SOLUTIA™

Applied Chemistry,
Creative Solutions™

FOCUSED ON VALUE

1997 ANNUAL REPORT

1997 Annual Report

Contents

About The Cover

With strong positions in a variety of markets, many of Solutia's products probably touch your life every day: *Skydrol* hydraulic fluids are the #1 choice of commercial aviation professionals around the world. Our *Wear-Dated* brand is one of North America's most recognized trademarks for carpet fibers and upholstery fabrics. We also make *Saflex* plastic interlayer – used in high-performance laminated glass for buildings, and automotive windshields and side windows.

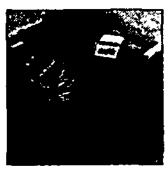
About Our Businesses

Solutia's portfolio includes ten business units. We compete in three broad segments.

Fibers Segment

***Acrilan* Acrylic Fibers.** We are North America's largest producer of acrylic fiber, which is used to make finished products such as apparel, craft yarns, upholstery fabrics, and brake fibers.

Carpet Fibers. We are the world's largest producer of nylon staple fiber and a major supplier of nylon BCF used to make carpeting and rugs under the *Wear-Dated* and *Ultron* VIP brands.



Nylon Industrial Fibers. We produce industrial-strength nylon fibers, which customers use to make finished products such as dental floss, cargo slings, auto airbags and tire cords.

Chemicals Segment

Industrial Products. We are a leading manufacturer of high performance specialty industrial fluids, including *Skydrol* hydraulic fluids for aviation, *Therminol* heat transfer fluids, and *Dequest* water treatment chemicals.

Intermediates. We manufacture more than three dozen "building block" chemicals that serve as feedstocks for our various manufacturing processes, or are sold to external customers on the merchant market.

Phosphorus Derivatives. We are a world leader in developing applications for phosphorus chemistry, including ingredients used in foods and beverages, personal care products and industrial cleaners.

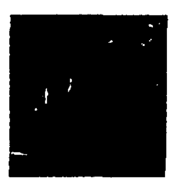
Polymers and Resins Segment

Nylon Plastics & Polymers. We manufacture nylon 6,6 resin for the engineering thermoplastic and polymer merchant markets, where our products add performance characteristics to finished goods.

Polymer Modifiers. We manufacture a line of polymer modifiers and specialty plasticizers that help improve the performance of flooring products, sealants, caulks, adhesives and other finished goods.

Resins. Our line of specialty resins covers a broad range of products such as crosslinkers, flow modifiers, pressure sensitive adhesives, paper surface size, and plastic products.

***Saflex* Plastic Interlayer.** We are the world's leading producer of polyvinyl butyral, a plastic interlayer used to make laminated glass for automotive and architectural applications.



SOLUTIA

Applied Chemistry, Creative Solutions

1997 Financial Highlights

(Dollars in millions, except per share)

	Unaudited Pro Forma[1]		Historical	
	1997	1996	1997	1996
Net Sales	$2,960	$2,962	$ 2,969	$2,977
Net Income[2]	$ 157	$ 17	$ 192	$ 32
Per Share, assuming dilution:				
Net Income[3]	$ 1.27	$ 0.14	$ 1.55	$ 0.27
Dividends[4]	–	–	$ 0.01	–
Depreciation and Amortization	$ 142	$ 166	$ 142	$ 166
Capital Expenditures	–	–	$ 165	$ 192
Percent of Total Debt to Total Capitalization	–	–	120%	–
Number of Registered Stockholders (year-end)	–	–	57,894	–
Share Outstanding (year-end, thousands)	–	–	117,408	–
Employees (year-end)	–	–	8,800	–

[1] The unaudited pro forma financial information gives effect to the spinoff and Solutia's 1997 debt offering as if the spinoff and the offering had occurred as of the beginning of the periods presented. The pro forma information is presented for illustrative purposes only and may not be indicative of the results that would have been obtained had the transactions actually occurred on the date assumed, nor is it necessarily indicative of future consolidated results of operations.

[2] Net income includes charges for changes in estimates for environmental liabilities of $46 million, or $0.37 per share, and other net unusual items of $7 million, or $0.06 per share, in 1997 and $164 million, or $1.37 per share, of restructuring charges in 1996.

[3] For periods ended prior to the spinoff, the number of Monsanto weighted average shares outstanding and common share equivalents were adjusted for the distribution ratio in the spinoff of one share of Solutia's common stock for every five shares of Monsanto common stock.

[4] Because Solutia was not formed as an independent public company until September 1, 1997, only one quarterly dividend was paid in 1997.

About Your Stake In Solutia

Solutia Inc. (NYSE: SOI) is one of the newest names in the stock market, but we are a company built on almost a century of success. Formerly the applied chemistry businesses of Monsanto Company, Solutia became an independent, publicly traded enterprise on September 1, 1997, as the result of the spinoff of those businesses by Monsanto. Shareholders received one share of Solutia stock for every five shares of Monsanto common stock they owned on August 20, 1997, the record date for the spinoff.*

Why was Solutia spun off from Monsanto? The primary reason was to create shareholder value. In 1996, Monsanto's Board of Directors determined that its life sciences and applied chemistry businesses would have the best opportunities to achieve their potential if they were managed as two separate enterprises. Monsanto's Board considered several alternatives, including the sale of the applied chemistry businesses to other companies, asset swaps, mergers, and other options. In the end, the Board chose a spinoff as the best way to generate long-term value for shareowners, as well as to serve the best interests of our customers and our employees.

In Solutia's case, independence means that we have the chance to optimize the performance of ten strong, technology-based business units serving three attractive segments – Chemicals, Fibers, and Polymers & Resins. Our portfolio consists of proven performers. All of Solutia's businesses meet a specific profile:

- Leading technology and/or cost position
- Strong share of the served market
- Experienced management
- A solutions-driven relationship with customers.

Solutia starts out, then, on a solid foundation. We are a new company, but we have strengths few start-up enterprises can match. Our vision – our commitment – is to make these good businesses even better. In the process, we intend to meet expectations for growth in the value of Solutia's stock.

* Stock certificates were not issued to shareholders unless specifically requested; instead, the new shares were distributed through a book entry system. Under this system, your ownership of shares is listed in records maintained by our stock transfer agent, First Chicago Trust Company of New York. For more information on how to contact First Chicago, please see Shareholder Information inside the back cover of this report.

SAR 0003

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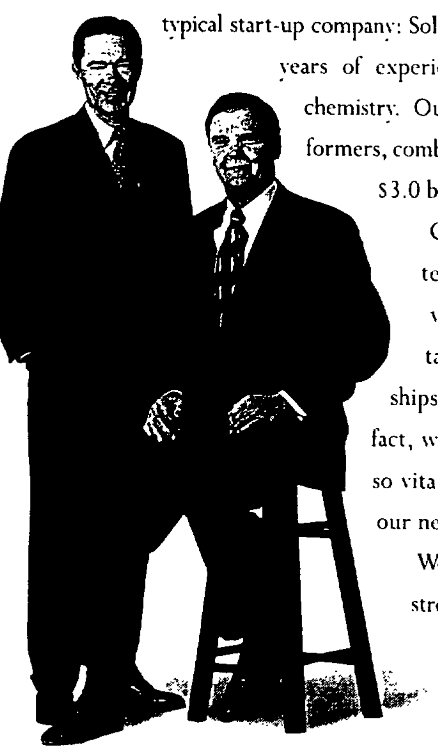
To Our Shareholders

September 1, 1997, was independence day for Solutia – the first official day in business for a strong, established competitor in attractive markets. It was a day worth celebrating for Solutia's leadership team and our 8,800 employees worldwide. Why? Because we now have the chance to spread our wings.

We are running successful businesses we know very well, but our entire outlook has changed. As an independent company, we are no longer simply generating cash for investment in other portions of a corporate portfolio. We have been given the opportunity to create value for shareowners in our own right.

We are focused on growth of earnings per share, cash flow generation, and stock price appreciation.

Solutia's people feel energized by this challenge, and with good reason. We are an odds-on favorite to succeed. After all, we are not a typical start-up company: Solutia draws on 96 years of experience in applied chemistry. Our businesses, all proven performers, combined to produce approximately $3.0 billion in sales in 1997.



Solutia Chairman and CEO Robert G. Potter (left), and President and Chief Operating Officer John C. Hunter III

Clearly, we have products and technologies that customers want and need. Just as important, we have strong relationships in every market we serve. In fact, we consider those relationships so vital that we paid them tribute in our new name.

We start out, then, with enviable strengths. That's not an accident. Over the past decade, we've made disciplined management decisions to exit underperforming product lines and to build our portfolio around profitable, market-leading businesses. We expect to carry this approach forward as an independent company because we think it's the best way for Solutia to produce consistent increases in our stock price over time.

In this letter, we will explain our targets and plans in more detail, including a look at our five priorities for the path forward. But first, let's review Solutia's 1997 financial results.

Financial Performance. Solutia produced strong financial results in 1997 as it began its operations as an independent company. The improved operations were primarily attributed to significant cost reductions. The combination of improved operating results and improved working capital management resulted in very strong cash flow subsequent to the spinoff.

This solid 1997 performance is all the more remarkable given the circumstances under which it was achieved. Despite the very real distractions of the spinoff, our people didn't miss a beat in 1997. We kept our businesses humming, kept our customers happy, and kept profits growing – even as we went about the considerable task of creating a new independent company.

Two elements of our financial performance are particularly noteworthy: the progress we made in strengthening our balance sheet, and our EPS performance.

With regard to the balance sheet, Solutia faced a challenge at the time of the spinoff. In exchange for our independence, we took on more than $1 billion in debt and over $1 billion in liabilities for postretirement benefits from Monsanto Company, resulting in negative equity of $139 million.

This opening position made one thing crystal clear: Solutia would have to earn the right to succeed by rigorously focusing on cash flow. We made substantial progress early, generating enough cash to pay off approximately $240 million of debt by year's end.

SAR 0004

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EPS performance was another bright spot, once we put our hands on the steering wheel. Our target is to generate at least 10 percent compound annual growth in EPS. It's a demanding goal, but we're determined to make it happen.

How will we get there? Our strategy is grounded in a handful of priorities that drive everything we do.

The Path Forward. At the top of the list is meeting customer commitments. One of the reasons Solutia's businesses have been successful is that we're very good at giving customers exactly what they need. We usually hit our target – whether it's performance, quality, delivery, technical support, price or whatever other measure is important to customers.

Another priority is to meet financial expectations consistently. It's an advantage here to be running well-established businesses. We know what level of sales and income they're capable of producing, so we can – and will – manage them with an eye toward controlling costs and maximizing cash flow. In addition, as in the past, we'll actively manage the portfolio to ensure that we participate only in markets and product areas where we can reasonably expect to exercise leadership and capture value for our shareowners.

The third part of our strategy is to deliver profitable long-term growth. The key word here is profitable. We have no interest in speculative, blue-sky products or projects. Our development efforts will be focused on answering identified market needs, and on securing cost reductions that enhance our ability to compete long term.

What's more, we will be pragmatic about investing in growth. We don't have to own the technology or make all the cash investments ourselves. As you'll learn later in this report, we are taking a creative approach to launching several capital projects that promise attractive returns. In the process, Solutia is building a reputation as a willing deal maker. We are not bound by tradition. Our industry peers are learning that we will consider almost any opportunity that demonstrably adds to shareowner value, whether it's an alliance, a joint venture, or a marketing partnership.

What makes Solutia different? Our strengths include a proven portfolio of businesses, the discipline to manage them for consistent profits and cash flow, and a keen eye for partnerships that add value to the enterprise.

The fourth key element of our strategy is to engage the full potential of our people. With the spinoff, we put an organization in place designed to do just that. Our ten market-focused business units are served by a centralized staff, which increases efficiency and allows us to mobilize people quickly around emerging opportunities.

We are also using our newly found independence as a chance to rethink and reengineer our basic business processes. A major initiative, called WWOF (for Worldwide Operations and Finance), is now under way to change how work gets done across Solutia. It will integrate procurement, order entry, manufacturing, shipping, and billing. This initiative, supported by software licensed from SAP AG, will dramatically improve the efficiency of our operations, even as it supports our final separation from Monsanto and addresses most of the company's "Year 2000" computer issues.

Along with the new structures and systems we've put in place, we are engaging Solutia's people by rewarding superior performance with a healthy measure of variable compensation. And at every level of the company, employees achieve their greatest earning potential only when Solutia hits aggressive annual targets for both cash flow generation and EPS growth.

Our fifth priority is to operate responsibly. This is really nothing new for the people of Solutia. We have a long track record of doing the right thing, not only in terms of running safe plants and respecting the environment, but also when it

To Our Shareholders (continued)

comes to drawing on people with diverse backgrounds and experience, and supporting the communities where we work. Our commitments in all of these areas will continue.

Taken together, these five priorities should help explain what Solutia is all about. We hope they also show you what makes us different from our peers, and what sets Solutia apart as an investment opportunity.

Dividend Policy. The Board of Directors declared a quarterly dividend of one cent per share. This very modest dividend policy was implemented so that Solutia stock could be held by funds and institutions that consider dividends a prerequisite for investment.

For the foreseeable future, our intention is to use stock repurchases as the primary vehicle for returning cash to shareholders. This approach will give Solutia the maximum flexibility in managing our cash flow to satisfy our debt obligations, to make future investments and to reward our owners. The Board has set a target of returning up to 35 percent of net income to shareholders through the combination of dividends and stock buy-backs. We delivered on that commitment in 1997, and turned in a performance which saw our market capitalization grow from $2.3 billion on September 1, 1997, to $3.1 billion on December 31, 1997.

A Look Ahead. Heading into our first full year as an independent enterprise, we are determined and confident – determined to compete and win in the marketplace; confident that we have the people, the portfolio and the plan we need to succeed. For all of us who work here, this new company is the opportunity of a lifetime. We're already hard at work, turning Solutia's bright potential into solid and continuing increases in the value of your investment.

Robert G. Potter
Chairman and Chief
Executive Officer

John C. Hunter III
President and Chief Operating Officer

A New Name. A World of Possibilities.

Selecting a new name and logo was one of our first important decisions as an independent company. We wanted our corporate identity to communicate concisely what the company is all about: Transforming the ordinary into the indispensable through chemistry.

We chose the name Solutia because it says a lot about the way we think and work. It tells you we're in business to solve problems for our customers –a commitment amplified by our tagline: *"Applied Chemistry, Creative Solutions."*

SOLUTIA
Applied Chemistry, Creative Solutions™

Our new logo surrounds the name with a shape that suggests both a molecule and the infinity symbol, emphasizing our strong foundation in applied chemistry and our forward-looking approach to new opportunities.

Although our corporate name is new, Solutia still owns many well-recognized trademarks, including *Wear-Dated* fiber for upholstery and residential carpets, *Saflex* plastic interlayer for automotive windshields and laminated architectural glass, *Acrilan* acrylic fiber for apparel, upholstery and craft yarns, and dozens of other well-respected brand names in industrial markets such as food processing, aviation, plastics manufacturing, construction materials, and personal care products.

A New Beginning... A Clear Path Forward

Solutia has many advantages over most start-up companies, not the least of which is a track record of success stretching back almost a century. We are proud of our past. At the same time, we embrace independence, and the chance it gives us to build something new. That spirit of purpose is captured in Solutia's mission and corporate priorities.

We will increase shareowner value by applying our knowledge of chemistry to provide creative solutions for our customers. We will accomplish this by:

1. Meeting customer commitments.

2. Meeting financial expectations.

3. Delivering long-term, profitable growth.

4. Engaging our people, and rewarding them.

5. Being a responsible company.

Throughout 1997, we made significant progress on all five counts. In this report, we'll review the highlights of our performance.

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Meeting Customer Commitments

New Products. Aggressive Marketing Strategies. Successful Partnerships. All Strengthen Solutia's Links To Its Customers.

There are good reasons why Solutia ranks #1 or #2 in sales to most of our targeted markets. We make and sell quality products. We consistently meet our customers' expectations for delivery and service. And we back up the products we sell with expert technical support that helps to give customers a competitive edge in the marketplace. In short, we're good at adding value to each customer's business.

It's a relatively simple formula for success – and we carried it out well in 1997, despite the distractions of the spinoff. Our businesses and manufacturing processes ran at high utilization rates throughout the year. We met our commitments on product quality and delivery, even as we went about the considerable task of splitting assets and systems, changing or inventing new work routines, and preparing for our future as an independent company.

An improved *Saflex* product solves manufacturing problems for customers; creates new markets for laminated glass.

A Commitment To Growth. Beyond hitting operating targets, one of Solutia's most important customer commitments is to provide technology, products, and marketing strategies that generate new sales. A case in point: Our *Saflex* business, where we developed a reformulated product to enhance performance and where we helped to create two promising new markets for laminated glass.

Saflex is Solutia's brand name for polyvinyl butyral (PVB), a plastic interlayer that adds safety, security, solar and sound control features to glass for applications such as automotive windows and architectural glazing. In recent years, our customers have introduced new manufacturing processes for laminated glass, developing techniques such as vacuum bag systems to remove air between the glass and PVB layers. (The traditional process uses nip-rollers to squeeze air out during lamination.)

Solutia helps customers develop a market for windows in homes and offices that offer hurricane protection.

New laminating techniques are important to our customers because they reduce manufacturing costs, and permit new shapes or bends in the finished glass product. Although our existing PVB interlayer worked well with the nip-roll process, it was less effective when used with the vacuum laminating processes. To improve our product's performance, Solutia in 1997 introduced, and began to commercialize, *Saflex IIIG*. The new product offers an improved chemical formulation, which enhances lamination processing and laminate long-term stability.

Saflex IIIG doesn't just solve process problems for customers. It also improves the performance of the laminated glass, offering greater edge stability, improved moisture insensitivity, and reduced delamination. As a result, *Saflex IIIG* makes it possible for glass laminators to offer automakers new "exposed-edge" products, such as flush-mounted windshields and laminated side windows.

Along with new products, Solutia is also working to develop new markets for laminated glass. In the United Kingdom, for example, we teamed up with law enforcement agencies and the insurance industry to establish a security standard for auto side and rear windows. In the United States, we are

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Laminated glass windows with *Saflex* minimize the potential for hurricane damage while eliminating the need for storm shutters on this residence in Florida. Solutia's support has led to building codes that are helping to drive sales of windows in coastal regions that offer hurricane protection.

working with federal safety officials to set rules for auto windows that would reduce passenger ejections during accidents.

SAR 0009

We are also helping our customers market the new auto window products directly to automakers. These efforts are starting to pay off: Car models such as the Audi A8, the BMW 750iL and the Mercedes 500 Series now offer laminated side and rear glass. Other major manufacturers are testing production models that feature laminated side and rear glass. Typically, such applications can triple the amount of laminated glass installed in each vehicle.

Hurricane Protection. In the architectural market, Solutia is playing a key role in creating demand for laminated glass as a way to minimize hurricane damage. Windows in homes and offices are usually the weak link during fierce storms. They can be penetrated by flying debris, allowing wind to rush in and

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Meeting Customer Commitments (continued)

pressurize the structure, leading to catastrophic failure of the roof and walls.

Windows laminated with PVB offer an excellent first line of defense. The glass may be broken by debris, but the interlayer remains intact – preventing the in-rush of damaging winds. In the wake of Hurricane Andrew, we began working with officials in South Florida to make window protection a requirement in new construction.

Improved dyeing technologies lead to exciting opportunities for commercial carpet fibers.

This effort has led to new building code provisions in Dade County, Broward County, Monroe County and Palm Beach in Florida that mandate protection in the form of shutters, precut 3/4 inch plywood sheets or laminated glass. Of the available protection devices, laminated glass windows are quickly becoming the preferred option, for obvious reasons: They are more attractive, more cost-effective, and require no storage or emergency installation.

Other hurricane-threatened areas of the country are learning from South Florida's experience. New laws in Texas, Hawaii and New York require insurance companies to provide premium discounts for homes and buildings equipped with laminated glass windows. As we continue to encourage such legislation in other at-risk regions, Solutia is providing technical and marketing support to help window manufacturers introduce products that satisfy this newly emerging demand.

Adding Vibrancy To The Carpet Market. Our customer commitment created new opportunities in the carpet fibers business, too. In 1997, we enhanced one dyeing technology and introduced another to help commercial carpet makers reap additional sales.

Solutia significantly expanded the color palette for our line of solution-dyed nylon fibers. With this product line, pigments are integrated into (rather than applied onto) the carpet yarns, so that the colors stand up to cleaning agents, ultraviolet light, and other perils in offices, hotels and similar settings. Solutia now markets the industry's widest range of solution-dyed nylon fibers for contract carpet makers – 116 different colors in all. We also support the product line with customer-pleasing extras, such as a quick-ship program that guarantees five-day availability on the most popular hues. At a major trade show in 1997, Solutia won orders for solution-dyed fibers that will be used to make 70 new grades of commercial carpet – our best year ever in the contract carpet market.

The year's other big news in carpet fibers is a revolutionary dyeing technique which we're calling *Dyenamix*. This new technology offers two key advantages for carpet makers: cleaner, more vibrant colors, and compatibility with our customers' new continuous dye range processes. These new techniques are more efficient and produce more consistent colors than the batch dyeing processes they replace. Two major customers – Milliken and Interface Group – have already announced new carpet product lines based on our *Dyenamix* technology.

A *Therminol* joint venture in China ensures responsiveness – and profitable sales – to global customers.

Turning Knowledge Into Profits. Strong customer relationships are critical to other parts of our business, as well. For example, chemical manufacturers know that we provide world-class customer support for our *Therminol* brand of heat transfer fluids – and this reputation has created attractive opportunities for us in the People's Republic of China.

Solutia is a world leader in liquid-phase heat transfer fluid systems. (Liquid-phase technology offers chemical manufacturers cost, efficiency and safety advantages over vapor-phase systems, which must be operated under pressure.) Several years

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Solutia offers the industry's widest range of solution-dyed nylon fibers for commercial carpets – providing an extraordinary color palette for interior designers to use in accenting offices, hotels and other buildings. New colors and dyeing techniques helped make 1997 our best year ever in contract carpets.

ago, we used our strong background in liquid-phase technology to help forge a partnership with Jiangsu Chemical Pesticide Group, the leading vapor-phase heat transfer fluid producer in China.

Today, Solutia and Jiangsu own and operate a highly successful joint venture in Suzhou. The joint venture was profitable in 1996, its first full year of operation, and increased its profitability in 1997. In addition, its sales are growing significantly faster than the market overall, thanks both to the performance of our *Therminol* products and to the engineering support we provide to our global customers who are designing and building process manufacturing plants in Asia.

Meeting Financial Expectations

We Are Ahead Of Schedule In Improving Our Post-Spinoff Financial Condition And In Returning Value To Shareholders.

At the time of our spinoff from Monsanto Company, we faced some significant financial challenges: Solutia took on about $1 billion of debt; we assumed about $1 billion in postretirement medical, insurance, and pension liabilities; and we started out in a negative equity position.

Despite the obvious hurdles imposed by our balance sheet, it has proven to be something of a tonic as well: Right from the start, we have had to focus on producing cash. We've communicated that message throughout the Solutia organization, and it's had an immediate impact.

Reducing Debt. By the end of 1997, Solutia had reduced its debt burden to about $790 million, reaching the level many observers did not expect us to achieve for several years.

Debt reduction is ahead of expectations, significantly strengthening Solutia's balance sheet.

This rapid progress was made possible by strong results from business operations and by improvements in Solutia's cash management worldwide. Solutia employees clearly understand the critical role they play in ensuring the company's long-term success, and they're acting accordingly. They are treating Solutia's cash as if it were their own.

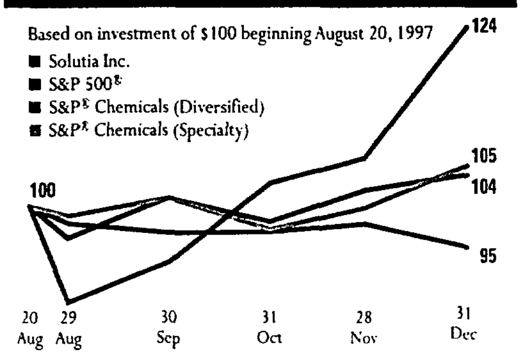
Trimming Costs. The company's cost-reduction initiatives are contributing to the overall improvement in our financial condition, too. By the year 2000, we expect to cut $200 million annually (in pretax dollars) from Solutia's total expenses, through a combination of business enhancements, process improvements, and staff reductions.

The savings won't come all at once. The first phase of our cost-reduction effort (including most of the expected staff cuts) began in 1997, with the full benefit to be reflected by 1999. The second phase, which involves capital projects to expand capacity, implement new process technologies and reduce manufacturing costs, will produce cost-saving benefits beginning in the year 2000. In the interim, Solutia will incur project expenses associated with those new capital projects required to produce the expected cost benefits.

Cost-cutting initiatives are expected to trim $200 million in ongoing expenses by 2000.

Returning Value. It's important to note that we haven't focused exclusively on debt reduction and cost savings. Solutia also made significant headway in returning cash to shareholders during 1997. In October, the company's Board of Directors announced that share repurchases would be the primary vehicle for rewarding the owners of Solutia stock. After only four months of existence, Solutia has repurchased approximately 1.4 million shares of common stock under this share repurchase program. In addition, Solutia paid its first dividend in December of 1997.

Total Return To Shareholders



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Delivering Profitable Growth

Solutia Is Finding Creative Ways To Invest In The Future Of Our Businesses And Compete Effectively In Attractive Growth Markets.

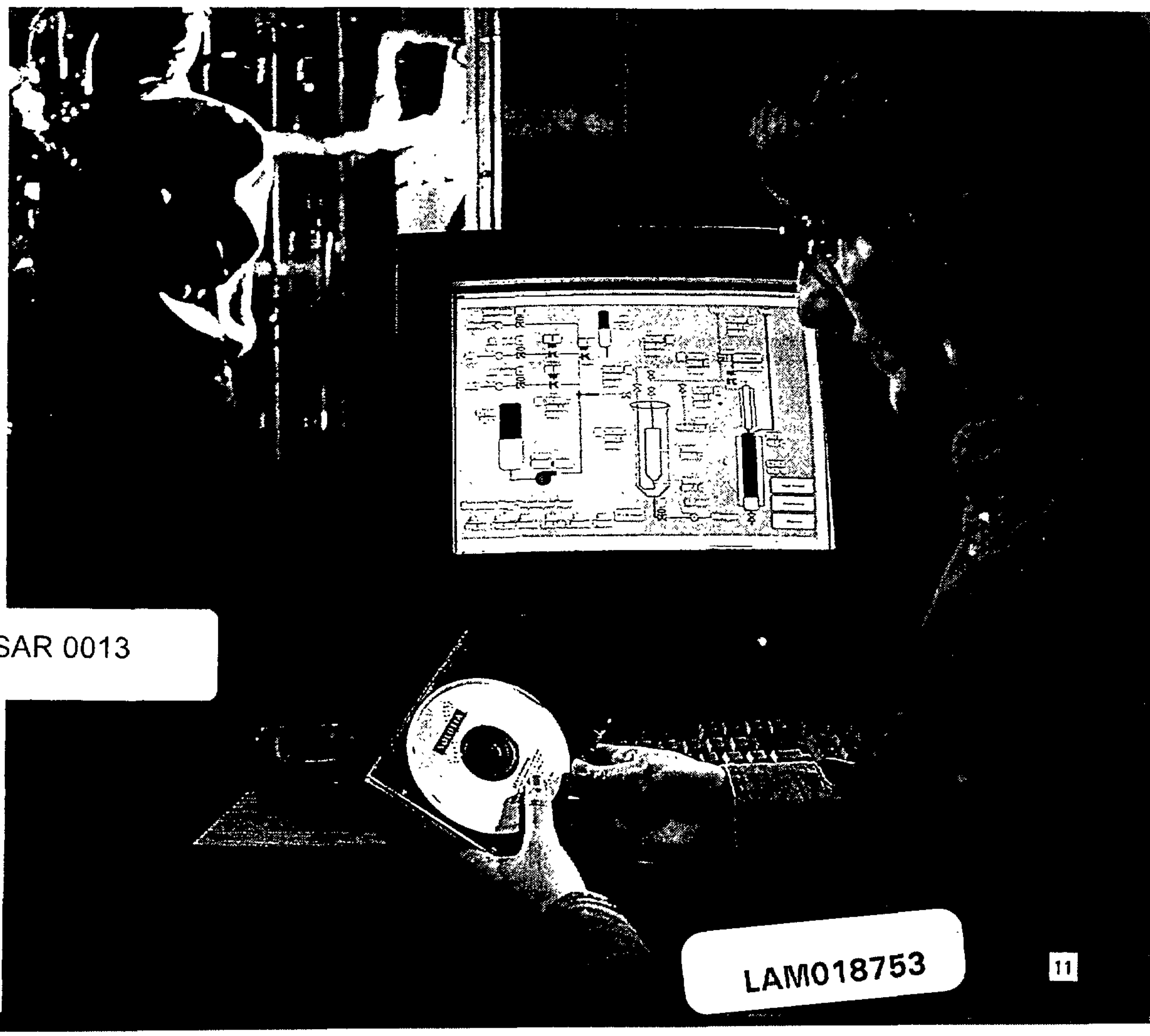
Profitable growth is essential to the long-term health of any business. For Solutia, the problem isn't finding attractive new markets to enter, or new technologies to pursue. Rather, our challenge is to invest in profitable growth while continuing to meet our considerable financial obligations and commitments.

It's a challenge we met with extraordinary success in 1997. During the year, we developed or launched two major projects that promise to provide attractive growth opportunities for Solutia well into the next century. In each case, we laid the foundation for profitable growth by finding practical, and often creative, ways to invest in our businesses.

Nylon Industrial Fiber Plant Expansion. This past July, Solutia brought a new industrial nylon fiber production unit on stream at our plant in Greenwood, South Carolina. The new unit was needed to bring Solutia's spinning technology up to world-class standards, so that our high-tenacity nylon industrial yarns could be sold into high-growth markets such as automotive air bags.

We had two choices in planning this expansion to keep our business competitive: We could invest time, money and expertise to develop our own state-of-

A revolutionary manufacturing process produces phenol (a key feedstock) with less waste and less environmental impact than the prior technology. Solutia has demonstrated a pilot scale version of the new process at our Pensacola plant.



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Delivering Profitable Growth (continued)

the-art spinning technology; or we could license a world-class technology, and get into the business sooner, with far less capital outlay. We chose the licensing option, purchasing technology rights from Toray Industries, the largest and most successful fiber producer in Japan.

The unit started up flawlessly, less than one year after we broke ground on the project. It's now producing approximately 20 million pounds of additional fibers annually, targeting the most attractive segments of the industrial nylon market.

Phenol Production Technology. In December, Solutia's Board agreed that we should actively seek a partner for a project to commercialize a revolutionary process for manufacturing phenol, a chemical intermediate that we will use as a feedstock for our various nylon businesses.

The new phenol technology promises to drive significant raw material cost reductions for all of Solutia's nylon businesses. But this groundbreaking technology is noteworthy on a number of other counts, as well. The new one-step process is environmentally friendly, producing only minor quantities of aqueous wastes, and no acetone by-product – both improvements over the two-step processes used by other phenol manufacturers. Best of all, the new process is highly efficient, providing a 98 percent yield, compared with the 93 percent yield from traditional two-step phenol manufacturing techniques.

Solutia finds creative ways to invest in projects that will lead to increased sales and profits.

The new phenol technology is based on catalyst research done at the Boreskov Institute of Catalysis in Russia. Solutia now owns the worldwide rights outside of the former Soviet Union, and we've applied for patents on the elements of the process we developed internally.

As an added benefit, the new phenol process will let us put a waste stream to work. It uses nitrous oxide, which is produced as a by-product from our adipic acid process. We now incinerate this stream in order to avoid releasing it to the atmosphere.

Licensed technology positions us to compete in high-growth industrial nylon fibers markets.

Solutia's board of directors has approved an investment to commercialize the one-step phenol process. In addition, we have reached an agreement in principle with a partner who will provide upfront payments that will be used to partially fund the cost of construction and start-up. In return, the partner will have the right to purchase phenol from Solutia at a beneficial price under a long-term contract. We expect to bring the new phenol process on-stream during the second half of 2001.

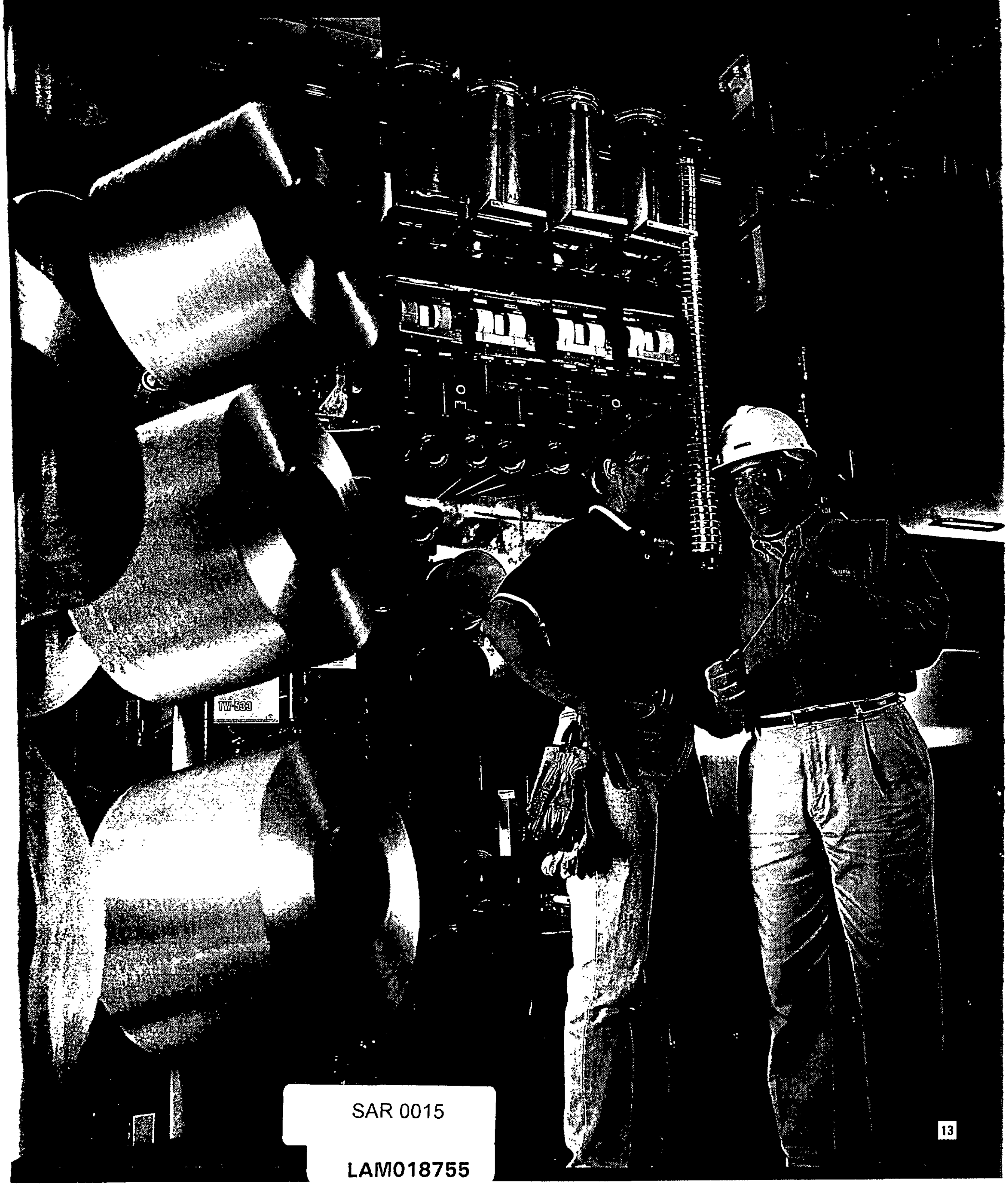
Acrylonitrile Plant Expansion. Solutia ranks as the world's leading consumer of acrylonitrile (AN), a major feedstock used to make nylon carpet fibers, acrylic fibers, nylon industrial fibers, and other products. Currently, about half the AN we need is manufactured at our plant in Chocolate Bayou, Texas. The remainder is purchased.

In 1997, we finalized plans for a project to double our AN production capacity. The project will significantly reduce our cost to acquire this key feedstock by allowing us to produce the vast majority of our AN requirements internally. We will break ground on the project in the second quarter of 1998, with the new AN unit coming on stream by mid-year 2000.

To partially fund the cost of construction and start-up, we are securing up-front payments from several customers in return for long-term supply contracts. Novus International Inc. has agreed to provide an advance payment for a by-product of the AN process, which they use to make a feed ingredient for poultry. Two other customers will purchase a portion of the actual AN volume: Bayer Corp., for their ABS plastics business, and a leading Japanese chemical company, for sale into the merchant market.

SAR 0014

To address fast-growing market opportunities, Solutia licensed a new nylon spinning technology from Japan's Toray Industries. Licensed technology minimizes our capital requirements, while allowing us to produce fibers that meet specifications for products such as automotive air bags.



Engaging Our People

We're Winning In The Marketplace, Thanks To An Efficient Enterprise Design, World-Class Work Processes, And Targeted Incentives.

One of our key opportunities in 1997 was to design an organization that would be well-equipped to compete and win in our target markets. The goal was simple: to build a Solutia that could draw on knowledge and experience from across the enterprise, and that would operate as efficiently as possible.

We did it by organizing our new company around ten business units – all served by a single, shared headquarters staff. As a result, we don't have any resource-wasting duplication inside Solutia. Instead, our energy and attention are focused on winning in the marketplace – winning as a single, successful enterprise.

We've rebuilt our organization to emphasize speed, efficiency and innovation.

Solutia's new Commercial Development organization provides a good illustration of how a market-focused structure will add value as we move ahead. Commercial Development combines a number of technology and marketing functions into a new, enterprise-level team.

Before, all our technology and marketing people were located in different business units, with relatively little opportunity for interaction. Today, these key employees are networked through Commercial Development, where they can draw on each others' expertise and share best practices more effectively.

The new organization has already dramatically improved the company's ability to coordinate and prioritize growth activities. All Solutia businesses are now using the same process to analyze growth projects. The projects that receive development funding are reviewed regularly to determine whether they're hitting expected benchmarks. If a particular project misses the mark, then we move on, shifting development resources to other opportunities. There's no shortage of good ideas at Solutia: At year's end, we had several hundred growth projects at various stages of incubation, assessment or commercialization.

World-Class Business Processes. In addition to launching Solutia with a lean, market-focused management structure, we are also using the spinoff as an opportunity to rethink and redesign our basic business processes. Internally, this initiative is called WWOF, or Worldwide Operations and Finance. It amounts to a complete overhaul of the company's supply chain and business processes, covering everything from procurement and production systems to sales, customer service, and accounting.

Today, such functions are handled differently at just about every Solutia site, a legacy of the hundreds of different computer systems that were installed or acquired over the past several decades. With the rollout of WWOF, Solutia will move to a single, integrated business system at all of our plants and offices worldwide. Four manufacturing plants and several Solutia business units have already converted to the new system. Our target is to have WWOF implemented at all sites worldwide by 1999.

Our business process re-engineering initiative will integrate plants and offices worldwide.

A New Spirit. The spinoff, and the changes we're making in the way we do business, have had an extraordinary effect on the people who work at Solutia. It's not an exaggeration to say that a new, more entrepreneurial culture took root over the

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As part of Operation Independence, Solutia uses business maps to educate employees about critical issues. Maps help employees understand how their decisions affect cash flow and other value drivers. One result: Employees have found ways to significantly reduce working capital since the spinoff.

course of 1997. For proof, just consider how we've generated cash, allowing us to accelerate our debt repayment schedule.

Solutia's people act as if they own the business because, in a sense, they do. The members of Solutia's executive leadership team are required to own significant amounts of the company's stock. Almost every Solutia employee has stock options, and most also own Solutia shares through the company's 401(k) savings plan. In addition, all Solutia employees participate in an incentive compensation program. Incentive payouts depend on the achievement of the company's annual goals for both free cash flow generation and earnings per share growth.

We chose to include these provisions in our various compensation programs, because we wanted to align the interests of shareholders and employees. We believe that giving employees a personal stake in the business is an outstanding way to encourage long-term growth in the price of the company's stock.

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Being A Responsible Company

We Create Value Through Our Commitments To Workplace Safety, Respect For The Environment, And Community Responsiveness.

The leading companies in our industry understand that operating responsibly isn't just a matter of regulatory compliance. It's a strategic business issue.

Over time, responsible companies can, and do, build a competitive advantage when they effectively manage the whole range of environmental, safety, health, employment and community issues. Such companies continue to earn the right to operate from their neighbors. They reduce risks and control operating costs. They may even find new business opportunities in their ability to use resources more efficiently.

VPP "Star" Status. Historically, each of Solutia's businesses has fit the profile of a responsible company. Ten of our manufacturing sites in the United States have achieved "Star" status, a rating that indicates full compliance with standards set by the U.S. Occupational Safety and Health Administration's Voluntary Protection Program (VPP). Two European plants have achieved similar standards under comparable local programs. Other Solutia manufacturing sites are working toward VPP certification.

Operating responsibly creates a competitive advantage for Solutia, and may lead to new business opportunities.

These voluntary certification activities are proof of the commitment we have made to workplace safety and to the safety of our communities over many decades. We have also consistently worked to strengthen our employee and management teams by including people of diverse backgrounds and experience. Our people have long been active, contributing members of their communities around the world. Since the 1980s, our businesses have led the industry in voluntary waste reductions, in disclosing emissions data, and in cleaning up abandoned waste sites.

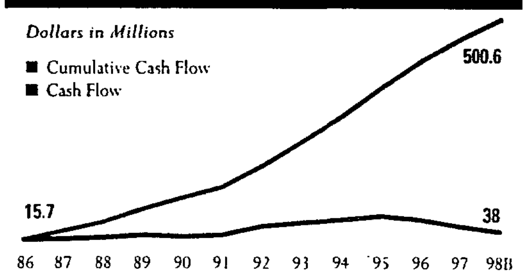
This tradition of responsible performance is important on two counts. First, it means that the majority of the spending on environmental matters is behind us.

Second, it means that Solutia is well-positioned to improve on that performance continuously as an independent enterprise. We have a solid foundation in place, and we intend to build on it.

Solutia emphasizes safety, people development, environmental stewardship, and community involvement.

Solutia's businesses have already made many of the investments required to meet our stewardship obligations. (See graph on this page.) In addition, we took aftertax charges of $46 million in the fourth quarter of 1997 to increase our environmental reserves. Approximately $22 million of these charges reflect revised estimates for previously known environmental matters. The remaining $24 million was due to a modification of our accounting practices to reflect the company's obligations under the Resource Conservation and Recovery Act. We believe that whenever possible, tomorrow's earnings should not be penalized by a legacy of environmental costs associated with yesterday's products. These charges should reduce the impact of environmental remediation on Solutia's earnings over the next several years.

Solutia Environmental Remediation Expenditures



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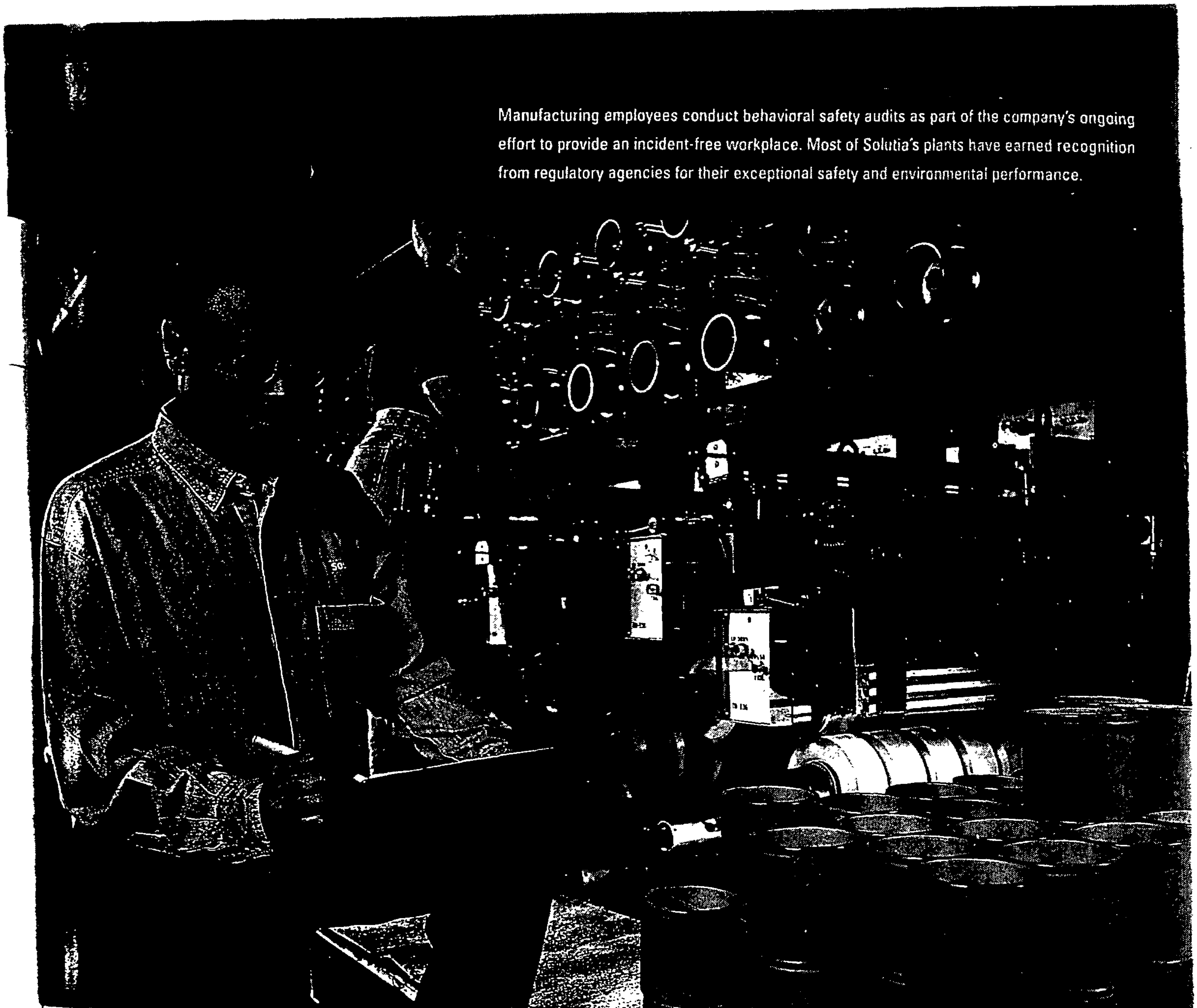

Our Environmental Commitments. In late 1997, the Governance Committee of Solutia's Board of Directors approved a set of six commitments to environment, safety and health. These statements combine to express the company's future direction and framework for operating responsibly.

- We will ensure that our operations and distribution systems are safe for employees, visitors, site contractors, communities and the environment.
- We will make products that are safe when used responsibly.
- We will keep our operations open to our communities and foster open communications with all of our stakeholders.
- We will continuously improve our raw material and energy utilization efficiencies, to reduce our impact on the environment and to improve the sustainability of our businesses.
- We will encourage active participation in and positive contributions to safety, health and environmental stewardship by our employees.
- We will search worldwide for new technologies that bring environmental, safety and health value to all of our stakeholders.

By carrying out these commitments, Solutia expects to match the best practices of our peer companies, and to adhere to the Responsible Care program developed by the Chemical Manufacturers Association. We consider the commitments a fundamental part of our company. They are integral to our strategy, and they contribute to our business goals.

Management Report

Management is responsible for the preparation of Solutia Inc.'s consolidated financial statements and all of the related information appearing in this annual report in accordance with generally accepted accounting principles. Where necessary, this information reflects estimates that are based upon currently available information and management's judgments.

Management is also responsible for maintaining a system of internal accounting controls with the objectives of providing reasonable assurance that Solutia's assets are safeguarded against material loss from unauthorized use or disposition and that authorized transactions are properly recorded to permit the preparation of accurate financial information. Cost/benefit judgments are an important consideration in this regard. The effectiveness of internal controls is maintained by personnel selection and training, division of responsibilities, establishment and communication of policies and ongoing internal review programs and audits.

Management believes that Solutia's system of internal accounting controls as of December 31, 1997, was effective and adequate to accomplish the objectives described above.

Robert G. Potter
Chairman and Chief Executive Officer

Robert A. Clausen
Senior Vice President and
Chief Financial Officer

February 25, 1998

Audit and Finance Committee Report

The Audit and Finance Committee, composed of three nonemployee members of the board of directors, met three times during 1997. The Committee reviews and monitors Solutia's internal accounting controls, financial reports, accounting practices and the scope and effectiveness of the audits performed by the independent auditors and internal auditors. The Committee also recommends to the full board of directors the appointment of Solutia's principal independent auditors, and it approves in advance all significant audit and nonaudit services provided by such auditors. Deloitte & Touche LLP was appointed independent auditor to examine, and to express an opinion as to the fair presentation of, the consolidated financial statements. This report follows.

The Committee discusses audit and financial reporting matters with representatives of the company's financial management, its internal auditors, and Deloitte & Touche LLP. The internal auditors and Deloitte & Touche LLP meet with the Committee, with and without management representatives present, to discuss the results of their examinations, the adequacy of Solutia's internal accounting controls, and the quality of its financial reporting. The Committee encourages the internal auditors and Deloitte & Touche LLP to communicate directly with the Committee.

The Audit and Finance Committee also reviews and monitors the company's financial policies, planning and structure so that they will conform to the company's requirements for growth and sound operation.

The Audit and Finance Committee has reviewed the financial section of this annual report. Pursuant to the recommendation of the Committee, the board of directors has approved the financial section.

Frank A. Metz Jr.
Chairman, Audit and Finance Committee

February 25, 1998

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Report of Independent Auditors

To the stockholders of Solutia Inc.:

We have audited the accompanying statements of consolidated financial position of Solutia Inc. and subsidiaries as of December 31, 1997 and 1996, and the related statements of consolidated income, stockholders' equity (deficit) and cash flow for each of the three years in the period ended December 31, 1997. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Solutia Inc. and subsidiaries as of December 31, 1997 and 1996, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1997, in conformity with generally accepted accounting principles.

As discussed in Note 16 to the financial statements, the company changed its method of accounting for environmental obligations under the Resource Conservation and Recovery Act in 1997.

Deloitte & Touche LLP

Deloitte & Touche LLP
St. Louis, Missouri

February 25, 1998

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Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

Solutia Inc. is an international producer and marketer of a range of high performance chemical-based materials that are used by its customers to make consumer, household, automotive and industrial products. These products include nylon and acrylic fibers, intermediates, *Saflex* plastic interlayer, phosphorus derivatives, and specialty chemicals.

The company's strategic focus is built on four key technology strengths: polymer chemistry, phosphorus chemistry, fiber technology, and process engineering expertise. These technologies are used in various combinations to create value-added products in three operating segments:

- **Chemicals** - comprised of the intermediates, phosphorus derivatives and industrial products business units;
- **Fibers** - comprised of carpet fibers, nylon industrial fibers and *Acrilan* acrylic fibers business units, and;
- **Polymers & Resins** - comprised of *Saflex* plastic interlayer, nylon plastics & polymers, resins and polymer modifier business units.

In 1997, the Chemicals, Fibers and Polymers & Resins segments accounted for approximately 32 percent, 33 percent and 35 percent, respectively, of the company's consolidated net sales. Solutia reported all of these businesses as one segment prior to its adoption of Statement of Financial Accounting Standards ("SFAS") No. 131, "Disclosures about Segments of an Enterprise and Related Information," effective December 31, 1997. The discussion of the company's results that follows has been prepared on the basis of one segment. As permitted by this new standard, information for years prior to 1997 was not restated to conform to the new disclosure requirements because it was impracticable to do so.

Prior to September 1, 1997, the businesses that form the company were wholly owned by Monsanto Company ("Monsanto"). On September 1, 1997, Monsanto distributed all of the outstanding shares of common stock of the company as a dividend to Monsanto stockholders (the "Spinoff"). The distribution resulted in the issuance of one share of the company's common stock for every five shares of Monsanto common stock held of record as of August 20, 1997. As a result of the Spinoff on September 1, 1997, the company became an independent publicly-held company listed on the New York Stock Exchange, and its operations ceased to be owned by Monsanto.

Financial data included in the company's consolidated financial statements for periods prior to the Spinoff were prepared on a combined basis. They reflect an estimate of what the historical assets, liabilities and operations would have been if Solutia had been organized as a separate legal entity, owning certain net assets of Monsanto. Management believes that the assumptions underlying these financial statements are reasonable. These historical consolidated financial statements, however, may not necessarily reflect the results of operations, cash flows or financial position of the company in the future, or what the results of operations, cash flows or financial position would have been had the company been a separate stand-alone public entity.

For periods subsequent to the Spinoff, Solutia's consolidated financial statements have been prepared on a basis that reflects the historical value of the assets, liabilities, and operations of the businesses that were contributed to Solutia by Monsanto. See Note 1 of the "Notes to Consolidated Financial Statements" for a detailed discussion of the basis of presentation used in the preparation of Solutia's consolidated financial statements.

Solutia produced strong financial results in 1997 as it began its operations as an independent company. The improved operations were primarily attributed to significant cost reductions. The combination of improved operating results and improved working capital management resulted in very strong cash flow subsequent to the Spinoff. These factors allowed the company to reduce significantly the debt burden of $1.029 billion that it assumed in the Spinoff to $790 million at year end and to make significant progress

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on its share repurchase program. The following section provides a detailed discussion of the company's results of operations in 1997.

Results of Operations

1997 Compared with 1996

In 1997, the company's net sales of $2.97 billion were down slightly when compared with net sales of $2.98 billion in 1996. The decrease was principally attributed to the effects of unfavorable currency exchange rates, and was partially offset by approximately $12 million of higher sales volumes. The effect of higher average selling prices was minimal. Sales volumes increased for the nylon plastics & polymers and the *Saflex* plastic interlayer business units. These increases were principally the result of higher demand. These sales increases were offset by the combination of unfavorable currency exchange rates and lower sales volumes of intermediates and carpet staple. The use of alternative floor coverings and competition from lower priced polyester staple had a negative effect on sales into the residential carpet market. Combined net sales of the other business units decreased slightly compared with net sales in 1996. While currency exchange rates had a negative effect on Solutia's net sales in 1997, the effect on company's 1997 operating income was minimal because ex-U.S. sales are sourced primarily from ex-U.S. operations.

Solutia's operating income in 1997 increased significantly from operating income in 1996. However, operating income was affected by unusual items in both years. In 1997, operating income included a first quarter charge of $10 million ($6 million aftertax, or $0.05 per share) associated with the adoption of the American Institute of Certified Public Accountants' Statement of Position ("SOP") 96-1, "Environmental Remediation Liabilities," which is further discussed in Note 16 of the "Notes to Consolidated Financial Statements." Operating income in the second quarter of 1997 included a charge of $10 million ($6 million aftertax, or $0.05 per share) for environmental-related litigation associated with the Brio Superfund site near Houston, Texas. In addition, operating income in the second quarter of 1997 included $8 million ($5 million aftertax, or $0.04 per share) of reversals of excess restructuring reserves from prior years. The excess was primarily the result of lower exit costs associated with the sale and closure of nonstrategic facilities included in 1995 restructuring actions. Operating income in the fourth quarter of 1997 included charges of $72 million ($46 million aftertax, or $0.37 per share) associated with environmental remediation liability changes. These charges are discussed further in Note 16 of the "Notes to Consolidated Financial Statements."

Operating income in 1996 included a net charge of $248 million ($156 million aftertax, or $1.30 per share) for restructuring and other actions, primarily for the costs of work force reductions, asset write-offs, and facility rationalizations.

The increase in operating income in 1997 can be attributed primarily to the effect of cost reductions. The cost reductions were realized principally through the restructuring actions that were taken during 1997. Significant progress was made on this restructuring plan. During 1997, employment was reduced by approximately 600 people. The effect of these cost savings was the primary driver behind the reductions in the company's marketing and administrative expenses in 1997. In addition, Solutia's operations in 1997 received lower cost allocations from Monsanto. As further described in Note 1 of the "Notes to Consolidated Financial Statements," on April 1, 1997, Monsanto discontinued its allocations of corporate expenses for general and administrative services that it had previously been providing. Solutia's 1997 administrative expenses consisted of three months of Monsanto allocations and nine months of stand-alone staff expenses. If Solutia had operated as a stand-alone entity in 1996 and 1997, management estimates that general and administrative services would have been lower by approximately $39 million in 1996 and higher by $13 million in 1997 in order to reflect the cost of replacing the services represented by these allocations.

The increase in "Earnings from equity affiliates" was driven by the Flexsys L.P. ("Flexsys") and Advanced Elastomer Systems L.P. ("AES") joint ventures. Solutia's share of the combined 1997 earnings for these ventures increased approximately 40 percent over the combined earnings from these ventures in

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1996. Solutia has a 50 percent ownership interest in each of these joint ventures.

The company is affected by economic conditions, particularly as they relate to the housing industry in the United States and the automotive industry both in the United States and internationally, which are cyclical businesses. In addition, global competition and customer demands for efficiency will continue to make sustained price increases difficult. The prices of purchased raw materials used by the company fluctuate in the short term and are affected by factors such as plant outages, oil prices, and supply and demand. However, in the long term, the company believes that the addition of new worldwide capacity should exert downward pressure on purchased raw material costs.

1996 Compared with 1995

The company's net sales increased $13 million in 1996. However, as further discussed in Note 4 of the "Notes to Consolidated Financial Statements," prior year operations reflect four months of sales and operating income from the rubber chemicals business that was contributed in May 1995 to the formation of the Flexsys joint venture. Sales and operating results for the rubber chemicals business are no longer included in the company's consolidated totals. If the sales from this business were excluded in 1995, the company's sales would have increased $153 million, or 5 percent, in 1996. Approximately $204 million of the increase can be attributed to higher sales volumes and an improved sales mix. This increase was partially offset by the effect of lower average selling prices, which totaled approximately $51 million.

Most of the sales growth was driven by increased sales for fibers products, primarily because of higher sales volumes of nylon and acrylic fibers. Nylon fiber sales were considerably higher than sales in 1995 because of higher demand in the carpet industry. Increased demand in U.S. markets and higher export sales, particularly into China, drove the sales volume growth for acrylic fibers. A decline in average selling prices partially offset the increase in nylon and acrylic fiber sales. Nylon polymer sales also contributed to the sales increase on the strength of higher sales volumes. Sales of intermediates and phosphorus and derivative products were essentially even with the prior year. Sales of industrial products in 1996 were up moderately from those in 1995, principally because of higher sales volumes, led by higher sales volumes for *Therminol* heat transfer fluids. Higher sales volumes, partially offset by lower average selling prices, resulted in a modest increase in the net sales of *Saflex* plastic interlayer in 1996. Polymer modifier sales declined slightly in 1996, primarily because of lower sales volumes.

In 1996, operating income for the company decreased $225 million from operating income in 1995. However, profitability in both years was affected by unusual items. Operating income in 1996 included a net charge of $248 million ($156 million, or $1.30 per share) for restructuring and other actions, primarily for the costs of work force reductions, asset write-offs, and facility rationalizations. Operating income in 1995 was reduced by $46 million ($39 million aftertax, or $0.34 per share), principally as the result of restructuring charges for employment reductions and the costs to close several facilities.

The positive effect of higher sales volumes and lower raw material costs on operating income was offset by lower average selling prices, by significantly higher administrative expenses, and by higher manufacturing costs. The manufacturing cost increase was principally associated with maintenance downtime and capacity expansion projects. Worldwide competitive pressures limited the company's pricing flexibility on most of its products. Future reductions or increases in average selling prices will continue to be contingent upon these demands and pressures. The 1996 increase in administrative expenses was principally due to higher costs associated with various employee incentive programs, as well as an increase in allocations related to Monsanto's business and organizational development initiatives.

The increase in "Earnings from equity affiliates" was principally attributed to higher earnings for the Flexsys and AES joint ventures.

Net of restructuring charges that are detailed in Note 4 of the "Notes to Consolidated Financial Statements," the increase in "Other income (expense) – net" resulted primarily from the combination of lower expense allocations from Monsanto and higher gains on the sale of certain assets.

The 1996 effective income tax rate of 3 percent compared with the federal statutory rate of 35 percent can be attributed primarily to the joint venture after-tax earnings included in "Earnings from equity affiliates" and benefits from the foreign sales corporation. It is expected that the effective income tax in future periods will be significantly higher and will approximate the U.S. federal statutory rate.

Liquidity and Capital Resources

Historically, the company has generated sufficient cash from its operations to fund its capital needs, including working capital. Capital expenditures were $165 million in 1997. These expenditures were used to fund various maintenance and capacity expansion projects. The company expects that its capital requirements will be in the range of $250 million to $350 million annually over the next few years, principally as a result of capacity expansion and cost reduction projects. A portion of these capital expenditures will be funded from up-front payments received from third parties participating in these projects. Environmental remediation expenditures were $39 million in 1997, and the company anticipates that these expenditures will approximate this amount annually over the next several years.

Solutia's working capital as of December 31, 1997, decreased to $106 million from $121 million at December 31, 1996, primarily because of the increase in short-term debt, principally commercial paper, the proceeds of which Solutia used to repay debt assumed with the Spinoff. The decrease in working capital was partially offset by increases in cash, receivables and inventories.

As of December 31, 1997, Solutia had negative equity of $131 million. This deficit position resulted primarily from the assumption of $1.029 billion of debt and $1.018 billion of postretirement liabilities from Monsanto in conjunction with the Spinoff.

Effective with the Spinoff, Solutia assumed approximately $1.029 billion of debt from Monsanto, primarily assumable commercial paper. The assumable commercial paper was guaranteed by Monsanto until repaid or refinanced by Solutia at maturity, which was up to 30 days following the Spinoff. In October of 1997, the company consummated the sale of debt securities in the amount of $600 million having maturities of 5 to 40 years. The proceeds of the offering were used to refinance a portion of the company's commercial paper as it matured. In the four months following the Spinoff, the company has reduced its debt outstanding by approximately $240 million. Solutia's debt securities were rated "BBB/Baa2" by the major rating agencies.

As of December 31, 1997, Solutia had a five-year revolving credit facility of $800 million with a syndicate of banks to support its commercial paper. The credit facility is also available for working capital and other general corporate purposes. No borrowings were outstanding under this credit facility as of December 31, 1997. This credit facility gives Solutia the financing flexibility to take advantage of investment opportunities that may arise and to satisfy future funding requirements.

In September 1997, the company's board of directors authorized the purchase of up to 5 million shares of the company's common stock. During 1997, the company acquired approximately 1.4 million shares at a cost of approximately $32 million. The company expects to substantially complete these purchases over the next year. This repurchase program is in addition to the normal repurchase of shares for compensation and benefits programs.

The company believes that its cash flow from operations, supplemented by periodic additional borrowings, provides it with sufficient resources to finance its operations and planned capital needs for the next 12 months.

Environmental Matters

Solutia continues to make a strong commitment to comply with various laws and government regulations concerning environmental matters and employee safety and health in the United Sates and other countries. U.S. federal environmental legislation that has a particular impact on the company includes the Toxic Substances Control Act; the Resource Conservation and Recovery Act ("RCRA"); the Clean Air Act; the Clean Water Act; the Safe Drinking Water

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Act; and the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA," commonly known as "Superfund"), as amended by the Superfund Amendments and Reauthorization Act. The company is also subject to the Occupational Safety and Health Act and regulations of the Occupational Safety and Health Administration ("OSHA") concerning employee safety and health matters. The U.S. Environmental Protection Agency ("EPA"), OSHA, and other federal agencies have the authority to promulgate regulations that have an impact on the company's operations. In addition to these federal activities, various states have been delegated certain authority under the aforementioned federal statutes. Many state and local governments have adopted environmental and employee safety and health laws and regulations, some of which are similar to federal requirements. State and federal authorities may seek fines and penalties for violation of these laws and regulations.

Solutia is dedicated to long-term environmental protection and compliance programs that reduce and monitor emissions of hazardous materials into the environment as well as to the remediation of identified existing environmental concerns. The company is among the leaders in the chemical industry's Responsible Care performance enhancement program.

Expenditures in 1997 were approximately $10 million for environmental capital projects and approximately $75 million for the management of environmental programs, including the operation and maintenance of facilities for environmental control. The company estimates that a total of approximately $25 million will be spent during 1998 and 1999 on additional capital projects for environmental protection and that expenses for the management of environmental programs in 1998 and 1999 will continue at levels comparable to 1997.

With respect to environmental remediation obligations, the company's policy is to accrue costs for remediation of contaminated sites in the accounting period in which the obligation is probable and the cost is reasonably estimable. Significant adjustments to these obligations included the 1997 fourth quarter charges of approximately $34 million ($22 million aftertax, or $0.18 per share) to increase the company's environmental reserves. This action was required in order to reflect revised estimates for changed circumstances relating to the ultimate outcome of previously known environmental matters. These revised estimates were based upon further discussions with environmental authorities and the availability of new information from recently completed environmental studies. These events and activities help to define better and to quantify the company's ultimate liability for these matters.

In addition, effective January 1, 1997, Solutia adopted SOP 96-1 which establishes authoritative guidance regarding the recognition, measurement and disclosure of environmental remediation liabilities. A charge of approximately $10 million ($6 million aftertax, or $0.05 per share) was recorded in the first quarter of 1997 associated with the adoption of SOP 96-1. The timing of this charge was predicated upon an application of SOP 96-1 in which liabilities arising under RCRA should be recorded when a RCRA corrective measures study ("CMS") is completed. Subsequently, the company reassessed its application of SOP 96-1 and concluded that these liabilities would be recorded over a continuum of events leading up to and including a CMS. As a result, the company recorded in the fourth quarter of 1997, additional charges of approximately $38 million ($24 million aftertax, or $0.19 per share) associated with these RCRA environmental liabilities.

Monsanto has intermittently received notices from the EPA alleging that it is a potentially responsible party ("PRP") with respect to Superfund at specific sites. In 1997, no such notices were received. With respect to many of the past notices, Monsanto has resolved disputes, entered partial and complete consent decrees, and executed administrative orders with the EPA settling a portion or all of Monsanto's liability at various sites. Remediation pursuant to such settlements is ongoing. At the time of the Spinoff, the company assumed from Monsanto, pursuant to a distribution agreement, liabilities related to specified Superfund proceedings. As a result, while Monsanto remains the named PRP or defendant for actions that occurred prior to September 1, 1997, the company will manage proceedings and litigation indemnifying Monsanto for costs, expense and judgments arising from these assumed liabilities.

The company's estimates of its liabilities for Superfund sites are based on evaluations of currently available facts with respect to each individual site and take into consideration factors such as existing technology, laws and agency policy, and prior experience in remediation of contaminated sites. As assessments and remediation activities progress at individual sites, these liabilities are reviewed periodically and adjusted to reflect additional technical, engineering and legal information that becomes available. The company has an accrued liability of $48 million as of December 31, 1997 for Superfund sites. Major Superfund sites in this category include the noncompany-owned sites at Brio and MOTCO in Texas, Fike/Artel in West Virginia and Woburn in Massachusetts, which account for $33 million of the accrued amount. The company spent approximately $12 million in 1997 for remediation of Superfund sites. Similar amounts can be expected in future years.

The company had an accrued liability of $88 million as of December 31, 1997, for shut-down plants and third-party sites for which the company assumed responsibility pursuant to a distribution agreement entered into with Monsanto. The company's estimate of its liability related to these sites is based on evaluations of currently available facts with respect to each individual site and takes into consideration factors such as existing technology, laws and agency policy and prior experience in remediation of contaminated sites. The company spent $11 million in 1997 for remediation of these sites. Similar amounts can be expected in the future.

The company had an accrued liability of $81 million as of December 31, 1997 for solid and hazardous waste remediation, and post-closure costs at the company's operating locations. The company recognizes certain post-closure costs over the estimated remaining useful life of the related facilities. The company spent $16 million in 1997 for remediation of these facilities.

Uncertainties related to all of the company's environmental liabilities are evolving government regulations, the method and extent of remediation and future changes in technology. Because of these uncertainties, the company estimates that potential future expenses associated with these liabilities could be an additional $20 million to $30 million. Although the ultimate costs and results of remediation of contaminated sites cannot be predicted with certainty, they are not expected to result in a material adverse effect on Solutia's consolidated financial position, liquidity, or profitability in any one year.

The Year 2000 Issue

The year 2000 ("Y2K") issue refers to the inability of a date-sensitive computer program to recognize a two-digit date field designated as "00" as the year 2000. Mistaking "00" for 1900 could result in a system failure or miscalculations causing disruptions to operations, including manufacturing, a temporary inability to process transactions, send invoices, or engage in other normal business activities. This is a significant issue for most, if not all companies, with far reaching implications, some of which cannot be anticipated or predicted with any degree of certainty.

Solutia has completed an assessment of the magnitude of its Y2K issue and has determined that it will be required to modify or replace significant portions of its software so that its computer systems will be able to function properly beyond December 31, 1999. The majority of the company's Y2K issue will be addressed though its worldwide implementation of new software licensed from SAP AG which is Y2K compliant. Issues that are not covered by the SAP implementation will have to be addressed individually and may require software replacement, reprogramming or other remedial action. The company is communicating with its suppliers and customers to determine the extent of the company's vulnerability to the failure of third parties to remediate their own Y2K issue.

In conjunction with this assessment, the company is finalizing its action plans to address the Y2K issue, including contingencies to address unforeseen problems. The company plans to use both internal and external resources to complete Y2K reprogramming, software replacement and testing. Preliminary plans anticipate completion of the SAP implementation and Y2K remedial work by mid-1999. To date, the company has incurred approximately $3 million related to the Y2K remedial work. The total remaining cost of the Y2K remedial work is estimated to be $5 million and will be expensed as incurred over the next two years. The costs of Y2K remedial work exclude the cost of SAP implementation.

The costs of the project and the date on which the company plans to complete the Y2K remediation work are based on management's best estimates, which were derived from numerous assumptions about future events, including the availability of certain resources, third-party modification plans, and other factors. However, there can be no guarantee that these estimates will be achieved and actual results could differ materially from those plans. Specific factors that might cause material differences include, but are not limited to, the availability and cost of personnel trained in this area and the ability to identify and correct all relevant computer codes.

Derivative Financial Instruments

The company is exposed to market risk, including changes in interest rates, currency exchange rates, and certain commodity prices. To manage the volatility relating to these exposures, the company enters into various derivative transactions pursuant to the company's policies. The company does not purchase or hold any derivative financial instruments for trading purposes.

The tests discussed below for exposure to interest rate and currency rate exposures are based on a variance/covariance value at risk model using a one-year horizon and a 95 percent confidence level. The model assumes that financial returns are normally distributed. The value at risk model takes into account correlations and diversification across market factors, including currencies and interest rates. Estimates of volatility and correlations or market factors are drawn from the JP Morgan RiskMetrics™ dataset as of December 31, 1997. In cases where data is unavailable, a reasonable approximation is included. The effect of these estimates did not significantly change the total value at risk.

Foreign Currency Exchange Rate Risk

Currency forward contracts are used to manage currency exposures for financial instruments denominated in currencies other than the entity's functional currency. Gains and losses on contracts that are designated and effective as hedges are included in net income and offset the exchange gain or loss of the transaction being hedged. Corporate policy prescribes the range of allowable hedging activity and the instruments permitted for use. Because the counterparties to these contracts are major international financing institutions, credit risk arising from these contracts is not significant and Solutia does not anticipate any counterparty losses. This hedging activity is intended to protect the company from adverse fluctuations in foreign currency exchange rates.

As of December 31, 1997, Solutia had currency forward contracts to purchase $22 million and to sell $22 million of other currencies with average maturities of 2 months, principally the Belgian franc and the British pound sterling. Net unrealized hedging losses as of December 31, 1997 were not material.

Based on the company's overall currency rate exposure at December 31, 1997, including derivative and other foreign currency sensitive instruments, a near-term change in currency rates within a 95 percent confidence level based on historical currency rate movements, would not materially affect the consolidated financial position, results of operations, or cash flows of the company.

Interest Rate Risk

Interest rate risk is primarily related to the changes in fair value on fixed-rate, long-term debt and short-term, floating rate debt. Based on the company's overall interest rate exposure at December 31, 1997, a near-term change in interest rates, within a 95 percent confidence level based on historical interest rate movements, would not materially affect the consolidated financial position, results of operations, or cash flows of the company.

Commodity Price Risk

Certain raw materials are subject to price volatility caused by weather, petroleum prices, and other unpredictable factors. The company employs commodity price swaps to hedge this exposure. The commodity price risk is not material to the company's consolidated financial position, results of operations, or cash flow.

Unaudited Pro Forma Condensed Consolidated Statements of Income

(Dollars in millions, except per share)

The following unaudited pro forma condensed consolidated statements of income for the years ended December 31, 1997 and 1996 give effect to the Spinoff and Solutia's 1997 debt offering as if the Spinoff and the offering had occurred as of the beginning of the periods presented. The pro forma information is presented for illustrative purposes only and may not be indicative of the results that would have been obtained had the transactions actually occurred on the date assumed, nor is it necessarily indicative of future consolidated results of operations. The unaudited pro forma condensed consolidated financial statements should be read in conjunction with the historical financial statements and the related notes thereto included elsewhere in this annual report.

	For the Year Ended December 31, 1997			For the Year Ended December 31, 1996		
	Historical	Pro Forma		Historical	Pro Forma	
	Solutia	Adjustments	Solutia	Solutia	Adjustments	Solutia
Net Sales	$ 2,969	$ (9)(A)	$ 2,960	$ 2,977	$ (15)(A)	$ 2,962
Cost of Goods Sold	2,316	(1)(B)	2,313	2,325	3 (B)	2,313
		1 (C)			3 (C)	
		(3)(D)			(18)(D)	
Gross Profit	653	(6)	647	652	(3)	649
Marketing, Administrative, and Technological Expenses	363	14 (B)	393	427	14 (B)	420
		(9)(D)			(67)(D)	
		25 (E)			46 (E)	
Restructuring Expenses – net				192		192
Operating Income	290	(36)	254	33	4	37
Interest Expense	(41)	(19)(F)	(60)	(36)	(28)(F)	(64)
Other Income (Expense) – net	41		41	36		36
Income Before Income Taxes	290	(55)	235	33	(24)	9
Income Taxes	98	(20)(G)	78	1	(9)(G)	(8)
Net Income	$ 192	$ (35)	$ 157	$ 32	$ (15)	$ 17
Earnings per Share	$ 1.63	$ (0.30)	$ 1.33	$ 0.28	$ (0.13)	$ 0.15
Earnings per Share, assuming dilution	$ 1.55	$ (0.28)	$ 1.27	$ 0.27	$ (0.13)	$ 0.14
Weighted Average Shares - Basic			117.7			116.2
Weighted Average Shares - Diluted			123.7			119.8

Notes

(A) To record the estimated effect of new selling prices and arrangements on former intercompany sales from Solutia to Monsanto.

(B) To record the assumed increase in retiree medical and pension costs as a result of the Spinoff.

(C) To record the estimated effect of transactions with the P4 joint venture formed by Monsanto in conjunction with the Spinoff.

(D) To reverse the historical Monsanto corporate expense allocation to the company because the company is no longer subject to the allocation of corporate expenses from Monsanto following the Spinoff.

(E) Because the company is no longer subject to this corporate expense allocation, a pro forma adjustment was made to record estimated general corporate costs that the company believes it would have incurred had the company been a separate public company for the periods presented.

(F) To record additional interest expense as a result of the company's assumption of debt from Monsanto and the borrowings of Solutia's 1997 public debt offering.

(G) To record the estimated provision for income tax as a result of the pro forma adjustments referred to in Notes (A) through (F) above at an estimated combined U.S. federal income and state income tax rate of 36 percent.

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Statement of Consolidated Income

(Dollars in millions, except per share)

	Year Ended December 31,		
	1997	1996	1995
Net Sales	$2,969	$2,977	$2,964
Cost of goods sold	2,316	2,325	2,243
Gross Profit	653	652	721
Marketing expenses	143	172	179
Administrative expenses	133	167	136
Technological expenses	87	88	95
Restructuring expenses–net	–	192	53
Operating Income	290	33	258
Equity earnings from affiliates	31	21	15
Interest expense	(41)	(36)	(36)
Other income (expense)–net	10	15	(6)
Income Before Income Taxes	290	33	231
Income taxes	98	1	84
Net Income	$ 192	$ 32	$ 147
Earnings per Share	$ 1.63	$ 0.28	$ 1.30
Earnings per Share, assuming dilution	$ 1.55	$ 0.27	$ 1.27

See accompanying Notes to Consolidated Financial Statements.

Key Financial Statistics (Unaudited)

As a Percent of Net Sales:	1997	1996	1995
Gross profit	22%	22%	24%
Marketing, administrative and technological expenses	12	14	14
Operating income	10	1	9
Net income	6	1	5
Effective Income Tax Rate	34	3	36

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Statement of Consolidated Financial Position

(Dollars in millions, except per share)

	As of December 31, 1997	1996
Assets		
Current Assets:		
Cash and cash equivalents	$ 24	$ –
Trade receivables, net of allowances of $6 in 1997 and $7 in 1996	425	412
Miscellaneous receivables and prepaid expenses	136	80
Deferred income tax benefit	91	108
Inventories	325	291
Total Current Assets	1,001	891
Property, Plant and Equipment:		
Land	17	18
Buildings	357	367
Machinery and equipment	2,707	2,622
Construction in progress	107	121
Total property, plant and equipment	3,188	3,128
Less accumulated depreciation	2,265	2,217
Net Property, Plant and Equipment	923	911
Investments in Affiliates	423	366
Long-Term Deferred Income Tax Benefit	300	194
Other Assets	121	121
Total Assets	$ 2,768	$ 2,483

Liabilities and Stockholders' Equity (Deficit)

	1997	1996
Current Liabilities:		
Accounts payable	$ 221	$ 223
Wages and benefits	106	156
Restructuring reserves	40	79
Miscellaneous accruals	335	312
Short-term debt	193	–
Total Current Liabilities	895	770
Long-Term Debt	597	–
Postretirement Liabilities	958	634
Other Liabilities	449	423
Stockholders' Equity (Deficit):		
Monsanto Company Equity	–	656
Common stock (authorized, 600,000,000 shares par value $0.01)		
Issued: 118,400,635 shares in 1997	1	–
Additional contributed capital	(119)	–
Treasury stock, at cost (992,828 shares in 1997)	(22)	–
Minimum pension liability adjustment	(7)	–
Unearned ESOP shares	(31)	–
Accumulated currency adjustment	19	–
Reinvested earnings	28	–
Total Stockholders' Equity (Deficit)	(131)	656
Total Liabilities and Stockholders' Equity (Deficit)	$ 2,768	$ 2,483

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See accompanying Notes to Consolidated Financial Statements.

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Statement of Consolidated Cash Flow

(Dollars in millions)

	Year Ended December 31,		
	1997	1996	1995
Increase (Decrease) In Cash and Cash Equivalents			
Operating Activities:			
Net income	$192	$ 32	$147
Adjustments to reconcile to Cash Provided by Operations:			
Items that did not use (provide) cash:			
Deferred income taxes	32	(45)	25
Depreciation and amortization	142	166	162
Restructuring expenses – net	–	192	53
Other	(39)	43	1
Working capital changes that provided (used) cash:			
Accounts receivable	(9)	(43)	64
Inventories	(32)	20	(78)
Accounts payable and accrued liabilities	(115)	(33)	(61)
Other	(45)	24	(13)
Other items	33	(20)	20
Total Cash Provided by Operations	159	336	320
Investing Activities:			
Capital expenditures	(165)	(192)	(179)
Acquisition and investment payments	(2)	(17)	(51)
Investment and property disposal proceeds	9	4	51
Cash Used in Investing Activities	(158)	(205)	(179)
Financing Activities:			
Net transactions with Monsanto Company prior to Spinoff	292	(131)	(141)
Long-term debt proceeds	600	–	–
Repayment of debt obligations	(840)	–	–
Treasury stock purchases	(35)	–	–
Dividend payments	(1)	–	–
Common stock issued under employee stock plans	13	–	–
Other financing activities	(6)	–	–
Cash Provided by (Used in) Financing Activities	23	(131)	(141)
Increase (Decrease) In Cash and Cash Equivalents	24	–	–
Cash and Cash Equivalents:			
Beginning of year	–	–	–
End of year	$ 24	$ –	$ –

See accompanying Notes to Consolidated Financial Statements.
The effect of exchange rate changes on cash and cash equivalents was not material. Cash payments for interest (net of amounts capitalized) were $3 million in 1997. Cash payments for income taxes were $30 million in 1997.

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Statement of Consolidated Stockholders' Equity (Deficit)

(Dollars in millions)

	Year Ended December 31,		
	1997	1996	1995
Monsanto Company Equity:			
Balance, Jan. 1	$ 656	$755	$741
Net income		32	147
Translation adjustments		–	8
Net transactions with Monsanto Company prior to Spinoff		(131)	(141)
1997 activity to date of Spinoff:			
Net income	163		
Translation adjustments	13		
Net transactions with Monsanto Company	292		
Elimination of Monsanto Company Equity at Spinoff	(1,124)		
Balance, Dec. 31	$ –	$656	$755
Common Stock:			
Balance, Jan. 1	$ –	$ –	$ –
Issuance of 118,371,280 shares at Spinoff	1		
Issuance of 29,355 shares for stock option exercises	–		
Balance, Dec. 31	$ 1	$ –	$ –
Additional Contributed Capital:			
Balance, Jan. 1	$ –	$ –	$ –
Net liability transfer to Solutia at Spinoff	(101)		
Post-Spinoff adjustments	(12)		
Employee stock plans and ESOP	(6)		
Balance, Dec. 31	$(119)	$ –	$ –
Treasury Stock:			
Balance, Jan. 1	$ –	$ –	$ –
Shares purchased (1,569,800 shares in 1997)	(35)		
Net shares issued under employee stock option plans (576,972 shares in 1997)	13		
Balance, Dec. 31	$ (22)	$ –	$ –
Minimum Pension Liability Adjustment:			
Balance, Jan. 1	$ –	$ –	$ –
Post-Spinoff adjustment	(7)		
Balance, Dec. 31	$ (7)	$ –	$ –
Unearned ESOP Shares:			
Balance, Jan. 1	$ –	$ –	$ –
Transfer of ESOP reserve balance to Solutia at Spinoff	(31)		
Amortization of ESOP balance	–		
Balance, Dec. 31	$ (31)	$ –	$ –
Accumulated Currency Adjustment:			
Balance, Jan. 1	$ –	$ –	$ –
Balance transferred to Solutia at Spinoff	11		
Translation adjustments	8		
Balance, Dec. 31	$ 19	$ –	$ –
Reinvested Earnings:			
Balance, Jan. 1	$ –	$ –	$ –
Net income from date of Spinoff through December 31, 1997	29		
Dividends	(1)		
Balance, Dec. 31	$ 28	$ –	$ –
Total Stockholders' Equity (Deficit)	$(131)	$656	$755

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See accompanying Notes to Consolidated Financial Stat

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Notes To Consolidated Financial Statements

(Dollars in millions, except per share)

1. Basis of Presentation

Solutia Inc. is an international producer and marketer of a range of high performance chemical-based materials that are used by its customers to make consumer, household, automotive and industrial products. Prior to September 1, 1997, the businesses that form the company were wholly owned by Monsanto Company ("Monsanto"). On September 1, 1997, Monsanto distributed all of the outstanding shares of common stock of the company as a dividend to Monsanto stockholders (the "Spinoff"). The distribution resulted in the issuance of one share of the company's common stock for every five shares of Monsanto common stock held of record as of August 20, 1997. As a result of the Spinoff on September 1, 1997, the company became an independent publicly-held company listed on the New York Stock Exchange and its operations ceased to be owned by Monsanto. Monsanto and Solutia have entered into a number of agreements with respect to the separation of the companies and to provide mechanisms for an orderly transition following the Spinoff.

Pre-Spinoff Financial Information

Financial data included in the accompanying consolidated financial statements, for periods prior to the Spinoff, were prepared on a combined basis. They reflect an estimate of what the historical assets, liabilities and operations would have been if Solutia had been organized as a separate legal entity, owning certain net assets of Monsanto. Generally, only those assets and liabilities of the ongoing chemicals businesses that were expected to be transferred to Solutia prior to the Spinoff were included in the Statement of Consolidated Financial Position.

The Spinoff was accomplished through a distribution agreement which defined the assets that were contributed to Solutia and the liabilities that were assumed by Solutia. Certain of those assets and liabilities were not included in the accompanying Statement of Consolidated Financial Position as of December 31, 1996. Those omitted assets and liabilities were principally comprised of a joint venture interest in Monsanto's elemental phosphorus business and a defined amount of cash and debt.

Monsanto and Solutia also entered into an employee benefits and compensation allocation agreement that set forth the manner in which assets and liabilities under employee benefit plans and other employment-related liabilities were divided between them. Certain assets and liabilities related to the plans have not been included in the accompanying Statement of Consolidated Financial Position as of December 31, 1996. Items excluded were comprised principally of assets and liabilities for U.S. and ex-U.S. defined benefit pension plans as well as workers' compensation and additional obligations for health care and other postretirement benefits that Solutia retained for substantially all retired U.S. employees.

The following unaudited pro forma amounts were estimated to give effect to the previously described assets and liabilities that were excluded from Solutia's December 31, 1996 Statement of Consolidated Financial Position, as well as certain other items. For the unaudited pro forma condensed Statement of Consolidated Financial Position, the amounts were estimated as if the Spinoff had occurred on December 31, 1996. The comparable audited amounts as of December 31, 1997 are included for informational purposes. For the unaudited pro forma condensed Statements of Consolidated Income, the amounts were estimated as if the Spinoff had occurred as of the beginning of the years presented.

Condensed Statements of Consolidated Financial Position as of December 31:

	1997	Unaudited Pro Forma 1996
Total Assets	**$2,768**	$2,660
Long-Term Debt	**597**	1,029
Postretirement Liabilities	**958**	876
Stockholders' Deficit	**(131)**	(439)
Total Liabilities and Stockholders' Deficit	**$2,768**	$2,660

Unaudited Pro Forma Condensed Statements of Consolidated Income for the years ended December 31, 1997 and 1996:

	1997	1996
Income Before Income Taxes	**$ 235**	$ 9
Net Income	**157**	17
Earnings per Share	**$1.33**	$0.15
Earnings per Share, assuming dilution	**$1.27**	$0.14

The pro forma information is presented for illustrative purposes only and may not be indicative of the results that would have been obtained had the transactions actually occurred on the dates assumed, nor is it necessarily indicative of the future consolidated results of operations.

The final determination of the assets contributed to Solutia and the liabilities assumed by Solutia was made pursuant to the agreements entered into between Monsanto and Solutia in connection with the Spinoff. As of the date of the Spinoff, a net liability transfer to Solutia was affected directly through the "Monsanto Company Equity" account in the Statement of Consolidated Financial Position.

Monsanto provided certain general and administrative services to Solutia, including finance, legal, treasury, information systems, and human resources. The cost allocated to Solutia for these services was based upon the percentage relationship between the net assets utilized in Solutia's operations and Monsanto's total net assets, as well as other methods which management believes to be reasonable. These allocations were $12 million, $85 million and $72 million in 1997, 1996 and 1995, respectively. In preparation for the Spinoff, Monsanto began a transition plan for the separation. As part of this plan, Monsanto discontinued its allocation of corporate expenses for these general and administrative services on April 1, 1997, as these expenses were specifically identified and segregated as part of Solutia's ongoing cost infrastructure. As a result of the Spinoff, Solutia is now required to perform these general and administrative functions using its own resources or purchased services and is responsible for the costs and expenses associated with the management of a public company. If Solutia had operated as a stand-alone entity in 1996 and 1997, management estimates that general and administrative services would have been lower by approximately $39 million in 1996 and higher by $13 million in 1997 in order to reflect the cost of replacing the services represented by these allocations.

As described in Notes 10, 11 and 12, Solutia employees and retirees participated in various Monsanto pension, health care, savings and other benefit plans. The costs and certain obligations related to these plans were included in Solutia's consolidated financial statements generally based on the percentage of Solutia payroll costs to total Monsanto payroll costs.

Certain assets and liabilities related to Solutia's operation had been managed and controlled by Monsanto on a centralized basis. Such assets and liabilities have been allocated to Solutia in the manner described in the preceding paragraphs for allocated general and administrative expenses and benefit plans. A portion of the following pre-Spinoff assets and liabilities have been determined in this manner: other assets, accounts payable, postretirement liabilities, miscellaneous accruals and other liabilities.

Monsanto used a centralized approach to cash management and the financing of its operations. As a result, cash and cash equivalents and debt were not allocated to Solutia in the pre-Spinoff historical financial statements. Solutia generally has not had borrowings except amounts due to Monsanto. Interest expense was allocated to Solutia in the consolidated financial statements to reflect Solutia's pro rata share of the financing structure of Monsanto. This allocation in the consolidated financial statements is based on the percentage relationship between the net assets utilized in Solutia's operations and Monsanto's net assets.

The allocation methodology followed in preparing the consolidated financial statements may not necessarily reflect the results of operations, cash flows, or financial position of Solutia in the future, or what the results of operations, cash flows, or financial position would have been had Solutia been a separate stand-alone entity.

Post-Spinoff Financial Information

Financial data included in the accompanying consolidated financial statements, for periods subsequent to the Spinoff, have been prepared on a basis that reflects the historical value of the assets, liabilities, and operations of the businesses that were contributed to Solutia by Monsanto in accordance with the distribution and employee benefits and compensation allocation agreements described in the preceding paragraphs.

Effective with the Spinoff on September 1, 1997, the assets contributed to Solutia and the liabilities assumed by Solutia included a joint venture interest in Monsanto's elemental phosphorus business, cash of $75.million, debt of $1.029 billion, accrued net pension liability for the U.S. and ex-U.S. defined benefit pension plans, and additional obligations for healthcare and other postretirement benefits. At the date of the Spinoff, the amount of postretirement liabilities assumed by Solutia totaled approximately $1.018 billion.

2. Significant Accounting Policies

Basis of Consolidation

Subsequent to the Spinoff, the consolidated financial statements include the accounts of Solutia and its majority owned subsidiaries. Other companies in which Solutia has a significant interest (20 to 50 percent) are included in "Investments in Affiliates" in the Statement of Consolidated Financial Position. Solutia's share of these companies' net earnings or losses is reflected in "Equity earnings from affiliates" in the Statement of Consolidated Income. Prior to the Spinoff, the consolidated financial statements included the accounts of Solutia as described in Note 1.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and temporary investments with maturities of three months or less when purchased.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and that affect revenues and expenses during the period reported. Estimates are adjusted when necessary to reflect actual experience. Significant estimates are used to account for the allocation between Monsanto and Solutia of financial statement amounts, restructuring reserves, environmental reserves, self-insurance reserves, employee benefit plans, asset impairments, and contingencies.

Currency Translation

The financial statements for most of Solutia's ex-U.S. operations are translated into U.S. dollars at current exchange rates. Unrealized currency adjustments in the Statement of Consolidated Financial Position are accumulated in equity. The financial statements of ex-U.S. entities that operate in hyperinflationary economies are translated at either current or historical exchange rates, as appropriate. These currency adjustments are included in net income.

Property, Plant and Equipment

Property, plant and equipment is recorded at cost. The cost of plant and equipment is depreciated over weighted average periods of 18

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years for buildings and 10 years for machinery and equipment, by the straight-line method.

Impairment of Long-lived Assets

Impairment tests of long-lived assets are made when conditions indicate a possible loss. Such impairment tests are based on a comparison of undiscounted cash flows to the recorded value of the asset. If an impairment is indicated, the asset value is written down to its fair value based upon discounted cash value, using an appropriate discount rate.

Inventory Valuation

Inventories are stated at cost or market, whichever is less. Actual cost is used to value raw materials and supplies. Standard cost, which approximates actual cost, is used to value finished goods and goods in process. Standard cost includes direct labor and raw materials, and manufacturing overhead based on practical capacity. The cost of certain inventories (77 percent as of December 31, 1997) is determined by the last-in, first-out ("LIFO") method, which generally reflects the effects of inflation or deflation on cost of goods sold sooner than other inventory cost methods. The cost of other inventories generally is determined by the first-in, first-out ("FIFO") method.

Income Taxes

Subsequent to the Spinoff, Solutia became responsible for its income taxes and will file its own income tax returns. Prior to the Spinoff, the company did not file separate tax returns because its results were included in the income tax returns filed by Monsanto and its subsidiaries in various U. S. and ex-U. S. jurisdictions. The tax provisions reflected in the Statement of Consolidated Income, for periods prior to the Spinoff, have been computed as if Solutia was a separate company.

The company accounts for income taxes using the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences of temporary differences between the carrying amounts and tax bases of assets and liabilities using enacted rates.

Earnings per Share

Effective December 31, 1997, Solutia adopted Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings per Share." Under this new standard, the presentation of primary and fully diluted earnings per share required by current standards is replaced by basic and diluted earnings per share. Basic earnings per share measures operating performance assuming no dilution from securities or contracts to issue common stock. Diluted earnings per share measures operating performance giving effect to the dilution that would occur when securities or contracts to issue common stock are exercised or converted. This change and the amounts associated with it are more fully described in Note 14.

For periods ended prior to the Spinoff, the number of weighted average shares outstanding and common share equivalents used in the earnings per share calculation was based upon the weighted average number of Monsanto shares outstanding and Monsanto common share equivalents for the applicable period, adjusted for the distribution ratio in the Spinoff of one share of the company's common stock for every five shares of Monsanto common stock.

Environmental Remediation

Costs for remediation of waste disposal sites are accrued in the accounting period in which the obligation is probable and when the cost is reasonably estimable. Postclosure costs for hazardous and other waste facilities at operating locations are accrued over the estimated life of the facility as part of its anticipated closure cost. Environmental liabilities are not discounted, and they have not been reduced for any claims for recoveries from insurance or third parties. In those cases where insurance carriers of third-party indemnitors have agreed to pay any amounts and management believes that collectibility of such amounts is probable, the amounts are reflected as receivables in the consolidated financial statements.

Effective January 1, 1997, Solutia adopted the American Institute of Certified Public Accountants' Statement of Position ("SOP") 96-1, "Environmental Remediation Liabilities." SOP 96-1 establishes authoritative guidance regarding the recognition, measurement and disclosure of environmental remediation liabilities. The primary change in Solutia's accounting principles associated with the adoption of this SOP was an acceleration of the recognition of certain environmental remediation liabilities at operating facilities. This change and the amounts associated with it are more fully described in Note 16.

Derivative Financial Instruments

Currency forward contracts are used to manage currency exposures for financial instruments denominated in currencies other than the entity's functional currency. Gains and losses on contracts that are designated and effective as hedges are included in net income and offset the exchange gain or loss of the transaction being hedged.

Major currencies effecting the company's business are the U.S. dollar, the British pound sterling, the Belgian franc, and the German deutsche mark. Currency restrictions are not expected to have a significant effect on Solutia's cash flow, liquidity, or capital resources.

3. Intercompany Transactions

Transactions with Monsanto prior to the Spinoff, included in the Statement of Consolidated Income, are summarized as follows:

	Year Ended December 31,		
	1997	1996	1995
Intercompany sales	$42	$63	$75
General and administrative services	12	85	72
Interest expense	26	36	36

Intercompany sales were made at Monsanto's established transfer prices. In addition, the costs for certain general and administrative services were allocated to Solutia. As further discussed in Note 1, Monsanto discontinued its allocation of the cost of general and administrative expenses to Solutia, effective April 1, 1997, as part of its transition plan of separation. Such expenses were specifically identified and segregated as part of Solutia's ongoing cost infrastructure. Interest expense charged to Solutia represents an allocation from Monsanto of its total interest expense.

4. Restructuring and Other Actions

Items that affected Solutia's results of operations in 1997 included a first quarter charge of $10 million ($6 million aftertax) associated with the adoption of the SOP 96-1 which is further discussed in Note 16. The second quarter of 1997 included a charge of $10 million ($6 million aftertax) for environmental-related litigation. This charge resulted from a settlement that Monsanto reached with 811 plaintiffs in six lawsuits related to the Brio Superfund site near Houston, Texas. The suits were among eleven suits brought in Harris County District Court or the United States District Court for the Southern District of Texas on behalf of 960 plaintiffs who claimed injuries resulting from alleged exposure to substances present at or emanating from the Brio site. In addition, the second quarter included $8 million ($5 million aftertax) of reversals of excess restructuring reserves from prior years. The excess was primarily the result of lower exit costs associated with the sale and closure of nonstrategic facilities included in 1995 restructuring actions. The fourth quarter of 1997 included charges of $72 million ($46 million aftertax) associated with changes in estimates for environmental remediation liabilities. These charges are discussed further in Note 16.

In December 1996, Solutia recorded pretax restructuring charges totaling $256 million ($164 million aftertax) to cover the costs associated with the closure or sale of certain facilities, asset write-offs, and workforce reductions. Included in these charges were pretax amounts for asset impairments totaling $56 million. These write-offs were necessary primarily because of excess production capacity, coupled with insufficient demand for certain products. Asset values were written down to their discounted cash values, using appropriate discount rates. Significant progress was made on this plan in 1997, with employment being reduced by approximately 600 people.

In December 1995, Monsanto's board of directors approved a restructuring plan. The pretax charge associated with these actions was $66 million ($57 million aftertax) and covered the costs of work force reductions, business consolidations, facility closures, and the exit from nonstrategic businesses and facilities. This plan was substantially completed by the end of 1996 and reduced employment by approximately 100 people.

In December 1994, Monsanto and Akzo Nobel N.V. agreed to form a 50-50 joint venture by combining their respective rubber chemicals businesses. The venture partners agreed to bear the one-time costs required to integrate their respective rubber chemicals businesses into the joint venture. For Solutia, these integration costs, which totaled $40 million pretax ($25 million aftertax), were primarily for the cost of reducing the work force by approximately 120 people and for special termination benefits for approximately 300 people transferring from Solutia to the joint venture. The charge for these action was recorded in the first quarter of 1995. On May 1, 1995, the joint venture, known as Flexsys, L.P. (" Flexsys"), began operation and is accounted for as an equity affiliate. Accordingly, Solutia's share of the earnings of Flexsys after that date has been reflected in "Equity earnings from affiliates" in the Statement of Consolidated Income. Solutia's results of operations for 1995 included net sales of $140 million from the rubber chemicals business. Operating income for this business during these periods was not significant.

Other items that affected Solutia's results of operations in 1995 included the receipt in the first and third quarters of settlement payments from various insurers related to environmental and other insurance litigation. The combined effect of these settlements totaled $88 million pretax ($55 million aftertax). In addition, Monsanto settled a lawsuit related to a Comprehensive Environmental Response, Compensation and Liability site, commonly known as a "Superfund" site, in La Marque, Texas. The suit was brought by IT Corporation ("IT"), a subsidiary of International Technology Corp., and claimed, among other things, breach of a contract calling for IT to perform incineration and remediation work at the site. Monsanto settled the suit by paying $41 million pretax ($25 million aftertax), and Solutia recorded the payment in the third quarter of 1995.

The components of the pretax expense (income) related to the restructuring programs and the other actions included in the accompanying Statement of Consolidated Income were:

	1997	1996	1995
Changes in estimates for environmental reserves and application of SOP 96-1	$82		
Cost of employee reductions		$157	$22
Shutdown and consolidation of various facilities and departments	(8)	33	44
Asset impairments		56	
Insurance-related settlement (income)			(88)
Litigation settlement	10		41
Joint venture integration costs			40
Other costs		10	
Total	$84	$256	$59

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Restructuring expenses are recorded based on estimates prepared at the time the restructuring actions are approved by the board of directors. The balance in restructuring reserves as of December 31, 1997, was $104 million. It is earmarked primarily for work force reduction costs and the costs associated with the consolidation of various facilities and departments. Management believes that the balance of these reserves as of December 31, 1997, is adequate for completion of those activities. Restructuring actions during the last three years have reduced these liabilities by approximately $350 million. Approximately 60 percent of these reductions were recorded for write-offs and expenditures related to the shutdown and consolidation of various facilities and departments. The remaining reductions were related primarily to the cost of work force reduction programs. As of December 31, 1997, substantially all of the restructuring reserves established in 1995 had been utilized.

The pretax expenses (income) related to the restructuring programs and the other unusual items were recorded in the Statement of Consolidated Income in the following categories:

	1997	1996	1995
Cost of goods sold	$84	$ 56	$ (7)
Restructuring expenses – net		192	53
Decrease in operating income	84	248	46
Other expense[1]		8	13
Total decrease in income before income taxes	$84	$256	$59

[1] In 1996 and 1995, other expense includes Solutia's share of restructuring actions undertaken for the Flexsys joint venture.

Net income was decreased by $53 million, $164 million, and $52 million in 1997, 1996, and 1995, respectively, because of these restructurings and other actions.

5. Investments in Affiliates

At December 31, 1997, Solutia's investments in affiliates consisted principally of its 50 percent interests in the Flexsys rubber chemicals joint venture and the Advanced Elastomers Systems, L.P. ("AES") joint venture for which Solutia uses the equity method of accounting. Summarized combined financial information for the Flexsys and AES joint ventures follows:

	1997	1996	1995
Results of operations:			
Net sales	$865	$779	$628
Net income	78	64	3
Financial position:			
Total assets	$899	$853	$854
Total liabilities	254	237	290

6. Inventory Valuation

The components of inventories were:

	1997	1996
Finished goods	$259	$258
Goods in process	60	47
Raw materials and supplies	148	126
Inventories, at FIFO cost	467	431
Excess of FIFO over LIFO cost	(142)	(140)
Total	$325	$291

Inventories at FIFO approximate current cost. The effect of LIFO inventory liquidations was not material in 1997, increased pretax income by $5 million in 1996 and was not material in 1995.

7. Income Taxes

The components of income before income taxes were:

	1997	1996	1995
United States	$187	$11	$221
Outside United States	103	22	10
Total	$290	$33	$231

The components of income tax expense charged to operations were:

	1997	1996	1995
Current:			
U.S. federal	$36	$13	$39
U.S. state	7	2	7
Outside United States	23	31	13
	66	46	59
Deferred:			
U.S. federal	19	(21)	23
U.S. state	2	(1)	3
Outside United States	11	(23)	(1)
	32	(45)	25
Total	$98	$ 1	$84

Factors causing Solutia's effective tax rate to differ from the U.S. federal statutory rate were:

	1997	1996	1995
U.S. federal statutory rate	35%	35%	35%
U.S. state income taxes	2	1	3
Tax benefit of foreign sales corporation	(2)	(23)	(4)
Taxes related to foreign income, net of credits	–	3	4
Income from equity affiliates recorded net of tax	(3)	(13)	(1)
Other	2	–	(1)
Effective income tax rate	34%	3%	36%

Deferred income tax balances were related to:

	1997	1996
Property	$(177)	$(176)
Postretirement benefits	394	248
Restructuring reserves	51	92
Environmental liabilities	80	57
Inventory	(2)	4
Other	41	77
Net asset	$ 387	$ 302

Income taxes and remittance taxes have not been recorded on $33 million in undistributed earnings of subsidiaries, either because any taxes on dividends would be offset substantially by foreign tax credits or because Solutia intends to reinvest those earnings indefinitely. It is not practicable to estimate the tax effect of remitting these earnings to the U.S.

8. Debt Obligations

Debt Maturing in One Year

Debt maturing in one year consisted principally of commercial paper balances, which totaled $190 million as of December 31, 1997. The weighted average interest rate on this debt was 6.99 percent as of December 31, 1997. Interest expense on commercial paper balances, charged to income subsequent to the Spinoff was at a weighted average rate of 5.78 percent.

As of December 31, 1997, Solutia had a five-year revolving credit facility of $800 million with a syndicate of banks to support its commercial paper. The credit facility is also available for working capital and other general corporate purposes. Interest on amounts borrowed under this credit facility is expected to approximate money market rates.

The credit agreement contains various covenants that, among other things, restrict the ability of Solutia to merge with another entity and that require Solutia to meet certain leverage and interest coverage ratios. The company does not anticipate that future borrowings will be limited by the terms of this agreement.

No borrowings were outstanding under this credit facility as of December 31, 1997.

Long-Term Debt

Long-term debt consisted of the following:

	1997	1996
6.5% notes due 2002	$ 150	$ –
7.375% debentures due 2027	300	–
6.72% debentures due 2037	150	–
Unamortized debt discount	(3)	–
Total	$ 597	$ –

The notes and debentures are unsecured obligations. Interest is payable semiannually, on April 15 and October 15 of each year, commencing April 15, 1998. The 2037 debentures may be repaid on October 15, 2004 at the option of the holder. The notes and debentures contain provisions that, among other things, restrict Solutia's ability to create liens against assets and its ability to enter into sale and leaseback transactions.

9. Fair Values of Financial Instruments

The estimated fair value of Solutia's long-term debt as of December 31, 1997, was $605 million. This estimate compares with the recorded amount of $597 million.

The recorded amounts of cash, trade receivables, third-party guarantees, accounts payable and short-term debt approximate their fair values. The estimated fair value of the company's foreign currency forward contracts approximates their notional amounts.

Fair values are estimated by the use of quoted market prices, estimates obtained from brokers, and other appropriate valuation techniques based upon information available as of December 31, 1997. The fair-value estimates do not necessarily reflect the values Solutia could realize in the current market.

10. Postretirement Benefits – Pensions

Prior to the Spinoff, Solutia's employees participated in Monsanto's noncontributory pension plans. In conjunction with the Spinoff, Solutia assumed pension liabilities and received related assets from those plans for its active employees and for certain former employees who left Monsanto in earlier years. Solutia's plans are substantially identical to Monsanto's plans. Pension benefits are based on the employee's years of service and/or compensation level. The pension plans are funded in accordance with Solutia's long-range projections of the plans' financial conditions. These projections take into account benefits earned and expected to be earned, anticipated returns on pension plan assets, and income tax and other regulations.

The company's net pension cost was $28 million in 1997. It consisted of $9 million of net pension costs incurred subsequent to the Spinoff and $19 million of cost allocations from Monsanto. Solutia's net pension cost allocations from Monsanto were $18 million and $1 million in 1996 and 1995, respectively. Separate calculations of the components of Solutia's net pension cost and the funded status of the plans prior to the Spinoff are not available. Subsequent to the

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Spinoff, the company's net pension cost was $9 million and its components were as follows:

	1997
Service costs for benefits earned	$ 11
Interest cost on benefit obligation	52
Assumed return on plan assets[1]	(53)
Amortization of unrecognized net gain	(1)
Total	$ 9

[1] Actual return on plan assets was $44 million for the four months ended December 31, 1997.

The funded status of Solutia's pension plans at year-end was:

	1997
Plan assets at fair value	$ 1,834
Actuarial present value of plan benefits:	
Vested	$ 1,538
Nonvested	107
Accumulated benefit obligation	1,645
Effect of projected future salary increases	179
Projected benefit obligation[1]	$ 1,824
Excess of plan assets over projected benefit obligation	$ 10
Less:	
Unrecognized initial net gain	33
Unrecognized prior service costs	(178)
Additional liability	14
Unrecognized subsequent net gain	269
Accrued net pension liability[2]	$ 128

[1] Included $27 million in 1997 for unfunded plans.
[2] Included $22 million in 1997 for unfunded plans.

The accrued net pension liability was included in:

	1997
Postretirement liabilities	$ 136
Less: Other assets	8
Accrued net pension liability	$ 128

Included in the preceding table are plan assets and projected benefit obligations for the principal U.S. plan of approximately $1.762 billion and $1.732 billion, respectively, as of December 31, 1997. Plan assets consist principally of common stocks and U.S. government and corporate obligations. Contributions to these plans were neither required nor made in 1997 because Solutia's principal pension plan is adequately funded, using assumed returns.

The significant actuarial assumptions used to estimate the projected benefit obligation for the company's principal pension plan were as follows:

	1997
Discount rate	7.25%
Assumed long-term rate of return on plan assets	9.50%
Annual rates of salary increase (for plans that base benefits on final compensation level)	4.00%

11. Postretirement Benefits – Health Care and Other

In connection with the Spinoff, Solutia assumed retiree medical liabilities for its active employees and for approximately two-thirds of the retired U.S. employees of Monsanto. Solutia's employees participate in benefit programs that provide certain health care and life insurance benefits for retired employees. Substantially all regular, full-time U.S. employees and certain employees in other countries may become eligible for these benefits if they reach retirement age while employed by Solutia. These postretirement benefits are unfunded and are generally based on the employee's years of service and/or compensation level. The costs of postretirement benefits are accrued by the date the employees become eligible for the benefits.

Solutia's postretirement benefit costs in 1997 were $54 million, which consisted of $23 million of postretirement benefit costs incurred subsequent to the Spinoff and $31 million of cost allocations from Monsanto. Solutia's postretirement benefit cost allocations from Monsanto were $50 million in 1996 and $54 million in 1995. Because of the significant increase in postretirement liabilities assumed in the Spinoff, future postretirement benefit costs are likely to increase when compared to historical amounts. Separate calculations of the components of Solutia's total cost for postretirement benefits and the status of the plans prior to the Spinoff are not available. Subsequent to the Spinoff, the company's postretirement benefit cost was $23 million, and its components were as follows:

	1997
Service costs for benefits earned	$ 4
Interest cost on benefit obligation	20
Amortization of unrecognized net gain	(1)
Total	$ 23

As of December 31, the status of Solutia's postretirement health care and life insurance benefit plans, and employee disability benefit plans was:

Accumulated benefit obligation:	1997
Retirees	$ 762
Eligible active employees	32
Other active employees	124
Total	$ 918
Unrecognized benefits from prior service	27
Unrecognized subsequent net loss	(32)
Accrued liability	$ 913

The accrued liability was included in :

	1997
Miscellaneous accruals	$ 91
Postretirement liabilities	822
Accrued liability	$ 913

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Postretirement benefit costs were determined using the following rate assumptions:

	1997
Discount rate	7.25%
Initial trend rate for health care costs	5.00%
Ultimate trend rate for health care costs	5.00%

A 1 percent increase in the assumed trend rate for health care costs would have increased the accumulated benefit obligation by $38 million as of December 31, 1997.

12. Employee Savings Plans

For some employee savings plans, employee contributions are matched in part by Solutia. The value of these contributions for Solutia was $10 million in 1997 and $11 million in 1996 and 1995.

In connection with the Spinoff, Monsanto common stock held by the Monsanto Employee Stock Ownership Plan ("ESOP") and related Monsanto ESOP borrowings were allocated between Solutia and Monsanto. As a result of this allocation, Solutia received 2.4 million shares of Monsanto common stock and assumed $29 million of ESOP debt to third parties. Simultaneously, Solutia created its own ESOP, established a trust to hold the Monsanto shares and issued a $29 million loan to the trust. Proceeds of the loan were used by the trust to repay the assumed third-party debt. Subsequent to the Spinoff, the ESOP trust was required by government regulations to divest its holdings of Monsanto common shares and use the proceeds to acquire Solutia common shares. As of December 31, 1997, Solutia's ESOP trust held approximately 9.9 million shares of Solutia common stock and approximately $21 million of cash.

A portion of the ESOP shares is allocated each year to employee savings accounts as matching contributions. In 1997, 232,674 shares were allocated to participants' accounts under the plan, leaving 3,700,792 unallocated shares as of December 31, 1997. Unallocated shares held by the ESOP are considered outstanding for earnings per share calculations. Compensation expense is equal to the cost of the shares allocated to participants, less dividends paid on the shares held by the ESOP. Information regarding the ESOP follows:

	1997	1996	1995
Total ESOP expense	$ 5	$ 3	$ 5
Interest portion of total ESOP expense	3	2	3
Cash contributions	–	–	–
Dividends paid on ESOP shares held	–	–	–

For periods prior to the Spinoff, the total Monsanto ESOP expense and the related interest were allocated to Solutia from Monsanto. Cash contributions and dividends paid on ESOP shares for periods prior to the Spinoff were not applicable to the Solutia ESOP.

13. Stock Option Plans

The Solutia Inc. 1997 Stock-Based Incentive Plan (the "1997 Plan") provides to officers and employees of the company and its subsidiaries incentives directly linked to the price of Solutia's stock. The 1997 Plan is the company's current stock-based incentive plan for management.

The 1997 Plan authorizes up to 7,800,000 shares of company common stock for grants of non-qualified and incentive stock options, stock appreciation rights, restricted stock awards, and bonus stock awards. Shares used may be either newly issued shares or treasury shares or both. Under the 1997 Plan, the exercise price of a stock option must be no less than the fair market value of the company common stock on the grant date. Additionally, the 1997 Plan provides that the term of any stock option granted under the plan may not exceed ten years. As of December 31, 1997, approximately 3,232,275 shares of company common stock remained available for grants under the 1997 Plan.

During 1997, non-qualified stock options granted under the 1997 Plan were 1,046,000 to all current executive officers and other senior executives as a group and 3,519,500 shares to all other employees at an exercise price of $19.25 per share. The options granted in September 1997 to the company's executive officers and other senior executives are accelerated performance options. The options granted to the other management employees are time-based. They become exercisable in thirds, one-third on each of the first three anniversaries of the option grant date.

Certain options granted under Monsanto's stock option plans ("Monsanto Options") to company employees in 1997 prior to the Spinoff were converted into Solutia options with adjustments to preserve their value. In addition, unexercised Monsanto Options granted to Solutia and Monsanto employees prior to 1997 were converted into two awards, one based on Monsanto common stock and one based on Solutia common stock, with the same overall value at the time of the Spinoff as the old award.

Effective January 1, 1996, Solutia adopted Statement of Financial Accounting Standard ("SFAS") No. 123, "Accounting for Stock-Based Compensation." As permitted by the standard, Solutia has elected to continue following the guidance of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," for measurement and recognition of stock-based transactions with employees. Accordingly, no compensation cost has been recognized for Solutia's option plans. Had the determination of compensation cost for these plans been based on the fair value at the grant dates for awards under these plans, consistent with the method of SFAS

No. 123, Solutia's net income would have been reduced to the pro forma amounts indicated below:

	1997	1996	1995
Net Income:			
As reported	$ 192	$ 32	$ 147
Pro forma	159	18	144
Earnings per share, assuming dilution:			
As reported	$1.55	$0.27	$1.27
Pro forma	1.29	0.15	1.24

The resulting compensation expense may not be representative of compensation expense to be incurred on a pro forma basis in future years.

The fair value of each option grant is estimated on the date of grant by using the Black-Scholes option-pricing model.

The following weighted-average assumptions were used to calculate the expense attributable to the company for Monsanto Options granted to company employees in 1997, 1996 and 1995:

	1997	1996	1995
Expected dividend yield	0.3%	1.5%	3.0%
Expected volatility	27.0%	25.0%	20.0%
Risk-free interest rates	6.3%	6.0%	7.1%
Expected option lives (years)	4.0	4.0	4.5

The following weighted-average assumptions were used for grants of Solutia options in 1997:

	1997
Expected dividend yield	0.2%
Expected volatility	25.0%
Risk-free interest rates	5.9%
Expected option lives (years)	4.0

The weighted-average fair values of options granted during 1997 and 1996 were $4.83 and $6.43, respectively.

A summary of the status of the company's stock option plans for the period subsequent to the Spinoff through December 31, 1997 follows:

		Outstanding	
	Exercisable Shares	Shares	Weighted-Average Exercise Price
September 1, 1997	10,269,960	24,122,741	$ 13.48
Granted		4,565,500	19.25
Exercised		(752,102)	9.29
Expired		(118,411)	16.36
December 31, 1997	9,517,858	27,817,728	$ 14.53

The following tables summarize information about stock options outstanding as of December 31, 1997:

Options Outstanding:

Range of Exercise Prices	Shares	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price
$ 3 to 7	5,627,732	3.6 years	$ 5.73
8 to 11	55,479	6.9	10.07
12 to 15	1,722,939	7.5	12.63
16 to 18	15,660,834	7.9	16.47
19 to 23	4,750,744	9.0	19.30
$ 3 to 23	27,817,728	7.2	$ 14.53

Options Exercisable:

Range of Exercise Prices	Shares	Weighted-Average Exercise Price
$ 3 to 7	5,623,032	$ 5.73
8 to 11	44,729	10.18
12 to 15	1,098,815	12.16
16 to 18	2,705,082	16.82
19 to 23	46,200	19.11
$ 3 to 23	9,517,858	$ 9.71

14. Earning per Share

Effective December 31, 1997, Solutia adopted Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings per Share." Under this new standard, the presentation of primary and fully diluted earnings per share required by current standards is replaced by basic and diluted earnings per share. Basic earnings per share measures operating performance assuming no dilution from securities or contracts to issue common stock. Diluted earnings per share measures operating performance giving effect to the dilution that would occur when securities or contracts to issue common stock are exercised or converted.

For periods ended prior to the Spinoff, the number of weighted average shares outstanding and common share equivalents used in the earnings per share calculation was based upon the weighted average number of Monsanto shares outstanding and Monsanto common share equivalents for the applicable period, adjusted for the distribution ratio in the Spinoff of one share of the company's common stock for every five shares of Monsanto common stock.

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The computation of basic earnings per share is reconciled with diluted earnings per share as follows:

1997	Income	Shares	Per-share Amount
Basic Earnings per Share:			
Net income	$192	117.7	$1.63
Effect of Dilutive Securities:			
Common share equivalents - common stock issuable upon exercise of outstanding stock options		6.0	
Diluted Earnings per Share	$192	123.7	$1.55

1996	Income	Shares	Per-share Amount
Basic Earnings per Share:			
Net income	$ 32	116.2	$0.28
Effect of Dilutive Securities:			
Common share equivalents - common stock issuable upon exercise of outstanding stock options		3.6	
Diluted Earnings per Share	$ 32	119.8	$0.27

1995	Income	Shares	Per-share Amount
Basic Earnings per Share:			
Net income	$147	113.5	$1.30
Effect of Dilutive Securities:			
Common share equivalents - common stock issuable upon exercise of outstanding stock options		2.6	
Diluted Earnings per Share	$147	116.1	$1.27

15. Capital Stock

The company's board of directors declared a dividend of one preferred stock purchase right on each share of the company's common stock issued in the distribution of shares by Monsanto to its stockholders on the effective date of the Spinoff. If a person or group acquires beneficial ownership of 20 percent or more, or announces a tender offer that would result in beneficial ownership of 20 percent or more, of the company's outstanding common stock, the rights become exercisable and for every right held, the owner will be entitled to purchase one one-hundredth of a share of a series of preferred stock for $125. If Solutia is acquired in a business combination transaction while the rights are outstanding, for every right held, the holder will be entitled to purchase, for $125, common shares of the acquiring company having a market value of $250. In addition, if a person or group acquires beneficial ownership of 20 percent or more of the company's outstanding common stock, for every right held, the holder (other than such person or members of such group) will be entitled to purchase, for $125, a number of shares of the company's common stock having a market value of $250. Furthermore, at any time after a person or group acquires beneficial ownership of 20 percent or more (but less than 50 percent) of the company's outstanding common stock, the board of directors may, at its option, exchange part or all of the rights (other than rights held by the acquiring person or group) for shares of the company's common stock on a one share-for-every-one-right basis. At any time prior to the acquisition of such a 20 percent position, the company can redeem each right for $0.01. The board of directors is also authorized to reduce the aforementioned 20 percent thresholds to not less than 10 percent. The rights expire in the year 2007.

The company has 10 million shares of preferred stock, par value $0.01 per share, authorized. As of December 31, 1997, there were no preferred shares issued or outstanding.

16. Commitments and Contingencies

Commitments, principally in connection with uncompleted additions to property, were approximately $21 million as of December 31, 1997. Solutia was contingently liable as a guarantor for bank loans totaling approximately $12 million as of December 31, 1997. Monsanto was contingently liable as a guarantor for bank loans and discounted customers' receivables relating to Solutia totaling approximately $16 million as of December 31, 1996. Solutia's future minimum payments under noncancelable operating leases and unconditional purchase obligations are $23 million for 1998, $17 million for 1999, $12 million for 2000, $8 million for 2001, $41 million for 2002, and $15 million thereafter.

Solutia has entered into agreements with customers to supply a guaranteed quantity of certain products annually at prices specified in the agreements. In return, the customers have advanced funds to Solutia to cover the costs of expanding capacity to provide the guaranteed supply. Solutia has recorded the advances as deferred credits and amortizes the amounts to income as the customers purchase the products. At December 31, 1997, the unamortized deferred credits were approximately $59 million.

The more significant concentrations in Solutia's trade receivables at year-end were:

	1997	1996
U.S. chemical industry	$130	$129
U.S. carpet industry	73	79
European chemical industry	41	36

Management does not anticipate losses on its trade receivables in excess of established allowances.

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Solutia's Statement of Consolidated Financial Position included accrued liabilities of $217 million and $150 million as of December 31, 1997 and 1996, respectively, for the remediation of identified waste disposal sites. Expenditures related to remediation activities were $39 million in 1997, $59 million in 1996, and $68 million in 1995. Solutia recorded charges of approximately $34 million ($22 million aftertax) in the fourth quarter of 1997 to increase its environmental reserves. This action was required in order to reflect revised estimates for changed circumstances relating to the ultimate outcome of previously known environmental matters. These revised estimates were based upon further discussions with environmental authorities and the availability of new information from recently completed environmental studies. These events and activities help to define better and to quantify the company's ultimate liability for these matters.

Effective January 1, 1997, Solutia adopted the American Institute of Certified Public Accountants' Statement of Position ("SOP") 96-1, "Environmental Remediation Liabilities." SOP 96-1 establishes authoritative guidance regarding the recognition, measurement and disclosure of environmental remediation liabilities. A charge of approximately $10 million ($6 million aftertax) was recorded in the first quarter of 1997 associated with the adoption of SOP 96-1. The timing of this charge was predicated upon an application of SOP 96-1 in which liabilities arising under the Resource Conservation and Recovery Act ("RCRA") should be recorded when a RCRA corrective measures study ("CMS") is completed. Subsequently, the company reassessed its application of SOP 96-1 and concluded that these liabilities would be recorded over a continuum of events leading up to and including a CMS. As a result, the company recorded in the fourth quarter of 1997 additional charges of approximately $38 million ($24 million aftertax) associated with these RCRA environmental liabilities.

Uncertainties related to all of the company's environmental liabilities are evolving government regulations, the method and extent of remediation and future changes in technology. Because of these uncertainties, the company estimates that potential future expenses associated with these liabilities could be an additional $20 million to $30 million. Although the ultimate costs and results of remediation of contaminated sites cannot be predicted with certainty, they are not expected to result in a material adverse effect on Solutia's consolidated financial position, liquidity, or profitability in any one year.

Monsanto is a party to a number of lawsuits and claims relating to Solutia, for which Solutia has assumed responsibility in the Spinoff and which Solutia intends to defend vigorously. Such matters arise out of the normal course of business and relate to product liability, government regulation, including environmental issues, and other issues. Certain of the lawsuits and claims seek damages in very large amounts. Although the results of litigation cannot be predicted with certainty, management's belief, based upon the advice of Solutia's counsel, is that the final outcome of such litigation will not have a material adverse effect on Solutia's consolidated financial position, profitability or liquidity in any one year, as applicable.

17. Supplemental Data

Supplemental income statement data were:

	1997	1996	1995
Raw material and energy costs	**$1,102**	$1,059	$929
Employee compensation and benefits	**746**	715	794
Current income and other taxes	**149**	134	152
Rent expense	**28**	29	31
Technological expenses:			
Research and development	**60**	81	77
Engineering, commercial development and patent	**27**	7	18
Total technological expenses	**87**	88	95
Interest expense:			
Total interest cost	**49**	41	42
Less capitalized interest	**8**	5	6
Net interest expense	**41**	36	36
Currency losses including equity in affiliates' currency gains and losses	**6**	2	3

18. Segment and Geographic Data

Effective December 31, 1997, Solutia adopted Statement of Financial Accounting Standards ("SFAS") No. 131, "Disclosures about Segments of an Enterprise and Related Information," which redefines how operating segments are determined and requires disclosure of certain financial and descriptive information about a company's operating segments. The required disclosures follow. As permitted by the standard, information for years prior to 1997 was not restated to conform to the new disclosure requirements because it was impracticable to do so. Solutia reported one segment prior to the adoption of SFAS No. 131.

Solutia has three reportable segments: Chemicals, Fibers, and Polymers & Resins. The Chemicals segment produces intermediate chemicals used in other finished products, phosphorus-based products used in food and beverages and personal care products, and specialty fluids and lubricants. The Fibers segment produces *Acrilan* acrylic fibers used in apparel, cloth and brake fibers; nylon carpet fibers for residential and contract markets; and industrial-strength nylon fibers used in tire and other industrial applications. The Polymers & Resins segment produces *Saflex* plastic interlayer used in automotive and architectural applications, specialty resins used in paints and adhesives, polymer modifiers and plasticizers used in flooring products, sealants, caulks, and adhesives, and *Vydyne* for engineering thermoplastics and nylon 6,6 polymers for fiber applications.

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Solutia's reportable segments are groupings of the company's ten business units, which are managed to focus on key technological strengths of polymer chemistry, phosphorus chemistry, fiber technology, and process engineering expertise. Business units sharing similar economic characteristics and similarities in the areas of products, production processes, types of customers, and methods of distribution were aggregated.

Accounting policies of the segments are the same as those described in the summary of significant accounting policies in Note 2. However, segment profit only reflects the operating expenses that are directly attributable to the segment. Unallocated service costs are managed centrally and primarily include costs of technology, engineering and manufacturing services that are provided to the segments. These amounts also include corporate administration costs. The company accounts for intersegment sales at agreed upon transfer prices. Intersegment sales are eliminated in consolidation. Segment assets consist primarily of customer receivables, finished goods inventories, and fixed assets directly associated with the production processes of the segment ("direct fixed assets"). Segment depreciation and amortization is based upon direct fixed assets. Unallocated assets consist primarily of deferred taxes, certain investments in equity affiliates, and indirect fixed assets.

Solutia's 1997 segment information follows:

Segment:	Net Sales	Intersegment Sales	Depreciation and Amortization
Chemicals	$ 965	$18	$ 37
Fibers	979	–	26
Polymers & Resins	1,041	5	41
Segment Totals	2,985	23	104
Reconciliation to consolidated totals:			
Elimination of intersegment sales	(23)	(23)	
Other revenues	7		
Unallocated depreciation and amortization			38
Consolidated Totals	$2,969	$ –	$142

Segment:	Profit	Assets	Capital Expenditures
Chemicals	$ 231	$ 601	$ 50
Fibers	161	400	33
Polymers & Resins	272	571	55
Segment Totals	664	1,572	138
Reconciliation to consolidated totals:			
Less unallocated service costs included in:			
Cost of goods sold	(148)		
Marketing, administrative and technological expenses	(226)		
Equity earnings from affiliates	31		
Interest expense	(41)		
Other income (expense) – net	10		
Income Before Income Taxes	$ 290		
Unallocated assets and capital expenditures		1,196	27
Consolidated Totals		$2,768	$165

Solutia's geographic information for 1997 follows:

Segment:	Net Sales	Long-Lived Assets
U.S.	$2,030	$803
Other countries	939	120
Consolidated Totals	$2,969	$923

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19. Quarterly Data – Unaudited

		First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total Year
Net Sales	**1997**	**$ 719**	**$ 770**	**$ 749**	**$ 731**	**$2,969**
	1996	705	749	753	770	2,977
Gross Profit	**1997**	**176**	**189**	**173**	**115**	**653**
	1996	160	175	200	117	652
Operating Income (Loss)	**1997**	**95**	**97**	**88**	**10**	**290**
	1996	56	62	96	(181)	33
Net Income (Loss)	**1997**	**65**	**62**	**56**	**9**	**192**
	1996	36	47	61	(112)	32
Earnings (Loss) per Share	**1997**	**0.56**	**0.52**	**0.47**	**0.08**	**1.63**
	1996	0.31	0.41	0.52	(0.96)	0.28
Earnings (Loss) per Share, assuming dilution	**1997**	**0.54**	**0.51**	**0.44**	**0.06**	**1.55**
	1996	0.30	0.39	0.51	(0.93)	0.27

In the first quarter of 1997, net income included an aftertax charge of $6 million associated with the adoption of SOP 96-1 for environmental reserves at operating locations. Net income in the second quarter of 1997 included an aftertax charge of $6 million for environmental-related litigation at the Brio Superfund site and $5 million of aftertax reversals of excess restructuring reserves from prior years. In the fourth quarter of 1997, net income included aftertax charges totaling $46 million related to changes in estimates for environmental remediation liabilities.

Net income for the fourth quarter of 1996 included an aftertax charge of $164 million for restructuring and other actions.

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Financial Summary

(Dollars in millions, except per share)

	Unaudited Pro Forma (1)		Historical				
Operating Results:	1997	1996	1997	1996	1995	1994	1993
Net Sales(2)	$ 2,960	$ 2,962	$ 2,969	$ 2,977	$ 2,964	$ 3,097	$ 3,028
Gross Profit	647	649	653	652	721	729	699
As percent of net sales	22%	22%	22%	22%	24%	24%	23%
Marketing, Administrative and Technological Expenses	393	420	363	427	410	439	438
As percent of net sales	13%	14%	12%	14%	14%	14%	14%
Operating Income(3)	254	37	290	33	258	256	300
As percent of net sales	9%	1%	10%	1%	9%	8%	10%
Income Before Income Taxes	235	9	290	33	231	228	290
Net Income(4)	157	17	192	32	147	149	192
As percent of net sales	5%	<1%	6%	1%	5%	5%	6%
Share Data:							
Earnings per Share(5)	$ 1.33	$ 0.15	$ 1.63	$ 0.28	$ 1.30	$ 1.30	$ 1.61
Earnings per Share, assuming dilution(5)	1.27	0.14	1.55	0.27	1.27	1.27	1.59
Dividends per Share			0.01				
Common Stock Price:							
High	–	–	27 3/4	–	–	–	–
Low	–	–	18 11/16	–	–	–	–
Close	–	–	26 11/16	–	–	–	–
Price/Earnings Ratio on Year-End Stock Price	–	–	17	–	–	–	–
Number of Registered Stockholders	–	–	57,894	–	–	–	–
Year-end Shares Outstanding (in thousands)	–	–	117,408	–	–	–	–
Shares Repurchased (in thousands)	–	–	1,570	–	–	–	–
Average Daily Trading Volume (in thousands)	–	–	1,053	–	–	–	–
Other Data:							
Interest Expense(6)	$ 60	$ 64	$ 41	$ 36	$ 36	$ 29	$ 19
Income Taxes	78	(8)	98	1	84	79	98
Depreciation and Amortization	142	166	142	166	162	219	224
Total Assets	–	2,660	2,768	2,483	2,462	2,435	2,491
Capital Expenditures	–	–	165	192	179	187	179
Intercompany Charges(7)	–	–	12	85	72	69	61
Long-Term Debt(6)	–	–	597	0	0	0	0
Employees (year-end)	–	–	8,800	–	–	–	–

(1) The unaudited pro forma financial information is presented for illustrative purposes only. It may not be indicative of the results that would have been obtained had the Spinoff and the company's 1997 debt offering actually occurred on the dates assumed, nor is it indicative of the future consolidated results of operations.

(2) Net sales for the company included $140 million in 1995, $400 million in 1994 and $407 million in 1993 for its rubber chemicals business. In May 1995, this business was contributed by Monsanto to the Flexsys L.P. joint venture.

(3) Operating income includes (charges) credits for restructuring and other actions of $(84) million in 1997, $(248) million in 1996, $(46) million in 1995, $(34) million in 1994 and $43 million in 1993. In addition, operating income in 1993 includes $25 million for the company's rubber chemicals business. Operating income for this business was not significant in 1994 and 1995.

(4) Net income includes (charges) credits for restructuring and other actions of $(53) million, or $(0.43) per share in 1997, $(164) million, or $(1.37) per share in 1996, $(52) million, or $(0.45) per share in 1995, $(21) million, or $(0.18) per share in 1994, and $26 million, or $0.22 in 1993.

(5) For periods ended prior to the Spinoff, the number of Monsanto weighted average shares outstanding and common share equivalents were adjusted for the distribution ratio in the Spinoff of one share of Solutia's common stock for every five shares of Monsanto common stock.

(6) Monsanto used a centralized approach to cash management and the financing of its operations. As a result, cash and cash equivalents and debt were not allocated to the company in the historical financial statements. Interest expense was allocated to the company in the company's consolidated financial statements to reflect the company's pro rata share of the financing structure of Monsanto.

(7) Prior to the Spinoff, Monsanto provided certain general and administrative services to the company, including finance, legal, treasury, information systems and human resources. The cost of these services was allocated to the company based upon the percentage relationship between the net assets utilized in the company's operations and Monsanto's total net assets, as well as other methods which management believes to be reasonable.

Quarterly Data

(Dollars in millions, except per share)

	Unaudited Pro Forma		Historical		
	1997	1996	1997	1996	1995
Net Sales					
1Q	$ 715	$ 701	$ 719	$ 705	$ 802
2Q	765	745	770	749	756
3Q	749	749	749	753	705
4Q	731	767	731	770	701
Total	$ 2,960	$ 2,962	$ 2,969	$ 2,977	$ 2,964
Gross Profit					
1Q	$ 173	$ 159	$ 176	$ 160	$ 189
2Q	186	174	189	175	183
3Q	173	198	173	200	165
4Q	115	118	115	117	184
Total	$ 647	$ 649	$ 653	$ 652	$ 721
Operating Income (Loss)					
1Q	$ 82	$ 56	$ 95	$ 56	$ 85
2Q	84	62	97	62	71
3Q	78	97	88	96	73
4Q	10	(178)	10	(181)	29
Total	$ 254	$ 37	$ 290	$ 33	$ 258
Income (Loss) Before Income Taxes					
1Q	$ 78	$ 46	$ 99	$ 53	$ 83
2Q	76	62	94	69	65
3Q	74	84	90	90	64
4Q	7	(183)	7	(179)	19
Total	$ 235	$ 9	$ 290	$ 33	$ 231
Net Income (Loss)					
1Q	$ 52	$ 32	$ 65	$ 36	$ 53
2Q	50	43	62	47	41
3Q	46	57	56	61	41
4Q	9	(115)	9	(112)	12
Total	$ 157	$ 17	$ 192	$ 32	$ 147
Earnings (Loss) per Share					
1Q	$ 0.44	$ 0.28	$ 0.56	$ 0.31	$ 0.47
2Q	0.43	0.37	0.52	0.41	0.37
3Q	0.38	0.49	0.47	0.52	0.36
4Q	0.08	(0.99)	0.08	(0.96)	0.10
Total	$ 1.33	$ 0.15	$ 1.63	$ 0.28	$ 1.30
Earnings (Loss) per Share, assuming dilution					
1Q	$ 0.43	$ 0.27	$ 0.54	$ 0.30	$ 0.47
2Q	0.41	0.36	0.51	0.39	0.35
3Q	0.37	0.48	0.44	0.51	0.35
4Q	0.06	(0.97)	0.06	(0.93)	0.10
Total	$ 1.27	$ 0.14	$ 1.55	$ 0.27	$ 1.27

Quarterly Data (Continued)

(Dollars in millions)

Quarterly operating income and net income, both on a pro forma and historical basis, were affected by restructuring and unusual items as follows [expense/(income)]:

Operating Income

	1Q97	2Q97	3Q97	4Q97	1997	1Q96	2Q96	3Q96	4Q96	1996
Cost of employee reductions									$157	$157
Shutdown and consolidation of various facilities and departments		$(8)			$(8)				33	33
Asset impairments									56	56
Environmental-related charges	$10	10		$72	92					
Other costs									2	2
Total	$10	$ 2		$72	$84				$248	$248

Net Income

	1Q97	2Q97	3Q97	4Q97	1997	1Q96	2Q96	3Q96	4Q96	1996
Cost of employee reductions									$100	$100
Shutdown and consolidation of various facilities and departments		$(5)			$(5)				21	21
Asset impairments									35	35
Environmental-related charges	$ 6	6		$46	58					
Other costs									8	8
Total	$ 6	$ 1		$46	$53				$164	$164

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Effects of Restructuring and Unusual Items

(Dollars in millions)

Operating income, pretax income and net income were affected by restructuring and unusual items as follows [expense/(income)]:

	Unaudited Pro Forma		Historical		
	1997	1996	1997	1996	1995
Operating Income					
Cost of employee reductions		$157		$157	$17
Shutdown and consolidation of various facilities and departments	$(8)	33	$(8)	33	36
Asset impairments		56		56	
Insurance-related settlement					(88)
Litigation settlement					41
Environmental-related charges	92		92		
Joint venture integration costs					40
Other costs		2		2	
Total	$84	$248	$84	$248	$46
Pretax Income					
Cost of employee reductions		$157		$157	$22
Shutdown and consolidation of various facilities and departments	$(8)	33	$(8)	33	44
Asset impairments		56		56	
Insurance-related settlement					(88)
Litigation settlement					41
Environmental-related charges	92		92		
Joint venture integration costs					40
Other costs		10		10	
Total	$84	$256	$84	$256	$59
Net Income					
Cost of employee reductions		$100		$100	$17
Shutdown and consolidation of various facilities and departments	$(5)	21	$(5)	21	40
Asset impairments		35		35	
Insurance-related settlement					(55)
Litigation settlement					25
Environmental-related charges	58		58		
Joint venture integration costs					25
Other costs		8		8	
Total	$53	$164	$53	$164	$52

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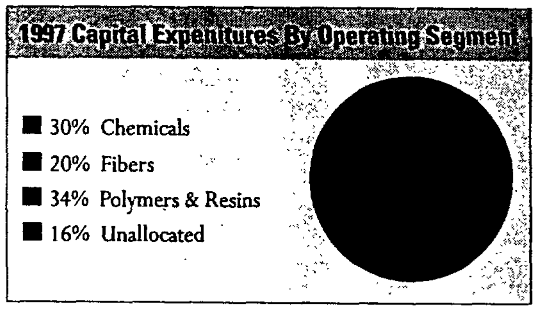
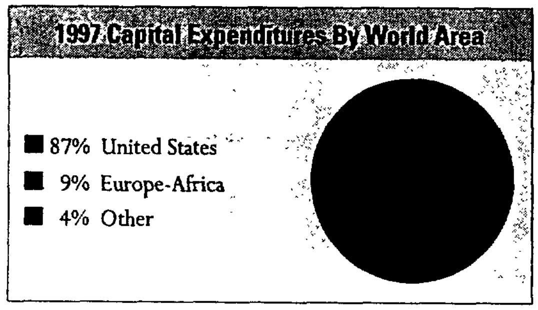
Key Financial Statistics

(Dollars in millions, except per share)

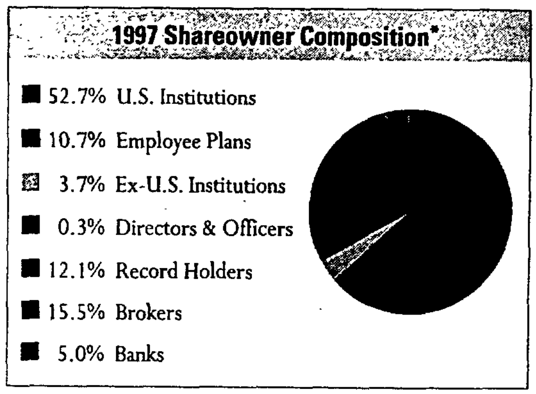
	1997	1996	1995
Working Capital (Current assets less current liabilities)	$106	$121	$231
Current Ratio (Current assets divided by current liabilities)	1.1	1.2	1.4
Trade Receivables - Days Sales Outstanding (Average receivables divided by net sales times 365 days)	51	48	49
Inventory Turnover Ratio (Cost of goods sold divided by inventory)	7.1	8.0	7.2
Interest Coverage Ratio (Income before interest expense and income taxes divided by total interest cost)	6.8	1.7	6.4
Cash Provided by Operations/Total Debt	20%	N/A	N/A
Total Debt/Total Capitalization (Total capitalization equals the sum of short-term debt, long-term debt and stockholders' equity)	120%	N/A	N/A





Share Data

	1997	1996
Earnings per Share, assuming dilution	$ 1.55	$ 0.27
Pro Forma Earnings per Share (Unaudited), assuming dilution	$ 1.27	$ 0.14
Common Stock Price:		
High	27 3/4	N/A
Low	18 11/16	N/A
Close	26 11/16	N/A
Price/Earnings Ratio on Year-End Stock Price	17	N/A
Dividends per Share[1]	$ 0.01	N/A
Other Share Data:		
Number of registered stockholders	57,894	N/A
Year-end shares outstanding (in thousands)	117,408	N/A
Shares repurchased (in thousands)	1,570	N/A
Average daily share trading volume (in thousands)	1,053	N/A



* Based upon estimated information provided by Georgeson & Company Inc.

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[1] Because Solutia was not formed as an independent public company until September 1, 1997, only one quarterly dividend was paid in 1997.

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Businesses and Products

Solutia manages its businesses as a single enterprise, to keep costs low and opportunities for synergy, high. All of the following units share a single staff for administrative functions (e.g., legal, human resources, controllership) and technical product support.

Fibers Segment

Acrilan **Acrylic Fibers.** We are North America's largest producer of acrylic fiber, which is used to make finished products such as apparel, craft yarns, upholstery fabrics and brake fibers. Our *Acrilan* trademark is widely recognized in the industry, as are the brand names used to identify products made with *Acrilan*, such as *Wear-Dated* upholstery and *Wintuk, Sayelle* and *Bounce-Back* fibers for craft yarns.

Carpet Fibers. Solutia is the world's largest producer of nylon staple fiber and major nylon BCF supplier to the carpet industry in North America. Our products are used by carpet mills to make carpeting and rugs for homes, offices, hotels and other buildings. Our carpet fibers are marketed under two of the industry's most respected brand names: *Wear-Dated* carpets for the residential market; and *Ultron* VIP nylon for the contract or commercial market.

Nylon Industrial Fibers. We produce a complete line of industrial-strength nylon fibers, which our customers use to make a wide variety of finished products – from dental floss to cargo slings. Some of our heaviest yarns are used to make bias tires for earth movers, NASA space shuttles and aircraft. Late in 1997, we opened a new production unit for high-tenacity nylon fiber for auto airbags.

Major End-Use Markets	Major Products	Major End-Use Products & Applications	Major Competitors	Major Raw Materials	Major Plants
Construction and Home Furnishings	Nylon carpet staple; nylon bulk continuous filament; *Acrilan* acrylic fiber	Broadloom and commercial carpet; area rugs; bath mats; upholstery fabrics; drapes; blankets	DuPont; Allied Signal; BASF	Acrylonitrile; ammonia; cyclohexane; propylene	Pensacola, FL; Greenwood, SC; Decatur and Foley, AL
Personal Products	*Acrilan* acrylic fiber; nylon polymer	Sweaters; knit apparel; half-hose; active wear; craft yarns; hand-knit yarns; apparel; dental floss	Sterling Chemicals; MonteFibre; Courtaulds plc; Mitsubishi; DuPont	Acrylonitrile; ammonia; cyclohexane; propylene	Pensacola, FL; Decatur, AL
Vehicles and Industrial Applications	Nylon filament; *ACRI-PULP*; acrylic friction fiber	Tires; air bags; brakes; convertible tops; sewing thread; conveyer belts; tents	DuPont; Allied Signal; Sterling	Acrylonitrile; ammonia; cyclohexane; propylene	Pensacola, FL; Decatur, AL; Greenwood, SC

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Chemicals Segment

Industrial Products. Solutia is a leading manufacturer of specialty industrial fluids and lubricants, known for their high performance characteristics. Our products include *Skydrol* hydraulic fluids for aviation, *Therminol* heat transfer fluids, *SkyKleen* environmentally friendly solvent, *Dequest* water treatment chemicals, and *Glacier Metalworking Fluids*. *Glacier* fluids are the industry's first environmentally-friendly lubricants for metalworking operations such as drilling and grinding that generate no oil mist and are biodegradable.

Intermediates. Solutia manufactures more than three dozen "building block" chemicals which are used to make a number of finished products, such as pigments, herbicides, solvents, resins, fertilizers, detergents and animal feed supplements. Our intermediates business is built around proprietary process technology, exceptional product quality and world-class manufacturing scale.

Phosphorus Derivatives. Solutia is a world leader in developing and marketing applications for phosphorus chemistry. Our proprietary products are used in a wide range of industries, including food and beverage ingredients; personal care products such as toothpaste; industrial cleaners; specialty chemicals; and fire retardants such as *Phos-Chek* which is dropped from aircraft to extinguish forest and brush fires.

Major End-Use Markets	Major Products	Major End-Use Products & Applications	Major Competitors	Major Raw Materials	Major Plants
Capital Equipment	*Therminol* heat transfer fluids; *Dequest* water treatment chemicals; *Glacier Metalworking Fluids*	Heat transfer fluids; scale inhibitors; oil field chemicals; lubricant for machining operations such as grinding, drilling and threading	Dow Chemical Co.; Nippon Steel Chemical Co.; Albright & Wilson; Bayer Corp.	Benzene; phenol; phosphorus trichloride	Alvin, TX; Anniston, AL; Newport, Wales (UK); St. Louis, MO; Bridgeport, NJ
Vehicles/ Transportation	*Skydrol* aviation hydraulic fluids; *SkyKleen* aviation solvents	Hydraulic fluids for commercial aircraft; cleaning fluids for aviation maintenance	Exxon; DuPont	Phosphorus oxychloride; methanol	St. Louis, MO
Chemicals	Industrial phosphates; phosphoric acid; phosphorus pentasulfide; phosphorus trichloride; acrylonitrile; *Phos-Chek* fire-fighting agents	Oil additives; pesticides; mining chemicals; chemical intermediates; fire retardants	Albright & Wilson; FMC; Rhodia*	Elemental phosphorus	Augusta, GA; St. Louis, MO; Sauget, IL; Trenton, MI
Personal Products	Oral care phosphates; industrial phosphates	Dentifrices; water conditioners; dishwasher detergents	Albright & Wilson; FMC; Rhodia*	Elemental phosphorus	Augusta, GA; Newport, Wales (UK); St. Louis, MO; São José dos Campos, Brazil; Soda Springs, ID; Trenton, MI
Food and Beverage	*Levn-Lite*, *Pan-O-Lite*, and *Leverage* phosphate; *Nutrifos* STP; *Katch* Fish phosphate; phosphoric acid	Leavening agents for bakery goods; agents used in curing and processing meats and poultry; agents for extending shelf life of meats, poultry and fish; soft drink additives	FMC; Rhodia*	Elemental phosphorus	St. Louis, MO; São José dos Campos, Brazil; Trenton, MI
Intermediate Chemicals	Nylon salt; adipic acid; hexamethylenediamine; adiponitrile; acrylonitrile; ammonia; chlorobenzenes	Nylon and acrylic fiber; nylon plastics; herbicides; feed supplements	DuPont; Rhodia*; BASF; Asahi	Natural gas; propylene; benzene; chlorine; cyclohexane	Anniston and Decatur, AL; Alvin, TX; Greenwood, SC; Bridgeport, NJ; Sauget, IL; Pensacola, FL

* The chemicals subsidiary of Rhone-Poulenc S.A.

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Polymers & Resins Segment

Nylon Plastics & Polymers. Solutia makes and sells merchant polymer and a line of *Vydyne* nylon molding resins and extrusion polymers. Our products give plastics molders the ability to add certain performance characteristics to their products, such as heat and chemical resistance and toughness – so they can be used in demanding applications such as electrical connectors and auto parts.

Polymer Modifiers. We use our knowledge of polymer chemistry to manufacture and market a line of polymer modifiers and specialty plasticizers. These products are used by our customers to improve the flexibility, resiliency, and other performance of flooring products, sealants, caulks, adhesives and other finished goods.

Resins. Solutia makes a line of specialty resins which are used in the manufacture of products such as crosslinkers, flow modifiers, pressure sensitive adhesives, paper surface size and plastic products, among others. Our products are marketed under a number of respected brand names, such as *Santosol* solvents, *Gelva* adhesives, *Butvar* specialty binders, and *Modaflow* flow and leveling agents.

***Saflex* Plastic Interlayer.** Solutia is the world's largest producer of polyvinyl butyral, a plastic interlayer used to make laminated glass for automotive and architectural applications. Our *Saflex* brand name is one of the automotive industry's most widely recognized trademarks. In addition, we recently launched a new trademark – *KeepSafe* glass for residential security windows.

Major End-Use Markets	Major Products	Major End-Use Products & Applications	Major Competitors	Major Raw Materials	Major Plants
Construction, Home Furnishings, and Industrial	*Saflex* plastic interlayer; *Modaflow* flow and leveling agents; *Resimene* crosslinkers; *Gelva* pressure sensitive adhesives; *Santicizer* plasticizers; Nylon polymer; AstroTurf* doormats; *Santosol* DME	Architectural glass; coatings and adhesives; resiliant sheet and tile flooring; caulks and sealants; paints; wall coverings; coated fabric; wire and cable; carpet; door mats; environmentally-friendly solvents	DuPont; Cytec Industries; National Starch and Chemical Co.; Ashland Inc.; Rohm & Haas Co.; Air Products and Chemicals Inc.; Akzo-Nobel	Butyraldehyde; ethanol; polyvinyl alcohol; vinyl acetate monomer; acrylate esters; butanol; methanol; formaldehyde; melamine; polyethylene	Antwerp and Ghent, Belgium; Bridgeport, NJ; LaSalle, Canada; Springfield, MA; São José dos Campos, Brazil; Trenton, MI; Pensacola, FL; Addyston, OH; Westport, MO
Vehicles	*Saflex* plastic interlayer; *Resimene* crosslinkers; *Modaflow* flow and leveling agents; *Gelva* pressure sensitive adhesives; *Vydyne* nylon molding resins; Nylon polymer; *Clear Pass* spray suppressors	Windshields; automotive coatings and sealants; automotive interior and exterior and under-the-hood molded parts; tire cord; carpet; spray suppressors	DuPont; Cytec Industries; National Starch and Chemical Co.; Ashland Inc.; Rohm & Haas Co.; Air Products and Chemicals Inc.; Rhodia**	Butyraldehyde; ethanol; polyvinyl alcohol; vinyl acetate monomer; acrylate esters; butanol; formaldehyde; melamine; acrylonitrile; ammonia; cyclohexane; propylene; polyethylene	Antwerp and Ghent, Belgium; Bridgeport, NJ; Foley, AL; LaSalle, Canada; Springfield, MA; Pensacola, FL; São José dos Campos, Brazil; Trenton, MI; Addyston, OH
Personal Products	*Santicizer* plasticizers; *Gelva* adhesives; *Vydyne* nylon molding resins; *Scripset* resins; Nylon polymer	Packaging; medical devices; paper; hosiery and apparel	Ashland Chemical; Cytec Industries; DuPont; Hoechst Celanese; Rhodia**; National Starch and Chemical Co.	Acrylate esters; styrene butyraldehyde; ethanol; formaldehyde; maleic anhydride; melamine; methanol; acrylonitrile; ammonia; cyclohexane; propylene	Springfield, MA; LaSalle, Canada; Greenwood, SC; Addyston, OH

*AstroTurf is a registered trademark of Southwest Recreational Industries, Inc. licensed to Solutia Inc.

** The chemicals subsidiary of Rhone-Poulenc S.A.

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Solutia Growth Opportunities

This table summarizes a number of products and technologies which Solutia has recently launched or is preparing to launch. Through our New Product and Process Development (NPPD) program, we are actively managing several hundred promising growth projects.

Post-Launch Phase	Product Category	Primary Uses and Benefits
***KeepSafe* Max**	*Saflex* plastic interlayer for architectural safety glass	Used to laminate window glass for homes and buildings in hurricane-prone regions; prevents flying debris from penetrating window; eliminates need for storm shutters
***Saflex* for Automotive Side Windows**	*Saflex* plastic interlayer for auto glass	Used to laminate auto side windows; prevents break-ins, car thefts; reduces potential for passenger ejection during accidents
SkyKleen	Aircraft equipment cleaning fluids	A biodegradable, non-combustible aircraft engine and equipment cleaning fluid; replaces traditional solvents; doesn't affect performance of aircraft hydraulics
Skydrol 5	Aircraft hydraulic fluids	An advanced aircraft hydraulic fluid; offers higher temperature stability, improved fuel and maintenance efficiency and reduced environmental impact compared to previous generation products
Early Launch Phase	**Product Category**	**Primary Uses and Benefits**
KeepSafe	*Saflex* plastic interlayer for residential security windows	Used to laminate residential window glass; enhances personal safety by preventing home break-ins
Pet-Agree	Carpeting underlayer	Carpet enhancement system, prevents odors, spills from penetrating carpet backing
Next Generation *Saflex*	*Saflex* plastic interlayer for laminated safety glass	Reformulated *Saflex* product; reduces glass manufacturer's costs by simplifying the lamination process; offers superior performance through improved adhesion
***Gelva* for Postage Stamps**	*Gelva* acrylic pressure-sensitive adhesives	New adhesive formulation; pressure-sensitive, for added convenience; recyclable
***Agrado* Antioxidant**	Animal feed ingredient	Animal feed supplement; improves cattle feed conversion; enhances meat quality
Pre-Launch Phase	**Product Category**	**Primary Uses and Benefits**
One-Step Phenol Manufacturing Process	Chemical intermediate manufacturing	Revolutionary one-step manufacturing process for a widely-used chemical intermediate; creates licensing opportunities for Solutia; improves yields, reduces costs for Solutia, other chemical manufacturers
Dyenamix	Commercial carpet color system	Improved carpet dyeing technology; offers superior color clarity, richness and stability
***Resimine* and *Gelva* Geographic Market Expansion**	Automotive and industrial paints and pressure-sensitive adhesives	New paint, adhesive formulations; products tailored to market demands of European, Asian customers
***Wear-Dated* and *Ultron* Carpet Alliances in China**	Commercial and residential carpeting	Established North American carpet fiber brands, manufacturing technology preparing for launch in China; products, marketing strategy tailored to needs of an emerging market
Fire Safety Products	Phosphorus derivatives	Ingredients for fibers, plastics, fluids; using flame-retardant properties of phosphorus to control and prevent fires in a wide range of products/applications
Next-Generation Paint Crosslinkers	Thermoset paints for automotive, industrial applications	Advanced crosslinker technology; simplifies paint application; reduces environmental impact
Technology Licensing	Acrylonitrile, acrylic fiber and other manufacturing technologies	Advanced manufacturing processes; offering a low-cost supply of intermediate chemicals, or access to world-class technologies through licensing agreements

Locations

Technical Centers

Belgium: Louvain-la-Neuve

United States:
Decatur, Ala.
Springfield, Mass.
(Indian Orchard)
Pensacola, Fla.
St. Louis, Mo.
Springfield, Mass.
(Indian Orchard)
Laguna Hills, Calif.
New York, N.Y.

U.S. Sales Offices

Atlanta, Ga.
Chicago, Ill.
Detroit, Mich.
Houston, Texas

Regional Centers

Belgium: Louvain-la-Neuve

Brazil: Sao Paulo

Singapore: Singapore

United States:
St. Louis, Mo.
Satellite Centers in key countries worldwide

Plant Sites

Belgium: Ghent

Canada: LaSalle, Quebec

Singapore: (1998 startup)

United Kingdom:
Newport, Wales

United States:
Alvin, Texas
(Chocolate Bayou)
Anniston, Ala.
Augusta, Ga.
Bridgeport, N.J.
(Delaware River)
Columbia, Tenn.
Decatur, Ala.
Foley, Ala.
Greenwood, S.C.
Ontario, Calif.
Pensacola, Fla.
Sauget, Ill.
(W.G. Krummrich)
Springfield, Mass.
(Indian Orchard)
St. Louis, Mo.
(Carondolet, J.F. Queeny, Westport)
Trenton, Mich.

Business General Managers

(left to right in photograph)

Ann McCorvey,
Vice President and General Manager, Nylon Plastics & Polymers

Graham Wildsmith,
Vice President and General Manager, Intermediates

Vicki Holt,
Vice President and General Manager, Acrilan

John Ferguson,
Vice President and General Manager, Saflex

Russ Belle,
Vice President and General Manager, Resins

Gary Weihs,
Vice President and General Manager, Industrial Products

Jeff Wolff,
Vice President and General Manager, Carpet Fibers

Norma Curby,
Vice President and General Manager, Phosphorus Derivatives

Bob Toth,
Vice President and General Manager, Polymer Modifiers

Hameed Bhombal,
Vice President and General Manager, Nylon Industrial Fibers

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Guest Operations at:

Belgium: Antwerp

Brazil: São José dos Campos

United States:

Addyston, Ohio (Port Plastics)

Luling, La.

Nitro, W.Va.

Employees

8,800

Selected Joint Ventures

Advanced Elastomer Systems (Elastomers JV with Exxon Corporation)

Flexsys (Rubber chemicals JV with Akzo Nobel N.V. - key plants located at Monongahela, Pa.; Nitro, W.Va.; Ruabon, Wales)

Fosbrasil S.A. (Phosphoric acid JV in Brazil)

Monsanto Chemical Co. Ltd. (*Therminol* Heat Transfer Fluid JV in China)

P4 Joint Venture (with Monsanto Company in Soda Springs, Idaho)

Quimica M (*Saflex* JV in Mexico)

Montor Performance Plastics Co. (Nylon plastics JV with Toray in Detroit, Mich.)

Thailon Six Six Limited (Nylon JV in Thailand)

Staff Team Leaders

(left to right in photograph)

Johnnie Foster,
Vice President and Chief Information Officer

Sheila Feldman,*
Vice President, Human Resources

Dennis Cavner,*
Vice President, Operations Excellence

Gary Dewel,
Vice President, Supply Chain

John Saucier,
Vice President, Strategic Planning, Mergers and Acquisitions

Christy Beckmann,
Vice President, Public Affairs

Roger Hoard,*
Vice President and Controller

Rod Bishop,*
Vice President and Treasurer

Bruce Greer,*
Vice President, Commercial Development

Jerry Mullis,*
Vice President, Technology

Mike Pierle,
Vice President, Environment, Safety and Health

Glenn Ruskin,
Vice President, Government Affairs

* Executive officers

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Board of Directors

Bob Blakely,
56, Executive Vice President and Chief Financial Officer, Tenneco Inc. He also serves as a director of the New York City Ballet, Manhattan and Bronx Council of the Boy Scouts of America.

Joan Bok,
68, Chairman of the Board, New England Electric System. She also serves as a director of Avery Dennison Corporation, the New England Electric System, and John Hancock Mutual Life Insurance Company.

Paul Hatfield,
62, Principal, Hatfield Capital Group. He also serves as a director of DEKALB Genetics Corporation and Penford Corporation.

John Hunter,*
51, President and Chief Operating Officer, Solutia. He also serves as a director of Missouri Baptist Hospital.

Bob Jenkins,
55, Chairman of the Board, CEO, and director of Sundstrand Corporation. He is also a director of AK Steel Holdings Corporation.

Pete Love,
67, retired Chief Executive Officer, National Intergroup, Inc. He serves as a director of AEA Investors.

Frank Metz,
64, retired Senior Vice President, Finance and Planning, and Chief Financial Officer, International Business Machines Corporation. He serves as a director of Allegheny Energy, Inc. and Norrell Corporation.

Bob Potter,*
58, Chairman of the Board and Chief Executive Officer, Solutia. He also serves as a director of Southdown Inc. and Stepan Company.

Bill Ruckelshaus,
65, Chairman, Browning-Ferris Industries, Inc., and Principal, Madrona Investment Group L.L.C. He also serves as a director of Browning-Ferris Industries Inc., Coinstar, Inc., Cummins Engine Co., Inc., Gargoyles, Inc., Monsanto Company, Nordstrom, Inc., and Weyerhaeuser Company.

John Slaughter,
63, President of Occidental College. He also serves as a director of Atlantic Richfield Company, Avery Dennison Corporation, International Business Machines Corporation, and Northrop Grumman Corp.

Secretary:

Karl Barnickol,*
56, Senior Vice President, General Counsel, and Secretary, Solutia.

Advisory Directors:

Bob Clausen,*
53, Senior Vice President and Chief Financial Officer, Solutia.

Mike Miller,*
56, Senior Vice President and Chief Administrative Officer, Solutia. He is a director of Watlow Electric Co.

* Executive officers

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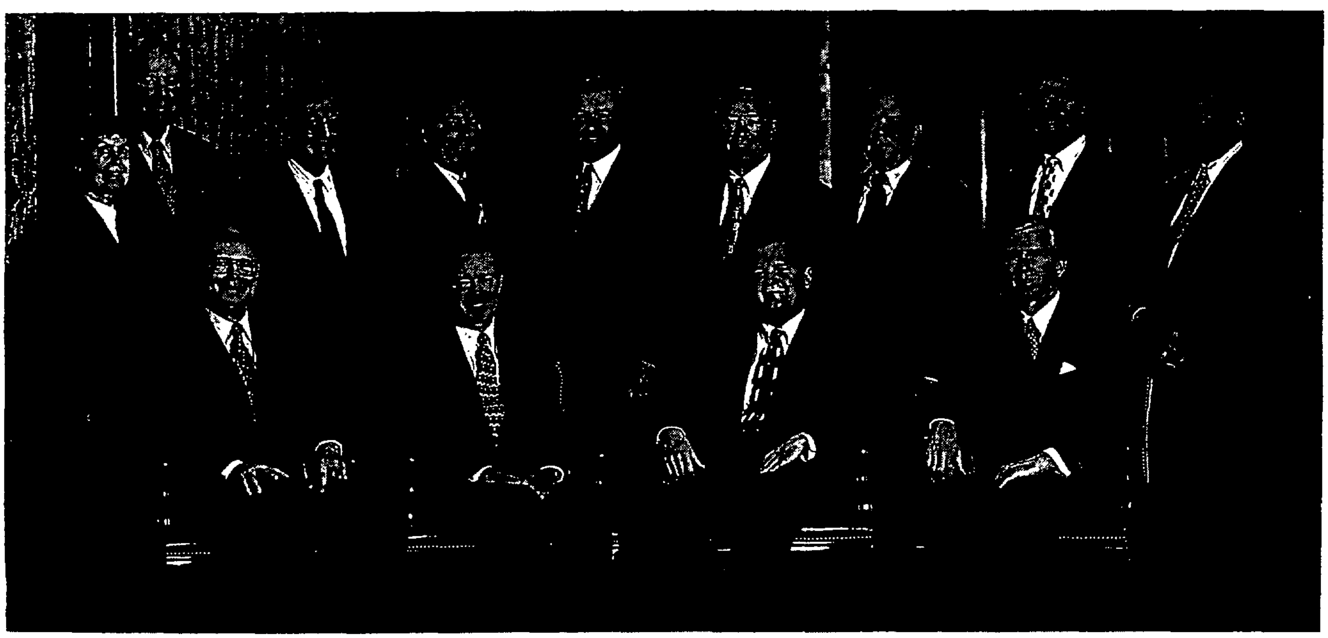

(Seated, left to right) Bill Ruckelshaus, Bob Potter, John Hunter, Bob Blakely; *(standing, left to right)* Joan Bok, Pete Love, Frank Metz, Bob Clausen, Karl Barnickol, Bob Jenkins, Paul Hatfield, Mike Miller, John Slaughter

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Shareholder Information

Stock Listing:

Solutia's stock is traded principally on the New York Stock Exchange. Our stock symbol is SOI.

Dividend Policy:

The declaration and payment of quarterly dividends is made at the discretion of Solutia's Board of Directors. The Board anticipates that its current dividend policy, 4¢/year paid quarterly, will remain unchanged for the foreseeable future. Solutia also uses its share repurchase program as an additional means of returning net income to shareholders.

Shareholder Services:

Please contact Solutia's Transfer Agent and Registrar, First Chicago Trust Company of New York (First Chicago) with questions concerning stock certificates, dividend checks, transfer of ownership, or other matters pertaining to your stock account.

First Chicago can be reached by writing to:
First Chicago Trust
Company of New York
P.O. Box 2500
Jersey City, N.J. 07303-2500

By telephone at its toll free number:
(888) 987-6588 (if you are calling from within the U.S.)

By E-mail at:
fctc@em.fcnbd.com

Dividend Reinvestment Plan:

Solutia shareholders who wish to have their dividends automatically reinvested in Solutia common stock may choose to enroll in the Dividend Reinvestment Plan (DRIP). To receive a DRIP brochure that explains the details of the plan, please contact First Chicago as noted above.

Duplicate Mailings:

If you receive duplicate mailings of Solutia's annual report and would like to help us eliminate redundant mailings, please send your written permission to First Chicago at the above address. (Duplicate mailings can occur if shares are held in multiple accounts, are registered under different names, or are registered with slight differences in names and addresses.) Please include the labels from the duplicate copies, or the names of the accounts and the account numbers.

Additional Information:

Shareholder, financial and other information about Solutia is available to you free of charge from several sources.

On the Internet: You can access financial and other information, such as significant news releases, Forms 10-K and 10-Q, and the text of this annual report on the internet at http://www.solutia.com

By telephone: You can obtain financial information such as Forms 10-K and 10-Q by calling (314)674-4520.

By writing: You can also request these materials by writing: Solutia Inc. Investor Relations - G4NJ P.O. Box 66760 St. Louis, Mo. 63166-6760

Annual Meeting:

The first annual meeting of the Solutia shareholders will be held at 1:45 p.m., Wednesday, April 22, 1998, at Westport Playhouse, 600 West Port Plaza, St. Louis, Mo. 63146. A formal notice of the meeting, together with a proxy statement, is being mailed to each shareholder.

Photo Credits:

We are grateful to the following individuals for permitting their photos to appear in this annual report (listed from left to right):
Page 9: Wendy Gray, principal; Christi Johaningmeyer, project manager, Gray Design Group, Inc.;
Page 11: Wes Harris, instrumentation and electrical technician; Jayne Morris, specialist, Intermediates Technical Center R&D Group, Pensacola, Fla. pilot plant;
Page 13: Gladys Smith, SDI operator; Dale Borths, SDI team leader; Greenwood, S.C. plant;
Page 15: Dan Reilly, plant trainer; Mary Morgan, Total Quality team leader; Eric Smith, materials handler operator, Elisabeth Neff, STP area operator; Carondelet (St. Louis) plant;
Page 17: Herb Brewton, senior safety coordinator, Barbara Jones, *No-Shock* operator, Pensacola, Fla. plant.

We are also grateful for the assistance of Charles H. Pawley Architect PA (Coral Gables, Fla.), designer of the home which appears on page 7.

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Cautionary Statement

This Annual Report contains forward-looking statements that involve risks and uncertainties. The Company's actual results may differ materially from those anticipated in these forward-looking statements. Readers are referred to the Company's Annual Report on Form 10-K for the year ended December 31, 1997, as filed with the Securities and Exchange Commission, which identifies important risk factors that could cause actual results to differ from those contained in the forward-looking statements, including general economic and business and market conditions, customer acceptance of new products, efficacy of new technology and facilities, changes in U.S. and ex-U.S. laws and regulations, costs or difficulties relating to the establishment of the Company as an independent entity, shortages of raw materials and fuels, and increased competitive and/or customer pressure.

SOLUTIA™

Applied Chemistry, Creative Solutions™

Solutia Inc.
10300 Olive Boulevard
P.O. Box 66760
St. Louis, Missouri 63166-6760

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