORINE DIOXIDE GENERATOR PATENT ISSUES. The Company's primary competitor in the supply of patented technology for generators which convert sodium chlorate into chlorine dioxide is Akzo Nobel AB (formerly Eka Nobel AB) and its affiliates ("Akzo Nobel"). The Company is engaged with Akzo Nobel in numerous patent disputes throughout the world in which the Company and Akzo Nobel are challenging certain patents of the other and attempting to restrict the other's operating range. If either party is successful in these disputes, the other party may have to make adjustments and modifications in its commercial operations or obtain a license from the prevailing party. The Company's management believes that any potential costs for such adjustments or modifications would be immaterial. The Company believes it is entitled to certain indemnities from Tenneco Canada with respect to the acquired technology.

ENVIRONMENTAL REGULATIONS. The Company's Texas City plant and Canadian operations are subject to extensive federal, state, provincial and local environmental regulations. The Company may incur significant expenditures in order to comply with environmental regulations.

Report of Independent Accountants'  
Review of Interim Financial Information

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

We have reviewed the accompanying condensed consolidated balance sheet of Sterling Chemicals, Inc. as of March 31, 1994 and the condensed consolidated statement of operations for the three and

six month periods ended March 31, 1994 and 1993 and the condensed consolidated statement of cash flows for the six months ended March 31, 1994 and 1993. 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 generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

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

We have previously audited, in accordance with generally accepted auditing standards, the consolidated balance sheet as of September 30, 1993, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated November 19, 1993, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of September 30, 1993 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

As more fully discussed in Note 4 to the condensed consolidated financial statements, effective October 1, 1993 the Company changed its method of accounting for income taxes.

COOPERS & LYBRAND

Houston, Texas  
April 22, 1994

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS

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#### RESULTS OF OPERATIONS

Revenues for the second quarter of fiscal 1994 were \$154.8 million compared to revenues of \$113.0 million for the second

quarter of fiscal 1993, an increase of 37%. Revenues for the six month period ended March 31, 1994 were \$285.3 million compared to revenues of \$250.8 million for the same period a year ago, an increase of 14%. Net income for the three month period ended March 31, 1994 was \$1.8 million (\$.03 per share) versus a net loss of \$2.6 million (\$.05 per share) for the second quarter of fiscal 1993. Net loss for the first six months of fiscal 1994 was \$1.7 million (\$.03 per share) compared to a net loss of \$2.5 million (\$.05 per share) for the corresponding period in fiscal 1993.

For the second quarter of fiscal 1994, the Company's revenues from its petrochemical operations increased 46% to \$123.5 million when compared to the second quarter of fiscal 1993. This increase in revenues was primarily due to an increase in direct sales which was largely the result of a change in styrene product sales mix compared to a year ago. Near the end of fiscal 1993, the Company's styrene conversion agreement with Novacor Chemicals Inc. ("Novacor") expired, which caused the Company to replace all of the lost conversion sales volumes with various direct sales arrangements. Acrylonitrile export sales volumes also increased in the second quarter of fiscal 1994 compared to the same period a year ago. Pulp chemicals revenues for the second quarter of fiscal 1994 increased \$2.6 million to \$31.3 million compared to the second quarter of fiscal 1993. This increase in revenue was due primarily to higher sodium chlorate sales volumes resulting from recently negotiated contracts.

In fiscal 1993, the Company granted stock appreciation rights ("SARs") to certain key employees and directors. Total expense for the second quarter of fiscal 1994 (\$2.5 million before tax) was determined based on the number of SARs granted (3.7 million), vesting period (five years beginning September 1992) and the price of the Company's stock at March 31, 1994 (\$5-5/8 per share). There was no expense related to SARs in fiscal 1993.

**STYRENE:** Styrene revenues in the second quarter of fiscal 1994 increased over 60% to \$57 million compared to the second quarter of fiscal 1993. This increase was primarily due to an approximate 100% increase in direct sales due to the change in sales mix as mentioned above.

Styrene's performance improved during the second quarter of fiscal 1994 compared to the same period in fiscal 1993 due to higher production rates and improved sales margins resulting from price increases. Demand for styrene increased due to higher worldwide demand for styrenic polymers, particularly from the Far East. The Company's styrene unit operated at almost 90% of its rated capacity for the first six months of fiscal 1994 compared to about 65% during the first six months of fiscal 1993. Styrene's performance during the second quarter of fiscal 1994



also benefited from an approximate 12% decrease in the price of each of its two major raw materials, benzene and ethylene, compared to the corresponding quarter of fiscal 1993. Overall, styrene sales margins are improving as a strengthening in the styrene market seems to be occurring much earlier than the Company anticipated. While it is difficult at this point in the styrene cycle to predict the duration of this improvement in market conditions, the Company expects significantly improved styrene earnings in the third quarter of fiscal 1994.

**ACRYLONITRILE:** Acrylonitrile revenues in the second quarter of fiscal 1994 increased approximately 75% compared to the second quarter of fiscal 1993. This increase was a result of an approximate 150% increase in export sales volumes, partially offset by a decrease in sales price during the second quarter of fiscal 1994 compared to the second quarter of fiscal 1993. The increase in acrylonitrile demand is primarily due to strengthening in the acrylic fiber market, in part due to the current stabilization of the Chinese economy. Demand for acrylonitrile is heavily influenced by demand from export customers, particularly those supplying acrylic fiber to the People's Republic of China. In recent years, the acrylic fiber market, the largest market for acrylonitrile, has been subject to volatility due to the relatively unstable nature of the Chinese market. Currently, export sales margins have firmed and are expected to continue to gradually improve.

Acrylonitrile's performance during the second quarter of fiscal 1994 also improved due to an approximate 10% decrease in the price of propylene, a major raw material, compared to the same period of fiscal 1993. The Company's acrylonitrile unit operated at approximately 75% of its rated capacity during the first six months of fiscal 1994 compared to almost 85% of its rated capacity during the same period a year ago.

**ACETIC ACID:** Acetic acid revenues for the second quarter of fiscal 1994 increased 14% when compared to the corresponding period in fiscal 1993. The increase in revenues was due to increased profit sharing from the Company's contract partner.

**PULP CHEMICALS:** Pulp chemicals revenues for the second quarter of fiscal 1994 increased 9% to \$31.3 million compared to the corresponding period a year ago. The revenue increase was due primarily to higher sodium chlorate sales volumes resulting from recently negotiated contracts for additional volumes entered into with new and existing customers. The increase in sales volumes was partially offset by lower sales prices due to the continued sluggish pulp and paper markets. The Company anticipates that sales prices and margins will begin to improve during the last half of fiscal 1994.



The sodium chlorate plants operated at approximately 80% of their rated capacity during both the first six months of fiscal 1994 and 1993.

OTHER PRODUCTS: Performance of the Company's other products remained consistent during the second quarter of fiscal 1994 compared to the second quarter of fiscal 1993. Revenues during the second quarter of fiscal 1994 from plasticizers, lactic acid, tertiary butylamine and sodium cyanide increased approximately 7% compared to the second quarter of fiscal 1993.

#### LIQUIDITY AND CAPITAL RESOURCES

- - - - -

Working capital increased to \$48.5 million at March 31, 1994 from \$31.0 million at September 30, 1993. Net cash used in operations was \$2.2 million during the first six months of fiscal 1994 compared to \$9.4 million net cash provided by operations for the corresponding period in fiscal 1993. The increase in working capital was primarily attributable to a \$32.4 million increase in accounts receivable which also negatively affected cash provided by operations. This increase in accounts receivable was due to greater acrylonitrile and styrene sales volumes during the second quarter of fiscal 1994 compared to the fourth quarter of fiscal 1993 along with the recognition of the agreed-to income tax settlement (as discussed in Note 5 of "Notes to Condensed Consolidated Financial Statements"). The recognition of the agreed-to income tax settlement also had the effect of increasing deferred income taxes.

In addition, current deferred income taxes were also increased, with a corresponding increase in deferred income taxes, due to the Company's adoption of Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS 109"), effective October 1, 1993. The adoption of SFAS 109 had no impact on the results of operations.

The increase in working capital due to the increase in accounts receivable was partially offset by the increase in accounts payable at March 31, 1994 from September 30, 1993. The increase in accounts payable resulted primarily from increased raw material purchases during the second quarter of fiscal 1994 as the Company's operating rates for its products improved.

The Company has a credit agreement with a syndicate of banks ("Credit Agreement"). The Credit Agreement provides for a revolving credit facility of up to \$80 million (\$58.0 million outstanding at March 31, 1994), the availability of which is reduced by outstanding letters of credit (\$2.3 million at March 31, 1994), provides for the outstanding project loan of \$19.9

million at March 31, 1994 and provides for the outstanding term loan of \$38.3 million at March 31, 1994. The Credit Agreement also allows for up to \$20 million of additional borrowings from other lenders (\$4.1 million outstanding at March 31, 1994). The revolving credit facility matures in August 1996, at which time any outstanding principal and interest are due. The term loan matures in August 1999 and provides for scheduled quarterly payments and for mandatory prepayments of certain percentages of the Company's Excess Cash Flow (as defined in the Credit Agreement). The project loan provides for monthly principal payments and matures in July 1996. The average interest rates on the term loan, the revolving credit line and the \$4.1 million of additional borrowings at March 31, 1994 and September 30, 1993 (including all associated interest rate swaps) were 5.5% and 5.1%, respectively.

The Credit Agreement contains a number of financial and other covenants which were based upon estimates of the Company's future financial performance provided by the Company at the time the Credit Agreement was negotiated in August 1992. Starting in late calendar year 1992, the styrene market became more depressed than the Company had anticipated in August 1992, and that market is just beginning to return to the levels projected by the Company at the time the Credit Agreement was entered into. Further, the disruption in the acrylonitrile market caused by the relatively unstable nature of the Chinese market in recent years was not foreseen by the Company in 1992. As a result primarily of these events, the Company's results of operations for fiscal 1993 and the first quarter of fiscal 1994 were significantly lower than it anticipated when the Credit Agreement was negotiated in 1992. Consequently, the Company would have failed to meet several of the financial covenants in the Credit Agreement at the end of the second quarter of fiscal 1994. Accordingly, in anticipation of such failure, the Company obtained waivers of these covenants through April 30, 1994, while a longer term solution to the financial covenant issue was being negotiated. The Company recently finalized an amendment to the Credit Agreement modifying the financial covenants in a manner that is expected to allow the Company to remain in compliance through the term of the Credit Agreement.

The Company's acquisition of the pulp chemicals business ("Sterling Canada") during the fourth quarter of fiscal 1992 was financed through additional debt, and in connection therewith, the Company obtained a separate stand-alone credit facility for Sterling Canada, which also issued an unsecured \$44.3 million subordinated note to the seller. The Sterling Canada credit facility includes a term loan to Sterling Canada (\$122.0 million outstanding at March 31, 1994), and an additional Cdn. \$20 million revolving credit line (\$0 million outstanding at March 31, 1994), the availability of which is reduced by outstanding

letters of credit (\$2.2 million at March 31, 1994) and outstanding bank overdrafts (Cdn.\$9.4 million at March 31,1994). The Sterling Canada term loan, which matures in August 1999, provides for scheduled quarterly payments and additionally provides for mandatory prepayments of certain percentages of the Excess Cash Flow (as defined in the Sterling Canada Credit Facility) of Sterling Canada and its subsidiaries.

The Sterling Canada revolving credit line expires in August 1997, at which time any outstanding principal and interest are due. The interest rate on the term loan and revolving credit line at March 31, 1994 and September 30, 1993 were 6.2% and 5.7%, respectively. The unsecured \$44.3 million subordinated note matures in December 1999 and provides for mandatory prepayments of a certain percentage of Sterling Canada's Excess Cash Flow (as defined in the credit facility). The interest rates on the subordinated note at March 31, 1994 and September 30, 1993 were 6.9% and 6.7%, respectively.

Capital expenditures for the second quarter of fiscal 1994 were \$1.3 million and totalled \$4.1 million for the first six months of fiscal 1994 and are expected to approach \$19 million for fiscal 1994, approximately \$6 million of which will be used for pulp chemicals operations. The Company anticipates \$8 million of these expenditures will be for environmental and safety matters, while the majority of the remainder will be for a part of the Company's contribution to a planned acetic acid expansion. In the future, the Company may incur additional significant expenditures in order to comply with environmental regulations.

Information contained in "Note 5 of Notes to Condensed Consolidated Financial Statements" is incorporated herein by reference.

## Part II - OTHER INFORMATION

### Item 1. LEGAL PROCEEDINGS

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ACETIC ACID PATENT INFRINGEMENT. On January 5, 1993, Hoeschst Celanese Corporation ("HCC") filed suit in U.S. District Court for the Southern District of Texas, Galveston Division against BP Chemicals Limited ("BP") and the Company (Civil Action No. G-93-001) alleging patent infringement in connection with the use of an ion exchange resin in a guard bed installed in the Company's acetic acid production facility in Texas City. The suit sought unspecified damages and issuance of an injunction against BP and the Company to enjoin further infringement. The trial commenced on January 10, 1994 and on January 19, 1994, the jury rendered its verdict that BP and the Company had willfully infringed HCC's patent and were liable to HCC for a reasonable royalty of .6 cents per pound (\$.006/lb) for the acetic acid produced by the

Company during the infringing period. On March 8, 1994, the court entered a final judgment upholding the jury verdict and awarding the following sums to HCC: \$5,592,000 as lost royalties; \$5,592,000 as enhancement damages; \$186,000 as prejudgment interest through March 8, 1994; and \$25,000 as HCC's costs. In addition, the court entered a permanent injunction against BP and the Company prohibiting any activities that constitute infringement or inducement of infringement of HCC's patent. On March 22, 1994, the court entered an order staying the final judgment pending a final decision of any appeal to the Court of Appeals for the Federal Circuit affirming the validity and infringement of HCC's patent and the award of damages. The order was based upon a stipulation of the parties waiving the condition of a supersedeas bond. Subject to the expected denial of a motion for new trial, BP and the Company intend to prosecute an appeal.

Under the terms of the Lease and Production Agreement between the Company and BP Chemicals, Inc. ("BPC"), a U.S. subsidiary of British Petroleum Company plc, BPC has undertaken the defense of the Company and will indemnify the Company against all damages incurred as a result of the suit. Regardless of the final outcome, the Company does not anticipate final resolution of this matter to have a material impact on the Company's financial position or results of operations. In addition, future operations of the acetic acid production facility are not expected to be materially impacted by the final resolution of this matter.

AMMONIA RELEASE. On May 8, 1994, an ammonia release occurred at the Company's Texas City facility when a reactor in the acrylonitrile unit was being restarted after a shutdown for routine maintenance. The Company estimates that approximately 3,000 pounds of ammonia were emitted into the atmosphere. Over one thousand residents of the Texas City area were examined at local hospitals as a result of alleged exposure to the ammonia. Fewer than 10 individuals were admitted for further observation and it appears that there are no serious injuries. Nevertheless, the Company anticipates that there is a substantial likelihood that litigation against the Company involving personal injury and property damage claims will ensue. On May 10, 1994, the Company presented the results of its preliminary investigation into the cause of the incident to the Occupational Safety and Health Administration and production from the affected reactor was resumed. The Company believes that final resolution of these matters will not have a material adverse effect on the financial position, liquidity or results of operations of the Company.

CHLORINE DIOXIDE GENERATOR PATENT ISSUES. The Company's primary competitor in the supply of patented technology for generators which convert sodium chlorate into chlorine dioxide is Akzo Nobel

AB (formerly Eka Nobel AB) and its affiliates ("Akzo Nobel"). The Company is engaged with Akzo Nobel in numerous patent disputes throughout the world in which the Company and Akzo Nobel are challenging certain patents of the other and attempting to restrict the other's operating range. If either party is successful in these disputes, the other party may have to make adjustments and modifications in its commercial operations or obtain a license from the prevailing party. The Company's management believes that any potential costs for such adjustments or modifications would be immaterial. At the time of the acquisition of the patented technology from Tenneco Canada, the Company received certain assurances in respect to the acquired technology.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS  
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At the annual meeting of stockholders held on January 26, 1994, the Company's nominees for directors were elected and Coopers & Lybrand was appointed as independent auditor for the Company for the fiscal year ended September 30, 1994. The results of the voting were as follows:

(a) Board of Directors:

<TABLE>

<CAPTION>

	NAME	VOTES FOR	VOTES WITHHELD
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	<C>	<C>	<C>
<S>	Gordon A. Cain	44,747,835	245,574
	J. Virgil Waggoner	44,748,605	244,804
	William A. McMinn	44,786,786	206,623
	James J. Kerley	44,772,200	221,209
	Gilbert M.A. Portal	44,711,861	281,548
	Frank J. Pizzitola	44,722,725	270,684
	Ray R. Knowland	44,780,076	213,333

</TABLE>

(b) Ratification of Independent Accountants:

<TABLE>

<CAPTION>

	VOTES FOR	VOTES AGAINST	ABSTENTIONS	
	-----	-----	-----	
	<C>	<C>	<C>	
<S>	Coopers & Lybrand	44,317,732	88,353	587,324

</TABLE>

There were no broker nonvotes with respect to either of

these matters.

Item 6. EXHIBITS AND REPORTS ON FORM 8-K  
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(a) Exhibits: None

(b) Reports on Form 8-K: No reports on Form 8-K were filed during the three months ended March 31, 1994.

SIGNATURES

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

STERLING CHEMICALS, INC.  
(Registrant)

Date: May 12, 1994

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J. Virgil Waggoner  
President and Chief Executive  
Officer (Principal Executive  
Officer)

Date: May 12, 1994

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J. David Heaney  
Vice President-Finance and Chief  
Financial Officer (Principal  
Financial Officer and Principal  
Accounting Officer)