

STAR GAS PARTNERS LP
Form 10-Q/A
May 08, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q/A

(Mark One)

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

For the quarterly period ended December 31, 2002

OR

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

For the transition period from _____ to _____

Commission File Number: 33-98490

STAR GAS PARTNERS, L.P.

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(Exact name of registrant as specified in its charter)

Delaware

06-1437793

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

2187 Atlantic Street, Stamford, Connecticut 06902

(Address of principal executive office)

(203) 328-7300

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes

No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes

No

Indicate the number of shares outstanding of each issuer's classes of common stock, as of January 10, 2003:

28,970,446 Common Units

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| | |
|-----------|---------------------------|
| 3,134,110 | Senior Subordinated Units |
| 345,364 | Junior Subordinated Units |
| 325,729 | General Partner Units |

STAR GAS PARTNERS, L.P. AND SUBSIDIARIES

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(in thousands)

| | September 30, 2002 | December 31, 2002 |
|--|-----------------------|----------------------|
| | | (unaudited) |
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 61,481 | \$ 10,524 |
| Receivables, net of allowance of \$8,282 and \$9,683, respectively | 83,452 | 170,838 |
| Inventories | 39,453 | 55,137 |
| Prepaid expenses and other current assets | 37,815 | 33,950 |
| Total current assets | 222,201 | 270,449 |
| Property and equipment, net of accumulated depreciation of \$89,270 and \$95,094, respectively | 241,892 | 240,734 |
| Long-term portion of accounts receivables | 6,672 | 7,232 |
| Goodwill | 264,551 | 260,650 |
| Intangibles, net of accumulated amortization of \$76,257 and \$82,887, respectively | 193,370 | 186,845 |
| Deferred charges and other assets, net | 15,080 | 9,041 |
| Total Assets | \$ 943,766 | \$ 974,951 |
| LIABILITIES AND PARTNERS CAPITAL | | |
| Current liabilities | | |
| Accounts payable | \$ 20,360 | \$ 50,272 |
| Working capital facility borrowings | 26,195 | 92,000 |
| Current maturities of long-term debt | 72,113 | 29,467 |
| Accrued expenses | 69,444 | 73,148 |
| Unearned service contract revenue | 30,549 | 34,377 |
| Customer credit balances | 70,583 | 49,068 |
| Total current liabilities | 289,244 | 328,332 |
| Long-term debt | 396,733 | 386,336 |
| Other long-term liabilities | 25,525 | 28,477 |
| Partners capital | | |
| Common unitholders | 242,696 | 240,317 |
| Subordinated unitholders | 3,105 | 4,387 |
| General partner | (2,710) | (2,551) |
| Accumulated other comprehensive loss | (10,827) | (10,347) |
| Total Partners capital | 232,264 | 231,806 |
| Total Liabilities and Partners Capital | \$ 943,766 | \$ 974,951 |

See accompanying notes to condensed consolidated financial statements.

STAR GAS PARTNERS, L.P. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

| (in thousands, except per unit data) | Three Months Ended December 31, | |
|---|------------------------------------|------------------|
| | 2001 | 2002 |
| Sales: | | |
| Product | \$ 238,835 | \$ 334,712 |
| Installations, service and appliances | 47,388 | 50,268 |
| Total sales | 286,223 | 384,980 |
| Costs and expenses: | | |
| Cost of product | 131,884 | 201,327 |
| Cost of installation, service and appliances | 52,363 | 54,020 |
| Delivery and branch expenses | 56,321 | 74,514 |
| Depreciation and amortization expenses | 14,503 | 12,848 |
| General and administrative expenses | 8,825 | 12,235 |
| TG&E customer acquisition expense | 221 | 614 |
| Operating income | 22,106 | 29,422 |
| Interest expense | (10,903) | (9,031) |
| Interest income | 759 | 661 |
| Amortization of debt issuance costs | (312) | (437) |
| Income before income taxes and cumulative effect of change in accounting principle | 11,650 | 20,615 |
| Income tax provision | 147 | 675 |
| Income before cumulative effect of change in accounting principle | 11,503 | 19,940 |
| Cumulative effect of change in accounting principle for adoption of SFAS No. 142 | | (3,901) |
| Net income | \$ 11,503 | \$ 16,039 |
| General Partner's interest in net income | \$ 139 | \$ 159 |
| Limited Partners' interest in net income | \$ 11,364 | \$ 15,880 |
| Basic and diluted net income per Limited Partner unit | \$ 0.42 | \$ 0.49 |
| Basic weighted average number of Limited Partner units outstanding | 26,760 | 32,449 |
| Diluted number of Limited Partner units | 26,988 | 32,564 |

See accompanying notes to condensed consolidated financial statements.

STAR GAS PARTNERS, L.P. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(unaudited)

| (in thousands) | Three Months Ended | |
|--|--------------------|-----------|
| | December 31, | |
| | 2001 | 2002 |
| Net income | \$ 11,503 | \$ 16,039 |
| Other comprehensive income (loss) Installation, service and appliances | | |
| Unrealized gain (loss) on derivative instruments Total sales | (4,400) | 480 |
| Comprehensive income | \$ 7,103 | \$ 16,519 |

| (in thousands) | Reconciliation of Accumulated Other Comprehensive Income (Loss) | | |
|----------------------------------|---|-------------|-------------|
| | Pension Plan | Derivative | |
| | Obligations | Instruments | Total |
| Balance as of September 30, 2001 | \$ (4,149) | \$ (8,050) | \$ (12,199) |
| Reclassification to earnings | | 4,665 | 4,665 |
| Other comprehensive loss | | (9,065) | (9,065) |
| Balance as of December 31, 2001 | \$ (4,149) | \$ (12,450) | \$ (16,599) |
| Balance as of September 30, 2002 | \$ (15,745) | \$ 4,918 | \$ (10,827) |
| Reclassification to earnings | | (2,702) | (2,702) |
| Other comprehensive income | | 3,182 | 3,182 |
| Balance as of December 31, 2002 | \$ (15,745) | \$ 5,398 | \$ (10,347) |

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See accompanying notes to condensed consolidated financial statements.

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STAR GAS PARTNERS, L.P. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF PARTNERS CAPITAL

(unaudited)

| (in thousands, except per unit amounts) | Number of Units | | | | Common | Senior Sub. | Junior Sub. | General Partner | Common | Senior Sub. | Junior Sub. | General Partner | Accum. Other Comprehensive Income (Loss) | Total Partners Capital |
|---|-----------------|-------------|-------------|-----------------|------------|-------------|-------------|-----------------|-------------|-------------|-------------|-----------------|--|------------------------|
| | Common | Senior Sub. | Junior Sub. | General Partner | | | | | | | | | | |
| Balance as of September 30, 2002 | 28,970 | 3,134 | 345 | 326 | \$ 242,696 | \$ 4,337 | \$ (1,232) | \$ (2,710) | \$ (10,827) | \$ 232,264 | | | | |
| Net income | | | | | 14,177 | 1,534 | 169 | 159 | | | | | | 16,039 |
| Other comprehensive income, net | | | | | | | | | 480 | | | | 480 | 480 |
| Unit compensation expense: | | | | | | | | | | | | | | |
| Common | | | | | 102 | | | | | | | | | 102 |
| Senior subordinated | | | | | | 370 | | | | | | | | 370 |
| Distributions: | | | | | | | | | | | | | | |
| (\$0.575 per unit) | | | | | (16,658) | | | | | | | | | (16,658) |
| (\$0.250 per unit) | | | | | | (791) | | | | | | | | (791) |
| Balance as of December 31, 2002 | 28,970 | 3,134 | 345 | 326 | \$ 240,317 | \$ 5,450 | \$ (1,063) | \$ (2,551) | \$ (10,347) | \$ 231,806 | | | | |

See accompanying notes to condensed consolidated financial statements.

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STAR GAS PARTNERS, L.P. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

| (in thousands) | Three Months Ended December 31, | |
|----------------|---------------------------------|------|
| | 2001 | 2002 |
| | | |

| | | |
|--|-----------|-----------|
| Cash flows provided by (used in) operating activities: | | |
| Net income | \$ 11,503 | \$ 16,039 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 14,503 | 12,848 |
| Amortization of debt issuance cost | 312 | 437 |
| Unit compensation expense | 640 | 472 |
| Provision for losses on accounts receivable | 1,237 | 1,383 |
| Gain on sales of fixed assets, net | (19) | (16) |
| Cumulative effect of change in accounting principle for the adoption of SFAS No. 142 | | 3,901 |
| Changes in operating assets and liabilities: | | |
| Increase in receivables | (25,858) | (89,325) |
| Increase in inventories | (10,881) | (15,564) |
| Decrease (increase) in other assets | (18,051) | 1,493 |
| Increase in accounts payable | 6,284 | 29,746 |
| Increase (decrease) in other current and long-term liabilities | 21,253 | (8,162) |
| Net cash provided by (used in) operating activities | 923 | (46,748) |
| Cash flows provided by (used in) investing activities: | | |
| Capital expenditures | (5,381) | (4,522) |
| Proceeds from sales of fixed assets | 1,128 | 192 |
| Acquisitions | (22,531) | (512) |
| Net cash used in investing activities | (26,784) | (4,842) |
| Cash flows provided by (used in) financing activities: | | |
| Working capital facility borrowings | 60,850 | 69,000 |
| Working capital facility repayments | (12,894) | (3,195) |
| Acquisition facility borrowings | 28,650 | |
| Acquisition facility repayments | (16,000) | (700) |
| Repayment of debt | (13,682) | (46,277) |
| Distributions | (15,406) | (17,449) |
| Increase in deferred charges | (120) | (746) |
| Other | (46) | |
| Net cash provided by financing activities | 31,352 | 633 |
| Net increase (decrease) in cash | 5,491 | (50,957) |
| Cash at beginning of period | 17,228 | 61,481 |
| Cash at end of period | \$ 22,719 | \$ 10,524 |

See accompanying notes to condensed consolidated financial statements.

(unaudited)

1) Partnership Organization

Star Gas Partners, L.P. (Star Gas or the Partnership) is a diversified home energy distributor and services provider, specializing in heating oil, propane, natural gas and electricity. Star Gas is a master limited partnership, which at December 31, 2002 had outstanding 29.0 million common units (NYSE: SGU representing an 88.4% limited partner interest in Star Gas Partners) and 3.1 million senior subordinated units (NYSE: SGH representing a 9.5% limited partner interest in Star Gas Partners) outstanding. Additional Partnership interests include 0.3 million junior subordinated units (representing a 1.1% limited partner interest) and 0.3 million general partner units (representing a 1.0% general partner interest).

Operationally the Partnership is organized as follows:

Star Gas Propane, L.P. (Star Gas Propane or the propane segment) is a wholly owned subsidiary of Star Gas. Star Gas Propane markets and distributes propane gas and related products to over 300,000 customers in the Midwest, Northeast, Florida and Georgia.

Petro Holdings, Inc. (Petro or the heating oil segment) is the nation's largest retail distributor of home heating oil and serves approximately 510,000 customers in the Northeast and Mid-Atlantic. Petro is an indirect wholly owned subsidiary of Star Gas Propane.

Total Gas and Electric (TG&E or the natural gas and electric reseller segment) is an energy reseller that markets natural gas and electricity to residential households in deregulated energy markets in New York, New Jersey, Florida and Maryland and serves over 70,000 residential customers. TG&E is a wholly owned indirect subsidiary of Petro.

Star Gas Partners (Partners or the Public Master Limited Partnership) includes the office of the Chief Executive Officer and in addition has the responsibility for maintaining investor relations and investor reporting for the Partnership.

2) Summary of Significant Accounting Policies

Basis of Presentation

The Consolidated Financial Statements include the accounts of Star Gas Partners, L.P., and its subsidiaries. All material intercompany items and transactions have been eliminated in consolidation.

The financial information included herein is unaudited; however, such information reflects all adjustments (consisting solely of normal recurring adjustments), which are, in the opinion of management, necessary for the fair statement of financial condition and results for the interim periods. The results of operations for the three month periods ended December 31, 2001 and December 31, 2002 are not necessarily indicative of the results to be expected for the full year.

2) Summary of Significant Accounting Policies (continued)

Inventories

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Inventories are stated at the lower of cost or market and are computed on a first-in, first-out basis. At the dates indicated, the components of inventory were as follows:

| (in thousands) | September 30, 2002 | December 31, 2002 |
|----------------------------------|-----------------------|----------------------|
| Propane gas | \$ 6,175 | \$ 8,748 |
| Propane appliances and equipment | 3,981 | 4,276 |
| Fuel oil | 15,555 | 26,910 |
| Fuel oil parts and equipment | 11,746 | 12,197 |
| Natural gas | 1,996 | 3,006 |
| | \$ 39,453 | \$ 55,137 |

Reclassifications

Certain prior year amounts have been reclassified to conform with the current year presentation.

Derivatives and Hedging

The Partnership uses derivative financial instruments to manage its exposure to market risk related to changes in the current and future market price of home heating oil, propane, and natural gas. The Partnership believes it is prudent to minimize the variability and price risk associated with the purchase of home heating oil and propane, accordingly, it is the Partnership's objective to hedge the cash flow variability associated with forecasted purchases of its inventory held for resale through the use of derivative instruments when appropriate. To a lesser extent, the Partnership also hedges the fair value of inventory on hand or firm commitments to purchase inventory. To meet these objectives, it is the Partnership's policy to enter into various types of derivative instruments to (i) manage the variability of cash flows resulting from the price risk associated with forecasted purchases of home heating oil, propane, and natural gas and (ii) hedge the downside price risk of firm purchase commitments and in some cases physical inventory on hand.

Derivatives that are not designated as hedges must be adjusted to fair value through income. Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a fair value hedge, along with the loss or gain on the hedged asset or liability or unrecognized firm commitment of the hedged item that is attributable to the hedged risk are recorded in earnings. Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a cash-flow hedge are recorded in accumulated other comprehensive income, until earnings are affected by the variability in cash flows of the designated hedged item. The ineffective portion of a derivative's change in fair value is immediately recognized in earnings.

All derivative instruments are recognized on the balance sheet at their fair value. On the date the derivative contract is entered into, the Partnership designates the derivative as either a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment (fair value hedge), or a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge). The Partnership formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as fair value or cash flow hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Partnership also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair value or cash flows of hedged items. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, the Partnership discontinues hedge accounting prospectively. When hedge accounting is discontinued because it is determined that the derivative no longer qualifies as an effective hedge, the Partnership continues to carry the derivative on the balance sheet at its fair value, and recognizes changes in the fair value of the derivative through current-period earnings.

2) Summary of Significant Accounting Policies (continued)

For the three months ended December 31, 2002, the change in accumulated other comprehensive income (loss) is principally attributable to the increase in fair value of existing cash flow hedges offset in part by the reclassification of accumulated gains on cash flow hedges that settled during the period.

Goodwill and Other Intangible Assets

Statement No. 142, *Goodwill and Other Intangible Assets* requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment at least annually in accordance with the provisions of Statement No. 142. Statement No. 142 also requires intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*.

The Partnership adopted the applicable provisions of Statement No. 142 on October 1, 2002, and recorded a non-cash charge of \$3.9 million to reduce the carrying value of the TG&E segment's goodwill. This charge is reflected as a cumulative effect of change in accounting principle in the Partnership's condensed consolidated statement of operations for the quarter ended December 31, 2002. The Partnership will perform its annual impairment review during the fourth fiscal quarter of each year, commencing in the fourth quarter of fiscal 2003.

Accounting Policies not yet Adopted

In June 2002, the FASB issued Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. This Statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)*. Statement No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. This Statement also establishes that fair value is the objective for initial measurement of the liability. The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002.

In December 2002, the FASB issued Statement No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosure*. This Statement amends Statement No. 123, *Accounting for Stock-Based Compensation* to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of Statement No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The transition guidance and annual disclosure provisions of Statement No. 148 are effective for fiscal years ending after December 15, 2002, with earlier application permitted in certain circumstances. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. The Partnership does not anticipate changing to the fair value based method of accounting for stock-based employee compensation and therefore expects that the provisions of this Statement will have no material impact on its financial condition or results of operations.

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In January 2003, the Financial Accounting Standards Board issued Interpretation No. 46, Consolidation of Variable Interest Entities. This Interpretation clarifies the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The interpretation requires consolidation of variable interest entities if certain conditions are met. The requirements are effective immediately to variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. It applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. The Partnership does not expect the adoption to have a material impact to the Partnership's financial position or results of operations.

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3) Long-term Debt

On October 1, 2002, the heating oil segment repaid an outstanding principle balance of \$45.3 million to the holders of its 9.0% senior secured notes that were then due.

In March 2002, the heating oil segment entered into two interest rate swap agreements designed to hedge \$73.0 million in underlying fixed rate senior note obligations, in order to reduce overall interest expense. The swap agreements would have expired August 1, 2006, and required the counterparties to pay an amount based on the stated fixed interest rate (annual rate 8.05%) pursuant to the senior notes for an aggregate \$2.9 million due every six months on August 1 and February 1. In exchange, the heating oil segment was required to make semi-annual floating interest rate payments on the first of August and February based on an annual interest rate equal to the 6 month LIBOR interest rate plus 2.83% applied to the same notional amount of \$73.0 million. The swap agreements were recognized as fair value hedges. Amounts to be paid or received under the interest rate swap agreements were accrued and recognized over the life of the agreements as an adjustment to interest expense. On October 17, 2002, Petro and the counterparties signed mutual termination agreements relating to its interest rate swap transactions. Petro terminated these obligations and liabilities in advance of its scheduled termination date, August 1, 2006, and received \$4.8 million which \$4.8 million was reflected as a basis adjustment to the fair values of the related debt and is being amortized using the effective yield over the remaining lives of the swap agreements as a reduction of interest expense.

4) Segment Reporting

The Partnership has three reportable operating segments: retail distribution of heating oil, retail distribution of propane and reselling of natural gas and electricity. The administrative expenses for the public master limited partnership, Star Gas Partners, have not been allocated to the segments. Management has chosen to organize the enterprise under these three segments in order to leverage the expertise it has in each industry, allow each segment to continue to strengthen its core competencies and provide a clear means for evaluation of operating results.

The heating oil segment is primarily engaged in the retail distribution of home heating oil, related equipment services, and equipment sales to residential and commercial customers. It operates primarily in the Northeast and Mid-Atlantic states. Home heating oil is principally used by the Partnership's residential and commercial customers to heat their homes and buildings, and as a result, weather conditions have a significant impact on the demand for home heating oil.

The propane segment is primarily engaged in the retail distribution of propane and related supplies and equipment to residential, commercial, industrial, agricultural and motor fuel customers, in the Midwest, Northeast, Florida and Georgia. Propane is used primarily for space heating, water heating and cooking by the Partnership's residential and commercial customers and as a result, weather conditions also have a significant impact on the demand for propane.

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The natural gas and electric reseller segment is primarily engaged in offering natural gas and electricity to residential consumers in deregulated energy markets. In deregulated energy markets, customers have a choice in selecting energy suppliers to power and / or heat their homes; as a result, a significant portion of this segment's revenue is directly related to weather conditions. TG&E operates in New York, New Jersey, Maryland and Florida.

The public master limited partnership includes the office of the Chief Executive Officer and has the responsibility for maintaining investor relations and investor reporting for the Partnership.

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4) Segment Reporting (continued)

The following are the condensed statements of operations and balance sheets for each segment as of and for the periods indicated. There were no inter-segment sales.

Three Months Ended December 31,

| (in thousands) | 2001 | | | | | 2002 | | | | |
|-------------------------------------|--------------|--------------|----------------|----------------|---------------|---------------|---------------|----------------|----------------|---------------|
| | Heating | | Partners | | | Heating | | Partners | | |
| | Oil | Propane | TG&E | & Other | Consol. | Oil | Propane | TG&E | & Other | Consol. |
| Statements of Operations | | | | | | | | | | |
| Sales | \$ 222,403 | \$ 54,375 | \$ 9,445 | \$ | \$ 286,223 | \$ 294,986 | \$ 76,345 | \$ 13,649 | \$ | \$ 384,980 |
| Cost of sales | 150,369 | 25,614 | 8,264 | | 184,247 | 206,918 | 36,568 | 11,861 | | 255,347 |
| Delivery and branch | 42,452 | 13,869 | | | 56,321 | 55,574 | 18,940 | | | 74,514 |
| Deprec. and amort | 10,247 | 3,903 | 351 | 2 | 14,503 | 8,567 | 4,157 | 124 | | 12,848 |
| G & A expense | 2,713 | 1,621 | 2,468 | 2,023 | 8,825 | 4,381 | 2,220 | 2,078 | 3,556 | 12,235 |
| TG&E customer acquisition expense | | | 221 | | 221 | | | 614 | | 614 |
| Operating | | | | | | | | | | |
| income (loss) | 16,622 | 9,368 | (1,859) | (2,025) | 22,106 | 19,546 | 14,460 | (1,028) | (3,556) | 29,422 |
| Net interest expense (income) | 6,658 | 3,373 | 875 | (762) | 10,144 | 4,994 | 3,299 | 81 | (4) | 8,370 |
| Amortization of debt issuance costs | 248 | 64 | | | 312 | 385 | 52 | | | 437 |
| Income (loss) before | | | | | | | | | | |
| income taxes | 9,716 | 5,931 | (2,734) | (1,263) | 11,650 | 14,167 | 11,109 | (1,109) | (3,552) | 20,615 |
| Income tax expense | 100 | 47 | | | 147 | 600 | 75 | | | 675 |
| Income (loss) before | 9,616 | 5,884 | (2,734) | (1,263) | 11,503 | 13,567 | 11,034 | (1,109) | (3,552) | 19,940 |
| cumulative change in | | | | | | | | | | |

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| | | | | | | | | | | | |
|----------------------|----------|----------|------------|------------|-----------|-----------|-----------|------------|------------|-----------|---------|
| accounting principle | | | | | | | | | | | |
| Cumulative change in | | | | | | | | | | | |
| accounting principle | | | | | | | | (3,901) | | | (3,901) |
| Net income (loss) | \$ 9,616 | \$ 5,884 | \$ (2,734) | \$ (1,263) | \$ 11,503 | \$ 13,567 | \$ 11,034 | \$ (5,010) | \$ (3,552) | \$ 16,039 | |
| Capital expenditures | \$ 3,128 | \$ 1,893 | \$ 360 | \$ | \$ 5,381 | \$ 2,657 | \$ 1,840 | \$ 25 | \$ | \$ 4,522 | |

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4) Segment Reporting (continued)

| (in thousands) | September 30, 2002 | | | | | December 31, 2002 | | | | |
|------------------------|--------------------|------------|-----------|--------------|------------|-------------------|------------|-----------|--------------|------------|
| | Partners | | | | | Partners | | | | |
| | Heating | & | | | Heating | & | | | Heating | |
| Balance Sheets | Oil | Propane | TG&E | Other (1) | Consol. | Oil | Propane | TG&E | Other (1) | Consol. |
| ASSETS | | | | | | | | | | |
| Current assets: | | | | | | | | | | |
| Cash and cash | | | | | | | | | | |
| equivalents | \$ 49,474 | \$ 8,904 | \$ 474 | \$ 2,629 | \$ 61,481 | \$ 2,673 | \$ 7,821 | \$ | \$ 30 | \$ 10,524 |
| Receivables, net | 70,063 | 10,669 | 2,720 | | 83,452 | 140,627 | 24,164 | 6,047 | | 170,838 |
| Inventories | 27,301 | 10,156 | 1,996 | | 39,453 | 39,107 | 13,024 | 3,006 | | 55,137 |
| Prepaid expenses and | | | | | | | | | | |
| other current assets | 34,817 | 2,793 | 1,009 | (804) | 37,815 | 31,832 | 2,167 | 715 | (764) | 33,950 |
| Total current assets | 181,655 | 32,522 | 6,199 | 1,825 | 222,201 | 214,239 | 47,176 | 9,768 | (734) | 270,449 |
| Property and | | | | | | | | | | |
| equipment, net | 66,854 | 174,298 | 740 | | 241,892 | 65,971 | 174,092 | 671 | | 240,734 |
| Long-term portion of | | | | | | | | | | |
| accounts receivable | 6,672 | | | | 6,672 | 7,232 | | | | 7,232 |
| Investment in | | | | | | | | | | |
| subsidiaries | | 137,689 | | (137,689) | | 1,882 | 143,639 | | (145,521) | |
| Goodwill | 219,031 | 35,502 | 10,018 | | 264,551 | 219,031 | 35,502 | 6,117 | | 260,650 |
| Intangibles, net | 132,628 | 60,129 | 613 | | 193,370 | 127,303 | 58,989 | 553 | | 186,845 |
| Deferred charges and | | | | | | | | | | |
| other assets, net | 12,902 | 2,178 | | | 15,080 | 7,118 | 1,923 | | | 9,041 |
| Total assets | \$ 619,742 | \$ 442,318 | \$ 17,570 | \$ (135,864) | \$ 943,766 | \$ 642,776 | \$ 461,321 | \$ 17,109 | \$ (146,255) | \$ 974,951 |
| LIABILITIES AND | | | | | | | | | | |

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| PARTNERS CAPITAL | | | | | | | | | | |
|---------------------------|------------|------------|-----------|--------------|------------|------------|------------|-----------|--------------|------------|
| Current Liabilities: | | | | | | | | | | |
| Accounts payable | \$ 11,070 | \$ 5,725 | \$ 3,565 | \$ | \$ 20,360 | \$ 29,717 | \$ 12,536 | \$ 8,019 | \$ | \$ 50,272 |
| Working capital | | | | | | | | | | |
| facility borrowings | 23,000 | | 3,195 | | 26,195 | 84,000 | 8,000 | | | 92,000 |
| Current maturities of | | | | | | | | | | |
| long-term debt | 60,787 | 10,626 | 700 | | 72,113 | 14,516 | 14,951 | | | 29,467 |
| Accrued expenses and | | | | | | | | | | |
| other current liabilities | 53,754 | 12,633 | 1,170 | 1,887 | 69,444 | 54,435 | 13,674 | 1,072 | 3,967 | 73,148 |
| Due to affiliate | (293) | (3,321) | 2,855 | 759 | | (3,600) | (3,423) | 2,698 | 4,325 | |
| Unearned service | | | | | | | | | | |
| contract revenue | 30,549 | | | | 30,549 | 34,377 | | | | 34,377 |
| Customer credit | | | | | | | | | | |
| balances | 49,346 | 16,487 | 4,750 | | 70,583 | 34,919 | 10,330 | 3,819 | | 49,068 |
| Total current liabilities | 228,213 | 42,150 | 16,235 | 2,646 | 289,244 | 248,364 | 56,068 | 15,608 | 8,292 | 328,332 |
| Long-term debt | 230,384 | 166,349 | | | 396,733 | 224,312 | 162,024 | | | 386,336 |
| Other long-term | | | | | | | | | | |
| liabilities | 23,456 | 2,069 | | | 25,525 | 26,461 | 2,016 | | | 28,477 |
| Partners Capital: | | | | | | | | | | |
| Equity Capital | 137,689 | 231,750 | 1,335 | (138,510) | 232,264 | 143,639 | 241,213 | 1,501 | (154,547) | 231,806 |
| Total liabilities and | | | | | | | | | | |
| Partners Capital | \$ 619,742 | \$ 442,318 | \$ 17,570 | \$ (135,864) | \$ 943,766 | \$ 642,776 | \$ 461,321 | \$ 17,109 | \$ (146,255) | \$ 974,951 |

- (1) The Partner and Other amounts include the balance sheet of the Public Master Limited Partnership, as well as the necessary consolidation entries to eliminate the investment in Petro Holdings, Star Gas Propane and TG&E.

5) Goodwill and Other Intangible Assets

On October 1, 2002, Star Gas adopted Statement No. 142, which required the Partnership to stop amortizing goodwill and certain intangible assets with an indefinite useful life. Statement No. 142 also requires that goodwill and intangible assets deemed to have an indefinite useful life be reviewed for impairment upon adoption of Statement No. 142 and annually thereafter. The Partnership will perform its annual impairment review during the fourth fiscal quarter of each year, commencing in the fourth quarter of 2003.

Under Statement No. 142, goodwill impairment is deemed to exist if the net book value of a reporting unit exceeds its estimated fair value. If goodwill of a reporting unit is determined to be impaired, the amount of impairment is measured based on the excess of the net book value of the goodwill over the implied fair value of the goodwill. The Partnership's reporting units are consistent with the operating segments identified in Note 4 Segment Reporting.

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Upon adoption of Statement No. 142 in the first fiscal quarter of 2003, the Partnership recorded a non-cash charge of approximately \$3.9 million to reduce the carrying value of its goodwill for its TG&E segment. This charge is reflected as a cumulative effect of change in accounting principle in the Partnership's condensed consolidated statement of operations for the three month period ended December 31, 2002. In calculating the impairment charge, the fair value of the reporting units were estimated using a discounted cash flow methodology.

The Partnership's results for the three months ended December 31, 2001 on a historic basis did not reflect the impact of the provisions of Statement No. 142. Had the Partnership adopted Statement No. 142 on October 1, 2001, the unaudited pro forma effect on Basic and Diluted net income and Limited Partners' interest in net income would have been as follows:

| | Three Months Ended | |
|--|---------------------------|---------------------|
| | December 31, 2002 | |
| | Basic and | |
| | diluted | |
| | net income | |
| | per Limited | |
| | Net | Partner unit |
| (in thousands, except per unit data) | income | |
| As reported: Net income | \$ 11,503 | \$ 0.43 |
| Add: Goodwill amortization | 2,069 | 0.08 |
| Income tax impact | | |
| | \$ 13,572 | \$ 0.51 |
| General Partner's interest in net income | \$ 164 | \$ 0.01 |
| Adjusted: Limited Partners' interest in net income | \$ 13,408 | \$ 0.50 |

Amortization expense for intangible assets was \$6.6 million for the three months ended December 31, 2002 compared to \$6.4 million for the three months ended December 31, 2001. Total estimated amortization expense related to intangible assets for the year ended September 30, 2003 and the five succeeding fiscal years ended September 30, is as follows:

| | Estimated |
|-----------------------|---------------------|
| | Annual |
| | Amortization |
| | Expense |
| (in thousands) | |
| 2003 | \$ 26,505 |
| 2004 | 26,504 |
| 2005 | 26,010 |
| 2006 | 24,847 |

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| | |
|------|--------|
| 2007 | 24,197 |
| 2008 | 22,266 |

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6) Acquisitions

During the three month period ended December 31, 2002, the Partnership acquired two retail propane dealers. The aggregate consideration for these acquisitions accounted for by the purchase method of accounting was approximately \$0.5 million. Purchase prices have been allocated to the acquired assets and liabilities based on their respective fair market values on the dates of acquisition. The purchase prices in excess of the fair values of net assets acquired are classified as goodwill in the Condensed Consolidated Balance Sheets.

The following table indicates the allocation of the aggregate purchase price paid for these acquisitions and the respective periods of amortization assigned:

| (in thousands) | | Useful Lives |
|-----------------------|---------------|-----------------|
| Tanks and equipment | \$ 425 | 5-30 years |
| Restrictive covenants | 107 | 5 years |
| Working capital | (20) | |
| Total | \$ 512 | |

Sales and net income have been included in the Condensed Consolidated Statements of Operations from the respective dates of acquisition. The following unaudited pro forma information presents the results of operations of the Partnership, including the fourteen acquisitions completed since October 1, 2001, as if the acquisitions had taken place on October 1, 2001. This pro forma information is presented for informational purposes; it is not indicative of future operating performance.

| (in thousands, except per unit data) | Three Months Ended | |
|---|--------------------|------------|
| | December 31, | |
| | 2001 | 2002 |
| Sales | \$ 292,634 | \$ 384,980 |
| Net income | \$ 11,953 | \$ 16,039 |
| General Partner's interest in net income | \$ 144 | \$ 159 |
| Limited Partners' interest in net income | \$ 11,809 | \$ 15,880 |
| Basic net income per limited partner unit | \$ 0.40 | \$ 0.49 |
| Diluted net income per limited partner unit | \$ 0.40 | \$ 0.49 |

7) Supplemental Disclosure of Cash Flow Information

| | Three Months Ended | |
|--|--------------------|------------|
| | December 31, | |
| | 2001 | 2002 |
| (in thousands) | | |
| Cash paid during the period for: | | |
| Income taxes | \$ 349 | \$ 329 |
| Interest | \$ 9,356 | \$ 9,530 |
| Non-cash financing activities: | | |
| Decrease in long-term debt for the termination of interest rate swap | \$ | \$ (6,068) |
| Decrease in other assets | \$ | \$ 6,068 |

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8) Guarantees

Star Gas Partners, L.P. guarantees the payments required under the heating oil segment's bank credit facilities, which at December 31, 2002 consisted of a \$123.0 million working capital facility, a \$20.0 million insurance letter of credit facility and a \$50.0 million acquisition facility. In addition, Star Gas Partners, L.P. also guarantees the payments required for the heating oil segment's senior notes, which at December 31, 2002 consisted of \$233.0 million of principal obligations. Star Gas Partners, L.P. also guarantees payments required under supply contracts with natural gas and electricity suppliers for its TG&E segment that total approximately \$9.9 million.

9) Earnings Per Limited Partner Unit

| (in thousands, except per unit data) | Three Months Ended December 31, | |
|---|---------------------------------|-----------|
| | 2001 | 2002 |
| Income before cumulative effect of change in accounting principle per Limited Partner unit: | | |
| Basic | \$ 0.42 | \$ 0.61 |
| Diluted | \$ 0.42 | \$ 0.61 |
| Cumulative effect of change in accounting principle per Limited Partner unit: | | |
| Basic | \$ | \$ (0.12) |
| Diluted | \$ | \$ (0.12) |
| Net income per Limited Partner unit: | | |
| Basic | \$ 0.42 | \$ 0.49 |
| Diluted | \$ 0.42 | \$ 0.49 |
| Basic Earnings Per Unit: | | |
| Net income | \$ 11,503 | \$ 16,039 |
| Less: General Partner's interest in net income | 139 | 159 |
| Limited Partners' interest in net income | \$ 11,364 | \$ 15,880 |

| | | |
|--|-----------|-----------|
| Common Units | 23,395 | 28,970 |
| Senior Subordinated Units | 3,020 | 3,134 |
| Junior Subordinated Units | 345 | 345 |
| Weighted average number of Limited Partner units | | |
| outstanding | 26,760 | 32,449 |
| Basic earnings per unit | \$ 0.42 | \$ 0.49 |
| <u>Diluted Earnings Per Unit:</u> | | |
| Effect of diluted securities | \$ | \$ |
| Limited Partners interest in net income | \$ 11,364 | \$ 15,880 |
| Weighted average number of Limited Partner units | | |
| outstanding | 26,760 | 32,449 |
| Senior subordinated units anticipated to be issued under | | |
| employee incentive plan | 228 | 115 |
| Diluted weighted average number of Limited | | |
| Partner units | 26,988 | 32,564 |
| Diluted earnings per unit | \$ 0.42 | \$ 0.49 |

10) Subsequent Event

Cash Distributions On January 21, 2003, the Partnership announced that it would pay a cash distribution of \$0.575 per Common Unit and \$0.250 per Senior Subordinated Unit for the quarter ended December 31, 2002. The distribution will be paid on February 14, 2003, to unitholders of record on February 7, 2003.

Item 2.

STAR GAS PARTNERS, L.P. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION

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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, propane, electricity and natural gas and the ability of the Partnership to obtain new accounts and retain existing accounts. 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 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.

Overview

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

The primary use for heating oil, propane and natural gas is for space heating in residential and commercial applications. As a result, weather conditions have a significant impact on financial performance and should be considered when analyzing changes in financial performance. In addition, gross margins vary according to customer mix. For example, sales to residential customers generate higher profit margins than sales to other customer groups, such as agricultural customers. Accordingly, a change in customer mix can affect gross margins without necessarily impacting total sales.

The heating oil, propane and natural gas industries are seasonal in nature with peak activity occurring during the winter months. Accordingly, results of operations for the periods presented are not indicative of the results to be expected for a full year.

The following is a discussion of the historical condition and results of operations of Star Gas Partners, L.P. and its subsidiaries, and should be read in conjunction with the historical Financial and Operating Data and Notes thereto included elsewhere in this quarterly report on Form 10-Q.

THREE MONTHS ENDED DECEMBER 31, 2002

COMPARED TO THREE MONTHS ENDED DECEMBER 31, 2001

Volume

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For the three months ended December 31, 2002, retail volume of home heating oil and propane increased 49.3 million gallons, or 28.9%, to 220.0 million gallons, as compared to 170.7 million gallons for the three months ended December 31, 2001. This increase was due to a 36.3 million gallon increase in the heating oil segment and a 12.9 million gallon increase in the propane segment. The increase in volume reflects the impact of significantly colder temperatures and the impact of an additional 4.0 million gallons provided by acquisitions. The Partnership also believes that a shift in the delivery pattern at the heating oil segment decreased volume for the quarter ended December 31, 2002 by an estimated 11.0 million gallons. Typical delivery patterns would have resulted in these gallons being delivered in the three months ended December 31, 2002 but were actually delivered in the three months ended September 30, 2002. Temperatures in the Partnership's areas of operations were an average of 34.9% colder than in the prior year's comparable quarter and approximately 7.5% colder than normal.

Sales

For the three months ended December 31, 2002, sales increased \$98.8 million, or 34.5%, to \$385.0 million, as compared to \$286.2 million for the three months ended December 31, 2001. This increase was due to \$72.6 million higher heating oil segment sales, \$22.0 million higher propane segment sales and a \$4.2 million increase in TG&E sales. Sales increased largely due to the higher retail volume and to a lesser extent, as a result of higher selling prices. Selling prices increased versus the prior year's comparable period in response to higher supply costs. Sales of rationally related products, including heating and air conditioning equipment installation and service and water softeners increased \$2.3 million in the heating oil segment and by \$0.6 million in the propane segment from the prior year's comparable period due to acquisitions and from colder temperatures. TG&E's sales also increased as a result of the colder weather.

Cost of Product

For the three months ended December 31, 2002, cost of sales increased \$69.4 million, or 52.7%, to \$201.3 million, as compared to \$131.9 million for the three months ended December 31, 2001. This increase was due to \$55.2 million of higher cost of product at the home heating oil segment, \$10.7 million higher cost of product at the propane segment and a \$3.6 million increase in TG&E cost of product. Cost of product increased largely due to the higher retail volume sold and to a lesser extent from higher supply cost.

Cost of Installations, Service and Appliances

For the three months ended December 31, 2002, cost of installations, service and appliances increased \$1.7 million, or 3.2%, to \$54.0 million, as compared to \$52.4 million for the three months ended December 31, 2001. This increase was due to an additional \$1.4 million at the heating oil segment and by an additional \$0.3 million at the propane segment from the prior years comparable period due to increased sales of these products.

Delivery and Branch Expenses

For the three months ended December 31, 2002, delivery and branch expenses increased \$18.2 million, or 32.3%, to \$74.5 million, as compared to \$56.3 million for the three months ended December 31, 2001. This increase was due to an additional \$13.1 million of delivery and branch expenses at the heating oil segment and a \$5.1 million increase in delivery and branch expenses for the propane segment. The period to period comparison was impacted from the purchase of weather insurance that allowed the Partnership to record approximately \$6.1 million of net weather insurance recoveries in fiscal 2002 versus a \$1.5 million expense in fiscal 2003 for weather insurance premiums paid. Excluding the impact of weather insurance, delivery and branch expenses would have increased \$10.6 million for the three months ended December 31, 2002, which was largely due to the additional operating cost associated with increased volumes delivered and to the impact of operating expense and wage increases.

Depreciation and Amortization Expenses

For the three months ended December 31, 2002, depreciation and amortization expenses decreased \$1.7 million, or 11.4%, to \$12.8 million, as compared to \$14.5 million for the three months ended December 31, 2001. This decrease was primarily due to the impact of the provisions of Statement No. 142 which required the Partnership to stop amortizing goodwill effective October 1, 2002. Approximately \$2.1 million of goodwill amortization was included in depreciation and amortization expense for the three months ended December 31, 2001.

General and Administrative Expenses

For the three months ended December 31, 2002, general and administrative expenses increased \$3.4 million, or 38.6%, to \$12.2 million, as compared to \$8.8 million for the three months ended December 31, 2001. This increase was largely due to the inclusion of \$1.1 million of incremental expense related to the on-going business process redesign project in the heating oil segment, a \$0.9 million increase in the accrual for compensation earned for unit appreciation rights previously granted and for other increases of \$1.9 million largely due to increased bonus compensation based upon results for the fiscal 2003 quarter. The increase was partially offset by lower general and administrative expenses at TG&E due to lower bad debt expense of approximately \$0.5 million. Based upon TG&E's implementation of new information systems and more stringent credit policies, the Partnership believes that TG&E's bad debt losses will be lower than the prior years.

The heating oil segment continues to progress with its on-going business process redesign project during the quarter ended December 31, 2002. The heating oil segment is seeking to take advantage of its large size and utilize modern technology to increase the efficiency and quality of services provided to its customers. The segment is seeking to create a more customer oriented service company to significantly differentiate itself from its competitive peers. A core business process redesign project began in fiscal 2002 with an exhaustive effort to identify customer expectations and document existing business processes.

Preliminary conclusions indicate that improved processes and related technology investments could have a meaningful impact on reducing the heating oil segment's annual operating costs. Technology investments in particular are a critical element of our strategy to improve the efficiency and quality of services provided to our customers. To this end, we are now testing second generation hand-held technology for the automation of our service workforce. These wireless hand held data terminals will allow our service and installation professionals on demand access to customer repair history, data to provide instant part and repair quotations, and capabilities to invoice at the completion of service. The \$1.1 million incremental expense in fiscal 2003 for this project largely consisted of consulting fees and travel related expenditures. The expenses related to the on-going business process redesign project will continue throughout fiscal 2003.

TG&E Customer Acquisition Expense

For the three months ended December 31, 2002, TG&E customer acquisition expense increased \$0.4 million, or 177.8% to \$0.6 million, as compared to \$0.2 million for the three months ended December 31, 2001. This TG&E segment expense is the cost of acquiring new accounts through the services of a third party direct marketing company.

Interest Expense

For the three months ended December 31, 2002, interest expense decreased \$1.9 million, or 17.2%, to \$9.0 million, as compared to \$10.9 million for the three months ended December 31, 2001. This decrease was largely due to a lower weighted average balance of long-term debt outstanding during the three months ended December 31, 2002 compared to the three month period ended December 31, 2001. This decrease resulted from the repayment of debt since December 31, 2001.

Income Tax Expense

For the three months ended December 31, 2002, income tax expense increased \$0.5 million to \$0.7 million, as compared to \$0.1 million for the three months ended December 31, 2001. This increase was due to higher state income taxes based upon the higher pretax earnings achieved for the three months ended December 31, 2002.

Cumulative Effect of Change in Accounting Principle

For the three months ended December 31, 2002, the Partnership recorded a \$3.9 million decrease in net income arising from the adoption of Statement No. 142 to reflect the impairment of its goodwill for its TG&E segment.

Net Income

For the three months ended December 31, 2002, net income increased \$4.5 million, or 39.4%, to \$16.0 million, as compared to \$11.5 million for the three months ended December 31, 2001. The increase was due to a \$4.0 million increase in net income at the heating oil segment and from a \$5.2 million increase in net income at the propane segment partially offset by a \$2.3 million increase in the net loss at TG&E and a \$2.3 million increase in the net loss at the Partnership level. The increase in net income was primarily due to the impact of colder weather and lower interest expense partially offset by the \$3.9 million decrease in net income at the TG&E segment for the adoption of Statement No. 142.

Liquidity and Capital Resources

The ability of Star Gas to satisfy its obligations will depend on its future performance, which will be subject to prevailing economic, financial, business, and weather conditions, and other factors, most of which are beyond its control. Future capital requirements of Star Gas are expected to be provided by cash flows from operating activities and cash on hand at December 31, 2002. To the extent future capital requirements exceed cash flows from operating activities:

a)

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working capital will be financed by the Partnership's working capital lines of credit and repaid from subsequent seasonal reductions in inventory and accounts receivable;

- b) growth capital expenditures, mainly for customer tanks and expenditures incurred in connection with the heating oil segment's business process redesign program will be financed, in fiscal 2003, by a combination of the proceeds received from the equity offerings completed during fiscal 2002 and the use of the Partnership's credit facilities; and
- c) acquisition capital expenditures will be financed by the revolving acquisition lines of credit, long-term debt, the issuance of additional Common Units or a combination thereof.

Cash Flows

Operating Activities. Cash used in operating activities for the quarter ended December 31, 2002 was \$46.7 million as compared to cash provided by operating activities of \$0.9 million for the quarter ended December 31, 2001. The net cash used in operations of \$46.7 million for fiscal 2003 consisted of net income of \$16.0 million, noncash charges of \$19.0 million, primarily depreciation and amortization of \$13.3 million, which were offset by an increase in operating assets and liabilities of \$81.7 million. Operating assets and liabilities have increased in fiscal year 2003 from fiscal year 2002, primarily due to a \$63.6 million increase in accounts receivable resulting from the increase in sales largely due to the colder weather experienced for the quarter ended December 31, 2002.

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Liquidity and Capital Resources (continued)

Investing Activities. Star Gas completed two acquisitions during the fiscal quarter ended December 31, 2002, investing \$0.5 million. This expenditure for acquisitions is reflected in the cash used in investing activities of \$4.8 million along with \$4.5 million invested for capital expenditures. The \$4.5 million for capital expenditures is comprised of \$2.3 million of capital additions needed to sustain operations at current levels and \$2.2 million for capital expenditures incurred in connection with the heating oil segment's business process redesign program and for customer tanks and other capital expenditures to support growth of operations. The capital expenditures made for the business process redesign program were largely for the purchase of modern technology to increase the efficiency and quality of services provided to its customers. Investing activities also includes proceeds from the sale of fixed assets of \$0.2 million.

Financing Activities. During the quarter ended December 31, 2002, increased bank working capital borrowings provided funds of \$65.8 million. Cash distributions paid to Unitholders of \$17.5 million, debt repayments of \$47.0 million and other financing activities of \$0.7 million reduced the net cash provided by financing activities to \$0.6 million.

As a result of the above activity, cash decreased by \$51.0 million to \$10.5 million as of December 31, 2002.

Earnings before interest, taxes, depreciation and amortization (EBITDA)

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For the three months ended December 31, 2002, EBITDA increased \$1.8 million, or 4.8%, to \$38.4 million as compared to \$36.6 million for the three months ended December 31, 2001. This increase was due to \$1.2 million of more EBITDA generated by the heating oil segment and a \$5.3 million increase in the propane segment partially offset by \$3.3 million less EBITDA at TG&E and by a \$1.5 million reduction in EBITDA at the Partnership level. TG&E's EBITDA was negatively impacted by the inclusion of a non-cash \$3.9 million decrease in net income for the cumulative effect of a change in accounting principle arising from the adoption of Statement No. 142 to reflect the impairment of its goodwill. The increase in EBITDA was largely due to the impact of colder temperatures in our areas of operations. 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 is calculated for the fiscal quarters ended December 31 as follows:

| (in thousands) | Three Months Ended December 31, | |
|-------------------------------------|------------------------------------|----------|
| | 2001 | 2002 |
| Net income | \$11,503 | \$16,039 |
| Plus: | | |
| Income tax expense | 147 | 675 |
| Amortization of debt issuance costs | 312 | 437 |
| Interest expense, net | 10,144 | 8,370 |
| Depreciation and amortization | 14,503 | 12,848 |
| EBITDA | \$36,609 | \$38,369 |

Financing and Sources of Liquidity

The Partnership's heating oil segment has a bank credit facility, which includes a working capital facility, providing for up to \$123.0 million of borrowings to be used for working capital purposes, an acquisition facility, providing for up to \$50.0 million of borrowings to be used for acquisitions and for certain improvements and a \$20.0 million insurance letter of credit facility. The working capital facility and letter of credit facility will expire on June 30, 2004. The acquisition facility will convert to a term loan for any outstanding borrowings on June 30, 2004, which balance will be payable in eight equal quarterly principal payments. At December 31, 2002, \$84.0 million of working capital borrowings were outstanding.

The Partnership's propane segment has a bank credit facility, which consists of a \$25.0 million acquisition facility, a \$25.0 million parity debt facility that can be used to fund maintenance and growth capital expenditures and an \$18.0 million working capital facility. The working capital facility expires on September 30, 2003. Borrowings under the acquisition and parity debt facilities will revolve until September 30, 2003, after which time any outstanding loans thereunder, will amortize in quarterly principal payments with a final payment due on September 30, 2005. At December 31, 2002, \$20.4 million of acquisition facility borrowings, \$14.2 million of Parity Debt Facility borrowings and \$8.0 million of working capital borrowings 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, amounts borrowed under the working capital facility are subject to a requirement to maintain a zero balance for at least forty-five 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

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ability to incur additional debt and/or pay distributions and could cause certain debt to become currently payable.

The Partnership had \$468.8 million of debt outstanding as of September 30, 2002 (amount does not include working capital borrowings), 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:

| | |
|------------|-----------------|
| 2003 | \$72.1 million |
| 2004 | \$36.2 million |
| 2005 | \$52.0 million |
| 2006 | \$108.8 million |
| 2007 | \$54.1 million |
| Thereafter | \$145.7 million |

The largest maturity for fiscal 2003 was a \$45.3 million payment due on October 1, 2002 under one of the heating oil segment's senior secured notes. This payment was made on October 1, from a portion of the equity proceeds raised in fiscal 2002. The heating oil segment also has \$11.0 million of senior secured notes maturing in April 2003 and the propane segment has \$10.6 million of first mortgage notes maturing in two equal installments in March 2003 and September 2003. The intention of the Partnership, barring any limitation of debt incurrence ability, would be to refinance these maturities along with the other \$5.2 million of debt maturing during fiscal 2003, with a new debt issuance. The Partnership believes that it has available sufficient proceeds from its 2002 equity offerings and availability to borrow under its propane acquisition facility to refinance the 2003 maturities if a new debt issuance were unsuccessful. However, funding for future year's debt maturities would be largely dependent upon new debt or equity issuances.

In general, the Partnership distributes to its partners on a quarterly basis, all of its Available Cash in the manner described below. 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 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. In August 2002, the Partnership purchased weather insurance that could provide up to \$20.0 million of coverage for the impact of warm weather on the Partnership's operating results for the 2002-2003 heating season. In addition, the Partnership purchased a base of \$12.5 million of weather insurance coverage for each year from 2004-2007. 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.

For the remainder of fiscal 2003, the Partnership anticipates paying interest of approximately \$27.9 million and anticipates growth and maintenance capital additions of approximately \$9.2 million. In addition, the Partnership plans to pay distributions on its units to the extent there is sufficient available cash in accordance with the partnership agreement. The Partnership plans to fund acquisitions made through a combination of debt and equity. Based on its current cash position, proceeds from the fiscal 2002 common unit offerings, bank credit availability and anticipated net cash to be generated from operating activities, the Partnership expects to be able to meet all of its obligations for fiscal 2003.

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In June 2002, the FASB issued Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. This Statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)*. Statement No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. This Statement also establishes that fair value is the objective for initial measurement of the liability. The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002.

In December 2002, the FASB issued Statement No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*. This Statement amends Statement No. 123, *Accounting for Stock-Based Compensation* to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of Statement No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The transition guidance and annual disclosure provisions of Statement No. 148 are effective for fiscal years ending after December 15, 2002, with earlier application permitted in certain circumstances. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. The Partnership does not anticipate changing to the fair value based method of accounting for stock-based employee compensation and therefore expects that the provisions of this Statement will have no material impact on its financial condition or results of operations.

In January 2003, the Financial Accounting Standards Board issued Interpretation No. 46, *Consolidation of Variable Interest Entities*. This Interpretation clarifies the application of Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The interpretation requires consolidation of variable interest entities if certain conditions are met. The requirements are effective immediately to variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. It applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. The Partnership does not expect the adoption to have a material impact to the Partnership's financial position or results of operations.

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. Star Gas believes the following are its critical accounting policies:

Goodwill and Other Intangible Assets

The FASB issued Statement No. 142, *Goodwill and Other Intangible Assets* in June 2001. Statement No. 142 requires that goodwill no longer be amortized, but instead be tested for impairment at least annually in accordance with the provisions of Statement No. 142. Statement No. 142 also requires that intangible assets with definite useful lives, such as customer lists, continue to be amortized over their respective estimated useful lives.

Statement No. 142 was adopted on October 1, 2002, with the Partnership now calculating amortization using the straight-line method over periods ranging from 5 to 15 years for intangible assets with definite useful lives. Star Gas uses amortization methods and determines asset values based on its best estimates using reasonable and supportable assumptions and projections. Star Gas assesses the useful lives of intangible

assets based on the estimated period over which Star Gas 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 December 31, 2002, the Partnership had \$186.8 million of net intangible assets subject to amortization. If circumstances required a change in estimated 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 the three month period ended December 31, 2002 would have increased by approximately \$0.7 million.

Critical Accounting Policies and Estimates (continued)

Statement No. 142 also requires goodwill to be assessed annually for impairment. These assessments involve management's estimates of future cash flows, market trends and other factors. If goodwill is determined to be impaired, a loss is recorded in accordance with Statement No. 142. At December 31, 2002, the Partnership had \$260.7 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 its future cash flows, an impairment loss is recorded based on the fair value of the asset.

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 3 to 30 years. Net property, plant and equipment was \$240.7 million for the Partnership at December 31, 2002. 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 the three month period ended December 31, 2002 would have increased by approximately \$1.0 million.

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

SFAS No. 87, *Employers' Accounting for Pensions* 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 rate used for fiscal 2002 would have increased pension expense by approximately \$0.1 million and would have increased the minimum pension liability by another \$1.7 million. The Partnership assumed a discount rate of 6.75% for its fiscal 2002 financials.

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. A 25 basis point decrease in the expected return on assets would have increased pension expense in fiscal 2002 by approximately \$0.1 million. The Partnership assumed an 8.5% rate of return on plan assets for its 2002 financials.

Insurance Reserves

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The Partnership's heating oil segment has in the past and is currently self-insuring a portion of workers' compensation and general liability claims. In addition, the segment in the past also self-insured for certain auto claims. The Partnership establishes reserves based upon expectations as to what its ultimate liability will be for these claims. As of September 30, 2002, the heating oil segment had approximately \$25.1 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 effect on results of operations.

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Item 3.

Quantitative and Qualitative Disclosures About Market Risk

The Partnership is exposed to interest rate risk primarily through its Bank Credit Facilities due to the fact that they are subject to variable interest rates. The Partnership utilizes these borrowings to meet its working capital needs and also to fund the short-term needs of its acquisition program.

At December 31, 2002, the Partnership had outstanding borrowings totaling \$507.8 million, of which approximately \$126.6 million is subject to variable interest rates under its Bank Credit Facilities. In the event that interest rates associated with these facilities were to increase 100 basis points, the impact on future cash flows would be a decrease of approximately \$1.3 million annually.

The Partnership also selectively uses derivative financial instruments to manage its exposure to market risk related to changes in the current and future market price of home heating oil, propane and natural gas. The Partnership does not hold derivatives for trading purposes. The value of market sensitive derivative instruments is subject to change as a result of movements in market prices. Consistent with the nature of hedging activity, associated unrealized gains and losses would be offset by corresponding decreases or increases in the purchase price the Partnership would pay for the product being hedged. Sensitivity analysis is a technique used to evaluate the impact of hypothetical market value changes. Based on a hypothetical ten percent increase in the cost of product at December 31, 2002, the potential gain on the Partnership's hedging activity would be to increase the fair market value of these outstanding derivatives by \$2.8 million to a fair market value of \$8.0 million; and conversely a hypothetical ten percent decrease in the cost of product would decrease the fair market value of these outstanding derivatives by \$2.6 million to a fair market value of \$2.7 million.

Item 4.

Controls and Procedures

Within the 90-day period prior to the filing of this report, an evaluation was carried out under the supervision and with the participation of the Partnership's management, including the Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of our disclosure controls and procedures. Based on that evaluation, the CEO and CFO have concluded that the Partnership's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Partnership's reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. Subsequent to the date of their evaluation, there were no significant changes in the Partnership's internal controls or in other factors that could significantly affect the disclosure controls, including any corrective actions with regard to significant deficiencies and

material weaknesses.

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PART II OTHER INFORMATION

Item 6.

Exhibits and Reports on Form 8-K

(a) *Exhibits Included Within:*

99.1 Section 906 Certificate
99.2 Section 906 Certificate

(b) *Reports on Form 8-K:*

11/04/02

Filing for a subsidiary of Star Gas Partners, L.P., for the completion of the purchase of Meenan Oil Co., Inc., a Delaware corporation (Meenan) and its affiliates for a purchase price of approximately \$131.8 million, payable in cash. The transaction was originally reported by the Partnership pursuant to a Current Report on Form 8-K dated July 31, 2001. The purpose of this Form 8-K is to update the previously filed historical and pro forma financial information relating to Meenan.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Partnership has duly caused this report to be signed on its behalf of the undersigned thereunto duly authorized:

Star Gas Partners, L.P.

By: Star Gas LLC (General Partner)

| Signature | Title | Date |
|---|--|-------------|
| <u>/s/ AMI TRAUBER</u> Ami Trauber | Chief Financial Officer Star Gas LLC (Principal Financial Officer) | May 8, 2003 |
| <u>/s/ JAMES J. BOTTIGLIERI</u> James J. Bottiglieri | Vice President Star Gas LLC | May 8, 2003 |

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CERTIFICATIONS

I, Irik P. Sevin, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Star Gas Partners, L.P.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
 - (a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - (c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date.
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

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- (a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls;
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 8, 2003

/s/ IRIK P. SEVIN

Irik P. Sevin

Chief Executive Officer

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CERTIFICATIONS

I, Ami Trauber, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Star Gas Partners, L.P.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
 - (a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this

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quarterly report is being prepared;

- (b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - (c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date.
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
- (a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls;
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 8, 2003

/s/ AMI TRAUBER

Ami Trauber

Chief Financial Officer