

WESTLAKE CHEMICAL CORP  
Form 10-K  
February 26, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**Form 10-K**

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ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the Fiscal Year Ended December 31, 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 No. 001-32260

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**Westlake Chemical Corporation**

(Exact name of registrant as specified in its charter)

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

**2801 Post Oak Boulevard, Suite 600**

**Houston, Texas 77056**

(Address of principal executive offices, including zip code)

**(713) 960-9111**

**76-0346924**  
(I.R.S. Employer  
Identification No.)

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(Registrant's telephone number, including area code)

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**Securities registered pursuant to Section 12(b) of the Act:**

Title of each class	Name of each exchange on which registered
Common Stock, \$0.01 par value	New York Stock Exchange, Inc.

Securities registered pursuant to Section 12(g) of the Act: None

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 Act). Yes  No

The aggregate market value of the registrant's voting stock held by non-affiliates of the registrant on June 30, 2006, the end of the registrant's most recently completed second fiscal quarter, based on a closing price on that date of \$29.80 on the New York Stock Exchange was approximately \$570 million.

There were 65,270,526 shares of the registrant's common stock outstanding as of February 20, 2007.

**DOCUMENTS INCORPORATED BY REFERENCE:**

Certain information required by Part II and Part III of this Form 10-K is incorporated by reference from the registrant's definitive Proxy Statement to be filed pursuant to Regulation 14A with respect to the registrant's 2007 Annual Meeting of Stockholders to be held on May 18, 2007.

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**INDUSTRY AND MARKET DATA**

Industry and market data used throughout this Form 10-K were obtained through internal company research, surveys and studies conducted by unrelated third parties and industry and general publications, including information from Chemical Market Associates, Inc., or CMAI, Chemical Data, Inc. and the Freedonia Group. We have not independently verified market and industry data from external sources. While we believe internal company estimates are reliable and market definitions are appropriate, neither such estimates nor these definitions have been verified by any independent sources.

**PRODUCTION CAPACITY**

Unless we state otherwise, annual production capacity estimates used throughout this Form 10-K represent rated capacity of the facilities at December 31, 2006. We calculated rated capacity by estimating the number of days in a typical year that a production unit of a plant is expected to operate, after allowing for downtime for regular maintenance, and multiplying that number by an amount equal to the unit's optimal daily output based on the design feedstock mix. Because the rated capacity of a production unit is an estimated amount, actual production volumes may be more or less than the rated capacity.

**NON-GAAP FINANCIAL MEASURES**

The body of accounting principles generally accepted in the United States is commonly referred to as GAAP. For this purpose, a non-GAAP financial measure is generally defined by the Securities and Exchange Commission (SEC) as one that purports to measure historical or future financial performance, financial position or cash flows, but excludes or includes amounts that would not be so adjusted in the most comparable GAAP measures. In this report, we disclose so-called non-GAAP financial measures, primarily EBITDA. EBITDA is calculated as net income before interest expense, income taxes, depreciation and amortization. The non-GAAP financial measures described in this Form 10-K are not substitutes for the GAAP measures of earnings and cash flow.

EBITDA is included in this Form 10-K because our management considers it an important supplemental measure of our performance and believes that it is frequently used by securities analysts, investors and other interested parties in the evaluation of companies in our industry, some of which present EBITDA when reporting their results. We regularly evaluate our performance as compared to other companies in our industry that have different financing and capital structures and/or tax rates by using EBITDA. In addition, we utilize EBITDA in evaluating acquisition targets. Management also believes that EBITDA is a useful tool for measuring our ability to meet our future debt service, capital expenditures and working capital requirements, and EBITDA is commonly used by us and our investors to measure our ability to service indebtedness. EBITDA is not a substitute for the GAAP measures of earnings or of cash flow and is not necessarily a measure of our ability to fund our cash needs. In addition, it should be noted that companies calculate EBITDA differently and, therefore, EBITDA as presented for us may not be comparable to EBITDA reported by other companies. EBITDA has material limitations as a performance measure because it excludes interest expense, depreciation and amortization, and income taxes.

**Table of Contents****PART I****Item 1. Business  
General**

We are a vertically integrated manufacturer and marketer of basic chemicals, vinyls, polymers and fabricated products. Our products include some of the most widely used chemicals in the world, which are fundamental to many diverse consumer and industrial markets, including flexible and rigid packaging, automotive products, coatings, residential and commercial construction as well as other durable and non-durable goods. We operate in two principal business segments, Olefins and Vinyls, and we are one of the few North American integrated producers of vinyls with substantial downstream integration into polyvinyl chloride, or PVC, fabricated products.

We began operations in 1986 after our first polyethylene plant, an Olefins segment business, near Lake Charles, Louisiana was acquired from Occidental Petroleum Corporation. We began our vinyls operations in 1990 with the acquisition of a vinyl chloride monomer, or VCM, plant in Calvert City, Kentucky from the Goodrich Corporation. In 1992, we commenced our Vinyls segment fabricated products operations after acquiring three PVC pipe plants. Since 1986, we have grown rapidly into an integrated producer of petrochemicals, polymers and fabricated products. We achieved this by acquiring 23 plants, constructing six new plants (including our joint venture in China) and completing numerous capacity or production line expansions. On November 30, 2006, we acquired Eastman Chemical Company's (Eastman) polyethylene and Epolene® polymers business, related assets and a 200 mile, ten inch pipeline from Mont Belvieu, Texas to Longview, Texas, all of which are located in Longview, Texas (Longview facilities). The polyethylene business and associated operating facilities have a capacity of 1,125 million pounds per year of polyethylene.

We benefit from highly integrated production facilities that allow us to process raw materials into higher value-added chemicals and fabricated products. We have 10.9 billion pounds per year of active aggregate production capacity at 15 manufacturing sites in North America. We also have a 58% interest in a joint venture in China that operates a vinyls facility.

**Olefins Business***Products*

Olefins are the basic building blocks used to create a wide variety of petrochemical products. We manufacture ethylene, polyethylene, styrene, and associated co-products at our manufacturing facilities in Lake Charles, Louisiana, and polyethylene and Epolene® at our Longview facilities. We have two ethylene plants, two polyethylene plants and one styrene monomer plant at our Lake Charles complex. We have three polyethylene plants and an Epolene® plant at our Longview facility. The following table illustrates our production capacities by principal product and the primary end uses of these materials:

<b>Product</b>	<b>Annual Capacity (Millions of pounds)</b>	<b>End Uses</b>
Ethylene	2,400	Polyethylene, ethylene dichloride, or EDC, styrene, ethylene oxide/ethylene glycol
Low-Density Polyethylene, or LDPE	1,500	High clarity packaging, shrink films, laundry and dry cleaning bags, ice bags, frozen foods packaging, bakery bags, coated paper board, cup stock, paper folding cartons, lids, housewares, closures and general purpose molding
Linear Low-Density Polyethylene, or LLDPE, and High-Density Polyethylene, or HDPE	980	Heavy-duty films and bags, general purpose liners (LLDPE); thin-walled food tubs, housewares, pails, totes and crates (HDPE)
Styrene	485	

Disposables, packaging material, appliances, paints  
and coatings, resins and building materials

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*Ethylene.* Ethylene is the world's most widely used petrochemical in terms of volume. It is the key building block used to produce a large number of higher value-added chemicals including polyethylene, EDC, VCM and styrene. We have the capacity to produce 2.4 billion pounds of ethylene per year at our Lake Charles complex and the capability to consume all of our production internally to produce polyethylene and styrene monomer in our Olefins business and to produce VCM and EDC in our Vinyls business. We also produce ethylene in our Vinyls segment at our Calvert City, Kentucky facilities, all of which is used internally in the production of VCM. In addition, we produce ethylene co-products including chemical grade propylene, crude butadiene, pyrolysis gasoline and hydrogen. We sell our entire output of these co-products to external customers. We completed a major turnaround at one of our ethylene plants in Lake Charles in the fourth quarter of 2006.

*Polyethylene.* Polyethylene, the world's most widely consumed polymer, is used in the manufacture of a wide variety of packaging, film, coatings and molded product applications. Polyethylene is generally classified as either LDPE, LLDPE or HDPE. The density correlates to the relative stiffness of the products. The difference between LDPE and LLDPE is molecular, and products produced from LLDPE are stronger than products produced from LDPE. LDPE is used in end products such as bread bags, dry cleaning bags, food wraps and milk carton and snack package coatings. LLDPE is used for higher film strength applications such as stretch film and heavy duty sacks. HDPE is used to manufacture products such as grocery, merchandise and trash bags, plastic containers and plastic caps and closures.

We are the third largest producer of LDPE in North America based on capacity and, in 2006, our annual capacity of 1.5 billion pounds was available in numerous formulations to meet the needs of our diverse customer base. We also have the combined capacity to produce 980 million pounds of either LLDPE or HDPE per year in various different formulations. We produce the three primary types of polyethylene and sell them to external customers as a final product in pellet form. We produce LDPE at one plant in Lake Charles and two plants in Longview, and we produce LLDPE and HDPE in one plant at Lake Charles and one plant in Longview. This flexibility allows us to maximize production of either HDPE or LLDPE depending on prevailing market conditions.

*Styrene.* Styrene is used to produce synthetic rubber and other derivatives such as polystyrene, acrylonitrile butadiene styrene and unsaturated polyester. These derivatives are used in a number of applications including injection molding, disposables, food packaging, housewares, paints and coatings, resins, building materials, tires and toys. We produce styrene at our Lake Charles plant, where we have the capacity to produce 485 million pounds of styrene per year, all of which is sold to external customers.

### ***Feedstocks***

We are highly integrated along our olefins product chain. We produce most of the ethylene required to produce our polyethylene, VCM and styrene. Ethylene can be produced from either petroleum liquid feedstocks, such as naphtha, condensates and gas oils, or from natural gas liquid feedstocks, such as ethane, propane and butane. One of our ethylene plants uses ethane as its feedstock and the other can use ethane, ethane/propane mix, propane and butane, a heavier feedstock. We continue to seek ways to minimize our feedstock cost by increasing our ability to use alternative feedstocks. We receive ethane, propane and butane at our Lake Charles facilities through several pipelines from a variety of suppliers in Texas and Louisiana.

In addition to our internally supplied ethylene, we also acquire ethylene from Eastman pursuant to a three-year contract to supply a portion of our ethylene requirements in Longview. In addition, we acquire butene and hexene to manufacture polyethylene and benzene to manufacture styrene. We receive butene and hexene at both the Lake Charles complex and the Longview complex via rail car from several suppliers. We receive benzene via pipeline pursuant to short-term arrangements. The butene and hexene contracts expire over the next one to three years and some are renewable for an additional term subject to either party to the contract notifying the other party that it does not wish to renew the contract.

### ***Marketing, Sales and Distribution***

We use the majority of our Lake Charles ethylene production in our polyethylene, styrene and VCM operations. We sell the remainder to external customers. In addition, we sell our ethylene co-products to external

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customers. Our primary ethylene co-products are chemical grade propylene, crude butadiene, pyrolysis gasoline and hydrogen. The majority of sales in our Olefins business are made under long-term agreements. Contract volumes are established within a range. The terms of these contracts are fixed for a period, although earlier termination may occur if the parties fail to agree on price and deliveries are suspended for a period of several months. In most cases, these contracts also contemplate extension of the term unless terminated by one of the parties.

We typically ship our ethylene and propylene via a pipeline system that connects our plants to numerous customers. Our hydrogen is sold via pipeline to a single customer. We also have storage agreements and exchange agreements that allow us access to customers who are not directly connected to the pipeline system. We transport our polyethylene, styrene, crude butadiene and pyrolysis gasoline by rail or truck. Additionally, our pyrolysis gasoline and styrene can be transported by barge.

We have an internal sales force that sells directly to our customers. Our polyethylene customers are some of the nation's largest purchasers of film and flexible packaging. In 2006, one contract customer in our Olefins segment accounted for 11% of segment net sales.

### ***Competition***

The markets in which our Olefins business operates are highly competitive. We compete on the basis of price, customer service, product deliverability, quality, consistency and performance. Our competitors in the ethylene, polyethylene and styrene markets are typically some of the world's largest chemical companies, including INEOS (successor to BP Chemicals Ltd.), The Dow Chemical Company, ExxonMobil Chemical Company, Lyondell Chemical Company, Chevron Phillips Chemical Company LP and NOVA Chemicals Corporation.

### **Vinyls Business**

#### ***Products***

Principal products in our integrated Vinyls segment include PVC, VCM, EDC, chlorine, caustic soda and ethylene. We also manufacture and sell products fabricated from the PVC we produce, including pipe, fence and deck, and window and patio door components. We manage our integrated Vinyls production chain, from the basic chemicals to finished fabricated products, to maximize product margins, pricing and capacity utilization. Our primary manufacturing facilities are located in our Calvert City, Kentucky and Geismar, Louisiana, complexes. Our Calvert City facilities include an ethylene plant, a chlor-alkali plant, a VCM plant and a PVC plant. Our Geismar facilities include an EDC plant, a VCM plant and a PVC plant. We also own 11 PVC fabricated product facilities and a 58% interest in a joint venture in China that produces PVC resin and film. The following table illustrates our production capacities by principal product and the end uses of these products:

<b>Product(1)</b>	<b>Annual Capacity(2) (Millions of pounds)</b>	<b>End Uses</b>
PVC	1,400	Construction materials including pipe, siding, profiles for windows and doors, film for packaging and other consumer applications
VCM	1,900	PVC
Chlorine	410	VCM, organic/inorganic chemicals, bleach
Caustic Soda	450	Pulp and paper, organic/inorganic chemicals, neutralization, alumina
Ethylene	450	VCM
Fabricated Products	915	Pipe: water and sewer, plumbing, irrigation, conduit; window and door components; fence and deck components

(1) EDC, a VCM intermediate product, is not included in the table.

(2) Annual capacity excludes total capacity of 130 million pounds of PVC film and 286 million pounds of PVC resin from the joint venture in China (in which we have a 58% interest).



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*PVC.* PVC, the world's third most widely used plastic, is an attractive alternative to traditional materials such as glass, metal, wood, concrete and other plastic materials because of its versatility, durability and cost-competitiveness. PVC is produced from VCM, which is, in turn, made from chlorine and ethylene. PVC compounds are made by combining PVC resin with various additives in order to make either rigid and impact-resistant or soft and flexible compounds. The various compounds are then fabricated into end-products through extrusion, calendaring, injection-molding or blow-molding. Flexible PVC compounds are used for wire and cable insulation, automotive interior and exterior trims and packaging. Rigid extrusion PVC compounds are commonly used in window frames, vertical blinds and construction products, including pipes. Injection-molding PVC compounds are used in specialty products such as computer housings and keyboards, appliance parts and bottles. We have the capacity to produce 800 million pounds of PVC per year at our Calvert City facilities and 600 million pounds per year at our Geismar facilities. We use a majority of our PVC internally in the production of our fabricated products. The remainder of our PVC is sold to downstream fabricators.

*VCM.* VCM is used to produce PVC, solvents and PVC-related products. We use ethylene and chlorine to produce VCM. We have the capacity to produce 1.3 billion pounds of VCM per year at our Calvert City facilities and 600 million pounds per year at our Geismar facilities. The majority of our VCM is used internally in our PVC operations. Most of the remainder of our VCM production is sold under long-term contracts with external customers.

*Chlorine and Caustic Soda.* We combine salt and electricity to produce chlorine and caustic soda, co-products commonly referred to as chlor-alkali, at our Calvert City facilities. We use our chlorine production in our VCM plants. We have the capacity to supply approximately 37% of our internal chlorine requirements. We purchase the remaining amount at market prices. Our caustic soda is sold to external customers who use it for, among other things, the production of pulp and paper, organic and inorganic chemicals and alumina.

*Ethylene.* We use all of the ethylene produced at Calvert City internally to produce VCM and, in 2006, we produced approximately 54% of the ethylene required for our VCM production. We obtain the remainder of the ethylene we need for our Vinyls business from our Lake Charles ethylene production. We completed a major turnaround at our ethylene plant in Calvert City in the second quarter of 2006.

*Fabricated Products.* Products made from PVC are used in construction materials ranging from water and sewer systems to home and commercial applications for fence, deck, window and patio door systems. We manufacture and market water, sewer, irrigation and conduit pipe products under the North American Pipe brand. We also manufacture and market PVC fence, decking, windows and patio door profiles under the Westech Building Products brand. All of our fabricated products production is sold to external customers.

*China Joint Venture.* We own a 58% interest in Suzhou Huasu Plastics Co. Ltd., a joint venture based near Shanghai, China. Our joint venture partners are Norway's Norsk Hydro ASA and two local Chinese chemical companies. In 1995, this joint venture constructed and began operating a PVC film plant that has a current annual capacity of 130 million pounds of PVC film. In 1999, the joint venture constructed and began operating a PVC resin plant that has an annual capacity of 286 million pounds of PVC resin. In 2006, we increased our ownership interest in this joint venture from 43% to 58%.

### ***Feedstocks***

We are highly integrated along our vinyls production chain. We produce most of the ethylene and all of the VCM and PVC used in our Vinyls business, and approximately 37% of our chlorine requirements. The remainder of our chlorine requirements are purchased at market prices. Ethylene produced at our Calvert City facility

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utilizes propane feedstock. We purchase the salt required for our chlor-alkali plant pursuant to a long-term contract. We purchase electricity for our chlor-alkali production from the Tennessee Valley Authority under a long-term contract.

We are one of the few North American integrated producers of vinyls with substantial downstream integration into PVC fabricated products. Our Calvert City and Geismar facilities supply all the PVC required for our fabricated products plants. The remaining feedstocks for fabricated products include pigments, fillers and stabilizers, which we purchase under short-term contracts based on prevailing market prices.

### ***Marketing, Sales and Distribution***

We are a leading manufacturer of PVC fabricated products in the geographic regions where we operate. We sell a majority of our PVC pipe through a combination of manufacturer's representatives and our internal sales force to distributors who serve the wholesale PVC pipe market. We use a regional sales approach that allows us to provide focused customer service and to meet the specified needs of individual customers. We use an internal salaried sales force to market and sell our fence, window and patio door profiles.

We sell substantially all of our caustic soda production to external customers, concentrating on customers who can receive the product by barge over the Mississippi, Tennessee and Ohio Rivers to minimize transportation costs. In 2006, two customers in our Vinyls segment accounted for 26% of segment net sales, each accounting for 13%.

### ***Competition***

Competition in the vinyls market is based on price, product availability, product performance and customer service. We compete in the vinyls market with other large and medium-sized producers including Oxy Vinyls, LP, Shintech, Inc., Georgia Gulf Corporation and Formosa Plastics Corporation.

Competition in the fabricated products market is based on price, on-time delivery, product quality, customer service and product consistency. We compete in the fabricated products market with other medium and large-sized producers and fabricators including J-M Manufacturing Company, Inc., Diamond Plastics Corporation, National Pipe & Plastics, Inc. and PW Eagle, Inc. J-M Manufacturing Company, Inc. and PW Eagle, Inc. have recently announced a merger transaction. We are a leading manufacturer of PVC pipe by volume in the geographic areas served by our North American Pipe Corporation subsidiary. We believe that we are the second largest manufacturer of PVC fence and deck components by volume in the United States.

### **Environmental and Other Regulation**

As is common in our industry, obtaining, producing and distributing many of our products involves the use, storage, transportation and disposal of large quantities of toxic and hazardous materials, and our manufacturing operations require the generation and disposal of large quantities of hazardous wastes. We are subject to extensive, evolving and increasingly stringent federal and local environmental laws and regulations, which address, among other things, the following:

emissions to the air;

discharges to land or to surface and subsurface waters;

other releases into the environment;

remediation of contaminated sites;

generation, handling, storage, transportation, treatment and disposal of waste materials; and

maintenance of safe conditions in the workplace.

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We are subject to environmental laws and regulations that can impose civil and criminal sanctions and that may require us to mitigate the effects of contamination caused by the release or disposal of hazardous substances into the environment. Under one law, an owner or operator of property may be held strictly liable for remediating contamination without regard to whether that person caused the contamination, and without regard to whether the practices that resulted in the contamination were legal at the time they occurred. Because several of our production sites have a history of industrial use, it is impossible to predict precisely what effect these requirements will have on us.

*Contract Litigation with Goodrich and PolyOne.* In connection with the 1990 and 1997 acquisitions of the Goodrich Corporation chemical manufacturing complex in Calvert City, Kentucky, Goodrich agreed to indemnify us for any liabilities related to preexisting contamination at the complex. For our part, we agreed to indemnify Goodrich for post-closing contamination caused by our operations. The soil and groundwater at the complex, which does not include our nearby PVC facility, had been extensively contaminated by Goodrich's operations. In 1993, Goodrich spun off the predecessor of PolyOne, and that predecessor assumed Goodrich's indemnification obligations relating to preexisting contamination. PolyOne is now coordinating the investigation and remediation of contamination at the complex. In mid-1997 we began operating (pursuant to contract) a certain piece of groundwater remediation equipment at the complex owned by Goodrich.

For a number of years, PolyOne has asserted that our operations after the 1990 and 1997 acquisitions have contributed to the contamination. In May 2003, Goodrich asserted that we are responsible for a portion of the costs of treating the complex's contaminated groundwater. Goodrich then began withholding payment of 45% of the monthly costs incurred by us to operate certain remediation equipment.

In October 2003, we sued Goodrich in the United States District Court for the Western District of Kentucky for breach of contract to recover our unpaid invoices for providing these services. Goodrich filed a counterclaim against us and a third-party complaint against PolyOne. PolyOne in turn filed motions to dismiss, counterclaims against Goodrich, and cross-claims against us, in which it alleged, among other things, that Goodrich and we had conspired to defraud PolyOne.

In March 2005, the court dismissed PolyOne's claims against us and granted our motion for summary judgment on our breach of contract claim against Goodrich. In July 2005, Goodrich agreed to pay us all past due amounts, including interest, in the amount of \$3.1 million. This reimbursement is reflected in the consolidated statement of operations for the year ended December 31, 2005, resulting in a \$2.6 million reduction of selling, general and administrative expenses and \$0.5 million of interest income. Goodrich further agreed to timely and fully pay us for all future services. Goodrich reserved the right to seek reconsideration of the court's order, which, if granted, could require us to reimburse Goodrich for its payments to us under the July 2005 agreement. The case is continuing with respect to Goodrich's counterclaim against us and the claims between Goodrich and PolyOne. A court-ordered mediation is expected to occur in early 2007 and trial is set for October 2007.

The current groundwater remediation activities at the Calvert City complex do not have a specified termination date but are expected to last for the foreseeable future. Since we acquired in mid-1997 the relevant portion of the complex where certain groundwater remediation equipment is located, we have spent approximately \$23.3 million through December 31, 2006 in operating this equipment, all of which has been reimbursed to us by Goodrich. Goodrich is continuing to reimburse us on a monthly basis as ongoing expenses for these services are incurred. The costs incurred to operate the groundwater remediation equipment were \$3.4 million in 2006.

*Administrative Proceedings.* There are several administrative proceedings in Kentucky involving us, Goodrich and PolyOne and the same manufacturing complex in Calvert City. In 2003, the Kentucky Environmental and Public Protection Cabinet (Cabinet) re-issued Goodrich's Resource Conservation and Recovery Act, or RCRA, permit which requires Goodrich to remediate contamination at the Calvert City manufacturing complex. Both Goodrich and PolyOne challenged various terms of the permit in an attempt to shift Goodrich's clean-up obligations under the permit to us.

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In January 2004, the Cabinet notified us that our ownership of a closed landfill (known as former Pond 4) requires us to submit an application for our own permit under RCRA. This could require us to bear the cost of performing remediation work at former Pond 4 and adjacent areas at the complex. We challenged the Cabinet's January 2004 order and have obtained several extensions to submit the required permit application, which is now due in March 2007. In October 2006, the Cabinet notified Goodrich and us that both were operators of former Pond 4 under RCRA, and ordered us to jointly submit an application for a RCRA permit no later than April 2007. Goodrich and Westlake have both challenged the Cabinet's October 2006 order.

All of these administrative proceedings have been consolidated. At a hearing on February 9, 2007, the administrative law judge vacated the hearing date and set a status conference for May 18, 2007 based on the fact that the parties are engaged in settlement discussions.

*Litigation Related to the Administrative Proceedings.* We have the contractual right to reconvey title to former Pond 4 back to Goodrich, and we have tendered former Pond 4 back to Goodrich under this provision. In March 2005, we sued Goodrich in the United States District Court for the Western District of Kentucky to require Goodrich to accept the tendered reconveyance and to indemnify us for costs we incurred in connection with former Pond 4. Goodrich subsequently filed a third-party complaint against PolyOne, seeking to hold PolyOne responsible for any of Goodrich's former Pond 4 liabilities to us. Goodrich moved to dismiss our suit against it, we filed a motion for partial summary judgment against Goodrich, and PolyOne moved to dismiss Goodrich's third-party complaint against it. All three motions are pending.

PolyOne filed a separate lawsuit against us in March 2005 in the United States District Court for the Western District of Kentucky seeking to require us to apply for our own RCRA permit. Purportedly brought under the citizen suit provisions of RCRA, PolyOne's suit involves the same issues raised in the Goodrich and PolyOne challenges to the RCRA permit discussed above. We filed a motion to dismiss PolyOne's suit, which is pending.

*Monetary Relief.* Neither the court nor the Cabinet has established any allocation of the costs of remediation among the various parties that are involved in the judicial and administrative proceedings discussed above. Any monetary liabilities that we might incur with respect to the remediation of contamination at the complex would likely be spread out over an extended period. As a result, we believe it is unlikely that any remediation costs allocable to us will be material. However, we are not in a position at this time to state what effect, if any, the resolution of these proceedings could have on our financial condition, results of operations, or cash flows.

*Environmental Investigations.* In 2002, the EPA's National Enforcement Investigations Center, or NEIC, investigated our manufacturing complex in Calvert City. In early 2004, the NEIC investigated our nearby PVC plant. The EPA subsequently submitted information requests to us under the Clean Air Act and RCRA. We met with the EPA in June 2004 to attempt to voluntarily resolve the notices of violation that were issued to us for the 2002 investigation and to voluntarily resolve any issues raised at the PVC plant in the 2004 investigation. Since then, parties have continued to engage in settlement discussions. The EPA has indicated that it will impose monetary penalties and require plant modifications that will involve capital expenditures. We expect that, based on the EPA's past practices, the amount of any monetary penalties would be reduced by a portion of the expenditures that we would agree to make for certain supplemental environmental projects. We have recorded an accrual for a probable loss related to monetary penalties and other items to be expensed; however, based on correspondence from the EPA, we reduced our loss accrual by \$1.5 million during the fourth quarter of 2006. This benefit is classified in cost of sales. Although the ultimate amount of liability is not ascertainable, based on correspondence with the EPA, we believe that the accrual is adequate and the ultimate resolution of such matters will not be material.

*General.* It is our policy to comply with all environmental, health and safety requirements and to provide safe and environmentally sound workplaces for our employees. In some cases, compliance can be achieved only by incurring capital expenditures, and we are faced with instances of noncompliance from time to time.

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In 2006, we made capital expenditures of \$4.6 million related to environmental compliance. We estimate that we will make capital expenditures of \$17.1 million in 2007 and \$17.6 million in 2008, respectively. A significant percentage of the 2007 and 2008 estimated amounts are related to equipment replacement and upgrades to maintain environmental compliance. We anticipate that stringent environmental regulations will continue to be imposed on us and the industry in general. Although we cannot predict with certainty future expenditures, management believes that our current spending trends will continue.

It is difficult to estimate the future costs of environmental protection and remediation because of many uncertainties, including uncertainties about the status of laws, regulations and information related to individual locations and sites and our ability to rely on third parties to carry out such remediation. Subject to the foregoing, but taking into consideration our experience regarding environmental matters of a similar nature and facts currently known, and except for the outcome of pending litigation and regulatory proceedings, which we cannot predict, but which could have a material adverse effect on us, we believe that capital expenditures and remedial actions to comply with existing laws governing environmental protection will not have a material adverse effect on our business and financial results.

**Employees**

As of December 31, 2006, we had 2,056 employees, 893 contractors and 4 consultants in the following areas:

Category	Number
Olefins segment	1,302
Vinyls segment	1,549
Headquarters	102

Approximately 12% of our employees are represented by labor unions and all of these employees are working under collective bargaining agreements. All of the collective bargaining agreements expire in 2009. There have been no strikes or lockouts and we have not experienced any work stoppages throughout our history. We believe that our relationship with the local union officials and bargaining committees is open and positive.

**Technology**

Historically, our technology strategy has been to selectively acquire and license third-party proprietary technology. Our selection process incorporates many factors, including the cost of the technology, our customers' requirements, raw material and energy consumption rates, product quality, capital costs, maintenance requirements and reliability. As part of the acquisition of the Longview facilities, we obtained ownership of a patent portfolio that contains intellectual property related to the polyethylene and Epolene® businesses, as well as the research and development group that developed this intellectual property. This group is expected to continue to help us develop our polyethylene and Epolene® assets. The acquisition of this group does not reduce our need to evaluate and access other third party technology for our Olefins businesses. After acquiring a technology, we devote considerable efforts to further develop and effectively apply the technology with a view to continuously improve our competitive position.

We license technology from a number of third-party providers. In 1988, we selected the MW Kellogg technology for our first ethylene plant at our Lake Charles complex. In 1995, we selected the ABB Lummus Crest technology for the second ethylene plant at Lake Charles. In 1990, we selected Mobil/Badger technology for our styrene monomer plant at Lake Charles and in 1996 we selected BP technology for our second Lake Charles polyethylene plant. In 1997, we entered into a corporate-wide technology agreement with Aspen Technology. The Aspen Technology Plantelligence includes an advanced process control software system which improves process control and economic optimization. In 1998, we licensed Asahi Chemical membrane technology for our chlor-alkali plant. In 2005, we licensed Badger EBMax technology for our plant in

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Lake Charles. Also in 2005, we entered into a license with Nova Chemicals Corporation to use the Novacat-T Catalyst System in connection with the production of polyethylene at our plant in Lake Charles. We have a license with INEOS (successor to BP Chemicals Ltd.) for technology used to produce LLDPE and HDPE that requires us to make annual payments of \$3.1 million through 2007. At Longview, we have a paid up license from INEOS for gas phase technology for the production of LLDPE and HDPE, and we license out our patented Energx<sup>®</sup> technology for LLDPE production on a limited basis.

## **Segment and Geographic Information**

Information regarding sales, income (loss) from operations and assets attributable to each of our industry segments, Olefins and Vinyls, and geographical information is presented in Note 17 to our consolidated financial statements included in Item 8 of this Form 10-K.

## **Available Information**

Our Web site address is [www.westlakechemical.com](http://www.westlakechemical.com). We make our Web site content available for information purposes only. It should not be relied upon for investment purposes, nor is it incorporated by reference in this Form 10-K. We make available on this Web site under Investor Relations/SEC Filings, free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports as soon as reasonably practicable after we electronically file those materials with, or furnish those materials to, the SEC. The SEC also maintains a Web site at [www.sec.gov](http://www.sec.gov) that contains reports, proxy statements and other information regarding SEC registrants, including us.

We intend to satisfy the requirement under Item 5.05 of Form 8-K to disclose any amendments to our Code of Ethics and any waiver from a provision of our Code of Ethics by posting such information on our Web site at [www.westlakechemical.com](http://www.westlakechemical.com) at Investor Relations/Corporate Governance.

## **Item 1A. Risk Factors**

***Cyclical in the petrochemical industry has in the past, and may in the future, result in reduced operating margins or operating losses.***

Our historical operating results reflect the cyclical and volatile nature of the petrochemical industry. The industry is mature and capital intensive. Margins in this industry are sensitive to supply and demand balances both domestically and internationally, which historically have been cyclical. The cycles are generally characterized by periods of tight supply, leading to high operating rates and margins, followed by periods of oversupply primarily resulting from significant capacity additions, leading to reduced operating rates and lower margins.

Moreover, profitability in the petrochemical industry is affected by the worldwide level of demand along with vigorous price competition which may intensify due to, among other things, new domestic and foreign industry capacity. In general, weak economic conditions either in the United States or in the world tend to reduce demand and put pressure on margins. It is not possible to predict accurately the supply and demand balances, market conditions and other factors that will affect industry operating margins in the future.

We face increasing competition and pricing pressures in the Olefins segment. Over the next five years some industry forecasts show a 5% per year increase in worldwide ethylene capacity with the largest increase occurring in the Middle East and Asia. Demand is expected to grow 4% per year during this period. As a result, operating rates in the U.S. are expected to peak in 2008 and decline gradually the remainder of the decade primarily due to reduced exports.

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Industry forecasts show that North American PVC capacity is projected to increase by 6% in 2008 and 6% in 2009, while it is projected that demand for PVC is expected to increase by 2% per year over the next five years. As a result, operating rates could decline further from peak levels achieved in early 2006.

***We sell commodity products in highly competitive markets and face significant competition and price pressure.***

We sell our products in highly competitive markets. Due to the commodity nature of many of our products, competition in these markets is based primarily on price and to a lesser extent on performance, product quality, product deliverability and customer service. As a result, we generally are not able to protect our market position for these products by product differentiation and may not be able to pass on cost increases to our customers. Accordingly, increases in raw material and other costs may not necessarily correlate with changes in prices for these products, either in the direction of the price change or in magnitude. Specifically, timing differences in pricing between raw material prices, which may change daily, and contract product prices, which in many cases are negotiated only monthly or less often, sometimes with an additional lag in effective dates for increases, have had and may continue to have a negative effect on profitability. Significant volatility in raw material costs tends to place pressure on product margins, as sales price increases generally tend to lag behind raw material cost increases. Conversely, when raw material costs decrease, customers seek relief in the form of lower sales prices.

***High costs of raw materials and energy may result in increased operating expenses and adversely affect our results of operations and cash flow.***

Significant variations in the costs and availability of raw materials and energy may negatively affect our results of operations. These costs have risen significantly over the past several years due primarily to oil and natural gas cost increases. We purchase significant amounts of ethane and propane feedstock, natural gas, chlorine and salt to produce several basic chemicals. We also purchase significant amounts of electricity to supply the energy required in our production processes. The cost of these raw materials and energy, in the aggregate, represents a substantial portion of our operating expenses. The prices of raw materials and energy generally follow price trends of, and vary with market conditions for, crude oil and natural gas, which are highly volatile and cyclical. Our results of operations have been and could in the future be significantly affected by increases in these costs. Price increases increase our working capital needs and, accordingly, can adversely affect our liquidity and cash flow. We typically do not enter into significant hedging arrangements with respect to prices of raw materials. However, we have occasionally entered into short-term contracts in order to hedge our costs for ethane and natural gas. In the future, we may decide not to hedge any of our raw material costs or any hedges we enter into may not have successful results.

In addition, higher natural gas prices adversely affect the ability of many domestic chemical producers to compete internationally since U.S. producers are disproportionately reliant on natural gas and natural gas liquids as an energy source and as a raw material. In addition to the impact that this has on our exports, reduced competitiveness of U.S. producers also has in the past increased the availability of chemicals in North America, as U.S. production that would otherwise have been sold overseas was instead offered for sale domestically, resulting in excess supply and lower prices in North America. We could also face the threat of imported products from countries that have a cost advantage.

***External factors beyond our control can cause fluctuations in demand for our products and in our prices and margins, which may negatively affect our results of operations and cash flow.***

External factors beyond our control can cause volatility in raw material prices, demand for our products, product prices and volumes and deterioration in operating margins. These factors can also magnify the impact of economic cycles on our business and results of operations. Examples of external factors include:

general economic conditions;

the level of business activity in the industries that use our products;



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competitor action;

technological innovations;

currency fluctuations;

international events and circumstances;

governmental regulation in the United States and abroad; and

severe weather and natural disasters.

We believe that events in the Middle East have had a particular influence over the past several years and may continue to do so until the situations normalize. In addition, a number of our products are highly dependent on durable goods markets, such as housing and construction, which are themselves particularly cyclical. The U.S. residential housing market has weakened significantly during 2006. If the global economy worsens in general, or the U.S. residential housing market in particular, demand for our products and our income and cash flow will be adversely affected.

We may reduce production at or idle a facility for an extended period of time or exit a business because of high raw material prices, an oversupply of a particular product and/or a lack of demand for that particular product, which makes production uneconomical. Temporary outages sometimes last for several quarters or, in certain cases, longer and cause us to incur costs, including the expenses of maintaining and restarting these facilities. Factors such as increases in raw material costs or lower demand in the future may cause us to further reduce operating rates, idle facilities or exit uncompetitive businesses.

Continued hostilities in the Middle East and/or the occurrence or threat of occurrence of terrorist attacks such as those against the United States on September 11, 2001 could adversely affect the economies of the United States and other developed countries. A lower level of economic activity could result in a decline in demand for our products, which could adversely affect our net sales and margins and limit our future growth prospects. In addition, these risks have increased, and may continue to increase, volatility in prices for crude oil and natural gas and could result in increased feedstock costs. In addition, these risks could cause increased instability in the financial and insurance markets and could adversely affect our ability to access capital and to obtain insurance coverage that we consider adequate or are otherwise required by our contracts with third parties.

***Our inability to compete successfully may reduce our operating profits.***

The petrochemical industry is highly competitive. In the last several years, there have been a number of mergers, acquisitions, spin-offs and joint ventures in the industry. This restructuring activity has resulted in fewer but more competitive producers, many of which are larger than we are and have greater financial resources than we do. Among our competitors are some of the world's largest chemical companies and chemical industry joint ventures. Competition within the petrochemical industry and in the manufacturing of fabricated products is affected by a variety of factors, including:

product price;

technical support and customer service;

quality;

reliability of supply;

availability of potential substitute materials; and

product performance.

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Changes in the competitive environment could have a material adverse effect on our business and our operations. These changes could include:

the emergence of new domestic and international competitors;

the rate of capacity additions by competitors;

change in customer base due to mergers;

the intensification of price competition in our markets;

the introduction of new or substitute products by competitors;

the technological innovations of competitors; and

the adoption of new environmental laws and regulatory requirements.

*Our production facilities process some volatile and hazardous materials that subject us to operating risks that could adversely affect our operating results.*

We have four major manufacturing facilities: our olefins complex in Lake Charles, Louisiana, our polyethylene and Epolene® complex in Longview, Texas, our vinyls complex in Calvert City, Kentucky and our vinyls facility in Geismar, Louisiana. Our operations are subject to the usual hazards associated with commodity chemical and plastics manufacturing and the related use, storage, transportation and disposal of feedstocks, products and wastes, including:

pipeline leaks and ruptures;

explosions;

fires;

severe weather and natural disasters;

mechanical failure;

unscheduled downtime;

labor difficulties;

transportation interruptions;

chemical spills;

discharges or releases of toxic or hazardous substances or gases;

storage tank leaks;

other environmental risks; and

terrorist attacks.

These hazards can cause personal injury and loss of life, catastrophic damage to or destruction of property and equipment and environmental damage, and may result in a suspension of operations and the imposition of civil or criminal penalties. We could become subject to environmental claims brought by governmental entities or third parties. A loss or shutdown over an extended period of operations at any one of our four major operating facilities would have a material adverse effect on us. We maintain property, business interruption and casualty insurance that we believe is in accordance with customary industry practices, but we cannot be fully insured against all potential hazards incident to our business, including losses resulting from war risks or terrorist acts. As a result of market conditions, premiums and deductibles for certain insurance policies can increase substantially and, in some instances, certain insurance may become unavailable or available only for reduced amounts of coverage. If we were to incur a significant liability for which we were not fully insured, it could have a material adverse effect on our financial position.

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***New regulations concerning the transportation of hazardous chemicals and the security of chemical manufacturing facilities could result in higher operating costs.***

Targets such as chemical manufacturing facilities may be at greater risk of terrorist attacks than other targets in the United States. As a result, the chemical industry responded to the issues surrounding the terrorist attacks of September 11, 2001 by starting initiatives relating to the security of chemicals industry facilities and the transportation of hazardous chemicals in the United States. Simultaneously, local, state and federal governments have begun a regulatory process that could lead to new regulations impacting the security of chemical plant locations and the transportation of hazardous chemicals. Our business or our customers' businesses could be adversely affected because of the cost of complying with new regulations.

***Our operations and assets are subject to extensive environmental, health and safety laws and regulations.***

We use large quantities of hazardous substances and generate large quantities of hazardous wastes in our manufacturing operations. Due to the large quantities of hazardous substances and wastes, our industry is highly regulated and monitored by various environmental regulatory authorities. As such, we are subject to extensive federal, state and local laws and regulations pertaining to pollution and protection of the environment, health and safety, which govern, among other things, emissions to the air, discharges onto land or waters, the maintenance of safe conditions in the workplace, the remediation of contaminated sites, and the generation, handling, storage, transportation, treatment and disposal of waste materials. Some of these laws and regulations are subject to varying and conflicting interpretations. Many of these laws and regulations provide for substantial fines and potential criminal sanctions for violations and require the installation of costly pollution control equipment or operational changes to limit pollution emissions and/or reduce the likelihood or impact of hazardous substance releases, whether permitted or not. For example, all four of our petrochemical facilities, in Lake Charles, Longview, Calvert City and Geismar, may require improvements to comply with the anticipated wastewater regulations of the synthetic organic chemical manufacturing industries.

In addition, we cannot accurately predict future developments, such as increasingly strict environmental laws or regulations, and inspection and enforcement policies, as well as resulting higher compliance costs, which might affect the handling, manufacture, use, emission, disposal or remediation of products, other materials or hazardous and non-hazardous waste, and we cannot predict with certainty the extent of our future liabilities and costs under environmental, health and safety laws and regulations. These liabilities and costs may be material.

We also may face liability for alleged personal injury or property damage due to exposure to chemicals or other hazardous substances at our facilities or to chemicals that we otherwise manufacture, handle or own. Although these types of claims have not historically had a material impact on our operations, a significant increase in the success of these types of claims could have a material adverse effect on our business, financial condition, operating results or cash flow.

Environmental laws may have a significant effect on the nature and scope of, and responsibility for, cleanup of contamination at our current and former operating facilities, the costs of transportation and storage of raw materials and finished products, the costs of reducing emissions and the costs of the storage and disposal of wastewater. In addition, the federal CERCLA and similar state laws impose joint and several liability for the costs of remedial investigations and actions on the entities that generated waste, arranged for disposal of the wastes, transported to or selected the disposal sites and the past and present owners and operators of such sites. All such potentially responsible parties (or any one of them, including us) may be required to bear all of such costs regardless of fault, legality of the original disposal or ownership of the disposal site. In addition, CERCLA and similar state laws could impose liability for damages to natural resources caused by contamination.

Although we seek to take preventive action, our operations are inherently subject to accidental spills, discharges or other releases of hazardous substances that may make us liable to governmental entities or private parties. This may involve contamination associated with our current and former facilities, facilities to which

we sent wastes or by-products for treatment or disposal and other contamination. Accidental discharges may

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occur in the future, future action may be taken in connection with past discharges, governmental agencies may assess damages or penalties against us in connection with any past or future contamination, or third parties may assert claims against us for damages allegedly arising out of any past or future contamination. In addition, we may be liable for existing contamination related to certain of our facilities for which, in some cases, we believe third parties are liable in the event such third parties fail to perform their obligations. For further discussion of such existing contamination, see Item 1, Business Environmental and Other Regulation.

***Our property insurance has only partial coverage for acts of terrorism and, in the event of terrorist attack, we could lose net sales and our facilities.***

As a result of the terrorist attacks of September 11, 2001 and other events, our insurance carriers created certain exclusions for losses from terrorism from our property insurance policies. While separate terrorism insurance coverage is available, premiums for full coverage are very expensive, especially for chemical facilities, and the policies are subject to high deductibles. Available terrorism coverage typically excludes coverage for losses from acts of war and from acts of foreign governments as well as nuclear, biological and chemical attacks. We have determined that it is not economically prudent to obtain full terrorism insurance, especially given the significant risks that are not covered by such insurance. Where feasible we have secured some limited terrorism insurance coverage on our property where insurers have included it in their overall programs. In the event of a terrorist attack impacting one or more of our facilities, we could lose the net sales from the facilities and the facilities themselves, and could become liable for any contamination or for personal or property damage due to exposure to hazardous materials caused by any catastrophic release that may result from a terrorist attack.

***We have significant debt, which could adversely affect our ability to operate our business.***

As of December 31, 2006, we had total outstanding debt of \$260.2 million, which represented approximately 18% of our total capitalization. Our annual interest expense for 2006 was \$16.5 million. Our level of debt and the limitations imposed on us by our existing or future debt agreements could have significant consequences on our business and future prospects, including the following:

a significant portion of our cash flow from operations will be dedicated to the payment of interest and principal on our debt and will not be available for other purposes, including the payment of dividends;

we may not be able to obtain necessary financing in the future for working capital, capital expenditures, acquisitions, debt service requirements or other purposes;

our less leveraged competitors could have a competitive advantage because they have greater flexibility to utilize their cash flow to improve their operations;

we may be exposed to risks inherent in interest rate fluctuations because some of our borrowings are at variable rates of interest, which would result in higher interest expense in the event of increases in interest rates; and

we could be more vulnerable in the event of a downturn in our business that would leave us less able to take advantage of significant business opportunities and to react to changes in our business and in market or industry conditions.

***To service our indebtedness, we will require a significant amount of cash. Our ability to generate cash depends on many factors beyond our control.***

Our ability to make payments on and to refinance our indebtedness and to fund planned capital expenditures and pay cash dividends will depend on our ability to generate cash in the future. This is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control.

Our business may not generate sufficient cash flow from operations, currently anticipated cost savings and operating improvements may not be realized on schedule and future borrowings may not be available to us under



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our credit facility in an amount sufficient to enable us to pay our indebtedness or to fund our other liquidity needs. We may need to refinance all or a portion of our indebtedness on or before maturity. In addition, we may not be able to refinance any of our indebtedness, including our credit facility and our senior notes, on commercially reasonable terms or at all.

***Our credit facility and the indenture governing our senior notes impose significant operating and financial restrictions, which may prevent us from capitalizing on business opportunities and taking some actions.***

Our credit facility and the indenture governing our senior notes impose significant operating and financial restrictions on us. These restrictions limit our ability to:

pay dividends on, redeem or repurchase our capital stock;

make investments and other restricted payments;

incur additional indebtedness or issue preferred stock;

create liens;

permit dividend or other payment restrictions on our restricted subsidiaries;

sell all or substantially all of our assets or consolidate or merge with or into other companies;

engage in transactions with affiliates; and

engage in sale-leaseback transactions.

These limitations are subject to a number of important qualifications and exceptions. Our credit facility also requires us to maintain a minimum fixed charge coverage ratio if the amount available to be borrowed falls below a specified level. These covenants may adversely affect our ability to finance our future operations and capital needs and to pursue available business opportunities. A breach of any of these covenants could result in a default in respect of the related debt. If a default occurred, the relevant lenders could elect to declare the debt, together with accrued interest and other fees, to be immediately due and payable and proceed against any collateral securing that debt. In addition, any acceleration of debt under our credit facility will constitute a default under some of our other debt, including the indenture governing our senior notes.

***We may pursue acquisitions, dispositions and joint ventures and other transactions that may impact our results of operations and financial condition.***

We seek opportunities to maximize efficiency and create stockholder value through various transactions. These transactions may include various domestic and international business combinations, purchases or sales of assets or contractual arrangements or joint ventures that are intended to result in the realization of synergies, the creation of efficiencies or the generation of cash to reduce debt. To the extent permitted under our credit facility and other debt agreements, some of these transactions may be financed by additional borrowings by us. Although these transactions are expected to yield longer-term benefits if the expected efficiencies and synergies of the transactions are realized, they could adversely affect our results of operations in the short term because of the costs associated with such transactions. Other transactions may advance future cash flows from some of our businesses, thereby yielding increased short-term liquidity, but consequently resulting in lower cash flows from these operations over the longer term.



*We may have difficulties integrating the operations of acquired businesses.*

If we are unable to integrate or to successfully manage the Longview facilities we acquired from Eastman or other businesses that we have acquired or that we may acquire in the future, our business, financial condition and results of operations could be adversely affected. We may not be able to realize the operating efficiencies, synergies, cost savings or other benefits expected from the acquisitions for a number of reasons, including the following:

we may fail to integrate the businesses we acquire into a cohesive, efficient enterprise;

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our resources, including management resources, are limited and may be strained if we engage in a significant number of acquisitions, and acquisitions may divert our management's attention from initiating or carrying out programs to save costs or enhance revenues; and

our failure to retain key employees and contracts of the businesses we acquire.

*We will be controlled by our principal stockholder and its affiliates as long as they own a majority of our common stock, and our other stockholders will be unable to affect the outcome of stockholder voting during that time. Our interests may conflict with those of the principal stockholder and its affiliates, and we may not be able to resolve these conflicts on terms possible in arms-length transactions.*

As long as TTWF LP (the principal stockholder) and its affiliates (the principal stockholder affiliates) own a majority of our outstanding common stock, they will be able to exert significant control over us, and our other stockholders, by themselves, will not be able to affect the outcome of any stockholder vote. As a result, the principal stockholder, subject to any fiduciary duty owed to our minority stockholders under Delaware law, will be able to control all matters affecting us (some of which may present conflicts of interest), including:

the composition of our board of directors and, through the board, any determination with respect to our business direction and policies, including the appointment and removal of officers and the determination of compensation;

any determinations with respect to mergers or other business combinations or the acquisition or disposition of assets;

our financing decisions, capital raising activities and the payment of dividends; and

amendments to our amended and restated certificate of incorporation or amended and restated bylaws.

The principal stockholder will be permitted to transfer a controlling interest in us without being required to offer our other stockholders the ability to participate or realize a premium for their shares of common stock. A sale of a controlling interest to a third party may adversely affect the market price of our common stock and our business and results of operations because the change in control may result in a change of management decisions and business policy. Because we have elected not to be subject to Section 203 of the General Corporation Law of the State of Delaware, the principal stockholder may find it easier to sell its controlling interest to a third party than if we had not so elected.

In addition to any conflicts of interest that arise in the foregoing areas, our interests may conflict with those of the principal stockholder affiliates in a number of other areas, including:

business opportunities that may be presented to the principal stockholder affiliates and to our officers and directors associated with the principal stockholder affiliates, and competition between the principal stockholder affiliates and us within the same lines of business;

the solicitation and hiring of employees from each other; and

agreements with the principal stockholder affiliates relating to corporate services that may be material to our business.

We may not be able to resolve any potential conflicts with the principal stockholder affiliates, and even if we do, the resolution may be less favorable than if we were dealing with an unaffiliated party, particularly if the conflicts are resolved while we are controlled by the principal stockholder affiliates. Our amended and restated certificate of incorporation provides that the principal stockholder affiliates have no duty to refrain from engaging in activities or lines of business similar to ours and that the principal stockholder affiliates will not be liable to us or our stockholders for failing to present specified corporate opportunities to us.



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### **Cautionary Statements about Forward Looking Statements**

The Private Securities Litigation Reform Act of 1995 provides safe harbor provisions for forward-looking information. Certain of the statements contained in this Form 10-K are forward-looking statements. All statements, other than statements of historical facts, included in this Form 10-K that address activities, events or developments that we expect, project, believe or anticipate will or may occur in the future are forward-looking statements. Forward-looking statements can be identified by the use of words such as believes, intends, may, should, could, anticipates, or comparable terminology, or by discussions of strategies or trends. Although we believe that the expectations reflected in such forward-looking statements are reasonable, we cannot give any assurances that these expectations will prove to be correct. Forward-looking statements relate to matters such as:

future operating rates, margins, cash flow and demand for our products;

production capacities;

our ability to borrow additional funds under our credit facility;

our ability to meet our liquidity needs;

our intended quarterly dividends;

future capacity additions and expansions in the industry;

timing, size, scope, cost and other matters related to the project in the Republic of Trinidad and Tobago;

timing of the planned maintenance turnarounds at our Lake Charles facility;

compliance with present and future environmental regulations and costs associated with environmentally related penalties, capital expenditures, remedial actions and proceedings;

effects of pending legal proceedings; and

timing of and amount of capital expenditures.

We have based these statements on assumptions and analyses in light of our experience and perception of historical trends, current conditions, expected future developments and other factors we believe were appropriate in the circumstances when the statements were made. Forward-looking statements by their nature involve substantial risks and uncertainties that could significantly impact expected results, and actual future results could differ materially from those described in such statements. While it is not possible to identify all factors, we continue to face many risks and uncertainties. Among the factors that could cause actual future results to differ materially are the risks and uncertainties discussed under Risk Factors and those described from time to time in our other filings with the SEC including, but not limited to, the following:

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general economic and business conditions;

the cyclical nature of the chemical industry;

the availability, cost and volatility of raw materials and energy;

uncertainties associated with the United States and worldwide economies, including those due to political tensions in the Middle East and elsewhere;

current and potential governmental regulatory actions in the United States and regulatory actions and political unrest in other countries;

industry production capacity and operating rates;

the supply/demand balance for our products;

competitive products and pricing pressures;

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access to capital markets;

terrorist acts;

operating interruptions (including leaks, explosions, fires, weather-related incidents, mechanical failure, unscheduled downtime, labor difficulties, transportation interruptions, spills and releases and other environmental risks);

changes in laws or regulations;

technological developments;

our ability to implement our business strategies; and

creditworthiness of our customers.

Many of such factors are beyond our ability to control or predict. Any of the factors, or a combination of these factors, could materially affect our future results of operations and the ultimate accuracy of the forward-looking statements. These forward-looking statements are not guarantees of our future performance, and our actual results and future developments may differ materially from those projected in the forward-looking statements. Management cautions against putting undue reliance on forward-looking statements or projecting any future results based on such statements or present or prior earnings levels. Every forward-looking statement speaks only as of the date of the particular statement, and we undertake no obligation to publicly update or revise any forward-looking statements.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

Our manufacturing facilities and principal products are set forth below. Except as noted, we own each of these facilities.

**Location**

Lake Charles, Louisiana  
 Longview, Texas(1)  
 Calvert City, Kentucky(2)  
 Geismar, Louisiana  
 Booneville, Mississippi  
 Springfield, Kentucky  
 Litchfield, Illinois  
 Wichita Falls, Texas  
 Van Buren, Arkansas  
 Bristol, Indiana  
 Leola, Pennsylvania  
 Greensboro, Georgia  
 Evansville, Indiana  
 Calgary, Alberta, Canada(3)

**Principal Products**

Ethylene, polyethylene, styrene  
 Polyethylene, Epolene®  
 PVC, VCM, chlorine, caustic soda, ethylene  
 PVC, VCM and EDC  
 PVC pipe  
 PVC pipe  
 PVC pipe  
 PVC pipe  
 PVC pipe  
 PVC pipe  
 PVC pipe  
 PVC pipe  
 Fence and deck components  
 Window, patio door and fence components

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Pawling, New York

Window, patio door and fence components

- (1) We lease the land on which our Longview facilities are located.
- (2) We lease a portion of our Calvert City facilities.
- (3) We lease our Calgary facility.

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### ***Olefins***

Our Lake Charles complex consists of three tracts on over 1,300 acres in Lake Charles, Louisiana, each within two miles of one another. The complex includes two ethylene plants, two polyethylene plants and a styrene monomer plant. The combined capacity of our two ethylene plants is approximately 2.4 billion pounds per year. The capacity of our two polyethylene plants is approximately 1.4 billion pounds per year and the capacity of our styrene plant is approximately 485 million pounds per year. Our newest polyethylene plant has two production units that use gas phase technology to manufacture both LLDPE and HDPE. Our styrene monomer plant is being modernized with state-of-the-art technology. We are planning to implement modifications to the styrene monomer plant in 2007 designed to save energy and reduce raw material consumption.

Our Lake Charles complex includes a marine terminal that provides for worldwide shipping capabilities. The complex also is located near rail transportation facilities, which allows for efficient delivery of raw materials and prompt shipment of our products to customers. In addition, the complex is connected by pipeline systems to our ethylene feedstock sources in both Texas and Louisiana. Within the complex, our ethylene plants are connected by pipeline systems to our polyethylene and styrene plants.

Our Longview, Texas facility consists of three polyethylene plants, an Epolene<sup>®</sup> polymers plant, and a 200 mile, ten inch ethylene pipeline that runs from Mt. Belvieu, Texas to Longview. The plants are located inside a large Eastman facility where Eastman produces a number of other chemical products. We can access ethylene to support our polyethylene operations either by purchasing ethylene from Eastman at the site or by transporting ethylene from our Lake Charles plant into the Gulf Coast grid and by transporting ethylene through our ethylene pipeline into our Longview facilities. The technologies we use to produce LDPE, LLDPE and HDPE at Longview are the same technologies that we employ at Lake Charles (autoclave LDPE and gas phase LLDPE and HDPE). The Longview facilities have a total capacity of 1.1 billion pounds per year.

### ***Vinyls***

Our Calvert City complex is situated on 550 acres on the Tennessee River in Kentucky and includes an ethylene plant, a chlor-alkali plant, a VCM plant and a PVC plant. The capacity of our Calvert City ethylene plant is 450 million pounds per year and the capacity of our chlor-alkali plant is 410 million pounds of chlorine and 450 million pounds of caustic soda per year. Our chlorine plant utilizes efficient, state-of-the-art membrane technology. Our VCM plant has a capacity of 1.3 billion pounds per year and our Calvert City PVC plant has a capacity of 800 million pounds per year.

In 2002, we acquired a vinyls facility in Geismar, Louisiana which is situated on 184 acres on the Mississippi River. The site includes a PVC plant with a capacity of 600 million pounds per year and a VCM plant with a capacity of 600 million pounds per year with related EDC capacity.

We currently operate eleven fabricated products plants, consisting of eight PVC pipe plants, and three profiles plants producing PVC fence, decking, windows and patio door profiles. The majority of our plants are strategically located near our Calvert City complex and serve customers throughout the middle United States. The combined capacity of our fabricated product plants is 915 million pounds per year.

We believe our current facilities are adequate to meet the requirements of our present and foreseeable future operations.

### ***Headquarters***

Our principal executive offices are located in Houston, Texas. Our office space is leased, at market rates, from an affiliate under a lease that expires on December 31, 2009. See Note 13 to the audited consolidated financial statements appearing elsewhere in this Form 10-K and "Certain Relationships and Related Transactions" in our proxy statement to be filed with the SEC within 120 days of December 31, 2006 pursuant to Regulation 14A with respect to our 2007 annual meeting of stockholders (the "Proxy Statement").



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**Item 3. Legal Proceedings**

In October 2003, we filed suit against CITGO Petroleum Corporation in state court in Lake Charles, Louisiana, asserting that CITGO had failed to take sufficient hydrogen under two successive contracts pursuant to which we supplied and we supply to CITGO hydrogen that we generate as a co-product in our ethylene plants in Lake Charles. In December 2003, CITGO responded with an answer and a counterclaim against us, asserting that CITGO had overpaid us for hydrogen due to our allegedly faulty sales meter and that we are obligated to reimburse CITGO for the overpayments. In January 2004, we filed a motion to compel arbitration of CITGO's counterclaim and to stay all court proceedings relating to the counterclaim. In May 2004, the parties filed a joint motion with the court to provide for CITGO's counterclaim to be resolved by arbitration. Our claim against CITGO was approximately \$8.1 million plus interest at the prime rate plus two percentage points and attorneys' fees. CITGO's claim against us was approximately \$7.8 million plus interest at the prime rate plus two percentage points and attorneys' fees. Effective November 21, 2006, the parties agreed to settle the litigation and dismiss their claims. As a result of this settlement, we recorded a benefit of \$2.6 million in cost of sales due to a reduction in contingency reserves.

In addition to the matters described above and under Item 1, Business Environmental and Other Regulation, we are involved in various routine legal proceedings incidental to the conduct of our business. We do not believe that any of these routine legal proceedings will have a material adverse effect on our financial condition, results of operations or cash flows.

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

None.

**Executive Officers of the Registrant**

*Albert Chao* (age 57). Mr. Chao has been our President since May 1996 and a director since June 2003. Mr. Chao has over 30 years of international experience in the chemical industry. In 1985, Mr. Chao assisted his father T.T. Chao and his brother James Chao in founding us, where he served as Executive Vice President until he succeeded James as President. He has held positions in the Controller's Group of Mobil Oil Corporation, in the Technical Department of Hercules Incorporated, in the Plastics Group of Gulf Oil Corporation and has served as Assistant to the Chairman of China General Plastics Group and Deputy Managing Director of a plastics fabrication business in Singapore. He is also a director of Titan Chemicals Corp. Bhd. Mr. Chao received a bachelor's degree from Brandeis University and an M.B.A. from Columbia University. Mr. Chao is a trustee of Rice University.

*James Chao* (age 59). Mr. Chao has been our Chairman of the Board since July 2004 and became a director in June 2003. He previously served as our Vice Chairman of the Board since May 1996. Mr. Chao also has responsibility for the oversight of our Vinyls business. Mr. Chao has over 30 years of international experience in the chemical industry. In June 2003, he was named Chairman of Titan Chemicals Corp. Bhd. and previously served as the Managing Director. He has served as a Special Assistant to the Chairman of China General Plastics Group and worked in various financial, managerial and technical positions at Mattel Incorporated, Developmental Bank of Singapore, Singapore Gulf Plastics Pte. Ltd. and Gulf Oil Corporation. Mr. Chao, along with his brother Albert Chao, assisted their father T.T. Chao in founding us and served as our first president from 1985 to 1996. Mr. Chao received his Bachelor of Science degree from the Massachusetts Institute of Technology and an M.B.A. from Columbia University.

*David R. Hansen* (age 56). Mr. Hansen has been our Senior Vice President, Administration, since September 1999 and served as Vice President, Human Resources from 1993 to 1999. From August 2003 until July 2004 he was also our Secretary. Prior to joining us in 1990, Mr. Hansen served as Director of Human Resources & Administration for Agrico Chemical Company and held various human resources and administrative management positions within the Williams Companies. He has 30 years of administrative management experience in the oil, gas, energy, chemicals, pipeline, plastics and computer industries. He received

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his Bachelor of Science degree in Social Science from the University of Utah and has completed extensive graduate work toward an M.S. in Human Resources Management.

*Wayne D. Morse* (age 63). Mr. Morse has been a Senior Vice President since 1994 and was named Senior Vice President, Vinyls and Manufacturing in January 2003. In July 2004, he was named Senior Vice President, Vinyls. Mr. Morse joined us in 1990 after 23 years of service with Goodrich Corporation. He held the position of Vice President and General Manager of BFG Intermediates Division, which had ethylene, chlor-alkali and EDC/VCM operations. Since joining us, Mr. Morse has had broad executive responsibility for all chemical operations and is the senior manufacturing executive of our company. Mr. Morse earned a B.S. degree in Chemical Engineering from the University of Louisville.

*M. Steven Bender* (age 50). Mr. Bender has been our Vice President and Treasurer since June 2005. On February 23, 2007, Mr. Bender was elected to the additional position of Chief Financial Officer. From June 2002 until June 2005, Mr. Bender served as Vice President and Treasurer of Kellogg Brown and Root, Inc., a subsidiary of Halliburton Company, and from 1996 to 2002 he held the position of Assistant Treasurer for Halliburton. Prior to that, he held various financial positions within that company. Additionally, he was employed by Texas Eastern Corporation for over a decade in a variety of increasingly responsible audit, finance and treasury positions. Mr. Bender received a Bachelor of Business Administration from Texas A&M University and an M.B.A. from Southern Methodist University. Mr. Bender is also a Certified Public Accountant.

*George J. Mangieri* (age 56). Mr. Mangieri has been our Vice President and Controller since joining us in April 2000. Prior to joining us, Mr. Mangieri served as Vice President and Controller of Zurn Industries, Inc. from 1998 to 2000. He previously was employed as Vice President and Controller for Imo Industries, Inc. in New Jersey, and spent over 10 years in public accounting with Ernst & Young LLP, where he served as Senior Manager. He received his Bachelor of Science degree from Monmouth College and is a Certified Public Accountant.

*Jeffrey L. Taylor* (age 53). Mr. Taylor has been our Vice President, Polyethylene, since January 2003. Mr. Taylor joined us in March 2002 as Manager, PE Marketing. Mr. Taylor joined us after a 25-year career with Chevron Phillips Chemical Company where he served as the Vice President, Polyethylene, Americas from 2000 to 2001 and Marketing Manager Polyethylene from 1999 to 2000. During his career, he has held a variety of sales, marketing, operations and general management assignments. He is a graduate of the University of Delaware with a B.S. in Business Administration and a B.A. in Mathematics.

*Stephen Wallace* (age 60). Mr. Wallace joined us in December 2003 as our Vice President and General Counsel and was elected Secretary in July 2004. He began his legal career over 20 years ago at the law firm of Baker Botts L.L.P., which he left as a partner in 1993. He subsequently held senior corporate legal positions with Transworld Oil U.S.A., Inc. (1993-1996; 2002-2003), Oman Oil Company Ltd. (1996-1997), and Enron Global Exploration & Production Inc. and its affiliates (1997-2002). Mr. Wallace holds a B.A. from Rice University and a Ph.D. from Cornell University in linguistics, and received his J.D. from the University of Houston.

*Warren W. Wilder* (age 49). Mr. Wilder has been our Senior Vice President, Olefins and Styrene, since May 2006. From January 2003 to May 2006, he was our Vice President, Olefins and Styrene. Mr. Wilder joined us in January 2000 as Vice President, Planning and Business Development, and in February 2001, he was appointed Vice President, Polyethylene. Prior to joining us, he was an executive with Koch Industries, Inc. for over 10 years where he held positions in planning and business development, finance, operations and general management, including Vice President, Koch Hydrocarbons from 1996 to 1999. Mr. Wilder holds a B.S. in Chemical Engineering from the University of Washington and an M.B.A. from the University of Chicago.

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**  
**Price Range of Common Stock**

As of February 20, 2007, there were 71 holders of record of our common stock. Our common stock is listed on the New York Stock Exchange under the symbol WLK. Set forth below are the high and low closing prices for our common stock, as reported on the New York Stock Exchange composite tape for the periods indicated and the cash dividends declared in these periods.

	High	Low	Cash Dividends Declared
<b>Year Ended December 31, 2006</b>			
4th Quarter	\$ 35.29	\$ 31.13	\$ 0.04000
3rd Quarter	33.29	26.38	0.04000
2nd Quarter	34.77	26.58	0.02750
1st Quarter	36.75	29.03	0.02750
<b>Year Ended December 31, 2005</b>			
4th Quarter	\$ 35.50	\$ 26.16	\$ 0.02750
3rd Quarter	32.97	24.55	0.02750
2nd Quarter	33.26	22.29	0.02125
1st Quarter	37.03	30.63	0.02125

Our credit facility and the indenture governing our 6<sup>5</sup>/<sub>8</sub>% notes due 2016 restrict our ability to pay dividends or other distributions on our equity securities. We do not currently expect these restrictions to materially limit our ability to pay regular quarterly dividends. See Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Debt for a discussion of the restrictions.

**Equity Compensation Plan Information**

Securities authorized for issuance under equity compensation plans are as follows:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights(a)	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column(a))
Equity compensation plans approved by security holders	356,284	\$ 20.57	5,547,760
Equity compensation plans not approved by security holders	N/A	N/A	N/A
<b>Total</b>	<b>356,284</b>	<b>\$ 20.57</b>	<b>5,547,760</b>

Other information regarding our equity compensation plans is set forth in the section entitled Executive Compensation in our Proxy Statement, which information is incorporated herein by reference.



**Table of Contents****Item 6. Selected Financial and Operational Data(1)**

	Year Ended December 31,				
	2006	2005	2004	2003	2002
	(dollars in thousands, except per share and volume data)				
<b>Statement of Operations Data:</b>					
Net sales	\$ 2,484,366	\$ 2,441,105	\$ 1,985,353	\$ 1,423,034	\$ 1,072,627
Gross profit	396,483	443,631	303,185	121,952	80,569
Selling, general and administrative expenses	83,232	76,598	60,238	57,014	64,258
Gain on sale of assets			(2,049)		
Gain on legal settlement				(3,162)	
Impairment of long-lived assets(2)			1,830	2,285	2,239
Income from operations	313,251	367,033	243,166	65,815	14,072
Interest expense	(16,519)	(23,717)	(39,350)	(38,589)	(35,044)
Debt retirement cost	(25,853)	(646)	(15,791)	(11,343)	
Other income, net(3)	11,670	2,658	2,637	7,620	6,769
Income (loss) before income taxes	282,549	345,328	190,662	23,503	(14,203)
Provision for (benefit from) income taxes	87,990	118,511	69,940	8,747	(7,141)
Net income (loss)	\$ 194,559	\$ 226,817	\$ 120,722	\$ 14,756	\$ (7,062)
<b>Earnings per share information(4):</b>					
Basic	\$ 2.99	\$ 3.49	\$ 2.19	\$ 0.30	\$ (0.14)
Diluted	\$ 2.98	\$ 3.48	\$ 2.18	\$ 0.30	\$ (0.14)
Weighted average shares outstanding					
Basic	65,133,628	65,008,253	55,230,786	49,499,395	49,499,395
Diluted	65,254,654	65,251,109	55,355,442	49,499,395	49,499,395
<b>Balance Sheet Data (end of period):</b>					
Cash and cash equivalents	\$ 52,646	\$ 237,895	\$ 43,396	\$ 37,381	\$ 11,123
Working capital(5)	527,875	597,014	421,723	197,715	158,993
Total assets	2,082,098	1,827,189	1,592,453	1,370,113	1,309,245
Total debt	260,156	266,889	298,089	537,289	533,350
Minority interest				22,100	22,100
Stockholders' equity	1,173,541	994,106	769,397	445,603	428,519
Cash dividends declared per share	\$ 0.1350	\$ 0.0975	\$ 0.02125	\$	\$
<b>Other Operating Data:</b>					
Cash flow from:					
Operating activities	\$ 237,184	\$ 318,447	\$ 150,781	\$ 78,087	\$ (21,326)
Investing activities	(404,336)	(87,590)	(79,963)	(41,581)	(38,686)
Financing activities	(18,097)	(36,358)	(64,803)	(10,248)	(7,690)
Depreciation and amortization	86,262	81,241	81,075	87,293	88,018
Capital expenditures	136,258	85,760	52,710	44,931	43,587
EBITDA(6)	385,330	450,286	311,087	149,385	108,859
<b>External Sales Volume (millions of pounds):</b>					
Olefins Segment					
Polyethylene	1,318	1,237	1,330	1,280	1,199
Ethylene, styrene and other	858	979	1,138	861	767
Vinyls Segment					
Fabricated finished products	758	854	660	517	543
VCM, PVC, and other	1,289	1,223	1,097	1,120	1,184

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- (1) The historical selected financial and operational data should be read together with item 7, Management Discussion and Analysis of Financial Condition and Results of Operations, and item 8, Financial Statements and Supplementary Data included in this annual report on Form 10-K.
- (2) The 2004 impairments related to a PVC plant not in service and Olefins segment assets written down to fair market value. The 2003 impairments related primarily to idled styrene assets and other miscellaneous assets written down to fair market value. The 2002 impairment related to a ceased product business.
- (3) Other income, net is composed of interest income, insurance proceeds, equity income, management fee income and other gains and losses.
- (4) Does not reflect the issuance of common stock in exchange for preferred stock as part of the internal reorganizations immediately prior to our initial public offering.
- (5) Working capital equals current assets less current liabilities.
- (6) EBITDA (a non-GAAP financial measure) is calculated as net income before interest expense, income taxes, depreciation and amortization. The body of accounting principles generally accepted in the United States is commonly referred to as GAAP. For this purpose a non-GAAP financial measure is generally defined by the SEC as one that purports to measure historical and future financial performance, financial position or cash flows, but excludes or includes amounts that would not be so adjusted in the most comparable GAAP measures. We have included EBITDA in this Form 10-K because our management considers it an important supplemental measure of our performance and believes that it is frequently used by securities analysts, investors and other interested parties in the evaluation of companies in our industry, some of which present EBITDA when reporting their results. We regularly evaluate our performance as compared to other companies in our industry that have different financing and capital structures and/or tax rates by using EBITDA. EBITDA allows for meaningful company-to-company performance comparisons by adjusting for factors such as interest expense, depreciation and amortization and taxes, which often vary from company to company. In addition, we utilize EBITDA in evaluating acquisition targets. Management also believes that EBITDA is a useful tool for measuring our ability to meet our future debt service, capital expenditures and working capital requirements, and EBITDA is commonly used by us and our investors to measure our ability to service indebtedness. EBITDA is not a substitute for the GAAP measures of earnings or of cash flow and is not necessarily a measure of our ability to fund our cash needs. In addition, it should be noted that companies calculate EBITDA differently and, therefore, EBITDA as presented in this Form 10-K may not be comparable to EBITDA reported by other companies. EBITDA has material limitations as a performance measure because it excludes (1) interest expense, which is a necessary element of our costs and ability to generate revenues because we have borrowed money to finance our operations, (2) depreciation, which is a necessary element of our costs and ability to generate revenues because we use capital assets and (3) income taxes, which is a necessary element of our operations. We compensate for these limitations by relying primarily on our GAAP results and using EBITDA only supplementally. The following table reconciles EBITDA to net income (loss) and to cash flow from operating activities.

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**Reconciliation of EBITDA to Net Income (Loss) and  
to Cash Flow from Operating Activities**

	Year Ended December 31,				
	2006	2005	2004	2003	2002
	(dollars in thousands)				
EBITDA	\$ 385,330	\$ 450,286	\$ 311,087	\$ 149,385	\$ 108,859
Less:					
Income tax (provision) benefit	(87,990)	(118,511)	(69,940)	(8,747)	7,141
Interest expense	(16,519)	(23,717)	(39,350)	(38,589)	(35,044)
Depreciation and amortization	(86,262)	(81,241)	(81,075)	(87,293)	(88,018)
Net income (loss)	194,559	226,817	120,722	14,756	(7,062)
Changes in operating assets and liabilities	21,931	41,438	(41,156)	48,245	(19,137)
Equity in income of unconsolidated subsidiary	(1,766)	(94)	(1,379)	(1,510)	(770)
Deferred income taxes	13,852	45,745	65,188	7,112	(4,716)
Impairment of long-lived assets			1,830	2,285	2,239
Write-off of debt issuance cost	3,623	646	4,153	7,343	
Loss (gain) from disposition of fixed assets	2,848	4,746	(218)	(2,903)	(2,259)
Amortization of debt issue costs	850	1,456	2,097	887	
Provision for (recovery of) doubtful accounts	1,287	(2,307)	(456)	1,872	10,379
Cash flow from operating activities	\$ 237,184	\$ 318,447	\$ 150,781	\$ 78,087	\$ (21,326)

**Table of Contents****Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations  
Overview**

We are a vertically integrated manufacturer and marketer of petrochemicals, polymers and fabricated products. Our two principal business segments are olefins and vinyls. We use the majority of our internally-produced basic chemicals to produce higher value-added chemicals and fabricated products.

Consumption of the basic chemicals that we manufacture in the commodity portions of our olefins and vinyls processes has increased significantly over the past 30 years. Our olefins and vinyls products are some of the most widely used chemicals in the world and are upgraded into a wide variety of higher value-added chemical products used in many end-markets. Petrochemicals are typically manufactured in large volume by a number of different producers using widely available technologies. The petrochemical industry exhibits cyclical commodity characteristics, and margins are influenced by changes in the balance between supply and demand and the resulting operating rates, the level of general economic activity and the price of raw materials. The cycle is generally characterized by periods of tight supply, leading to high operating rates and margins, followed by a decline in operating rates and margins primarily as a result of significant capacity additions. Due to the significant size of new plants, capacity additions are built in large increments and typically require several years of demand growth to be absorbed. In 2003 and 2004 the olefins and vinyls markets began a cyclical recovery and operating rates and margins began to increase as economic growth improved and excess capacity was absorbed. These factors resulted in increased industry product margins in 2004, 2005 and 2006.

In our Vinyls segment, industry forecasts estimate that PVC industry operating rates dropped to 75% for the fourth quarter of 2006 from 94% in the third quarter of 2006. This downturn was primarily due to weakness in the residential housing market and a reduction of inventory by PVC converters due to falling prices. The decline started in September 2006 and continued through December 2006. Looking forward, North American PVC capacity is projected to increase by 6% in 2008 and 6% in 2009. Demand for PVC is expected to increase by 2% per year over the next five years. As a result, operating rates could decline from peak levels achieved in early 2006.

In our Olefins segment, industry ethylene operating rates reached a peak of 90% in the second quarter of 2006 and trended down to 87% in the fourth quarter of 2006. Over the next five years some industry forecasts show a 5% per year increase in worldwide ethylene capacity with the largest increase in the Middle East and Asia. Demand is expected to grow 4% per year during this period. Operating rates in the U.S. are expected to peak in 2008 and decline gradually during the remainder of the decade primarily due to reduced exports.

We purchase significant amounts of ethane and propane feedstock, natural gas, chlorine and salt from external suppliers for use in production of basic chemicals in the olefins and vinyls chains. We also purchase significant amounts of electricity to supply the energy required in our production processes. While we have agreements providing for the supply of ethane and propane feedstocks, natural gas, chlorine, salt and electricity, the contractual prices for these raw materials and energy vary with market conditions and may be highly volatile. Factors which have caused volatility in our raw material prices in the past and which may do so in the future, include:

shortages of raw materials due to increasing demand;

capacity constraints due to construction delays, strike action or involuntary shutdowns;

the general level of business and economic activity; and

the direct or indirect effect of governmental regulation.

Significant volatility in raw material costs tends to put pressure on product margins, as sales price increases generally tend to lag behind raw material cost increases. Conversely, when raw material costs decrease, customers seek relief in the form of lower sales prices. We currently use derivative instruments to reduce price



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volatility risk on feedstock commodities and lower overall costs. Normally, there is a pricing relationship between a commodity that we process and the feedstock from which it is derived. When this pricing relationship deviates from historical norms, we have from time to time entered into derivative instruments and physical positions in an attempt to take advantage of this relationship.

Our historical results have been significantly affected by our plant production capacity, our efficient use of the capacity and our ability to increase our capacity. Since our inception, we have followed a disciplined growth strategy that focuses on plant acquisitions, new plant construction and internal expansion. We evaluate each expansion project on the basis of its ability to produce sustained returns in excess of our cost of capital and its ability to improve efficiency or reduce operating costs.

On November 30, 2006, we closed the acquisition of Eastman Chemical Company's polyethylene and Epolen® polymers businesses, related assets and a 200 mile, 10 inch pipeline from Mont Belvieu, Texas to Longview, Texas, all of which are headquartered in Longview, Texas. The purchase price was \$235.0 million in cash, which included working capital, and is subject to working capital adjustments. The polyethylene business and associated operating facilities have a capacity of 1,125 million pounds per year of polyethylene. This capacity is comprised of 700 million pounds per year of low density polyethylene (LDPE) and 425 million pounds of linear low density polyethylene (LLDPE) and high density polyethylene (HDPE). With this acquisition, our total polyethylene capacity is now in excess of 2.5 billion pounds per year. We also acquired technology for the production of specialty polyolefin polymers including: acrylate co-polymers; Epolene® polymers for the adhesives, coatings and other consumer products markets; and Energx® technology for LLDPE and HDPE, which is designed to provide enhanced strength and performance properties. We believe that the acquisition of these assets is an excellent strategic fit, will further strengthen our position in the North American polyethylene market and will increase our ability to provide an improved overall product mix and new technology.

In addition, during 2006 we purchased additional interests in Suzhou Huasu Plastics Co. Ltd., our joint venture in China. All governmental approvals were obtained and the transaction closed in the second quarter of 2006. We increased our ownership percentage from approximately 43% to approximately 58% at a cost of \$6.4 million (\$1.8 million was paid in the fourth quarter of 2005 and \$4.6 million was paid in the second quarter of 2006). We will continue to account for this investment using the equity method of accounting because the entity does not meet the definition of a variable interest entity under FIN 46R, Consolidation of Variable Interest Entities (revised December 2003) an interpretation of ARB No. 51, and because contractual arrangements allowing certain substantive participatory rights to minority shareholders prevent us from exercising a controlling financial interest over this entity.

On April 18, 2006, we announced that we had entered into a Memorandum of Understanding to develop an ethane-based ethylene, polyethylene and other derivatives project in the Republic of Trinidad and Tobago. The Government of The Republic of Trinidad and Tobago has expressed an interest in becoming a minority equity partner in the project. As currently envisioned, the project would use 37,500 barrels per day of ethane to produce 570,000 metric tons (1.25 billion pounds) per year of ethylene, which would in turn be used to produce polyethylene and other derivative products. The project could be expanded in the future as more ethane becomes available. The capital cost is initially estimated to be approximately \$1.5 billion. The size, scope, and cost of the project are subject to further definition in connection with a detailed feasibility study that we are currently performing. It is expected that the project will be financed through a project financing arrangement. The preliminary project schedule contemplates that construction would start in late 2007 and that the project would start operations in late 2010.

In the second quarter of 2006, we completed a major maintenance turnaround in Calvert City. The ethylene and VCM units at Calvert City were down for 16 days while the chlor-alkali and PVC units were down for a shorter period. Sales continued during the turnaround from inventory on hand. In early September 2006, we encountered mechanical problems with a compressor and related equipment at one of our ethylene units in Lake Charles, Louisiana, resulting in an unscheduled shutdown of that unit. While that unit was down, we completed a

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maintenance turnaround of that unit that was scheduled for early 2007. During the unit's shut-down, we also completed portions of our previously announced project to upgrade the feedstock flexibility at our ethylene plant, which is expected to reduce energy costs and provide for additional ethylene capacity. The unit was successfully restarted in late October 2006 and resumed full production. As a result of the Lake Charles outage, we incurred approximately \$3.1 million in maintenance expense and \$27.4 million in turnaround costs which have been capitalized. We are also planning additional major turnarounds during 2007 at our Lake Charles facility. Early in the second quarter of 2007, we expect to shut down one of our ethylene units for approximately 45 days to tie in the project designed to upgrade the feedstock flexibility. In the fourth quarter of 2007, we are planning to complete a major maintenance turnaround at our Lake Charles styrene facility, which is expected to take approximately 35 days.

**Results of Operations***Segment Data*

	Year Ended December 31,		
	2006	2005	2004
	(dollars in thousands)		
<b>Net External Sales</b>			
Olefins			
Polyethylene	\$ 783,968	\$ 697,662	\$ 601,269
Ethylene, styrene and other	585,612	652,380	649,985
<b>Total olefins</b>	<b>1,369,580</b>	<b>1,350,042</b>	<b>1,251,254</b>
Vinyls			
Fabricated finished products	596,461	587,547	394,513
VCM, PVC, and other	518,325	503,516	339,586
<b>Total vinyls</b>	<b>1,114,786</b>	<b>1,091,063</b>	<b>734,099</b>
<b>Total</b>	<b>\$ 2,484,366</b>	<b>\$ 2,441,105</b>	<b>\$ 1,985,353</b>
<b>Intersegment Sales</b>			
Olefins	\$ 131,277	\$ 116,822	\$ 53,668
Vinyls	1,077	1,173	553
<b>Total</b>	<b>\$ 132,354</b>	<b>\$ 117,995</b>	<b>\$ 54,221</b>
<b>Income (Loss) from Operations:</b>			
Olefins	\$ 160,875	\$ 195,670	\$ 179,587
Vinyls	157,918	179,407	69,723
Corporate and other	(5,542)	(8,044)	(6,144)
<b>Total</b>	<b>\$ 313,251</b>	<b>\$ 367,033</b>	<b>\$ 243,166</b>
<b>Depreciation and Amortization:</b>			
Olefins	\$ 51,741	\$ 46,844	\$ 49,213
Vinyls	34,391	34,343	31,671
Corporate and other	130	54	191
<b>Total</b>	<b>\$ 86,262</b>	<b>\$ 81,241</b>	<b>\$ 81,075</b>
<b>Other Income (Expense), Net:</b>			
Olefins	\$ (12)	\$ (1,933)	\$ (981)

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Vinyls	216	301	121
Corporate and other(1)	(14,387)	3,644	(12,294)
<b>Total</b>	<b>\$ (14,183)</b>	<b>\$ 2,012</b>	<b>\$ (13,154)</b>

(1) Debt retirement costs of \$25,853, \$646 and \$15,791 are included in the years ended December 31, 2006, 2005 and 2004, respectively.

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	2006		2005	
	Average Sales Price	Volume	Average Sales Price	Volume
<b>Key product sales price and volume percentage change from prior year period</b>				
Olefins(1)	+7.8%	-1.9%	+20.7%	-8.8%
Vinyls(2)	+4.5%	-2.2%	+24.6%	+19.3%
Company average	+6.3%	-2.0%	+21.9%	+2.6%

(1) Includes: Ethylene and co-products, polyethylene, and styrene.

(2) Includes: Ethylene co-products, caustic, VCM, PVC resin, PVC pipe, and other fabrication products.

	2006	2005	2004
<b>Average industry prices(1)</b>			
Ethane (cents/lb)	22.1	21.0	16.9
Propane (cents/lb)	23.9	21.6	17.5
Ethylene (cents/lb)(2)	48.1	44.2	33.8
Polyethylene (cents/lb)(3)	74.4	70.3	58.2
Styrene (cents/lb)(4)	64.8	62.5	58.5
Caustic (\$/short ton)(5)	379.2	393.8	175.2
Chlorine (\$/short ton)(6)	330.0	346.9	268.1
VCM (cents/lb)(7)	42.5	40.7	32.4
PVC (cents/lb)(8)	60.3	56.8	45.8

Source: CMAI

(1) Industry pricing data was obtained through the Chemical Market Associates, Inc., or CMAI. We have not independently verified the data.

(2) Represents average North American spot prices of ethylene over the period as reported by CMAI.

(3) Represents average North American contract prices of polyethylene film over the period as reported by CMAI.

(4) Represents average North American spot prices of styrene over the period as reported by CMAI.

(5) Represents average North American spot prices of caustic soda (diaphragm grade) over the period as reported by CMAI.

(6) Represents average North American contract prices of chlorine (into chemicals) over the period as reported by CMAI.

(7) Represents North American contract prices of VCM over the period as reported by CMAI.

(8) Represents North American contract prices of PVC over the period as reported by CMAI.

Summary

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For the year ended December 31, 2006, net income was \$194.6 million, or \$2.98 per diluted share, on net sales of \$2,484.4 million. This compares to the year ended December 31, 2005 net income of \$226.8 million, or \$3.48 per diluted share, on net sales of \$2,441.1 million. Results for 2006 included an after-tax charge which reduced net income by \$16.3 million, or \$0.25 per diluted share, related to the early retirement of debt and a tax benefit which increased net income by \$10.2 million, or \$0.16 per diluted share. The tax benefit was related to the reversal of various tax accruals due to the resolution of certain tax matters, the refinement of the estimate of deferred income taxes and the extra-territorial exclusion income benefit. Income from operations was \$313.3 million for the year ended December 31, 2006 as compared to \$367.0 million for the year ended December 31, 2005. For the first nine months of 2006, net income and income from operations were greater than the first nine months of 2005. However, the residential housing market slow down, inventory reduction

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(partly due to falling prices and partly due to the lack of hurricane activity on the U.S. gulf coast) and normal seasonal weakness resulted in a very weak fourth quarter of 2006. By comparison, the fourth quarter of 2005 was very strong due in large part to the impact of hurricanes Katrina and Rita. Income from operations during 2006 was also negatively impacted by lower production volumes, higher feedstock costs and higher maintenance expense due to a maintenance turnaround at our facility in Calvert City, Kentucky and the 55-day unscheduled outage at one of our ethylene units at Lake Charles, Louisiana. These negative impacts were partially offset by improved feedstock commodity trading gains of \$18.6 million in 2006 compared to a loss of \$3.8 million in 2005.

For the year ended December 31, 2005, net income was \$226.8 million, or \$3.48 per diluted share, on net sales of \$2,441.1 million. This compared favorably with the year ended December 31, 2004 net income of \$120.7 million, or \$2.18 per diluted share, on net sales of \$1,985.4 million. Results for 2004 included an after-tax charge of \$10.0 million, or \$0.18 per diluted share, related to the early retirement of debt. Income from operations was \$367.0 million for the year ended December 31, 2005 as compared to \$243.2 million for the year ended December 31, 2004. These increases were primarily due to higher sales volumes in the company's Vinyls segment and higher selling prices for the company's olefins and vinyls products, which outpaced higher feedstock and energy costs. Net income for 2005 also benefited from lower interest expense resulting from lower debt balances.

*2006 Compared with 2005*

*Net Sales.* Net sales increased by \$43.3 million, or 1.8%, to \$2,484.4 million in 2006 from \$2,441.1 million in 2005. This increase was primarily due to higher selling prices for our major products and higher sales volumes for PVC resin and polyethylene which was largely offset by lower sales volumes for ethylene, VCM, and PVC pipe. Higher selling prices largely resulted from higher raw material costs that were generally passed through to customers. PVC resin sales volumes increased primarily due to the supply of additional volumes from our Geismar facility and polyethylene sales volumes increased primarily due to the acquisition of the Longview facilities. Sales volumes for other major products were down largely due to the slowing market for new home construction, inventory reductions in the second half of 2006 and increased internal consumption of ethylene at our Geismar facility.

*Gross Margin.* Gross margin percentage decreased to 16.0% in 2006 from 18.2% in 2005. This decrease was primarily due to turnaround maintenance activity and weak demand in the fourth quarter of 2006 for many of our major products as customers generally reduced their inventories. Maintenance costs increased due to the outages at Lake Charles and Calvert City and additional fixed costs were expensed as several of the facilities curtailed production late in the year due to declining demand. In addition, margins decreased due to higher raw material costs. Our raw materials costs in both segments normally track industry prices, which experienced, according to CMAI, an increase of 5.1% for ethane and 10.9% for propane in 2006 as compared to 2005. As previously discussed, we use derivative instruments in conjunction with certain physical commodity positions to reduce price volatility risk on commodities and take advantage of pricing relationships. In 2006, cost of sales benefited from an improved feedstock commodity trading gain of \$18.6 million compared to a loss of \$1.9 million in 2005.

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses increased \$6.6 million, or 8.6%, in 2006 as compared to 2005. The increase was primarily due to higher professional fees, the Goodrich settlement in 2005 with no comparable activity in 2006 (see Note 16 to the consolidated financial statements), additional headcount as a result of the acquisition of the Longview facilities and higher sales commissions.

*Interest Expense.* Interest expense decreased by \$7.2 million in 2006 to \$16.5 million from \$23.7 million in 2005. Average interest rates were lower in 2006 due to the issuance of \$250.0 million aggregate principal amount of 6<sup>5</sup>/<sub>8</sub>% senior notes on January 13, 2006 and the redemption of the \$247.0 million aggregate principal amount of 8<sup>3</sup>/<sub>4</sub>% senior notes in February 2006.

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*Debt Retirement Cost.* As a result of the redemption of \$247.0 million aggregate principal amount of 8<sup>3</sup>/<sub>4</sub>% senior notes and the repayment of \$9.0 million of our term loan, we recognized \$25.9 million in non-operating expense in the first quarter of 2006, consisting of a pre-payment premium on our 8<sup>3</sup>/<sub>4</sub>% senior notes of \$22.2 million and a write-off of \$3.7 million in previously capitalized debt issuance cost. We recognized \$0.6 million in non-operating expense in the first quarter of 2005 resulting from a write-off in previously capitalized debt issuance cost in connection with the repayment of \$30.0 million of our term loan.

*Other Income, Net.* Other income, net increased by \$9.0 million to \$11.7 million in 2006 from \$2.7 million in 2005 primarily due to higher interest income associated with higher cash balances and higher interest rates, increased equity in income from our joint venture in China, and a derivative loss reflected in 2005.

*Income Taxes.* The effective income tax rate was 31.1% in 2006. The current year rate is below the statutory rate of 35% primarily due to the release of, among other things, a tax benefit related to the reversal of various tax accruals due to the resolution of certain tax matters. This reduced the rate approximately 2.3 percentage points. In addition, adjustments were made to income taxes for deferred income taxes, tax benefits related to extraterritorial income exclusion tax benefits (ETI), tax benefits related to tax exempt interest and the manufacturing deduction. These reductions in the effective tax rate were partially offset by state taxes. The 2005 effective income tax rate of 34.3% was lower than the statutory rate of 35% due to ETI (approximately 1.6 percentage points), tax benefits related to the new domestic manufacturing deduction and other adjustments to deferred income taxes partially offset by state taxes.

**Olefins Segment**

*Net Sales.* Net sales increased by \$19.5 million, or 1.5%, to \$1,369.6 million in 2006 from \$1,350.0 million in 2005. Sales improved due to higher sales prices throughout the Olefins segment, which were largely offset by lower sales volumes for ethylene. Polyethylene sales volumes increased due to the acquisition of the Longview facilities on November 30, 2006. Average selling prices for the Olefins segment increased by 7.8% in 2006 as compared to 2005. Higher selling prices were primarily the result of our ability to pass along higher raw material costs to our customers. Overall sales volumes for the Olefins segment decreased 1.9% primarily due to an increase in the internal requirements for ethylene at our Geismar facility. Sales volumes were also impacted by inventory reductions by our customers and the housing slowdown that has occurred in the U.S. as previously discussed.

*Income from Operations.* Income from operations decreased by \$34.8 million, or 18.0%, to \$160.9 million in 2006 from \$195.7 million in 2005. This decrease was primarily due to higher raw material costs for ethane and propane, lower overall sales volumes and higher expenses related to the unscheduled outage and maintenance turnaround at one of our Lake Charles ethylene units. This decrease was partially offset by price increases throughout the Olefins segment which resulted in higher profit margins for polyethylene and ethylene although profit margins for these products dropped significantly in the fourth quarter of 2006. Income from operations also benefited from an improved feedstock trading gain of \$18.6 million compared to a loss of \$1.9 million in 2005.

**Vinyls Segment**

*Net Sales.* Net sales increased by \$23.7 million, or 2.2%, to \$1,114.8 million in 2006 from \$1,091.1 million in 2005. This increase was primarily due to overall higher selling prices for our Vinyls products, especially PVC resin, and higher sales volumes of PVC resin. Average selling prices for the Vinyls segment increased by 4.5% in 2006 as compared to 2005 as we were able to pass along higher raw material costs to our customers. Overall, the Vinyls segment sales volumes decreased by 2.2% compared to 2005 as a result of declines in VCM and PVC fabricated product sales volumes. PVC resin sales volumes increased primarily due to additional volumes from the Geismar facility. PVC pipe sales volumes were negatively impacted by the slowing rate of new home construction in the U.S. and inventory reductions by our customers.

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*Income from Operations.* Income from operations decreased by \$21.5 million, or 12.0%, to \$157.9 million in 2006 from \$179.4 million in 2005. This decrease was primarily due to lower production volumes and higher maintenance expense related to the planned maintenance turnaround at our Calvert City facility that occurred in May 2006, higher raw material costs and a significant reduction in demand for most of our vinyls products in the fourth quarter of 2006 as previously discussed. Selling prices and sales volumes decreased significantly in the fourth quarter resulting in lower operating rates and higher unabsorbed cost. The higher raw material costs resulted in lower margins for several of our products despite higher sales prices.

*2005 Compared with 2004*

*Net Sales.* Net sales increased by \$455.7 million, or 23.0%, to \$2,441.1 million in 2005 from \$1,985.4 million in 2004. This increase was primarily due to price increases throughout our Olefins and Vinyls segments and higher sales volumes in VCM, PVC resin and PVC pipe. Higher selling prices largely resulted from stronger demand for our products and higher raw material costs that were generally passed through to customers. PVC pipe sales in 2005 were higher than in 2004 due to the August 2004 acquisition of the assets of Bristolpipe Corporation.

*Gross Margin.* Gross margins increased to 18.2% in 2005 from 15.3% in 2004. This increase was primarily due to higher selling prices throughout our Olefins and Vinyls segments and higher sales volumes for VCM, PVC resin and PVC pipe resulting from increased demand. These increases were partially offset by lower sales volumes for ethylene, polyethylene and styrene, higher raw material costs for ethane, propane and benzene and higher energy costs. Our raw materials costs in both segments normally track industry prices, which experienced, according to CMAI, an increase of 24.2% for ethane, 23.3% for propane and 0.7% for benzene in 2005 as compared to 2004. A fire at our Calvert City ethylene plant also negatively impacted our 2004 gross margin. We estimate that the gross margin impact of the outage in 2004 relating to the fire was approximately \$8.4 million, which was comprised of higher maintenance cost of \$3.4 million, lost margin on sales of approximately \$4.6 million and a write-off of equipment of \$0.4 million. Gross margin decreased by \$1.9 million due to feedstock-related trading losses in 2005.

*Selling, General and Administrative Expenses.* Selling, general and administrative, or SG&A, expenses increased \$16.4 million, or 27.2%, in 2005 as compared to 2004. The increase was primarily due to costs related to compliance with the Sarbanes-Oxley Act, higher legal and environmental consultant fees, increased sales commissions and increased costs resulting from the Bristolpipe acquisition, partially offset by lower provision for doubtful accounts. SG&A costs in 2005 also increased as compared to 2004 due to the receipt of \$1.5 million in the first quarter of 2004 resulting from a legal settlement with a customer.

*Gain on Sale of Asset.* During the fourth quarter of 2004, we sold a co-generation unit that was included in the purchase of the Geismar assets. We recognized a \$2.0 million gain from the sale of those assets. We did not have any gain or loss on sale of assets in 2005.

*Impairment of Long-Lived Assets.* Impairment of long-lived assets of \$1.8 million in 2004 was related to an idled PVC plant in Pace, Florida in the Vinyls segment (\$1.3 million) that was written down to its estimated sales value less commissions and ethylene assets in our Olefins segment (\$0.5 million) which were written down to their remaining fair market value. We did not have any impairments of long-lived assets in 2005.

*Interest Expense.* Interest expense in 2005 decreased by \$15.7 million to \$23.7 million from \$39.4 million in 2004 due to lower average debt balances, which were partially offset by higher average interest rates. The average monthly debt balance decreased by \$198.1 million to \$271.7 million in 2005 from \$469.8 million in 2004.

*Debt Retirement Cost.* We recognized \$0.6 million in non-operating expense in 2005 resulting from a write-off in previously capitalized debt issuance cost in connection with the repayment of \$30.0 million of our



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term loan. We recognized \$15.8 million in non-operating expense in 2004, consisting of a pre-payment premium on our 8<sup>3</sup>/<sub>4</sub>% senior notes of \$11.6 million and a write off of \$4.2 million in previously capitalized debt cost.

*Other Income, Net.* Other income, net of \$2.7 million in 2005 increased slightly over the \$2.6 million in 2004 as 2005 reflected improved interest and derivative income, partially offset by lower earnings from our joint venture in China and insurance proceeds received in 2004.

*Income Taxes.* The effective income tax rate was 34.3% in 2005 as compared to 36.7% in 2004. The 2005 effective income tax rate is lower than the statutory rate of 35% due to Extraterritorial Income (ETI) exclusion tax benefits of approximately 1.6%, tax benefit of approximately 1% related to the new domestic manufacturing deduction and other provision adjustments partially offset by state taxes. The 2004 effective income tax rate is higher than the statutory rate primarily due to state taxes.

### *Olefins Segment*

*Net Sales.* Net sales increased by \$98.7 million, or 7.9%, to \$1,350.0 million in 2005 from \$1,251.3 million in 2004. This increase was primarily due to price increases for all of our Olefins segment products. These increases were partially offset by lower sales volumes for ethylene, polyethylene and styrene. Average selling prices for the Olefins segment increased by 20.7% in 2005 as compared to 2004. These increased prices were due primarily to higher industry demand and higher energy and raw material costs that were generally passed through to customers. The decrease in sales volumes resulted primarily from a three week outage caused by Hurricane Rita. In addition, styrene sales volumes decreased due to lower demand and merchant ethylene sales volumes decreased because our internal requirements for ethylene at Geismar increased.

*Income from Operations.* Income from operations increased by \$16.1 million to \$195.7 million in 2005 from \$179.6 million in 2004. This increase was primarily due to price increases for ethylene, polyethylene and styrene. These increases were partially offset by lower sales volumes for ethylene, polyethylene and styrene, higher raw material costs for ethane, propane and benzene and higher energy costs.

### *Vinyls Segment*

*Net Sales.* Net sales increased by \$357.0 million, or 48.6%, to \$1,091.1 million in 2005 from \$734.1 million in 2004. This increase was primarily due to higher selling prices for all of our Vinyls segment products and higher sales volumes for VCM, PVC resin and PVC pipe. Average selling prices for the Vinyls segment increased by 24.6% in 2005 as compared to 2004. These increases were largely due to stronger industry demand for our products and higher raw material costs for propane and chlorine that were generally passed through to our customers. In addition to strong industry demand, PVC pipe sales volume also increased due to the August 2004 acquisition of the assets of Bristolpipe Corporation.

*Income from Operations.* Income from operations increased by \$109.7 million to \$179.4 million in 2005 from \$69.7 million in 2004. This increase was primarily due to higher selling prices for all of our Vinyls segment products and higher sales volumes for VCM, PVC resin and PVC pipe, partially offset by higher energy costs and higher raw material costs for propane and chlorine. The earnings for 2004 were adversely impacted by a fire at the Calvert City ethylene plant. We estimate that the impact on income from operations from the outage relating to the fire was approximately \$8.4 million.

## **Cash Flows**

### *Operating Activities*

Operating activities provided cash of \$237.2 million in 2006 compared to \$318.4 million in 2005. The \$81.2 million decrease in cash flows from operating activities was primarily due to a decrease in income from

operations, debt retirement costs of \$25.9 million, turnaround costs of \$33.1 million and higher income tax

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payments in 2006. Tax payments are higher in 2006 than 2005 because 2005 benefited from utilization of net operating loss and alternative minimum tax credit carryforwards. Changes in components of working capital, which we define for purposes of this cash flow discussion as accounts receivable, inventories, prepaid expense and other current assets less accounts payable and accrued liabilities, used cash of \$17.8 million in 2006, compared to \$34.4 million of cash used in 2005. This change represents a decrease in cash use of \$16.6 million. In 2006, inventory increased by \$47.3 million primarily due to a drop in demand late in the year. Accounts payable and accrued liabilities (excluding those accruals that are included in the section Cash flows from investing activities ) increased by \$43.6 million during 2006.

Operating activities provided cash of \$318.4 million in 2005 compared to \$150.8 million in 2004. The \$167.6 million increase in cash flows from operating activities in 2005 as compared to 2004 was primarily due to improvements in income from operations, as described above, and less cash used for working capital. Income from operations increased by \$123.9 million in 2005 as compared to 2004. Changes in components of working capital used cash of \$34.4 million in 2005, compared to \$115.0 million cash used in 2004, a decrease of cash used of \$80.6 million. In 2005, receivables increased by \$66.2 million largely due to higher selling prices while inventory increased by \$20.1 million, primarily due to higher feedstock and energy prices. Accounts payable and accrued liabilities increased by \$52.5 million largely due to higher raw material and energy costs. The primary reasons for the \$115.0 million use of cash in 2004 related to working capital components were a \$39.3 million increase in receivables and a \$119.1 million increase in inventories, partially offset by a \$42.3 million increase in accounts payable and accrued liabilities. The increase in receivables was mainly due to higher average selling prices and sales volumes. The increase in inventories was primarily due to higher feedstock and energy prices. The increase in accounts payable and accrued liabilities was primarily due to higher energy and raw material costs.

***Investing Activities***

Net cash used for investing activities during 2006 was \$404.3 million as compared to \$87.6 million in 2005. Capital expenditures were \$136.3 million in 2006 as compared to \$85.8 million in 2005. The increase in capital expenditures was primarily due to a project designed to upgrade the feedstock flexibility in one of our ethylene plants at our Lake Charles facility and a project to expand our ethylene capacity. The remaining capital expenditures in 2006 primarily related to maintenance, safety and environmental projects. The capital expenditures in 2005 primarily related to maintenance, safety and environmental projects. Over the next two years, the Company expects to increase capital expenditures related to environmental compliance from \$4.6 million in 2006 to \$17.1 million in 2007 and \$17.6 million in 2008. A significant percentage of the 2007 and 2008 estimated amounts are related to equipment replacement and upgrades to maintain environmental compliance. We used \$235.7 million in cash during 2006 to acquire the Longview facilities (see Note 14 to the consolidated financial statements). The additions to equity investments of \$4.6 million in 2006 related to the additional equity interest purchased in Suzhou Huasu Plastics Co. Ltd., our joint venture in China, as discussed previously. In addition, the settlement of derivative instruments in 2006 was an outflow due to the settlement on derivative losses recognized in 2005, which was partially offset by cash settlement receipts from 2006.

Net cash used in investing activities was \$87.6 million in 2005 as compared to \$80.0 million in 2004 and \$41.6 million in 2003. We made capital expenditures in 2005 of \$85.8 million. These expenditures were for technological modifications to the EDC plant in Geismar, Louisiana and start up of the VCM and PVC portions of our facilities in Geismar (\$16.9 million), and we invested \$17.4 million in a project designed to upgrade the feedstock flexibility in our ethylene plant and a project to expand our ethylene capacity. The remaining capital expenditures of \$51.5 million were related to maintenance, safety and environmental projects. The \$1.9 million equity investment represents an additional equity investment in an unconsolidated subsidiary. We made capital expenditures in 2004 of \$52.7 million for refurbishment and upgrades related to the January 2004 fire at the Calvert City ethylene plant (\$2.6 million), technological modifications at the Geismar facility (\$15.5 million) and maintenance capital, safety and environmental related projects (\$34.6 million). The acquisition of business of \$33.3 million related to the acquisition of the assets of Bristolpipe Corporation, which was completed on

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August 2, 2004. These expenditures were partially offset by \$3.3 million of proceeds from the disposition of assets and \$2.8 million of insurance proceeds. We made capital expenditures in 2003 of \$44.9 million primarily related to maintenance, safety and environmental projects. These expenditures were partially offset by \$3.3 million of insurance proceeds.

### ***Financing Activities***

Net cash used by financing activities during 2006 was \$18.1 million as compared to \$36.4 million in 2005. During 2006, we received proceeds of \$249.2 million from the issuance of our 6<sup>5</sup>/<sub>8</sub>% senior notes, which was offset by the repayment of \$256.0 million of debt and the payment of \$8.8 million of cash dividends. We also incurred \$4.3 million in costs associated with the debt repayment that were capitalized and that will be amortized over the term of the 6<sup>5</sup>/<sub>8</sub>% senior notes. During 2005 we used \$31.2 million to repay debt and \$6.3 million to pay dividends.

Financing activities used cash of \$36.4 million in 2005, compared to \$64.8 million in 2004 and \$10.2 million in 2003. During 2005, we used \$31.2 million to repay debt and \$6.3 million to pay dividends, which was partially offset by proceeds of \$1.2 million from the exercise of stock options. In August 2004 we completed the initial public offering of our common stock (the "IPO"). Net proceeds from the IPO of \$181.2 million and cash generated from operating activities were used to repay \$244.9 million of debt and affiliate borrowings in 2004. See "Liquidity and Capital Resources" below. In 2003, we incurred \$14.1 million in costs associated with the refinancing that were capitalized and that will be amortized over the term of the new debt.

### **Liquidity and Capital Resources**

#### ***Liquidity and Financing Arrangements***

Our principal sources of liquidity are from cash and cash equivalents, cash from operations, short-term borrowings under our revolving credit facility and our long-term financing. As discussed previously, we are currently performing a feasibility study in connection with the potential development of an ethane-based ethylene, polyethylene and other derivatives project in the Republic of Trinidad and Tobago. The capital cost is initially estimated to be approximately \$1.5 billion, in which we would be a majority partner. If this project is approved, construction could commence in late 2007. It is expected that we would invest some level of cash and the remainder would be financed through a project financing arrangement. We believe that our sources of liquidity as described above, along with any additional project financing, will be adequate to fund our cash requirements.

#### ***Cash***

Cash balances were \$52.6 million at December 31, 2006 compared to \$237.9 million at December 31, 2005. In addition, we have a revolving credit facility available to supplement cash if needed, as described under "Debt" below.

#### ***Debt***

Our \$300.0 million senior secured revolving credit facility is a source of liquidity. As of December 31, 2006, any borrowings under the revolving credit facility bore interest at either LIBOR plus 1.00% or prime rate minus 0.50%. The revolving credit facility also requires an unused commitment fee of 0.25%. All interest rates under the facility are subject to quarterly grid pricing adjustments based on a fixed charge coverage ratio. The facility matures on January 6, 2011. As of December 31, 2006, we had outstanding letters of credit totaling \$13.6 million and available borrowing capacity of \$286.4 million under this facility.

As of December 31, 2006, our long-term debt, including current maturities, totaled \$260.1 million, consisting of \$249.2 million principal amount of 6<sup>5</sup>/<sub>8</sub>% senior notes due 2016 and a \$10.9 million loan from the

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proceeds of tax-exempt revenue bonds (supported by an \$11.3 million letter of credit). Debt outstanding under the tax-exempt bonds bears interest at variable rates.

On January 13, 2006, we issued \$250.0 million of 6<sup>5</sup>/<sub>8</sub>% aggregate principal amount of senior notes due 2016, the proceeds of which, together with cash on hand, were used to redeem our 8<sup>3</sup>/<sub>4</sub>% senior notes due 2011 and repay our term loan as follows:

On January 18, 2006, we repaid the entire \$9.0 million outstanding under our term loan, plus accrued but unpaid interest.

On two redemption dates, February 8, 2006 and February 13, 2006, we redeemed the entire \$247.0 million principal amount outstanding of our 8<sup>3</sup>/<sub>4</sub>% senior notes due 2011, and paid a pre-payment premium of \$22.2 million, plus accrued and unpaid interest. As a result of the early redemption of the 8<sup>3</sup>/<sub>4</sub>% senior notes due 2011 and the repayment of the term loan, we recognized \$25.9 million in non-operating expense in the first quarter of 2006 consisting of a pre-payment premium on the 8<sup>3</sup>/<sub>4</sub>% senior notes of \$22.2 million and a write-off of \$3.7 million in previously capitalized debt issuance cost.

The 6<sup>5</sup>/<sub>8</sub>% senior notes are unsecured and were issued with an original issue discount of \$0.8 million. There is no sinking fund and no scheduled amortization of the notes prior to maturity. The notes are subject to redemption and the holders may require us to repurchase the notes upon a change of control. All domestic restricted subsidiaries that guarantee other debt of ours or of another guarantor of the senior notes in excess of \$5 million are guarantors of the notes.

The agreements governing the 6<sup>5</sup>/<sub>8</sub>% senior notes and the revolving credit facility each contain customary covenants and events of default. Accordingly, these agreements impose significant operating and financial restrictions on us. These restrictions, among other things, provide limitations on incurrence of additional indebtedness, the payment of dividends, certain investments and acquisitions and sales of assets. These limitations are subject to a number of important qualifications and exceptions, including, without limitation, an exception for the payment of our regular quarterly dividend of up to \$0.20 per share (currently \$0.04 per share). The 6<sup>5</sup>/<sub>8</sub>% senior notes indenture does not allow distributions, including dividends and certain other restricted payments unless, after giving pro forma effect to the distribution, our fixed charge coverage ratio is at least 2.0 and such payment, together with the aggregate amount of all other distributions after January 13, 2006, is less than the sum of 50% of our consolidated net income for the period from October 1, 2003 to the end of the most recent quarter for which financial statements have been filed, plus 100% of net cash proceeds received after October 1, 2003 as a contribution to our common equity capital or from the issuance or sale of certain securities, plus several other adjustments. The amount allowed under this restriction was \$436.3 million at December 31, 2006. The revolving credit facility also restricts dividend payments unless, after giving effect to such payment, the availability under the line of credit equals or exceeds \$60.0 million. None of the agreements require us to maintain specified financial ratios, except that the revolving credit facility requires us to maintain a minimum fixed charge coverage ratio of 1.0 to 1.0 when availability falls below \$60.0 million. In addition, the 6<sup>5</sup>/<sub>8</sub>% senior notes indenture and the revolving credit facility restrict our ability to create liens, to engage in certain affiliate transactions and to engage in sale-leaseback transactions.

Our ability to make payments on our indebtedness and to fund planned capital expenditures will depend on our ability to generate cash in the future, which is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. Based on our current level of operations, we believe our cash flow from operations, available cash and available borrowings under our revolving credit facility will be adequate to meet our liquidity needs for the foreseeable future.

**Table of Contents****Contractual Obligations and Commercial Commitments**

In addition to long-term debt, we are required to make payments relating to various types of obligations. The following table summarizes our minimum payments as of December 31, 2006 relating to long-term debt, operating leases, unconditional purchase obligations and operating leases, other long-term liabilities and interest payments for the next five years and thereafter, after giving effect to the refinancing transaction described above.

	Total	Payment Due by Period			Thereafter
		2007	2008-2009 (dollars in millions)	2010-2011	
<b>Contractual Obligations</b>					
Long-term debt	\$ 260.9	\$	\$	\$	\$ 260.9
Operating leases	123.2	27.6	49.3	30.3	16.0
Unconditional purchase obligations	490.6	231.7	238.3	11.0	9.6
Other liabilities included in the balance sheet	3.1	3.1			
Interest payments	166.5	17.0	34.0	34.0	81.5
<b>Total</b>	<b>\$ 1,044.3</b>	<b>\$ 279.4</b>	<b>\$ 321.6</b>	<b>\$ 75.3</b>	<b>\$ 368.0</b>
<b>Other Commercial Commitments</b>					
Standby letters of credit	\$ 13.6	\$ 2.3	\$ 11.3	\$	\$

*Long-Term Debt.* Long-term debt reflects the 6<sup>5</sup>/<sub>8</sub>% senior notes and the tax-exempt revenue bonds.

*Operating Leases.* We lease various facilities and equipment under noncancelable operating leases (primarily related to rail car leases and land) for various periods.

*Unconditional Purchase Obligations.* We are party to various unconditional obligations to purchase products and services, primarily including commitments to purchase ethylene, power, nitrogen, oxygen, wastewater treatment services, product storage and pipeline usage. The ethylene obligation included above is based on a December 31, 2006 price and is subject to price variation in the future. We also have various purchase commitments for materials, supplies and services incident to the ordinary conduct of business which may not be unconditional and are not reflected in the table above.

*Other Liabilities.* The amounts represent a current liability for a technology license used to produce LLDPE and HDPE. The license requires us to make annual payments of \$3.1 million through May 2007. The amounts do not include pension liabilities, post-retirement medical liabilities, deferred charges and other items due to the uncertainty of the future payment schedule. Long-term liabilities for pension and post-retirement liabilities totaled \$33.3 million as of December 31, 2006.

*Interest Payments.* Interest payments are based on interest rates in effect at December 31, 2006 and assume contractual amortization payments.

*Standby Letters of Credit.* This includes (1) our obligation under a \$11.3 million letter of credit issued in connection with the \$10.9 million tax-exempt revenue bonds and (2) other letters of credit totaling \$2.3 million issued to support obligations under our insurance programs, including workers' compensation claims and other commercial obligations.

**Off-Balance Sheet Arrangements**

None.

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### **Critical Accounting Policies**

Critical accounting policies are those that are important to our financial condition and require management's most difficult, subjective, or complex judgments. Different amounts would be reported under different operating conditions or under alternative assumptions. We have evaluated the accounting policies used in the preparation of the accompanying consolidated financial statements and related notes and believe those policies are reasonable and appropriate.

We apply those accounting policies that we believe best reflect the underlying business and economic events, consistent with GAAP. Our more critical accounting policies include those related to long-lived assets, accruals for long-term employee benefits, inventories, accounts receivable and environmental and legal obligations. Inherent in such policies are certain key assumptions and estimates. We periodically update the estimates used in the preparation of the financial statements based on our latest assessment of the current and projected business and general economic environment. Our significant accounting policies are summarized in Note 1 to the audited consolidated financial statements appearing elsewhere in this Form 10-K. We believe the following to be our most critical accounting policies applied in the preparation of our financial statements.

*Revenue Recognition.* Revenue is recognized when title and risk of loss passes to the customer upon delivery under executed customer purchase orders or contracts. For export contracts, the title and risk of loss passes to customers at the time specified by each contract. Provisions for discounts, rebates and returns are provided for in the same period as the related sales are recorded.

*Long-Lived Assets.* Key estimates related to long-lived assets include useful lives, recoverability of carrying values and existence of any retirement obligations and such estimates could be significantly modified. The carrying values of long-lived assets could be impaired by new technological developments, new chemical industry entrants with significant raw material or other cost advantages, uncertainties associated with the U.S. and world economies, the cyclical nature of the chemical and refining industries and uncertainties associated with governmental actions.

We periodically evaluate long-lived assets for potential impairment indicators. Our judgments regarding the existence of impairment indicators are based on legal factors, market conditions and the operational performance of our businesses. Actual impairment losses incurred could vary significantly from amounts estimated. Additionally, future events could cause us to conclude that impairment indicators exist and that associated long-lived assets of our businesses are impaired. Any resulting impairment loss could have a material adverse impact on our financial condition and results of operations.

The estimated useful lives of long-lived assets range from three to 25 years. Depreciation and amortization of these assets, including amortization of deferred turnaround costs, under the straight-line method over their estimated useful lives totaled \$86.3 million, \$81.2 million and \$81.1 million in 2006, 2005 and 2004, respectively. If the useful lives of the assets were found to be shorter than originally estimated, depreciation charges would be accelerated.

We defer the costs of major turnaround maintenance and repair activities and amortize the costs over the period until the next expected major turnaround of the affected unit. In 2006, we had a major turnaround at our Calvert City facility and at one of our ethylene units in Lake Charles. Total costs deferred on these turnarounds were \$33.1 million. There were no major turnarounds in 2005 and 2004. Amortization in 2006, 2005 and 2004 of previously deferred turnaround costs was \$4.9 million, \$5.0 million and \$6.4 million, respectively. As of December 31, 2006, capitalized turnaround costs, net of accumulated amortization, totaled \$35.6 million. Expensing turnaround costs would likely result in greater variability of our quarterly operating results and would adversely affect our financial position and results of operations.

Additional information concerning long-lived assets and related depreciation and amortization appears in Note 6 to the audited consolidated financial statements appearing elsewhere in this Form 10-K.

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*Long-Term Employee Benefit Costs.* Our costs for long-term employee benefits, particularly pension and postretirement medical and life benefits, are incurred over long periods of time and involve many uncertainties over those periods. The net periodic benefit cost attributable to current periods is based on several assumptions about such future uncertainties, and is sensitive to changes in those assumptions. It is our responsibility, often with the assistance of independent experts, to select assumptions that represent the best estimates of those uncertainties. It is also our responsibility to review those assumptions periodically and, if necessary, adjust the assumptions to reflect changes in economic or other factors.

Accounting for employee retirement plans involves estimating the cost of benefits that are to be provided in the future and attempting to match, for each employee, that estimated cost to the period worked. To accomplish this, we rely extensively on advice from actuaries, and assumptions are made about inflation, investment returns, mortality, employee turnover and discount rates that ultimately impact amounts recorded. While we believe that the amounts recorded in the consolidated financial statements appearing elsewhere in this Form 10-K related to these retirement plans are based on the best estimates and judgments available, the actual outcomes could differ from these estimates.

Assumed healthcare trend rates do not have a significant effect on the amounts reported for the healthcare plans because benefits for participants are capped at a fixed amount.

Additional information on the key assumptions underlying these benefit costs appears in Note 12 to the audited consolidated financial statements appearing elsewhere in this Form 10-K.

*Inventories.* Inventories primarily include product, materials and supplies. Inventories are stated at lower of cost or market. Cost is determined using the first-in, first-out, or FIFO, method. The use of other methods, such as LIFO, could result in differing amounts being reported as inventories and cost of sales depending on price changes and sales turnover levels.

*Allowance for Doubtful Accounts.* In our determination of the allowance for doubtful accounts, and consistent with our accounting policy, we estimate the amount of accounts receivable that we believe are unlikely to be collected and we record an expense of that amount. Estimating this amount requires us to analyze the financial strength of our customers, and, in our analysis, we combine the use of historical experience, our accounts receivable aged trial balance and specific collectibility analysis. We review our allowance for doubtful accounts quarterly. Balances over 90 days past due and accounts determined by our analysis of financial strength of customers to be high risk are reviewed individually for collectibility. By its nature, such an estimate is highly subjective and it is possible that the amount of accounts receivable that we are unable to collect may be different than the amount initially estimated.

*Income Taxes.* The Company utilizes the liability method of accounting for income taxes. Under the liability method, deferred tax assets or liabilities are recorded based upon temporary differences between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. Deferred tax expense or benefit is the result of changes in the deferred tax assets and liabilities during the period. Valuation allowances are recorded against deferred tax assets when it is considered more likely than not that the deferred tax assets will not be realized.

*Environmental and Legal Obligations.* We consult with various professionals to assist us in making estimates relating to environmental costs and legal proceedings. We accrue an expense when we determine that it is probable that a liability has been incurred and the amount is reasonably estimable. While we believe that the amounts recorded in the accompanying consolidated financial statements related to these contingencies are based on the best estimates and judgments available, the actual outcomes could differ from our estimates. Additional information about certain legal proceedings and environmental matters appears in Note 16 to the audited consolidated financial statements appearing elsewhere in this Form 10-K.

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### **Recent Accounting Pronouncements**

See Note 1 to the audited consolidated financial statements for a full description of recent accounting pronouncements, including expected dates of adoption and estimated effects on results of operations and financial condition, which is incorporated herein by reference.

### **Item 7A. Quantitative and Qualitative Disclosures about Market Risk**

#### ***Commodity Price Risk***

A substantial portion of our products and raw materials are commodities whose prices fluctuate as market supply and demand fundamentals change. Accordingly, product margins and the level of our profitability tend to fluctuate with changes in the business cycle. We try to protect against such instability through various business strategies. Our strategies include ethylene product feedstock flexibility and moving downstream into the olefins and vinyls products where pricing is more stable. We use derivative instruments in certain instances to reduce price volatility risk on feedstocks and products. Based on our open derivative positions at December 31, 2006, a hypothetical \$1.00 increase in the price of a MMBtu of natural gas would have increased our income before taxes by \$1.5 million, a hypothetical \$1.00 increase in the price of a barrel of crude oil would have decreased our income before taxes by \$0.4 million, a hypothetical \$0.10 increase in the price of a gallon of ethane would have increased our income before taxes by \$0.9 million and a hypothetical \$0.10 increase in the price of a gallon of benzene would have decreased our income before taxes by \$2.1 million. Additional information concerning derivative commodity instruments appears in Note 10 to the consolidated financial statements.

#### ***Interest Rate Risk***

We are exposed to interest rate risk with respect to fixed and variable rate debt. At December 31, 2006, we had variable rate debt of \$10.9 million outstanding. All of the debt outstanding under our tax-exempt revenue bonds is at variable rates. We do not currently hedge our variable interest rate debt, but we may do so in the future. The interest rate for our variable rate debt of \$10.9 million as of December 31, 2006 was 4.02%. A hypothetical 100 basis point increase in the average interest rate on our variable rate debt would increase our annual interest expense by approximately \$0.1 million. Also, at December 31, 2006, we had \$249.2 million of fixed rate debt. We are subject to the risk of higher interest cost if and when this debt is refinanced. If interest rates are 1% higher at the time of refinancing, our annual interest expense would increase by approximately \$2.5 million.



**Table of Contents****Item 8. Financial Statements and Supplementary Data****Index to Consolidated Financial Statements**

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Financial statement schedules not included in this Form 10-K have been omitted because they are not applicable or because the required information is shown in the financial statements or notes thereto.	

**MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The management of Westlake Chemical Corporation is responsible for establishing and maintaining adequate internal control over financial reporting. Westlake's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles.

Westlake acquired Westlake Longview Corporation ( Longview ), which is now a wholly owned subsidiary of Westlake Chemical Corporation, on November 30, 2006. Longview's sales that are included in Westlake's consolidated net sales comprise approximately 1.6% of the consolidated net sales for the year ended December 31, 2006. Total assets of Longview comprise approximately 17.4% of the consolidated total assets as of December 31, 2006. Since the acquisition occurred late in 2006, Westlake was not required to include Longview in its assessment of the effectiveness of internal control over financial reporting for Westlake as of December 31, 2006. Accordingly, Longview is excluded from Westlake management's assessment of the effectiveness of its internal control over financial reporting as of December 31, 2006.

Westlake management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2006. 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*. Based on its assessment, Westlake's management has concluded that the Company's internal control over financial reporting (which excludes Westlake Longview Corporation as permitted and discussed above) was effective as of December 31, 2006 based on those criteria.

PricewaterhouseCoopers LLP, the independent registered public accounting firm that audited the financial statements included in this Annual Report on Form 10-K, has also audited management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2006, and the effectiveness of internal control over financial reporting as of December 31, 2006 as stated in their report that appears on the following page.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders

of Westlake Chemical Corporation:

We have completed integrated audits of Westlake Chemical Corporation's 2006 and 2005 consolidated financial statements and of its internal control over financial reporting as of December 31, 2006 and an audit of its 2004 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

*Consolidated financial statements and financial statement schedule*

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Westlake Chemical Corporation and its subsidiaries at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

*Internal control over financial reporting*

Also, in our opinion, management's assessment, included in Management's Report on Internal Control Over Financial Reporting appearing on page 41, that the Company maintained effective internal control over financial reporting as of December 31, 2006 based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting

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includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) 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 (iii) 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.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As described in Management's Report on Internal Control Over Financial Reporting, management has excluded Westlake Longview Corporation from its assessment of internal control over financial reporting as of December 31, 2006 because it was acquired by the Company in a purchase business combination during 2006. We have also excluded Westlake Longview Corporation from our audit of internal control over financial reporting. Westlake Longview Corporation is a wholly-owned subsidiary whose total assets and total revenues represent 17% and 2%, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 2006.

PricewaterhouseCoopers LLP

Houston, Texas

February 23, 2007

**Table of Contents****WESTLAKE CHEMICAL CORPORATION****CONSOLIDATED BALANCE SHEETS**

	December 31,	
	2006	2005
	(in thousands of dollars, except par values and share amounts)	
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 52,646	\$ 237,895
Accounts receivable, net	308,903	302,779
Inventories, net	456,276	339,870
Prepaid expenses and other current assets	16,086	9,306
Deferred income taxes	15,876	13,013
Total current assets	849,787	902,863
Property, plant and equipment, net	1,076,903	863,232
Equity investment	26,382	20,042
Other assets, net	129,026	41,052
<b>Total assets</b>	<b>\$ 2,082,098</b>	<b>\$ 1,827,189</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities		
Accounts payable	\$ 238,914	\$ 199,777
Accrued liabilities	82,998	104,872
Current portion of long-term debt		1,200
Total current liabilities	321,912	305,849
Long-term debt	260,156	265,689
Deferred income taxes	281,828	221,088
Other liabilities	44,661	40,457
Total liabilities	908,557	833,083
Commitments and contingencies (Notes 8 and 16)		
Stockholders' equity		
Preferred stock, nonvoting, noncumulative, no par value; no shares issued and outstanding		
Common stock, \$0.01 par value, 150,000,000 shares authorized; 65,268,585 and 65,121,850 shares issued and outstanding in 2006 and 2005, respectively	653	651
Additional paid-in capital	427,893	424,537
Retained earnings	754,921	569,164
Unearned compensation on restricted stock		(971)
Accumulated other comprehensive income		
Benefits liability, net of tax	(12,186)	
Minimum pension liability, net of tax		(1,976)
Cumulative translation adjustment	2,260	2,701