STAR GAS PARTNERS LP
Form 8-K
June 22, 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934

Date of report (Date of earliest event reported) June 22, 2005

STAR GAS PARTNERS, L.P.

(Exact name of registrant as specified in its charter)

Delaware	**001-14129**	**06-1437793**
(State or other jurisdiction of incorporation)	**(Commission File Number)**	**(IRS Employer Identification No.)**

2187 Atlantic Street, Stamford, CT	**06902**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code (203) 328-7300

Not Applicable

(Former name or former address, if changed since last report.)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

¨ Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

¨ Soliciting material pursuant to Rule 14a-12(b) under the Exchange Act (17 CFR 240.14a-12(b))

¨ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

¨ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

ITEM 8.01 OTHER EVENTS

On December 17, 2004, Star Gas Partners, L.P. (the Partnership) completed the sale of all of its interests in its propane segment to Inergy Propane, LLC for a cash purchase price of approximately $481.3 million. The propane segment was the Partnership s principal distributor of propane and related supplies and equipment to residential, industrial, agricultural and motor fuel customers. Closing and other settlement costs totaled approximately $14 million and approximately $311 million was used to repay outstanding debt of the propane segment and the secured notes at the heating oil segment. $10 million of the proceeds were used to reimburse the heating oil segment for expenses paid on behalf of the Partnership. The remainder of the proceeds were contributed to the heating oil segment as a capital contribution. In accordance with the purchase agreement, the effective date of the disposition was November 30, 2004. The Partnership recognized a gain on the sale of the propane segment totalling approximately $155 million during the year ended September 30, 2005.

This Form 8-K consists of Items 6, 7 and 8 from the Partnership s Annual Report on Form 10-K for the fiscal year ended September 30, 2004, which have been recast to give effect to the sale of the Partnership s propane segment as of November 30, 2004 as discontinued operations and should be read in conjunction with the Partnership s Quarterly Report on Form 10-Q for the three- and six-month periods ended March 31, 2005 filed on May 6, 2005. Except as specifically indicated herein, the information contained in the Form 8-K has not been updated from the information contained in the Form 10-K that was filed with the SEC on December 14, 2004.

ITEM 9.01(c) EXHIBITS

23.1 Consent of Independent Registered Public Accounting Firm

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

STAR GAS PARTNERS, L.P.
By: Star Gas LLC (General Partner)

By: /s/ Richard F. Ambury
Name: Richard F. Ambury
Title: Chief Financial Officer

Principal Financial & Accounting Officer

Date: June 22, 2005

ITEM 6. SELECTED HISTORICAL FINANCIAL AND OPERATING DATA

The selected financial data as of September 30, 2003 and 2004, and for the years ended September 30, 2002, 2003 and 2004 is derived from the financial statements of the Partnership included elsewhere in this Report. The selected financial data as of September 30, 2000 and 2001 and for the fiscal years ended September 30, 2000 and 2001 is derived from financial statements of the Partnership not included elsewhere in this Report. See Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

The following selected financial and other data of the Partnership for fiscal years ended September 30, 2000 through September 30, 2004 have been recast to give effect to the sale of the Partnership s propane segment as of November 30, 2004. The results of the propane segment have been restated as a component of discontinued operations.

	Fiscal Year Ended September 30,				
(in thousands, except per unit data)	2000[c]	2001[c]	2002[c]	2003	2004
Statement of Operations Data:					
Sales	$ 570,877	$ 767,959	$ 790,378	$ 1,102,365	$ 1,105,669
Costs and expenses:					
Cost of sales	403,260	563,803	546,495	793,543	799,055
Delivery and branch expenses	112,820	142,968	174,030	217,244	232,985
General and administrative expenses	12,341	19,374	17,745	39,763	19,937
Depreciation and amortization expenses	22,376	28,595	40,444	35,535	37,313
Operating income	20,080	13,219	11,664	16,883	15,801
Interest expense, net	(16,969)	(20,716)	(23,843)	(29,530)	(36,682)
Amortization of debt issuance costs	(343)	(506)	(1,197)	(2,038)	(3,480)
Loss on redemption of debt				212	
Income (loss) from continuing operations before income taxes	2,768	(8,003)	(13,376)	(14,473)	(24,361)
Income tax expense (benefit)	400	1,200	(1,700)	1,200	1,240
Income (loss) from continuing operations	2,368	(9,203)	(11,676)	(15,673)	(25,601)
Income (loss) from discontinued operations	(1,015)	2,488	507	19,786	20,276
Loss on sale of TG&E segment, net of income taxes					(538)
Cumulative effects of changes in accounting principles for discontinued operations:					
Adoption of SFAS No. 133		(627)			
Adoption of SFAS No. 142				(3,901)	
Income (loss) before cumulative effects of changes in accounting principle for continuing operations	1,353	(7,342)			
Cumulative effects of changes in accounting principle for adoption of SFAS No. 133		2,093			
Net income (loss)	$ 1,353	$ (5,249)	$ (11,169)	$ 212	$ (5,863)
Weighted average number of limited partner units:					
Basic	18,288	22,439	28,790	32,659	35,205
Diluted	18,288	22,552	28,821	32,767	35,205
Per Unit Data:					
Basic and diluted income (loss) from continuing operations per unit [a]	$ 0.13	$ (0.51)	$ (0.64)	$ (0.92)	$ (1.18)

Basic and diluted net income (loss) per unit [(a)]	$ 0.07	$ (0.23)	$ (0.38)	$ 0.01	$ (0.16)
Cash distribution declared per common unit	$ 2.30	$ 2.30	$ 2.30	$ 2.30	$ 2.30
Cash distribution declared per senior sub. unit	$ 0.25	$ 1.98	$ 1.65	$ 1.65	$ 1.73
Balance Sheet Data (end of period):					
Current assets	$ 126,990	$ 185,262	$ 222,201	$ 211,109	$ 234,171
Total assets	$ 618,976	$ 898,819	$ 943,766	$ 975,610	$ 960,976
Long-term debt	$ 308,551	$ 456,523	$ 396,733	$ 499,341	$ 503,668
Partners Capital	$ 139,178	$ 198,264	$ 232,264	$ 189,776	$ 169,771
Summary Cash Flow Data:					
Net Cash provided by operating activities	$ 11,039	$ 38,078	$ 18,773	$ 15,365	$ 13,669
Net Cash provided by (used in) investing activities	$ (41,425)	$ (295,885)	$ (12,381)	$ (48,395)	$ 6,447
Net Cash provided by (used in) financing activities	$ 34,039	$ 263,355	$ 28,135	$ 48,049	$ (19,874)
Other Data:					
Earnings from continuing operations before interest, taxes, depreciation and amortization (EBITDA) [(b)]	$ 42,456	$ 43,907	$ 52,108	$ 52,630	$ 53,114
Heating oil segment s retail gallons sold	345,684	427,168	457,749	567,024	551,612

[(a)] Income (loss) from continuing operations per unit is computed by dividing the limited partners interest in income (loss) from continuing operations by the weighted average number of limited partner units outstanding. Net income (loss) per unit is computed by dividing the limited partners interest in net income (loss) by the weighted average number of limited partner units outstanding.

ITEM 6. SELECTED HISTORICAL FINANCIAL AND OPERATING DATA (Continued)

(b) EBITDA from continuing operations should not be considered as an alternative to net income (as an indicator of operating performance) or as an alternative to cash flow (as a measure of liquidity or ability to service debt obligations), but provides additional information for evaluating the Partnership s ability to make the minimum quarterly distribution. The revolving credit facility and, as applicable, the bridge facility or the senior secured notes, impose certain restrictions on the Partnership s ability to pay distributions to unitholders. On October 18, 2004, the Partnership announced that it would not pay a distribution on the common units. The Partnership had previously announced the suspension of distributions on the senior subordinated units on July 29, 2004. It is unlikely that regular distributions on the common units or senior subordinated units will be resumed in the forseeable future. While the Partnership hopes to position itself to pay some regular distribution on its common units in future years, of which there can be no assurance, it is considerably less likely that regular distributions will ever resume of the senior subordinated units because of their subordination terms.

The definition of EBITDA set forth above may be different from that used by other companies. EBITDA from continuing operations is calculated for the fiscal years ended September 30 as follows:

(in thousands)	2000	2001	2002	2003	2004
Income (loss) from continuing operations	$ 2,368	$ (9,203)	$ (11,676)	$ (15,673)	$ (25,601)
Cumulative effects of changes in accounting principle for adoption of SFAS No. 133 for continuing operations		2,093			
Plus:					
Income tax expense (benefit)	400	1,200	(1,700)	1,200	1,240
Amortization of debt issuance cost	343	506	1,197	2,038	3,480
Interest expense, net	16,969	20,716	23,843	29,530	36,682
Depreciation and amortization	22,376	28,595	40,444	35,535	37,313
EBITDA from continuing operations	$ 42,456	$ 43,907	$ 52,108	$ 52,630	$ 53,114

(c) The Partnership s results for fiscal years ended September 30, 2000, 2001 and 2002 do not reflect the impact of the provisions of SFAS No. 142.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Statement Regarding Forward-Looking Disclosure

This Report includes forward-looking statements which represent the Partnership s expectations or beliefs concerning future events that involve risks and uncertainties, including those associated with the effect of weather conditions on the Partnership s financial performance, the price and supply of home heating oil, the Partnership s ability to obtain satisfactory gross profit margins, the ability of the Partnership to obtain new accounts and retain existing accounts, the realization of savings from the business process redesign project at the heating oil segment, the ability of the Partnership to correct operational problems with such project and the closings of a new revolving credit facility and bridge facility in connection with the refinancing transactions and the sale of the propane segment. All statements other than statements of historical facts included in this Report including, without limitation, the statements under Management s Discussion and Analysis of Financial Condition and Results of Operations and Business and elsewhere herein, are forward-looking statements. Although the Partnership believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct. Important factors that could cause actual results to differ materially from the Partnership s expectations (Cautionary Statements) are disclosed in this Report, including without limitation and in conjunction with the forward-looking statements included in this Report. All subsequent written and oral forward-looking statements attributable to the Partnership or persons acting on its behalf are expressly qualified in their entirety by the Cautionary Statements.

Recent Events

On October 18, 2004, the Partnership announced that it had advised the heating oil segment s bank lenders that this segment would not be able to make the required representations included in the borrowing certificate under its working capital line. In addition, the Partnership notified such lenders that, for the quarter ending December 31, 2004 and for the foreseeable future thereafter, the heating oil segment will be unlikely to satisfy the drawing condition that requires that the consolidated funded debt of the Partnership not exceed 5.00 times its consolidated operating cash flow. Further, the Partnership advised the lenders that the heating oil segment may not be able to maintain a zero balance under the working capital facility (except for letter of credit obligations) for 45 consecutive days from April 1, 2005 to September 30, 2005, as required by the heating oil segment s covenants. The Partnership indicated that the source of the problem is a combination of (a) the inability to pass on the full impact of record heating oil prices to customers and (b) the effects of unusually high customer attrition principally related to the heating oil segment s operational restructuring undertaken in the past 18 months. The Partnership also announced that it anticipated that because of the requirements of the Partnership s current and potential bank lenders, it would not be permitted to make any distributions on its common units.

In addition, the Partnership announced that the heating oil segment s bank lenders had agreed to permit the heating oil segment to request new working capital advances daily while the Partnership was in discussions with such lenders about modifying the terms and conditions of the heating oil segment s credit agreement. In connection with that understanding, the bank lenders requested that the Partnership allow an independent financial advisor to review the heating oil segment s operations and performance on their behalf.

On November 5, 2004, the Partnership announced that the heating oil segment had entered into a letter amendment and waiver under its credit agreement with Wachovia Bank, N.A. The amendment provided for the waiver, through December 17, 2004, of various terms under the credit agreement. As a result of the amendment, the heating oil segment was able to continue to borrow funds under the credit agreement to support its working capital requirements for the near term. The amendment provides for the waiver, through December 17, 2004, of various terms under the credit agreement. The amendment also amends for the waiver period the financial covenant regarding the Partnership s consolidated funded debt to cash flow ratio and the financial covenant regarding the heating oil segment s cash flow to interest expense ratio.

The Partnership also announced that its propane segment had entered into a commitment letter with JPMorgan Securities Inc. and JPMorgan Chase Bank. Under the commitment letter, as amended, JP Morgan Chase Bank committed, subject to certain conditions, to provide a $350 million ($260 million if the propane segment is sold, as discussed below) asset-based senior secured revolving credit facility referred to herein as

the revolving credit facility and a $300 million senior secured bridge facility referred to herein as the bridge facility to refinance (the refinancing transactions) all of the heating oil segment and the propane segment s working capital facilities (if the propane segment is not sold) and senior secured notes.

On December 17, 2004, the Partnership sold its propane segment to Inergy Propane LLC (Inergy) for a net purchase price of $481.3 million. The propane segment was the Partnership s principal distributor of propane and related supplies and equipment to residential, industrial, agricultural and motor fuel customers. Closing and other settlement costs totaled approximately $14 million and approximately $311 million was used to repay the outstanding debt of the propane segment and the secured notes at the heating oil segment. $10 million of the proceeds were used to reimburse the heating oil segment for expenses paid by the heating oil segment on behalf of the Partnership. The remainder of the proceeds were contributed to the heating oil segment (Petro Holdings, Inc.) as a capital contribution. In accordance with the purchase agreement, the effective date of the disposition was November 30, 2004. The Partnership recognized a gain on the sale of the propane segment totaling approximately $155 million during the year ended September 30, 2005.

Results of Operations

Overview

In analyzing the Partnership s financial results, the following matters should be considered.

The following is a discussion of the historical condition and results of operations of the Partnership and its subsidiaries, and should be read in conjunction with the historical Financial and Operating Data and Notes thereto included elsewhere in this Report on Form 8K. The Partnership completed the sale of its TG&E segment in March 2004 and propane segment in December 2004. The following discussion reflects the historical results for the TG&E segment and propane segment as discontinued operations.

The Partnership s fiscal year ends on September 30. All references to quarters and years respectively in this document are to fiscal quarters and years unless otherwise noted. The seasonal nature of the Partnership s business results in the sale of approximately 30% of its volume in the first quarter (October through December) and 45% of its volume in the second quarter (January through March) of each year, the peak heating season, because heating oil is primarily used for space heating in residential and commercial buildings. The Partnership generally realizes net income in both of these quarters and net losses during the quarters ending June and September. The Partnership typically has negative working capital at the end of each fiscal year due to seasonality. In addition, sales volume typically fluctuates from year to year in response to variations in weather, wholesale energy prices and other factors. Gross profit is not only affected by weather patterns but also by changes in customer mix. For example, sales to residential customers ordinarily generate higher margins than sales to other customer groups, such as commercial or agricultural customers. In addition, gross profit margins vary by geographic region. Accordingly, gross profit margins could vary significantly from year to year in a period of identical sales volumes.

As discussed below under the heading Cost of Product, when heating oil wholesale costs increased, the heating oil segment s retail sales prices did not increase as rapidly as the increase in heating oil prices, which resulted in lower per gallon margins. In general, the timing of cost pass-throughs can significantly affect margins.

As of September 30, 2004, the wholesale cost of home heating oil, as measured by the closing price of the New York Mercantile Exchange, had increased by 38% to $1.39 from $1.01 on June 30, 2004. This represents a 78% increase over the heating oil price per gallon of $0.78 on September 30, 2003. Per gallon heating oil prices subsequently increased to a high of $1.59 per gallon on October 22, 2004, before retreating to $1.23 per gallon as of December 10, 2004. The unprecedented rise in the wholesale price of heating oil has adversely impacted the heating oil segment s margins and added to the heating oil segment s difficulties in both attracting new and retaining existing customers. The heating oil segment believes its rate of customer loss has risen not only because of the greater than normal price competition resulting from the rise in oil prices but also because of operational problems in the heating oil segment and management s decision to upgrade the credit quality of its customer base. Prior to the 2004 winter heating season, the heating oil segment attempted to develop a competitive advantage in customer service and, as part of that effort, centralized the heating equipment service and oil dispatch functions and engaged a centralized call center to fulfill its telephone requirements. The implementation of this initiative is taking longer and incurring greater difficulties than the heating oil segment had anticipated, which adversely impacted the customer base. As a result of the above, for the fiscal year ended September 30, 2004, the heating oil segment experienced annual customer attrition of approximately 6.6% excluding the impact of acquisitions. For the fiscal year ended September 30, 2003, before the increase in the price of home heating oil and the full implementation of the business process improvement program, the rate of customer loss was approximately 1.3%.

While the Partnership believes that the heating oil segment has made progress in correcting the early inefficiencies associated with its customer service, and that it has improved its responsiveness to customer needs, the Partnership expects that attrition will continue into the 2004-2005 winter heating season and perhaps beyond. The Partnership notes that even to the extent that attrition can be halted, the current reduced customer base will adversely impact net income for the fiscal year ended September 30, 2005 and perhaps beyond.

Fiscal Year Ended September 30, 2004 (Fiscal 2004)

Compared to Fiscal Year Ended September 30, 2003 (Fiscal 2003)

Statements of Operations by Segment

	Fiscal 2003			Fiscal 2004		
(in thousands)	Heating Oil	Partners & Others	Consol.	Heating Oil	Partners & Others	Consol.
Statements of Operations						
Sales:						
Product	$ 934,967	$	$ 934,967	$ 921,443	$	$ 921,443
Installations, service and appliances	168,001		168,001	183,648		183,648
Total sales	1,102,968		1,102,968	1,105,091		1,105,091
Cost and expenses:						
Cost of product	598,397		598,397	594,153		594,153
Cost of installations, service and appliances	195,146		195,146	204,902		204,902
Delivery and branch expenses	217,244		217,244	232,985		232,985
Depreciation & amortization expenses	35,535		35,535	37,313		37,313
General and administrative expenses	22,356	17,407	39,763	16,535	3,402	19,937
Operating income (loss)	34,290	(17,407)	16,883	19,203	(3,402)	15,801
Net interest expense	22,760	6,770	29,530	28,038	8,644	36,682
Amortization of debt issuance costs	1,655	383	2,038	2,750	730	3,480
(Gain) on redemption of debt	(212)		(212)			
Income (loss) from continuing operations before income taxes	10,087	(24,560)	(14,473)	(11,585)	(12,776)	(24,361)
Income tax expense	1,200		1,200	1,240		1,240
Income (loss) from continuing operations	8,887	(24,560)	(15,673)	(12,825)	(12,776)	(25,601)
Income from discontinued operations		19,786	19,786		20,276	20,276
Loss on sale of TG&E segment, net of taxes					(538)	(538)
Cumulative effect of change in accounting principle for discontinued operations - adoption of SFAS 142		(3,901)	(3,901)			
Net income (loss)	$ 8,887	$ (8,675)	$ 212	$ (12,825)	$ 6,962	$ (5,863)

Volume

For fiscal 2004, retail volume of home heating oil decreased 15.4 million gallons, or 2.7%, to 551.6 million gallons, as compared to 567 million gallons for fiscal 2003. An analysis is found below:

(in millions of gallons)	Heating Oil Segment
Volume Fiscal 2003	567.0
Impact of warmer temperatures	(43.9)
Impact of acquisitions	36.1
Net customer attrition	(18.2)
Other	10.6
Change	(15.4)
Volume Fiscal 2004	551.6

We believe that this 15.4 million gallon decline at the heating oil segment was due to the impact of warmer temperatures and net customer attrition partially offset by acquisitions and other volume changes. Net customer attrition is the difference between gross customer losses and customers added through internal marketing efforts. Customers added through acquisitions do not impact the calculation of net attrition. Temperatures in the heating oil segment s geographic areas of operations were 7.7% warmer in fiscal 2004 than in fiscal 2003 and approximately 0.2% warmer than normal as reported by the National Oceanic Atmospheric Administration (NOAA).

At September 30, 2004, after adjusting for acquisitions, the heating oil segment estimated that it had approximately 6.6% fewer home heating oil customers than as of September 30, 2003. For the quarter ended September 30, 2004, the heating oil segment (excluding acquisitions) lost approximately 11,000 customers (net) as compared to the quarter ended September 30, 2003, in which the heating oil segment lost approximately 1,000 customers (net). We believe that net customer attrition is the result of various factors including but not limited to price, service and credit. The continued rise in the price of heating oil, especially during the fourth quarter of fiscal 2004, added to the heating oil segment s difficulties in reducing customer attrition. The Partnership believes that the unprecedented rise in heating oil prices has increased the competitive pressures facing its heating oil segment. As wholesale prices have risen, many of the Partnership s competitors have not raised their retail prices to fully offset the wholesale price rise. In an effort to minimize the loss of customers to price competition, the Partnership has also not increased its prices to fully offset for the rise in wholesale prices, resulting in reduced margins. Nevertheless, many of the Partnership s competitors appear to have succeeded in inducing the Partnership s customers to leave through various price-related strategies. The Partnership believes that going forward it may need to be even more sensitive to price competition, resulting in the possibility of further reductions in margins.

In addition, prior to the 2004 winter heating season, the heating oil segment attempted to develop a competitive advantage in customer service and, as part of that effort, centralized its heating equipment service dispatch and engaged a centralized call center to respond to telephone inquiries. The implementation of that initiative has taken longer than the heating oil segment anticipated, impacting customer service. The Partnership believes that the heating oil segment s rate of customer loss in fiscal 2004 was due to a combination of higher energy prices, operational and customer service problems together with the implementation of stricter customer credit requirements towards the end of fiscal 2004.

Product Sales

At the heating oil segment, product sales declined by $13.5 million, or 1.4%, to $921.4 million in fiscal 2004, as compared to $935.0 million in fiscal 2003. While warmer temperatures and customer losses at the heating oil segment led to a reduction in product sales, the decline was partially offset by an increase in product sales attributable to acquisitions and higher selling prices.

Sales, Installation, Service and Appliances

At the heating oil segment, installation, service and appliance sales increased $15.6 million, or 9.3%, to $183.6 million for fiscal 2004, as compared to $168.0 million for fiscal 2003 due to acquisitions and measures taken in the last several years to increase service revenues.

Cost of Product

In the heating oil segment, cost of product declined by $4.2 million, or 0.7%, to $594.2 million in fiscal 2004, as compared to $598.4 million in fiscal 2003, as the impact of net customer attrition and warmer temperatures exceeded wholesale cost increases and the additional product requirement for acquisitions.

While selling prices and wholesale prices increased on a per gallon basis, the increase in selling prices exceeded the increase in supply costs during the first nine months of fiscal 2004. At September 30, 2004, heating oil supply costs were approximately 38% higher than at June 30, 2004. During the three months ended September 30, 2004, we were not able to fully pass these increases on to our respective customers. As a result, per gallon margins for the three months ended September 30, 2004 declined by 2.3 cents per gallon at the heating oil segment, as compared to the three months ended September 30, 2003, which partially offset per gallon margin increases that the heating oil segment experienced earlier in the year. The per gallon margins realized in the heating oil segment for the three months ended September 30, 2004 were significantly less than expectations. For fiscal 2004, per gallon margin increases were realized in the base business compared to fiscal 2003 (excluding the impact of acquisitions) of 0.8 cents per gallon at the heating oil segment.

The Partnership continues to experience high wholesale supply costs and believes that it will not be able to pass all these increases on to its customers through retail sales prices. If wholesale supply costs remain volatile and at historically high levels, per gallon profit margins and results are likely to be adversely impacted.

Cost of Installations, Service and Appliances

At the heating oil segment, cost of installations, service and appliances increased $9.8 million, or 5.0%, to $204.9 million in fiscal 2004, as compared to $195.1 million in fiscal 2003. This change was primarily due to acquisitions and wage and other cost increases.

Delivery and Branch Expenses

At the heating oil segment, delivery and branch expenses increased $15.7 million, or 7.2%, to $233.0 million in fiscal 2004, as compared to $217.2 million in fiscal 2003. This increase in the heating oil segment of $15.7 million was due to a higher level of fixed and variable operating costs attributable to acquisitions, (primarily those completed in eastern Pennsylvania) of $10.1 million and approximately $6.3 million due to operating and wage increases. These increases in delivery and branch expenses were partially reduced by cost reductions relating to lower volume delivered due to warmer temperatures and net customer attrition experienced in fiscal 2004. Prior to the 2004 winter heating season, the heating oil segment attempted to develop a competitive advantage in customer service, and as part of that effort centralized its heating equipment service dispatch and engaged a centralized call center to respond to telephone inquiries. Start-up challenges associated with this initiative impacted the customer base and unanticipated training and support was required. The expected savings from this initiative were less than expected.

Depreciation and Amortization

For fiscal 2004, depreciation and amortization expenses increased approximately $1.8 million, or 5%, to $37.3 million, as compared to $35.5 million for fiscal 2003. This increase was primarily due to a larger depreciable base of assets, as a result of the impact of recent acquisitions and to increased depreciation resulting from the technology investment made by the heating oil segment in centralizing its customer service and dispatcher functions.

General and Administrative Expenses

For fiscal 2004, general and administrative expenses declined approximately $20 million, or 50%, to $19.9 million, as compared to $39.8 million for fiscal 2003. At the Partnership level, general and administrative expenses declined by $14.0 million from $17.4 million in fiscal 2003 to $3.4 million in fiscal 2004, due to a $10.4 million reduction in the expense for compensation earned for unit appreciation rights on the Partnership s senior subordinated units, a $2.5 million reduction in restricted stock awards and a reduction of $1.4 million in bonus compensation expense. For fiscal 2004, Partnership level expenses totaled $3.4 million, which included $2.5 million in salary expense and bonus, $4.9 million in legal and administrative costs, partially offset by a credit of $4.0 million for unit appreciation rights. For fiscal 2003, Partnership expenses totaled $17.4 million, which included $3.4 million in salary and bonus expense, $9.0 million in unit appreciation rights and restricted stock awards expense and $5.0 million in legal and administrative costs. At the heating oil segment, general and administrative

expenses declined by $5.8 million, or 26.0%, to $16.5 million in fiscal 2004 from $22.4 million in fiscal 2003. This decline was due to a reduction in certain expenses relating to the heating oil segment s centralized customer service and dispatch project of $7.0 million. The reduction in general and administrative expenses at the heating oil segment was partially offset by $1.2 million in additional expenses due to severance paid and a higher level of legal and professional expenses.

Operating Income (Loss)

For fiscal 2004, operating income decreased approximately $1.1 million, or 6.5%, to $15.8 million, as compared to $16.9 million for fiscal 2003. At the Partnership level, the operating loss decreased by $14.0 million from a $17.4 million loss in fiscal 2003 to a $3.4 million loss in fiscal 2004 due to a $10.4 million reduction in the accrual for compensation earned for unit appreciation rights on Partnership s senior subordinated units, lower restricted stock awards of $2.5 million and lower bonus compensation expense of $1.4 million. At the heating oil segment, operating income declined by $15.1 million, or 44.0%, to $19.2 million, as compared to $34.3 million for fiscal 2003. This decline was due to warmer temperatures of 7.7% in the heating oil segment s geographic areas of operations in fiscal 2004 than in fiscal 2003, net customer attrition, operating and wage increases and higher depreciation and amortization expense, which were reduced in part by the operating income attributable to acquisitions, an increase in per gallon gross profit margins of the base business, lower expenses associated with the heating oil segment s centralized customer service and dispatch project and increased service revenues.

Interest Expense

For fiscal 2004, interest expense increased $6.7 million, or 20%, to $40 million, as compared to $33.3 million for fiscal 2003. This increase was due to higher principal amount of long-term debt outstanding and an increase in the Partnership s weighted average interest rate during fiscal 2004, as compared to fiscal 2003.

Amortization of Debt Issuance Costs

For fiscal 2004, amortization of debt issuance costs increased $1.4 million, or 66.7%, to $3.5 million, as compared to $2.1 million for fiscal 2003. This increase was largely due to the amortization of debt issuance costs for the Partnership s $265.0 million senior notes offerings and for the amortization of bank fees incurred in connection with refinancing certain bank facilities.

Income Tax Expense

Income tax expense for fiscal 2004 was $1.2 million and represents certain state income taxes. The amount recorded in fiscal 2004 was unchanged from fiscal 2003.

Income (Loss) From Continuing Operations

For fiscal 2004, income (loss) from continuing operations decreased $9.9 million, to a loss of $25.6 million, as compared to a loss of $15.7 million for fiscal 2003. This decline was due to a $21.7 million decrease in income at the heating oil segment offset by $12.9 million in lower losses at the Partnership level. Income (loss) from continuing operations declined as the effects of warmer temperatures, other volume changes, including customer losses, operating and wage increases and an increase in interest expense were partially offset by the positive impacts of acquisitions, improved per gallon gross profit margins on the base business and lower compensation expenses at the Partnership level of $14.3 million in the form of unit appreciation rights, restricted stock awards and bonus expense.

Income From Discontinued Operations

For fiscal 2004, income from discontinued operations increased $0.5 million from $19.8 million in 2003 to $20.3 million in 2004. This income relates to the operating results of the TG&E segment that was sold on March 31, 2004 and the propane segment sold on December 17, 2004. Net income attributable to the TG&E segment decreased $0.3 million and net income attributable to the propane segment increased $0.8 million. The TG&E segment includes operations for six months of the fiscal year ended September 30, 2004 and the propane segment includes operations for the entire 2004 fiscal year. Propane segment sales increased approximately $70 million, operating income decreased approximately $1.5 million, and net income increased approximately $0.8 million. The increase in sales is attributable to higher selling prices due to the higher wholesale cost of propane and to a lesser extent an increased customer base resulting from acquisitions. The decrease in operating income is principally due to higher product costs as a result of the higher wholesale cost of propane.

Loss On Sale of TG&E Segment

For fiscal 2004, the Partnership recorded a $0.5 million loss on the sale of the TG&E segment. TG&E was sold in March 2004.

Cumulative Effect of Change in Accounting Principle

For fiscal 2003, the Partnership recorded a $3.9 million charge arising from the adoption of Statement No. 142 to reflect the impairment of its goodwill for TG&E.

Net Income (loss)

For fiscal 2004, net income (loss) decreased $6.1 million, to a loss of $5.9 million, as compared to $0.2 million in income for fiscal 2003. The change was due to a $9.9 million decrease in income from continuing operations, a $0.5 million increase in income from discontinued operations and the $0.5 million loss on the sale of TG&E. Net income was also impacted by the adoption of SFAS No. 142, which resulted in a charge of $3.9 million in fiscal 2003.

Earnings From Continuing Operations Before Interest, Taxes, Depreciation and Amortization (EBITDA)

For the fiscal year ended September 30, 2004, EBITDA increased $0.5 million, or 1.0%, to $53.1 million as compared to $52.6 million for fiscal 2003. This increase was due to $14.0 million additional EBITDA at the Partnership level largely due to the reduction in the accrual for compensation earned for unit appreciation rights, reduced by a decline in EBITDA at the heating oil segment of $13.5 million. EBITDA should not be considered as an alternative to net income (as an indicator of operating performance) or as an alternative to cash flow (as a measure of liquidity or ability to service debt obligations), but provides additional information for evaluating the Partnership s ability to make the minimum quarterly distribution. EBITDA for the Partnership is calculated for the fiscal years ended September 30 as follows:

	Fiscal Year Ended September 30,	
	2003	2004
(in thousands)		
Income (loss) from continuing operations	$ (15,673)	$ (25,601)
Plus:		
Income tax expense	1,200	1,240
Amortization of debt issuance costs	2,038	3,480
Interest expense, net	29,530	36,682
Depreciation and amortization	35,535	37,313
EBITDA	52,630	53,114
Add/(subtract)		
Gain on redemption of debt	(212)	
Income tax expense	(1,200)	(1,240)
Interest expense, net	(29,530)	(36,682)
Unit compensation expense	2,606	86
Provision for losses on accounts receivable	6,601	7,646
Gain on sales of fixed assets, net	(52)	(281)
Change in operating assets and liabilities	(15,478)	(8,974)
Net cash used in operating activities	$ 15,365	$ 13,669

Fiscal Year Ended September 30, 2003 (Fiscal 2003)

Compared to Fiscal Year Ended September 30, 2002 (Fiscal 2002)

Statements of Operations by Segment

	Fiscal 2002			Fiscal 2003		
(in thousands)	Heating Oil	Partners & Others	Consol.	Heating Oil	Partners & Others	Consol.
Statements of Operations						
Sales:						
Product	$ 637,619	$	$ 637,619	$ 934,967	$	$ 934,967
Installations, service and appliances	152,759		152,759	168,001		168,001
Total sales	790,378		790,378	1,102,968		1,102,968
Cost and expenses:						
Cost of product	368,324		368,324	598,397		598,397
Cost of installations, service and appliances	178,171		178,171	195,146		195,146
Delivery and branch expenses	174,030		174,030	217,244		217,244
Depreciation & amortization expenses	40,437	7	40,444	35,535		35,535
General and administrative expenses	13,630	4,115	17,745	22,356	17,407	39,763
Operating income (loss)	15,786	(4,122)	11,664	34,290	(17,407)	16,883
Net interest expense (income)	24,087	(244)	23,843	22,760	6,770	29,530
Amortization of debt issuance costs	1,197		1,197	1,655	383	2,038
(Gain) on redemption of debt				(212)		(212)
Income (loss) from continuing operations before income taxes	(9,498)	(3,878)	(13,376)	10,087	(24,560)	(14,473)
Income tax expense (benefit)	(1,700)		(1,700)	1,200		1,200
Income (loss) from continuing operations	(7,798)	(3,878)	(11,676)	8,887	(24,560)	(15,673)
Income from discontinued operations		507	507		19,786	19,786
Cumulative effect of change in accounting principle for discontinued operations - adoption of SFAS 142					(3,901)	(3,901)
Net income (loss)	$ (7,798)	$ (3,371)	$ (11,169)	$ 8,887	$ (8,675)	$ 212

Volume

For fiscal 2003, retail volume of home heating oil increased 109.3 million gallons, or 23.9%, to 567.0 million gallons, as compared to 457.7 million gallons for fiscal 2002. An analysis is below:

(in millions of gallons)	Heating Oil Segment
Volume Fiscal 2002	457.7
Impact of colder temperatures	125.1
Impact of acquisitions	12.1
Net customer attrition	(14.5)
Other	(13.4)
Change	109.3
Volume Fiscal 2003	567.0

The Partnership believes that this 109.3 gallon increase at the heating oil segment was due to the impact of colder temperatures and acquisitions reduced by net customer attrition and other volume changes. Net customer attrition is the difference between gross customer losses and customers added through internal marketing efforts. Customers added through acquisitions do not impact the calculation of net attrition. Temperatures in the heating oil segment s geographic areas of operations were 32.3% colder in fiscal 2003 than in fiscal 2002 and approximately 10.4% colder than normal as reported by NOAA.

Product Sales

At the heating oil segment, product sales increased by $297.3 million, or 46.6%, to $935.0 million in fiscal 2003, as compared to $637.6 million in fiscal 2002. This increase at the heating oil segment was primarily due to colder temperatures, additional sales from acquisitions and higher selling prices reduced in part by customer attrition. Selling prices at the heating oil segment were higher in fiscal 2003 than in fiscal 2002 in response to higher home heating oil supply costs.

Sales, Installation, Service and Appliances

At the heating oil segment, installation, service and appliance sales increased $15.2 million, or 10.0%, to $168.0 million, as compared to $152.8 million in fiscal 2002 due to acquisitions, colder temperatures and measures taken to increase service revenue.

Cost of Product

In the heating oil segment, cost of product increased by $230.1 million, or 62.5%, to $598.4 million, as compared to $368.3 million for fiscal 2002. This increase was primarily due to colder temperatures, additional sales from acquisitions and higher selling prices, which offset customer attrition. At the heating oil segment, the increase in selling prices exceeded the increase in wholesale supply costs. As a result, per gallon margins increased by 0.7 cents in the base business (excluding the impact of acquisitions).

Cost of Installations, Service and Appliances

At the heating oil segment, cost of installations, service and appliances increased $17.0 million, or 9.5%, to $195.1 million in fiscal 2003, as compared to $178.2 million in fiscal 2002. This change was primarily due to acquisitions and wage and other cost increases.

Delivery and Branch Expenses

For fiscal 2003, delivery and branch expenses increased $43.2 million, or 24.8%, to $217.2 million, as compared to $174 million for fiscal 2002. The period-to-period comparison was impacted by the purchase of weather insurance that allowed the Partnership to record approximately $6.4 million of net weather insurance recoveries in the fiscal 2002 period versus a $3.6 million expense in the fiscal 2003 period for weather insurance premiums paid. The remaining increase in delivery and branch expenses of $43.2 million, for fiscal 2003, was largely due to the additional operating cost associated with increased volumes delivered, higher marketing costs totaling $5.7 million, higher bad debt expense of $2.9 million and the impact of operating expense and wage increases.

Depreciation and Amortization Expenses

For fiscal 2003, depreciation and amortization expenses decreased $4.9 million, or 12.2%, to $35.5 million, as compared to $40.4 million for fiscal 2002. As of October 1, 2002, goodwill is no longer amortized in accordance to SFAS No. 142. Depreciation and amortization expense related to acquisitions and fixed asset additions acquired after September 30, 2002 resulted in increases which partially offset the decrease attributable to goodwill amortization.

General and Administrative Expenses

For fiscal 2003, general and administrative expenses increased $22.1 million, or 125%, to $39.8 million, as compared to $17.7 million for fiscal 2002. This increase was largely due to the inclusion of $7.4 million of incremental expense related to the business process redesign project in the heating oil segment, a $9.9 million increase in the accrual for compensation earned for unit appreciation rights and restricted stock awards previously granted and for other increases of $6.8 million, largely due to increased bonus compensation based upon results for fiscal 2003 ($1.9 million), and higher legal and professional expenses at the Partnership level ($2.4 million). The increase in legal and professional expenses at the Partnership level were largely attributable to achieving and maintaining compliance with SEC rules and regulations, acquisitions and financing related issues.

The heating oil segment undertook to consolidate certain heating oil operational activities in an attempt to create operating efficiencies and cost savings with service technicians being dispatched from two consolidated locations rather than 27 local offices and oil delivery being managed from 11 regional locations rather than 27 local offices. A transition to outsourcing in the area of customer relationship management was undertaken as both a customer satisfaction and a cost-reduction strategy. The Partnership believed outsourcing customer inquiries would improve performance and leverage technology to eliminate system redundancy available from third-party service organizations. In addition, an outsourcing partner has greater flexibility to manage extreme seasonal volume. The complexity of customer interactions combined with the Partnership s goal for service excellence led to protracted training efforts. The heating oil segment began introducing call-based technology enhancements including capabilities for customer inquiries via automated interactive telephone response and the web.

The $7.4 million incremental expense in fiscal 2003 ($9.4 million of actual fiscal 2003 expense) related to this redesign project largely consisted of consulting fees, employee termination benefits and separation cost and travel related expenditures. In connection with this project, the Partnership reduced the size of its work force and recognized a liability of approximately $2.0 million related to certain employee termination benefits and separation costs.

Interest Expense

For fiscal 2003, interest expense increased $6.2 million, or 22.9%, to $33.3 million, as compared to $27.1 million for fiscal 2002. This increase was largely due to additional interest expense of $1.5 million for higher average outstanding working capital borrowings and due to additional interest related to the higher interest rate on the Partnership s $200.0 million debt offering partially offset by interest expense related to the debt repaid with the offering.

Income Tax Expense

For fiscal 2003, income tax expense increased $2.9 million to $1.2 million, as compared to a tax benefit of $1.7 million for fiscal 2002. This increase was due to higher state income taxes based upon the higher pretax earnings achieved for fiscal 2003 and the absence in fiscal 2003 of the tax benefit from a federal tax loss carryback of $2.2 million recorded in fiscal 2002.

Loss from Continuing Operations

For fiscal 2003, net losses from continuing operations increased $4.0 million, to a loss of $15.7 million, as compared to losses of $11.7 million for fiscal 2002. The decrease was principally due to a $16.7 million increase in net income at the heating oil segment, offset by a $20.7 million increase in the net loss at the Partnership level. This increase at the heating oil segment was primarily due to the impact of colder weather on continuing operations and lower depreciation and amortization for continuing operations.

Income (Loss) from Discontinued Operations

For fiscal 2003, the income from discontinued operations increased $19.3 million from income of $0.5 million in fiscal 2002 to income of $19.8 million in fiscal 2003. TG&E was sold on March 31, 2004 and the propane segment was sold as of November 30, 2004. The results of operations for each of these segments are included as discontinued operations. The increase is attributable to increases in the net income of the TG&E segment totaling approximately $12.6 million due principally to the positive impact of colder average temperatures together with a

reduction in bad debt and other collection costs in 2003 compared to 2002. In addition increases in net income at the propane segment of approximately $6.7 million contributed to the increase in income from discontinued operations in 2003. The increase in net income attributed to the propane segment is the result of increased sales of approximately $84 million and associated increased operating income totaling $5 million due principally to an increased customer base as a result of acquisitions, and to a lesser extent colder average temperatures in fiscal 2003 compared to fiscal 2002. The Partnership recorded a $3.9 million decrease in net income in fiscal 2003 arising from the adoption of SFAS No. 142 to reflect the impairment of its goodwill for its TG&E segment.

Net Income (Loss)

For fiscal 2003, net income increased $11.4 million, or 101.9%, to $0.2 million, as compared to a loss of $11.2 million in fiscal 2002. This increase was due almost entirely to the increase in net income from discontinued operations of $19.3 million partially offset by the $3.9 million decrease in net income at the discontinued TG&E segment from the adoption of SFAS No. 142, as well as increased costs at the Partnership level, particularly general and administrative costs ($13 million) and net interest expense ($7.0 million).

Recent Performance

The following is a discussion of certain important factors that have had a significant impact on the Partnership s recent performance.

Volume

For the three months ended September 30, 2004, retail volume of home heating oil decreased 0.7 million gallons, or 1.0%, to 68.5 million gallons, as compared to 69.2 million gallons for the three months ended September 30, 2003. Retail volume sold in the heating segment declined by 1.5 million gallons, or 3.6%, to 44.1 million gallons for the three months ended September 30, 2004, as compared to 42.6 million gallons for the three months ended September 30, 2003. The Partnership believes that this decline was due to the impact of customer attrition throughout fiscal 2004. Based on the preliminary data available to it, the Partnership believes that for the period from October 1, 2004 to November 30, 2004, retail volume sold in the heating oil segment declined by 5.5 million gallons, or 7.3%, to 70.0 million gallons, as compared to 75.4 million gallons in the prior year s comparable period. This was primarily due to the carryover impact of the 6.6% customer attrition from fiscal 2004.

For the three months ended September 30, 2004, the heating oil segment lost 11,000 accounts (net) or approximately 2.2% of its customer base, as compared to the three months ended September 30, 2003 in which the heating oil segment lost 1,000 accounts (net) or approximately 0.2% of its customer base. The Partnership believes that net customer losses are a result of various factors including but not limited to price, service and credit. The continuous rise in the price of heating oil especially during the fourth quarter of fiscal 2004 added to the heating oil segment s difficulties in reducing customer attrition. As of September 30, 2004, the cost of home heating oil, as measured by the closing price of the New York Mercantile Exchange, had increased by 38% to $1.39 from $1.01 on June 30, 2004. The heating oil segment cannot estimate the net customer attrition rate for fiscal 2005. However, even if the net customer attrition rate is reduced, the lower customer base resulting from the fiscal 2004 customer attrition will continue to adversely affect the Partnership during fiscal 2005 and perhaps beyond.

Cost of Product

As of September 30, 2004, the wholesale cost of home heating oil, as measured by the closing price of the New York Mercantile Exchange, had increased by 38% to $1.39 from $1.01 on June 30, 2004. Per gallon heating oil prices subsequently increased to a high of $1.59 per gallon on October 22, 2004, before retreating to $1.23 per gallon as of December 10, 2004.

During the three months ended September 30, 2004, the heating oil segment was not able to fully pass these increases on to their respective customers resulting in a decline in per gallon margins (in the base business, excluding the impact of acquisitions) for the three months ended September 30, 2004 as compared to the three months ended September 30, 2003 of approximately 2.3 cents. The per gallon margin realized was significantly less than expectations.

The heating oil segment continues to experience high wholesale supply costs and believes that it will not be able to pass all these increases on to its customers through retail sales prices. If wholesale supply costs remain at volatile and historically high levels, per gallon profit margins and results are likely to be adversely impacted.

The continuous rise and the volatility in the price of heating oil have adversely impacted the heating oil segment s per gallon gross profit margins.

Liquidity and Capital Resources

The ability of the Partnership to satisfy its obligations will depend on its future performance, which will be subject to prevailing economic, financial, business and weather conditions, the ability to pass on the full impact of record heating oil prices to customers, the effects of higher customer attrition and other factors, most of which are beyond its control. Future capital requirements of the Partnership are expected to be provided by cash flows from operating activities and cash on hand at September 30, 2004. To the extent future capital requirements exceed cash flows from operating activities, the Partnership anticipates that:

a) working capital will be financed by the Partnership s new revolving credit facility as discussed below and repaid from subsequent seasonal reductions in inventory and accounts receivable; and

b) maintenance and growth capital expenditures, mainly for customer tanks, will be financed in fiscal 2005 by the use of the new revolving credit facility.

See Financing and Sources of Liquidity Following Refinancing Transactions below.

Operating Activities

The net cash provided by operating activities of $13.7 million for fiscal 2004 consisted of losses from continuing operations of $25.6 million, non-cash charges of $48.2 million and $8.9 million cash utilized as a result of an increase in operating assets and liabilities. In fiscal 2003, the net cash provided by operating activities totaled $15.4 million. In fiscal 2003, sales increased by $312.5 million, or 39.5%, to $1.1 billion, which resulted in an increase in accounts receivable of $20.7 million or 6.6% of the increase in sales. In contrast to the change from fiscal 2002 to 2003, sales for fiscal 2004 increased $2 million compared to 2003 and resulted in an increase in accounts receivable of $6.2 million.

Investing Activities

During fiscal 2004, the Partnership completed three acquisitions, investing $3.5 million, and spent $4.0 million for capital expenditures. Investing activities also includes $12.5 million received from the sale of TG&E and $1.5 million from the sale of excess fixed assets. As a result, cash flows provided by investing activities were $6.4 million.

During fiscal 2003, the Partnership completed three acquisitions, investing $35.9 million. This expenditure for acquisitions is included in the cash used in investing activities of $48.4 million along with the $12.9 million invested for capital expenditures. Capital expenditures is comprised of $1.5 million of capital additions needed to sustain operations at current levels and $11.4 million for capital expenditures incurred in connection with the heating oil segment s business process redesign program and other capital expenditures to support growth of operations. Investing activities also includes proceeds from the sale of fixed assets of $0.3 million.

Financing Activities

Cash flows used in financing activities were $19.9 million for fiscal 2004. During this period, $105.5 million of cash was provided from the issuance of $70.5 million in the Partnerships 10 1/4% senior notes due 2013 (MLP Notes) and the issuance of $35.0 million in common units. The Partnership also drew down $131 million from its working capital and acquisition facilities. Also during this period $256.4 million of cash was used to pay unit distributions of $79.9 million, $44.5 million went to repay the acquisition facility and other long-term debt, $126 million was used to repay working capital borrowings, and $6.0 million in deferred charges were paid, primarily $5.8 million relating to the renewal, in December 2003, of the heating oil segment s bank credit facilities and debt related financing costs.

As a result of the above activity and $0.2 million of cash provided by discontinued operations, cash increased by $0.4 million to $4.7 million as of September 30, 2004.

Financing and Sources of Liquidity Following Refinancing Transactions

The following discussion gives effect to the sale of the Partnership s propane segment and the refinancing of the Partnership s indebtedness as of December 17, 2004

The heating oil segment executed a new $260 million revolving credit facility agreement with a group of lenders led by JP Morgan Chase Bank, as administrative agent on December 17, 2004. The proceeds of the revolving credit facility and/or the sale of the propane segment were used to refinance the heating oil segment s existing working capital facilities, to refinance all of the outstanding institutional indebtedness of the heating oil segment, including any premiums that are payable thereunder and to pay various transaction expenses.

The revolving credit facility provides the heating oil segment with the ability to borrow up to $260 million for working capital purposes (subject to certain borrowing base limitations), including the issuance of up to $75 million in letters of credit. Obligations under the revolving credit facility are secured by liens on substantially all of the assets of the heating oil segment including accounts receivable, inventory, general intangibles, real property, fixtures and equipment. Obligations under the revolving credit facility are guaranteed by the heating oil segment subsidiaries and by the Partnership.

Under the terms of the revolving credit facility, the heating oil segment must maintain at all times either availability (borrowing base less amounts borrowed and letters of credit issued) of $25.0 million or a fixed charge coverage ratio (as defined) of not less than 1.1 to 1.0.

In the short-term, availability under the Partnership s revolving credit facility could be significantly impacted by the heating oil segment s hedging strategy. The heating oil segment enters into various hedging arrangements to manage the majority of its exposure to market risk related to changes in the current and future market price of home heating oil purchased for resale to its protected price customers. Certain of these instruments are marked to market on a daily basis and the Partnership is required to maintain a cash margin account, which is also adjusted daily. For example, a 10-cent per gallon decline in the market value of these hedged instruments would create an additional cash margin requirement of approximately $5.0 million assuming 50 million gallons, which approximates the maximum volume hedged under the program for fiscal 2005. Availability in the short-term is reduced, as the Partnership funds the margin call. This availability short-fall should be temporary, as the heating oil segment should be able to purchase product at a later date for 10 cents a gallon less than the anticipated strike price when the agreement with the price protected customer was entered into. In addition, a spike in wholesale heating oil prices could also reduce availability, as the Partnership must finance a portion of its inventory and accounts receivable with internally generated cash as the net advance for eligible accounts receivable and inventory under the Revolving Credit Facility is approximately 80%.

Prior to October 18, 2004, the heating oil segment generally was able to obtain trade credit from home heating oil suppliers of two to three business days. Since October 18, 2004, the heating oil segment must now prepay for its heating oil supply by at least two days. The loss of trade credit has reduced availability. Availability is also impacted by outstanding letters of credit.

For the majority of the fiscal year, the amount of cash received from customers with a budget payment plan is greater than actual billings. This amount, which is due to a customer, is reflected on the balance sheet under the caption customer credit balances. Generally, customer credit balances are at their low point after the end of the heating season and peak prior to the beginning of the heating season. At September 30, 2004, before the most recent heating season, customer credit balances were $53.9 million. During the non-heating season, cash is provided from customer credit balances and funds operating activities. If net receipts from budget customers are reduced, availability in the non-heating season will be reduced as the heating oil segment would have to borrow under the revolving credit facility to fund operations.

Pursuant to the terms of the indenture relating to the Partnership s MLP Notes, the Partnership will be obligated, within 360 days of the sale, to apply the net proceeds of the sale of the propane segment either to reduce indebtedness of the Partnership or of a restricted subsidiary, or to make an investment in assets or capital expenditures useful to the Partnership s or any subsidiary s business. To the extent any net proceeds that are not so applied exceed $10 million (excess proceeds), the indenture requires the Partnership to make an offer to all holders of MLP Notes to purchase for cash that number of MLP Notes that may be purchased with excess proceeds at a purchase price equal to 100% of the principal amount of the MLP Notes plus accrued and unpaid interest to the date of purchase. The Partnership cannot determine the amount of excess proceeds that will result from the sale of the propane segment. Accordingly, the Partnership cannot predict the size of any offer to purchase MLP Notes and whether or to what extent holders of MLP Notes will accept the offer to purchase when made.

Following consummation of the refinancing transactions, the Partnership s primary source of liquidity will be internally generated cash, the remaining proceeds from the sale of the propane segment (subject to the repayment of the Partnership s MLP Notes, if any) and the revolving credit facility. At September 30, 2004, the Partnership would have had $152.2 million of cash and cash equivalents available to fund its operations on a pro forma basis after giving effect to the refinancing transactions, sale of the propane segment and before the application of excess proceeds to purchase MLP Notes. Total bank borrowing would be reduced from $8.0 million to zero.

After giving effect to the refinancing transactions and sale of the propane segment, and before the application of excess proceeds to purchase MLP Notes, the Partnership s total long-term debt would have been approximately $269.8 million as of September 30, 2004 compared to $528.1 million on an actual basis.

At March 31, 2005 excess proceeds totalled approximately $93.2 million. The Partnership expects it may utilize all or a portion of the remaining excess proceeds to invest in working capital assets.

The following summarizes the long-term debt maturities that the Partnership would have had as of September 30, 2004, on a pro forma basis, after giving effect to the refinancing transactions and sale of the propane segment:

(in millions)	Refinancing Transactions and Sale of Propane Segment
2005	$ 1.3
2006	$ 94.0*
2007	$
2008	$
2009	$
Thereafter	$ 174.5

* Includes $93.2 million in excess proceeds (as defined) from the sale of the propane segment.

The Partnership expects that its significant liquidity requirements after the refinancing transaction will consist of payments on MLP Notes, working capital requirements and capital expenditures.

The revolving credit facility and the MLP Notes impose certain restrictions on the Partnership, including restrictions on its ability to incur additional indebtedness, to pay distributions, make investments, grant liens, sell its assets and engage in certain other activities. The revolving credit facility also requires the Partnership to maintain certain financial ratios, and contains borrowing conditions and customary events of default, including nonpayment of principal or interest, violation of covenants, inaccuracy of representations and warranties, cross-defaults to other indebtedness, bankruptcy and other insolvency events. The occurrence of an event of default or an acceleration under the revolving credit facility would result in its inability to obtain further borrowings under that facility, which could adversely affect its liquidity. An acceleration under the revolving credit facility would result in a default under the MLP Notes and, as applicable, the Partnership s other funded debt.

Based on the Partnership s current level of operations, the Partnership believes that its existing financial resources together with its current and anticipated cash from operations, the revolving credit facility and the proceeds of the sale of the propane segment should be adequate for the foreseeable future to make required payments of principal and interest on its debt and fund its working capital and capital expenditure requirements. The Partnership cannot assure you, however, that its business will generate sufficient cash flow from operations or that future borrowings will be available under its revolving credit facility in an amount sufficient to enable the Partnership to service its debt, including the MLP Notes, and to fund its other liquidity needs.

To the extent the Partnership makes acquisitions, or otherwise expands its operations in the future, it may require new sources of funding, including additional debt which could further increase its leverage. The Partnership cannot assure you that it will be able to raise any necessary funds in addition to those currently available to the Partnership through bank financing or the issuance of equity or debt securities on terms acceptable to the Partnership, if at all.

The revolving credit facility imposes certain restrictions on the Partnership s ability to pay distributions to unitholders. On October 18, 2004, the Partnership announced that it would not pay a distribution on the common units. The Partnership had previously announced the suspension of distributions on the senior subordinated units on July 29, 2004. It is unlikely that regular distributions on the common units or senior subordinated units will be resumed in the foreseeable future. While the Partnership hopes to position itself to pay some regular distribution on its common units in future years, of which there can be no assurance, it is considerably less likely that regular distributions will ever resume on the

senior subordinated units because of their subordination terms.

Historical Financing and Sources of Liquidity

At September 30, 2004, the Partnership s heating oil segment had a bank credit facility consisting of three facilities totaling $235.0 million having a maturity date of June 30, 2006. These facilities consisted of a $150.0 million revolving credit facility, the proceeds of which are to be used for working capital purposes, a $35.0 million revolving credit facility, the proceeds of which were to be used for the issuance of standby letters of credit in connection with surety, worker s compensation and other financial guarantees, and a $50.0 million revolving credit facility, the proceeds of which were to be used to finance or refinance certain acquisitions and capital expenditures, for the issuance of letters of credit in connection with acquisitions and, to the extent that there is insufficient availability under the working capital facility. At September 30, 2004, $8.0 million of working capital borrowings and $34.5 million of the insurance letters of credit were outstanding.

The Partnership s bank credit facilities and debt agreements contain several financial tests and covenants restricting the various segments and Partnership s ability to pay distributions, incur debt and engage in certain other business transactions. In general these tests are based upon achieving certain debt to cash flow ratios and cash flow to interest expense ratios. In addition, the heating oil segment s working capital facility requires the heating oil segment to maintain a zero balance for at least 45 consecutive days. Failure to comply with the various restrictive and affirmative covenants of the Partnership s various bank and note facility agreements could negatively impact the Partnership s ability to incur additional debt and/or pay distributions and could cause certain debt to become currently payable.

As of September 30, 2004, the Partnership was in compliance with all debt covenants, except for the required ratio of Consolidated Cash Flow to Consolidated Interest Expense (as defined in its credit agreement) in the heating oil segment s bank facility. The heating oil segment obtained a waiver of this covenant on November 5, 2004 through December 17, 2004. On October 13, 2004, the heating oil segment advised its bank lenders that it would not be able to make the required representations included in the borrowing certificate under its working capital line. In addition, the heating oil segment notified its lenders that, for the quarter ending December 31, 2004 and for the foreseeable future thereafter, the heating oil segment will be unlikely to satisfy the drawing condition that requires that the consolidated funded debt of the Partnership not exceed 5.00 times its consolidated operating cash flow. Further, the heating oil segment advised the lenders that the heating oil segment may not be able to maintain a zero balance under the working capital facility (except for letter of credit obligations) for 45 consecutive days from April 1, 2005 to September 30, 2005, as required by the heating oil segment s covenants.

On November 5, 2004, the heating oil segment entered into a letter amendment and waiver under its heating oil segment credit agreement. As a result of the amendment, the heating oil segment expects to be able to continue to borrow funds under the credit agreement to support its working capital requirements for the near term. The amendment provides for the waiver, through December 17, 2004, of various terms under the credit agreement. The amendment also amends for the waiver period the financial covenant regarding the Partnership s consolidated funded debt to cash flow ratio and the financial covenant regarding the heating oil segment cash flow to interest expense ratio. The Partnership is relying upon the closing of the revolving credit facility to provide funds to repay the amounts outstanding under the heating oil segment s current bank facilities and to provide an ongoing source of working capital.

On January 22, 2004, the Partnership and Star Gas Finance Company jointly issued $35.0 million face value senior notes due on February 15, 2013. These notes accrue interest at an annual rate of 10.25% and require semi-annual interest payments on February 15 and August 15 of each year, commencing on February 15, 2004. These notes are redeemable at the option of the Partnership, in whole or in part, from time to time by payment of a premium as defined. These notes were priced at 110.5% for total gross proceeds of $38.7 million. The Partnership also incurred $0.5 million of fees and expenses in connection with the issuance of these notes, resulting in net proceeds of $38.2 million. The net proceeds from the offering were largely used to repay indebtedness.

In February 2004, the Partnership received net proceeds after expenses of $35.0 million from a publicly underwritten equity offering for the sale of 1,495,000 common units. The proceeds from this underwriting were largely used to repay indebtedness.

On July 8, 2004, the Partnership and Star Gas Finance Company jointly issued $30.0 million face value senior notes due on February 15, 2013. These notes accrue interest at an annual rate of 10.25% and require semi-annual interest payments on February 15 and August 15 of each year, commencing on August 15, 2004. These notes are redeemable at the option of the Partnership, in whole or in part, from time to time by payment of a premium as defined. These notes were priced at 106.3% for total gross proceeds of $31.9 million. The Partnership also incurred $0.7 million of fees and expenses in connection with the issuance of these notes, resulting in net proceeds of $31.2 million. The net proceeds from the offering were largely used to repay indebtedness.

The Partnership has $528.1 million of debt outstanding as of September 30, 2004 (amount does not include working capital borrowings of $8.0 million), with significant maturities occurring over the next five years. The following summarizes the Partnership s long-term debt maturities during fiscal years ending September 30, exclusive of amounts that have been repaid through September 30, 2004:

	(in millions)	
2005	$	24.4[(a)]
2006	$	81.4
2007	$	38.7
2008	$	17.6
2009	$	17.5
Thereafter	$	348.5

(a) On November 18, 2004, the Partnership gave notice to holders of the heating oil segment s secured notes of its optional election to prepay such secured notes and gave notice of its optional election to prepay its propane segment s secured notes. As a result, the amount due in fiscal 2005 increases by $233.2 million to $257.6 million.

The Partnership s heating oil segment s bank facilities allow for the refinancing of up to $20.0 million of existing senior debt. The refinancing capabilities are subject to capacity and other restrictions. The Partnership is dependent upon the closing of the bridge facility and/or the sale of the propane segment to fund the repayment of this indebtedness.

In general, the Partnership distributes to its partners on a quarterly basis, all of its Available Cash in the manner described in Note 5 (Quarterly Distribution of Available Cash) of the consolidated financial statements. Available Cash is defined for any of the Partnership s fiscal quarters, as all cash on hand at the end of that quarter, less the amount of cash reserves that are necessary or appropriate in the reasonable discretion of the general partner to (i) provide for the proper conduct of the business; (ii) comply with applicable law, any of its debt instruments or other agreements; or (iii) provide funds for distributions to the common unitholders and the senior subordinated unitholders during the next four quarters, in some circumstances. The revolving credit facility imposes certain restrictions on the Partnership s ability to pay distributions to unitholders. On October 18, 2004, the Partnership announced that it would not pay a distribution on the common units. The Partnership had previously announced the suspension of distributions on the senior subordinated units on July 29, 2004. It is unlikely that regular distributions on the common units or senior subordinated units will be resumed in the foreseeable future. While the Partnership hopes to position itself to pay some regular distribution on its common units in future years, of which there can be no assurance, it is considerably less likely that regular distributions will ever resume on the senior subordinated units because of their subordination items.

In the short-term, availability under the Partnership s revolving credit facility could be significantly impacted by the heating oil segment s hedging strategy. The heating oil segment enters into various hedging arrangements to manage the majority of its exposure to market risk related to changes in the current and future market price of home heating oil purchased for resale to its protected price customers. Certain of these instruments are marked to market on a daily basis and the Partnership is required to maintain a cash margin account, which is also adjusted daily. For example, a 10-cent per gallon decline in the market value of these hedged instruments would create an additional cash margin requirement of approximately $5.0 million assuming 50 million gallons, which approximates the maximum volume hedged under the program for fiscal 2005. Availability in the short-term is reduced, as the Partnership funds the margin call. This availability short-fall should be temporary, as the heating oil segment should be able to purchase product at a later date for 10 cents a gallon less than the anticipated strike price when the agreement with the price protected customer was entered into. In addition, a spike in wholesale heating oil prices could also reduce availability, as the Partnership must finance a portion of its inventory and accounts receivable with internally generated cash as the net advance for eligible

accounts receivable and inventory under the Revolving Credit Facility is approximately 80%.

Prior to October 18, 2004, the heating oil segment generally was able to obtain trade credit from home heating oil suppliers of two to three business days. Since October 18, 2004, the heating oil segment must now prepay for its heating oil supply by at least two days. The loss of trade credit has reduced availability. Availability is also impacted by outstanding letters of credit.

For the majority of the fiscal year, the amount of cash received from customers with a budget payment plan is greater than actual billings. This amount, which is due to a customer, is reflected on the balance sheet under the caption customer credit balances. Generally, customer credit balances are at their low point after the end of the heating season and peak prior to the beginning of the heating season. At September 30, 2004, before the most recent heating season, customer credit balances were $53.9 million. During the non-heating season, cash is provided from customer credit balances and funds operating activities. If net receipts from budget customers are reduced, availability in the non-heating season will be reduced as the heating oil segment would have to borrow under the revolving credit facility to fund operations.

The Partnership believes that the purchase of weather insurance could be an important element in the Partnership s ability to maintain the stability of its cash flows. The Partnership purchased weather insurance that could have provided up to $20.0 million of coverage for the impact of warm weather on the heating oil segment s operating results for the 2002 2003 and 2003 2004 heating seasons. No amounts were received under the policies during fiscal 2003 and fiscal 2004 due to colder than normal temperatures. In addition, the Partnership purchased a base of $12.5 million of weather insurance coverage for each year from fiscal 2005 fiscal 2007 and purchased an additional $7.5 million of weather insurance coverage for fiscal 2005. The amount of insurance proceeds that could be realized under these policies is calculated by multiplying a fixed dollar amount by the degree day deviation from an agreed upon cumulative degree day strike price.

Contractual Obligations and Off-Balance Sheet Arrangements

It is not the Partnership s business practice to enter into off-balance sheet arrangements with third parties. See Note 14 to the Partnership s consolidated financial statements for a description of the Partnership s off-balance sheet arrangements.

Long-term contractual obligations, except for our long-term debt obligations, are not recorded in our consolidated balance sheet. Non-cancelable purchase obligations are obligations the Partnership incurs during the normal course of business, based on projected needs.

The table below summarizes the payment schedule of contractual obligations at September 30, 2004 (in thousands):

	Payments Due by Year				
	Total	**Less Than 1 Year**	**1-3 Years**	**3-5 Years**	**More Than 5 Years**
Long-term debt obligations [a]	$ 503,668	$ (d)	$ 120,094	$ 35,100	$ 348,474
Operating lease obligations [b]	43,377	9,228	12,995	8,410	12,774
Purchase obligations [c]	18,604	9,543	7,053	2,008	
	$ 565,649	$ 18,771	$ 140,142	$ 45,518	$ 361,248

(a) Excludes current maturities of long-term debt of $24.4 million, which are classified within current liabilities. On November 18, 2004, the Partnership gave notice to holders of the heating oil segment s secured notes of its option election to prepay such secured notes and gave notice of its option election to prepay its propane segment s secured notes. As a result, the amount due in fiscal 2005 increases by $233.2 million to $257.6 million.

(b) The Partnership has entered into various operating leases for office space, trucks, vans and other equipment from third parties with lease terms running from one day to 16 years.

(c) Reflects non-cancelable commitments as of September 30, 2004.

(d) Does not include $93.2 million in excess proceeds (as defined) from the sale of the propane segment.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with Generally Accepted Accounting Principles requires management to establish accounting policies and make estimates and assumptions that affect reported amounts of assets and liabilities at the date of the Consolidated Financial Statements. Star Gas evaluates its policies and estimates on an on-going basis. The Partnership s Consolidated Financial Statements may differ based upon different estimates and assumptions. The Partnership s critical accounting policies have been reviewed with the Audit Committee of the Board of Directors.

The Partnership s significant accounting policies are discussed in Note 3 to the consolidated financial statements. The Partnership believes the following are its critical accounting policies:

Goodwill and Other Intangible Assets

The Partnership calculates amortization using the straight-line method over periods ranging from 7 to 15 years for intangible assets with definite useful lives. The Partnership uses amortization methods and determines asset values based on its best estimates using reasonable and supportable assumptions and projections. The Partnership assesses the useful lives of intangible assets based on the estimated period over which the Partnership will receive benefit from such intangible assets such as historical evidence regarding customer churn rate. In some cases, the estimated useful lives are based on contractual terms. At September 30, 2004, the Partnership had $104 million of net intangible assets subject to amortization. If circumstances required a change in estimated useful lives of the assets, it could have a material effect on results of operations. For example, if lives were shortened by one year, the Partnership estimates that amortization for these assets for fiscal 2004 would have increased by approximately $2.5 million.

SFAS No. 142 requires the Partnership s goodwill to be assessed at least annually for impairment. These assessments involve management s estimates of future cash flows, market trends and other factors to determine the fair value of the reporting unit, which includes the goodwill to be assessed. If the carrying amount of goodwill exceeds its implied fair value and is determined to be impaired, an impairment charge is recorded. At September 30, 2004, the Partnership had $233.5 million of goodwill. Intangible assets with finite lives must be assessed for impairment whenever changes in circumstances indicate that the assets may be impaired. Similar to goodwill, the assessment for impairment requires estimates of future cash flows related to the intangible asset. To the extent the carrying value of the assets exceeds it future cash flows, an impairment loss is recorded based on the fair value of the asset. The Partnership tests the carrying amount of goodwill annually during the fourth quarter of its fiscal year. The Partnership has determined that there is no impairment of goodwill at either the heating oil segment or propane segment as of September 30, 2003 and 2004.

Depreciation of Property, Plant and Equipment

Depreciation is calculated using the straight-line method based on the estimated useful lives of the assets ranging from 1 to 30 years. Net property, plant and equipment was $63.7 million for the Partnership at September 30, 2004. If circumstances required a change in estimated useful lives of the assets, it could have a material effect on results of operations. For example, if lives were shortened by one year, the Partnership estimates that depreciation for fiscal 2004 would have increased by approximately $4.0 million.

Assumptions Used in the Measurement of the Partnership s Defined Benefit Obligations

SFAS No. 87, Employers Accounting for Pensions as amended by SFAS No. 132 Employers Disclosure about Pensions and Other Postretirement Benefits requires the Partnership to make assumptions as to the expected long-term rate of return that could be achieved on defined benefit plan assets and discount rates to determine the present value of the plans pension obligations. The Partnership evaluates these critical assumptions at least annually.

The discount rate enables the Partnership to state expected future cash flows at a present value on the measurement date. The rate is required to represent the market rate for high-quality fixed income investments. A lower discount rate increases the present value of benefit obligations and increases pension expense. A 25 basis point decrease in the discount rated used for fiscal 2004 would have increased pension expense by approximately $0.1 million and would have increased the minimum pension liability by another $1.8 million. The Partnership assumed a discount rate of 6.00% as of September 30, 2004.

The Partnership considers the current and expected asset allocations, as well as historical and expected returns on various categories of plan assets to determine its expected long-term rate of return on pension plan assets. The expected long-term rate of return on assets is developed with input from the Partnership s qualified actuaries. The long-term rate of return assumption used for determining net periodic pension expense for fiscals 2003 and 2004 was 8.5% and 8.25% respectively. As of September 30, 2003, this assumption was reduced to 8.25% for determining net periodic pension expense. A further 25 basis point decrease in the expected return on assets would have increased pension expense in fiscal 2004 by approximately $0.1 million.

Over the life of the plans, both gains and losses have been recognized by the plans in the calculation of annual pension expense. As of September 30, 2004, $15.4 million of unrecognized losses remain to be recognized by the plans. These losses may result in increases in future pension expense as they are recognized.

Allowance for Doubtful Accounts

The Partnership periodically reviews past due customer accounts receivable balances. After giving consideration to economic conditions, overdue status and other factors, the Partnership establishes an allowance for doubtful accounts at each of its segments, which it deems sufficient to cover future potential losses. As a result, actual losses could differ from management s estimates; however, based on historical experience, the Partnership does not expect its estimate of uncollectible accounts to vary significantly from actual losses.

Insurance Reserves

The Partnership s heating oil segment has in the past and is currently self-insuring a portion of workers compensation, auto and general liability claims. In February 2003, the propane segment also began self-insuring a portion of its workers compensation claims. The Partnership establishes reserves based upon expectations as to what its ultimate liability may be for these claims using developmental factors based upon historical claim experience. The Partnership continually evaluates the potential for changes in loss estimates with the support of qualified actuaries. As of September 30, 2004, the heating oil segment had approximately $30.1 million of insurance reserves. The ultimate settlement of these claims could differ materially from the assumptions used to calculate the reserves, which could have a material adverse effect on results of operations.

STAR GAS PARTNERS, L.P. AND SUBSIDIARIES

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

AND FINANCIAL STATEMENT SCHEDULE

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All other schedules are omitted because they are not applicable or the required information is shown in the consolidated financial statements or the notes therein.

STAR GAS PARTNERS, L.P. AND SUBSIDIARIES

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Partners of Star Gas Partners, L.P.:

We have audited the consolidated financial statements of Star Gas Partners, L.P. and Subsidiaries as listed in the accompanying index. In connection with our audits of the consolidated financial statements, we have also audited the financial statement schedule as listed in the accompanying index. These consolidated financial statements and financial statement schedule are the responsibility of the Partnership s management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit 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, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Star Gas Partners, L.P. and Subsidiaries as of September 30, 2003 and 2004 and the results of their operations and their cash flows for each of the years in the three-year period ended September 30, 2004, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

The accompanying financial statements have been prepared assuming that the Partnership will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Partnership s home heating oil segment advised its bank lenders that the heating oil segment would not be able to make the required representations included in the borrowing certificate under its working capital line of credit and that it is unlikely that it would be able to meet certain conditions for drawing under this line of credit for the quarter ending December 31, 2004 and for the foreseeable future thereafter. The heating oil segment entered into a letter amendment and waiver under its credit agreement whereby it enables borrowings under its working capital line of credit through December 17, 2004. After that date, no further borrowings will be available under this working capital line of credit. These factors raise substantial doubt about the Partnership s ability to continue as a going concern. Management s plans in regard to these matters are also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Notes 3 and 9 to the consolidated financial statements, Star Gas Partners, L.P. adopted the provisions of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, as of October 1, 2002.

KPMG LLP

Stamford, Connecticut

December 10, 2004, except for the first paragraph of note 4 and note 21, which are as of April 18, 2005

STAR GAS PARTNERS, L.P. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands)	Years Ended September 30, 2003	2004
ASSETS		
Current assets		
Cash and cash equivalents	$ 4,256	$ 4,692
Receivables, net of allowance of $6,346 and $5,622, respectively	84,814	84,005
Inventories	24,146	34,213
Prepaid expenses and other current assets	47,734	60,973
Net current assets of discontinued operations	50,159	50,288
Total current assets	211,109	234,171
Property and equipment, net	75,715	63,701
Long-term portion of accounts receivables	6,108	5,458
Goodwill	232,602	233,522
Intangibles, net	123,415	103,925
Deferred charges and other assets, net	11,676	13,885
Net long-term assets of discontinued operations	314,985	306,314
Total Assets	$ 975,610	$ 960,976
LIABILITIES AND PARTNERS CAPITAL		
Current liabilities		
Accounts payable	$ 19,428	$ 25,010
Working capital facility borrowings	12,000	8,000
Current maturities of long-term debt	12,597	24,418
Accrued expenses	73,134	65,491
Unearned service contract revenue	31,023	35,361
Customer credit balances	49,258	53,927
Net current liabilities of discontinued operations	62,521	50,676
Total current liabilities	259,961	262,883
Long-term debt	499,341	503,668
Other long-term liabilities	26,532	24,654
Partners capital (deficit)		
Common unitholders	210,636	167,367
Subordinated unitholders	(57)	(6,768)
General partner	(3,082)	(3,702)
Accumulated other comprehensive income (loss)	(17,721)	12,874
Total Partners capital	189,776	169,771
Total Liabilities and Partners Capital	$ 975,610	$ 960,976

See accompanying notes to consolidated financial statements.

STAR GAS PARTNERS, L.P. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per unit data)	**Years Ended September 30, 2002**	**2003**	**2004**
Sales:			
Product	$ 637,619	$ 934,967	$ 921,443
Installations, service and appliances	152,759	168,001	183,648
Total sales	790,378	1,102,968	1,105,091
Cost and expenses:			
Cost of product	368,324	598,397	594,153
Cost of installations, service and appliances	178,171	195,146	204,902
Delivery and branch expenses	174,030	217,244	232,985
Depreciation and amortization expenses	40,444	35,535	37,313
General and administrative expenses	17,745	39,763	19,937
Operating income	11,664	16,883	15,801
Interest expense	(27,126)	(33,306)	(40,072)
Interest income	3,283	3,776	3,390
Amortization of debt issuance costs	(1,197)	(2,038)	(3,480)
Loss on redemption of debt		212	
Income (loss) from continuing operations before income taxes	(13,376)	(14,473)	(24,361)
Income tax expense (benefit)	(1,700)	1,200	1,240
Income (loss) from continuing operations	(11,676)	(15,673)	(25,601)
Income from discontinued operations	507	19,786	20,276
Loss on sale of TG&E segment, net of income taxes			(538)
Cumulative effect of changes in accounting principle for discontinued operations - Adoption of SFAS No. 142		(3,901)	
Net income (loss)	$ (11,169)	$ 212	$ (5,863)
General Partner s interest in net income (loss)	$ (116)	$ 2	$ (57)
Limited Partners interest in net income (loss)	$ (11,053)	$ 210	$ (5,806)
Basic and diluted income (loss) from continuing operations per Limited Partner unit	$ (0.40)	$ (0.48)	$ (0.73)
Basic and diluted net income (loss) per Limited Partner unit	$ (0.38)	$ 0.01	$ (0.16)
Weighted average number of Limited Partner units outstanding:			
Basic	28,790	32,659	35,205
Diluted	28,821	32,767	35,205

See accompanying notes to consolidated financial statements.

STAR GAS PARTNERS, L.P. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Years Ended September 30,		
(in thousands)	**2002**	**2003**	**2004**
Net income (loss)	$ (11,169)	$ 212	$ (5,863)
Other comprehensive income (loss):			
Unrealized gain (loss) on derivative instruments	12,968	(5,425)	29,436
Unrealized gain (loss) on pension plan obligations	(11,596)	(1,469)	1,159
Comprehensive gain (loss)	$ (9,797)	$ (6,682)	$ 24,732

Reconciliation of Accumulated Other Comprehensive Income (Loss)

(in thousands)	**Pension Plan Obligations**	**Derivative Instruments**	**Total**
Balance as of September 30, 2001	$ (4,149)	$ (8,050)	$ (12,199)
Reclassification to earnings		16,252	16,252
Unrealized loss on pension plan obligations	(11,596)		(11,596)
Unrealized gain on derivative instruments		(3,284)	(3,284)
Other comprehensive income (loss)	(11,596)	12,968	(1,372)
Balance as of September 30, 2002	(15,745)	4,918	(10,827)
Reclassification to earnings		(8,074)	(8,074)
Unrealized loss on pension plan obligations	(1,469)		(1,469)
Unrealized gain on derivative instruments		2,649	2,649
Other comprehensive loss	(1,469)	(5,425)	(6,894)
Balance as of September 30, 2003	(17,214)	(507)	(17,721)
Reclassification to earnings		(11,843)	(11,843)
Unrealized gain on pension plan obligations	1,159		1,159
Unrealized gain on derivative instruments		41,279	41,279
Other comprehensive income	1,159	29,436	30,595
Balance as of September 30, 2004	$ (16,055)	$ 28,929	$ 12,874

See accompanying notes to consolidated financial statements.

STAR GAS PARTNERS, L.P. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF PARTNERS CAPITAL

Years Ended September 30, 2002, 2003 and 2004

(in thousands, except per unit amounts)	Number of Units								Accumulative Other Comprehensive Income (Loss)	Total Partners Capital
	Common	Senior Sub.	Junior Sub.	General Partner	Common	Senior Sub.	Junior Sub.	General Partner		
Balance as of September 30, 2001	23,394	2,717	345	326	$ 209,911	$ 3,483	$ (711)	$ (2,220)	$ (12,199)	$ 198,264
Issuance of units:										
Common	5,576				100,409					100,409
Senior Subordinated		417				6,742				6,742
Net Loss					(9,815)	(1,115)	(123)	(116)		(11,169)
Other Comprehensive Loss, net									(1,372)	(1,372)
Unit Compensation Expense:										
Common					201					201
Senior Subordinated						166				166
Distributions:										
($2.30 per unit)					(58,010)					(58,010)
($1.65 per unit)						(4,939)				(4,939)
($1.15 per unit)							(398)	(374)		(772)
Balance as of September 30, 2002	28,970	3,134	345	326	242,696	4,337	(1,232)	(2,710)	(10,827)	232,264
Issuance of units	1,701	8			34,180					34,180
Net Income					189	20	1	2		212
Other Comprehensive Loss, net									(6,894)	(6,894)
Unit Compensation Expense:										
Common					204					204
Senior Subordinated						2,402				2,402
Distributions:										
($2.30 per unit)					(66,633)					(66,633)
($1.65 per unit)						(5,188)				(5,188)
($1.15 per unit)							(397)	(374)		(771)
Balance as of September 30, 2003	30,671	3,142	345	326	210,636	1,571	(1,628)	(3,082)	(17,721)	189,776
Issuance of units	1,495	103			34,996					34,996
Net Loss					(5,222)	(530)	(54)	(57)		(5,863)
Other Comprehensive Income, net									30,595	30,595
Unit Compensation Expense:										
Common					76					76
Senior Subordinated						10				10
Distributions:										
($2.30 per unit)					(73,119)					(73,119)
($1.725 per unit)						(5,540)	(597)	(563)		(6,700)
Balance as of September 30, 2004	32,166	3,245	345	326	$ 167,367	$ (4,489)	$ (2,279)	$ (3,702)	$ 12,874	$ 169,771

See accompanying notes to consolidated financial statements.

STAR GAS PARTNERS, L.P. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended September 30,		
(in thousands)	**2002**	**2003**	**2004**
Cash flows provided by (used in) operating activities:			
Net income (loss)	$ (11,169)	$ 212	$ (5,863)
Deduct: (Income) loss from discontinued operations	(507)	(19,786)	(20,276)
Loss on sale of discontinued operations			538
Add: Cumulative effect of change in accounting principles for the adoption of SFAS No. 142 for discontinued operations		3,901	
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	40,444	35,535	37,313
Amortization of debt issuance cost	1,197	2,038	3,480
Loss on redemption of debt		(212)	
Unit compensation expense	367	2,606	86
Provision for losses on accounts receivable	3,716	6,601	7,646
(Gain) loss on sales of fixed assets, net	70	(52)	(281)
Changes in operating assets and liabilities, net of amounts related to acquisitions:			
Decrease (increase) in receivables	8,785	(20,735)	(6,178)
Decrease (increase) in inventories	(2,566)	3,155	(10,067)
Decrease (increase) in other assets	(18,448)	(13,611)	9,300
Increase (decrease) in accounts payable	(11,468)	7,923	5,832
Increase (decrease) in other current and long-term liabilities	8,352	7,790	(7,861)
Net cash provided by (used in) operating activities	18,773	15,365	13,669
Cash flows provided by (used in) investing activities:			
Capital expenditures	(9,105)	(12,851)	(3,984)
Proceeds from sales of fixed assets	1,374	306	1,462
Cash proceeds from disposition of segment, net			12,495
Acquisitions	(4,650)	(35,850)	(3,526)
Net cash provided by (used in) investing activities	(12,381)	(48,395)	6,447
Cash flows provided by (used in) financing activities:			
Working capital facility borrowings	67,000	136,000	128,000
Working capital facility repayments	(44,000)	(153,000)	(126,000)
Acquisition facility borrowings		50,000	3,000
Acquisition facility repayments	(16,000)	(17,000)	(36,000)
Proceeds from issuance of debt		197,333	70,512
Repayment of debt	(14,229)	(119,668)	(8,471)
Distributions	(63,721)	(72,592)	(79,819)
Proceeds from issuance of Common Units	100,244		