

CONSTAR INTERNATIONAL INC
Form 10-Q
August 14, 2006
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For Quarterly Period Ended June 30, 2006

OR

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

For the transition period from _____ to _____

Commission file number 000-16496

Constar International Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of

incorporation or organization)

One Crown Way, Philadelphia, PA
(Address of principal executive offices)

13-1889304
(IRS Employer

Identification Number)

19154
(Zip Code)

(215) 552-3700

Edgar Filing: CONSTAR INTERNATIONAL INC - Form 10-Q

(Registrant's telephone number, including area code)

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

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

Large accelerated filer Accelerated filer Non-accelerated filer
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes No

As of August 9, 2006, 12,600,861 shares of the Registrant's Common Stock were outstanding.

Table of Contents

TABLE OF CONTENTS

	Page Number
<u>PART I. FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements (Unaudited)</u>	3
<u>Condensed Consolidated Balance Sheets</u>	3
<u>Condensed Consolidated Statements of Operations</u>	4
<u>Condensed Consolidated Statements of Cash Flows</u>	5
<u>Condensed Consolidated Statements of Stockholders' Equity (Deficit)</u>	6
<u>Notes to Condensed Consolidated Financial Statements</u>	7
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	26
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	36
Item 4. <u>Controls and Procedures</u>	36
<u>PART II. OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	39
Item 1A. <u>Risk Factors</u>	39
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	39
Item 6. <u>Exhibits</u>	39
<u>Signatures</u>	40

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****CONSTAR INTERNATIONAL INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(in thousands)****(unaudited)**

	June 30, 2006	December 31, 2005
Assets		
Current Assets		
Cash and cash equivalents	\$ 9,371	\$ 9,663
Accounts receivable, net (Note 3)	98,648	79,562
Inventories, net (Note 4)	95,443	100,353
Prepaid expenses and other current assets	14,914	18,856
Total current assets	218,376	208,434
Property, plant and equipment, net (Note 5)	150,760	156,708
Goodwill	148,813	148,813
Other assets	22,440	20,697
Total assets	\$ 540,389	\$ 534,652
Liabilities and Stockholders Deficit		
Current Liabilities		
Short-term debt (Note 6)	\$ 24,168	\$ 10,453
Accounts payable and accrued liabilities	135,944	143,144
Income taxes payable	6	205
Total current liabilities	160,118	153,802
Long-term debt, net of current portion (Note 6)	393,334	393,205
Pension and post-retirement liabilities	20,040	19,988
Deferred income taxes	3,190	3,536
Other liabilities	6,345	5,981
Total liabilities	583,027	576,512
Commitments and contingent liabilities (Note 8)		
Stockholders deficit	(42,638)	(41,860)
Total liabilities and stockholders deficit	\$ 540,389	\$ 534,652

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

Table of Contents**CONSTAR INTERNATIONAL INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share data)

(unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2006	2005	2006	2005
Net customer sales	\$ 257,198	\$ 256,734	\$ 481,972	\$ 472,481
Net affiliate sales	1,256	1,179	2,212	2,213
Net sales	258,454	257,913	484,184	474,694
Cost of products sold, excluding depreciation	226,514	236,205	431,596	435,459
Depreciation	10,757	11,328	18,839	22,527
Gross profit	21,183	10,380	33,749	16,708
Selling and administrative expenses	8,228	6,123	15,830	12,245
Research and technology expenses	1,688	1,572	3,026	3,046
Write-off of deferred financing costs				10,025
Asset impairment charges	870		870	
Provision for restructuring	182	51	225	110
Total operating expenses	10,968	7,746	19,951	25,426
Operating income (loss)	10,215	2,634	13,798	(8,718)
Interest expense	10,464	9,373	20,650	19,004
Other (income) expense, net	(936)	736	(1,187)	349
Income (loss) from continuing operations before income taxes	687	(7,475)	(5,665)	(28,071)
(Provision for) benefit from income taxes		(314)		154
Income (loss) from continuing operations	687	(7,789)	(5,665)	(27,917)
Income (loss) from discontinued operations, net of taxes	(518)	88	(509)	168
Net Income (loss)	\$ 169	\$ (7,701)	\$ (6,174)	\$ (27,749)
Basic earnings (loss) per common share:				
Continuing operations	\$ 0.06	\$ (0.64)	\$ (0.46)	\$ (2.30)
Discontinued operations	(0.05)	0.01	(0.04)	0.01
Net income (loss) per share	\$ 0.01	\$ (0.63)	\$ (0.50)	\$ (2.29)
Diluted earnings (loss) per common share:				
Continuing operations	\$ 0.05	\$ (0.64)	\$ (0.46)	\$ (2.30)
Discontinued operations	\$ (0.04)	\$ 0.01	\$ (0.04)	\$ 0.01
Net income (loss) per share	\$ 0.01	\$ (0.63)	\$ (0.50)	\$ (2.29)

Edgar Filing: CONSTAR INTERNATIONAL INC - Form 10-Q

Weighted average common shares outstanding:				
Basic	12,208	12,129	12,203	12,124
Diluted	12,540	12,129	12,203	12,124

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

Table of Contents**CONSTAR INTERNATIONAL INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)****(unaudited)**

	Six months ended June 30,	
	2006	2005
Cash flows from operating activities:		
Net loss	\$ (6,174)	\$ (27,749)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	20,078	23,549
Stock-based compensation	365	358
Asset impairment charges	870	
Write-off of deferred financing costs		6,556
Deferred income taxes	(107)	22
Changes in operating assets and liabilities:		
Accounts receivable	(15,330)	(28,201)
Inventories	7,611	(358)
Other operating assets	2,004	3,234
Accounts payable and accrued expenses	(8,486)	21,429
Other operating liabilities	(659)	(1,509)
Other	205	3,978
Net cash provided by operating activities	377	1,309
Cash flows from investing activities:		
Purchases of property, plant and equipment	(12,677)	(19,628)
Proceeds from the sale of property, plant and equipment	41	570
Net cash used in investing activities	(12,636)	(19,058)
Cash flows from financing activities:		
Proceeds from sale of Senior Notes		220,000
Repayment of term loan		(121,941)
Proceeds from Revolver loan	430,359	362,000
Repayment of Revolver loan	(416,644)	(359,000)
Repayment of second lien loan		(75,000)
Change in outstanding overdrafts	(162)	1,996
Costs associated with debt refinancing	(320)	(10,774)
Other financing activities	(1,540)	(85)
Net cash provided by financing activities	11,693	17,196
Effect of exchange rate changes on cash and cash equivalents	274	(411)
Net decrease in cash and cash equivalents	(292)	(964)
Cash and cash equivalents at beginning of period	9,663	9,316
Cash and cash equivalents at end of period	\$ 9,371	\$ 8,352

Edgar Filing: CONSTAR INTERNATIONAL INC - Form 10-Q

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

Table of Contents**CONSTAR INTERNATIONAL INC.****CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY (DEFICIT)**

(in thousands)

(unaudited)

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive loss	Treasury Stock	Unearned Compensation	Accumulated Deficit	Total Stockholders Equity (Deficit)
Balance, December 31, 2004	\$ 125	\$ 276,403	\$ (20,993)	\$ (210)	\$ (2,284)	\$ (229,044)	\$ 23,997
Net loss						(27,749)	(27,749)
Foreign currency translation adjustments			(4,211)				(4,211)
Revaluation of cash flow hedge			(1,514)				(1,514)
Comprehensive loss							(33,474)
Issuance of restricted stock		22		(82)			(60)
Forfeitures of restricted stock		(20)		(14)	25		(9)
Stock-based compensation					358		358
Balance, June 30, 2005	\$ 125	\$ 276,405	\$ (26,718)	\$ (306)	\$ (1,901)	\$ (256,793)	\$ (9,188)
Balance, December 31, 2005	\$ 125	\$ 276,331	\$ (27,441)	\$ (457)	\$ (1,384)	\$ (289,034)	\$ (41,860)
Net loss						(6,174)	(6,174)
Foreign currency translation adjustments			1,557				1,557
Revaluation of cash flow hedge			3,522				3,522
Comprehensive loss							(1,095)
Reclassification upon adoption of SFAS 123R		(1,384)			1,384		
Forfeitures of restricted stock				(48)			(48)
Stock-based compensation		365					365
Balance, June 30, 2006	\$ 125	\$ 275,312	\$ (22,362)	\$ (505)	\$	\$ (295,208)	\$ (42,638)

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

Table of Contents

CONSTAR INTERNATIONAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

(Dollar amounts in thousands, unless otherwise noted)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and in accordance with the Securities and Exchange Commission (SEC) regulations for interim financial reporting. In the opinion of management, these consolidated financial statements contain all adjustments of a normal and recurring nature necessary to provide a fair statement of the financial position, results of operations and cash flows for the periods indicated. Results for interim periods should not be considered indicative of results for a full year. These financial statements should be read in conjunction with the Consolidated Financial Statements and notes thereto contained in Constar International Inc. s (the Company or Constar) Annual Report on Form 10-K for the year ended December 31, 2005. The Condensed Consolidated Financial Statements include the accounts of the Company and all of its subsidiaries in which a controlling interest is maintained.

In accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144), the Company has classified the results of operations of its Turkish joint venture as discontinued operations in the condensed consolidated statements of operations for all periods presented. The assets and related liabilities of the joint venture have been classified as assets and liabilities of discontinued operations on the condensed consolidated balance sheets. See Note 16 in Notes to Condensed Consolidated Financial Statements for further discussion of the divestiture of the joint venture. Unless otherwise indicated, amounts provided throughout this Form 10-Q relate to continuing operations only.

Reclassifications Certain reclassifications have been made to prior year balances in order to conform these balances to the current year s presentation.

2. Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (the FASB) issued Statement of Financial Accounting Standards 123 (revised 2004), *Share-Based Payment* (SFAS 123R) which requires measurement of all employee stock-based compensation awards using a fair-value method and the recording of such expense in the consolidated financial statements. In addition, the adoption of SFAS 123R requires additional accounting changes related to the income tax effects and disclosure regarding the cash flow effects resulting from share-based payment arrangements. In January 2005, the SEC issued Staff Accounting Bulletin No. 107, which provides supplemental implementation guidance for SFAS 123R. The Company will recognize compensation expense on a straight-line basis over the requisite service period. The Company adopted SFAS 123R in the first quarter of fiscal 2006. (See Note 10).

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments* an amendment of FASB Statements No. 133 and 140 (SFAS 155). SFAS 155 simplifies the accounting for certain hybrid financial instruments that contain an embedded derivative that otherwise would have required bifurcation. SFAS 155 also eliminates the interim guidance in SFAS 133, which provides that beneficial interests in securitized financial assets are not subject to the provisions of SFAS 133. SFAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006. SFAS 155 is required to be adopted by the Company in the first quarter of fiscal 2007. The Company does not expect the adoption of SFAS 155 to have a material impact on our results of operations and financial condition.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets* an amendment of FASB Statement No. 140 (SFAS 156). SFAS 156 requires that all separately recognized

Table of Contents

servicing assets and servicing liabilities be initially measured at fair value, if practicable. The statement permits, but does not require, the subsequent measurement of servicing assets and servicing liabilities at fair value. SFAS 156 is effective as of the beginning of an entity's first fiscal year that begins after September 15, 2006. SFAS 156 is required to be adopted by the Company in the first quarter of fiscal 2007. The Company does not expect the adoption of SFAS 156 to have a material impact on our results of operations or financial condition.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. This interpretation prescribes a recognition threshold and measurement attribute of tax positions taken or expected to be taken on a tax return. This interpretation is effective for the Company beginning January 1, 2007. We are currently evaluating the impact FIN 48 will have on our financial statements.

3. Accounts Receivable

	June 30, 2006	December 31, 2005
Trade and notes receivable	\$ 93,514	\$ 75,759
Less: allowance for doubtful accounts	(966)	(1,688)
Net trade receivables	92,548	74,071
Value added taxes recoverable	4,315	3,507
Miscellaneous receivables	1,785	1,984
Total	\$ 98,648	\$ 79,562

4. Inventories

	June 30, 2006	December 31, 2005
Finished goods	\$ 58,470	\$ 63,112
Raw materials and supplies	36,973	37,241
Total	\$ 95,443	\$ 100,353

The finished goods inventory balance has been reduced by reserves for obsolete and slow-moving inventories of \$656 and \$369 as of June 30, 2006 and December 31, 2005, respectively.

5. Property, Plant and Equipment

	June 30, 2006	December 31, 2005
Land and improvements	\$ 3,726	\$ 3,610
Buildings and improvements	68,634	67,096
Machinery and equipment	632,675	615,608
Less: accumulated depreciation and amortization	(571,674)	(554,844)
	133,361	131,470
Construction in progress	17,399	25,238
Total	\$ 150,760	\$ 156,708

Table of Contents**6. Debt**

A summary of short-term and long-term debt follows:

	June 30, 2006	December 31, 2005
Short-Term		
Revolver	\$ 24,168	\$ 10,453
Long-Term		
Senior notes	\$ 220,000	\$ 220,000
Senior subordinated notes	175,000	175,000
Unamortized debt discount	(1,666)	(1,795)
	\$ 393,334	\$ 393,205

At June 30, 2006, there was \$5.0 million outstanding under letters of credit.

The Revolver Loan imposes maximum capital expenditures of \$42.5 million in 2006, \$47.5 million in 2007 and \$47.5 million in 2008. These capital expenditure covenants allow for the carry forward of a certain amount of spending below covenant levels in previous periods. In 2005, Constar spent \$32.6 million in capital expenditures, allowing \$9.3 million to be carried over to 2006, so that the effective capital expenditure limit for 2006 is \$51.8 million. Constar currently expects to spend between \$30.0 million and \$35.0 million in capital expenditures in 2006. In order to satisfy significant business awards, including those relating to conversions from other forms of packaging, the Company may need to purchase additional equipment. To the extent such purchases would cause the Company to exceed the capital expenditure restrictions of the Revolver Loan, the Company would have to obtain the lenders' consent before making such purchases. There can be no assurances that the lenders would grant any such consent.

Liquidity, defined as cash and availability under the Revolver Loan, is a key measure of the Company's ability to finance its operations. The principal determinant of 2006 liquidity will be financial performance including the following factors:

achievement of the Company's operating plan,

changes in working capital,

interest payments on the Company's debt,

the amount and timing of contributions to the Company's pension plans, and

the amount and timing of capital expenditures.

Liquidity will vary on a daily, monthly and quarterly basis based upon the seasonality of the Company's sales as well as the factors mentioned above. The Company's cash requirements are typically greater during the first and second quarters of each fiscal year because of the build up of inventory levels in anticipation of the seasonal sales increase during the warmer months and the collection cycle from customers following the higher seasonal sales.

The Company currently believes its anticipated liquidity will be adequate to finance its operations during 2006. However, actual results have differed from expectations in the past and may do so in the future as a result of several factors, including but not limited to: changes in sales and

Edgar Filing: CONSTAR INTERNATIONAL INC - Form 10-Q

sales mix, operating performance in the Company's European operations, the impact of higher fuel and energy related costs, the impact of changes in resin costs on a particular quarter, currency fluctuations and the other factors discussed under "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2005 and subsequent Quarterly Reports on Form 10-Q.

Table of Contents**7. Restructuring**

In 2003, the Company announced its plans to implement a cost reduction initiative (2003 Plan) under which it closed facilities in Birmingham, Alabama and in Reserve, Louisiana. The restructuring reserve balance at June 30, 2006 represents lease termination costs which are expected to be paid in 2006.

The following table presents an analysis of the 2003 Plan s restructuring reserve activity for the six months ended June 30, 2006:

	Lease Termination Costs
Balance at December 31, 2005	\$ 1,403
Charges to income	49
Payments	(694)
Adjustments	(195)
Balance at June 30, 2006	\$ 563

In 1997, the Company implemented a restructuring plan (1997 Plan) which included the reorganization and closing of manufacturing locations within the U.S. The balance in the restructuring reserves, which represents exit costs for the closed facilities associated with the 1997 Plan, was \$390 and \$467 as of June 30, 2006 and December 31, 2005, respectively. The Company expects that all payments pertaining to this initiative will be paid out in 2006.

During the quarter ended June 30, 2006, the Company charged \$371 of severance costs related to our UK operations to restructuring expense.

The restructuring reserves are reported in accounts payable and accrued liabilities on the Condensed Consolidated Balance Sheets.

8. Commitments and Contingencies

The Company and certain of its present and former directors, along with Crown Holdings, Inc., as well as various underwriters, have been named as defendants in a consolidated putative securities class action lawsuit filed in the United States District Court for the Eastern District of Pennsylvania, In re Constar International Inc. Securities Litigation (Master File No. 03-CV-05020). This action consolidates previous lawsuits, namely Parkside Capital LLC v. Constar International Inc et al.(Civil Action No. 03-5020), filed on September 5, 2003 and Walter Frejek v. Constar International Inc. et al. (Civil Action No. 03-5166), filed on September 15, 2003. The consolidated and amended complaint, filed June 17, 2004, generally alleges that the registration statement and prospectus for the Company s initial public offering of its common stock on November 14, 2002 contained material misrepresentations and/or omissions. Plaintiffs claim that defendants in these lawsuits violated Sections 11 and 15 of the Securities Act of 1933. Plaintiffs seek class action certification and an award of damages and litigation costs and expenses. Under the Company s charter documents, an agreement with Crown and an underwriting agreement with Crown and the underwriters, Constar has incurred certain indemnification and contribution obligations to the other defendants with respect to this lawsuit. The court denied the Company s motion to dismiss for failure to state a claim upon which relief may be granted on June 7, 2005 and the Company s answer was filed on August 8, 2005. The Special Master issued a Report and Order denying the Company s motion for judgment on the pleadings on February 22, 2006. The Company filed objections to the Report and Order on March 6, 2006. The court heard the objections on May 1, 2006 and issued an order overruling the objections on May 24, 2006. The case is now proceeding with class certification and discovery. The Company believes the claims in the action are without merit and intends to defend against them vigorously. The Company cannot reasonably estimate the amount of any loss that may result from this matter.

Table of Contents

On November 15, 2005, Constar filed a lawsuit against Honeywell International Inc. (Honeywell) and Ball Plastic Container Corp. (Ball) in the United States District Court for the Western District of Wisconsin, captioned *Constar International Inc. v. Ball Plastic Container Corp. and Honeywell International Inc.* The lawsuit alleged that Ball's use of Honeywell's Aegix and Aegis HFX oxygen scavenging nylon resins in plastic beer and juice containers infringes Constar's patent rights, and that Honeywell induced such infringement by selling such resins to Ball. Constar's complaint sought an injunction against further infringement and unspecified money damages for past infringement. Both Ball and Honeywell asserted counterclaims alleging that Constar's patent at issue is invalid and unenforceable. In February 2006, Constar and Honeywell settled all claims between them regarding this action. In July 2006, Constar and Ball settled all claims between them regarding this action.

The Company reached an agreement regarding its dispute of certain pricing provisions of a customer contract.

9. Comprehensive Income (Loss)

The components of comprehensive income (loss) are as follows:

	Three months ended June 30,		Six months ended June 30,	
	2006	2005	2006	2005
Net income (loss)	\$ 169	\$ (7,701)	\$ (6,174)	\$ (27,749)
Foreign currency translation adjustment	1,021	(1,514)	1,557	(4,211)
Revaluation of cash flow hedge	1,450	(2,855)	3,522	(1,514)
Comprehensive income (loss)	\$ 2,640	\$ (12,070)	\$ (1,095)	\$ (33,474)

10. Stock-Based Compensation

The Company has a stock-based incentive compensation plan (the 2002 Plan) under which employees may be granted deferred stock, restricted stock, stock appreciation rights (SAR) and incentive or non-qualified stock options. The Company also has a plan (the Directors Plan) under which non-employee directors may be granted restricted stock or non-qualified stock options to purchase shares of Common Stock. The 2002 Plan and the Directors Plan, together, are referred to hereafter as the Option Plans .

Options granted are to be issued at prices equal to at least fair market value and expire up to ten years after the grant date in the case of the 2002 Plan and up to five years after the grant date in the case of the Directors Plan. The plan is administered by the Compensation Committee of the Board of Directors, which determines the vesting provisions, the form of payment for shares and all other terms of the options or grants. The maximum number of shares reserved under the 2002 Plan is 850,000 shares. At June 30, 2006, 38,989 shares were available for future grants. The maximum number of shares reserved under the Directors Plan is 25,000. At June 30, 2006, 10,667 shares were available for future grants.

Effective January 1, 2006, the Company adopted the fair value measurement and recognition provisions of SFAS No. 123R Share-Based Payment , using the modified prospective basis transition method. Under this method, stock-based compensation expense recognized in the first six months of 2006 includes: (a) compensation expense for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair values estimated in accordance with the original provisions of SFAS 123, and (b) compensation expense for all share-based payments granted subsequent to January 1, 2006, determined under the provisions of SFAS 123R. The fair value of restricted stock awards is the average market price of the Company's common stock at the date of grant. Restricted stock units (RSU s) are classified as liabilities in the accompanying condensed consolidated financial statements. The fair value of the liabilities related to the RSU s is remeasured at each balance sheet date. Adjustments to the fair value of the RSU liabilities are recorded as compensation expense.

Table of Contents

The following table summarizes employee stock option activity for the six months ended June 30, 2006:

	Options (in thousands)	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2005	176	\$ 12.00		
Granted				
Exercised				
Forfeited	(5)	12.00		
Outstanding at June 30, 2006	171	\$ 12.00	1.4	\$
Exercisable at June 30, 2006	171	\$ 12.00	1.4	\$

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Company's closing common stock price on the last trading day of the second quarter of 2006 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on June 30, 2006. The aggregate intrinsic value varies based on the fair market value of the Company's common stock. The total number of in-the-money options exercisable as of June 30, 2006 was zero.

The following table summarizes restricted stock activity during the six months ended June 30, 2006:

	Shares (in thousands)	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2005	330	\$ 5.26
Granted	100	3.79
Vested	(36)	5.79
Forfeited	(3)	5.90
Outstanding at June 30, 2006	391	\$ 5.00

As of June 30, 2006, there was \$1.4 million of unrecognized stock-based compensation cost related to restricted stock which is expected to be recognized over a weighted average period of 2.3 years.

As of June 30, 2006, the Company had 49,000 restricted stock units (RSUs) outstanding. The RSUs were issued under the Company's Annual Incentive and Management Stock Purchase Plan and cliff-vest three years from the grant date. The Company has assumed a 10% rate of forfeiture. The fair value of the liability associated with the outstanding RSUs was \$0.1 million as of June 30, 2006.

For the three and six months ended June 30, 2006, stock-based compensation expense totaled \$0.2 million and \$0.4 million, respectively. For the three and six months ended June 30, 2005, stock-based compensation expense totaled \$0.1 million and \$0.2 million, respectively.

Table of Contents

The following pro forma information illustrates the pro forma effect on net loss and loss per share for the periods presented, as if the Company had elected to recognize compensation cost associated with stock-based awards under the method prescribed by SFAS 123, as amended by SFAS 148 (in thousands, except per share data):

	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Net loss as reported	\$ (7,701)	\$ (27,749)
Add: Stock-based employee compensation included in reported net loss, net of tax	116	233
Deduct: Total stock-based employee compensation determined under fair value based method for all awards, net of tax	(144)	(289)
Pro forma loss	\$ (7,729)	\$ (27,805)
Net loss per share basic and diluted:		
As reported	\$ (0.63)	\$ (2.29)
Pro forma	\$ (0.64)	\$ (2.29)

11. Earnings (Loss) Per Common Share

Basic earnings (loss) per common share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per common share (Diluted EPS) is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period after giving effect to all potentially dilutive securities outstanding during the period.

The Company's potentially dilutive securities include potential common shares related to our stock options and restricted stock. Diluted EPS includes the impact of potentially dilutive securities except in periods in which there is a loss because the inclusion of the potential common shares would be anti-dilutive. Diluted EPS also excludes the impact of potential common shares related to our stock options in periods in which the option exercise price is greater than the average market price of our common stock for the period.

The following table presents a reconciliation between the weighted average number of basic shares outstanding and the weighted average number of fully diluted shares outstanding:

(in thousands)	Three months ended June 30,		Six months ended June 30,	
	2006	2005	2006	2005
Basic weighted average shares outstanding	12,208	12,129	12,203	12,124
Potentially dilutive securities:				
Employee stock options				
Restricted stock		332		
Total		332		
Diluted weighted average shares outstanding	12,540	12,129	12,203	12,124

Diluted EPS for the three months ended June 30, 2006 excludes approximately 0.2 million stock options because the option price was greater than the average market price of our common stock. Diluted EPS for the six months ended June 30, 2006 excludes approximately 0.3 million shares of restricted stock, and 0.2 million stock options because the option price was greater than the average market price of our common stock.

Edgar Filing: CONSTAR INTERNATIONAL INC - Form 10-Q

Diluted EPS for the three and six months ended June 30, 2005 excludes approximately 0.4 million shares of restricted stock, and 0.2 million stock options because the option price was greater than the average market price of our common stock.

Table of Contents**12. Pension and Postretirement Benefits**

The U.S. salaried and hourly personnel participate in a defined benefit pension plan. The benefits under this plan for salaried employees are based primarily on years of service and remuneration near retirement. The benefits for hourly employees are based primarily on years of service and a fixed monthly multiplier. Plan assets consist principally of common stocks and fixed income securities.

In the U.S., the Company sponsors unfunded plans to provide health care and life insurance benefits to pensioners and survivors. Generally, the medical plans pay a stated percentage of medical expenses reduced by deductibles and other coverage. Life insurance benefits are generally provided by insurance contracts. The Company reserves the right, subject to existing agreements, to change, modify or discontinue the plans.

Employees of our U.K. operation may participate in a contributory pension plan with a benefit based on years of service and final salary. Participants contribute 5% of their salary each year and the U.K. operation contributes the balance, which is currently approximately 21.9% of their salary. The assets of the plan are held in a trust and are primarily invested in equity securities.

Employees of our Netherlands operation are entitled to a retirement benefit based on years of service and final salary. The plan is financed via participating annuity contracts and the values of the participation rights approximate the unfunded service obligation based on future compensation increases.

The components of the pension and postretirement benefit expense/(income) for the Company's plans were as follows:

	Three Months Ended		Three Months Ended	
	June 30, 2006		June 30, 2005	
	Pension	Post-retirement	Pension	Post-retirement
Service cost	\$ 814	\$	\$ 801	\$
Interest cost	1,271	62	1,219	102
Expected return on plan assets	(1,452)		(1,329)	
Amortization of net loss	891	171	839	194
Amortization of prior service cost	38	(77)	38	(49)
Total pension and post-retirement expense	\$ 1,562	\$ 156	\$ 1,568	\$ 247
	Six Months Ended		Six Months Ended	
	June 30, 2006		June 30, 2005	
	Pension	Post-retirement	Pension	Post-retirement
Service cost	\$ 1,628	\$	\$ 1,602	\$
Interest cost	2,542	124	2,438	204
Expected return on plan assets	(2,904)		(2,659)	
Amortization of net loss	1,782	342	1,678	388
Amortization of prior service cost	76	(154)	76	(98)
Total pension and post-retirement expense	\$ 3,124	\$ 312	\$ 3,135	\$ 494

The Company estimates that its expected contribution to its pension plans for the 2006 fiscal year will be approximately \$6.3 million of which \$1.8 million and \$3.2 million, respectively, were paid during the three and six month periods ended June 30, 2006.

13. Segment Information

Constar has only one operating segment and one reporting unit. The Company has operating plants in the United States and Europe.

Table of Contents

Net customer sales for the countries in which Constar operated were:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
United States	\$ 204,347	\$ 199,399	\$ 385,890	\$ 368,846
United Kingdom	32,099	34,538	58,109	62,434
Other	20,752	22,797	37,973	41,201
	\$ 257,198	\$ 256,734	\$ 481,972	\$ 472,481

14. Income Taxes

During the six months ended June 30, 2006 the company recorded a valuation allowance of \$2.8 million to offset net operating losses and deferred tax assets generated for the U.S. and foreign operations during fiscal 2006. The Company does not currently anticipate realizing deferred tax assets to the extent assets exceed deferred tax liabilities.

15. Derivative Financial Instruments (Cash Flow Hedge)

The Company reviews opportunities and options to reduce the Company's financial risks and exposure. The Company may enter into a derivative instrument by approval of the Company's executive management based on guidelines established by the Company's Board of Directors. Market and credit risks associated with this instrument are regularly reviewed by the Company's executive management.

The Company has an interest rate swap for a notional amount of \$100.0 million relating to its Senior Notes. The Company effectively exchanged its floating interest rate of LIBOR plus 3.375% for a fixed rate of 7.9% over the remaining term of the underlying notes. The objective and strategy for undertaking this Interest Rate Swap was to hedge the exposure to variability in expected future cash flows as a result of the floating interest rate associated with the Company's debt due in 2012.

The Company accounted for this interest rate swap as a cash flow hedge and assumes that there is no ineffectiveness in the hedging relationship and recognizes in other comprehensive income the entire change in the fair value of the swap. The fair value of the interest rate swap asset was \$4.9 million at June 30, 2006 and \$1.4 million at December 31, 2005. For the six months ended June 30, 2006, the Company recorded an unrealized gain in other comprehensive income of \$3.5 million.

16. Discontinued Operations

The supply agreement of the Company's Turkish joint venture has expired and the Company has decided to discontinue the joint venture's operations. Operations of the joint venture ceased in May 2006. The Company is currently seeking buyers for the building and manufacturing assets of the joint venture. In accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144), the assets and related liabilities of the joint venture have been classified as assets and liabilities of discontinued operations on the condensed consolidated balance sheets and the results of operations of the joint venture have been classified as discontinued operations in the condensed consolidated statements of operations for all periods presented. The assets of the discontinued operation are included in other current assets and the liabilities of the discontinued operation are included in other current liabilities in the condensed consolidated balance sheets.

Table of Contents

The following summarizes the assets and liabilities of discontinued operations:

	June 30, 2006	December 31, 2005
Assets:		
Accounts receivable	\$ 1,765	\$ 3,016
Inventory		1,482
Prepaid expenses and other current assets	35	67
Property, plant and equipment	2,269	2,437
Total	\$ 4,069	\$ 7,002
Liabilities:		
Short-term debt	\$	\$ 1,540
Accounts payable and accrued liabilities	401	1,193
Other liabilities	61	477
Minority interests	2,323	2,322
Total	\$ 2,785	\$ 5,532

The following is a summary of results of operations of discontinued operations:

	Three months ended June 30,		Six months ended June 30,	
	2006	2005	2006	2005
Net sales	4,643	7,444	9,605	11,943
Income (loss) from discontinued operations before income taxes and minority interests	(643)	180	(615)	216
(Provision for) benefit from income taxes	107	(82)	107	(29)
Income (loss) from discontinued operations before minority interests	(536)	98	(508)	187
Minority interests	18	(10)	(1)	(19)
Income (loss) from discontinued operations	\$ (518)	\$ 88	\$ (509)	\$ 168

The Company has accrued an estimate of the restructuring charges expected to be incurred as a result of the plan to close the joint venture operations. The balance in the restructuring reserves is principally comprised of employee severance and benefits costs which are expected to be paid in 2006. The following table presents an analysis of the 2006 Plan's restructuring reserve activity for the six months ended June 30, 2006:

Balance at December 31, 2005	\$
Charges to income from discontinued operations	740
Payments	(517)
Adjustments	
Balance at June 30, 2006	\$ 223

Table of Contents

17. Condensed Consolidating Financial Information

The Company's Senior Notes are guaranteed on a senior basis by each of the Company's domestic and United Kingdom restricted subsidiaries. The guarantor subsidiaries are 100% owned and the guarantees are made on a joint and several basis and are full and unconditional. The following guarantor and non-guarantor condensed financial information gives effect to the guarantee of the Senior Notes by each of our domestic and United Kingdom restricted subsidiaries. The following condensed consolidating financial statements are required in accordance with Regulation S-X Rule 3-10:

Balance sheets as of June 30, 2006 and December 31, 2005;

Statements of operations for the three months and six months ended June 30, 2006 and June 30, 2005; and

Statements of cash flows for the six months ended June 30, 2006 and June 30, 2005.

Table of Contents**CONDENSED CONSOLIDATING BALANCE SHEET****JUNE 30, 2006****(in thousands)****(unaudited)**

	Parent	Guarantor	Non-Guarantor	Eliminations	Total Company
Assets					
Current Assets					
Cash and cash equivalents	\$	\$ 5,716	\$ 3,655	\$	\$ 9,371
Intercompany receivable		80,055	5,132	(85,187)	
Accounts receivable, net		80,824	17,824		98,648
Inventories, net		90,212	5,231		95,443
Prepaid expenses and other current assets		10,589	4,325		14,914
Total current assets		267,396	36,167	(85,187)	218,376
Property, plant and equipment, net		144,477	6,283		150,760
Goodwill		148,813			148,813
Investments in subsidiaries	440,532	18,362		(458,894)	
Other assets	15,010	7,430			22,440
Total assets	\$ 455,542	\$ 586,478	\$ 42,450	\$ (544,081)	\$ 540,389
Liabilities and Stockholders Equity (Deficit)					
Current Liabilities					
Short-term debt	\$ 24,168	\$	\$	\$	\$ 24,168
Intercompany payable	76,448	5,031	3,708	(85,187)	
Accounts payable and accrued liabilities	4,230	111,353	20,361		135,944
Income taxes payable			6		6
Total current liabilities	104,846	116,384	24,075	(85,187)	160,118
Long-term debt, net of current portion	393,334				393,334
Pension and post-retirement liabilities		20,029	11		20,040
Deferred income taxes		3,190			3,190
Other liabilities		6,343	2		6,345
Total liabilities	498,180	145,946	24,088	(85,187)	583,027
Commitments and contingent liabilities					
Stockholders' equity (deficit)	(42,638)	440,532	18,362	(458,894)	(42,638)
Total liabilities and stockholders' equity (deficit)	\$ 455,542	\$ 586,478	\$ 42,450	\$ (544,081)	\$ 540,389

Table of Contents**CONDENSED CONSOLIDATING BALANCE SHEET****DECEMBER 31, 2005****(in thousands)****(unaudited)**

	Parent	Guarantor	Non-Guarantor	Eliminations	Total Company
Assets					
Current Assets					
Cash and cash equivalents	\$	\$ 6,744	\$ 2,919	\$	\$ 9,663
Intercompany receivable		70,168	3,749	(73,917)	
Accounts receivable, net		65,542	14,020		79,562
Inventories, net		95,007	5,346		100,353
Prepaid expenses and other current assets		11,644	7,212		18,856
Total current assets		249,105	33,246	(73,917)	208,434
Property, plant and equipment, net		151,156	5,552		156,708
Goodwill		148,813			148,813
Investments	421,732	16,453		(438,185)	
Other assets	10,958	9,739			20,697
Total assets	\$ 432,690	\$ 575,266	\$ 38,798	\$ (512,102)	\$ 534,652
Liabilities and Stockholders Equity (Deficit)					
Current Liabilities					
Short-term debt	\$ 10,453	\$	\$	\$	\$ 10,453
Intercompany payable	67,012	3,094	3,811	(73,917)	
Accounts payable and accrued liabilities	3,880	120,812	18,452		143,144
Income taxes payable		205			205
Total current liabilities	81,345	124,111	22,263	(73,917)	153,802
Long-term debt, net of current portion	393,205				393,205
Pension and post-retirement liabilities		19,971	17		19,988
Deferred income taxes		3,536			3,536
Other liabilities		5,916	65		5,981
Total liabilities	474,550	153,534	22,345	(73,917)	576,512
Commitments and contingent liabilities					
Stockholders' equity (deficit)	(41,860)	421,732	16,453	(438,185)	(41,860)
Total liabilities and stockholders' equity (deficit)	\$ 432,690	\$ 575,266	\$ 38,798	\$ (512,102)	\$ 534,652

Table of Contents**CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS****FOR THE THREE MONTHS ENDED JUNE 30, 2006****(in thousands)****(unaudited)**

	Parent	Guarantor	Non-Guarantor	Eliminations	Total Company
Net sales	\$	\$ 237,702	\$ 20,752	\$	\$ 258,454
Cost of products sold, excluding depreciation		207,303	19,211		226,514
Depreciation		10,464	293		10,757
Gross profit		19,935	1,248		21,183
Selling and administrative expenses		7,836	392		8,228
Research and technology expenses		1,688			1,688
Asset impairment charges		870			870
Provision for restructuring		182			182
Total operating expenses		10,576	392		10,968
Operating income		9,359	856		10,215
Interest expense	10,230	258	(24)		10,464
Other (income) expense, net		(793)	(143)		(936)
Income (loss) from continuing operations before income taxes	(10,230)	9,894	1,023		687
(Provision for) benefit from income taxes					
Income (loss) from continuing operations	(10,230)	9,894	1,023		687
Equity earnings	10,399	505		(10,904)	
Loss from discontinued operations, net of taxes			(518)		(518)
Net income (loss)	\$ 169	\$ 10,399	\$ 505	\$ (10,904)	\$ 169

Table of Contents**CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS****FOR THE THREE MONTHS ENDED JUNE 30, 2005****(in thousands)****(unaudited)**

	Parent	Guarantor	Non-Guarantor	Eliminations	Total Company
Net sales	\$	\$ 235,115	\$ 22,798	\$	\$ 257,913
Cost of products sold, excluding depreciation		214,953	21,252		236,205
Depreciation		10,576	752		11,328
Gross profit		9,586	794		10,380
Selling and administrative expenses		5,693	430		6,123
Research and technology expenses		1,572			1,572
Provision for restructuring		51			51
Total operating expenses		7,316	430		7,746
Operating income		2,270	364		2,634
Interest expense	9,089	236	48		9,373
Other (income) expense, net	688	(117)	165		736
Income (loss) from continuing operations before income taxes	(9,777)	2,151	151		(7,475)
(Provision for) benefit from income taxes		(156)	(158)		(314)
Income (loss) from continuing operations	(9,777)	1,995	(7)		(7,789)
Equity earnings	2,076	81		(2,157)	
Income from discontinued operations, net of taxes			88		88
Net income (loss)	\$ (7,701)	\$ 2,076	\$ 81	\$ (2,157)	\$ (7,701)

Table of Contents**CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS****FOR THE SIX MONTHS ENDED JUNE 30, 2006****(in thousands)****(unaudited)**

	Parent	Guarantor	Non-Guarantor	Eliminations	Total Company
Net sales	\$	\$ 446,211	\$ 37,973	\$	\$ 484,184
Cost of products sold, excluding depreciation		396,032	35,564		431,596
Depreciation		18,267	572		18,839
Gross profit		31,912	1,837		33,749
Selling and administrative expenses		14,997	833		15,830
Research and technology expenses		3,026			3,026
Asset impairment charges		870			870
Provision for restructuring		225			225
Total operating expenses		19,118	833		19,951
Operating income		12,794	1,004		13,798
Interest expense	20,238	439	(27)		20,650
Other (income) expense, net		(986)	(201)		(1,187)
Income (loss) from continuing operations before income taxes	(20,238)	13,341	1,232		(5,665)
(Provision for) benefit from income taxes					
Income (loss) from continuing operations	(20,238)	13,341	1,232		(5,665)
Equity earnings	14,064	723		(14,787)	
Loss from discontinued operations, net of taxes			(509)		(509)
Net income (loss)	\$ (6,174)	\$ 14,064	\$ 723	(14,787)	\$ (6,174)

Table of Contents**CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS****FOR THE SIX MONTHS ENDED JUNE 30, 2005****(in thousands)****(unaudited)**

	Parent	Guarantor	Non-Guarantor	Eliminations	Total Company
Net sales	\$	\$ 433,493	\$ 41,201	\$	\$ 474,694
Cost of products sold, excluding depreciation		396,574	38,885		435,459
Depreciation		21,077	1,450		22,527
Gross profit		15,842	866		16,708
Selling and administrative expenses		11,364	881		12,245
Research and technology expenses		3,046			3,046
Write-off of deferred financing costs	10,025				10,025
Provision for restructuring		110			110
Total operating expenses	10,025	14,520	881		25,426
Operating income (loss)	(10,025)	1,322	(15)		(8,718)
Interest expense	18,563	352	89		19,004
Other (income) expense, net	688	(624)	285		349
Income (loss) from continuing operations before income taxes	(29,276)	1,594	(389)		(28,071)
(Provision for) benefit from income taxes		202	(48)		154
Income (loss) from continuing operations	(29,276)	1,796	(437)		(27,917)
Equity earnings	1,527	(269)		(1,258)	
Income from discontinued operations, net of taxes			168		168
Net income (loss)	\$ (27,749)	\$ 1,527	\$ (269)	\$ (1,258)	\$ (27,749)

Table of Contents**CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS****FOR THE SIX MONTHS ENDED JUNE 30, 2006****(in thousands)****(unaudited)**

	Parent	Guarantor	Non-Guarantor	Eliminations	Total Company
Cash flows from operating activities:					
Net income (loss)	\$ (6,174)	\$ 14,064	\$ 723	\$ (14,787)	\$ (6,174)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Depreciation and amortization	1,110	18,230	738		20,078
Stock-based compensation		365			365
Asset impairment charges		870			870
Equity earnings	(14,064)	(723)		14,787	
Changes in operating assets and liabilities, net	(3,703)	(12,581)	1,522		(14,762)
Net cash provided by (used in) operating activities	(22,831)	20,225	2,983		377
Cash flows from investing activities:					
Purchases of property, plant and equipment		(11,845)	(832)		(12,677)
Proceeds from the sale of property, plant and equipment		41			41
Net cash used in investing activities		(11,804)	(832)		(12,636)
Cash flows from financing activities:					
Proceeds from Revolver loan	430,359				430,359
Repayment of Revolver loan	(416,644)				(416,644)
Net change in intercompany loans	9,436	(9,436)			
Change in outstanding overdrafts		(162)			(162)
Costs associated with debt refinancing	(320)				(320)
Other financing activities			(1,540)		(1,540)
Net cash provided by (used in) financing activities	22,831	(9,598)	(1,540)		11,693
Effect of exchange rate changes on cash and cash equivalents		149	125		274
Net increase (decrease) in cash and cash equivalents		(1,028)	736		(292)
Cash and cash equivalents at beginning of period		6,744	2,919		9,663
Cash and cash equivalents at end of period	\$	\$ 5,716	\$ 3,655	\$	\$ 9,371

Table of Contents**CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS****FOR THE SIX MONTHS ENDED JUNE 30, 2005****(in thousands)****(unaudited)**

	Parent	Guarantor	Non-Guarantor	Eliminations	Total Company
Cash flows from operating activities:					
Net income (loss)	\$ (27,749)	\$ 1,527	\$ (269)	\$ (1,258)	\$ (27,749)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Depreciation and amortization	688	21,206	1,655		23,549
Stock-based compensation		358			358
Write-off of deferred financing costs	6,556				6,556
Equity earnings	(1,527)	269		1,258	
Changes in operating assets and liabilities	1,989	(3,105)	(289)		(1,405)
Net cash provided by (used in) operating activities	(20,043)	20,255	1,097		1,309
Cash flows from investing activities:					
Purchases of property, plant and equipment		(18,922)	(706)		(19,628)
Proceeds from the sale of property, plant and equipment		570			570
Net cash used in investing activities		(18,352)	(706)		(19,058)
Cash flows from financing activities:					
Proceeds from sale of Senior Notes	220,000				220,000
Repayment of term loan	(121,941)				(121,941)
Proceeds from Revolver loan	362,000				362,000
Repayment of Revolver loan	(359,000)				(359,000)
Repayment of second lien loan	(75,000)				(75,000)
Change in outstanding overdrafts		1,996			1,996
Costs associated with debt refinancing	(10,774)				(10,774)
Net change in intercompany accounts	4,758	(5,192)	434		
Other financing activities		(85)			(85)
Net cash provided by (used in) financing activities	20,043	(3,281)	434		17,196
Effect of exchange rate changes on cash and cash equivalents		(138)	(273)		(411)
Net increase (decrease) in cash and cash equivalents		(1,516)	552		(964)
Cash and cash equivalents at beginning of period		6,791	2,525		9,316
Cash and cash equivalents at end of period	\$	\$ 5,275	\$ 3,077	\$	\$ 8,352

Table of Contents

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

Overview

The Company is a manufacturer of PET plastic containers for food and beverages. Approximately 80 percent of the Company's revenues in the first half of 2006 were generated in the United States, with the remainder attributable to its European operations. During the first half of 2006, one customer accounted for approximately 33 percent of the Company's consolidated revenues, while the top ten customers accounted for an aggregate of approximately 70 percent of the Company's consolidated revenues. Approximately 74 percent of the Company's sales in the first half of 2006 related to conventional PET containers which are primarily used for carbonated soft drinks and bottled water. Profitability is driven principally by price, volume and maintaining efficient manufacturing operations. In recent years, the largest growth within conventional products has come from bottled water. The Company believes that over time, growth and profitability from bottled water may decline as economic factors force some water bottlers into self manufacturing of PET bottles or out of business. The Company does not expect growth in the carbonated soft drink market in the near term due to consumer preference for healthier beverages.

In addition to the conventional product lines, the Company is also a producer of higher margin custom products that are used in such packaging applications as hot-filled beverages, food, beer and flavored alcoholic beverages, most of which require containers with special performance characteristics. Approximately 20 percent of the Company's sales in the first half of 2006 related to custom PET containers. Critical success factors in the custom PET market include technology, design capabilities and expertise with specialized equipment. The technology required to produce certain types of custom products is commonly available, which has resulted in increased competition and lower margins for such products.

In recent years, the PET packaging industry has experienced very competitive pricing conditions. Pricing pressure continues especially for custom products that can be produced with commercially available technology. Pricing pressure for conventional products and domestic conventional capacity continues to remain tight. Most of the Company's business, both in conventional and custom PET products, is subject to long term contracts with major consumer packaged goods producers. Some of these contracts come up for renewal each year, and are often offered to the market for competitive bidding. The Company's main contract with PepsiCo, its largest customer, expires on December 31, 2007.

In negotiations with certain customers for the continuation and the extension of supply agreements, predominantly in the custom segment, the Company has agreed to price concessions. These concessions have been partially offset by energy surcharges and other provisions obtained under new contracts for conventional business that renewed since the Company implemented its strategic value initiative in the fourth quarter of 2005. The net negative impact of contractual pricing is currently expected to be approximately \$3.0 million in 2006, which is expected to predominately impact the second half of the year. Under its strategic value initiative, the Company has presented to conventional customers whose contracts are up for renewal a new contract structure with integrated terms and conditions, service level options, and pricing components that give the customer the flexibility to choose from a set of service options that are priced as additions to a negotiated base product price. In addition to the revenue gain from higher prices under the new contracts, the Company believes the new structure will enable it to reduce costs by limiting services it must provide when a customer chooses a lower price that does not entitle the customer to such services.

The Company believes that it will continue to face two significant sources of pricing pressure. The first source is customer consolidation. When customers merge or purchase through buying cooperatives and thereby aggregate purchasing power, the profitability of Constar's business tends to decline. The Company will negotiate aggressively and seek to minimize the impact of customer consolidation. The second source of pricing pressure is contractual provisions that permit customers to terminate contracts if the customer receives an offer from another manufacturer that the Company chooses not to match. The Company is continuing to seek to remove, or lessen the impact of, these provisions in all new contracts and contract renewals.

Table of Contents

Constar's gross margin, excluding depreciation expense, was 10.9 percent in the first half of 2006 as compared to 8.3 percent for the same period in 2005. This margin improvement is a result of the Company's effort to improve customer and product mix, increase prices on certain products, and the impact of the Company's strategic value initiative, partially offset by unfavorable foreign currency translations which reduced sales by approximately 2.0 percent of sales from the six months of 2005. The Company's ability to sustain and grow its operating margins will depend on the extent of the Company's ongoing success in these efforts. Constar has recently operated at high utilization rates; however, the Company does not intend to invest in additional capacity in the low margin conventional business until overall margins and prices increase to levels where acceptable returns can be achieved and sustained.

The primary raw material and component cost of the Company's products is PET resin, which is a commodity available globally. The price of PET resin is subject to frequent fluctuations as a result of raw material costs, overseas markets, PET production capacity and seasonal demand. The price of PET resin has declined through the first half of 2006; however the Company anticipates significantly higher prices in the third quarter due to increases in petrochemical product costs. Constar is one of the largest purchasers of PET resin in North America, which it believes provides it with negotiating leverage. However, higher resin prices may impact the demand for PET packaging where customers have a choice between PET and other forms of packaging.

Substantially all of the Company's sales are made pursuant to contracts that allow for the pass-through of changes in the price of PET resin to its customers. Period-to-period comparisons of gross profit and gross profit as a percentage of sales may not be meaningful indicators of actual performance, because the effects of the pass-through mechanisms are affected by the magnitude and timing of resin price changes.

PET bottle manufacturing is capital intensive, requiring both specialized production equipment and significant support infrastructure for power, high pressure air and resin handling. Constar believes that there are significant opportunities for the conversion of glass containers to PET containers for bottled teas, beer, flavored alcoholic beverages and food applications. These conversion opportunities will require significant capital expenditures to obtain the appropriate production equipment. The Company's credit agreement imposes maximum capital expenditures of \$42.5 million in 2006, \$47.5 million in 2007, and \$47.5 million in 2008. These capital expenditure covenants allow for the carry forward of a certain amount of spending below covenant levels in previous periods. In 2005 Constar spent \$32.6 million in capital expenditures, allowing \$9.3 million to be carried over to 2006, so that the effective capital expenditure limit for 2006 is \$51.8 million. Constar currently expects to spend \$30.0 million to \$35.0 million on capital expenditures in 2006. If Constar is awarded a significant volume of conversions over a short period of time, it may have to seek waivers or amendments to these covenants which it may not be able to obtain on commercially reasonable terms or at all. However, some conversions can be serviced with the equipment currently devoted to our conventional business and Constar has and will continue to redeploy equipment where possible.

In order to capture economies of scale, the Company favors large plants located within a few hours driving distance of the major markets that it services. Normally, this proximity helps the Company to minimize freight costs. However, in order to meet its customers' requirements, the Company must sometimes manufacture products out of territory at a plant that is not its closest plant to the necessary delivery location. This increases freight costs, and depending on the circumstances, the Company may be required to bear these additional freight costs. These out of territory freight costs tend to peak during the second and third quarters, when the Company's customers' requirements are at their highest. In addition, any general increase in freight rates may impact the Company's margins to the extent that its contracts do not permit it to pass the increase through to its customers.

The Company is highly leveraged. As of June 30, 2006, the Company's debt structure consisted of a \$70.0 million credit agreement, \$220.0 million of secured notes and \$175.0 million of subordinated notes. As of June 30, 2006, the Company had \$24.2 million borrowed under the credit agreement and \$5.0 million outstanding on letters of credit. Interest expense for the six months ended June 30, 2006 was \$20.6 million. Effective March 16, 2006, the Company amended its credit agreement to increase available credit to provide

Table of Contents

flexibility during the seasonal buildup of working capital. The amendment eliminated the interest coverage test and reduced the minimum available credit requirement to \$5.0 million from \$10.0 million. The amendment also added a requirement that the Company maintain minimum collateral availability in excess of \$20.0 million. The Company was in compliance with the financial covenants of these debt instruments as of June 30, 2006.

The Company's cash flow from operations of \$0.4 million was positive through the first half of 2006 mainly due to operating income growth and improved management of working capital.

Results of Operations**Three Months Ended June 30, 2006 and 2005***Net Sales*

(dollars in millions)	Three months ended June 30,		Increase	% Increase
	2006	2005	(Decrease)	(Decrease)
United States	\$ 205.6	\$ 200.6	\$ 5.0	2.5%
Europe	52.9	57.3	(4.4)	(7.7)%
Total	\$ 258.5	\$ 257.9	\$ 0.6	0.2%

Consolidated net sales increased by \$0.6 million, or 0.2 percent, to \$258.5 million in the second quarter of 2006 from \$257.9 million in the second quarter of 2005. This increase in consolidated net sales was primarily driven by increased shipments of custom products, partially offset by unfavorable foreign currency translations, and a slight decline in conventional unit volumes.

In the U.S., net sales increased \$5.0 million, or 2.5 percent, to \$205.6 million in the second quarter of 2006 from \$200.6 million in the second quarter of 2005. This increase in U.S. net sales in 2006 was due to increased sales of custom units, improved product mix and the impact of the Company's strategic value initiative, partially offset by lower unit sales of conventional products. Total U.S. unit volume increased 1.6 percent over the second quarter of 2005. Custom unit volume growth was 34.7 percent, while conventional unit volume declined 4.3 percent.

In Europe, net sales decreased \$4.4 million, or 7.7 percent, to \$52.9 million in the second quarter of 2006 from \$57.3 million in the second quarter of 2005. The decrease in European net sales in the second quarter of 2006 was primarily due to the weakening of the British Pound and Euro against the U.S. Dollar.

Net sales in the U.S. accounted for 79.6 percent of net sales in the second quarter of 2006 compared to 77.8 percent of net sales in the second quarter of 2005.

Gross Profit

(dollars in millions)	Three months ended June 30,		Increase
	2006	2005	(Decrease)
United States	\$ 19.4	\$ 9.9	\$ 9.5
Europe	1.8	0.5	1.3
Total	\$ 21.2	\$ 10.4	\$ 10.8
Percent of net sales	8.2%	4.0%	

Table of Contents

Gross profit increased \$10.8 million to \$21.2 million or 8.2 percent of consolidated net sales in the second quarter of 2006 from \$10.4 million in the second quarter of 2005 or 4.0 percent of consolidated net sales. The increase reflects greater custom sales units, favorable product mix, benefits from the Company's strategic value initiative, improved pricing related to the settlement of a pricing dispute which contributed to approximately 20 percent of the improvement, improved operating efficiencies in our U.S. manufacturing operations and reduced depreciation expense. The second quarter gross profit gains were partially offset by a non-cash depreciation adjustment of \$1.8 million resulting from a review of property, plant and equipment.

Selling and Administrative Expenses

Selling and administrative expenses increased \$2.1 million, or 34.4 percent, to \$8.2 million in the second quarter of 2006 from \$6.1 million in the second quarter of 2005. This increase in 2006 primarily related to increased compensation expense of \$1.0 million, and increased legal, audit, and Sarbanes-Oxley related expenses of \$0.8 million.

Research and Technology Expenses

Research and technology expenses were \$1.7 million in the second quarter of 2006 compared to \$1.6 million in the second quarter of 2005. The research and technology expenses relate to spending for the Company's existing proprietary technologies and new emerging technologies.

Asset Impairment Charge

In the second quarter of 2006, the Company recorded a non-cash asset impairment charge of \$0.9 million to write down the carrying value of an asset to fair value.

Provision for Restructuring

These expenses relate to the 2003 restructuring initiative under which the Company closed two facilities operating in Birmingham, Alabama and Reserve, Louisiana and severance and benefit costs associated with the shut down of the plant operation in Izmir, Turkey.

Operating Income

Operating income was \$10.2 million in the second quarter of 2006 compared to \$2.6 million in the second quarter of 2005. This increase in operating income in 2006 compared to 2005 was primarily related to the improved operating performance described above, partially offset by the increase in selling and administrative expenses.

Interest Expense

Interest expense increased \$1.1 million to \$10.5 million in the second quarter of 2006 from \$9.4 million in the second quarter of 2005 as a result of higher average borrowings and a higher effective interest rate.

Other (Income) Expense, net

Other income was \$0.9 million in the second quarter of 2006 compared to other expense of \$0.7 million in the second quarter of 2005. The income in 2006 primarily resulted from the positive impact of changes in foreign currency translation rates on intra-company balances and from royalty income.

(Provision for) Benefit from Income Taxes

There was no provision for income taxes related to continuing operations in the second quarter of 2006 compared to a provision for \$0.3 million in the second quarter of 2005. Income from continuing operations

Table of Contents

before income taxes was \$0.7 million in second quarter of 2006 compared to a loss of \$7.5 million in 2005. During the second quarter of 2006, the Company recorded a valuation allowance of \$0.7 million to offset net operating losses and deferred tax assets generated for the U.S. and foreign operations. During the second quarter of 2005, the Company recorded an additional valuation allowance of \$1.8 million to reduce certain deferred tax assets in the United States.

Income (loss) from Discontinued Operations, net of taxes

The Company's Turkish joint venture ceased operations in May 2006 and has been classified as discontinued operations for all periods presented. Unless otherwise indicated, amounts provided throughout the Form 10-Q relate to continuing operations only.

Loss from discontinued operations was \$0.5 million in the second quarter of 2006 compared to income from discontinued operations of \$0.1 million in the second quarter of 2005. The decrease in the income in 2006 compared to 2005 was primarily related to the shutdown of the plant operation in Izmir, Turkey in May 2006.

Net Income (loss)

Net income was \$0.2 million in the second quarter of 2006, or \$0.01 income per basic and diluted share, compared to a net loss of \$7.7 million, or \$0.63 loss per basic and diluted share, in the second quarter of 2005.

Six Months Ended June 30, 2006 and 2005*Net Sales*

(dollars in millions)	Six months ended June 30,		Increase	% Increase
	2006	2005		
United States	\$ 388.1	\$ 371.1	\$ 17.0	4.6%
Europe	96.1	103.6	(7.5)	(7.3%)
Total	\$ 484.2	\$ 474.7	\$ 9.5	2.0%

Consolidated net sales increased by \$9.5 million, or 2.0 percent, to \$484.2 million in the six months ended June 30, 2006 from \$474.7 million in the six months ended June 30, 2005. The increase in consolidated net sales was primarily driven by the increase in custom sales units, improved product mix, and the impact of the Company's strategic value initiative, partially offset by unfavorable foreign currency translations.

In the U.S., net sales increased \$17.0 million, or 4.6 percent, to \$388.1 million in the six months ended June 30, 2006 from \$371.1 million in the six months ended June 30, 2005. This increase in U.S. net sales in 2006 reflects the increase in custom sales units, improved product mix and the impact of the Company's strategic value initiative. Total U.S. unit volume increased 3.3 percent over the first six months of 2005. This increase reflects custom unit volume growth of 37.4 percent, which was offset by a 2.9 percent decrease in conventional unit volume.

In Europe, net sales decreased \$7.5 million, or 7.3 percent, to \$96.1 million in the six months ended June 30, 2006 from \$103.6 million in the six months ended June 30, 2005. The decrease in European net sales in the first six months of 2006 was due to the weakening of the British Pound and Euro against the U.S. Dollar along with the pass through of lower resin costs to customers.

Net sales in the U.S. accounted for 80.2 percent of net sales in the first six months of 2006 compared to 78.2 percent of net sales in the first six months of 2005.

Table of Contents**Gross Profit**

(dollars in millions)	Six months ended June 30,		Increase
	2006	2005	(Decrease)
United States	\$ 32.0	\$ 16.5	\$ 15.5
Europe	1.7	0.2	1.5
Total	\$ 33.7	\$ 16.7	\$ 17.0
Percent of net sales	7.0%	3.5%	

Gross profit increased \$17.0 million to \$33.7 million or 7.0 percent of consolidated net sales in the six months ended June 30, 2006, from \$16.7 million or 3.5 percent of consolidated net sales in the six months ended June 30, 2005. The increases reflect the growth in custom sales units, improved product mix, the impact of the Company's strategic value initiative, improved operating efficiencies in our U.S. manufacturing operations and \$3.7 million less in depreciation expense.

Selling and Administrative Expenses

Selling and administrative expenses increased by \$3.6 million, or 28.7 percent, to \$15.8 million in the six months ended June 30, 2006 from \$12.2 million in the six months ended June 30, 2005. This increase in 2006 primarily related to increased legal fees of \$1.4 million, increased compensation expense of \$1.4 million, and increased audit and Sarbanes-Oxley related expenses of \$0.9 million, partially offset by reduced other spending of \$0.2 million.

Research and Technology Expenses

Research and technology expenses were \$3.0 million in the six months ended June 30, 2006 compared to \$3.0 million in the six months ended June 30, 2005. The research and technology expenses relate to spending for the Company's existing proprietary technologies and new emerging technologies.

Write off of Deferred Financing Costs

In connection with its February 2005 refinancing, the Company repaid amounts outstanding under its former revolving loan facility and two term loans. As a result of these repayments, last year the Company wrote off approximately \$6.5 million of the remainder of the deferred financing costs related to those three facilities and incurred prepayment penalties of approximately \$3.5 million.

Asset Impairment Charge

In the second quarter of 2006, the Company recorded a non-cash asset impairment charge of \$0.9 million to write down the carrying value of an asset to fair value.

Provision for Restructuring

Restructuring costs were \$0.2 million in the six months ended June 30, 2006 compared to \$0.1 million expense in the six months ended June 30, 2005. These expenses relate to the 2003 restructuring initiative under which the Company closed two facilities operating in Birmingham, Alabama and Reserve, Louisiana and severance and benefit costs associated with the shut down of the plant operation in Izmir, Turkey.

Operating Income (loss)

Operating income was \$13.8 million in the six months ended June 30, 2006 compared to an operating loss of \$8.7 million in the six months ended June 30, 2005. This increase in operating income in the first six months

Table of Contents

of 2006 compared to the first six months of 2005 was primarily related to the improved operating performance described above, and the absence in 2006 of the \$10.0 million write-off of deferred financing costs and prepayment penalties associated with the 2005 refinancing.

Interest Expense

Interest expense increased \$1.6 million to \$20.6 million in the six months ended June 30, 2006 from \$19.0 million in the six months ended June 30, 2005 as a result of a higher effective interest rate and higher average borrowings.

Other (Income) Expense, Net

In the first half of the year the Company reported other income of \$1.2 million compared to other expense of \$0.3 million in the first six months of 2005. The income in 2006 was primarily from the positive impact of the changes in the foreign currency translation rates on intra-company balances and royalty income.

(Provision for) Benefit from Income Taxes

There was no provision for income taxes related to continuing operations in the six months ended June 30, 2006 compared to a benefit of \$0.2 million in the six months ended June 30, 2005. Loss from continuing operations before taxes was \$5.7 million in 2006 compared to \$28.1 million in 2005. During the first half of 2006, the Company recorded a valuation allowance of \$2.8 million to offset net operating losses and deferred tax assets generated for the U.S. and foreign operations during fiscal 2006. During the first half of 2005, the Company recorded an additional valuation allowance of \$8.6 million to reduce certain deferred tax assets in the United States.

Income (loss) from Discontinued Operations, net of taxes

Loss from discontinued operations was \$0.5 million in the six months ended June 30, 2006 compared to income from discontinued operations of \$0.2 million in the six months ended June 30, 2005. The decrease in income in 2006 compared to 2005 was primarily related to the shutdown of the plant operation in Izmir, Turkey in May 2006.

Net Loss

Net loss in the six months ended June 30, 2006 was \$6.2 million, or \$0.50 loss per basic and diluted share, compared to a net loss of \$27.7 million or \$2.29 loss per basic and diluted share in the six months ended June 30, 2005.

Liquidity and Capital Resources

At June 30, 2006, there was \$220.0 million outstanding on the Senior Notes, \$175.0 million outstanding on the Subordinated Notes, \$24.2 million outstanding on the Revolver Loan, and \$5.0 million outstanding under letters of credit.

The Revolver Loan imposes maximum capital expenditures of \$42.5 million in 2006, \$47.5 million in 2007 and \$47.5 million in 2008. These capital expenditure covenants allow for the carry forward of a certain amount of spending below covenant levels in previous periods. In 2005, Constar spent \$32.6 million in capital expenditures, allowing \$9.3 million to be carried over to 2006, so that the effective capital expenditure limit for 2006 is \$51.8 million. Constar currently expects to spend between \$30.0 million and \$35.0 million in capital expenditures in 2006. In order to satisfy significant business awards, including those relating to conversions from other forms of packaging, the Company may need to purchase additional equipment. To the extent such purchases would cause the Company to exceed the capital expenditure restrictions of the Revolver Loan, the Company would have to obtain the lenders' consent before making such purchases. There can be no assurances that the lenders would grant any such consent.

Table of Contents

Liquidity, defined as cash and availability under the Revolver Loan, is a key measure of the Company's ability to finance its operations. The principal determinant of 2006 liquidity will be financial performance including the following factors:

achievement of the Company's operating plan,

changes in working capital,

interest payments on the Company's debt,

the amount and timing of contributions to the Company's pension plans, and

the amount and timing of capital expenditures.

Liquidity will vary on a daily, monthly and quarterly basis based upon the seasonality of the Company's sales as well as the factors mentioned above. The Company's cash requirements are typically greater during the first and second quarters of each fiscal year because of the build up of inventory levels in anticipation of the seasonal sales increase during the warmer months and the collection cycle from customers following the higher seasonal sales.

The Company currently believes its anticipated liquidity will be adequate to finance its operations during 2006. However, actual results have differed from expectations in the past and may do so in the future as a result of several factors, including but not limited to: changes in sales and sales mix, operating performance in the Company's European operations, the impact of higher fuel and energy related costs, the impact of changes in resin costs on a particular quarter, currency fluctuations, and the other factors discussed under "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2005 and subsequent Quarterly Reports on Form 10-Q.

Cash Flows

The following table shows selected cash flow data.

(dollars in millions)	Six months ended	
	June 30,	
	2006	2005
Net cash provided by operations	\$ 0.4	\$ 1.3
Net cash used in investing activities	\$ (12.6)	\$ (19.1)
Net cash provided by financing activities	\$ 11.7	\$ 17.2

Net cash provided by operations decreased \$0.9 million from \$1.3 million for the six months ended June 30, 2005, to \$0.4 million for the six months ended June 30, 2006. Days sales in accounts receivable improved to approximately 36.9 days at June 30, 2006 from 40.1 days at June 30, 2005. Inventory days improved slightly to approximately 38.4 days at June 30, 2006 from 38.7 days at June 30, 2005. Actual payment terms related to accounts payable remained approximately the same during the six months ended June 30, 2006 as they were during the six months ended June 30, 2005; however, the timing of payments can significantly impact the cash flow in a quarter compared to a previous quarter. The Company made payments of approximately \$12.0 million on June 29, 2006 related to accounts payable. The timing of these payments was the principal reason for the decline in net cash provided by operations for the six months ended June 30, 2006 as compared to the six months ended June 30, 2005.

Edgar Filing: CONSTAR INTERNATIONAL INC - Form 10-Q

Net cash used in investing activities decreased \$6.5 million from \$19.1 million for the six months ended 2005 to \$12.6 million for the six months ended June 30, 2006, reflecting a decrease in capital spending on equipment for conventional products which was partially offset by an increase in capital spending to expand custom capacity needed to meet customer supply agreements.

Table of Contents

Net cash provided by financing activities was \$11.7 million for the six months ended June 30, 2006. The 2006 amount was primarily comprised of \$13.7 million net borrowings on the Revolver Loan less the repayment of \$1.5 million of debt associated with the Turkey operation. Net cash provided by financing activities of \$17.2 million during the six months ended June 30, 2005, was primarily comprised of the net proceeds from the Senior Notes of \$220.0 million offset by the repayment of amounts outstanding under the Company's former revolver facility and two term loans of \$196.9 million and costs associated with the debt refinancing of \$10.8 million. Proceeds from and repayments of the revolver loan in 2006 each increased over 2005 because of the implementation of a lockbox mechanism in 2005 which resulted in more frequent borrowings and repayments.

Commitments

Information regarding the Company's contingent liabilities appears in Part I within Item 1 of this report under Note 8 to the accompanying Condensed Consolidated Financial Statements, which information is incorporated herein by reference.

Stockholders' Deficit

Stockholders' deficit increased to \$42.6 million at June 30, 2006 from \$41.9 million deficit at December 31, 2005. This increase was primarily due to a net loss of \$6.2 million which was partially offset by a gain on the revaluation of a cash flow hedge of \$3.5 million and currency translation adjustments of \$1.6 million during the six months ended June 30, 2006.

Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (the "FASB") issued Statement of Financial Accounting Standards 123 (revised 2004), *Share-Based Payment* (SFAS 123R) which requires measurement of all employee stock-based compensation awards using a fair-value method and the recording of such expense in the consolidated financial statements. In addition, the adoption of SFAS 123R requires additional accounting changes related to the income tax effects and disclosure regarding the cash flow effects resulting from share-based payment arrangements. In January 2005, the SEC issued Staff Accounting Bulletin No. 107, which provides supplemental implementation guidance for SFAS 123R. The Company will recognize compensation expense on a straight-line basis over the requisite service period. The Company adopted SFAS 123R in the first quarter of fiscal 2006.

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments: an amendment of FASB Statements No. 133 and 140* (SFAS 155). SFAS 155 simplifies the accounting for certain hybrid financial instruments that contain an embedded derivative that otherwise would have required bifurcation. SFAS 155 also eliminates the interim guidance in SFAS 133, which provides that beneficial interests in securitized financial assets are not subject to the provisions of SFAS 133. SFAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. SFAS 155 is required to be adopted by the Company in the first quarter of fiscal 2007. The Company does not expect the adoption of SFAS 155 to have a material impact on our results of operations and financial condition.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets: an amendment of FASB Statement No. 140* (SFAS 156). SFAS 156 requires that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. The statement permits, but does not require, the subsequent measurement of servicing assets and servicing liabilities at fair value. SFAS 156 is effective as of the beginning of an entity's first fiscal year that begins after September 15, 2006. SFAS 156 is required to be adopted by the Company in the first quarter of fiscal 2007. The Company does not expect the adoption of SFAS 156 to have a material impact on our results of operations or financial condition.

Table of Contents

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. This interpretation prescribes a recognition threshold and measurement attribute of tax positions taken or expected to be taken on a tax return. This interpretation is effective for the Company beginning January 1, 2007. We are currently evaluating the impact FIN 48 will have on our financial statements.

Forward-Looking Statements

Statements included herein that are not historical facts (including, but not limited to, any statements concerning plans and objectives of management for future operations or economic performance, or assumptions related thereto), are forward-looking statements within the meaning of the federal securities laws. In addition, the Company and its representatives may from time to time make other oral or written statements which are also forward-looking statements.

These forward-looking statements are based on the Company's current expectations and projections about future events. Statements that include the words expect, believe, intend, plan, anticipate, project, will, may, could, should, pro forma, continues, estimates, objective and similar statements of a future nature identify forward-looking statements. These forward-looking statements and forecasts are subject to risks, uncertainties and assumptions. The Company cautions that forward-looking statements are not guarantees and that actual results could differ materially from those expressed or implied in the forward-looking statements. The Company does not intend to review or revise any particular forward-looking statement or forecast in light of future events.

A discussion of important factors that could cause the actual results of operations or financial condition of the Company to differ from expectations has been set forth in the Company's Annual Report on Form 10-K for the year ended December 31, 2005 under the captions Cautionary Statement Regarding Forward Looking Statements and Item 1.A Risk Factors and is incorporated herein by reference. Some of the factors are also discussed elsewhere in this Form 10-Q and have been or may be discussed from time to time in the Company's other filings with the Securities and Exchange Commission.

Table of Contents

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market Risk

In the normal course of business, the Company is exposed to fluctuations in currency values, interest rates, commodity prices and other market risks.

The Company derived approximately 20 percent of total revenues from sales in foreign currencies during the six months ended June 30, 2006. In the Company's financial statements, operating results in local currency are translated into U.S. dollars based on average exchange rates during the period and balance sheet items are translated at rates in effect on the balance sheet date. During periods of a strengthening dollar, the Company's U.S. dollar financial results related to operations conducted in foreign currencies are reduced because the local currency amounts are translated into fewer U.S. dollars. Conversely, as the dollar weakens, the Company's foreign results reported in U.S. dollars will increase accordingly. Based on the Company's revenues in the first six months of 2006 from its foreign locations that utilize currencies other than the U.S. dollar, a 10 percent increase in the U.S. dollar value would result in approximately a \$13.5 million reduction in net sales. The Company may enter into foreign exchange contracts to reduce the effects of fluctuations in foreign currency exchange rates on assets, liabilities, firm commitments and anticipated transactions. However, the Company does not generally hedge its exposure to translation gains or losses on non-U.S. net assets. At June 30, 2006, the Company had no foreign currency derivative contracts outstanding.

Under the procedures and controls of the Company's risk management, the Company entered into an agreement to manage the floating interest rate on a portion of the Company's Senior Notes and Revolver Loan. The interest rate swap involved the exchange of floating interest payments based on three month LIBOR rate for a fixed rate. The Company uses the interest rate swap to manage and hedge its exposure to interest rate risks. Therefore, the Company has an exposure to interest rate risk on the portion of the Senior Notes and borrowings under the Revolver Loan that is not part of the cash flow hedge. The extent of the Company's interest rate risk in connection with the Revolver Loan and the Senior Notes is not quantifiable or predictable because of the variability of future interest rates and borrowing requirements. Based on borrowing levels as of June 30, 2006, a 1% change in LIBOR would have resulted in an increase of \$1.4 million in annual interest expense. However, current amounts borrowed under the Revolver Loan might not be representative of future borrowings which will be based on our future requirements and seasonal needs.

The principal raw materials used in the manufacture of the Company's products are resins that are petrochemical derivatives. The markets for these resins are cyclical, and are characterized by fluctuations in supply, demand and pricing. Substantially all of the Company's sales are made under contracts that allow for the pass-through of changes in the price of PET resin under various pass-through mechanisms. PET resin is our principal raw material and a major component of cost of goods sold. Period to period comparisons of gross profit and gross profit as a percentage of sales may not be meaningful indicators of actual performance, because the effects of the pass-through mechanisms are affected by the magnitude and timing of resin price changes.

Item 4. Controls and Procedures

Disclosure Controls and Internal Controls

The Company's disclosure controls and procedures are designed with the objective of ensuring that information required to be disclosed in our reports, such as this quarterly report, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls are designed with the objective of ensuring that this information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding the required disclosure. Internal controls and procedures for financial reporting are procedures that are designed with the objective of providing reasonable assurance regarding the reliability of

Table of Contents

financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and include those policies and procedures that:

Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;

Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Limitations on the Effectiveness of Controls

Our management, including our principal executive officer and principal financial officer, does not expect that our disclosure controls or internal controls will prevent all errors or fraud. A control system, no matter how well conceived and implemented, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include realities that judgments in decision making can be faulty and that breakdown can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the control. Because of inherent limitations in a cost effective control system, misstatements due to error or fraud may occur and not be detected.

Evaluation of Disclosure Controls

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2005. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control - Integrated Framework* (COSO). Based on this assessment, management identified the following material weaknesses as of December 31, 2005. A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

1. *Financial Statement Close and Reporting Process* The Company did not maintain effective controls over the financial statement close and reporting process because the Company lacked a complement of personnel with a level of financial reporting expertise commensurate with the Company's financial reporting requirements. Specifically, the Company lacked sufficient resources to perform properly the quarterly and year-end financial statement close processes, including the review of certain account reconciliations and financial statement preparation and disclosures. This control deficiency contributed to the material weaknesses discussed in 2 and 3 below and the resulting audit adjustments to the 2005 annual consolidated financial statements.

2. *Accounting for Income Taxes* The Company did not maintain effective controls over the completeness, accuracy, presentation and disclosure of its accounting for income taxes, including the determination of income tax expense, income taxes payable and deferred income tax assets and liabilities. Specifically, the Company did not maintain effective controls to calculate accurately income tax expense and income taxes payable, monitor the difference between the income tax basis and the financial reporting basis of assets and liabilities and reconcile the resulting basis difference to its deferred income tax asset and liability balances. This control deficiency resulted in audit adjustments to the 2005 annual consolidated financial statements.

Table of Contents

3. *Accounting for Inventory* The Company did not maintain effective controls over the accuracy and valuation of inventory and related cost of sales accounts. Specifically, the Company did not maintain effective controls to ensure that the computation of standard to actual cost variance adjustments was accurate. In addition, the Company failed to ensure that intercompany profit or loss in ending inventory was eliminated and to ensure the accuracy of its analysis of the lower of cost or market reserve for finished goods inventory. This control deficiency resulted in audit adjustments to the 2005 annual consolidated financial statements.

Additionally, each of these control deficiencies could result in a misstatement of the aforementioned account balances or disclosures that would result in a material misstatement to the annual or interim consolidated financial statements that would not be prevented or detected. Accordingly, management has determined that each of the above control deficiencies represents a material weakness.

Changes in internal controls

At the end of the period covered by this quarterly report on Form 10-Q, Constar carried out an evaluation, under the supervision and with the participation of its principal executive officer and principal financial officer, of the effectiveness of the design and operation of its disclosure controls and procedures. Because the material weaknesses identified above were not remediated at June 30, 2006, the Company's principal executive officer and principal financial officer have concluded that the disclosure controls and procedures are not effective at a reasonable assurance level as of June 30, 2006.

The Company has begun efforts to design and implement improvements in its internal control over financial reporting to address the material weaknesses in the close and reporting process, accounting for income taxes, and accounting for inventory. During the second quarter of 2006, the Company hired additional finance and accounting personnel. The Company continues to train existing accounting staff and hire and train skilled accounting staff to address the identified deficiencies. In addition, during the second quarter of 2006, the Company began to implement additional policies and procedures needed to remediate the deficiencies in its internal control over financial reporting. The Company also has retained a consulting firm to assist the Company in assessing, implementing and documenting improvements to the Company's internal control over financial reporting related to the financial statement close and reporting process and accounting for inventory. The Company has retained a firm to assist in designing and implementing controls surrounding accounting for income taxes.

No other changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the second quarter ended June 30, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**PART II Other Information****Item 1. Legal Proceedings**

Information regarding legal proceedings involving the Company appears in Part I within Item 1 of this quarterly report under Note 8 to the Condensed Consolidated Financial Statements, which information is incorporated herein by reference.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2005, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing us. Additional risk and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or operating results.

Item 4. Submission of Matters to a Vote of Security Holders

The Company's Annual Meeting of Stockholders was held on May 4, 2006. The matters voted upon and the results thereof are as follows:

	Votes	
	For	Withheld
Election of Class 1 Directors		
Michael J. Hoffman	11,731,685	7,981
A. Alexander Taylor	11,406,392	333,274

Item 6. Exhibits

- 10.1 Description of oral amendment to Lease Agreement dated as of January 1, 2006, by and between CROWN Cork & Seal USA, Inc., as Lessor, and Constar Inc., as Lessee.
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of President and Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Executive Vice President and Chief Financial Officer Pursuant to U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Constar International Inc.

Dated: August 14, 2006

By: /s/ WALTER S. SOBON
Walter S. Sobon

Executive Vice President and Chief Financial Officer

(duly authorized officer and principal accounting officer)