

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549**

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2008

OR

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

For the transition period from _____ to _____

Commission File Number: 001-14129
Commission File Number: 333-103873

**STAR GAS PARTNERS, L.P.
STAR GAS FINANCE COMPANY**

(Exact name of registrants as specified in its charters)

Delaware

06-1437793

Delaware
(State or other jurisdiction of
incorporation or organization)

75-3094991
(I.R.S. Employer
Identification No.)

2187 Atlantic Street, Stamford, Connecticut
(Address of principal executive office)

06902

(203) 328-7310
(Registrants' telephone number, including area code)

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

Indicate by check mark whether the registrants (1) have 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) have been subject to such filing requirements for the past 90 days. Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrants are shell companies (as defined in Rule 12b-2 of the Act). Yes No

At April 30, 2008, the registrants had units and shares of each issuer's classes of common stock outstanding as follows:

Star Gas Partners, L.P.	Common Units	75,774,336
Star Gas Partners, L.P.	General Partner Units	325,729
Star Gas Finance Company	Common Shares	100

[Table of Contents](#)

STAR GAS PARTNERS, L.P. AND SUBSIDIARIES
INDEX TO FORM 10-Q

	<u>Page</u>
Part I Financial Information	
Item 1—Condensed Consolidated Financial Statements	
Condensed Consolidated Balance Sheets as of March 31, 2008 (unaudited) and September 30, 2007	3
Condensed Consolidated Statements of Operations (unaudited) for the three and six months ended March 31, 2008 and March 31, 2007	4
Condensed Consolidated Statement of Partners' Capital and Comprehensive Income for the six months ended March 31, 2008 (unaudited)	5
Condensed Consolidated Statements of Cash Flows (unaudited) for the six months ended March 31, 2008 and March 31, 2007	6
Notes to Condensed Consolidated Financial Statements (unaudited)	7-14
Item 2—Management's Discussion and Analysis of Financial Condition and Results of Operations	15-27
Item 3—Quantitative and Qualitative Disclosures About Market Risk	27
Item 4—Controls and Procedures	28
Part II Other Information:	
Item 1—Legal Proceedings	28
Item 1A—Risk Factors	28-29
Item 6—Exhibits	30
Signatures	31

[Table of Contents](#)

STAR GAS PARTNERS, L.P. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

<u>(in thousands)</u>	<u>March 31,</u> <u>2008</u> <u>(unaudited)</u>	<u>September 30,</u> <u>2007</u>
ASSETS		
Current assets		
Cash and cash equivalents	\$ 13,624	\$ 112,886
Receivables, net of allowance of \$12,255 and \$7,645, respectively	265,472	78,923
Inventories	64,473	85,968
Fair asset value of derivative instruments	22,188	14,510
Prepaid expenses and other current assets	37,220	28,216
Total current assets	<u>402,977</u>	<u>320,503</u>
Property and equipment, net	39,404	41,721
Long-term portion of accounts receivables	956	1,362
Goodwill	181,524	181,496
Intangibles, net	38,952	48,468
Deferred charges and other assets, net	7,314	8,554
Total assets	<u>\$671,127</u>	<u>\$ 602,104</u>
LIABILITIES AND PARTNERS' CAPITAL		
Current liabilities		
Accounts payable	\$ 21,888	\$ 18,797
Revolving credit facility borrowings	48,016	—
Fair liability value of derivative instruments	—	5,312
Accrued expenses and other current liabilities	68,671	65,444
Unearned service contract revenue	40,219	37,219
Customer credit balances	21,570	71,109
Total current liabilities	<u>200,364</u>	<u>197,881</u>
Long-term debt	173,848	173,941
Other long-term liabilities	13,439	13,951
Partners' capital		
Common unitholders	299,264	232,895
General partner	156	(129)
Accumulated other comprehensive loss	(15,944)	(16,435)
Total partners' capital	<u>283,476</u>	<u>216,331</u>
Total liabilities and partners' capital	<u>\$671,127</u>	<u>\$ 602,104</u>

See accompanying notes to condensed consolidated financial statements.

[Table of Contents](#)

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

<u>(in thousands, except per unit data - unaudited)</u>	Three Months Ended March 31,		Six Months Ended March 31,	
	2008	2007	2008	2007
Sales:				
Product	\$620,916	\$534,856	\$1,021,956	\$815,258
Installations and service	44,370	42,068	97,274	91,910
Total sales	665,286	576,924	1,119,230	907,168
Cost and expenses:				
Cost of product	491,188	385,922	810,446	592,158
Cost of installations and service	45,288	44,384	97,862	94,858
(Increase) decrease in the fair value of derivative instruments	1,813	(18,462)	(15,940)	(12,147)
Delivery and branch expenses	66,802	68,652	124,754	115,146
Depreciation and amortization expenses	6,862	7,316	13,870	14,688
General and administrative expenses	4,193	6,260	9,039	10,948
Operating income	49,140	82,852	79,199	91,517
Interest expense	(5,662)	(5,136)	(10,721)	(10,244)
Interest income	1,401	1,579	2,853	3,373
Amortization of debt issuance costs	(585)	(571)	(1,155)	(1,141)
Income before income taxes	44,294	78,724	70,176	83,505
Income tax expense	2,737	3,845	3,522	3,910
Net income	\$ 41,557	\$ 74,879	\$ 66,654	\$ 79,595
General Partner's interest in net income	178	320	285	340
Limited Partners' interest in net income	\$ 41,379	\$ 74,559	\$ 66,369	\$ 79,255
Basic and Diluted income per Limited Partner Unit	\$ 0.55	\$ 0.98	\$ 0.88	\$ 1.05
Weighted average number of Limited Partner units outstanding:				
Basic and Diluted	75,774	75,774	75,774	75,774

See accompanying notes to condensed consolidated financial statements.

[Table of Contents](#)

STAR GAS PARTNERS, L.P. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF PARTNERS' CAPITAL
AND COMPREHENSIVE INCOME

(in thousands)	Number of Units		Common	General Partner	Accum. Other Comprehensive Income (Loss)	Total Partners' Capital
	Common	General Partner				
Balance as of September 30, 2007	75,774	326	\$232,895	\$ (129)	\$ (16,435)	\$216,331
Comprehensive Income (unaudited):						
Net income			66,369	285	—	66,654
Unrealized gain on pension plan obligation			—	—	491	491
Total comprehensive income			66,369	285	491	67,145
Balance as of March 31, 2008 (unaudited)	<u>75,774</u>	<u>326</u>	<u>\$299,264</u>	<u>\$ 156</u>	<u>\$ (15,944)</u>	<u>\$283,476</u>

See accompanying notes to condensed consolidated financial statements.

[Table of Contents](#)

STAR GAS PARTNERS, L.P. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands - unaudited)	Six Months Ended	
	March 31,	
	2008	2007
Cash flows provided by (used in) operating activities:		
Net income	\$ 66,654	\$ 79,595
Adjustment to reconcile net income to net cash provided by (used in) operating activities:		
Increase in fair value of derivative instruments	(15,940)	(12,147)
Depreciation and amortization	15,025	15,829
Provision for losses on accounts receivable	6,857	4,605
Changes in operating assets and liabilities:		
Increase in receivables	(193,001)	(115,576)
Decrease in inventories	21,529	27,210
Increase in weather insurance contract	—	(4,305)
Decrease (increase) in other assets and assets held for sale, net	(6,014)	6,148
Increase in accounts payable	3,064	181
Decrease in customer credit balances	(49,550)	(42,275)
Increase in other current and long-term liabilities	6,135	13,290
Net cash used in operating activities	<u>(145,241)</u>	<u>(27,445)</u>
Cash flows provided by (used in) investing activities:		
Capital expenditures	(1,693)	(2,492)
Proceeds from sales of fixed assets	166	733
Cash paid for acquisitions	(400)	(2,155)
Net cash used in investing activities	<u>(1,927)</u>	<u>(3,914)</u>
Cash flows provided by (used in) financing activities:		
Revolving credit facility borrowings	57,161	—
Revolving credit facility repayments	(9,145)	—
Repayment of debt	—	(47)
Increase in deferred charges	(110)	—
Net cash provided by (used in) financing activities	<u>47,906</u>	<u>(47)</u>
Net decrease in cash and cash equivalents	<u>(99,262)</u>	<u>(31,406)</u>
Cash and cash equivalents at beginning of period	112,886	91,121
Cash and cash equivalents at end of period	<u>\$ 13,624</u>	<u>\$ 59,715</u>

See accompanying notes to condensed consolidated financial statements.

STAR GAS PARTNERS, L.P. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1) Partnership Organization

Star Gas Partners, L.P. ("Star Gas Partners," the "Partnership," "we," "us," or "our") is a home heating oil distributor and services provider with one reportable operating segment that principally provides services to residential and commercial customers to heat their homes and buildings. Star Gas Partners is a master limited partnership, which at March 31, 2008, had outstanding 75.8 million common units (NYSE: "SGU") representing 99.6% limited partner interest in Star Gas Partners, and 0.3 million general partner units, representing 0.4% general partner interest in Star Gas Partners.

The Partnership is organized as follows:

- The general partner of the Partnership is Kestrel Heat, LLC, a Delaware limited liability company ("Kestrel Heat" or the "general partner"). The Board of Directors of Kestrel Heat is appointed by its sole member, Kestrel Energy Partners, LLC, a Delaware limited liability company ("Kestrel").
- The Partnership's operations are conducted through Petro Holdings, Inc. and its subsidiaries ("Petro"). Petro is a Minnesota corporation that is an indirect wholly-owned subsidiary of the Partnership. Petro is a Northeast and Mid-Atlantic region retail distributor of home heating oil that at March 31, 2008 served approximately 406,000 residential and commercial customers, and 7,000 propane customers. Petro also sold home heating oil, gasoline and diesel fuel to approximately 28,000 customers on a delivery only basis. In addition, Petro installed, maintained, and repaired heating and air conditioning equipment for its customers, and provided ancillary home services, including home security and plumbing, to approximately 11,000 customers.
- Star Gas Finance Company is a wholly-owned subsidiary of the Partnership. Star Gas Finance Company serves as the co-issuer, jointly and severally with the Partnership, of the Partnership's \$172.8 million 10 1/4% Senior Notes, which are due in 2013. The Partnership is dependent on distributions including intercompany interest payments from its subsidiaries to service the Partnership's debt obligations. The distributions from the Partnership's subsidiaries are not guaranteed and are subject to certain loan restrictions. Star Gas Finance Company has nominal assets and conducts no business operations.

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. Due to the seasonal nature of the Partnership's business, the results of operations for the three and six month periods ended March 31, 2008 and March 31, 2007 are not indicative of the results to be expected for the full year.

These interim financial statements of the Partnership have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and Rule 10-01 of Regulation S-X of the U.S. Securities and Exchange Commission and should be read in conjunction with the Partnership's Annual Report on Form 10-K for the year ended September 30, 2007.

Reclassification

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

Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Table of Contents

Revenue Recognition

Sales of heating oil and other fuels are recognized at the time of delivery of the product to the customer and sales of heating and air conditioning equipment are recognized at the time of installation. Revenue from repairs and maintenance service is recognized upon completion of the service. Payments received from customers for heating oil equipment service contracts are deferred and amortized into income over the terms of the respective service contracts, on a straight-line basis, which generally do not exceed one year. To the extent that the Partnership anticipates that future costs for fulfilling its contractual obligations under its service maintenance contracts will exceed the amount of deferred revenue currently attributable to these contracts, the Partnership recognizes a loss in current period earnings equal to the amount that anticipated future costs are estimated to exceed related deferred revenues.

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, it establishes an allowance for doubtful accounts, representing the Partnership's best estimate of amounts that may not be collectible.

Basic and Diluted Net Income per Limited Partner Unit

Net income per limited partner unit is computed by dividing net income, after deducting the general partner's interest, by the weighted average number of common units outstanding. Each unit in each of the partnership's ownership classes participates in net income equally.

Cash Equivalents

The Partnership considers all highly liquid investments with a maturity of three months or less, when purchased, to be cash equivalents.

Inventories

The Partnership's inventories of heating oil and other fuels are stated at the lower of cost or market computed on the weighted average cost (WAC) method. All other inventories, representing parts and equipment are stated at the lower of cost or market using the FIFO method.

<u>(in thousands)</u>	<u>March 31, 2008</u>	<u>September 30, 2007</u>
Heating oil and other fuels	\$50,185	\$ 72,309
Fuel oil parts and equipment	14,288	13,659
	<u>\$64,473</u>	<u>\$ 85,968</u>

Weather Insurance Contract

Weather insurance contract is recorded in accordance with the intrinsic value method defined by the Emerging Issues Task Force ("EITF") 99-2, "Accounting for Weather Derivatives." The premium paid is amortized over the life of the contract and the intrinsic value method is applied at each interim period.

Property, Plant, and Equipment

Property, plant, and equipment are stated at cost. Depreciation is computed over the estimated useful lives of the depreciable assets using the straight-line method.

<u>(in thousands)</u>	<u>March 31, 2008</u>	<u>September 30, 2007</u>
Property, plant and equipment	\$129,806	\$ 128,775
Less: accumulated depreciation	90,402	87,054
Property, plant and equipment, net	<u>\$ 39,404</u>	<u>\$ 41,721</u>

Goodwill and Intangible Assets

Goodwill and intangible assets include goodwill, customer lists, trade names and covenants not to compete.

Goodwill is the excess of cost over the fair value of net assets in the acquisition of a company. In accordance with Statements of Financial Accounting Standards ("SFAS") No. 142 "Goodwill and Other Intangible Assets," goodwill and intangible assets with indefinite useful lives are not amortized, but instead are annually tested for impairment. Also in accordance with this standard, intangible assets with definite useful lives are amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."

[Table of Contents](#)

Customer lists are the names and addresses of an acquired company's customers. Based on historical retention experience, these lists are amortized on a straight-line basis over seven to ten years.

Trade names are the names of acquired companies. Based on the economic benefit expected and historical retention experience of customers, trade names are amortized on a straight-line basis over seven to ten years.

Covenants not to compete are agreements with the owners of acquired companies and are amortized over the respective lives of the covenants on a straight-line basis, which are generally five years.

Partners' Capital

Comprehensive income includes net income, plus certain other items that are recorded directly to partners' capital. Accumulated other comprehensive income reported on the Partnerships' consolidated balance sheets consists of unrealized losses on pension plan obligations. For the three months ended March 31, 2008, comprehensive income was \$41.8 million, comprised of net income of \$41.6 million and an unrealized gain on pension plan obligation of \$0.2 million. For the three months ended March 31, 2007, comprehensive income and net income was \$74.9 million. For the six months ended March 31, 2008, comprehensive income was \$67.2 million, comprised of net income of \$66.7 million and an unrealized gain on pension plan obligation of \$0.5 million. For the six months ended March 31, 2007 comprehensive income and net income was \$79.6 million.

Income Taxes

The Partnership is a master limited partnership and is not subject to tax at the entity level for federal and state income tax purposes. Rather, income and losses of the Partnership are allocated directly to the individual partners. Except for the Partnership's corporate subsidiaries, no recognition has been given to federal income taxes in the accompanying financial statements of the Partnership. While the Partnership will generate non-qualifying Master Limited Partnership revenue, distributions from the corporate subsidiaries to the Partnership are generally included in the determination of qualified Master Limited Partnership income. All or a portion of the distributions received by the Partnership from the corporate subsidiaries could be a dividend or capital gain to the partners.

The accompanying financial statements are reported on a fiscal year, however, the Partnership and its Corporate subsidiaries file Federal and State income tax returns on a calendar year.

For corporate subsidiaries of the Partnership, a consolidated Federal income tax return is filed. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amount of assets and liabilities and their respective tax bases and operating loss carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. A valuation allowance is recognized if based on the weight of available evidence including historical tax losses, it is more likely than not that some or all of deferred tax assets will not be realized.

In the first quarter of fiscal 2008, we adopted the provisions of Financial Accounting Standards Board ("FASB") Interpretation No. 48 (As amended) — "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes and requires that we recognize in our financial statements the impact of a tax position taken or expected to be taken in a tax return, if that position is more likely than not to be sustained under audit, based on the technical merits of the position.

The implementation of FIN 48 had no effect on Partners' Capital, deferred tax assets or deferred tax liabilities. At March 31, 2008, we had unrecognized income tax benefits totaling \$0.6 million and related accrued interest and penalties of \$0.1 million. These unrecognized tax benefits are primarily the result of state and local income tax uncertainties. If recognized, essentially all of the tax benefits and related interest and penalties would be recorded as a benefit to the effective tax rate.

We believe that it is reasonably possible that the total liability for unrecognized tax benefits will decrease by as much as \$0.1 million during the next 12 months ending March 31, 2009, as a result of settling audits in one of the jurisdictions in which we pay taxes. Our continuing practice is to recognize interest and penalties related to income tax matters as a component of income tax expense.

[Table of Contents](#)

We file U.S. federal income tax returns and various state and local returns. A number of years may elapse before an uncertain tax position is audited and finally resolved. For our Federal income tax returns we have four tax years subject to examination. In our major state tax jurisdictions of New York, Pennsylvania and New Jersey, we have four, five, and five tax years, respectively, that are subject to examination. While it is often difficult to predict the final outcome or the timing of resolution of any particular uncertain tax position, based on our assessment of many factors including past experience and interpretation of tax law, we believe that our provision for income taxes reflect the most probable outcome. This assessment relies on estimates and assumptions and may involve a series of complex judgments about future events.

The Contractual Obligations and Off-Balance Sheet Arrangements disclosed in our Form 10-K for the year ended September 30, 2007 did not include any provision for income taxes because we cannot reasonably predict the ultimate amount or timing of settlement of our provision for income taxes with the respective taxing authorities, and we expect that our net deferred tax assets will offset our deferred tax liabilities. There has been no material change to Contractual Obligations and Off-Balance Sheet Arrangements table since September 30, 2007, and therefore, the table has not been included in this Form 10-Q.

Sales, Use and Value Added Taxes

Taxes are assessed by various governmental authorities on many different types of transactions. Sales reported for product, installation and service exclude taxes.

Derivatives and Hedging

SFAS No. 133 established accounting and reporting standards requiring that derivative instruments be recorded at fair value and included in the consolidated balance sheet as assets or liabilities. To the extent derivative instruments designated as cash flow hedges are effective and SFAS No. 133 documentation requirements have been met, changes in fair value are recognized in other comprehensive income until the underlying hedged item is recognized in earnings. Currently, the Partnership's derivative instruments do not qualify for hedge accounting treatment.

Recent Accounting Pronouncements

In September 2006, the FASB issued Statement No. 157 "Fair Value Measurements" ("SFAS No. 157"), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 is effective in fiscal years beginning after November 15, 2007. In November 2007, the FASB issued a one-year deferral of SFAS No. 157's fair value measurement requirements for nonfinancial assets and liabilities that are not required or permitted to be measured at fair value on a recurring basis. We are required to adopt SFAS No. 157 in fiscal 2009. The Partnership is currently assessing the impact of adopting SFAS No. 157.

In February 2007, the FASB issued "The Fair Value Option for Financial Assets and Financial Liabilities," ("SFAS No. 159") which provides companies an option to report eligible financial assets and liabilities at fair value. This Statement also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We are required to adopt SFAS No. 159 in fiscal 2009. The Partnership is currently assessing the impact of adopting SFAS No. 159.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" ("SFAS No. 141R"). SFAS No. 141R establishes a business combination principles and requirements for how an acquirer recognizes and measures identifiable assets acquired, goodwill acquired, liabilities assumed, and any noncontrolling interests. SFAS No. 141R is effective in fiscal years beginning after December 15, 2008. The Partnership is required to adopt SFAS No. 141R in fiscal 2010. The Partnership is currently assessing the impact of adopting SFAS No. 141R.

In March 2008, the FASB issued Statement No. 161 "Disclosures about Derivative Instruments and Hedging Activities," ("SFAS No. 161") which amends and expands the disclosure requirements of Statement No. 133. SFAS No. 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. We are required to adopt SFAS No. 161 in fiscal 2010. The Partnership is currently assessing the impact of adopting SFAS No. 161.

[Table of Contents](#)

3) Goodwill and Intangibles, net

Goodwill

A summary of changes in the Partnership's goodwill is as follows (in thousands):

Balance as of September 30, 2007	\$181,496
Fiscal year 2008 acquisitions	28
Balance as of March 31, 2008	<u>\$181,524</u>

Intangibles, net

The gross carrying amount and accumulated amortization of intangible assets subject to amortization is as follows:

(in thousands)	March 31, 2008			September 30, 2007		
	Gross Carrying Amount	Accum. Amortization	Net	Gross Carrying Amount	Accum. Amortization	Net
Customer lists and other intangibles	<u>\$200,539</u>	<u>\$ 161,587</u>	<u>\$38,952</u>	<u>\$200,209</u>	<u>\$ 151,741</u>	<u>\$48,468</u>

Amortization expense for intangible assets and deferred charges was \$10.0 million for the six months ended March 31, 2008 compared to \$10.4 million for the six months ended March 31, 2007. Total estimated annual amortization expense related to intangible assets subject to amortization and deferred charges, for the fiscal year ending September 30, 2008, and the four succeeding fiscal years ending September 30, is as follows (in thousands):

	Estimated Annual Amortization Expense
2008	\$ 19,115
2009	\$ 12,386
2010	\$ 7,203
2011	\$ 5,152
2012	\$ 785

4) Acquisitions

For the six months ended March 31, 2008 the Partnership acquired one retail heating oil dealer. The aggregate purchase price was approximately \$0.4 million.

For the six months ended March 31, 2007 the Partnership acquired two retail heating oil dealers. The aggregate purchase price was approximately \$2.2 million.

The acquired assets and assumed liabilities were recorded at fair value based on valuations and estimates. The excess of the cost of acquired net assets over fair value was recorded as goodwill. Estimates used to determine the fair value of acquisitions made within the previous twelve months may be subject to change.

The following table indicates the allocation of the aggregate purchase price paid and the respective periods of amortization assigned for the acquisitions made as of March 31, 2008 (in thousands):

	March 31, 2008	Useful Lives
Furniture and equipment	\$ —	7 years
Fleet	25	1 - 10 years
Customer lists and other intangibles	320	7 - 10 years
Goodwill	28	—
Trade names	10	7 - 10 years
Working capital	17	—
Total	<u>\$ 400</u>	

[Table of Contents](#)

5) Employee Pension Plan

(in thousands)	Three Months Ended March 31,		Six Months Ended March 31,	
	2008	2007	2008	2007
<u>Components of net periodic benefit cost:</u>				
Service cost	\$ —	\$ —	\$ —	\$ —
Interest cost	893	873	1,786	1,746
Expected return on plan assets	(916)	(966)	(1,832)	(1,932)
Net amortization	245	345	490	690
Net periodic benefit cost	<u>\$ 222</u>	<u>\$ 252</u>	<u>\$ 444</u>	<u>\$ 504</u>

The Partnership estimates minimum cash contributions of \$1.2 million to fund its pension obligations for fiscal 2008.

6) Supplemental Disclosure of Cash Flow Information

(in thousands)	Six Months Ended March 31,	
	2008	2007
<u>Cash paid (received) during the period for:</u>		
Income taxes, net	\$ 932	\$ (92)
Interest	\$10,478	\$10,224
Non-cash financing activities:		
Decrease in interest expense—amortization of debt discount	\$ 93	\$ 102

7) Commitments and Contingencies

On or about October 21, 2004, a purported class action lawsuit on behalf of a purported class of unitholders was filed against the Partnership and various subsidiaries and officers and directors in the United States District Court of the District of Connecticut entitled *Carter v. Star Gas Partners, L.P., et al*, No. 3:04-cv-01766-IBA, et al. Subsequently, 16 additional class action complaints, alleging the same or substantially similar claims, were filed in the same district court collectively referred to herein as the “Class Action Complaints”). The class actions have been consolidated into one action entitled *In re Star Gas Securities Litigation*, No 3:04cv1766 (JBA).

The class action plaintiffs generally allege that the Partnership violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 promulgated hereunder, by purportedly failing to disclose, among other things: (1) problems with the restructuring of Star Gas’ dispatch system and customer attrition related thereto; (2) that Star Gas’ business process improvement program was not generating the benefits allegedly claimed; (3) that Star Gas was struggling to maintain its profit margins; (4) that Star Gas’s fiscal 2004 second quarter profit margins were not representative of its ability to pass on heating oil price increases; and (5) that Star Gas was facing an inability to pay its debts and that, as a result, its credit rating and ability to obtain future financing was in jeopardy. The class action plaintiffs seek an unspecified amount of compensatory damages including interest against the defendants jointly and severally and an award of reasonable costs and expenses. On February 23, 2005, the Court consolidated the Class Action Complaints and heard argument on motions for the appointment of lead plaintiff. On April 8, 2005, the Court appointed the lead plaintiff. Pursuant to the Court’s order, the lead plaintiff filed a consolidated amended complaint on June 20, 2005 (the “Consolidated Amended Complaint”). The Consolidated Amended Complaint named: (a) Star Gas Partners, L.P.; (b) Star Gas LLC; (c) Irik Sevin; (d) Audrey

[Table of Contents](#)

Sevin; (e) Hanseatic Americas, Inc.; (f) Paul Biddelman; (g) Ami Trauber; (h) A.G. Edwards & Sons Inc.; (i) UBS Investment Bank; and (j) RBC Dain Rauscher Inc. as defendants. The Consolidated Amended Complaint added claims arising out of two registration statements and the same transactions under Sections 11, 12(a)(2) and 15 of the Securities Act of 1933 as well as certain allegations concerning the Partnership's hedging practices. On September 23, 2005, defendants filed motions to dismiss the Consolidated Amended Complaint for failure to state a claim under the federal securities laws and failure to satisfy the applicable pleading requirements of the Private Securities Litigation Reform Act of 1995 or PSLRA, and the Federal Rules of Civil Procedure. On July 27, 2006, the Court heard oral argument on the pending motions to dismiss. On August 21, 2006, the court issued its rulings on defendants' motions to dismiss, granting the motions and dismissing the consolidated amended complaint in its entirety. On August 23, 2006, the court entered a judgment of dismissal. On September 7, 2006, the plaintiffs moved for reconsideration and to alter and reopen the court's August 23, 2006 judgment of dismissal and for leave to file a second consolidated amended complaint ("Plaintiffs' Post-Judgment Motion"). On October 20, 2006, defendants filed their memorandum of law in opposition to the Plaintiffs' Post-Judgment Motion. Plaintiffs filed their reply brief on or about November 20, 2006. On March 22, 2007 the Court issued its decision denying Plaintiffs' Post-Judgment Motion.

On April 3, 2007, the Star Gas Defendants filed a Motion for a Mandatory Rule 11 Inquiry and fee shifting which seeks recovery of Defendants' legal fees pursuant to the PSLRA. On April 24, 2007, class plaintiffs filed their opposition to that motion. The Star Gas Defendants' reply was filed on May 8, 2007. The matter is now under consideration by the Court.

On April 20, 2007, class plaintiffs filed a notice of appeal to the Court of Appeals for the Second Circuit for Judge Arterton's decisions dismissing the amended complaint and denying Plaintiffs' Post-Judgment Motion. Subsequent to the filing of the notice of appeal, class plaintiffs stipulated to the dismissal of the appeal as against Hanseatic Americas, Inc., Paul Biddelman, A.G. Edwards & Sons, Inc., RBC Dain Rauscher Inc., UBS Investment Bank, and Audrey Sevin. On or about July 6, 2007, class plaintiffs filed their brief on appeal. The Star Gas Defendants filed their opposition brief on or about August 21, 2007, and class plaintiffs filed their reply brief on or about September 11, 2007. Oral argument on the appeal has not yet been scheduled. In the interim, discovery in the matter remains stayed pursuant to the mandatory stay provisions of the PSLRA. While no prediction may be made as to the outcome of litigation, we intend to defend against this class action vigorously.

In the event that the above action is decided adversely to us, it could have a material effect on our results of operations, financial condition and liquidity. The Partnership has not accrued any amount for this action because, based on the court's judgment of dismissal, we believe an unfavorable outcome is not probable.

The Partnership's operations are subject to all operating hazards and risks normally incidental to handling, storing and transporting and otherwise providing for use by consumers of combustible liquids such as home heating oil and propane. As a result, at any given time the Partnership is a defendant in various legal proceedings and litigation arising in the ordinary course of business. The Partnership maintains insurance policies with insurers in amounts and with coverages and deductibles we believe are reasonable and prudent. However, the Partnership cannot assure that this insurance will be adequate to protect it from all material expenses related to potential future claims for personal and property damage or that these levels of insurance will be available in the future at economical prices. In the opinion of management, except as described above the Partnership is not a party to any litigation, which individually or in the aggregate could reasonably be expected to have a material adverse effect on the Partnership's results of operations, financial position or liquidity.

[Table of Contents](#)

8) Earnings Per Limited Partner Units

(in thousands, except per unit data)	Three Months Ended		Six Months Ended	
	March 31,		March 31,	
	2008	2007	2008	2007
Net income per Limited Partner unit—Basic and Diluted	\$ 0.55	\$ 0.98	\$ 0.88	\$ 1.05
Basic and Diluted Earnings Per Limited Partner:				
Net income	\$41,557	\$74,879	\$66,654	\$79,595
Less: General Partners' interest in net income	178	320	285	340
Limited Partner's interest in net income	\$41,379	\$74,559	\$66,369	\$79,255
Weighted average number of Limited Partner units outstanding	75,774	75,774	75,774	75,774

9) Subsequent Events

In April 2008, the Partnership purchased the customer lists and assets of a heating oil dealership for approximately \$0.5 million.

Item 2.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

Statement Regarding Forward-Looking Disclosure

This Quarterly Report on Form 10-Q includes "forward-looking statements" which represent our expectations or beliefs concerning future events that involve risks and uncertainties, including those associated with the effect of weather conditions on our financial performance, the price and supply of home heating oil, the consumption patterns of our customers, our ability to obtain satisfactory gross profit margins, our ability to obtain new accounts and retain existing accounts, our ability to make strategic acquisitions, the impact of litigation, the continuing residual impact of the business process redesign project and our ability to address issues related to that project, our ability to contract for our current and future supply needs, natural gas conversions, future union relations and outcome of current and future union negotiations, the impact of future environmental, health, and safety regulations, the ability to attract and retain employees, customer credit worthiness, counter party credit worthiness, marketing plans and general economic conditions. 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 we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such expectations will prove to be correct and actual results may differ materially from those projected as a result of certain risks and uncertainties. Important factors that could cause actual results to differ materially from our expectations ("Cautionary Statements") include, but are not limited to, those set forth under the heading "Risk Factors" and "Business Initiatives and Strategy" in the Partnership's Annual Report on Form 10-K (the "Form 10-K") for the fiscal year ended September 30, 2007 and under the heading "Risk Factors" in this Quarterly Report on Form 10-Q. Without limiting the foregoing, the words "believe," "anticipate," "plan," "expect," "seek," "estimate" and similar expressions are intended to identify forward-looking statements. 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. Unless otherwise required by law, we undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise after the date of this Report.

Overview

The following is a discussion of the historical financial condition and results of operations of the Partnership and its subsidiaries, and should be read in conjunction with the description of our business in Item 1. "Business" of the Form 10-K and the historical Financial and Operating Data and Notes thereto included elsewhere in this Report.

During March 2007, we completed our transition from a centralized customer service model to a more traditional customer service model in which the majority of our customer service calls are answered locally. We have implemented an employee staffed centralized call center to augment our internal staffing requirements for certain overflow, off-peak and weekend hours.

Seasonality

In analyzing our financial results, the following matters should be considered. Our 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 our business results in the sale of approximately 30% of our volume of home heating oil in the first fiscal quarter and 45% of our volume in the second fiscal quarter of each fiscal year, the peak heating season. We generally realize net income in the first and second fiscal quarters and net losses in the third and fourth fiscal quarters. 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. In addition, our 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.

Degree Day

A "degree day" is an industry measurement of temperature designed to evaluate energy demand and consumption. Degree-days are based on how far the average temperature departs from 65°F. Each degree of temperature above 65°F is counted as one cooling day, and each degree of temperature below 65°F is counted as one heating degree-day. Degree-days are accumulated each day over the course of a year and can be compared to a monthly or a long-term (multi-year) average, or normal, to see if a month or a year was warmer or cooler than usual. Degree-days are officially observed by the National Weather Service and officially archived by the National Climatic Data Center. For purposes of evaluating our results of operations, we use the normal heating degree-day amount as reported by the National Weather Service in our operating areas.

[Table of Contents](#)

EBITDA and Adjusted EBITDA

EBITDA (Earnings from continuing operations before interest, taxes, depreciation and amortization) and Adjusted EBITDA (defined in the next paragraph) are used as supplemental financial measures by management and external users of our financial statements, such as investors, commercial banks and research analysts, to assess:

- our compliance with certain financial covenants included in our debt agreements;
- our financial performance without regard to financing methods, capital structure, income taxes or historical cost basis;
- our ability to generate cash sufficient to pay interest on our indebtedness and to make distributions to our partners;
- our operating performance and return on invested capital as compared to those of other companies in the retail distribution of refined petroleum products business, without regard to financing methods and capital structure; and
- the viability of acquisitions and capital expenditure projects and the overall rates of return of alternative investment opportunities.

Adjusted EBITDA is calculated as EBITDA before (increase) decrease in the fair value of derivatives, loss on debt redemption, goodwill impairment, and other non-cash and non-operating charges. Management believes the presentation of this measure is relevant and useful because it allows investors to view the Partnership's performance in a manner similar to the method management uses, and makes it easier to compare its results with other companies that have different financing and capital structures. In addition, this measure is consistent with the manner in which the Partnership's debt covenants in its material debt agreements are calculated and investors measure its overall performance and liquidity, including its ability to pay quarterly equity distributions, service its long-term debt and other fixed obligations and fund its capital expenditures and working capital requirements. This method of calculating Adjusted EBITDA may not be consistent with that of other companies and should be viewed in conjunction with measurements that are computed in accordance with GAAP. (See the three and six month Adjusted EBITDA tables.)

Per Gallon Gross Profit Margins

We believe the change in home heating oil margins should be evaluated on a cents per gallon basis, before the effects of increases or decreases in the fair value of derivative instruments, as we believe that realized per gallon margins should not include the impact of non-cash changes in the market value of hedges before the settlement of the underlying transaction.

Derivatives

SFAS No. 133, established accounting and reporting standards requiring that derivative instruments be recorded at fair value and included in the consolidated balance sheet as assets or liabilities. To the extent derivative instruments designated as cash flow hedges are effective, as defined in SFAS No. 133, changes in fair value are recognized in other comprehensive income until the forecasted hedged item is recognized in earnings. The Partnership's derivative instruments do not qualify for hedge accounting treatment. Therefore, we could experience great volatility in earnings as outstanding home heating oil derivative instruments are marked to market and non-cash gains and losses are recorded prior to the sale of the commodity to the customer. To the extent that the Partnership continues this accounting treatment, the volatility in any given period related to unrealized non-cash gains or losses on derivative home heating oil instruments can be significant to the overall results of the Partnership. However, we ultimately expect those gains and losses to be offset by a change in the underlying commodity when they become realized.

Home Heating Oil Price Volatility

The wholesale price of home heating oil has been extremely volatile over the last several years and especially over the last six months. As a result, consumer awareness of home heating oil costs has increased, which we believe has led to increased net customer attrition due to greater customer price shopping and a decrease in volume as a result of customer conservation. The price of home heating oil is subject to many economic and geo-political forces. The price of home heating oil is closely linked to the price refiner's pay for crude oil, which is the principal cost component of home heating oil. During the six months ended March 31, 2008, new record highs for home heating oil were achieved 28 times and subsequent to March 31, 2008, new record highs were also reached in April 2008. We believe that this increase in home heating oil prices has and will continue to adversely impact liquidity, profitability, our bad debt experience, net customer attrition and our cost of capital.

Weather Insurance Contract — Warm Weather

Weather conditions have a significant impact on the demand for home heating oil because our customers depend on this product principally for space heating purposes. Actual weather conditions can vary substantially from year to year, significantly affecting our financial performance. Furthermore, warmer than normal temperatures in one or more regions in which we operate can significantly decrease the total volume we sell and the gross profit realized on those sales and,

[Table of Contents](#)

consequently, our results of operations. We purchased weather insurance to help mitigate the adverse effect of warm weather on our cash flows for the period from November 1, 2007 to February 29, 2008, taken as a whole and for the period November 1, 2008 to February 28, 2009, taken as a whole. The strike or "pay-off" price is based on the 10 year moving average of degree-days for the contract period and has been set at approximately 3% less than the 10 year moving average. For every degree-day not realized below the strike-price we are entitled to received \$35,000 up to a maximum of \$12.5 million. In accordance with EITF 99-2, we recorded an asset under this weather insurance contract at March 31, 2008 and 2007, of zero and \$4.3 million, respectively.

Customer Attrition

The following table summarizes the Partnership's customer gains and losses for the three and six months ended March 31, 2008 versus the prior year's comparable period.

	<u>Three Months Ended</u>		<u>Increase/ (Decrease)</u>	<u>Six Months Ended</u>		<u>Increase/ (Decrease)</u>
	<u>03/31/08</u>	<u>03/31/07</u>		<u>03/31/08</u>	<u>3/31/2007</u>	
Gross customer gains	12,400	13,900	(1,500)	34,300	35,400	(1,100)
Gross customer losses	19,000	19,200	(200)	46,500	44,800	1,700
Net customer loss	<u>(6,600)</u>	<u>(5,300)</u>	<u>(1,300)</u>	<u>(12,200)</u>	<u>(9,400)</u>	<u>(2,800)</u>
Percent of Home Heating Oil Customer Base	(1.6)%	(1.2)%		(2.9)%	(2.3)%	

During the six months ended March 31, 2008, the weak housing market resulted in 3,700 less account losses versus the prior year's comparable period attributable to customers moving from one home to another. As a result, we also experienced lower customer gains from new owners moving into a former customer's home by 1,200 accounts and our new customer real estate gains were less by 800 accounts. While our net customer attrition improved by 1,700 due to the poor housing market, customer losses increased due to additional price losses of 4,900 and higher credit losses of 800. The dramatic increase in the price of home heating oil of over \$0.90 per gallon versus the prior year drove the increase in price losses. In addition, our ability to sign new accounts was diminished by the current economic conditions in the United States which led to an over 25% increase in our rejection rate due to low unacceptable credit scores of potential accounts. The year-over-year comparison was favorably impacted by organic growth of 400 accounts at the acquisition companies.

Results of Operations

The following is a discussion of the 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 Quarterly Report.

**Three Months Ended March 31, 2008
Compared to the Three Months Ended March 31, 2007**

Volume

For the three months ended March 31, 2008, retail volume of home heating oil decreased by 25.7 million gallons, or 13.2%, to 169.4 million gallons, as compared to 195.1 million gallons for the three months ended March 31, 2007, as the additional volume from acquisitions was reduced by warmer weather, net customer attrition, conservation and other factors. Volume of other petroleum products decreased by 6.3 million gallons, or 30.3%, to 14.6 million gallons for the three months ended March 31, 2008, as compared to 20.9 million gallons for the three months ended March 31, 2007. The majority of the other petroleum products decline was in the very low margin wholesale operations. An analysis of the change in the retail volume of home heating oil, which is based on managements' estimates, sampling and other mathematical calculations, is found below:

<u>(in millions of gallons)</u>	<u>Heating Oil</u>
Volume—Three months ended March 31, 2007	195.1
Impact of warmer temperatures	(12.3)
Net customer attrition—retail/commercial	(11.3)
Acquisitions	6.8
Conservation/Other	(8.9) (a)
Change	(25.7)
Volume—Three months ended March 31, 2008	<u>169.4</u>

(a) Includes an estimated 0.7 million gallons reclassified to other petroleum product sales.

Temperatures in our geographic areas of operations for the three months ended March 31, 2008 were 6.4% warmer than the three months ended March 31, 2007 and 4.8% warmer than normal, as reported by the National Oceanic Atmospheric Administration ("NOAA"). For the twelve months ended March 31, 2008, net customer attrition was 5.8%. Excluding the impact of weather, we expect that home heating oil volume for the remainder of fiscal 2008 will be less than the comparable period in fiscal 2007 due to net customer attrition, conservation and other factors.

The percentage of home heating oil volume sold to residential variable price customers decreased to 42.7% of total home heating oil volume sales for the three months ended March 31, 2008, as compared to 46.5% for the three months ended March 31, 2007. Accordingly, the percentage of home heating oil volume sold to residential price-protected customers increased to 43.1% for the three months ended March 31, 2008, as compared to 38.3% for the three months ended March 31, 2007. For the three months ended March 31, 2008, sales to commercial/industrial customers represented 14.2% of total home heating oil volume sales, as compared to 15.2% for the three months ended March 31, 2007.

Product Sales

For the three months ended March 31, 2008, product sales increased \$86.1 million, or 16.1%, to \$620.9 million, as compared to \$534.9 million for the three months ended March 31, 2007, as an increase in home heating oil selling prices of 34.4% was reduced by the decline in home heating oil volume and other petroleum products of 13.2% and 30.3%, respectively. Average home heating oil selling prices increased by \$0.8730 per gallon, or 34.4%, from \$2.54 per gallon for the three months ended March 31, 2007 to \$3.41 for the three months ended March 31, 2008 in response to the 48.5% increase in home heating oil products costs described below.

Installation and Service Sales

For the three months ended March 31, 2008, service and installation sales increased \$2.3 million, or 5.5%, to \$44.4 million, as compared to \$42.1 million for the three months ended March 31, 2007, largely due to the service and installation sales associated with acquisitions completed in fiscal 2007.

Cost of Product

For the three months ended March 31, 2008, cost of product increased \$105.3 million, or 27.3%, to \$491.2 million, as compared to \$385.9 million for the three months ended March 31, 2007, as the decrease in cost of product attributable to the

[Table of Contents](#)

decline in home heating oil and other petroleum products sold was more than offset by an increase in wholesale product cost. Average wholesale product cost for home heating oil increased by \$0.87 per gallon, or 48.5%, to an average of \$2.67 per gallon for the three months ended March 31, 2008, from an average of \$1.79 for the three months ended March 31, 2007.

We believe that the change in home heating oil margins should be evaluated before the effects of increases or decreases in the fair value of derivative instruments, as we believe that realized per gallon margins should not include the impact of non-cash changes in the market value of hedges before the settlement of the underlying transaction. On that basis, home heating oil margins for the three months ended March 31, 2008 increased \$0.0025 per gallon to \$0.7448 per gallon in the three months ended March 31, 2008 from \$0.7423 per gallon in the three months ended March 31, 2007, as home heating oil prices reached record highs on 13 occasions during the three months ended March 31, 2008. The Partnership did not expect to achieve a similar expansion of its home heating oil margins as it experienced in the three months ended March 31, 2007, when per gallon margins increased by \$0.0675 per gallon, or 10%, versus the prior year's comparable quarter. During the three months ended March 31, 2008, the rise in home heating oil product costs limited margin expansion capability. Conversely, during the three months ended March 31, 2007, home heating oil product costs dropped, which contributed to the Partnership's ability to expand its home heating oil margin during that period. In addition, during the three months ended March 31, 2008, a larger percentage of the Partnership's home heating oil sales were made to price protected customers, whose per gallon margin is less than variable residential customers. As a result of this shift, per gallon margin expansion was restricted.

For the three months ended March 31, 2008, total product gross profit decreased by \$19.2 million, as compared to the three months ended March 31, 2007, as the slight increase in realized home heating oil per gallon margins (\$0.4 million) was more than offset by the decrease in home heating oil volume (\$19.0 million) and lower gross profit realized on other petroleum products (\$0.6 million).

Change in the Fair Value of Derivative Instruments

During the three months ended March 31, 2008, the change in the fair value of derivative instruments resulted in the recording of a \$1.8 million net debit due to the expiration of certain hedged positions (\$12.9 million debit), and an increase in the market value of unexpired hedges (\$11.1 million credit). During the three months ended March 31, 2008, the net change in the fair value of derivatives on the balance sheet was \$6.0 million, which consisted of the non-cash portion described above of \$1.8 million and a net cash component of \$4.2 million relating to the historic cost of purchased options.

During the three months ended March 31, 2007, the change in the fair value of derivative instruments resulted in the recording of an \$18.5 million net credit due to the expiration of certain hedged positions (\$13.9 million credit), and an increase in the market value for unexpired hedges (\$4.6 million credit). During the three months ended March 31, 2007, the net change in the fair value of derivatives on the balance sheet was \$16.2 million, which consisted of the non-cash portion described above of \$18.5 million and a net cash component of \$2.3 million relating to the historic cost of purchased options.

Cost of Installations and Service

During the three months ended March 31, 2008, cost of installations and service increased \$0.9 million, or 2.0%, to \$45.3 million, as compared to \$44.4 million for the three months ended March 31, 2007, as the service and installation costs from acquisitions of \$3.3 million was reduced by lower service and installation costs in the base business of \$2.4 million. Management views the service and installation department on a combined basis, because many expenses cannot be separated or allocated to either service or installation billings. Many overhead functions and direct expenses such as service technician time cannot be precisely allocated and are generally left in service costs. As a result, reported service profitability is reduced and reported installation profitability is increased.

Installation costs were \$13.8 million, or 87.4% of installation sales during the three months ended March 31, 2008, and were \$12.7 million, or 85.7% of installation sales during the three months ended March 31, 2007. Service expenses decreased to \$31.6 million, or 110.1% of service sales during the three months ended March 31, 2008, from \$31.7 million in the three months ended March 31, 2007, or 116.3% of service sales. Service costs as a percentage of total service revenue declined, as the Partnership continued to increase its rates for service billings and further reduced its service costs. The gross profit realized from service and installations was a loss of \$0.9 million for the three months ended March 31, 2008, as compared to a loss of \$2.3 million for the three months ended March 31, 2007.

Delivery and Branch Expenses

For the three months ended March 31, 2008, delivery and branch expenses decreased \$1.9 million, or 2.7%, to \$66.8 million, as compared to \$68.7 million for the three months ended March 31, 2007. During the three months ended March 31, 2007, the Partnership reversed \$2.8 million of expected proceeds under its weather insurance contract, as temperatures turned colder, which increased operating expenses. For the three months ended March 31, 2008 no such amount was recorded.

[Table of Contents](#)

Exclusive of the weather insurance reversal, operating expenses increased \$1.0 million, or 1.6%. Operating expense were reduced by an estimated \$3.3 million due to the volume decline attributable to warmer weather, customer attrition and other factors but were more than offset by increases in delivery and branch expenses from the stand-alone acquisitions of \$2.9 million and higher bad debt expense of \$2.2 million. On a cents per gallon basis (excluding the impact of weather insurance and acquisitions), delivery and branch expenses increased 5.7 cents per gallon, or 17.0%, from 33.7 cents per gallon for the three months ended March 31, 2007 to 39.4 cents per gallon for the three months ended March 31, 2008, due to the fixed nature of certain delivery and branch expenses, the disproportionate increases in bad debt expense and inflationary pressures.

Depreciation and Amortization

For the three months ended March 31, 2008, depreciation and amortization expenses declined by \$0.5 million, or 6.2% to \$6.9 million, as compared to \$7.3 million for the three months ended March 31, 2007 as certain assets, which were not replaced, became fully depreciated or amortized.

General and Administrative Expenses

For the three months ended March 31, 2008, general and administrative expenses decreased by \$2.1 million, or 33.0%, to \$4.2 million, as compared to \$6.3 million for the three months ended March 31, 2007 due to lower profit sharing expense of \$1.5 million and lower legal and professional expenses of \$0.6 million.

Operating Income

For the three months ended March 31, 2008, operating income decreased \$33.7 million to \$49.1 million, as compared to \$82.9 million for the three months ended March 31, 2007, as a decrease in product gross profit of \$19.2 million and an unfavorable change in the impact of derivative instruments of \$20.3 million was partially offset by lower operating costs (including depreciation and amortization) of \$4.4 million and lower net service and installation expense of \$1.4 million.

Interest Expense

For the three months ended March 31, 2008, interest expense increased \$0.5 million, or 10.2%, to \$5.7 million, as compared to \$5.1 million for the three months ended March 31, 2006. This increase resulted from a higher average principal amount in total debt outstanding of approximately \$40.2 million.

Interest Income

For the three months ended March 31, 2008, interest income decreased by \$0.2 million, or 11.3%, to \$1.4 million, as compared to \$1.6 million for the three months ended March 31, 2007. Both lower invested cash balances and lower interest rates led to a reduction in interest income of \$0.7 million which was reduced by an increase in late fees charged on past due accounts of \$0.5 million.

Amortization of Debt Issuance Costs

For the three months ended March 31, 2008, amortization of debt issuance costs was \$0.6 million, unchanged from the three months ended March 31, 2007.

Income Tax Expense

For the three months ended March 31, 2008, income tax expense declined by \$1.1 million to \$2.7 million, due to the reduction in pretax income.

Net Income

For the three months ended March 31, 2008, net income of \$41.6 million was recorded as compared to net income of \$74.9 million for the three months ended March 31, 2007. This decrease in net income of \$33.3 million was due to a \$33.7 million decrease in operating income and higher net interest expense of \$0.7 million partially offset by a decrease in income tax expense of \$1.1 million.

Adjusted EBITDA

For the three months ended March 31, 2008, Adjusted EBITDA decreased by \$13.9 million to \$57.8 million, as compared to \$71.7 million for the three months ended March 31, 2007. While the Partnership's acquisition program led to an increase in EBITDA, the EBITDA provided from the acquisitions was more than offset by the reduction in EBITDA attributable to the decline in home heating oil volume which was primarily due to warmer temperatures, net customer attrition, conservation and other factors.

[Table of Contents](#)

<u>(in thousands)</u>	Three Months Ended	
	March 31,	
	<u>2008</u>	<u>2007</u>
Income from continuing operations	\$ 41,557	\$ 74,879
Plus:		
Income tax expense	2,737	3,845
Amortization of debt issuance cost	585	571
Interest expense, net	4,261	3,557
Depreciation and amortization	<u>6,862</u>	<u>7,316</u>
EBITDA from continuing operations	56,002	90,168
(Increase) / decrease in the fair value of derivative instruments	<u>1,813</u>	<u>(18,462)</u>
Adjusted EBITDA (a)	57,815	71,706
Add / (subtract)		
Income tax expense	(2,737)	(3,845)
Interest expense, net	(4,261)	(3,557)
Provision for losses on accounts receivable	5,147	2,653
Increase in weather insurance contract	—	2,895
Change in operating assets and liabilities	<u>(75,513)</u>	<u>(76,412)</u>
Net cash used in operating activities	<u><u>\$(19,549)</u></u>	<u><u>\$ (6,560)</u></u>

- (a) Adjusted EBITDA is calculated as earnings from continuing operations before net interest expense, income taxes, depreciation and amortization, (increase) decrease in the fair value of derivatives, loss on debt redemption, goodwill impairment, and other non-cash and non-operating charges. Management believes the presentation of this measure is relevant and useful because it allows investors to view the Partnership's performance in a manner similar to the method management uses, and makes it easier to compare its results with other companies that have different financing and capital structures. In addition, this measure is consistent with the manner in which the Partnership's debt covenants in its material debt agreements are calculated and investors measure its overall performance and liquidity, including its ability to pay quarterly equity distributions, service its long-term debt and other fixed obligations and fund its capital expenditures and working capital requirements. This method of calculating Adjusted EBITDA may not be consistent with that of other companies and should be viewed in conjunction with measurements that are computed in accordance with GAAP.

**Six Months Ended March 31, 2008
Compared to the Six Months Ended March 31, 2007**

Volume

For the six months ended March 31, 2008, retail volume of home heating oil decreased by 11.9 million gallons, or 4.0%, to 282.5 million gallons, as compared to 294.4 million gallons for the six months ended March 31, 2007, as the additional volume from acquisitions and slightly colder temperatures was reduced by net customer attrition, conservation and other factors. Volume of other petroleum products declined by 6.4 million gallons, or 17.4%, to 30.3 million gallons for the six months ended March 31, 2008, as compared to 36.7 million gallons for the six months ended March 31, 2007. The majority of the other petroleum products decline was in the very low margin wholesale operations. An analysis of the change in the retail volume of home heating oil, which is based on management's estimates, sampling and other mathematical calculations, is found below:

<u>(in millions of gallons)</u>	<u>Heating Oil</u>
Volume-Six months ended March 31, 2007	294.4
Impact of colder temperatures	3.9
Net customer attrition—retail/commercial	(17.1)
Acquisitions	11.8
Conservation/Other	(10.5) (a)
Change	(11.9)
Volume-Six months ended March 31, 2008	<u>282.5</u>

(a) Includes an estimated 1.4 million gallons reclassified to other petroleum product sales.

Temperatures in our geographic areas of operations for the six months ended March 31, 2008 were 1.3% colder than the six months ended March 31, 2007 and 2.9% warmer than normal, as reported by the NOAA. Net customer attrition for the twelve months ended March 31, 2008 was 5.8%. The percentage of home heating oil volume sold to residential variable price customers decreased to 44.2% of total home heating oil sales for the six months ended March 31, 2008, as compared to 46.7% for the six months ended March 31, 2007. Accordingly, the percentage of home heating oil volume sold to residential price-protected customers increased to 41.4% for the six months ended March 31, 2008, as compared to 37.6% for the six months ended March 31, 2007. For the six months ended March 31, 2008, sales to commercial/industrial customers represented 14.4% of total home heating oil volume sales, for the six months ended March 31, 2007, compared to 15.7% of sales.

Product Sales

For the six months ended March 31, 2008, product sales increased \$206.7 million, or 25.4%, to \$1.0 billion, as compared to \$815.3 million for the six months ended March 31, 2007, as a 31.0% increase in home heating oil selling prices was reduced by decreases in home heating oil volume of 4.0% and in other petroleum products volume of 17.4%. Average home heating oil selling prices increased by \$0.78 per gallon from \$2.53 per gallon for the six months ended March 31, 2007 to \$3.31 for the six months ended March 31, 2008, in response to the increase in home heating oil product cost.

Installation and Service Sales

For the six months ended March 31, 2008, service and installation sales increased \$5.4 million, or 5.8%, to \$97.3 million, as compared to \$91.9 million for the six months ended March 31, 2007, as an \$8.7 million increase associated with acquisitions was partially offset by a \$3.3 million decline driven largely by net customer attrition and other economic factors.

Cost of Product

For the six months ended March 31, 2008, cost of product increased \$218.3 million, or 36.9%, to \$810.4 million, as compared to \$592.2 million for the six months ended March 31, 2007 primarily due to the 44.1% increase in product cost for home heating oil. Average wholesale product cost for home heating oil increased by \$0.79 per gallon, or 44.1%, to an average of \$2.59 per gallon for the six months ended March 31, 2008, from an average of \$1.79 for the six months ended March 31, 2007.

[Table of Contents](#)

Home heating oil margins for the six months ended March 31, 2008 decreased by \$0.0096 per gallon to \$0.7241 per gallon in the six months ended March 31, 2008 from \$0.7338 per gallon in the six months ended March 31, 2007, as home heating oil prices reached record highs on 28 occasions during the six months ended March 31, 2008. The partnership did not expect to achieve a similar expansion of its home heating oil margins as it experienced in the six months ended March 31, 2007, when per gallon margins increased by \$0.0451 per gallon, or 6.5%, versus the prior year's comparable period. During the six months ended March 31, 2008, home heating oil costs continued to escalate, which limited margin expansion capability. Conversely, during the six months ended March 31, 2007, home heating oil product costs dropped which largely contributed to the Partnership's ability to expand its home heating oil margin during that period. In addition, a larger percentage of the home heating oil sales were made to price protected customers whose per gallon margin is less than variable residential customers.

For the six months ended March 31, 2008, total product gross profit decreased by \$11.6 million, as compared to the six months ended March 31, 2007, due to the decrease in home heating oil per gallon margins of (\$2.7 million) and lower home heating oil volume of (\$8.7 million).

Change in the Fair Value of Derivative Instruments

During the six months ended March 31, 2008, the change in the fair value of derivative instruments resulted in the recording of a \$15.9 million net credit due to the expiration of certain hedged positions (\$0.6 million debit), and an increase in market value for unexpired hedges (\$16.5 million credit). During the six months ended March 31, 2008, the net change in the fair value of derivatives on the balance sheet is \$13.0 million, which consisted of the non-cash portion described above of \$15.9 million and a net cash component of \$2.9 million relating to the historic cost of purchased options.

During the six months ended March 31, 2007, the change in the fair value of derivative instruments resulted in the recording of a \$12.1 million net credit due to the expiration of certain hedged positions (\$11.3 million credit), and an increase in the market value for unexpired hedges (\$0.8 million credit). During the six months ended March 31, 2007, the net change in the fair value of derivatives on the balance sheet was \$10.5 million, which consisted of the non-cash portion described above of \$12.1 million and a net cash component of \$1.6 million relating to the historic cost of purchased options.

Cost of Installations and Service

During the six months ended March 31, 2008, cost of installations and service increased \$3.0 million, or 3.2%, to \$97.9 million, as compared to \$94.9 million for the six months ended March 31, 2007, as the service and installation costs from acquisitions of \$7.1 million was reduced by lower service and installation costs in the base business of \$4.1 million. Management views the service and installation department on a combined basis because many expenses cannot be separated or allocated to either service or installation billings. Many overhead functions and direct expenses such as service technician time cannot be precisely allocated and are generally left in service costs. As a result, reported service profitability is reduced and reported installation profitability is increased.

Installation costs were \$33.4 million, or 84.9% of installation sales during the six months ended March 31, 2008, and were \$31.5 million, or 84.3% of installation sales during the six months ended March 31, 2007. Service expenses increased to \$64.4 million, or 111.3% of service sales during the six months ended March 31, 2008, from \$63.4 million in the six months ended March 31, 2007, or 116.2% of service sales. Service costs as a percentage of total service revenue declined, as the Partnership continues to increase its rates for service billings and continues to further reduce its service costs. The net gross profit realized from service and installations was \$0.6 million for the six months ended March 31, 2008, as compared to a loss of \$ 3.0 million for the six months ended March 31, 2007.

Delivery and Branch Expenses

For the six months ended March 31, 2008, delivery and branch expenses increased \$9.6 million, or 8.3% to \$124.8 million, as compared to \$115.1 million for the six months ended March 31, 2007. During the six months ended March 31, 2007, the Partnership recorded \$4.3 million of expected proceeds under our weather insurance contract, which reduced operating expenses. While temperatures for the six months ended March 31, 2008 were slightly colder than the six months ended March 31, 2007, no weather insurance benefit was recorded during the six months ended March 31, 2008. The Partnership's weather insurance contract covers the period from November 1 to February 28/29, as one period taken as a whole. Temperatures for the four months ended February 28, 2007 were approximately 4.0% warmer than the weather insurance contracts strike price, which triggered a pay-off. For the four months ended February 29, 2008, temperatures were colder than the weather insurance contract strike price, which resulted in no payoff.

Exclusive of the weather insurance benefit, operating expenses increased \$5.3 million, or 4.4%. Operating expenses were reduced by an estimated \$2.3 million due to the volume decline but were more than offset by increases in delivery and

[Table of Contents](#)

branch expenses from the stand-alone acquisitions of \$5.3 million and higher bad debt expense of \$1.9 million. On a cents per gallon basis (excluding the impact of weather insurance and acquisitions), delivery and branch expenses increased 3.6 cents per gallon, or 8.8%, from 40.6 cents per gallon for the six months ended March 31, 2007 to 44.2 cents per gallon for the six months ended March 31, 2008, due to the fixed nature of certain delivery and branch expenses, the disproportionate increases in bad debt expense and inflationary pressures.

Depreciation and Amortization

For the six months ended March 31, 2008, depreciation and amortization expenses declined by \$0.8 million, or 5.6%, to \$13.9 million, as compared to \$14.7 million for the six months ended March 31, 2007 as certain assets, which were not replaced, became fully depreciated or amortized.

General and Administrative Expenses

For the six months ended March 31, 2008, general and administrative expenses decreased by \$1.9 million, or 17.4%, to \$9.0 million, as compared to \$10.9 million for the six months ended March 31, 2007 due to lower profit sharing expense of \$1.3 million and lower legal and professional expenses of \$ 0.6 million.

Operating Income

For the six months ended March 31, 2008, operating income decreased \$12.3 million to \$79.2 million, as compared to \$91.5 million for the six months ended March 31, 2007. This decline of \$12.3 million was due to the decrease in home heating oil per gallon margins (\$2.7 million), lower home heating oil volume (\$8.7 million), lower other gross profit (\$0.6 million), higher operating expenses, including net service expenses (\$ 5.3 million) reduced by a favorable change in the fair value of derivative instruments (\$3.8 million).

Interest expense

For the six months ended March 31, 2008, interest expense increased \$0.5 million, or 4.7%, to \$10.7 million, as compared to \$10.2 million for the six months ended March 31, 2007. This decrease resulted from a higher average principal amount in total debt outstanding of approximately \$20.6 million.

Interest Income

For the six months ended March 31, 2008, interest income decreased by \$0.5 million to \$2.9 million, as compared to \$3.4 million for the six months ended March 31, 2007. Both lower invested cash balances and lower interest rates lead to a reduction by an increase in late fees charged on past due balances of \$0.8 million

Amortization of Debt

For the six months ended March 31, 2008, amortization of debt issuance costs was \$1.2 million unchanged for the six months ended March 31, 2007.

Income Tax Expense

For the six months ended March 31, 2008, income tax expense was \$3.5 million and represents certain state income tax, alternative minimum federal tax and capital taxes. Income taxes are recorded based on an annual effective rate, which is then applied to book income (loss) before taxes, resulting in a tax charge (or benefit). Income tax expense for the six months ended March 31, 2007 was \$3.9 million. The decline in income tax expense of \$0.4 million was largely due to the decline in income before income tax expense of \$12.3 million. As of December 31, 2007, the Partnership's corporate subsidiary had an estimated \$110.2 million in net operating loss carryforwards, after a projected utilization of \$50.6 million for the tax year ended December 31, 2007. The Partnership utilized \$7.5 million of its net operating loss carryforwards for the tax year ended December 31, 2006.

Net Income

For the six months ended March 31, 2008, net income of \$66.7 million was recorded as compared to net income of \$79.6 million for the six months ended March 31, 2007. This change of \$12.9 million was due to a \$12.3 million decrease in operating income and higher net interest expense of \$1.0 million, reduced by lower income tax expense of \$0.4 million.

Adjusted EBITDA

For the six months ended March 31, 2008, Adjusted EBITDA decreased by \$17.0 million to \$77.1 million, as compared to \$94.1 million for the six months ended March 31, 2007. While the Partnership's acquisition program led to an increase in EBITDA, the EBITDA provided from the acquisitions was more than offset by the reduction in EBITDA attributable to the decline in home heating oil volume, which was primarily due to net customer attrition, conservation and

Table of Contents

other factors. Home heating oil margins for the six months ended March 31, 2008 decreased by \$0.0096 per gallon which also contributed to the decline in EBITDA, as home heating oil prices reached record highs on 28 occasions during the six months ended March 31, 2008. In addition, while temperatures for the six months ended March 31, 2008 were similar to the six months ended March 31, 2007, the significantly warmer temperatures experienced during the weather insurance contract period (November 1-February 28) for fiscal 2007 resulted in the recording of a \$4.3 million benefit.

<u>(in thousands)</u>	Six Months Ended March 31,	
	2008	2007
Income from continuing operations	\$ 66,654	\$ 79,595
Plus:		
Income tax expense	3,522	3,910
Amortization of debt issuance cost	1,155	1,141
Interest expense, net	7,868	6,871
Depreciation and amortization	13,870	14,688
EBITDA from continuing operations	93,069	106,205
(Increase) / decrease in the fair value of derivative instruments	(15,940)	(12,147)
Adjusted EBITDA (a)	77,129	94,058
Add / (subtract)		
Income tax expense	(3,522)	(3,910)
Interest expense, net	(7,868)	(6,871)
Provision for losses on accounts receivable	6,857	4,605
Increase in weather insurance contract	—	(4,305)
Change in operating assets and liabilities	(217,837)	(111,022)
Net cash used in operating activities	<u>\$(145,241)</u>	<u>\$ (27,445)</u>

- (a) Adjusted EBITDA is calculated as earnings from continuing operations before net interest expense, income taxes, depreciation and amortization, (increase) decrease in the fair value of derivatives, loss on debt redemption, goodwill impairment, and other non-cash and non-operating charges. Management believes the presentation of this measure is relevant and useful because it allows investors to view the Partnership's performance in a manner similar to the method management uses, and makes it easier to compare its results with other companies that have different financing and capital structures. In addition, this measure is consistent with the manner in which the Partnership's debt covenants in its material debt agreements are calculated and investors measure its overall performance and liquidity, including its ability to pay quarterly equity distributions, service its long-term debt and other fixed obligations and fund its capital expenditures and working capital requirements. This method of calculating Adjusted EBITDA may not be consistent with that of other companies and should be viewed in conjunction with measurements that are computed in accordance with GAAP.

DISCUSSION OF CASH FLOWS

Operating Activities

For the six months ended March 31, 2008, cash used in operating activities was \$145.2 million, as compared to cash used in operating activities of \$27.4 million for the six months ended March 31, 2007. The increase of \$117.8 million was largely due to an increase in accounts receivable of \$77.4 million, lower operating cash flows of \$15.3 million, an increase in the cash required to finance inventory of \$5.7 million due to higher wholesale product costs, lower customer credit balances of \$7.3 million due to higher home heating oil prices and other changes of \$12.1 million. The increase in accounts receivable is due to the 23.4% increase in sales for the six months ended March 31, 2008. Customer accounts receivable were \$265.5 million as of March 31, 2008 and represents an increase of \$65.4 million versus March 31, 2007. The number of day's sales in accounts receivable increased from an estimated 30.7 days as of March 31, 2007 to 36.8 days as of March 31, 2008.

Investing Activities

During the six months ended March 31, 2008, we spent \$1.7 million for fixed assets, completed one acquisition for \$0.4 million and received \$0.2 million from the sale of certain fixed assets. During the six months ended March 31, 2007, we spent \$2.5 million for fixed assets, completed two acquisitions for \$2.2 million and received \$0.7 million from the sale of certain fixed assets.

[Table of Contents](#)

Financing Activities

For the six months ended March 31, 2008, we borrowed \$57.2 million under our revolving credit facility and repaid \$9.2 million of the amount borrowed. For the six months ended March 31, 2007, cash used in financing activities was \$0.1 million.

As a result of the above activity, cash decreased by \$ 112.9 million, to \$13.6 million as of March 31, 2008.

FINANCING AND SOURCES OF LIQUIDITY

Liquidity and Capital Resources

Our ability to satisfy our financial obligations depends on our future performance, which will be subject to prevailing economic, financial, business and weather conditions, the ability to pass on the ever increasing full impact of high wholesale heating oil prices to customers, the effects of high net customer attrition, conservation and other economic and geo-political factors, most of which are beyond our control. In the near term, capital requirements are expected to be provided by cash flows from operating activities, cash on hand at March 31, 2008 or a combination thereof. To the extent future capital requirements exceed cash on hand plus cash flows from operating activities, we anticipate that working capital will be financed by our revolving credit facility and repaid from subsequent seasonal reductions in inventory and collections of accounts receivable, especially those customers who are on the budget payment plan.

We have an asset based revolving credit facility with a group of lenders, which provides us with the ability to borrow up to \$260 million for working capital purposes (subject to certain borrowing base limitations and coverage ratios) including the issuance of up to \$95 million in letters of credit. From December through March of each year, we can borrow up to \$360.0 million. During this past heating season, our borrowings peaked at \$57.2 million under this facility and borrowings as of March 31, 2008 were \$48.0 million, which were subsequently repaid by April 23, 2008. Also as of March 31, 2008, \$64.3 million in letters of credit were outstanding, of which \$48.2 million are for current and future insurance reserves and \$16.1 million are for seasonal inventory purchases and other working capital purposes. Obligations under the revolving credit facility are secured by liens on substantially all of our assets including accounts receivable, inventory, general intangibles, real property, fixtures and equipment. This facility expires in December 2009.

Under the terms of the revolving credit facility, we 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 in the credit agreement) of not less than 1.1 to 1.0. As of March 31, 2008, availability was \$121.6 million and the fixed charge coverage ratio was 2.58 to 1.0.

Before July 2009, we must implement certain changes to ensure compliance with amended Environmental Protection Agency regulations. We currently estimate that the capital required to effectuate these requirements will range from \$1.0 to \$1.5 million. Annual maintenance capital expenditures for fixed assets are estimated to be approximately \$3 to \$5 million, excluding the capital requirements for environmental compliance and capital requirements for leased fleet. Our business strategy is to increase unitholder value through increased market share and we are actively pursuing the acquisition of other home heating oil distributors. These acquisitions will be funded from cash.

At March 31, 2008, we had over \$181.8 million in working capital, excluding the fair value of derivative instruments and are considering various alternatives for the use of our excess liquidity, primarily the purchase of additional home heating oil distributors.

Based on the funding levels required by the Pension Protection Act of 2006 (effective January 1, 2008), and on actuarial assumptions in the Partnership's fiscal year 2007 actuarial report, we estimate that the Partnership will be required to make minimum cash contributions to fund its pension obligations of at least \$9.0 million over the next five years.

[Table of Contents](#)

Recent Accounting Pronouncements

In the first quarter of fiscal 2008, the Partnership adopted the provisions of FIN 48 (As amended), see Note 2. Summary of Significant Accounting Policies – Income Taxes.

In September 2006, the FASB issued Statement No. 157 “Fair Value Measurements” (“SFAS No. 157”), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 is effective in fiscal years beginning after November 15, 2007. In November 2007, the FASB issued a one-year deferral of SFAS No. 157’s fair value measurement requirements for nonfinancial assets and liabilities that are not required or permitted to be measured at fair value on a recurring basis. We are required to adopt SFAS No. 157 in fiscal 2009. The Partnership is currently assessing the impact of adopting SFAS No. 157.

In February 2007, the FASB issued “The Fair Value Option for Financial Assets and Financial Liabilities,” (“SFAS No. 159”) which provides companies an option to report eligible financial assets and liabilities at fair value. This Statement also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We are required to adopt SFAS No. 159 in fiscal 2009. The Partnership is currently assessing the impact of adopting SFAS No. 159.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), “Business Combinations” (“SFAS No. 141R”). SFAS No. 141R establishes in a business combination, principles and requirements for how an acquirer recognizes and measures identifiable assets acquired, goodwill acquired, liabilities assumed, and any noncontrolling interests. SFAS No. 141R is effective in fiscal years beginning after December 15, 2008. The Partnership is required to adopt SFAS No. 141R in fiscal 2010. The Partnership is currently assessing the impact of adopting SFAS No. 141R.

In March 2008, the FASB issued Statement No. 161 “Disclosures about Derivative Instruments and Hedging Activities,” (“SFAS No. 161”) which amends and expands the disclosure requirements of Statement No. 133. SFAS No. 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. We are required to adopt SFAS No. 161 in fiscal 2010. The Partnership is currently assessing the impact of adopting SFAS No. 161.

**Item 3.
Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to interest rate risk primarily through our bank credit facilities. We utilize these borrowings to meet our working capital needs.

At March 31, 2008, we had outstanding borrowings totaling \$221.9 million, of which approximately \$48 million is subject to variable interest rates under our revolving credit facility. In the event that interest rates associated with this facility were to increase 100 basis points, the impact on future cash flows would be a decrease of \$0.5 million.

We also selectively use derivative financial instruments to manage our exposure to market risk related to changes in the current and future market price of home heating oil. The value of market sensitive derivative instruments is subject to change as a result of movements in market prices. 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 March 31, 2008, the potential impact on our hedging activity would be to increase the fair market value of these outstanding derivatives by \$5.0 million to a fair market value of \$27.2 million; and conversely a hypothetical ten percent decrease in the cost of product would decrease the fair market value of these outstanding derivatives by \$3.0 million to a fair market value of \$19.2 million.

Item 4.
Controls and Procedures

(a) Evaluation of disclosure controls and procedures.

The General Partner's principal executive officer and its principal financial officer evaluated the effectiveness of the Partnership's disclosure controls and procedures (as that term is defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended) as of March 31, 2008. Based on that evaluation, such principal executive officer and principal financial officer concluded that the Partnership's disclosure controls and procedures were effective as of March 31, 2008. For purposes of Rule 13a-15(e), the term *disclosure controls and procedures* means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Act (15 U.S.C. 78a et seq.) is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

(b) Change in Internal Control over Financial Reporting.

No change in the Partnership's internal control over financial reporting occurred during the Partnership's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect the Partnership's internal control over financial reporting.

(c) The General Partner and the Partnership believe that a controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

PART II OTHER INFORMATION

Item 1

Legal Proceedings

On or about October 21, 2004, a purported class action lawsuit on behalf of a purported class of unitholders was filed against the Partnership and various subsidiaries and officers and directors in the United States District Court of the District of Connecticut entitled *Carter v. Star Gas Partners, L.P.*, et. al., No. 3:04-cv-01766-IBA, et. al. Subsequently, 16 additional class action complaints, alleging the same or substantially similar claims, were filed in the same district court. The class actions were consolidated into one consolidated amended complaint. For information concerning the procedural history and current status of this lawsuit, see Note 7—Commitments and Contingencies.

In the event that the above action is decided adversely to us, it could have a material effect on our results of operations, financial condition and liquidity. The Partnership has not accrued any amount for this action because, based on the court's judgment of dismissal, we believe an unfavorable outcome is not probable.

In the opinion of management, except as described above we are not a party to any litigation, which individually or in the aggregate could reasonably be expected to have a material adverse effect on our results of operations, financial position or liquidity. (See Note 7 — Commitments and Contingencies)

Item 1A

Risk Factors

An investment in the Partnership involves a high degree of risk, including the following factors:

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended September 30, 2007 which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing the Partnership. Other unknown or unpredictable factors could also have material adverse effects on future results.

[Table of Contents](#)

The Partnership relies on the continued solvency of our derivative counterparties. The Partnership periodically uses derivative instruments such as futures, options, and swap agreements, in order to mitigate our exposure to market risk associated with the purchase of home heating oil for our protected price customers, physical inventory on hand, inventory in transit and priced purchase commitments.

If counterparties to our derivative instruments were to fail the Partnership's liquidity, results of operations and financial condition could be materially impacted, as we would be obligated to fulfill our operational requirement of purchasing, storing and selling home heating oil, while losing the mitigating benefits of economic hedges with a failed counterparty. Currently we have outstanding derivative instruments with the following counterparties: Wachovia Bank, NA, Societe Generale, Newedge USA, LLC, JPMorgan Chase Bank, NA, Cargill, Inc., Bank of America, N.A., Credit Suisse, Morgan Stanley, Citibank, N.A., and BP North America Petroleum.

The Partnership principally serves residential and commercial customers and is affected by general economic conditions and broad financial crises that negatively impact these customers, like the current sub-prime crisis.

If tighter lending practices persist and the sub-prime and other adjustable rate mortgage crisis continues to impact more homeowners, the Partnership will likely experience an increase in bad debts from financially distressed customers and accounts whose home was foreclosed or business failed, which would have a negative effect on our liquidity, results of operations and financial condition. In addition, our ability to sign new accounts is diminished by broad financial crises and adverse economic conditions in the United States, which increase our rejection rate of potential accounts due to unacceptably low credit scores.

Our results of operations and financial condition may be adversely affected by governmental regulation and associated environmental and regulatory costs.

The home heating oil business is subject to a wide range of federal and state laws and regulations related to environmental and other matters. We have implemented environmental programs and policies designed to avoid potential liability and costs under applicable environmental laws. It is possible, however, that we will experience increased costs due to stricter pollution control requirements or liabilities resulting from noncompliance with operating or other regulatory permits. New environmental regulations might adversely impact operations, including underground storage and transportation of home heating oil. In addition, there are environmental risks inherently associated with home heating oil operations, such as the risks of accidental release or spill. It is possible that material costs and liabilities will be incurred, including those relating to claims for damages to property and persons.

In addition, our results of operations and ability to issue distributions may be negatively impacted by significant changes in federal and state tax law.

Our substantial debt and other financial obligations could impair our financial condition and our ability to fulfill our debt obligations. Any refinancing of this substantial debt could be at significantly higher interest rates.

As of March 31, 2008, we had total debt, exclusive of borrowings under our revolving credit facility, of approximately \$172.8 million (excluding discounts and premiums). Our substantial indebtedness and other financial obligations could:

- impair our ability to obtain additional financing in the future for working capital, capital expenditures, acquisitions or general corporate purposes;
- have a material adverse effect on us if we fail to comply with financial and affirmative and restrictive covenants in our debt agreements and an event of default occurs as a result of a failure that is not cured or waived;
- require us to dedicate a substantial portion of our cash flow for interest payments on our indebtedness and other financial obligations, thereby reducing the availability of our cash flow to fund working capital and capital expenditures;
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate; and
- place us at a competitive disadvantage compared to our competitors that have proportionately less debt.

If we are unable to meet our debt service obligations and other financial obligations, we could be forced to restructure or refinance our indebtedness and other financial transactions, seek additional equity capital or sell our assets. We might then be unable to obtain such financing or capital or sell our assets on satisfactory terms, if at all. Any refinancing of our indebtedness could be at significantly higher interest rates, and/or incur significant transaction fees.

Item 6.

Exhibits

(a) *Exhibits Included Within:*

- 31.1 Rule 13a-14(a) Certification, Star Gas Partners, L.P.
- 31.2 Rule 13a-14(a) Certification, Star Gas Finance Company
- 31.3 Rule 13a-14(a) Certification, Star Gas Partners, L.P.
- 31.4 Rule 13a-14(a) Certification, Star Gas Finance Company
- 32.1 Section 906 Certification.
- 32.2 Section 906 Certification.

[Table of Contents](#)

SIGNATURE

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

Star Gas Partners, L.P.
(Registrant)

By: Kestrel Heat LLC AS GENERAL PARTNER

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ RICHARD F. AMBURY</u> Richard F. Ambury	Chief Financial Officer Kestrel Heat LLC (Principal Financial Officer)	May 7, 2008

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ RICHARD G. OAKLEY</u> Richard G. Oakley	Vice President - Controller Kestrel Heat LLC (Principal Accounting Officer)	May 7, 2008

Star Gas Finance Company
(Registrant)

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ RICHARD F. AMBURY</u> Richard F. Ambury	Chief Financial Officer (Principal Financial Officer)	May 7, 2008

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ RICHARD G. OAKLEY</u> Richard G. Oakley	Vice President - Controller (Principal Accounting Officer)	May 7, 2008

CERTIFICATIONS

I, Daniel P. Donovan, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Star Gas Partners, L.P. ("Registrant").
2. Based on my knowledge, this 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly presents 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 report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
 - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information and;
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 7, 2008

/s/ DANIEL P. DONOVAN

Daniel P. Donovan
President and Chief Executive Officer
Star Gas Partners, L.P.

CERTIFICATIONS

I, Daniel P. Donovan, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Star Gas Finance Company (“Registrant”).
2. Based on my knowledge, this 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly presents 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 report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
 - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors:
 - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information and;
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: May 7, 2008

/s/ DANIEL P. DONOVAN

Daniel P. Donovan
President and Chief Executive Officer
Star Gas Finance Company

CERTIFICATIONS

I, Richard F. Ambury, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Star Gas Partners, L.P. ("Registrant").
2. Based on my knowledge, this 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly presents 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 report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
 - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information and;
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 7, 2008

/s/ RICHARD F. AMBURY

Richard F. Ambury
Chief Financial Officer
Star Gas Partners, L.P.

CERTIFICATIONS

I, Richard F. Ambury, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Star Gas Finance Company (“Registrant”).
2. Based on my knowledge, this 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly presents 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 report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
 - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors:
 - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information and;
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: May 7, 2008

/s/ RICHARD F. AMBURY

Richard F. Ambury
Chief Financial Officer
Star Gas Finance Company

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Star Gas Partners, L.P. (the "Partnership") and Star Gas Finance Company on Form 10-Q for the quarterly period ended March 31, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Daniel P. Donovan, President and Chief Executive Officer of the Partnership and Star Gas Finance Company, certify to my knowledge, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350) that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Partnership and Star Gas Finance Company.

STAR GAS PARTNERS, L.P.
STAR GAS FINANCE COMPANY

By: KESTREL HEAT LLC (General Partner)

May 7, 2008

By: _____ /s/ DANIEL P. DONOVAN
Daniel P. Donovan
President and Chief Executive Officer
Star Gas Partners, L.P.
Star Gas Finance Company

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Star Gas Partners, L.P. (the "Partnership") and Star Gas Finance Company on Form 10-Q for the quarterly period ended March 31, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Richard F. Ambury, Chief Financial Officer of the Partnership and Star Gas Finance Company, certify to my knowledge, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350) that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Partnership and Star Gas Finance Company.

STAR GAS PARTNERS, L.P.
STAR GAS FINANCE COMPANY

By: KESTREL HEAT LLC (General Partner)

May 7, 2008

By: _____
/s/ RICHARD F. AMBURY
Richard F. Ambury
Chief Financial Officer
Star Gas Partners, L.P.
Star Gas Finance Company