

CONSTAR INTERNATIONAL INC

Form 10-Q

August 14, 2008

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**FORM 10-Q**

(Mark One)

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

For Quarterly Period Ended June 30, 2008

OR

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

For the transition period from to

Commission file number 000-16496

**Constar International Inc.**

(Exact name of registrant as specified in its charter)

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<b>Delaware</b> (State or other jurisdiction of incorporation or organization)	<b>13-1889304</b> (IRS Employer Identification Number)
<b>One Crown Way, Philadelphia, PA</b> (Address of principal executive offices)	<b>19154</b> (Zip Code)
<b>(215) 552-3700</b> (Registrant's telephone number, including area code)	

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

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

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☒

(Do not check if a smaller reporting company)

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

As of August 13, 2008, 12,951,430 shares of the Registrant's Common Stock were outstanding.

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

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 3,603	\$ 4,254
Accounts receivable, net	88,555	61,212
Accounts receivable - related party	1,033	483
Inventories, net	82,190	73,213
Prepaid expenses and other current assets	21,042	19,205
Deferred income taxes	1,373	2,045
Current assets held for sale	427	
Current assets of discontinued operations	385	527
<b>Total current assets</b>	<b>198,608</b>	<b>160,939</b>
Property, plant and equipment, net	145,772	147,061
Goodwill	148,813	148,813
Other assets	12,859	15,476
Non-current assets held for sale	953	
<b>Total assets</b>	<b>\$ 507,005</b>	<b>\$ 472,289</b>
<b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>		
<b>Current Liabilities:</b>		
Short-term debt	\$ 23,757	\$ 438
Accounts payable (includes bank overdrafts of \$14,717 and \$12,695 at June 30, 2008 and December 31, 2007, respectively)	108,872	83,856
Accounts payable - related party	570	1,000
Accrued expenses and other current liabilities	35,254	36,607
Current liabilities of discontinued operations	74	395
<b>Total current liabilities</b>	<b>168,527</b>	<b>122,296</b>
Long-term debt, net of debt discount	393,864	393,733
Pension and postretirement liabilities	9,448	11,368
Deferred income taxes	1,373	2,045
Other liabilities	13,705	14,411
Liabilities associated with assets held for sale	643	
Non-current liabilities of discontinued operations	874	743

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<b>Total liabilities</b>	588,434	544,596
Commitments and contingent liabilities (Note 10)		
<b>Stockholders' deficit:</b>		
Preferred Stock, \$.01 par value - none issued or outstanding at June 30, 2008 and December 31, 2007		
Common stock, \$.01 par value - 13,264 shares and 13,008 shares issued, 12,963 shares and 12,717 shares outstanding at June 30, 2008 and December 31, 2007, respectively	125	125
Additional paid-in capital	277,043	276,546
Accumulated other comprehensive loss	(15,645)	(18,620)
Treasury stock, at cost - 301 and 291 shares at June 30, 2008 and December 31, 2007, respectively	(991)	(945)
Accumulated deficit	(341,961)	(329,413)
Total stockholders' deficit	(81,429)	(72,307)
<b>Total liabilities and stockholders' deficit</b>	<b>\$ 507,005</b>	<b>\$ 472,289</b>

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

**Table of Contents****CONSTAR INTERNATIONAL INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands, except per share data)****(Unaudited)**

	<b>Three months ended June 30,</b>		<b>Six months ended June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Net customer sales	\$ 242,552	\$ 239,192	\$ 454,813	\$ 450,808
Net affiliate sales	1,717	1,047	2,834	2,112
<b>Net sales</b>	<b>244,269</b>	<b>240,239</b>	<b>457,647</b>	<b>452,920</b>
Cost of products sold, excluding depreciation	223,493	217,551	417,702	410,034
Depreciation	8,622	7,952	15,816	15,533
<b>Gross profit</b>	<b>12,154</b>	<b>14,736</b>	<b>24,129</b>	<b>27,353</b>
Selling and administrative expenses	4,789	4,756	11,550	11,864
Research and technology expenses	2,309	2,156	4,355	3,770
Provision for restructuring	725	2,832	806	3,135
<b>Total operating expenses</b>	<b>7,823</b>	<b>9,744</b>	<b>16,711</b>	<b>18,769</b>
<b>Operating income</b>	<b>4,331</b>	<b>4,992</b>	<b>7,418</b>	<b>8,584</b>
Interest expense	(9,501)	(10,302)	(19,377)	(20,419)
Other income (expense), net	2	557	(567)	925
Loss from continuing operations before income taxes	(5,168)	(4,753)	(12,526)	(10,910)
Benefit from income taxes	118	6	32	
<b>Loss from continuing operations</b>	<b>(5,050)</b>	<b>(4,747)</b>	<b>(12,494)</b>	<b>(10,910)</b>
Earnings (loss) from discontinued operations, net of taxes	33	(102)	(54)	(55)
<b>Net loss</b>	<b>\$ (5,017)</b>	<b>\$ (4,849)</b>	<b>\$ (12,548)</b>	<b>\$ (10,965)</b>
<b>Basic loss per common share:</b>				
Continuing operations	\$ (0.41)	\$ (0.38)	\$ (1.01)	\$ (0.89)
Discontinued operations		(0.01)	(0.00)	
Net loss per share	\$ (0.41)	\$ (0.39)	\$ (1.01)	\$ (0.89)
<b>Diluted loss per common share:</b>				
Continuing operations	\$ (0.41)	\$ (0.38)	\$ (1.01)	\$ (0.89)
Discontinued operations		(0.01)	(0.00)	
Net loss per share	\$ (0.41)	\$ (0.39)	\$ (1.01)	\$ (0.89)

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### Weighted average common shares outstanding:

Basic	12,394	12,308	12,385	12,301
Diluted	12,394	12,308	12,385	12,301

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

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

	<b>Six months ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
<b>Cash flows from operating activities:</b>		
Net loss	\$ (12,548)	\$ (10,965)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	16,870	16,163
Bad debt expense	514	123
Stock-based compensation	472	488
Reclassification gain of foreign currency translation adjustments		(142)
Gain on disposal of assets		(154)
Minority interest		(178)
Changes in operating assets and liabilities:		
Accounts receivable	(27,795)	(10,004)
Inventories	(8,709)	(2,761)
Prepaid expenses and other current assets	(394)	4,832
Accounts payable	21,946	7,079
Change in book overdrafts	2,022	(1,450)
Accrued expenses and other current liabilities	(1,289)	4,514
Pension and postretirement benefits	(345)	(351)
<b>Net cash provided by (used in) operating activities</b>	<b>(9,256)</b>	<b>7,194</b>
<b>Cash flows from investing activities:</b>		
Purchases of property, plant and equipment	(14,789)	(17,614)
Proceeds from the sale of property, plant and equipment		545
<b>Net cash used in investing activities</b>	<b>(14,789)</b>	<b>(17,069)</b>
<b>Cash flows from financing activities:</b>		
Proceeds from Revolver loan	400,482	387,458
Repayment of Revolver loan	(377,163)	(387,458)
Costs associated with debt financing		(385)
<b>Net cash provided by (used in) financing activities</b>	<b>23,319</b>	<b>(385)</b>
Effect of exchange rate changes on cash and cash equivalents	75	91
<b>Net decrease in cash and cash equivalents</b>	<b>(651)</b>	<b>(10,169)</b>
Cash and cash equivalents at beginning of period	4,254	19,370
<b>Cash and cash equivalents at end of period</b>	<b>\$ 3,603</b>	<b>\$ 9,201</b>

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





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

	<b>Common Stock</b>	<b>Additional Paid-in Capital</b>	<b>Accumulated Other Comprehensive loss</b>	<b>Treasury Stock</b>	<b>Accumulated Deficit</b>	<b>Total Stockholders Deficit</b>
<b>Balance, December 31, 2006</b>	\$ 125	\$ 275,754	\$ (22,378)	\$ (704)	\$ (302,389)	\$ (49,592)
Net loss					(10,965)	(10,965)
Foreign currency translation adjustments			505			505
Reclassification of foreign currency translation adjustments			(142)			(142)
Amortization of prior service cost			(158)			(158)
Amortization of actuarial net loss			1,736			1,736
Revaluation of cash flow hedge			1,295			1,295
Comprehensive loss						(7,729)
Cumulative effect adjustment due to the adoption of FIN 48					(678)	(678)
Treasury stock purchased				(140)		(140)
Stock-based compensation		322				322
<b>Balance, June 30, 2007</b>	\$ 125	\$ 276,076	\$ (19,142)	\$ (844)	\$ (314,032)	\$ (57,817)
<b>Balance, December 31, 2007</b>	\$ 125	\$ 276,546	\$ (18,620)	\$ (945)	\$ (329,413)	\$ (72,307)
Net loss					(12,548)	(12,548)
Foreign currency translation adjustments			1,429			1,429
Amortization of prior service cost			(141)			(141)
Amortization of actuarial net loss			1,574			1,574
Revaluation of cash flow hedge			113			113
Comprehensive loss						(9,573)
Treasury stock purchased				(46)		(46)
Stock-based compensation		497				497
<b>Balance, June 30, 2008</b>	\$ 125	\$ 277,043	\$ (15,645)	\$ (991)	\$ (341,961)	\$ (81,429)

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

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**CONSTAR INTERNATIONAL INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(Dollar and share amounts in thousands, unless otherwise noted)**

**1. Basis of Presentation**

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and in accordance with Securities and Exchange Commission ( SEC ) regulations for interim financial reporting. In the opinion of management, these consolidated financial statements contain all adjustments of a normal and recurring nature necessary to provide a fair statement of the financial position, results of operations and cash flows for the periods presented. Results for interim periods should not be considered indicative of results for a full year. These financial statements should be read in conjunction with the Consolidated Financial Statements and notes thereto contained in Constar International Inc. s (the Company or Constar ) Annual Report on Form 10-K for the year ended December 31, 2007. The Condensed Consolidated Financial Statements include the accounts of the Company and all of its subsidiaries in which a controlling interest is maintained.

In accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ( SFAS 144 ), the Company has classified the results of operations of its Turkish joint venture and its Italian operation as discontinued operations in the condensed consolidated statements of operations for all periods presented. The assets and related liabilities of these entities have been classified as assets and liabilities of discontinued operations on the condensed consolidated balance sheets. See Note 4 in Notes to Condensed Consolidated Financial Statements for further discussion of the divestitures. Unless otherwise indicated, amounts provided throughout this Form 10-Q relate to continuing operations only.

The Company has classified certain inventory, spare parts, machinery and equipment and asset retirement obligations as *held for sale* related to its decision to close its Houston, Texas manufacturing facility in the condensed consolidated balance sheets. Depreciation of machinery and equipment has ceased and no gain or loss has been recorded as of June 30, 2008. Subsequent to June 30, 2008, the company received proceeds of \$1.8 million from the sale of these assets and will recognize a gain of \$1.0 million that will be reflected in the third quarter of 2008.

Where right of offset does not exist, book overdrafts representing outstanding checks are included in accounts payable in the accompanying condensed consolidated balance sheets since the Company is not relieved of its obligations to vendors until the outstanding checks have cleared the bank. The change in outstanding book overdrafts is considered an operating activity and is presented as such in the Statement of Cash Flows. When outstanding checks are presented for payment subsequent to the balance sheet date, the Company deposits funds (subsequent to the balance sheet date) in the disbursement account from cash either available from other accounts or a combination of cash available from other accounts or from funds from the Company s available credit facilities (subsequent to the balance sheet date).

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

**2. Recent Accounting Pronouncements**

In September 2006, the Financial Accounting Standards Board (the FASB ) issued SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ). SFAS 157 establishes a common definition for fair value to be applied to U.S. GAAP guidance requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. In February 2008, the FASB issued FASB Staff Position 157-2 ( FSP 157 ) which delays the effective date of SFAS 157 for one year for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). SFAS 157 and FSP 157 are effective for fiscal years beginning after November 15, 2007. The adoption of SFAS 157 did not have a material impact on the Company s results of operations or financial condition (see Note 17). The Company is currently assessing the impact of FAS 157 for nonfinancial assets and liabilities.

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In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS 159 ). SFAS 159 permits entities to choose to measure certain financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company did not elect the fair value option under SFAS 159 for eligible items that existed as of January 1, 2008.

In March 2007, the FASB ratified Emerging Issues Task Force ( EITF ) Issue No. 06-10, *Accounting for Collateral Assignment Split-Dollar Life Insurance Agreements* ( EITF 06-10 ). EITF 06-10 provides guidance for determining a liability for the postretirement benefit obligation as well as recognition and measurement of the associated asset on the basis of the terms of the collateral assignment agreement. EITF 06-10 is effective for fiscal years beginning after December 15, 2007. The adoption of EITF 06-10 did not have a material impact on the Company's results of operations or financial condition.

In September 2006, the FASB ratified the EITF consensus in EITF Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements* ( EITF 06-4 ). EITF 06-4 indicates that an employer should recognize a liability for future post-employment benefits based on the substantive agreement with the employee. EITF 06-4 is effective for fiscal years beginning after December 15, 2007. The adoption of EITF 06-04 did not have a material impact on the Company's results of operations or financial condition.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* ( SFAS 141R ). SFAS 141R provides revised guidance on how acquirors recognize and measure the consideration transferred, identifiable assets acquired, liabilities assumed, noncontrolling interests, and goodwill acquired in a business combination. In addition, SFAS 141R expands required disclosures surrounding the nature and financial effects of business combinations. SFAS 141R is effective for fiscal years beginning on or after December 15, 2008 with earlier adoption prohibited. The Company is currently assessing the impact of SFAS No. 141R on its consolidated financial statements, however the impact could be material for business combinations which may be consummated subsequent to the adoption of SFAS 141R.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51* ( SFAS 160 ). SFAS 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 requires noncontrolling interests in subsidiaries initially to be measured at fair value and classified as a separate component of equity. SFAS 160 also requires a new presentation on the face of the consolidated financial statements to separately report the amounts attributable to controlling and non-controlling interests. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company is currently assessing the impact of SFAS 160 on its consolidated financial statements.

In September 2007, the FASB ratified EITF Issue No. 07-1, *Accounting for Collaborative Agreements* ( EITF 07-1 ). EITF 07-1 defines collaborative agreements as contractual arrangements that involve a joint operating activity. These arrangements involve two (or more) parties who are both active participants in the activity and that are exposed to significant risks and rewards dependent on the commercial success of the activity. EITF 07-1 provides that a company should report the effects of adoption as a change in accounting principle through retrospective application to all periods and requires additional disclosures about a company's collaborative arrangements. EITF 07-1 is effective for fiscal years beginning after December 15, 2008. The Company does not expect the adoption of EITF 07-1 to have a material impact on its results of operations or financial condition.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133* ( SFAS 161 ). SFAS 161 expands the disclosure requirements of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* ( SFAS 133 ), to include how and why an entity uses derivative instruments, the accounting treatment for derivative instruments and hedging activity under SFAS 133 and related guidance, and how derivative instruments and hedged items affect an entity's financial position, financial performance and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company will comply with the additional disclosure requirements upon adoption of SFAS No. 161.

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In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. SFAS No. 162 identifies a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with GAAP. SFAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. This standard is not expected to have a material impact on the Company's results of operations or financial condition.

### **3. Risks and Uncertainties**

The Company is highly leveraged, has incurred net losses during the past three years and its main contract with Pepsi expires on December 31, 2008. In addition, the Company is exposed to risks, including but not limited to, interest rate fluctuations, the seasonal nature of its business and potential consolidation of customers. Liquidity will vary on a daily, monthly, and quarterly basis, as described below.

#### ***The Company is highly leveraged.***

As of June 30, 2008, there were \$23.8 million of borrowings under the Revolver Loan as defined in Note 8, \$6.1 million outstanding under letters of credit and \$395.0 million in other debt. We had \$3.6 million of cash on our balance sheet, and we had the ability to borrow \$40.1 million under the Revolver Loan.

Our debt may have important negative consequences for us, such as:

limiting our ability to obtain additional financing;

limiting funds available to us because we must dedicate a substantial portion of our cash flow from operations to the payment of interest expense, thereby reducing the funds available to us for other purposes, including capital expenditures;

increasing our vulnerability to economic downturns and changing market and industry conditions; and

limiting our ability to compete with companies that are not as highly leveraged and that may be better positioned to withstand economic downturns.

We currently plan to finance ordinary business operations through borrowings under our Revolver Loan. Our ability to borrow funds under our the Revolver Loan is subject to our compliance with various covenants as of the date of borrowing, including borrowing base limitations that are dependent upon the future level of our eligible accounts receivable and inventory in the United States and the United Kingdom. Even if we are in compliance with all such covenants, the total amount of the facility may be unavailable if the value of the collateral securing the facility falls below certain levels, or if the administrative agent determines that eligibility reserves should be applied to the amount otherwise available under the facility. Certain of the components of the borrowing base are subject to the discretion of the administrative agent. In addition, the administrative agent has the customary ability to reduce, unilaterally, our borrowing availability at any time by, for example, establishing reserves or declaring certain collateral ineligible. The administrative agent placed a reserve of \$2.5 million against our borrowing base as of June 30, 2008 relating to the interest rate swap between the Company and the administrative agent due to the impact of lower interest rates and current volatility. We believe that this \$2.5 million reserve will not have a significant impact on our liquidity if the value of our borrowing base increases as expected over the next few months as we build inventory for the summer months. The value of this reserve will change over time. Certain of our inventory is located on properties that we lease and if we are unable to obtain consents from the landlords, such inventory may not be eligible for inclusion in the borrowing base, thereby reducing our borrowing availability. If we are unable to fully access the Revolver Loan, we may become illiquid and we may be unable to finance our ordinary business activities.

#### ***Reliance on Pepsi and other customers.***

During the first six months of 2008 Pepsi accounted for approximately 36% of the Company's consolidated revenues, while the top ten customers accounted for an aggregate of approximately 69% of the Company's consolidated revenues. The loss or reduction of our business with any of these significant customers could have a material adverse impact on our net sales, profitability, and cash flows. A decline in cash flows may cause the carrying value of our assets to become unrecoverable and may result in a write-down or impairment of the Company's assets.



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Furthermore, Pepsi may terminate its supply agreements with us if we materially breach any of our obligations under the applicable agreement or if a third party acquires more than 20% (or 25% in the case of a specified third party) of our outstanding capital stock or United States-based PET assets. The loss of Pepsi as a customer would cause our net sales and profitability to decline significantly. Our cold fill supply agreement with Pepsi expires on December 31, 2008. In addition, notwithstanding Pepsi's commitment to purchase containers from us in certain geographic regions, Pepsi may purchase containers from a third party for such regions under several circumstances, including our failure to meet our supply obligations and our failure to meet specified contractual quality standards. The Company expects that customers, including Pepsi, will continue to take water and soft drink manufacturing in house where merchant suppliers' transportation costs are high and where large volume, low complexity and space for expansion exists.

The Company is negotiating a new cold fill supply contract with Pepsi and believes the economic terms and conditions have been settled. The new agreement with Pepsi will be at significantly lower volumes and with a mix shift towards fewer bottles and more preforms. In conjunction with this new contract, the Company expects to implement restructuring programs to reduce costs. Based upon the Company's current estimates, the Company believes that the new Pepsi cold fill agreement will result in lower sales but, after taking into account the expected net reduction in costs from restructuring programs and investments to restructure, would result in higher cash flows from operating activities, net of investing activities in 2009 and over the total term of the new agreement as compared to those realized from the Pepsi cold fill business in 2008. The Company's expectations regarding the renewal of this cold fill supply agreement are subject to several risks and assumptions, including without limitation, whether the contract is signed on terms consistent with the Company's current expectations; whether expected future volumes are realized; whether the future product mix is consistent with the Company's expectations; and whether the Company achieves the expected restructuring savings.

If an agreement is not reached, the loss of all Pepsi volume under this contract will have a material adverse effect on the Company, including the Company's ability to make principal and interest payments on its borrowings as they become due and to fund its operations. If the cold fill Pepsi contract is not renewed, the material adverse change would constitute a default under the Company's Revolver Loan and the payment of this debt could be accelerated. An acceleration of the Revolver Loan would permit the acceleration of the Secured Notes and the Subordinated Notes. Should such acceleration occur, the Company would have to seek other forms of financing. There can be no assurance that such financing would be available or that it would be available to the Company on satisfactory economic terms.

Although there has been no material change in the Company's relationship with its customers or suppliers, there can be no assurance that as the December 31, 2008 contract expiration for Pepsi approaches there would not be a change. Customers and suppliers may seek to change the terms of their economic relationship with the Company. If such a change is material, it could cause a strain on the Company's liquidity or eliminate its current liquidity and reduce its level of cash flow. Should such a change occur, the Company would have to seek other forms of financing and there can be assurance that such financing would be available or that it would be available to the Company on satisfactory economic terms.

Should the cold fill Pepsi contract not be renewed on satisfactory economic terms to the Company, the Company will need to review its infrastructure including its manufacturing footprint and the carrying value of its long-lived assets and may have to record an impairment charge on those assets.

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### ***The Company has had net losses in recent years.***

The Company incurred a net loss for the six months ended June 30, 2008 of \$12.5 million and for the fiscal years ended December 31, 2007 and 2006 we incurred net losses of \$26.3 million and \$10.3 million, respectively. Continuing net losses may limit our ability to service our debt and fund our operations and we may not generate net income in the future. Factors contributing to net losses in recent years included, but were not limited to, price competition and the implementation of price reductions to extend customer contracts; asset impairment charges; a write-off of deferred financing costs; restructuring costs; customer contract losses; delays in conversions to PET from other forms of packaging; a high proportion of conventional products in our product mix; customers shifting to self manufacturing of bottles; and operating difficulties in our European businesses. These and other factors may adversely affect our ability to generate profits in the future.

### ***Sales and profitability could be reduced if seasonal demand does not materialize.***

Unseasonably cool weather during a summer could reduce our sales and profitability. A significant portion of our revenue is attributable to the sale of beverage containers. Demand for beverages tends to peak during the summer months. In the past, significant changes in summer weather conditions have affected the demand for beverages, which in turn affects the demand for beverage containers manufactured by us.

As a result of the seasonal nature of our business, cash flow requirements are the greatest in the first several months of each fiscal year because of the increased working capital required to build inventory for the warmer months and because of lower levels of profitability associated with softer sales during the first few months of each fiscal year. A cool summer may have a significant impact on cash flow because of lower profitability and the impact on working capital.

### ***Customer consolidation may reduce sales and profitability.***

The consolidation of our customers may reduce our net sales and profitability. If one of our larger customers acquires one of our smaller customers, or if two of our customers merge, the combined customer's negotiating leverage with us may increase and our business with the combined customer may become less profitable. In addition, if one of our customers is acquired by a company that has a relationship with one of our competitors, we may lose that customer's business. The consolidation of purchasing power through buyer cooperatives or similar organizations may also harm our profitability.

### ***Company Plans***

Liquidity (defined as cash and availability under the Revolver Loan) is a key measure of the Company's ability to finance its operations. The main determinant of 2008 liquidity will be 2008 financial performance. Liquidity will be further influenced by:

the Company's 2008 operating results,

changes in working capital,

interest payments on the Company's debt,

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

the amount and timing of capital expenditures.

Liquidity will vary on a daily, monthly and quarterly basis based upon the seasonality of the Company's sales as well as the factors mentioned above. The Company's cash requirements are typically greater during the first and second quarters of each fiscal year because of the build up of inventory levels in anticipation of the seasonal sales increase during the warmer months and the collection cycle from customers following the higher seasonal sales. Based on the terms and conditions of our debt obligations and our current operations and expectations for future growth, subject to the risk factors identified above, we believe that cash generated from operations together with amounts available under our Revolver



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Loan will be adequate to permit us to meet our current and expected operating requirements and capital investment, although no assurance can be given in this regard.

The Company continually monitors its working capital and has programs in place to manage its investment in both accounts receivable and inventory. The Company also monitors its capital spending and future capital requirements and may have the ability to reduce its projected cash requirements by entering into leases for equipment that would limit its initial cash outlay. It may also have the ability to delay specific capital investments.

**Table of Contents****4. Discontinued Operations**

The supply agreement for the Company's Turkish joint venture expired and the Company discontinued the joint venture's operations in May 2006. The joint venture's manufacturing assets were sold in December 2006 and the joint venture's remaining assets were sold in the third quarter of 2007. The Company received final tax clearance from the Turkish authorities and completed the liquidation of the joint venture in October 2007.

In addition, the Company decided to close its Italian operation since its principal customer notified the Company that the customer would not renew its contract effective January 1, 2007. In accordance with Statement of Financial Accounting Standards No. 52, *Foreign Currency Translation*, for the six months ended June 30, 2007, the Company reclassified \$142 of cumulative translation adjustments out of accumulated other comprehensive loss and into other income.

In accordance with SFAS 144, the assets and related liabilities of the discontinued entities have been classified as assets and liabilities of discontinued operations on the condensed consolidated balance sheets and the results of operations of the entities have been classified as discontinued operations in the condensed consolidated statements of operations for all periods presented.

The following summarizes the assets and liabilities of discontinued operations:

	June 30, 2008	December 31, 2007
<b>Assets of Discontinued Operations:</b>		
Accounts receivable	\$ 16	\$ 185
Prepaid expenses and other current assets	369	342
Total current assets of discontinued operations	\$ 385	\$ 527
<b>Liabilities of Discontinued Operations:</b>		
Accounts payable and accrued expenses	\$ 74	\$ 395
Total current liabilities of discontinued operations	74	395
Other liabilities	874	743
Total liabilities of discontinued operations	\$ 948	\$ 1,138

The following is a summary of the results of operations for discontinued operations for the three and six months ended June 30, 2008 and 2007:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Net sales	\$	\$ 317	\$	\$ 529
Loss from discontinued operations before income taxes and minority interest	(16)	(192)	(70)	(228)
(Provision for) benefit from income taxes	49	(5)	16	(5)
Loss from discontinued operations before minority interest	33	(197)	(54)	(233)
Minority interest		95		178
<b>Loss from discontinued operations</b>	<b>\$ 33</b>	<b>\$ (102)</b>	<b>\$ (54)</b>	<b>\$ (55)</b>

**Table of Contents****5. Accounts Receivable**

Trade receivables	\$ 79,995	\$ 53,756
Less: allowance for doubtful accounts	(1,354)	(1,166)
Net trade receivables	78,641	52,590
Value added taxes recoverable	7,151	5,760
Miscellaneous receivables	2,763	2,862
Total	\$ 88,555	\$ 61,212

Trade receivables at June 30, 2008 increased from December 31, 2007 by \$26.2 million as compared to \$21.0 million in the same period last year. The increase is due to increased sales of \$22.6 million in June 2008 as compared to December 31, 2007, higher days sales in accounts receivable of \$3.2 million and foreign currency translation.

The Company is in the process of pursuing the collection of an account receivable from a customer in the amount of \$1.4 million. The Company believes that the amount receivable is valid under the terms of its contract. The customer is disputing the amount due to the Company. Under the terms of the contract, the Company has the right to audit any customer claim and will pursue this right if it is unable to reach an agreement with the customer. The Company has also asserted that the customer is obligated to pay an additional \$1.8 to \$2.0 million under the contract, which the Company has not recorded in the financial statements.

**6. Inventories**

	June 30, 2008	December 31, 2007
Finished goods	\$ 64,326	\$ 57,633
Raw materials and supplies	17,864	15,580
Total	\$ 82,190	\$ 73,213

The inventory balance has been reduced by reserves for obsolete and slow-moving inventories of \$582 and \$693 as of June 30, 2008 and December 31, 2007, respectively.

**7. Property, Plant and Equipment**

	June 30, 2008	December 31, 2007
Land and improvements	\$ 3,816	\$ 3,754
Buildings and improvements	95,593	95,922
Machinery and equipment	592,652	589,740
	692,061	689,416
Less: accumulated depreciation and amortization	(560,410)	(545,233)
	131,651	144,183
Construction in progress	14,121	2,878
Property, plant and equipment, net	\$ 145,772	\$ 147,061

## 8. Debt

The Company's outstanding debt consists of \$175.0 million of Senior Subordinated Notes due December 1, 2012 ( "Subordinated Notes" ), \$220.0 million of Senior Secured Floating Rate Notes due February 15, 2012 ( "Senior Notes" ) and a \$75.0 million Senior Secured Asset Based Revolving Credit Facility ( "Revolver Loan" ). The Subordinated Notes bear interest at a rate of 11.0% per annum. Interest on the Subordinated Notes is payable semi-annually on each December 1 and June 1. The Senior Notes bear interest at the rate of three-month LIBOR plus 3.375% per annum. Interest on the Senior Notes is reset and payable quarterly. Under the Revolver Loan, interest charges for loans are calculated based on a floating rate plus a fixed margin. In addition, under the Revolver Loan, there is a per annum unused commitment fee.

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

	June 30, 2008	December 31, 2007
<b>Short-Term:</b>		
Revolver	\$ 23,757	\$ 438
<b>Long-Term:</b>		
Senior notes	\$ 220,000	\$ 220,000
Senior subordinated notes	175,000	175,000
Unamortized debt discount	(1,136)	(1,267)
	<b>\$ 393,864</b>	<b>\$ 393,733</b>

At June 30, 2008, there was \$6.1 million outstanding under letters of credit.

**9. Restructuring**

As a result of previously disclosed customer losses and a strategic decision to exit the limited extrusion blow-molding business the Company closed its manufacturing facility in Houston, Texas in May 2008. The Company will continue to service the Houston plant's PET business using existing assets at the Company's Dallas, Texas facility. The cumulative cash flow impact to the Company is expected to turn positive in the fourth quarter of 2008, with cash restructuring expenses being offset by overhead cost savings.

In connection with the closing of the Houston facility, the Company expects to incur total charges of approximately \$2.8 - \$4.4 million depending on the Company's ability to enter into a sublease agreement for the facility. The total charges include (i) an estimated \$0.9 million related to costs to exit the Houston facility, (ii) an estimated \$0.4 million related to employee severance and other termination benefits, and (iii) an estimated \$1.7 million of accelerated depreciation and other non-cash charges. Per SFAS No. 146 Accounting for Costs Associated with Exit or Disposal Activities, the Company's estimated future rental costs due under the current facility lease agreement have been reduced by the potential of a sublease agreement. If the Company is unable to negotiate a sublease, the estimated cash costs associated with this lease agreement, including executory and other exit costs, would be approximately \$1.0 million in each of 2009 and 2010. The Company expects total annual cash savings from overhead cost reductions of approximately \$2.0 million in 2009 and \$0.2 million in 2010 during which the current lease agreement expires.

In November of 2007, the Company terminated its agreement for the supply of bottles and preforms with its supplier in Salt Lake City. As a result, the Company recorded restructuring charges for the costs to remove its equipment from this location and for severance benefits that will be paid to terminated personnel. The Company currently estimates expenditures related to this restructuring to total approximately \$0.4. The customer sales volume provided by the Salt Lake City supply agreement has been shifted to other production facilities.

In response to the decision of a customer in Europe not to renew a contract related to the Company's Dutch facility, the Company evaluated restructuring options for its Dutch subsidiary. On May 22, 2007 the Company received regulatory approval of a plan to terminate the employment of approximately 40 Dutch employees (the 2007 Holland Plan). In connection with these terminations, the Company estimates that it will make net cash expenditures of approximately \$2.8 million. Remaining payments of approximately \$0.2 million are expected to be made in 2008. The payments principally relate to severance costs.

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The following table presents a summary of the restructuring reserve activity:

	2007 Holland Plan		2007 Salt Lake City Plan		2008 Houston Plan		
	Severance and Termination Benefits	Other Costs	Contract and Lease Termination Costs	Severance and Termination Benefits	Contract and Lease Termination Costs	Severance and Termination Benefits	Total
Balance, December 31, 2007	\$ 214	\$ 228	\$ 488	\$ 14	\$	\$	\$ 944
Charges to income			117		428	396	941
Payments	(107)	(136)	(407)		(148)	(232)	(1,030)
Adjustments	15	14	(152)				(123)
Balance, June 30, 2008	\$ 122	\$ 106	\$ 46	\$ 14	\$ 280	\$ 164	\$ 732

In addition to the charges above, during the three months ended June 30, 2008, the Company wrote off deferred rent of \$180 which reduced restructuring expense, and recorded accretion related to an asset retirement obligation liability of \$6. Also, as a result of the Houston restructuring the Company recorded accelerated depreciation and other non-cash charges of \$1.7 million which are included in cost of goods sold in the condensed consolidated statement of operations.

**10. Commitments and Contingencies**

The Company and certain of its present and former directors, along with Crown Holdings, Inc., as well as various underwriters, have been named as defendants in a consolidated securities class action lawsuit filed in the United States District Court for the Eastern District of Pennsylvania, In re Constar International Inc. Securities Litigation (Master File No. 03-CV-05020). This action consolidates previous lawsuits, namely Parkside Capital LLC v. Constar International Inc et al. (Civil Action No. 03-5020), filed on September 5, 2003 and Walter Frejek v. Constar International Inc. et al. (Civil Action No.03-5166), filed on September 15, 2003. The consolidated and amended complaint, filed June 17, 2004, generally alleges that the registration statement and prospectus for the Company's initial public offering of its common stock on November 14, 2002 contained material misrepresentations and/or omissions. Plaintiffs claim that defendants in these lawsuits violated Sections 11 and 15 of the Securities Act of 1933. Plaintiffs seek class action certification and an award of damages and litigation costs and expenses. Under the Company's charter documents, an agreement with Crown and an underwriting agreement with Crown and the underwriters, Constar has incurred certain indemnification and contribution obligations to the other defendants with respect to this lawsuit. The court has previously denied the Company's motion to dismiss for failure to state a claim upon which relief may be granted and motion for judgment on the pleadings. On May 7, 2007, the Special Master issued a Report and Order granting plaintiffs' motion for class certification. The Company filed objections to the Special Master's Report and Order. On March 4, 2008, the Court entered an Order overruling the Company's objections, adopting the Special Master's Report and Order, and granting plaintiffs' motion for class certification. On March 18, 2008, the Company filed a Rule 23(f) Petition with the United States Court of Appeals for the Third Circuit seeking leave to take an immediate appeal from the class certification ruling. On April 30, 2008, the Third Circuit entered an Order granting the Company's Rule 23(f) Petition. The Third Circuit has not yet issued a briefing schedule for the class certification appeal. At the Company's request, the Special Master and the District Court have agreed to stay all further proceedings before the District Court pending the outcome of the appeal, with the exception of certain limited discovery. The Company believes the claims in the action are without merit and intends to defend against them vigorously. The Company cannot reasonably estimate the amount of any loss that may result from this matter.

On March 13, 2007, Marshall Packaging Co. LLC brought suit in the Eastern District of Texas, C. A. No. 6:07cv118, against Amcor PET Packaging USA Inc. and Wal-Mart Stores Inc., alleging infringement of U.S. Patent No. RE 38,770, entitled Collapsible Container, and seeking injunctive relief and monetary damages (the Lawsuit). On April 5, 2007, Marshall settled with Amcor for an undisclosed amount and Amcor was subsequently dismissed from the Lawsuit. On June 29, 2007, Marshall amended its Complaint to add Premium Waters, Inc., a Wal-Mart supplier, as a defendant. Trial is currently set to begin on October 13, 2009. The Company is a supplier of certain containers to Premium, and Premium is claiming indemnity from the Company with respect to some as yet unknown portion of the containers that Premium sells to Wal-Mart. The Company does not know which or how many Constar containers are included among those accused in the Lawsuit. The Company does not believe that it is subject to liability in connection with the patent at issue and intends to vigorously defend against any attempt to implicate its containers in the Lawsuit. The Company cannot reasonably estimate the amount of any loss that may result from this matter.



**Table of Contents****11. Accumulated Other Comprehensive Loss**

Accumulated other comprehensive loss consisted of the following:

	June 30, 2008	December 31, 2007
Postretirement liabilities, net of tax	\$ (19,110)	\$ (20,543)
Cash-flow hedge, net of tax	(1,908)	(2,021)
Foreign currency translation adjustments	5,373	3,944
Accumulated other comprehensive loss	\$ (15,645)	\$ (18,620)

The components of comprehensive loss are as follows:

	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Net loss	\$ (5,017)	\$ (4,849)	\$ (12,548)	\$ (10,965)
Foreign currency translation adjustment	(61)	256	1,429	363
Postretirement amortization	715	790	1,433	1,578
Revaluation of cash flow hedge	3,824	1,866	113	1,295
Comprehensive loss	\$ (539)	\$ (1,937)	\$ (9,573)	\$ (7,729)

**12. Stock-Based Compensation**

The following table summarizes restricted stock activity during the six months ended June 30, 2008:

	Number of Shares				
	2002 Plan	2002 Directors Plan	2007 Plan	2007 Directors Plan	Total
<i>(Shares in thousands)</i>					
Nonvested, December 31, 2007	310	9	35		354
Granted			264	5	269
Vested	(48)				(48)
Forfeited	(6)				(6)
Nonvested, June 30, 2008	256	9	299	5	569

During the six months ended June 30, 2008, the Company granted 264 shares of restricted stock under its 2007 Stock-Based Incentive Compensation Plan. These grants include a condition that provides that such restricted stock will vest only if certain targets for the Company's stock price are achieved. If the market condition is not satisfied by the third anniversary of the date of grant, the awards will not vest. Subject to the attainment of the market condition by the Company, the awards will vest, if at all, in annual installments over a three year period beginning in the first quarter of 2009, the first anniversary of the grant date. The awards may vest more rapidly if certain other targets for the Company's stock price are achieved. The awards have a term of three years from the date of grant.

In addition, during the six months ended June 30, 2008, the Company granted 5 shares of restricted stock under its 2007 Non-Employee Director's Equity Incentive Plan. These grants vest one-third per year over three years.





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In accordance with SFAS 123R, a market condition must be considered in the grant date fair value of the award which contemplates that the market condition may never be met. Stock-based compensation expense related to an award with a market condition will be recognized over the requisite service period regardless of whether the market condition is satisfied, provided that the requisite service period has been completed. The requisite service periods for the market-based awards are based on the Company's estimate of the dates on which the market conditions will be met as determined using a Monte Carlo simulation model. Compensation expense is recognized over the requisite service periods, but is accelerated if market capitalization targets are achieved earlier than estimated.

The assumptions used to estimate the fair value of restricted stock awards granted during the six months ended June 30, 2008 were as follows:

Expected volatility	71.4%
Risk-free rate	2.6%
Dividend yield	%

As of June 30, 2008, there was \$1,037 of unrecognized compensation cost related to restricted stock which is expected to be recognized over a weighted average period of 1.3 years. The total fair value of shares vested was \$133 for the six months ended June 30, 2008.

The following table summarizes restricted stock unit ( RSU ) activity for the six months ended June 30, 2008:

<i>(RSUs in thousands)</i>	<b>RSUs</b>
Outstanding, December 31, 2007	211
Vested	(44)
Outstanding, June 30, 2008	167

The RSUs generally vest between three and four years from the grant date. The Company has assumed a zero percent rate of forfeiture based upon an evaluation of each outstanding award. The fair value of the liability associated with the outstanding RSUs was \$197 and \$223 as of June 30, 2008 and December 31, 2007, respectively.

The following table summarizes total stock-based compensation expense included in the condensed consolidated statements of operations for the three and six months ended June 30, 2008 and 2007:

<i>(in thousands)</i>	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Restricted stock	\$ 255	\$ 171	\$ 497	\$ 321
Restricted stock units	23	(101)	(25)	167
	\$ 278	\$ 70	\$ 472	\$ 488

**13. Earnings (Loss) Per Share**

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

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



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

<i>(shares in thousands)</i>	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Basic weighted average shares outstanding	12,394	12,308	12,385	12,301
Potentially dilutive securities:				
Employee stock options				
Restricted stock				
<b>Total</b>				
Diluted weighted average shares outstanding	12,394	12,308	12,385	12,301

Diluted EPS excludes approximately 0.6 million shares and 0.3 million shares of restricted stock for the three and six months ended June 30, 2008 and 2007, respectively, due to the losses for the periods.

Diluted EPS for the three and six months ended June 30, 2007 excludes approximately 0.2 million stock options because the option price was greater than the average market price of our common stock. There were no stock options outstanding during the three months ended June 30, 2008.

**14. Pension and Other Postretirement Benefits**

The components of net periodic pension cost for the three and six months ended June 30, 2008 and 2007 were as follows:

<i>(in thousands)</i>	Three Months Ended June 30, 2008			Three Months Ended June 30, 2007		
	U.S.	Europe	Total	U.S.	Europe	Total
Service cost	\$ 185	\$ 177	\$ 362	\$ 258	\$ 177	\$ 435
Interest cost	1,269	172	1,441	1,193	161	1,354
Expected return on plan assets	(1,558)	(228)	(1,786)	(1,469)	(208)	(1,677)
Amortization of net loss	485	57	542	649	43	692
Amortization of prior service cost	15	(10)	5	16	(18)	(2)
<b>Total pension expense</b>	<b>\$ 396</b>	<b>\$ 168</b>	<b>\$ 564</b>	<b>\$ 647</b>	<b>\$ 155</b>	<b>\$ 802</b>

<i>(in thousands)</i>	Six Months Ended June 30, 2008			Six Months Ended June 30, 2007		
	U.S.	Europe	Total	U.S.	Europe	Total
Service cost	\$ 370	\$ 356	\$ 726	\$ 517	\$ 353	\$ 870
Interest cost	2,538	346	2,884	2,388	323	2,711
Expected return on plan assets	(3,116)	(458)	(3,574)	(2,938)	(415)	(3,353)
Amortization of net loss	970	115	1,085	1,297	84	1,381
Amortization of prior service cost	31	(20)	11	31	(36)	(5)
<b>Total pension expense</b>	<b>\$ 793</b>	<b>\$ 339</b>	<b>\$ 1,132</b>	<b>\$ 1,295</b>	<b>\$ 309</b>	<b>\$ 1,604</b>

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The Company estimates that its expected contribution to its pension plans for 2008 will be approximately \$4.5 million of which \$0.7 million and \$2.2 million was paid during the three and six months ended June 30, 2008, respectively.

**Table of Contents****Other Postretirement Benefits**

The components of other postretirement benefits cost were as follows for the three and six months ended June 30, 2008 and 2007:

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Interest cost	\$ 91	\$ 62	\$ 183	\$ 125
Amortization of net loss	244	177	489	356
Amortization of prior service cost	(77)	(77)	(153)	(154)
Total other postretirement benefits expense	\$ 258	\$ 162	\$ 519	\$ 327

**15. Income Taxes**

The Company recorded a benefit from income taxes of \$118 and \$32 for the three and six months ended June 30, 2008, respectively. The Company does not currently anticipate realizing deferred tax assets to the extent the assets exceed deferred tax liabilities.

Total unrecognized tax benefits as of June 30, 2008 and December 31, 2007, were \$0.7 million and is included in non-current liabilities of discontinued operations on the condensed consolidated balance sheet. The Company believes that it has adequately provided for any reasonably foreseeable resolution of any tax disputes, but will adjust its reserves in accordance with FIN 48 if events so dictate. To the extent that the ultimate results differ from the original or adjusted estimates of the Company, the effect will be recorded in the provision for income taxes.

**16. Derivative Financial Instruments**

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

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

The Company accounted for this interest rate swap as a cash flow hedge and assumes that there is no ineffectiveness in the hedging relationship and recognizes in other comprehensive income the entire change in the fair value of the swap. The fair value of the interest rate swap liability was \$1,908 at June 30, 2008 and \$2,021 at December 31, 2007. For the six months ended June 30, 2008 and 2007, the Company recorded an unrealized gain in other comprehensive income of \$113 and \$1,296, respectively.

**17. Fair Value Measurements**

Effective January 1, 2008, the Company adopted the provisions of SFAS No. 157 with respect to fair value measurements of financial assets and liabilities. Under SFAS 157, fair value is the price to sell an asset or transfer a liability between market participants as of the measurement date. Fair value measurements assume the asset or liability is exchanged in an orderly manner; the exchange is in the principal market for that asset or liability (or in the most advantageous market when no principal market exists); and the market participants are independent, knowledgeable, able and willing to transact an exchange. SFAS 157 also clarifies that the reporting entity's nonperformance risk (credit risk) should be considered in valuing liabilities.

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SFAS 157 establishes a framework for measuring fair value by creating a hierarchy for observable independent market inputs and unobservable market assumptions and expands disclosures about fair value measurements. Considerable judgment is required in interpreting market data used to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that could be realized in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value.

A description of the fair value hierarchy follows:

**Level 1** Inputs represent unadjusted quoted prices for identical assets or liabilities exchanged in active markets.

**Level 2** Inputs include directly or indirectly observable inputs other than Level 1 inputs such as quoted prices for similar assets or liabilities exchanged in active or inactive markets; quoted prices for identical assets or liabilities exchanged in inactive markets; other inputs that are considered in fair value determinations of the assets or liabilities, such as interest rates and yield curves that are observable at commonly quoted intervals, and credit risks; and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

**Level 3** Inputs are unobservable inputs that are used in the measurement of assets and liabilities. Management is required to use its own assumptions regarding unobservable inputs because there is little, if any, market activity in the asset or liability or related observable inputs that can be corroborated at the measurement date. Measurements of non-exchange traded derivative contract assets and liabilities are primarily based on valuation models, discounted cash flow models or other valuation techniques that are believed to be used by market participants. Unobservable inputs require management to make certain projections and assumptions about the information that would be used by market participants in pricing an asset or liability.

Financial assets and liabilities measured at fair value on a recurring basis as of June 30, 2008 are summarized in the following table by the type of inputs applicable to the fair value measurements.

	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
<i>(in thousands)</i>				
<b>Liabilities</b>				
Interest rate swap	\$	\$ 1,908	\$	\$ 1,908

The fair value measurements of the Company's interest rate swap is a model-derived valuation as of a given date in which all significant inputs are observable in active markets including certain financial information and certain assumptions regarding past, present and future market conditions, such as LIBOR yield curves. The Company does not believe that changes in the fair value of its interest rate swap will materially differ from the amounts that could be realized upon settlement or maturity.

**Table of Contents****18. Other (Expense) Income**

Other (expense) income consisted of the following for the three and six months ended June 30, 2008 and 2007:

<i>(in thousands)</i>	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Royalty income	\$ 289	\$ 259	\$ 505	\$ 503
Interest income	20	215	94	266
Foreign exchange gains (losses)	(302)	244	(1,141)	258
Other income (expense)	(5)	(161)	(25)	(102)
Other income (expense), net	\$ 2	\$ 557	\$ (567)	\$ 925

**19. Segment Information**

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

Net customer sales by country for the three and six months ended June 30, 2008 and 2007 were as follows:

<i>(in thousands)</i>	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
United States	\$ 188,614	\$ 181,898	\$ 357,252	\$ 346,043
United Kingdom	46,135	43,904	81,231	73,466
Other	7,803	13,390	16,330	31,299
	\$ 242,552	\$ 239,192	\$ 454,813	\$ 450,808

**20. Condensed Consolidating Financial Information**

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

Balance sheets as of June 30, 2008 and December 31, 2007;

Statements of operations for the three and six months ended June 30, 2008 and June 30, 2007; and

Statements of cash flows for the six months ended June 30, 2008 and June 30, 2007.



**Table of Contents****CONDENSED CONSOLIDATING BALANCE SHEET****JUNE 30, 2008****(In thousands)****(Unaudited)**

	Parent	Guarantors	Non Guarantors	Eliminations	Total Company
<b>ASSETS</b>					
<b>Current Assets:</b>					
Cash and cash equivalents	\$	\$ 2,574	\$ 1,029	\$	\$ 3,603
Intercompany receivables		168,353	12,141	(180,494)	
Accounts receivable, net		85,724	3,864		89,588
Inventories, net		78,671	3,519		82,190
Prepaid expenses and other current assets		20,421	621		21,042
Deferred income taxes		1,373			1,373
Current assets held for sale		427			427
Current assets of discontinued operations			385		385
<b>Total current assets</b>		357,543	21,559	(180,494)	198,608
Property, plant and equipment, net		141,210	4,948	(386)	145,772
Goodwill		148,813			148,813
Investments in subsidiaries	485,402	19,986		(505,388)	
Other assets	7,621	5,094	144		12,859
Non current assets held for sale		953			953
Non-current assets of discontinued operations					
<b>Total assets</b>	\$ 493,023	\$ 673,599	\$ 26,651	\$ (686,268)	\$ 507,005
<b>LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)</b>					
<b>Current Liabilities:</b>					
Short-term debt	\$ 23,757	\$	\$	\$	\$ 23,757
Accounts payable and accrued liabilities	3,645	136,256	4,795		144,696
Intercompany payable	151,277	29,080	523	(180,880)	
Current liabilities of discontinued operations			74		74
<b>Total current liabilities</b>	178,679	165,336	5,392	(180,880)	168,527
Long-term debt, net of current portion	393,864				393,864
Pension and postretirement liabilities		9,049	399		9,448
Deferred income taxes		1,373			1,373
Other liabilities	1,909	11,796			13,705
Liabilities associated with assets held for sale		643			643
Non-current liabilities of discontinued operations			874		874
<b>Total liabilities</b>	574,452	188,197	6,665	(180,880)	588,434
Commitments and contingent liabilities					
Stockholders' equity (deficit)	(81,429)	485,402	19,986	(505,388)	(81,429)

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<b>Total liabilities and stockholders' equity (deficit)</b>	\$ 493,023	\$ 673,599	\$ 26,651	\$ (686,268)	\$ 507,005
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**Table of Contents****CONDENSED CONSOLIDATING BALANCE SHEET****DECEMBER 31, 2007****(In thousands)**

	<b>Parent</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Total Company</b>
<b>ASSETS</b>					
<b>Current Assets:</b>					
Cash and cash equivalents	\$	\$ 3,294	\$ 960	\$	\$ 4,254
Intercompany receivables		168,235	10,774	(179,009)	
Accounts receivable, net		58,706	2,989		61,695
Inventories, net		69,822	3,391		73,213
Prepaid expenses and other current assets		18,899	306		19,205
Deferred income taxes		2,045			2,045
Current assets of discontinued operations			527		527
<b>Total current assets</b>		321,001	18,947	(179,009)	160,939
Property, plant and equipment, net		142,662	4,814	(415)	147,061
Goodwill		148,813			148,813
Investments in subsidiaries	475,587	16,977		(492,564)	
Other assets	7,552	7,578	346		15,476
Non-current assets of discontinued operations					
<b>Total assets</b>	\$ 483,139	\$ 637,031	\$ 24,107	\$ (671,988)	\$ 472,289
<b>LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)</b>					
<b>Current Liabilities:</b>					
Short-term debt	\$ 438	\$	\$	\$	\$ 438
Accounts payable and accrued liabilities	5,267	111,179	5,017		121,463
Intercompany payable	153,987	25,133	304	(179,424)	
Current liabilities of discontinued operations			395		395
<b>Total current liabilities</b>	159,692	136,312	5,716	(179,424)	122,296
Long-term debt	393,733				393,733
Pension and postretirement liabilities		10,697	671		11,368
Deferred income taxes		2,045			2,045
Other liabilities	2,021	12,390			14,411
Non-current liabilities of discontinued operations			743		743
<b>Total liabilities</b>	555,446	161,444	7,130	(179,424)	544,596
Commitments and contingent liabilities					
Stockholders' equity (deficit)	(72,307)	475,587	16,977	(492,564)	(72,307)
<b>Total liabilities and stockholders' equity (deficit)</b>	\$ 483,139	\$ 637,031	\$ 24,107	\$ (671,988)	\$ 472,289



**Table of Contents****CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS****FOR THE THREE MONTHS ENDED JUNE 30, 2008****(In thousands)****(Unaudited)**

	<b>Parent</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Total Company</b>
<b>Net sales</b>	\$	\$ 236,466	\$ 7,803	\$	\$ 244,269
Cost of products sold, excluding depreciation		216,186	7,307		223,493
Depreciation		8,414	208		8,622
<b>Gross profit</b>		11,866	288		12,154
Selling and administrative expenses		4,634	155		4,789
Research and technology expenses		2,309			2,309
Provision for restructuring		725			725
Total operating expenses		7,668	155		7,823
<b>Operating income</b>		4,198	133		4,331
Interest expense	(9,283)	(376)	158		(9,501)
Other income (expense), net		(98)	100		2
<b>Income (loss) from continuing operations before income taxes</b>	(9,283)	3,724	391		(5,168)
Provision for income taxes		(2)	120		118
<b>Income (loss) from continuing operations</b>	(9,283)	3,722	511		(5,050)
Equity earnings	4,266	544		(4,810)	
Income from discontinued operations, net of taxes			33		33
<b>Net income (loss)</b>	\$ (5,017)	\$ 4,266	\$ 544	\$ (4,810)	\$ (5,017)

**Table of Contents****CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS****FOR THE THREE MONTHS ENDED JUNE 30, 2007****(In thousands)****(Unaudited)**

	<b>Parent</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Total Company</b>
<b>Net sales</b>	\$	\$ 226,848	\$ 13,391	\$	\$ 240,239
Cost of products sold, excluding depreciation		205,765	11,786		217,551
Depreciation		7,727	225		7,952
<b>Gross profit</b>		13,356	1,380		14,736
Selling and administrative expenses		4,712	44		4,756
Research and technology expenses		2,156			2,156
Provision for restructuring		107	2,725		2,832
Total operating expenses		6,975	2,769		9,744
<b>Operating income</b>		6,381	(1,389)		4,992
Interest expense	(10,040)	(316)	54		(10,302)
Other income (expense), net		585	(28)		557
<b>Income (loss) from continuing operations before income taxes</b>	(10,040)	6,650	(1,363)		(4,753)
Provision for income taxes		6			6
<b>Income (loss) from continuing operations</b>	(10,040)	6,656	(1,363)		(4,747)
Equity earnings	5,191	(1,465)		(3,726)	
Income from discontinued operations, net of taxes			(102)		(102)
<b>Net income (loss)</b>	\$ (4,849)	\$ 5,191	\$ (1,465)	\$ (3,726)	\$ (4,849)

**Table of Contents****CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS****FOR THE SIX MONTHS ENDED JUNE 30, 2008****(In thousands)****(Unaudited)**

	<b>Parent</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Total Company</b>
<b>Net sales</b>	\$	\$ 441,317	\$ 16,330	\$	\$ 457,647
Cost of products sold, excluding depreciation		403,130	14,572		417,702
Depreciation		15,432	384		15,816
<b>Gross profit</b>		22,755	1,374		24,129
Selling and administrative expenses		11,257	293		11,550
Research and technology expenses		4,355			4,355
Provision for restructuring		806			806
Total operating expenses		16,418	293		16,711
<b>Operating income</b>		6,337	1,081		7,418
Interest expense	(18,963)	(697)	283		(19,377)
Other income (expense), net		(621)	54		(567)
<b>Income (loss) from continuing operations before income taxes</b>	(18,963)	5,019	1,418		(12,526)
Provision for income taxes		(86)	118		32
<b>Income (loss) from continuing operations</b>	(18,963)	4,933	1,536		(12,494)
Equity earnings	6,415	1,482		(7,897)	
Income from discontinued operations, net of taxes			(54)		(54)
<b>Net income (loss)</b>	\$ (12,548)	\$ 6,415	\$ 1,482	\$ (7,897)	\$ (12,548)

**Table of Contents****CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS****FOR THE SIX MONTHS ENDED JUNE 30, 2007****(In thousands)****(Unaudited)**

	<b>Parent</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Total Company</b>
<b>Net sales</b>	\$	\$ 421,621	\$ 31,299		\$ 452,920
Cost of products sold, excluding depreciation		382,028	28,006		410,034
Depreciation		15,040	492		15,532
<b>Gross profit</b>		24,553	2,801		27,354
Selling and administrative expenses		11,232	633		11,865
Research and technology expenses		3,770			3,770
Provision for restructuring		410	2,725		3,135
Total operating expenses		15,412	3,358		18,770
<b>Operating income</b>		9,141	(557)		8,584
Interest expense	(19,897)	(662)	140		(20,419)
Other income (expense), net		973	(48)		925
<b>Income (loss) from continuing operations before income taxes</b>	(19,897)	9,452	(465)		(10,910)
Provision for income taxes					
<b>Income (loss) from continuing operations</b>	(19,897)	9,452	(465)		(10,910)
Equity earnings	8,932	(520)		(8,412)	
Income from discontinued operations, net of taxes			(55)		(55)
<b>Net income (loss)</b>	\$ (10,965)	\$ 8,932	\$ (520)	\$ (8,412)	\$ (10,965)



**Table of Contents****CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS****FOR THE SIX MONTHS ENDED JUNE 30, 2008****(In thousands)****(Unaudited)**

	<b>Parent</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Total Company</b>
<b>Cash flows from operating activities:</b>					
Net income (loss)	\$ (12,548)	\$ 6,415	\$ 1,482	\$ (7,897)	\$ (12,548)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:					
Depreciation and amortization		16,502	368		16,870
Stock-based compensation		472			472
Reclassification gain of foreign currency translation adjustments					
Equity earnings	(6,415)	(1,482)		7,897	
Changes in operating assets and liabilities	(1,624)	(9,665)	(2,761)		(14,050)
<b>Net cash provided by (used in) operating activities</b>	<b>(20,587)</b>	<b>12,242</b>	<b>(911)</b>		<b>(9,256)</b>
<b>Cash flows from investing activities:</b>					
Purchases of property, plant and equipment		(14,659)	(130)		(14,789)
Proceeds from the sale of property, plant and equipment					
<b>Net cash used in investing activities</b>		<b>(14,659)</b>	<b>(130)</b>		<b>(14,789)</b>
<b>Cash flows from financing activities:</b>					
Proceeds from Revolver loan	400,482				400,482
Repayment of Revolver loan	(377,163)				(377,163)
Net change in intercompany loans	(2,732)	1,689	1,043		
Costs associated with debt refinancing					
<b>Net cash provided by (used in) financing activities</b>	<b>20,587</b>	<b>1,689</b>	<b>1,043</b>		<b>23,319</b>
Effect of exchange rate changes on cash and cash equivalents		8	67		75
Net increase (decrease) in cash and cash equivalents		(720)	69		(651)
Cash and cash equivalents at beginning of period		3,294	960		4,254
Cash and cash equivalents at end of period	\$	\$ 2,574	\$ 1,029	\$	\$ 3,603

**Table of Contents****CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS****FOR THE SIX MONTHS ENDED JUNE 30, 2007****(In thousands)****(Unaudited)**

	<b>Parent</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Total Company</b>
<b>Cash flows from operating activities:</b>					
Net income (loss)	\$ (10,965)	\$ 8,932	\$ (520)	\$ (8,412)	\$ (10,965)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:					
Depreciation and amortization	1,125	14,669	369		16,163
Stock-based compensation		488			488
Reclassification gain of foreign currency translation adjustments			(142)		(142)
Equity earnings	(8,932)	520		8,412	
Changes in operating assets and liabilities	289	(2,131)	3,492		1,650
<b>Net cash provided by (used in) operating activities</b>	<b>(18,483)</b>	<b>22,478</b>	<b>3,199</b>		<b>7,194</b>
<b>Cash flows from investing activities:</b>					
Purchases of property, plant and equipment		(17,614)			(17,614)
Proceeds from the sale of property, plant and equipment		94	451		545
<b>Net cash used in investing activities</b>		<b>(17,520)</b>	<b>451</b>		<b>(17,069)</b>
<b>Cash flows from financing activities:</b>					
Proceeds from Revolver loan	387,458				387,458
Repayment of Revolver loan	(387,458)				(387,458)
Net change in intercompany loans	18,868	(18,027)	(841)		
Costs associated with debt refinancing	(385)				(385)
<b>Net cash provided by (used in) financing activities</b>	<b>18,483</b>	<b>(18,027)</b>	<b>(841)</b>		<b>(385)</b>
Effect of exchange rate changes on cash and cash equivalents		32	59		91
Net increase (decrease) in cash and cash equivalents		(13,037)	2,868		(10,169)
Cash and cash equivalents at beginning of period		16,288	3,082		19,370
Cash and cash equivalents at end of period	\$	\$ 3,251	\$ 5,950	\$	\$ 9,201

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

The Company is a manufacturer of PET plastic containers for food and beverages. In addition, the Company produces plastic closures and other non-PET containers representing 4% of sales for the first six months of 2008. Approximately 79% of the Company's revenues in the first six months of 2008 were generated in the United States, with the remainder attributable to its European operations. During the second quarter of 2008, one customer accounted for approximately 36% of the Company's consolidated revenues, while the top ten customers accounted for an aggregate of approximately 69% of the Company's consolidated revenues. Approximately 69% of the Company's sales in the first six months of 2008 related to conventional PET containers which are primarily used for carbonated soft drinks and bottled water. Conventional product profitability is driven principally by price, volume and maintaining efficient manufacturing operations. During the second quarter of 2008, consolidated conventional unit volume declined 20.2% due to the continued movement of water bottlers to self-manufacturing, the previously disclosed losses of conventional customer contracts, the negative impact of high gasoline prices on the convenience store and gas station distribution channels and consumers shifting their preferences from carbonated soft drinks to alternative beverages.

The Company expects that water bottlers will continue to shift towards manufacturing their own single service water bottles. This trend accounted for approximately 38% of the consolidated conventional unit volume decline for the second quarter of 2008 as mentioned above. The Company believes that this trend is reaching the end of its cycle, with the majority of single service water bottles now being produced in-house. What remaining volume is produced by merchant suppliers will likely transition to in-house manufacture over the next few years. In addition, the Company expects that some future movement toward self-manufacturing of carbonated soft drink (CSD) packages will occur. CSD manufacturing infrastructure costs are much higher than what is required for water and the cost of complexity is significantly greater. Thus, the Company expects a transition over time at selected locations where merchant suppliers' transportation costs are high, and where large volume, low complexity and space for expansion exists. The Company believes that in most cases, customers will continue to purchase water and CSD preforms to support these in-house blow-molding operations from merchant suppliers. The Company plans to continue to offset the potential financial impact on the Company of customers blowing their own bottles through cost reductions, plant consolidations, increased pricing, and retaining the replacement preform volume at acceptable margins.

During the second quarter of 2008, a customer notified Constar of its intention to self-manufacture a portion of its CSD bottle volume beginning in the fourth quarter of 2008. The Company will be supplying the preforms to these operations. The financial impact of this change, net of restructuring charges related to workforce reductions at the affected manufacturing facilities, is expected to be immaterial to the Company's 2008 results.

The Company is also a producer of higher profit custom PET products that are used in such packaging applications as hot-filled beverages, food, household chemicals, beer and flavored alcoholic beverages, most of which require containers with special performance characteristics. Part of the Company's strategy is to increase its presence in this higher profit and growth segment of the market. The Company believes its portfolio of proprietary oxygen scavenging technologies (Oxbar<sup>®</sup>, MonOxbar<sup>®</sup>, and DiamondClear<sup>®</sup>) are the best performing oxygen barrier technologies in the market today and will drive continued growth for the Company within the custom segment of the market. The Company's patents pertaining to Oxbar<sup>®</sup> and MonOxbar<sup>®</sup> begin to expire in 2008. The technology required to produce certain types of custom products is commonly available. The Company believes that there are significant growth opportunities for the conversion of glass and aluminum containers to PET containers for small sized carbonated soft drinks, bottled teas, beer, energy drinks, flavored alcoholic beverages and various food applications. Approximately 27% of the Company's sales in the first six months of 2008 related to custom PET containers. Custom unit volume increased approximately 16.9% in the second quarter of 2008 as compared to the same period in 2007.

In negotiations with certain customers for the continuation and the extension of supply agreements, the Company has historically agreed to price concessions. However, in 2008, the Company expects to achieve a net positive impact of contractual price increases of approximately \$6.0 million.

The volume-weighted average term of the Company's contracts, excluding Pepsi, is approximately 4.1 years. Some of these contracts come up for renewal each year, and are often offered to the market for competitive bidding. The Company's cold fill contract with Pepsi, its largest customer, is scheduled to expire on December 31, 2008.

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The Company is negotiating a new cold fill supply contract with Pepsi and believes the economic terms and conditions have been settled. The new agreement with Pepsi will be at significantly lower volumes and with a mix shift towards fewer bottles and more preforms. In conjunction with this new contract, the Company expects to implement restructuring programs to reduce costs. Based upon the Company's current estimates, the Company believes that the new Pepsi cold fill agreement will result in lower sales but, after taking into account the expected net reduction in costs from restructuring programs and investments to restructure, would result in higher cash flows from operating activities, net of investing activities in 2009 and over the total term of the new agreement as compared to those realized from the Pepsi cold fill business in 2008. The Company's expectations regarding the renewal of this cold fill supply agreement are subject to several risks and assumptions, including without limitation, whether the contract is signed on terms consistent with the Company's current expectations; whether expected future volumes are realized; whether the future product mix is consistent with the Company's expectations; and whether the Company achieves the expected restructuring savings.

The Company believes that it will continue to face several sources of pricing pressure. One source is customer consolidation. When customers aggregate their purchasing power by combining their operations with other customers or purchasing through buying cooperatives, the profitability of the Company's business tends to decline. The Company will negotiate aggressively and seek to minimize the impact of customer consolidation. Another source of pricing pressure may come as a result of water and CSD customers moving towards self-manufacturing of bottles which may result in increasing industry capacity. In addition, contractual provisions may permit customers to terminate contracts if the customer receives an offer from another manufacturer that the Company chooses not to match. The Company is continuing to seek to remove, or lessen the impact of, these provisions in all new contracts and contract renewals.

The primary raw material and component cost of the Company's products is PET resin, which is a commodity available globally. The price of PET resin is subject to frequent fluctuations as a result of raw material costs, overseas markets, PET production capacity and seasonal demand. Constar is one of the largest purchasers of PET resin in North America, which it believes provides it with negotiating leverage. Higher resin prices may impact the demand for PET packaging where customers have a choice between PET and other forms of packaging. However, recent price increases for glass and aluminum may soften the demand for the use of those products.

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

During the last six months, the Company has experienced unprecedented cost increases in energy and freight, which are major cost components of the Company's operations. In reaction to these cost increases the Company implemented two freight related increases effective February 1 and July 1, 2008 for its U.S. operations. In addition, to offset the negative impact of energy and other cost increases, the Company announced a price increase effective August 1, 2008 for all US customers. At this time the Company is unable to determine the impact of this increase on its financial results.

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The Company is highly leveraged. As of June 30, 2008, the Company's debt structure consisted of a \$75.0 million Revolver Loan, \$220.0 million of Senior Notes and \$175.0 million of Subordinated Notes. As of June 30, 2008, the Company had \$23.8 million outstanding under its Revolver Loan and \$6.1 million outstanding under letters of credit. Interest expense for the first six months of 2008 was \$19.4 million.

In accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144), the Company has classified the results of operations of its Turkish joint venture and its Italian operation as discontinued operations in the condensed consolidated statements of operations for all periods presented. The assets and related liabilities of these entities have been classified as assets and liabilities of discontinued operations on the condensed consolidated balance sheets. In October 2007, the Company completed the liquidation of its Turkish joint venture. See Note 4 in Notes to Condensed Consolidated Financial Statements for further discussion of these discontinued operations. Unless otherwise indicated, amounts provided throughout this report relate to continuing operations only.

**Table of Contents****Results of Operations****Three Months Ended June 30, 2008 and 2007***Net Sales*

<i>(dollars in millions)</i>	Three months ended June 30,		Increase (Decrease)	% Increase (Decrease)
	2008	2007		
United States	\$ 190.3	\$ 182.9	\$ 7.4	4.0%
Europe	54.0	57.3	(3.3)	(5.8)%
Total	\$ 244.3	\$ 240.2	\$ 4.1	1.7%

The increase in consolidated net sales was driven by the pass-through of resin costs to customers, an increase in custom unit sales, the positive impact of foreign currency translations, and price increases, offset by a decrease in conventional unit volume. Conventional unit volume declined 20.2% for the three months ended June 30, 2008 as compared to the same period last year. The decline in conventional unit volume was driven by a decrease in water volume due to the continued movement of water bottlers to self-manufacturing and the previously disclosed loss of conventional customer contracts in the U.S. and the Company's Holland operations. CSD volume was also impacted by the negative impact of high gasoline prices on the convenience store and gas station distribution channels. In addition, CSD volume decreased due to consumers shifting their preferences from carbonated soft drinks to non-carbonated drinks such as energy drinks and teas, some of which are in non-PET forms of packaging. The decrease in water and CSD bottle volumes was partially offset by an increase in custom unit volume of 16.9%, and a strengthening of the British Pound and Euro against the dollar.

In the U.S., net sales in the second quarter of 2008 increased compared to net sales in the second quarter of 2007. The increase in U.S. net sales was principally driven by the pass-through of resin costs to customers, along with an increase in price, offset by a decrease in unit volume. Total U.S. unit volume decreased 8.3% over the second quarter of 2007. Custom unit volume increased 16.9%, while conventional unit volume declined 17.7% compared to the second quarter of 2007. Approximately 60 percent of the conventional unit volume decline in the U.S. was due to water bottlers shifting to self-manufacturing with an additional 15.5 percent of the decline due to the previously disclosed loss of a conventional customer contract.

The decrease in European net sales in the first quarter of 2008 was primarily due to lower unit volume, offset by the pass-through of resin costs to customers and a positive impact on foreign currency translations. Total European unit volume decreased by 19.8% compared to the second quarter of 2007 due primarily to the previously disclosed customer loss in the Company's Holland operations.

*Gross Profit*

<i>(dollars in millions)</i>	Three months ended June 30,		Increase (Decrease)
	2008	2007	
United States	\$ 10.1	\$ 12.5	\$ (2.4)
Europe	2.1	2.2	(0.1)
Total	\$ 12.2	\$ 14.7	\$ (2.5)
Percent of net sales	5.0%	6.1%	

The decrease in gross profit in the second quarter of 2008 compared to the second quarter of 2007 was the result of lower unit volumes and higher energy costs as described above and increased depreciation expense, offset in part by increases in price.



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***Selling and Administrative Expenses***

Selling and administrative expenses remained constant at \$4.8 million in the second quarter of 2008 and 2007, with an increase in compensation expenses of \$0.7 million offset by lower audit and Sarbanes Oxley fees.

***Research and Technology Expenses***

Research and technology expenses were \$2.3 million in the second quarter of 2008 compared to \$2.2 million in the second quarter of 2007. The research and technology expenses relate to spending for the Company's existing proprietary technologies and new emerging technologies.

***Provision for Restructuring***

Restructuring charges were \$0.7 million for the second quarter of 2008 compared to \$2.8 million in the second quarter of 2007. The restructuring charges recorded in the second quarter of 2008 primarily relate to the shutdown of the Company's Houston, Texas facility as a result of previously disclosed customer losses and a strategic decision to exit the Company's limited extrusion blow-molding business. The restructuring charges for Houston consist of \$0.3 million of facility exits costs, and \$0.4 million of severance costs. In addition, the Company recorded \$1.7 million for accelerated depreciation and other non-cash charges that were reflected in the Company's calculation of gross profit.

During the second quarter of 2007 the Company recorded restructuring charges of \$2.8 million as a result of the loss of a key customer contract as previously disclosed, which consisted of severance costs principally related to the Company's operations in the Netherlands. (See Note 9 of the accompanying Condensed Consolidated Financial Statements).

***Operating Income***

Operating income was \$4.3 million in the second quarter of 2008 compared to \$5.0 million in the second quarter of 2007. This decrease in operating income primarily relates to the lower unit volume described above and increases in energy and restructuring costs.

***Interest Expense***

Interest expense decreased \$0.8 million to \$9.5 million in the second quarter of 2008 from \$10.3 million in the second quarter of 2007 as a result of lower effective interest rates, offset in part by higher average borrowings.

***Other Income (Expense), net***

Other expense, net was zero in the second quarter of 2008 compared to other income of \$0.6 million in the second quarter of 2007. The decrease in other income in the second quarter of 2008 primarily resulted from the negative impact of foreign currency on the translation of intra-company balances. Other income (expense), net consists primarily of royalty income, interest income, and foreign exchange gains.

***Provision for Income Taxes***

The Company recorded a benefit from income taxes of \$0.1 million for the second quarter of 2008 compared to no provision in the second quarter of 2007.

Total unrecognized tax benefits as of June 30, 2008 and December 31, 2007, were \$0.7 million and is included in non-current liabilities of discontinued operations on the condensed consolidated balance sheets. In addition, the Company had accrued approximately \$0.2 million for estimated interest and penalties on uncertain tax positions as of June 30, 2008 and December 31, 2007. The Company believes that it has adequately provided for any reasonably foreseeable resolution of any tax disputes, but will adjust its reserves in accordance with FIN 48 if events so dictate. To the extent that the ultimate results differ from the original or adjusted estimates of the Company, the effect will be recorded in the provision for income taxes.



**Table of Contents****Income from Discontinued Operations, net of taxes**

Loss from discontinued operations in the second quarter of 2008 was zero compared to loss from discontinued operations of \$0.1 million in the second quarter of 2007. The losses related to the shutdown and run-off of operations in Turkey, which began in May 2006, and in Italy, which began in December 2006. The Company completed the liquidation of its Turkish joint venture in October 2007. Unless otherwise indicated, amounts provided throughout this Form 10-Q relate to continuing operations only.

**Net Loss**

Net loss in the second quarter of 2008 was \$5.0 million, or \$0.41 loss per basic and diluted share, compared to a net loss in the second quarter of 2007 of \$4.8 million, or \$0.39 loss per basic and diluted share.

**Six Months Ended June 30, 2008 and 2007*****Net Sales***

<i>(dollars in millions)</i>	<b>Six months ended June 30,</b>		<b>%</b>	
	<b>2008</b>	<b>2007</b>	<b>Increase (Decrease)</b>	<b>Increase (Decrease)</b>
United States	\$ 360.0	\$ 348.2	\$ 11.8	3.4%
Europe	97.6	104.7	(7.1)	(6.8)%
Total	\$ 457.6	\$ 452.9	\$ 4.7	1.0%

The increase in consolidated net sales was primarily driven by the pass through of higher resin costs, the increase in custom unit sales, and price increases offset by a decline in conventional unit volumes. The decline in conventional unit volume was driven by a decrease in water volume due to the continued movement of water bottlers to self-manufacturing and the loss of previously disclosed conventional customer contracts in the U.S. and the Company's Holland operations. CSD volume was also impacted by the negative impact of high gasoline prices on the convenience store and gas station distribution channels. In addition, CSD volume decreased due to consumers shifting their preferences from carbonated soft drinks to non-carbonated drinks such as energy drinks and teas, most of which are in non-PET forms of packaging.

The increase in U.S. net sales was principally driven by the pass through of higher resin costs, the impact of contractual price increases and the increase in custom unit volume offset in part by lower conventional unit volume. Total U.S. unit volume decreased 6.4% compared to the six months ended June 30, 2007. Custom unit volume increased 18.5%, while conventional unit volume declined 14.3% compared to the six months ended June 30, 2007 driven primarily by the water bottlers continuing the trend towards self-manufacturing and the loss of a previously disclosed conventional customer contract.

The decrease in European net sales for the six months ended June 30, 2008 was primarily due to decreased total unit volume of 14.0% driven primarily by the previously disclosed loss of a customer in the Company's Holland operation, offset in part by favorable foreign currency translations compared to the six months ended June 30, 2007.

**Table of Contents****Gross Profit**

(dollars in millions)	Six months ended June 30,		Increase (Decrease)
	2008	2007	
United States	\$ 21.4	\$ 24.6	\$ (3.2)
Europe	2.7	2.8	(0.1)
<b>Total</b>	<b>\$ 24.1</b>	<b>\$ 27.4</b>	<b>\$ (3.3)</b>
Percent of net sales	5.3%	6.0%	

The decrease in gross profit for the six months ended June 30, 2008 compared to the six months ended June 30, 2007 was the result of the lower units volumes described above and increases in energy costs, offset in part by increases in prices and higher custom unit volume.

**Selling and Administrative Expenses**

Selling and administrative expenses decreased \$0.4 million, or 3.4%, to \$11.5 million for the six months ended June 30, 2008 from \$11.9 million for the six months ended June 30, 2007. This decrease was primarily driven by lower legal and audit fees, partially offset by increased compensation expense.

**Research and Technology Expenses**

Research and technology expenses were \$4.4 million for the six months ended June 30, 2008 compared to \$3.8 million for the six months ended June 30, 2007. The research and technology expenses relate to spending for the Company's existing proprietary technologies and new emerging technologies.

**Provision for Restructuring**

Restructuring charges were \$0.8 million for the six months ended June 30, 2008 compared to \$3.1 million in the six months ended June 30, 2007.

The restructuring charges recorded in the six months ended June 30, 2008 primarily relate to the shut-down of the Company's Houston facility as a result of previously disclosed customer losses and a strategic decision to exit the Company's limited extrusion blow-molding business. The restructuring charges for Houston consist of \$0.3 million of facility exits costs and \$0.4 million of severance costs. In addition, the Company recorded \$1.7 million for accelerated depreciation and other non-cash charges that were reflected in the Company's calculation of gross profit.

During the six months ended June 30, 2007 the Company recorded restructuring charges of \$3.1 million as a result of the loss of a key customer contract as previously disclosed, which consisted primarily of severance costs principally related to the Company's operations in the Netherlands. (See Note 9 to the accompanying Condensed Consolidated Financial Statements).

**Operating Income**

Operating income was \$7.4 million for the six months ended June 30, 2008 compared to \$8.6 million for the six months ended June 30, 2007. This decrease in operating income primarily relates to the decreased operating performance described above, along with an increase in energy costs and restructuring expenses of \$0.4 million compared to the six months ended June 30, 2007.

**Interest Expense**

Interest expense decreased \$1.0 million to \$19.4 million in the six months ended June 30, 2008 from \$20.4 million in the six months ended June 30, 2007 as a result of lower effective interest rates, offset in part by higher average borrowings.



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### ***Other Income (Expense), net***

Other expense, net was \$0.6 million in the six months ended June 30, 2008 compared to other income \$0.9 million in the six months ended June 30, 2007. The decrease in other income primarily resulted from the negative impact of foreign currency on the translation of intra-company balances. Other income (expense), net consists primarily of royalty income, interest income, and foreign exchange gains.

### ***Provision for Income Taxes***

The Company recorded no provision for income taxes for the six months ended June 30, 2008 and 2007.

Total unrecognized tax benefits as of June 30, 2008 and December 31, 2007, were \$0.7 million and is included in non-current liabilities of discontinued operations on the condensed consolidated balance sheets. In addition, the Company had accrued approximately \$0.2 million for estimated interest and penalties on uncertain tax positions as of June 30, 2008 and 2007. The Company believes that it has adequately provided for any reasonably foreseeable resolution of any tax disputes, but will adjust its reserves in accordance with FIN 48 if events so dictate. To the extent that the ultimate results differ from the original or adjusted estimates of the Company, the effect will be recorded in the provision for income taxes.

### ***Loss from Discontinued Operations, net of taxes***

Losses from discontinued operations for the six months ended June 30, 2008 and 2007 were \$0.1 million. The losses are related to the shutdown and run-off of operations in Turkey, which began in May 2006, and in Italy, which began in December 2006. The Company completed the liquidation of its Turkish joint venture in October 2007. Unless otherwise indicated, amounts provided throughout this report relate to continuing operations only.

### ***Net Loss***

Net loss for the six months ended June 30, 2008 was \$12.6 million, or \$1.01 loss per basic and diluted share, compared to a net loss for the six months ended June 30, 2007 of \$11.0 million, or \$0.89 loss per basic and diluted share.

### ***Liquidity and Capital Resources***

The Company's outstanding debt consists of \$175.0 million of Senior Subordinated Notes due December 1, 2012 ( Subordinated Notes ), \$220.0 million of Senior Secured Floating Rate Notes due February 15, 2012 ( Senior Notes ) and a \$75.0 million Senior Secured Asset Based Revolving Credit Facility ( Revolver Loan ). The Subordinated Notes bear interest at a rate of 11.0% per annum. Interest on the Subordinated Notes is payable semi-annually on each December 1 and June 1. The Senior Notes bear interest at the rate of three-month LIBOR plus 3.375% per annum. Interest on the Senior Notes is reset and payable quarterly.

At June 30, 2008, there was \$220.0 million outstanding on the Senior Notes, \$175.0 million outstanding on the Subordinated Notes, \$23.8 million outstanding on the Revolver Loan, and \$6.1 million of letters of credit issued under the Revolver Loan.

The Revolver Loan imposes maximum capital expenditures of \$47.5 million in 2008 and 2009. These capital expenditure covenants allow for the carry forward of a certain amount of spending below covenant levels in previous periods. In 2007, Constar spent \$31.1 million in capital expenditures, allowing \$12.3 million to be carried over to 2008. The Company currently expects to spend between \$28 million and \$32 million in capital expenditures in 2008.

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Liquidity, defined as cash and availability under the Revolver Loan, is a key measure of the Company's ability to finance its operations. The principal determinant of 2008 liquidity will be 2008 financial performance. Liquidity at June 30, 2008 was \$43.7 million as compared to \$75.2 million at June 30, 2007.

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

Based on the terms and conditions of our debt obligations and our current operations and expectations for future growth, we believe that cash generated from operations, together with amounts available under our Revolver Loan, will be adequate to permit us to meet our current and expected operating requirements and capital investment, although no assurance can be given in this regard. The Company continually monitors its working capital and has programs in place to manage its investment in both accounts receivable and inventory.

The Company also monitors its capital spending and future capital requirements and may have the ability to reduce its projected cash requirements by entering into leases for equipment that would limit its initial cash outlay. It may also have the ability to delay specific capital investment.

The Company is negotiating a new cold fill supply contract with Pepsi and believes the economic terms and conditions have been settled. The new agreement with Pepsi will be at significantly lower volumes and with a mix shift towards fewer bottles and more preforms. In conjunction with this new contract, the Company expects to implement restructuring programs to reduce costs. Based upon the Company's current estimates, the Company believes that the new Pepsi cold fill agreement will result in lower sales but, after taking into account the expected net reduction in costs from restructuring programs and investments to restructure, would result in higher cash flows from operating activities, net of investing activities in 2009 and over the total term of the new agreement as compared to those realized from the Pepsi cold fill business in 2008. The Company's expectations regarding the renewal of this cold fill supply agreement are subject to several risks and assumptions, including without limitation, whether the contract is signed on terms consistent with the Company's current expectations; whether expected future volumes are realized; whether the future product mix is consistent with the Company's expectations; and whether the Company achieves the expected restructuring savings.

The credit markets have been volatile and are experiencing a shortage in overall liquidity. We have assessed the potential impact on various aspects of our operations, including, but not limited to, the continued availability and general creditworthiness of our debt and financial instrument counterparties, the impact of market developments on customers and insurers, and the general recoverability and realizability of certain financial instruments, including investments held under our defined benefit pension plans. To date, we have not identified a significant risk based on the aforementioned assessment. However, there can be no assurance that our business, liquidity, financial condition or results of operations will not be materially and adversely impacted in the future as a result of the existing or future credit market conditions.

**Table of Contents****Cash Flows**

The following table presents selected cash flow data.

<i>(dollars in millions)</i>	Six months ended June 30,		Increase (Decrease)
	2008	2007	
Net cash provided by (used in) operating activities	\$ (9.3)	\$ 7.2	\$ 16.5
Net cash used in investing activities	\$ (14.8)	\$ (17.1)	\$ (2.3)
Net cash provided by (used in) financing activities	\$ 23.3	\$ (0.4)	\$ 23.7

Net cash used in operations for the six months ended June 30, 2008 compared to the six months ended June 30, 2007, increased primarily due to a working capital increase of \$16.4 million. This working capital increase related primarily to a higher increase in the dollar amount of accounts receivable during the six months of 2008 than during the first six months of 2007 due to higher sales, the liquidation of assets in the first six months of 2007 related to discontinued operations and a source of cash in 2007 related to a prepaid asset.

Days sales in accounts receivable increased to approximately 33.3 days at June 30, 2008 from 31.7 days at June 30, 2007. The dollar impact of the increase in days sales outstanding was approximately \$4.5 million and is the result of a delay in payment related to a customer dispute (\$1.2 million), the timing of cash receipts at month end (\$1.0 million) and the impact of a receivable from a customer with longer payment terms (approximately \$2.0 million) at the end of June, 2008 compared to the end of June, 2007. The increase in sales, including foreign currency, in the second quarter of 2008 compared to the second quarter of 2007, contributed approximately \$1.4 million to the dollar increase in accounts receivable. We expect that the customer dispute will be resolved with the collection of the amount due during the third quarter. In early July, the company received approximately \$1.0 million related to amounts due on June 30, 2008. In addition, the Company improved payment terms with a customer that contributed to higher days sales outstanding at the end of June, 2008. Inventory days increased to approximately 32.2 days at June 30, 2008 from 25.7 days at June 30, 2007. The higher inventory supply is due to advanced purchases of resin inventory (\$6 million) during a period of rising resin prices and higher inventory levels to support expected sales increases. The additional supply of resin was used in July, 2008. The dollar amount of inventory also increased related to the higher cost of resin at the end of June, 2008 as compared to the same period last year. Days payable in accounts payable and accrued liabilities increased to 56.7 days at June 30, 2008 compared to 55.5 days at June 30, 2007 due to the timing of disbursements at quarter end and the advanced purchases of resin inventory. The dollar amount of accounts payable increased because of the higher price of resin at the end of June, 2008. Working capital is impacted by the normal timing of purchases to meet customer demand and the timing of payments to vendors that may vary from period to period and during the period and on a daily basis. For example, on July 2, 2008, we made a payment of approximately \$18.3 million to a vendor in the normal course of business; the company also received cash from customers on that date.

The decrease in net cash used in investing activities was due to a decrease in capital spending. Capital expenditures primarily related to custom projects.

Net cash provided by financing activities for the six months ended June 30, 2008 was comprised of net borrowings of \$23.3 million on the Revolver Loan. Net cash used in financing activities for the six months ended June 30, 2007 consisted of costs related to the amendment to the Revolver Loan.

**Commitments**

Information regarding the Company's contingent liabilities appears in Part I within Item 1 of this report under Note 10 to the accompanying Condensed Consolidated Financial Statements, which information is incorporated herein by reference.

**Stockholders' Deficit**

Stockholders' deficit increased to \$81.4 million at June 30, 2008 from \$72.3 million at December 31, 2007. This increase was primarily due to a net loss for the six months ended June 30, 2008 of \$12.5 million, which was partially offset by currency translation adjustments of \$1.4 million and pension and postretirement benefits amortization of \$1.4 million for the six months ended June 30, 2008.

**Recent Accounting Pronouncements**

In September 2006, the Financial Accounting Standards Board (the FASB ) issued SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ). SFAS 157 establishes a common definition for fair value to be applied to U.S. GAAP guidance requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. In February 2008, the FASB issued FASB Staff Position 157-2 ( FSP 157 ) which delays the effective date of

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SFAS 157 for one year for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). SFAS 157 and FSP 157 are effective for fiscal years beginning after November 15, 2007. The adoption of SFAS 157 did not have a material impact on the Company's results of operations or financial condition (see Note 17). The Company is assessing the impact of FAS 157 for nonfinancial assets and liabilities.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 permits entities to choose to measure certain financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company did not elect the fair value option under SFAS 159 for eligible items that existed as of January 1, 2008.

In March 2007, the FASB ratified Emerging Issues Task Force (EITF) Issue No. 06-10, *Accounting for Collateral Assignment Split-Dollar Life Insurance Agreements* (EITF 06-10). EITF 06-10 provides guidance for determining a liability for the postretirement benefit obligation as well as recognition and measurement of the associated asset on the basis of the terms of the collateral assignment agreement. EITF 06-10 is effective for fiscal years beginning after December 15, 2007. The adoption of EITF 06-10 did not have a material impact on the Company's results of operations or financial condition.

In September 2006, the FASB ratified the EITF consensus in EITF Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements* (EITF 06-4). EITF 06-4 indicates that an employer should recognize a liability for future post-employment benefits based on the substantive agreement with the employee. EITF 06-4 is effective for fiscal years beginning after December 15, 2007. The adoption of EITF 06-04 did not have a material impact on the Company's results of operations or financial condition.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (SFAS 141R). SFAS 141R provides revised guidance on how acquirors recognize and measure the consideration transferred, identifiable assets acquired, liabilities assumed, noncontrolling interests, and goodwill acquired in a business combination. In addition, SFAS 141R expands required disclosures surrounding the nature and financial effects of business combinations. SFAS 141R is effective for fiscal years beginning on or after December 15, 2008 with earlier adoption prohibited. The Company is currently assessing the impact of SFAS No. 141R on its consolidated financial statements, however the impact could be material for business combinations which may be consummated subsequent to the adoption of SFAS 141R.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51* (SFAS 160). SFAS 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 requires noncontrolling interests in subsidiaries initially to be measured at fair value and classified as a separate component of equity. SFAS 160 also requires a new presentation on the face of the consolidated financial statements to separately report the amounts attributable to controlling and non-controlling interests. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company is currently assessing the impact of SFAS 160 on its consolidated financial statements.

In September 2007, the FASB ratified EITF Issue No. 07-1, *Accounting for Collaborative Agreements* (EITF 07-1). EITF 07-1 defines collaborative agreements as contractual arrangements that involve a joint operating activity. These arrangements involve two (or more) parties who are both active participants in the activity and that are exposed to significant risks and rewards dependent on the commercial success of the activity. EITF 07-1 provides that a company should report the effects of adoption as a change in accounting principle through retrospective application to all periods and requires additional disclosures about a company's collaborative arrangements. EITF 07-1 is effective for fiscal years beginning after December 15, 2008. The Company does not expect the adoption of EITF 07-1 to have a material impact on its results of operations or financial condition.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* an amendment of FASB Statement No. 133 (SFAS 161). SFAS 161 expands the disclosure requirements of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), to include how and why an entity uses derivative instruments, the



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accounting treatment for derivative instruments and hedging activity under SFAS 133 and related guidance, and how derivative instruments and hedged items affect an entity's financial position, financial performance and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company will comply with the additional disclosure requirements upon adoption of SFAS No. 161.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. SFAS No. 162 identifies a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with GAAP. SFAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. This standard is not expected to have a material impact on the Company's results of operations or financial condition.

## **Forward-Looking Statements**

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

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

A discussion of important factors that could cause the actual results of operations or financial condition of the Company to differ from expectations has been set forth in the Company's Annual Report on Form 10-K for the year ended December 31, 2007 under the captions

Cautionary Statement Regarding Forward Looking Statements and Item 1.A Risk Factors and is incorporated herein by reference. Some of the factors are also discussed elsewhere in this Form 10-Q and have been or may be discussed from time to time in the Company's other filings with the Securities and Exchange Commission. In addition, the Company's expectations regarding the renewal of its Pepsi cold fill supply agreement are subject to several risks and assumptions, including without limitation, whether the contract is signed on terms consistent with the Company's current expectations; whether expected future volumes are realized; whether the future product mix is consistent with the Company's expectations; and whether the Company achieves the expected restructuring savings.

## **Item 4. Controls and Procedures**

### **Evaluation of Disclosure Controls and Procedures**

The Company maintains a system of disclosure controls and procedures for financial reporting to give reasonable assurance that information required to be disclosed in the Company's reports submitted under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. These controls and procedures also give reasonable assurance that information required to be disclosed in such reports is accumulated and communicated to management to allow timely decisions regarding required disclosures.

As of June 30, 2008, the Company's Chief Executive Officer (CEO) and Chief Financial Officer (CFO), together with management, conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures pursuant to Rules 13a-15(f) and 15d-15(f) of the Exchange Act. Based on that evaluation, the CEO and CFO concluded that these disclosure controls and procedures were not effective because of the material weakness described below.

A material weakness is a control deficiency, or combination of control deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.

As of June 30, 2008, our management concluded that we did not maintain effective controls over the restructuring reserve and related expense. Specifically, the controls over the evaluation of the sublease market conditions related to the implementation of SFAS No. 146 Accounting for

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Costs Associated with Exit and Disposal Activities as it applies to the closure of our Houston facility were not effective to ensure the completeness and accuracy of the restructuring reserve in accordance with generally accepted accounting principles. This control deficiency resulted in an audit adjustment to our preliminary interim consolidated financial statements for the quarter ended June 30, 2008. In addition, this control deficiency would have resulted in a misstatement the restructuring reserve and related expense that would have resulted in a material misstatement to our annual or interim consolidated financial statements that would not have been prevented or detected. Accordingly, we have determined that this control deficiency constitutes a material weakness. Notwithstanding this material weakness, we believe our unaudited quarterly consolidated financial statements included in this Quarterly Report on Form 10-Q fairly present in all material respects our financial position, results of operations and cash flows for the periods presented in accordance with generally accepted accounting principles.

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### **Changes in Internal Control Over Financial Reporting**

As previously disclosed, the Company's CEO and CFO concluded that the Company's disclosure controls and procedures were not effective as of December 31, 2007 as a result of a restatement surrounding certain property, plant and equipment acquired in 2003. Specifically, the Company did not have controls designed and operating effectively to ensure that property, plant and equipment capitalized in 2003 and prior years were capitalized on a timely basis in accordance with generally accepted accounting principles and that related depreciation expense was recorded associated with the Company's 2003 acquisition of certain property, plant and equipment acquired in 2003.

As a result of this finding management has designed and implemented controls to determine that property, plant and equipment capitalized as part of an acquisition are properly amortized or depreciated and that assets are capitalized, on a timely basis, in accordance with generally accepted accounting principles. The change in the Company's internal control over financial reporting described in the previous paragraph were implemented prior to the Company reporting its results for the quarter ended June 30, 2008.

There were no other changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the quarter ended June 30, 2008, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### **Remediation of Material Weakness**

To address the material weakness described above, we performed additional analysis on the restructuring reserve and related expense and recorded adjustments to the consolidated financial statement to correct the errors identified to ensure that the aforementioned accounts were prepared in accordance with generally accepted accounting principles.

Accordingly, management believes that the financial statements included in this report fairly present in all material respects the company's financial position, results of operations and cash flows for the periods presented.

To remediate the above described material weakness, the Company plans to implement the following:

Increase documentation supporting management's discussions with operations and conclusions reached relating to restructuring transactions

Provide training to subject matter experts involved in facility leasing such that they better understand the accounting related to restructuring

Establish a communication timeline between subject matter experts involved in facilities leasing and finance personnel as well as outside sources related to market conditions to ensure timely communication of changes in market conditions

We continue to monitor and assess our remediation activities to ensure that the material weakness discussed above is remediated as soon as practicable.

## **PART II Other Information**

### **Item 1. Legal Proceedings**

Information regarding legal proceedings involving the Company appears in Part I within Item 1 of this quarterly report under Note 10 to the Condensed Consolidated Financial Statements, which information is incorporated herein by reference.

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

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The Company is highly leveraged, has incurred net losses during the past three years and its main contract with Pepsi expires on December 31, 2008. In addition, the Company is exposed to risks, including but not limited to, interest rate fluctuations, the seasonal nature of its business and potential consolidation of customers. Liquidity will vary on a daily, monthly, and quarterly basis, as described below.

### ***The Company is highly leveraged.***

As of June 30, 2008, there were \$23.8 million of borrowings under the Revolver Loan as defined in Note 8, \$6.1 million outstanding under letters of credit and \$395.0 million in other debt. We had \$3.6 million of cash on our balance sheet, and we had the ability to borrow \$40.1 million under the Revolver Loan.

Our debt may have important negative consequences for us, such as:

limiting our ability to obtain additional financing;

limiting funds available to us because we must dedicate a substantial portion of our cash flow from operations to the payment of interest expense, thereby reducing the funds available to us for other purposes, including capital expenditures;

increasing our vulnerability to economic downturns and changing market and industry conditions; and

limiting our ability to compete with companies that are not as highly leveraged and that may be better positioned to withstand economic downturns.

We currently plan to finance ordinary business operations through borrowings under our Revolver Loan. Our ability to borrow funds under our the Revolver Loan is subject to our compliance with various covenants as of the date of borrowing, including borrowing base limitations that are dependent upon the future level of our eligible accounts receivable and inventory in the United States and the United Kingdom. Even if we are in compliance with all such covenants, the total amount of the facility may be unavailable if the value of the collateral securing the facility falls below certain levels, or if the administrative agent determines that eligibility reserves should be applied to the amount otherwise available under the facility. Certain of the components of the borrowing base are subject to the discretion of the administrative agent. In addition, the administrative agent has the customary ability to reduce, unilaterally, our borrowing availability at any time by, for example, establishing reserves or declaring certain collateral ineligible. The administrative agent placed a reserve of \$2.5 million against our borrowing base as of June 30, 2008 relating to the interest rate swap between the Company and the administrative agent due to the impact of lower interest rates and current volatility. We believe that this \$2.5 million reserve will not have a significant impact on our liquidity if the value of our borrowing base increases as expected over the next few months as we build inventory for the summer months. The value of this reserve will change over time. Certain of our inventory is located on properties that we lease and if we are unable to obtain consents from the landlords, such inventory may not be eligible for inclusion in the borrowing base, thereby reducing our borrowing availability. If we are unable to fully access the Revolver Loan, we may become illiquid and we may be unable to finance our ordinary business activities.

### ***Reliance on Pepsi and other customers.***

During the first six months of 2008 Pepsi accounted for approximately 36% of the Company's consolidated revenues, while the top ten customers accounted for an aggregate of approximately 69% of the Company's consolidated revenues. The loss or reduction of our business with any of these significant customers could have a material adverse impact on our net sales, profitability, and cash flows. A decline in cash flows may cause the carrying value of our assets to become unrecoverable and may result in a write-down or impairment of the Company's assets.

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Furthermore, Pepsi may terminate its supply agreements with us if we materially breach any of our obligations under the applicable agreement or if a third party acquires more than 20% (or 25% in the case of a specified third party) of our outstanding capital stock or United States-based PET assets. The loss of Pepsi as a customer would cause our net sales and profitability to decline significantly. Our cold fill supply agreement with Pepsi expires on December 31, 2008. In addition, notwithstanding Pepsi's commitment to purchase containers from us in certain geographic regions, Pepsi may purchase containers from a third party for such regions under several circumstances, including our failure to meet our supply obligations and our failure to meet specified contractual quality standards. The Company expects that customers, including Pepsi, will continue to take water and soft drink manufacturing in house where merchant suppliers' transportation costs are high and where large volume, low complexity and space for expansion exists.

The Company is negotiating a new cold fill supply contract with Pepsi and believes the economic terms and conditions have been settled. The new agreement with Pepsi will be at significantly lower volumes and with a mix shift towards fewer bottles and more preforms. In conjunction with this new contract, the Company expects to implement restructuring programs to reduce costs. Based upon the Company's current estimates, the Company believes that the new Pepsi cold fill agreement will result in lower sales but, after taking into account the expected net reduction in costs from restructuring programs and investments to restructure, would result in higher cash flows from operating activities, net of investing activities in 2009 and over the total term of the new agreement as compared to 2008. The Company's expectations regarding the renewal of this cold fill supply agreement are subject to several risks and assumptions, including without limitation, whether the contract is signed on terms consistent with the Company's current expectations; whether expected future volumes are realized; whether the future product mix is consistent with the Company's expectations; and whether the Company achieves the expected restructuring savings.

If an agreement is not reached, the loss of all Pepsi volume under this contract will have a material adverse effect on the Company, including the Company's ability to make principal and interest payments on its borrowings as they become due and to fund its operations. If the cold fill Pepsi contract is not renewed, the material adverse change would constitute a default under the Company's Revolver Loan and the payment of this debt could be accelerated. An acceleration of the Revolver Loan would permit the acceleration of the Secured Notes and the Subordinated Notes. Should such acceleration occur, the Company would have to seek other forms of financing. There can be no assurance that such financing would be available or that it would be available to the Company on satisfactory economic terms.

Although there has been no material change in the Company's relationship with its customers or suppliers, there can be no assurance that as the December 31, 2008 contract expiration for Pepsi approaches there would not be a change. Customers and suppliers may seek to change the terms of their economic relationship with the Company. If such a change is material, it could cause a strain on the Company's liquidity or eliminate its current liquidity and reduce its level of cash flow. Should such a change occur, the Company would have to seek other forms of financing and there can be assurance that such financing would be available or that it would be available to the Company on satisfactory economic terms.

Should the cold fill Pepsi contract not be renewed on satisfactory economic terms to the Company, the Company will need to review its infrastructure including its manufacturing footprint and the carrying value of its long-lived assets and may have to record an impairment charge on those assets.

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### ***The Company has had net losses in recent years.***

The Company incurred a net loss for the six months ended June 30, 2008 of \$12.5 million and for the fiscal years ended December 31, 2007 and 2006 we incurred net losses of \$26.3 million and \$10.3 million, respectively. Continuing net losses may limit our ability to service our debt and fund our operations and we may not generate net income in the future. Factors contributing to net losses in recent years included, but were not limited to, price competition and the implementation of price reductions to extend customer contracts; asset impairment charges; a write-off of deferred financing costs; restructuring costs; customer contract losses; delays in conversions to PET from other forms of packaging; a high proportion of conventional products in our product mix; customers shifting to self manufacturing of bottles; and operating difficulties in our European businesses. These and other factors may adversely affect our ability to generate profits in the future.

### ***Sales and profitability could be reduced if seasonal demand does not materialize.***

Unseasonably cool weather during a summer could reduce our sales and profitability. A significant portion of our revenue is attributable to the sale of beverage containers. Demand for beverages tends to peak during the summer months. In the past, significant changes in summer weather conditions have affected the demand for beverages, which in turn affects the demand for beverage containers manufactured by us.

As a result of the seasonal nature of our business, cash flow requirements are the greatest in the first several months of each fiscal year because of the increased working capital required to build inventory for the warmer months and because of lower levels of profitability associated with softer sales during the first few months of each fiscal year. A cool summer may have a significant impact on cash flow because of lower profitability and the impact on working capital.

### ***Customer consolidation may reduce sales and profitability.***

The consolidation of our customers may reduce our net sales and profitability. If one of our larger customers acquires one of our smaller customers, or if two of our customers merge, the combined customer's negotiating leverage with us may increase and our business with the combined customer may become less profitable. In addition, if one of our customers is acquired by a company that has a relationship with one of our competitors, we may lose that customer's business. The consolidation of purchasing power through buyer cooperatives or similar organizations may also harm our profitability.

### ***Company Plans***

Liquidity (defined as cash and availability under the Revolver Loan) is a key measure of the Company's ability to finance its operations. The main determinant of 2008 liquidity will be 2008 financial performance. Liquidity will be further influenced by:

the Company's 2008 operating results,

changes in working capital,

interest payments on the Company's debt,

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

the amount and timing of capital expenditures.

Liquidity will vary on a daily, monthly and quarterly basis based upon the seasonality of the Company's sales as well as the factors mentioned above. The Company's cash requirements are typically greater during the first and second quarters of each fiscal year because of the build up of inventory levels in anticipation of the seasonal sales increase during the warmer months and the collection cycle from customers following the higher seasonal sales. Based on the terms and conditions of our debt obligations and our current operations and expectations for future growth, subject to the risk factors identified above, we believe that cash generated from operations together with amounts available under our Revolver

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Loan will be adequate to permit us to meet our current and expected operating requirements and capital investment, although no assurance can be given in this regard.

The Company continually monitors its working capital and has programs in place to manage its investment in both accounts receivable and inventory. The Company also monitors its capital spending and future capital requirements and may have the ability to reduce its projected cash requirements by entering into leases for equipment that would limit its initial cash outlay. It may also have the ability to delay specific capital investments.

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2007, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing us. Additional risk and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or operating results.

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The Company's Annual Meeting of Stockholders was held on May 22, 2008. The matters voted upon and the results thereof are as follows:

	Votes	
	For	Withheld
<b>Election of Class III Directors</b>		
Michael D. McDaniel	8,361,178	431,194
Frank J. Mechura	8,352,985	439,387

Also at the meeting, 8,673,108 shares were voted in favor of the ratification of PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm for the year ending December 31, 2008, and 809 shares were voted against such proposal. Proxies filed by the holders of 118,455 shares at the 2008 Annual Meeting instructed the proxy holders to abstain from voting on such proposal.

**Item 6. Exhibits**

- 10.18a First Amendment to Employment Agreement between Constar International Inc. and Walter Sobon, dated June 4, 2008.
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of President and Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Executive Vice President and Chief Financial Officer Pursuant to U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.



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**SIGNATURES**

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

**Constar International Inc.**

Dated: August 14, 2008

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

**Executive Vice President and Chief Financial Officer**

**(duly authorized officer and principal accounting officer)**