

STAR GAS FINANCE CO
Form 10-K
December 09, 2009
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended September 30, 2009

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
Delaware
(State or other jurisdiction of incorporation or organization)

06-1437793
75-3094991
(I.R.S. Employer Identification No.)

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

(203) 328-7310

06902
(Zip Code)

(Registrants telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Units	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). * Yes No

* The registrant has not yet been phased into the interactive data requirements.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

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

Edgar Filing: STAR GAS FINANCE CO - Form 10-K

The aggregate market value of Star Gas Partners, L.P. Common Units held by non-affiliates of Star Gas Partners, L.P. on March 31, 2009 was approximately \$197,013,000. As of November 30, 2009, the registrants had units and shares outstanding for each of the issuers' classes of common stock as follows:

Star Gas Partners, L.P.	Common Units	71,714,982
Star Gas Partners, L.P.	General Partner Units	325,729
Star Gas Finance Company	Common Shares	100

Documents Incorporated by Reference: None

Table of Contents

STAR GAS PARTNERS, L.P.

2009 FORM 10-K ANNUAL REPORT

TABLE OF CONTENTS

	Page
<u>PART I</u>	
Item 1. <u>Business</u>	3
Item 1A. <u>Risk Factors</u>	8
Item 1B. <u>Unresolved Staff Comments</u>	16
Item 2. <u>Properties</u>	16
Item 3. <u>Legal Proceedings</u> <u>Litigation</u>	16
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	16
<u>PART II</u>	
Item 5. <u>Market for the Registrant's Units and Related Matters</u>	17
Item 6. <u>Selected Historical Financial and Operating Data</u>	19
Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	22
Item 7A. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	46
Item 8. <u>Financial Statements and Supplementary Data</u>	46
Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	46
Item 9A. <u>Controls and Procedures</u>	46
Item 9B. <u>Other Information</u>	47
<u>PART III</u>	
Item 10. <u>Directors and Executive Officers of the Registrant</u>	48
Item 11. <u>Executive Compensation</u>	51
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management</u>	62
Item 13. <u>Certain Relationships and Related Transactions</u>	62
Item 14. <u>Principal Accounting Fees and Services</u>	64
<u>PART IV</u>	
Item 15. <u>Exhibits and Financial Statement Schedules</u>	64

Table of Contents

PART I

Statement Regarding Forward-Looking Disclosure

This Annual Report on Form 10-K 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, our ability to contract for our current and future supply needs, natural gas conversions, future union relations and the outcome of union negotiations, the impact of current and future environmental, health, and safety regulations, the ability to attract and retain employees, customer credit worthiness, counterparty 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. These risks and uncertainties include, but are not limited to, those set forth under the heading Risk Factors and Business Initiatives and Strategy. Without limiting the foregoing, the words believe, anticipate, plan, expect, seek, estimate, similar expressions are intended to identify forward-looking statements. Important factors that could cause actual results to differ materially from our expectations (Cautionary Statements) are disclosed in this Annual Report on Form 10-K. 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.

**ITEM 1. BUSINESS
Structure**

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 November 30, 2009, had outstanding 71.7 million common units (NYSE: SGU) representing a 99.5% limited partner interest in Star Gas Partners, and 0.3 million general partner units, representing a 0.5% 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. (a Minnesota corporation that is an indirect wholly owned subsidiary of the Partnership) and its subsidiaries (Petro). Petro is a Northeast and Mid-Atlantic region retail distributor of home heating oil and related services.

Star Gas Finance Company is a 100% owned subsidiary of the Partnership. Star Gas Finance Company serves as the co-issuer, jointly and severally with the Partnership, of the Partnership's \$133.1 million 10.25% Senior Notes, which are due in 2013. The Partnership is dependent on distributions including inter-company 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.

We file annual, quarterly, current and other reports and information with the SEC. These filings can be viewed and downloaded from the Internet at the SEC's website at www.sec.gov. In addition, these SEC filings are available at no cost as soon as reasonably practicable after the filing thereof on our website at www.star-gas.com/sec.cfm. These reports are also available to be read and copied at the SEC's public reference

Edgar Filing: STAR GAS FINANCE CO - Form 10-K

room located at Judiciary Plaza, 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the public reference room by calling the SEC at 1-800-SEC-0330. You may also obtain copies of these filings and other information at the offices of the New York Stock Exchange located at 11 Wall Street, New York, New York 10005.

Table of Contents**Business Overview**

As of September 30, 2009, we sold home heating oil to approximately 374,000 full service residential and commercial home heating oil customers and propane to approximately 7,000 propane customers. We believe we are the largest retail distributor of home heating oil in the United States. We also sell home heating oil, gasoline and diesel fuel to approximately 34,000 customers on a delivery only basis. We install, maintain, and repair heating and air conditioning equipment for our customers and provide ancillary home services, including home security and plumbing, to approximately 11,000 customers. During fiscal 2009, total sales were comprised approximately 79% from sales of home heating oil; 15% from the installation and repair of heating and air conditioning equipment and ancillary services; and 6% from the sale of other petroleum products. We provide home heating equipment repair service 24 hours a day, seven days a week, 52 weeks a year. These services are an integral part of our heating oil business, and are intended to maximize customer satisfaction and loyalty.

In fiscal 2009, sales to residential customers represented 88% of the retail heating oil gallons sold and 95% of heating oil gross profits.

We have operations and markets in the following states, regions and counties:

<i>Connecticut</i>	<i>Massachusetts</i>	<i>New York</i>	<i>Rhode Island</i>
Fairfield	Suffolk	Dutchess	Providence
New Haven	Norfolk	Ulster	Kent
Middlesex	Essex	Orange	Washington
Litchfield	Bristol	Westchester	Newport
Hartford	Middlesex	Putnam	Bristol
	Barnstable	Nassau	
<i>Maryland</i>	Plymouth	Suffolk	<i>Virginia</i>
Baltimore	Worcester	Bronx	Loudoun
Harford		Queens	Prince William
Cecil	<i>New Jersey</i>	Kings	Fauquier
Anne Arundel	Salem	Richmond	Stafford
Carroll	Gloucester	New York	Arlington
Howard	Camden		Fairfax
Montgomery	Burlington	<i>Pennsylvania</i>	
Prince George's	Ocean	Philadelphia	<i>Washington, D.C.</i>
Calvert	Monmouth	Bucks	District of Columbia
Charles	Somerset	Montgomery	
Frederick	Middlesex	Chester	
	Mercer	Lancaster	
	Hunterdon	Lebanon	
	Union	Lehigh	
	Hudson	Northampton	
	Bergen	Berks	
	Essex	Monroe	
	Passaic	Dauphin	
	Sussex	Cumberland	
	Morris	York	
	Warren		

Industry Characteristics

Home heating oil is primarily used as a source of fuel to heat residences and businesses in the Northeast and Mid-Atlantic regions. According to the U.S. Department of Energy Energy Information Administration, 2005 Residential Energy Consumption Survey (the latest survey published), these regions account for 81% of the households in the United States where heating oil is the main space-heating fuel and 31% of the homes in these regions use home heating oil as their main space-heating fuel. In recent years, as the price of home heating oil increased, customers have tended to increase their conservation efforts, which has decreased their consumption of home heating oil.

The retail home heating oil industry is mature, with total market demand expected to decline in the foreseeable future due to conversions to natural gas. Our customer losses to natural gas have recently increased. In each of the fiscal years 2009 and 2008, we lost 1.6% of our home heating oil customer base to natural gas conversions, which compares to an approximate 1.0% per annum loss in prior years. Therefore, our

Edgar Filing: STAR GAS FINANCE CO - Form 10-K

ability to maintain our business or grow within the industry is dependent on the acquisition of other retail distributors as well as the success of our marketing programs. It is common practice in our

Table of Contents

business to price products to customers based on a per gallon margin over wholesale costs. As a result, we believe distributors such as ourselves generally seek to maintain their per gallon margins by passing wholesale price increases through to customers, thus insulating themselves from the volatility in wholesale heating oil prices. However, distributors may be unable or unwilling to pass the entire product cost increases through to customers. In these cases, significant decreases in per gallon margins may result. The timing of cost pass-throughs can also significantly affect margins. The retail home heating oil industry is highly fragmented, characterized by a large number of relatively small, independently owned and operated local distributors. Some dealers provide full service, as we do, and others offer delivery only on a cash-on-delivery basis, which we also do to a significantly lesser extent. The industry is becoming more complex and costly due to increasing regulations, working capital requirements, including the cost to hedge for protected price customers. We utilize derivative instruments in order to hedge a substantial majority of the heating oil volume we expect to sell to protected price customers that have renewed their protected price plans, mitigating our exposure to changing commodity prices. We also use derivative instruments as a hedge against our physical inventory and priced purchase commitments. We do not enter into any forward hedges for our variable price customers.

Business Initiatives and Strategy

We are committed to our strategy to increase unitholder value and increase distributions over time through (i) reduced net customer attrition, (ii) operational efficiencies and productivity improvements, and (iii) increased market share through the acquisition of other heating oil distributors or the possible expansion into other energy or petroleum-related businesses.

To engage our employees and enhance their abilities to provide superior customer service and reduce gross customer losses, we require all employees to attend a team-building and role-playing program that we call Boot Camp. The initiatives covered in Boot Camp are consistently reinforced through constant customer service monitoring and training in the field. In addition, we have recently created an internal, Director-level position, called the Director of Quality Assurance. This position is responsible for the customer service evaluation process and directs the teams that conduct district quality assurance assessments. These assessments are focused on escalating the performance in customer relations and retention and on driving customer service performance to the best possible level.

Seasonality

The following matters should be considered in analyzing our financial results. 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. In addition, sales volume typically fluctuates from year to year in response to variations in weather, wholesale energy prices and other factors.

Competition

Most of our district locations compete with numerous distributors, primarily on the basis of reliability of service, price, and response to customer needs. Each district location operates in its own competitive environment.

We compete with distributors offering a broad range of services and prices, from full-service distributors, like ourselves, to those offering delivery only. Like many companies in the home heating oil business, we provide home heating equipment repair service on a 24-hour-a-day, seven-day-a-week, 52 weeks a year basis. We believe that this level of service tends to help build customer loyalty. In some instances homeowners have formed buying cooperatives that seek to purchase fuel oil from distributors at a price lower than individual customers are otherwise able to obtain. We also compete for retail customers with suppliers of alternative energy products, principally natural gas, propane and electricity. The expansion of natural gas into traditional home heating oil markets in the Northeast has historically been inhibited by the capital costs required to expand distribution and pipeline systems.

Customers and Pricing

Our full service home heating oil customer base is comprised of 97% residential customers and 3% commercial customers. Our residential customer receives small deliveries on average of 160 gallons and our commercial accounts receive larger deliveries on average of 350 gallons. Typically, we make four to six deliveries per customer per year. Currently, 90% of our deliveries are scheduled automatically and 10% of our home heating oil customer base call from time to time to schedule a delivery. Automatic deliveries are scheduled based on each customer's historical consumption pattern and prevailing weather conditions. Our practice is to bill customers promptly after delivery. We also offer a balanced payment plan in which a customer's estimated annual oil purchases and service contract fees are paid for in a series of equal monthly payments. Approximately 34% of our residential home heating oil customers have selected this billing option.

Table of Contents

We offer several pricing alternatives to our customers. Our variable pricing program allows the price to float with the home heating oil market and generally move up or down in response to market changes and other factors. In addition, we offer price protection programs, which establish either a ceiling or a fixed per gallon price that the customer would pay over a defined period. Over the last several years, a greater number of our price protected customers have selected the ceiling plan over the fixed price plan.

	As of September 30th	
	2009	2008
Variable	52.3%	48.6%
Ceiling	44.6%	34.4%
Fixed	3.1%	17.0%
	100.0%	100.0%

Sales to residential customers ordinarily generate higher per gallon margins than sales to commercial customers. Due to greater price sensitivity and hedging complexities of residential protected price customers, the per gallon margins realized from price protected customers generally are less than variable priced residential customers.

Customer Attrition

We measure net customer attrition for our full service residential and commercial home heating oil customers. Net customer attrition is the difference between gross customer losses and customers added through internal marketing efforts. Customers added through acquisitions are not included in the calculation of gross customer gains. Gross customer losses are the result of a number of factors, including price competition, move outs, service issues, credit losses and conversions to natural gas. When a customer moves out of an existing home we count the move out as a loss and if we are successful in signing up the new homeowner, the move in is treated as a gain.

For fiscal 2009, we lost 30,200 accounts (net), or 7.5% of our home heating oil customer base, as compared to fiscal 2008, where we lost 18,300 accounts (net), or 4.4% of our home heating oil customer base. In fiscal 2007 we lost 21,300 accounts (net), or 5.0% of our home heating oil customer base. Our net customer attrition increased in fiscal 2009 when compared to fiscal 2008, as gross losses (which is reflective of customer turn-over) increased to 21.0% in fiscal 2009, as compared to 19.1% in fiscal 2008 and 17.6% in fiscal 2007. (See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Customer Attrition)

Suppliers and Supply Arrangements

We purchase home heating oil for delivery in either barge, pipeline or truckload quantities, and have contracts with approximately 60 third-party terminals for the right to temporarily store heating oil at their facilities. Purchases are made under supply contracts or on the spot market. Including our own physical storage, we have entered into market price based contracts for approximately 77% of our home heating oil requirements for fiscal 2010. During fiscal 2009, Sunoco Inc., Global Companies, and NIC Holding Corp. (Northville Industries) provided 15.1%, 13.5% and 8.7% respectively, of our product purchases. Aside from these three suppliers, no single supplier provided more than 10% of our product supply during fiscal 2009. For fiscal 2010, we have supply contracts for similar quantities with Sunoco Inc., Global Companies, and NIC Holding Corp. Supply contracts typically have terms of 6 to 12 months. All of the supply contracts provide for minimum quantities. In all cases, the supply contracts do not establish in advance the price of fuel oil. This price is based upon a published market index price at the time of delivery or pricing date plus an agreed upon differential. We believe that our policy of contracting for the majority of our anticipated supply needs with diverse and reliable sources will enable us to obtain sufficient product should unforeseen shortages develop in worldwide supplies.

Derivatives

We use derivative instruments 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.

The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 815-10-05 Derivatives and Hedging topic (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. Currently, the Partnership has elected not to designate its derivative instruments as hedging instruments under this standard, and the change in fair value of the derivative instruments are recognized in our statement of operations. While we largely expect our realized

Table of Contents

derivative gains and losses to be offset by increases or decreases in the value of our physical purchases, we will experience volatility in reported earnings due to the recording of unrealized non-cash gains and losses on our derivative instruments prior to their maturity.

Home Heating Oil Price Volatility

In recent years, the wholesale price of home heating oil has been extremely volatile, resulting in increased consumer price sensitivity to heating costs and increased gross customer attrition. Like any other market commodity, the price of home heating oil is generally impacted by many factors, including economic and geopolitical forces. The price of home heating oil is closely linked to the price refiners pay for crude oil, which is the principal cost component of home heating oil. The volatility in the wholesale cost of home heating oil, as measured by the New York Mercantile Exchange (Nymex) for fiscal 2009, 2008 and 2007 by quarter, is illustrated by the following chart:

Quarter Ended	Fiscal 2009		Fiscal 2008		Fiscal 2007	
	Low	High	Low	High	Low	High
December 31	\$ 1.1983	\$ 2.8469	\$ 2.1596	\$ 2.7066	\$ 1.5869	\$ 1.8477
March 31	1.1331	1.6263	2.4188	3.1483	1.4707	1.8794
June 30	1.3147	1.8630	2.8797	3.9748	1.7978	2.0424
September 30	1.5038	1.9569	2.7197	4.1060	1.9393	2.2609

Acquisitions

In fiscal 2009, we completed the purchase of one retail heating oil dealer with approximately 3,800 home heating oil customers for an aggregate cost of approximately \$4.0 million, reduced by \$0.7 million of working capital credits. In fiscal 2008, we completed the purchase of seven retail heating oil dealers with approximately 5,700 home heating oil customers and one small home security business for an aggregate cost of approximately \$2.6 million, reduced by \$0.7 million of working capital credits. In fiscal 2007, we completed the purchase of seven retail heating oil dealers with approximately 19,400 home heating oil customers and several thousand plumbing customers for an aggregate cost of \$26.4 million.

Employees

As of September 30, 2009, we had 2,655 employees, of whom 825 were office, clerical and customer service personnel; 844 were equipment technicians; 360 were oil truck drivers and mechanics; 356 were management and 270 were employed in sales. Of these employees 951 are represented by 21 different local chapters of labor unions. Some of these unions have union administered pension plans that have significant unfunded liabilities, a portion of which could be assessed to us should we withdraw from these plans. The Partnership does not expect to withdraw from these plans. In addition, approximately 378 seasonal employees (275 of which are represented by the local chapters of labor unions indicated earlier) are rehired annually to support the requirements of the heating season. We are currently involved in 4 union negotiations. We believe that our relations with both our union and non-union employees are generally satisfactory.

Government Regulations

We are subject to various federal, state and local environmental, health and safety laws and regulations. Generally, these laws impose limitations on the discharge of pollutants and establish standards for the handling of solid and hazardous wastes. These laws include the Resource Conservation and Recovery Act, the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), the Clean Air Act, the Occupational Safety and Health Act, the Emergency Planning and Community Right to Know Act, the Clean Water Act and comparable state statutes. CERCLA, also known as the Superfund law, imposes joint and several liabilities without regard to fault or the legality of the original conduct on certain classes of persons that are considered to have contributed to the release or threatened release of a hazardous substance into the environment. Products stored and/or delivered by the Partnership and certain automotive waste products generated by the Partnership's fleet are hazardous substances within the meaning of CERCLA. These laws and regulations could result in civil or criminal penalties in cases of non-compliance or impose liability for remediation costs.

In addition, transportation of distillates and gasoline by truck are subject to regulations promulgated under the Federal Motor Carrier Safety Act. These regulations cover the transportation of hazardous materials and are administered by the United States Department of Transportation or similar state agencies. We conduct ongoing training programs to help ensure that our operations are in compliance with applicable safety regulations. We maintain various permits that are necessary to operate some of our facilities, some of which may be material to our operations.

Table of Contents

Trademarks and Service Marks

We market our products and services under various trademarks, which we own. They include marks such as Petro and Meenan. We believe that the Petro, Meenan and other trademarks and service marks are an important part of our ability to attract new customers and to effectively maintain and service our customer base.

ITEM 1A. RISK FACTORS

An investment in the Partnership involves a high degree of risk. Security holders and investors should carefully review the following risk factors.

Current economic conditions could adversely affect our results of operations and financial condition.

In 2008 and continuing into fiscal 2009, economic conditions in the United States have experienced a downturn due to the sequential effects of the sub-prime lending crisis, general credit market crisis, the general unavailability of financing, collateral effects on the finance and banking industries, volatile energy prices, concerns about inflation, slower economic activity, decreased consumer confidence, reduced corporate profits and capital spending, adverse business conditions, increased unemployment, liquidity concerns and declines in housing prices and house sales.

Uncertainty about current economic conditions poses a risk as our customers may postpone spending in response to tighter credit, negative financial news and/or declines in income or asset values, which could have a material negative effect on the demand for the Partnership's equipment and services and could lead to increased conservation and the possibility of certain of our customers seeking lower cost providers. Any increase in existing customers seeking lower cost providers and/or increase in the rejection rate of potential accounts could increase the Partnership's overall rate of net customer attrition. If adverse economic conditions persist, the Partnership could experience an increase in bad debts from financially distressed customers, which would have a negative effect on our liquidity, results of operations and financial condition.

In light of the recent financial turmoil, there can be no assurance that the lenders within our lending group will fund a borrowing request.

From time to time, the Partnership borrows to meet its seasonal working capital needs. In light of the current financial turmoil affecting the banking system and financial markets, there can be no assurances that all of the lending institutions within our lending group will have the ability to fund their pro rata portion of a borrowing request. Our lending group includes JP Morgan Chase, Bank of America, RBS Citizens, PNC Bank, Societe Generale, Key Bank, TD Banknorth, Israel Discount Bank, and RZB Finance.

The Partnership relies on the continued solvency of our derivative and insurance counterparties. The Partnership regularly 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. The Partnership insures itself against catastrophic property and other losses with insurance companies.

The financial turmoil affecting the banking system and financial markets and the possibility that financial institutions may consolidate or go out of business have resulted in a tightening in the credit markets, a low level of liquidity in many financial markets, and extreme volatility in fixed income, credit, currency and equity markets that may also adversely affect the Partnership's results of operations and financial conditions. There could be a number of follow-on effects from the credit crisis on the Partnership's business, including insolvency of key suppliers resulting in product delays and failure of derivative counterparties and other financial institutions negatively impacting the Partnership's liquidity and financial condition.

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. If one of our insurance carriers should fail, the Partnership's liquidity, results of operations and financial condition could be materially impacted, as we would have to fund any catastrophic loss. Currently, we have outstanding derivative instruments with the following counterparties: Newedge USA, LLC, Cargill, Inc., Key Bank National Association, JPMorgan Chase Bank, NA, Wachovia Bank, NA, Societe Generale, Bank of America, N.A., and RBS Sempra. Our primary insurance carrier is a subsidiary of Chartis, formerly known as American International Group.

Table of Contents

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 September 30, 2009, we had total debt, exclusive of borrowings under our revolving credit facility, of approximately \$133.1 million. 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.

Unitholders may have to report income for federal income tax purposes on their investment in the Partnership without receiving any cash distributions from us.

Star Gas Partners is a master limited partnership. Our unitholders are required to report for federal income tax purposes their allocable share of our income, gains, losses, deductions and credits, regardless of whether we make cash distributions. We expect that an investor will be allocated taxable income (mostly dividend, interest income and cancellation of indebtedness income) regardless of whether a cash distribution has been paid.

Our corporate subsidiary Star Acquisitions, Inc. and its subsidiaries (Star Acquisitions) are subject to federal and state income taxes. See the following risk factor regarding net operating loss availability.

A change in ownership of Star Gas Partners may result in the limitation of the potential utilization of net operating loss carry forwards by our corporate subsidiary may impact our ability to pay cash distributions.

If Star Gas Partners were to experience an ownership change under Section 382 of the Internal Revenue Code of 1986, as amended, its corporate subsidiary, Star Acquisitions (the Parent of Petro) may be materially restricted in the potential utilization of its net operating loss carry forwards to offset future taxable income. A restriction on Star Acquisitions' ability to use its net operating loss carry forwards to reduce its federal taxable income would reduce the amount of cash Star Acquisitions has available to make distributions to the Partnership, which would consequently reduce the amount of cash the Partnership has available to make distributions to its unitholders.

As of the calendar tax year ended December 31, 2009, we anticipate that Star Acquisitions will have a federal net operating loss carry forward (NOL) of approximately \$43.9 million. The NOLs, which will expire between 2018 and 2024, are generally available to offset any future taxable income. In general, the Partnership would be deemed to have an ownership change under Section 382 if, immediately after any owner shift involving a 5% unitholder or any equity structure shift, the percentage of units of the Partnership owned by one or more 5% unitholders has increased by more than 50% over the lowest percentage of units of the Partnership (or any predecessor entity) owned by such unitholder at any

time during the three-year testing period.

If the Partnership elects to be treated as a corporation for federal and state income tax purposes, such an election may result in adverse tax consequences to unitholders.

Currently, the Partnership's main asset and source of income is an investment in Star Acquisitions. Our unitholders do not receive any of the tax benefits normally associated with owning units in a publicly traded partnership, as any cash coming from Star Acquisitions to the Partnership will generally have been taxed first at a corporate level and then may also be taxable to our unitholders as dividends, reported via annual Forms K-1. The production of the Forms K-1 themselves is an expensive and administratively intensive process. Thus the Partnership has all the administrative issues and costs associated with being a publicly traded partnership, but our unitholders do not currently receive any material tax benefits from this structure.

Table of Contents

To reduce these administrative expenses and to rationalize our tax reporting structure, the Partnership is actively considering making an election sometime in calendar 2010 or thereafter to be treated as a corporation for federal and state income tax purposes. While the Partnership would still remain a publicly traded partnership for legal and governance purposes, for income tax purposes its unitholders will be treated as owning stock in a corporation rather than being partners in a partnership. Subsequent to the year of election the unitholders would receive annually Form 1099-DIV for any dividends and would no longer receive K-1s. In the year of election they would receive both, each form covering part of the year.

This election may have immediate short term tax implications as any unitholder who owns units at the time of the election would be deemed to have exchanged his units for shares in a new corporation, and to have received a certain amount of dividend income related to having had some share of the Partnership's public debt assumed, as the new corporation would assume this liability.

Assuming that the Partnership's taxable earnings and profits are equal to or less than the amount of distributions/dividends paid out during the year by the Partnership and the unitholder holds the units for the entire calendar year (or at least long enough during the year to receive a distribution(s) at least equal to the tax resulting from a share of dividend income reported on Form K-1), then most partners should not have any material negative cash flow consequences as a result of the Partnership making this election. Note that nothing herein should be interpreted as a projection of any future earnings amount or a projection or guarantee of future distributions or dividends.

In addition, there are risks that the Partnership could make this election and:

Not distribute or dividend enough cash to cover the taxes that may be due as a result of the dividend income generated by the election.

Even if distributions are made equal to the total taxable earnings of the Partnership, a particular unitholder could buy or sell units in a time period that might give rise to deemed dividend income caused by the election and not receive enough (or any) cash to offset the taxes due on such dividend income.

The Partnership intends to only make this election if it believes that it will have no overall material adverse impact on its unitholders, of which there can be no assurance. Since determining this is a function of projecting taxable earnings, making assumptions regarding the payment of distributions, and trying to determine when during any particular calendar year making the election will have the least impact on the most number of unitholders, when or, even if, it will make this election is not determinable at this time. Unitholders are encouraged to consult their tax advisors with respect to these possible outcomes.

Since weather conditions may adversely affect the demand for home heating oil, our financial condition is vulnerable to warm winters.

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. As a result, weather conditions may materially adversely impact our operating results and financial condition. During the peak-heating season of October through March, sales of home heating oil historically have represented approximately 75% to 80% of our annual home heating oil volume. Actual weather conditions can vary substantially from year to year or from month to month, 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 and, consequently, our results of operations. For example, in fiscal 2002 and fiscal 2006, temperatures were significantly warmer than normal for the areas in which we sell home heating oil, which adversely affected the amount of net income, EBITDA and Adjusted EBITDA (see Item 6. EBITDA and Adjusted EBITDA calculation) that we generated during these periods. In fiscal 2002, temperatures in our areas of operation were an average of 18.4% warmer than in fiscal 2001 and 18.0% warmer than normal. To partially mitigate the adverse effect of warm weather on our cash flows, we have purchased a weather hedge from Swiss Re Financial Products. We will receive a payment of \$35,000 per degree-day, when the actual degree-days are less than the 10 year average by 7.5%. The hedge covers the period from November 1, 2009 through March 31, 2010 taken as a whole and has a maximum payout of \$12.5 million.

However, there can be no assurance that this hedge will be adequate to protect us from adverse effects of weather conditions or that we may be able to obtain similar protection in the future.

Table of Contents

Our operating results will be adversely affected if we continue to experience significant net attrition in our home heating oil customer base.

Our net attrition rate of home heating oil customers for fiscal 2009, 2008, and 2007 was approximately 7.5%, 4.4%, and 5.0%, respectively. This rate represents the net of our annual gross customer losses after gross customer gains. For fiscal 2009, 2008, and 2007 we had gross customer losses of 21.0%, 19.1%, and 17.6%, respectively, which were partially offset by gross customer gains during these periods of 13.5%, 14.7%, and 12.6%, respectively. The gain of a new customer does not fully compensate for the loss of an existing customer because of the expenses incurred during the first year to acquire a new customer. Customer losses are the result of various factors, including but not limited to:

price competition;

customer relocations;

credit worthiness; and

conversions to natural gas.

The continuing unprecedented volatility in the price of heating oil has intensified price competition and added to our difficulty in reducing net customer attrition.

For additional information about customer attrition, See Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Customer Attrition.

Because of the highly competitive nature of the home heating oil business, we may not be able to retain existing customers or acquire new customers, which would have an adverse impact on our operating results and financial condition.

Our home heating oil business is subject to substantial competition. Most of our district locations compete with numerous distributors, primarily on the basis of reliability of service, price, and response to customer needs. Each district location operates in its own competitive environment.

We compete with distributors offering a broad range of services and prices, from full-service distributor, like ourselves, to those offering delivery only. Like many companies in the home heating oil business, we provide home heating equipment repair service on a 24-hour-a-day, seven-day-a-week, 52 weeks a year basis. We believe that this tends to build customer loyalty. In some instances homeowners have formed buying cooperatives that seek to purchase fuel oil from distributors at a price lower than individual customers are otherwise able to obtain. We also compete for retail customers with suppliers of alternative energy products, principally natural gas, propane and electricity.

If we are unable to compete effectively, we may lose existing customers or fail to acquire new customers, which would have a material adverse effect on our operating results and financial condition.

If we do not make acquisitions on economically acceptable terms, our future growth will be limited.

The home heating oil industry is not a growth industry because new housing generally uses natural gas when it is available, and competition has also increased from alternative energy sources. Accordingly, future growth will depend on our ability to make acquisitions at attractive prices. We cannot assure that we will be able to identify attractive acquisition candidates in the home heating oil sector in the future or that we will be able to acquire businesses on economically acceptable terms. Factors that may adversely affect home heating oil operating and financial results may limit our access to capital and adversely affect our ability to make acquisitions. Under the terms of our revolving credit facility, our most restrictive agreement, as long as we maintain certain financial ratios, we are not limited on the number of individual acquisitions or aggregate dollar amount of acquisitions we make in any fiscal year, but we are restricted from making any individual acquisition in excess of \$25.0 million without the lenders' approval. In addition, to make an acquisition, the Partnership is required to have Availability (as defined in the credit agreement) of \$40.0 million, on a historical pro forma and forward-looking basis. This covenant restriction may limit our ability to make acquisitions. Any acquisition may involve potential risks to us and ultimately to our unitholders, including:

an increase in our indebtedness;

an increase in our working capital requirements;

our inability to integrate the operations of the acquired business;

our inability to successfully expand our operations into new territories;

the diversion of management's attention from other business concerns;

Table of Contents

an excess of customer loss or loss of key employees from the acquired business; and

the assumption of additional liabilities including environmental liabilities.

In addition, acquisitions may be dilutive to earnings and distributions to unitholders, and any additional debt incurred to finance acquisitions may among other things, affect our ability to make distributions to our unitholders.

Increases in home heating oil prices beyond current levels may have adverse effects on our business, financial condition and results of operations.

Increases in home heating oil prices beyond current levels may have adverse effects on our business, financial condition and results of operations, including the following:

higher bad debt expense as a result of higher selling prices;

higher interest expense as a result of increased working capital borrowing to finance higher receivables and/or inventory balances; and

reduced liquidity as a result of higher receivables and/or inventory balances as the Partnership must fund a portion of any increase in receivables, inventory and hedging costs from its own resources thereby tying up funds that would otherwise be available for other purposes.

The volatility in wholesale energy costs may adversely affect our liquidity.

Our business requires a significant investment in working capital to finance accounts receivable and inventory during the heating season. Under our revolving credit facility, we may borrow up to \$240 million, which increases to \$290 million during the peak winter months from December through April of each year (subject to borrowing base limitations and a coverage ratio) for working capital purposes subject to maintaining availability (as defined in the credit agreement) of \$43.5 million or a fixed charge coverage ratio of not less than 1.10x.

If increases in home heating oil costs cause our working capital requirements to exceed the amounts available under our revolving credit facility or should we fail to maintain the required availability, we would not have sufficient working capital to operate our business, which could have a material adverse effect on our financial condition and results of operations.

We generally utilize forward swaps with members of our lending group to manage market risk associated with our fixed price customers, our physical inventory and fuel we use for our vehicles. These institutions have not required an initial cash margin deposit or any mark to market maintenance margin for these swaps. Any mark to market exposure is reserved against our borrowing base and can thus reduce the amount available to us under our revolving credit facility. The mark to market reserve against our borrowing base for swap derivative instruments with our lending group was \$4.7 million as of September 30, 2009 and \$6.5 million as of November 30, 2009.

For our ceiling price customers and some of our fixed price customers, we purchase call options, which usually requires the Partnership to pay an up front cash payment. This reduces our liquidity, as we must pay for the option before any sales are made to the customer.

For certain of our supply contracts, we are required to establish the purchase price in advance of receiving the physical product. This occurs at the end of the month and is usually no more than 20 days prior to receipt of the product. We use futures contracts or swaps to short the purchase commitment such that the commitment floats with the market. As a result, any upward movement in the market for home heating oil would reduce our liquidity, as we would be required to post additional cash collateral for a futures contract or our availability to borrow under our bank facility would be reduced in the case of a swap. At December 31, 2009, we expect to have approximately 40 million gallons of purchase commitments and physical inventory shorted with a futures contract or swap. Assuming a \$1.00 per gallon increase in price, our near term liquidity would be reduced by \$40 million.

For the majority of our fiscal year, the amount of cash received from customers with a balanced payment plan is greater than actual billings. This amount is reflected on the balance sheet under the caption customer credit balances. At September 30, 2009, customer credit balances aggregated \$74.2 million. Generally, customer credit balances are at their low point after the end of the heating season and at their peak prior to

Edgar Filing: STAR GAS FINANCE CO - Form 10-K

the beginning of the heating season. We have approximately 133,000 customers, or 34% of our residential customer base, on the balanced payment plan. If home heating oil prices increased and we failed to recalculate the balanced payments to reflect current heating oil prices, our liquidity could also be reduced.

Table of Contents

Sudden and sharp oil price increases that cannot be passed on to customers may adversely affect our operating results.

The retail home heating oil industry is a margin-based business in which gross profit depends on the excess of retail sales prices per gallon over supply costs per gallon. Consequently, our profitability is sensitive to changes in the wholesale price of home heating oil caused by changes in supply or other market conditions. These factors are beyond our control and thus, when there are sudden and sharp increases in the wholesale cost of home heating oil, we may not be able to pass on these increases to customers through increased retail sales prices. In an effort to retain existing accounts and attract new customers we may offer discounts, which will impact the net per gallon gross margin realized.

A significant portion of our home heating oil volume is sold to price-protected customers (ceiling and fixed) and our gross margins could be adversely affected if we are not able to effectively hedge against fluctuations in the volume and cost of product sold to these customers.

A significant portion of our home heating oil volume is sold to individual customers under an arrangement pre-establishing the ceiling sales price or a fixed price of home heating oil over a fixed period. When the customer makes a purchase commitment for the next period we currently purchase option contracts, swaps and futures contracts for a substantial majority of the heating oil that we expect to sell to these price-protected customers. The amount of home heating oil volume that we hedge per price-protected customer is based upon the estimated fuel consumption per average customer, per month. In the event that the actual usage exceeds the amount of the hedged volume on a monthly basis, we could be required to obtain additional volume at unfavorable margins. In addition, should actual usage in any month be less than the hedged volume, (including, for example, as a result of early terminations by fixed price customers) our hedging losses could be greater. Currently, the Partnership has elected not to designate its derivative instruments as hedging instruments under FASB ASC 815-10-05 Derivatives and Hedging topic (SFAS 133), and the change in fair value of the derivative instruments are recognized in our statement of operations. Therefore, we could experience great volatility in earnings as these currently outstanding derivative contracts are marked to market and non-cash gains or losses are recorded in the statement of operations.

Significant declines in the wholesale price of home heating oil may cause protected price customers to renegotiate or terminate their arrangements which may adversely impact our gross profit and net income.

When the wholesale price of home heating oil declines significantly after a customer enters into a protected price arrangement with us, some customers elect to renegotiate their arrangement in order to enter into a lower cost pricing plan with us or terminate their arrangement and switch to a competitor. As a result of significant decreases in the price of home heating oil following the summer of 2008, many protected price customers decided to renegotiate their agreements with us in fiscal 2009. It is our policy to bill a termination fee when customers terminate their arrangement with us. It is our belief that approximately 10,000 customers chose another supplier as a result of being billed the termination fee.

We are subject to operating and litigation risks that could adversely affect our operating results whether or not covered by insurance.

Our operations are subject to all operating hazards and risks normally incidental to handling, storing, transporting and otherwise providing customers with our products. As a result, we may be a defendant in legal proceedings and litigation arising in the ordinary course of business.

We maintain insurance policies with insurers in amounts and with coverage and deductibles that we believe are reasonable. However, there can be no assurance that this insurance will be adequate to protect us from all material expenses related to potential future claims for remediation costs and personal and property damage or that these levels of insurance will be available in the future at economical prices.

Our operations are subject to operational hazards and our insurance reserves may not be adequate to cover actual losses.

We self-insure workers compensation, automobile and general liability claims up to pre-established limits. In storing and delivering product to our customers, our operations are subject to operational hazards such as natural disasters, adverse weather, accidents, fires, explosions, hazardous materials releases, mechanical failures and other events beyond our control. If any of these events were to occur, we could incur substantial losses because of personal injury or loss of life, severe damage to and destruction of property and equipment, and pollution or other environmental damage resulting in curtailment or suspension of our related operations.

Table of Contents

We establish reserves based upon expectations as to what our ultimate liability will be for claims using our historical developmental factors. We evaluate on an annual basis the potential for changes in loss estimates with the support of qualified actuaries. As of September 30, 2009, we had approximately \$34.8 million of insurance reserves and had issued \$37.4 million in letters of credit for current and future claims. The ultimate settlement of these claims could differ materially from the assumptions used to calculate the reserves, which could have a material effect on our results of operations.

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.

Proposed legislation concerning the regulation of greenhouse gases and other issues that impact the Partnership's operations could, if adopted, increase the Partnership's costs and/or require changes to its operations, which could have a material adverse effect on the Partnership's financial condition and results of operations.

There is increasing attention in the United States and worldwide concerning the issue of climate change and the effect of emissions of greenhouse gases, in particular from the combustion of fossil fuels. There are efforts to develop new federal proposals by Congress and the EPA that could lead to the adoption of a mandatory program to reduce greenhouse gas emissions through, for example, an economy-wide cap-and-trade program, a carbon tax or a combination of both. Debate continues on the direction, scope and timing of U.S. policy on the regulation of greenhouse gas emissions. It is probable that any regulatory program that caps emissions or imposes a carbon tax will increase costs for the Partnership and its customers which could lead to increased conservation or customers seeking lower cost alternatives. However, at this time an estimate of such costs to comply with potential national, regional or state greenhouse gas emissions reduction legislation, regulations or initiatives is not possible because these programs and proposals are in the early stages of development and any final program, if adopted, could vary from current proposals.

There is also pending legislation directed at over-the-counter derivatives that is considering the establishment of position limits in the energy market. While this legislation is in its early stages, passage of over-the-counter derivative position limits would affect the Partnership's liquidity, expose it to greater counterparty credit risk and contribute to earnings volatility, as the Partnership would have to alter its heating oil hedging program, and concentrate positions to the derivatives that would be available at fewer select counterparties.

Furthermore, laws and regulations that affect the Partnership's operations continue to evolve at both the state and federal levels, which may ultimately add compliance costs to the Partnership. Changes in regulations under different political administrations, the imposition of additional regulations, or the enactment of new legislation that impacts employment, labor, trade, transportation or logistics, health care, tax or environmental issues could have the potential of materially impacting our financial condition or results of operations.

The Partnership will continue to monitor and evaluate federal, regional or state programs and proposals and judicial and administrative decisions that could affect our customers or operations.

Energy efficiency and new technology may reduce the demand for our products and adversely affect our operating results.

Increased conservation and technological advances, including installation of improved insulation and the development of more efficient furnaces and other heating devices, have adversely affected the demand for our products by retail customers. Future conservation measures or technological advances in heating, conservation, energy generation or other devices might reduce demand and adversely affect our operating results.

Table of Contents

Conflicts of interest have arisen and could arise in the future as a result of relationships between the general partner and its affiliates on the one hand, and the Partnership and its limited partners, on the other hand.

Conflicts of interest have arisen and could arise in the future as a result of relationships between the general partner and its affiliates, on the one hand, and the Partnership or any of the limited partners, on the other hand. As a result of these conflicts the general partner may favor its own interests and those of its affiliates over the interests of the unitholders. The nature of these conflicts is ongoing and includes the following considerations:

The general partner's affiliates are not prohibited from engaging in other business or activities, including direct competition with us.

The general partner determines the amount and timing of asset purchases and sales, capital expenditures, borrowings and reserves, each of which can impact the amount of cash, if any, available for distribution to unitholders, and available to pay principal and interest on debt.

The general partner controls the enforcement of obligations owed to the Partnership by the general partner.

The general partner decides whether to retain separate counsel or others to perform services for the Partnership.

In some instances the general partner may borrow funds in order to permit the payment of distributions to unitholders.

The general partner may limit its liability and reduce its fiduciary duties, while also restricting the remedies available to unitholders for actions that might, without limitations, constitute breaches of fiduciary duty. Unitholders are deemed to have consented to some actions and conflicts of interest that might otherwise be deemed a breach of fiduciary or other duties under applicable state law.

The general partner is allowed to take into account the interests of parties in addition to the Partnership in resolving conflicts of interest, thereby limiting its fiduciary duty to the unitholders.

The general partner determines whether to issue additional units or other securities of the Partnership.

The general partner determines which costs are reimbursable by us.

The general partner is not restricted from causing us to pay the general partner or its affiliates for any services rendered on terms that are fair and reasonable to us or entering into additional contractual arrangements with any of these entities on our behalf.

The risk of global terrorism and political unrest may adversely affect the economy and the price and availability of home heating oil and have a material adverse effect on our business, financial condition, and results of operations.

Terrorist attacks and political unrest may adversely impact the price and availability of home heating oil, our results of operations, our ability to raise capital and our future growth. The impact that the foregoing may have on the heating oil industry in general, and on our business in particular, is not known at this time. An act of terror could result in disruptions of crude oil supplies and markets, the source of home heating oil, and its facilities could be direct or indirect targets. Terrorist activity may also hinder our ability to transport home heating oil if our normal means of transportation become damaged as a result of an attack. Instability in the financial markets as a result of terrorism could also affect our

Edgar Filing: STAR GAS FINANCE CO - Form 10-K

ability to raise capital. Terrorist activity could likely lead to increased volatility in prices for home heating oil. Insurance carriers are routinely excluding coverage for terrorist activities from their normal policies, but are required to offer such coverage as a result of new federal legislation. We have opted to purchase this coverage with respect to our property and casualty insurance programs. This additional coverage has resulted in additional insurance premiums.

The impact of hurricanes and other natural disasters could cause disruptions in supply and have a material adverse effect on our business, financial condition and results of operations.

Hurricanes, particularly in the Gulf of Mexico, and other natural disasters may cause disruptions in the supply chains for home heating oil and other products that we sell. Disruptions in supply could have a material adverse effect on our business, financial condition and results of operations, causing an increase in wholesale prices and decrease in supply.

Cash distributions (if any) are not guaranteed and may fluctuate with performance and reserve requirements.

Distributions of available cash by us to unitholders will depend on the amount of cash generated, and distributions may fluctuate based on our performance. The actual amount of cash that is available will depend upon numerous factors, including:

profitability of operations;

required principal and interest payments on debt or debt prepayments;

Table of Contents

debt covenants;

margin account requirements;

cost of acquisitions;

issuance of debt and equity securities;

fluctuations in working capital;

capital expenditures;

adjustments in reserves;

prevailing economic conditions;

financial, business and other factors;

increased pension funding requirements;

the amount of our net operating loss carry forwards; and

federal, state and local corporate income and franchise taxes.

Most of these factors are beyond the control of the general partner.

The partnership agreement gives the general partner discretion in establishing reserves for the proper conduct of our business, including acquisitions. These reserves will also affect the amount of cash available for distribution.

The revolving credit facility and the indenture for the senior notes both impose certain restrictions on our ability to pay distributions to unitholders. The most restrictive covenant is found in the Partnership's revolving credit facility. Under the terms of our credit facility, the Partnership must have a fixed charge coverage ratio of 1.15x to pay the minimum quarterly distribution of \$0.0675. Any distribution in excess of the minimum quarterly distribution requires the Partnership to have a fixed charge coverage ratio of 1.25x. (See Note 11-Long-Term Debt and Bank Facility Borrowings)

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

We provide services to our customers in the Northeast and Mid-Atlantic regions of the United States from 25 principal operating locations and 46 depots, 26 of which are owned and 45 of which are leased. As of September 30, 2009, we had a fleet of 845 truck and transport vehicles, the majority of which were owned and 1,012 service vans, the majority of which were leased. We lease our corporate headquarters in Stamford, Connecticut. Our obligations under our credit facility are secured by liens and mortgages on substantially all of the Partnership's and subsidiaries' real and personal property.

ITEM 3. LEGAL PROCEEDINGS LITIGATION

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 were consolidated into one action entitled *In re Star Gas Securities Litigation*, No 3:04cv1766 (JBA). The class action plaintiffs generally alleged that the Partnership violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 promulgated thereunder. On August 23, 2006, the court entered a judgment of dismissal dismissing the consolidated amended complaint in its entirety. The court subsequently denied plaintiffs' motion to modify the judgment to grant leave to amend the complaint and other relief.

On August 20, 2009, the Second Circuit issued a Summary Order affirming (1) the District Court's order dismissing the class action with prejudice and (2) the District Court's order denying plaintiffs' motion to modify the judgment to grant leave to amend the complaint and other relief.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

Table of Contents**PART II****ITEM 5. MARKET FOR REGISTRANT'S UNITS AND RELATED MATTERS**

The common units, representing common limited partner interests in the Partnership, are listed and traded on the New York Stock Exchange, Inc. (NYSE) under the symbol SGU .

The following tables set forth the high and low closing price ranges for the common units and the cash distribution declared on each unit for the fiscal 2009 and 2008 quarters indicated.

Quarter Ended	SGU Common Unit Price Range		Distributions Declared			
	High		Low		per Unit	
	Fiscal Year 2009	Fiscal Year 2008	Fiscal Year 2009	Fiscal Year 2008	Fiscal Year 2009	Fiscal Year 2008
December 31,	\$ 2.40	\$ 4.82	\$ 1.83	\$ 3.62	\$	\$
March 31,	\$ 2.71	\$ 3.97	\$ 2.22	\$ 2.79	\$ 0.0675	\$
June 30,	\$ 3.62	\$ 3.45	\$ 2.70	\$ 2.55	\$ 0.0675	\$
September 30,	\$ 3.71	\$ 2.90	\$ 3.26	\$ 2.05	\$ 0.0675	\$

As of September 30, 2009, there were approximately 500 holders of record of common units.

There is no established public trading market for the Partnership's 0.3 million general partner units.

Partnership Distribution Provisions

Commencing with the fiscal quarter ended December 31, 2008, we are required to make distributions in an amount equal to our Available Cash, as defined in our Partnership Agreement, no more than 45 days after the end of each fiscal quarter, to holders of record on the applicable record dates. Available Cash, as defined in our Partnership Agreement, generally means all cash on hand at the end of the relevant fiscal quarter less the amount of cash reserves established by the Board of Directors of our general partner in its reasonable discretion for future cash requirements. These reserves are established for the proper conduct of our business, including acquisitions, the payment of debt principal and interest, for distributions during the next four quarters and to comply with applicable laws and the terms of any debt agreements or other agreement to which we are subject. The Board of Directors of our general partner reviews the level of Available Cash each quarter based upon information provided by management.

According to the terms of our partnership agreement, minimum quarterly distributions on the common units accrue at the rate of \$0.0675 per quarter (\$0.27 on an annual basis). The information concerning restrictions on distributions required by Item 5. of this report is incorporated by reference to Note 5. Quarterly Distribution of Available Cash, of the Partnership's consolidated financial statements.

The revolving credit facility and the indenture for the notes both impose certain restrictions on our ability to pay distributions to unitholders. The most restrictive covenant is found in the Partnership's revolving credit facility. Under the terms of our credit facility, the Partnership must have a fixed charge coverage ratio of 1.15x to pay the minimum quarterly distribution of \$0.0675. Any distribution in excess of the minimum quarterly distribution requires the Partnership to have a fixed charge coverage ratio of 1.25x.

Table of Contents**Common Unit Repurchase and Retirement**

On July 21, 2009, the Board of Directors of the Partnership's General Partner authorized the repurchase of up to 7.5 million of the Partnership's common units. The authorized common unit repurchases may be made from time-to-time in the open market, in privately negotiated transactions or in such other manner deemed appropriate by management. The program does not have a time limit. The Partnership's repurchase activities take into account SEC safe harbor rules and guidance for issuer repurchases. All of the common units purchased in the repurchase program will be retired.

(in thousands, except per unit amounts)

Period	Total Number of Units Purchased as Part of a Publicly Announced Plan or Program	Average Price Paid per Unit	Maximum Number (or approximate Dollar Value) of Units that May Yet Be Purchased Under the Plans or Programs
July 2009		\$	7,500
August 2009	160	\$ 3.59	7,340
September 2009	477	\$ 3.69	6,863
Fiscal year 2009 total	637	\$ 3.67	6,863
October 2009	3,072(1)	\$ 3.97	3,791
November 2009	350	\$ 3.96	3,441

(1) October 2009 common unit repurchases include 2.7 million common units acquired in a private sale.

Table of Contents**ITEM 6. SELECTED HISTORICAL FINANCIAL AND OPERATING DATA**

The selected financial data as of September 30, 2009 and 2008, and for the years ended September 30, 2009, 2008 and 2007 is derived from the financial statements of the Partnership included elsewhere in this Report. The selected financial data as of September 30, 2007, 2006 and 2005 and for the years ended September 30, 2006 and 2005 is derived from financial statements of the Partnership not included elsewhere in this Report. See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

(in thousands, except per unit data)	Fiscal Years Ended September 30,				
	2009	2008	2007	2006	2005
Statement of Operations Data:					
Sales	\$ 1,206,813	\$ 1,543,093	\$ 1,267,175	\$ 1,296,512	\$ 1,259,478
Costs and expenses:					
Cost of sales	875,755	1,257,592	981,559	1,014,565	983,732
(Increase) decrease in the fair value of derivative instruments	(13,690)	25,467	(15,664)	45,677	(6,081)
Delivery and branch expenses	222,740	211,868	197,513	203,535	231,086
Depreciation and amortization expenses	19,406	26,784	28,995	32,415	35,480
General and administrative expenses	22,480	18,077	19,661	23,518	43,685
Goodwill impairment charge					67,000
Operating income (loss)	80,122	3,305	55,111	(23,198)	(95,424)
Interest expense, net	13,637	13,808	11,525	21,203	31,838
Amortization of debt issuance costs	2,750	2,339	2,282	2,438	2,540
(Gain) loss on redemption of debt	(9,706)			6,603	42,082
Income (loss) from continuing operations before income taxes	73,441	(12,842)	41,304	(53,442)	(171,884)
Income tax expense (benefit)	(57,597)	566	2,002	477	696
Income (loss) from continuing operations	131,038	(13,408)	39,302	(53,919)	(172,580)
Loss from discontinued operations, net of income taxes					(6,189)
Gain (loss) on sales of discontinued operations, net of income taxes			(1,061)		157,560
Income (loss) before cumulative effects of changes in accounting principle for continuing operations	131,038	(13,408)	38,241	(53,919)	(21,209)
Cumulative effects of changes in accounting principles-change in inventory pricing method				(344)	
Net income (loss)	\$ 131,038	\$ (13,408)	\$ 38,241	\$ (54,263)	\$ (21,209)
Weighted average number of limited partner units:					
Basic	75,738	75,774	75,774	52,944	35,821
Diluted	75,738	75,774	75,774	52,944	35,821

Table of Contents

(in thousands, except per unit data)	Fiscal Years Ended September 30,				
	2009	2008	2007	2006	2005
Per Unit Data:					
Basic and diluted income (loss) from continuing operations per unit (a)	\$ 1.43	\$ (0.18)	\$ 0.51	\$ (1.01)	\$ (4.77)