N E W S
L E T T E R

Invest

Vol. 12 No. 2 August 2012

Star Gas Partners, L.P.

(Ticker Symbol: SGU)

Greetings from LFS

Dear Clients and Friends:

Invest is a quarterly newsletter created and distributed by LFS. The purposes are to offer:

- An investment idea that will perform regardless of market conditions.
- Insight into an industry including trends, opportunity and challenges.

I welcome any questions, comments or suggestions.

Sincerely,

Doug Ruth

Douglas Ruth

Invest

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Star Gas Partners, L.P. ("Star") is a home heating oil and propane distributor and services provider. LFS believes there is a unique opportunity to own bonds in Star. The opportunity is unique for two primary reasons:

1. The company operates in a "necessity of life" industry.
2. The bonds provide an above-average income stream during a time when it is difficult to earn an acceptable return on a bank certificate of deposit.

Bond Specifics:

Bond maturity	12/01/17
Coupon	8.875%
Price per bond	$1,035.00
Bond is callable 12/01/14 at	$1044.38
Yield to call	7.89%

The company provides home heating equipment repair service 24 hours day, seven days a week, and 52 weeks a year.

Star became a public entity in 1995 and has been involved with fuel in various forms since its creation. The organization operates as a master limited partnership. Kestrel Heat, LLC, has been the general partner since April 2006.

LFS believes that the company's previous limited partner structured the organization's balance sheet incorrectly.

This was corrected with the arrival of Dan Donovan. He was named President and Chief Executive Officer in March 2005.

Mr. Donovan developed a business plan that was implemented in April 2006. His plan is simple and straightforward – to increase both profits and cash flow.

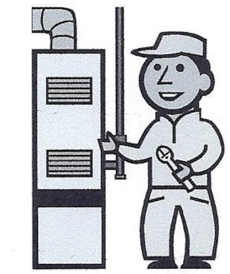
Under his leadership, the company:

- Simplified its capital structure;
- Issued additional equity;
- Paid down its debt;
- Resumed paying a quarterly dividend;
- Returned to being a predictable, profitable enterprise; and
- The management team has been stable.

Services:

As of September 30, 2011, the company:

- Sold home heating oil and propane to full-service residential and commercial customers.
  - Star believes it is the largest retail distributor of home heating oil in the United States, based on sales volume.



- Installs, maintains, and repairs heating and air-conditioning equipment for its customers and provides ancillary home services, including home security and plumbing.
- Markets other petroleum products, including diesel fuel and gasoline to commercial customers.

Services Provided by Star
(By Number of Customers)

	2007	2008	2009	2010	2011
Full-service sale of home heating oil and propane	416,000	402,000	374,000	404,000	407,000
Delivery-only sale of home heating oil, gasoline, diesel fuel	27,000	28,000	34,000	35,000	39,000
Install, maintain, repair HVAC equipment; provide home security and plumbing	11,000	11,000	11,000	11,000	11,000
Propane customers	7,000	7,000	7,000	10,000	ND[1]
Total	461,000	448,000	426,000	460,000	457,000[2]

1. Not disclosed
2. Number of propane customers not included in the total.

Star Sales
(In Percentages)

	2007	2008	2009	2010	2011
Sales of home heating oil and propane	76%	78%	79%	77%	79%
Installation and report of HVAC equipment	14%	12%	15%	15%	13%
Sales of other petroleum products	10%	10%	6%	8%	8%
Total sales	100%	100%	100%	100%	100%

Areas Served:

The company primarily serves the Northeast and Mid-Atlantic regions of the United States, including:

- Connecticut
- Maine
- Maryland
- Massachusetts
- New Hampshire
- New Jersey
- New York
- Pennsylvania
- Rhode Island
- South Carolina
- Virginia
- Washington, D.C.

Percentage of Customers in New York
(On September 30 of Each Year)

2007	2008	2009	2010	2011
			42.6%	38.6%

Fuel of Choice:

Homes can be heated with propane, electricity, natural gas and fuel oil. Customer fuel choices often depend on physical location and fuel availability.

- 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, 2009 *Residential Energy Consumption Survey* (the latest survey published), these are the facts:
  - 6.9 million households use fuel oil as their primary heating source.
  - Of these 6.9 million households, 5.7 million are located in the Northeast and Mid-Atlantic regions of the country.
- Fuel oil has developed its own distinctive market.
  - The fuel oil industry generally believes that this market is somewhat secure because of the costs of converting a furnace from burning one type of fuel to another.
- The company believes that approximately 1 percent of its customer base converts from home heating oil to natural gas each year.

Business Plan:

The goals of Mr. Donovan's business plan are to increase profits and cash flow.

In 2003, Star issued $265 million in bonds that yielded 10.25 percent. Over the next five-year period, the company reduced its debt outstanding, down to $173.7 million.

- During the next two years, the company further reduced its debt by $90 million.

Star Gas Long-term Debt Outstanding By Fiscal Year
(In $Millions)

2005	2008	2009	2010
$267.4	$174.1	$133.1	$82.8

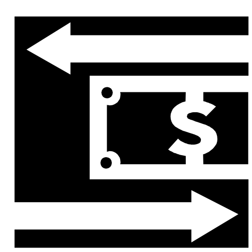
- The company wanted to expand its business so it refinanced the existing debt at a lower rate and issued new bonds.
- In November 2010, the company issued $125 million in 8.875-percent bonds, which mature in 2017. The issuance of these bonds should provide a level of stability and predictability for Star's management. They now know what their interest expense will be for the next several years.
- The bonds are rated B2 by Moody's.

For investors seeking new current income, we can take comfort in knowing that management has a history of paying its bills. Investors who purchase Star bonds should receive the following, if everything goes as planned.

Calculation of Investment

Date	Interest per Bond
Cost per bond as of 08/06/12	$1,035.00
12/01/2012	$44.38
06/01/2013	$44.38
12/01/2013	$44.38
06/01/2014	$44.38
12/01/2014	$44.38
06/01/2015	$44.38
12/01/2015	$44.38
06/01/2016	$44.38
12/01/2016	$44.38
06/01/2017	$44.38
12/01/2017	$44.38
Return of principal 12/01/17	$1,000.00
Total	$1,488.18

- Under Mr. Donovan's leadership, Star has delivered profits four out of the last five years. The following table shows that Mr. Donovan's plan is working. The company is consistently profitable.



Profits and Cash Flow

	2007	2008	2009	2010	2011
Sales in $Thousands	$1,268	$1,543	$1,207	$1,213	$1,591
Net income in $Millions	$38.2	($13.4)	$131.0	$28.3	$24.3

Four Parts of the Business Plan:

The business plan has four distinct parts:

1. Increasing operating efficiencies
2. Delivering superior customer service.
3. Pursuing select acquisitions.
4. Broadening products and services.

Part 1 – Increasing Operating Efficiencies:

Gross margin and operating income: The largest and most important measure is the gross margin on fuel oil. The highest margin was achieved in 2009.

Gross Fuel Oil Margin
(In $Millions except Percentages)

	2005	2006	2007	2008	2009	2010	2011
Fuel oil sales	$1.07	$1.10	$1.09	$1.35	$1.03	$1.03	$1.39
Cost of fuel	(0.79)	(0.82)	(0.80)	(1.08)	(0.71)	(0.74)	(1.06)
Gross margin	$0.28	$0.28	$0.29	$0.27	$0.32	$0.29	$0.33
Gross margin as a % of product sales	26.6%	25.6%	26.1%	20.1%	31.4%	28.6%	24.1%

Percentage of Profits Generated From Home Heating Oil

2007	2008	2009	2010	2011
93%	94%	95%	93%	ND[1]

1. Not disclosed.

The table below shows that the gross margins achieved in the years 2009 through 2011 were higher than those achieved in 2006 through 2008. As a result, the operating income in the years 2009 through 2011 was higher versus that in 2006 through 2008.

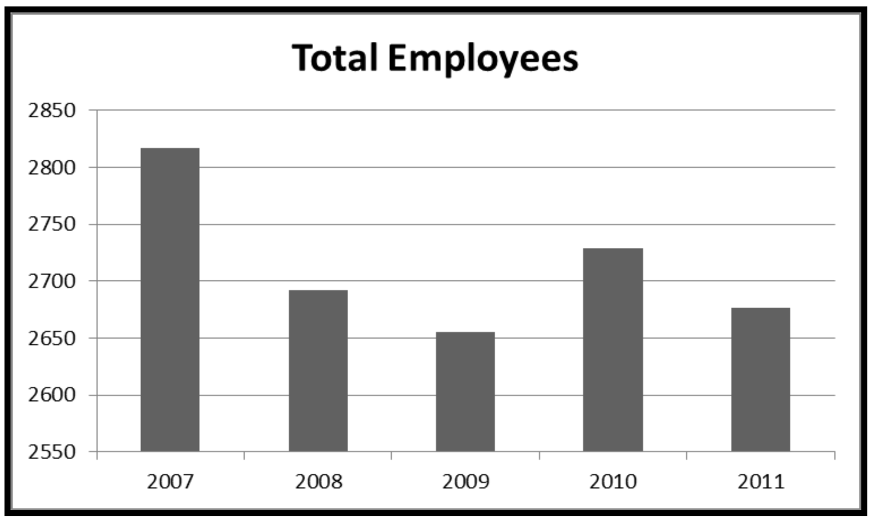
Selected Financial Data in Percentages

	2006	2007	2008	2009	2010	2011
Total sales	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Total cost of fuel, installations and service	(78.3%)	(77.5%)	(81.5%)	(72.6%)	(74.5%)	(77.8%)
Gross margin	21.7%	22.5%	18.5%	27.4%	25.5%	22.2%
Delivery and branch expenses	(15.8%)	(15.6%)	(13.7%)	(18.6%)	(18.0%)	(15.8%)
SG&A expense	(1.7%)	(1.5%)	(1.1%)	(1.7%)	(1.8%)	(1.3%)
Operating income	4.2%	5.4%	3.7%	7.1%	5.7%	5.1%

Employee count: The company is trying to control other costs. The employee count is tracking down.

Number of Employees

	2007	2008	2009	2010	2011
Office, clerical and customer service	877	778	825	810	846
Equipment technicians	1,012	967	844	848	797
Oil truck drivers	362	366	360	388	376
Management	374	378	356	396	391
Sales representatives	192	203	270	287	267
Total	**2,817**	**2,692**	**2,655**	**2,729**	**2,677**
Seasonal workers	280	394	378	456	500
Union data:					
Number of full-time employees	1,262	1,245	951	909	854
Number of seasonal employees			275	305	353
Number of local chapters	20	17	21	24	34
Number of contracts in negotiation	2	6	4	3	5



Delivery and branch expense: Delivery and branch expense is the second largest category.

SG&A expense: The third highest expense category is sales, general and administrative expense (SG&A). Included in the SG&A value are advertising and direct mail expenses.

Advertising and Direct Mail Expenses
(In $Millions)

2005	2006	2007	2008	2009	2010	2011
$9.2	$5.9	$7.1	$7.2	$8.4	$9.6	$9.5

Part 2 – Delivering Superior Customer Service:

The company:

- Is focused on providing the best possible customer service to the regions it serves, with the aim of maximizing customer retention.
- Believes that its customer service helps build customer loyalty. The company provides home heating equipment repair service 24 hours a day, seven days a week, 52 weeks a year.
- Requires that all of its employees participate in customer-service training.

- Has the following facilities to serve its customers:

Star Facilities

	2007	2008	2009	2010	2011
Principal operating locations	25	25	25	35	36
Depots	47	47	46	52	53
Properties:					
Owned	28	28	26	33	31
Leased	44	44	45	54	58
Total	72	72	71	87	89
Number of trucks and transport vehicles	982	879	845	990	984
Number of service vans	1,136	1,084	1,012	1,097	1,082

The majority of the trucks and transport vehicles are owned, while the majority of the service vans are leased.

The company made mistakes in the past with customer service. As a result, management has made changes which include:

- Answering the majority of customer service calls locally; and
- Adding more personnel if the need arises.

Part 3 – Pursuing Select Acquisitions:

The fuel oil industry is not a growth industry. Today, the fuel of choice is natural gas. Better heating equipment and conservation measures have been factors which allow the average consumer who used 1,200 gallons of heating oil in 1989 to perform the same tasks in 2012 using only 800 gallons.

When an industry is not growing, consolidation is often used. The economic theory behind consolidation is to try to make the business larger and more efficient. Possibly the same amount (or more) work can be completed with fewer employees.

Star's business can be expanded by making acquisitions. The nature of the industry encourages larger organizations to buy smaller companies.

- The retail home heating oil industry is highly fragmented, characterized by a large number of relatively small, independently owned and operated local distributors.
- The industry is becoming more complex and costly due to new regulations, working capital requirements and the cost to hedge for price-protected customers.
- Also, the cost to provide customer service has increased.

Star's management believes that:

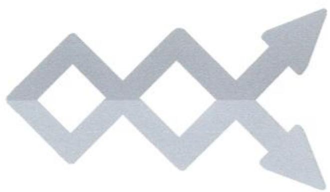
- Its senior management team has developed expertise in identifying acquisition opportunities and integrating acquired customers into Star's operations.
- Through acquisitions, the company has been able to increase its presence in some existing geographic markets and selectively expand into new markets.

The company is spending millions of dollars acquiring smaller companies.

Cost of Acquisitions
(In $Millions)

2007	2008	2009	2010	2011
$26.4	$1.9	$3.4	$68.8	$9.7

As a general rule, heating a home with fuel oil is less expensive than using natural gas. In recent years, natural gas has been less expensive than fuel oil.



Volatility in the marketplace has affected:

- The price of fuel; and
- The rate of homeownership.

These factors affect the attrition rate.

Acquisition Facts:

Even though Star adds customers through acquisitions, the company is affected by attrition. Customer turnover is called *attrition*. There are several reasons for attrition. The fuel oil industry carefully tracks the attrition rate of customers who convert to using natural gas.

Customer Attrition and Gains

	2005	2006	2007	2008	2009	2010	2011
Attrition of home heating oil and propane[1] customers	7.1%	6.6%	5.0%	4.3%	7.6%	5.0%	3.5%
Gross customer losses	20.0%	19.6%	17.6%	19.1%	21.1%	16.6%[2]	16.7%
Gross customer gains	12.9%	13.0%	12.6%	14.8%	13.5%	11.6%[2]	13.2%

1. Starting October 1, 2010, the number of propane customers has been included in this calculation as several of Star's acquisitions since such date have included propane operations.
2. Number inconsistent.

Conversions: Overall, the fuel industry is in a slight decline. Some customers are converting from fuel oil to natural gas.

Customer Losses Because of Natural Gas Conversions
(In Percentages)

2007	2008	2009	2010	2011
1.0%	1.6%	1.6%	1.2%	1.4%

Analysis of Balance Sheet:

Most of the partners' capital, which can also be called *shareholders' equity*, is made up of goodwill and intangibles.

Companies that make acquisitions develop a balance sheet that is different from those that build their businesses organically. Organizations that make acquisitions often have a large amount of goodwill and intangibles on their balance sheets.

Star Gas Partial Balance Sheet
(In $Millions)

Year Ending September 30	2006	2007	2008	2009	2010	2011
Total partners' capital	$173.3	$216.3	$200.0	$306.3	$279.9	$272.6
Goodwill	$166.5	$181.5	$182.0	$182.9	$199.0	$199.3
Intangibles, net	61.0	48.5	30.9	20.5	58.9	52.4
Total	$227.5	$230.0	$212.9	$203.4	$257.9	$251.7

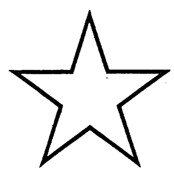
Revenue per Customer:

Determining the value of a company that has a lot of goodwill and intangibles on its balance sheet requires a different strategy to determine shareholders' equity. One valuation strategy that is considered acceptable is based on revenue generated per customer.

Revenue Generated per Customer

	2007	**2008**	**2009**	**2010**	**2011**
Sales in thousands	$1,268	$1,543	$1,207	$1,213	$1,591
Total number of customers in thousands	461	448	426	460	456
Value per customer	$2,751	$3,444	$2,833	$2,637	$3,489

Customer Value:



Star regularly acquires other companies that supply propane and fuel oil to home and business owners. Essentially, Star is buying the selling organization's customer list and equipment. Star adds the purchased company employees to its own. The customer list allows Star to sell and distribute more fuel. It can be debated how much Star should pay to buy a customer list. A couple of examples show a range of possibilities.

Example 1:

Sam and Rachel recently graduated from college and got married. They decide to buy a home in Star's service area. As children, both of them fondly remember the fuel oil driver coming to their respective homes several times a year. They look forward to living in the community, establishing roots and building their own family over the coming decades.

Example 2:

Joel and Joyce, age 60, work for a large company and have accepted a job transfer to the east coast where they have purchased a home. Joel would like to work until age 65, after which the couple hopes to retire to Florida.

Higher Customer Value:

In theory, the customer value of Sam and Rachel for Star would be higher than that of Joel and Joyce.

The average fuel customer buys about 800 gallons of fuel each year. If Sam and Rachel are in their mid-twenties and if they became a Star customer for 40 years, they could possibly consume 32,000 gallons of fuel oil. During fiscal 2011, the Star's per-gallon gross margin was $0.91.

On the other hand, Joel and Joyce appear to be customers for only five years. Their consumption would probably be approximately 4,000 gallons of fuel. What we do not know is whether the next purchaser of Joel and Joyce's home would continue to heat the house with fuel oil.

Calculating Customer Value:

Sam and Rachel, age 25:

Fuel consumption:	800 gallons of fuel per year x 40 years = 32,000 gallons
Profit:	32,000 gallons of fuel x $0.91 = $29,120 gross profit over 40 years

Joel and Joyce, age 60:

Fuel consumption:	800 gallons of fuel per year x 5 years = 4,000 gallons
Profit:	4,000 gallons of fuel x $0.91 = $3,640 gross profit over 5 years

The calculation of revenue per customer allows us to further analyze our two hypothetical families. In 2011, our calculation shows that each customer is worth $3,489. Paying this amount to supply fuel oil to Sam and Rachel sounds like a great deal. In theory, we would earn a great return on this investment.

Simple Calculation

Investment:
$3,489

$29,120 ÷ $3,489 = 8.3

Future profit:
$29,120

The payback would be more than eight times the amount invested. On the other hand, paying $3,489 to supply fuel oil to Joel and Joyce sounds mediocre.

Investment:
$3,489

$3,640 ÷ $3,489 = 4% more than we started with

Future profit:
$3,640

The volatility in the price of fuel oil is unprecedented.

- LFS believes that fuel oil prices are affecting Star's attrition rate.
- Fuel oil prices are alternating between surging and plunging.
- During fiscal 2008:
  - New record highs for heating oil were recorded 47 times during the first three quarters of the year.
  - Home heating oil prices both increased and decreased by $2.00 per gallon in a short period of time.

High and Low Fuel Oil Prices by Quarter

Quarter	2006	2007	2008	2009	2010	2011	2012
1[1]							
High	$2.08	$1.85	$2.71	$2.85	$2.12	$2.54	$3.17
Low	$1.61	$1.50	$2.16	$1.20	$1.78	$2.19	$2.72
2[2]							
High	$1.88	$1.88	$3.15	$1.63	$2.20	$3.09	$3.32
Low	$1.61	$1.47	$2.42	$1.13	$1.89	$2.49	$2.99
3[3]							
High	$2.10	$2.04	$3.97	$1.86	$2.35	$3.32	$3.25
Low	$1.86	$1.80	$2.88	$1.31	$1.87	$2.75	$2.53
4[4]							
High	$2.14	$2.26	$4.11	$1.96	$2.24	$3.13	TBD
Low	$1.65	$1.94	$2.72	$1.50	$1.92	$2.77	TBD

1. Quarter ends on December 31.
2. Quarter ends on March 31.
3. Quarter ends on June 30.
4. Quarter ends on September 30.

Part 4 – Broadening Products and Services:

The company sells related and complementary products and services, such as air conditioning systems, plumbing services and home security systems. You can see the following:

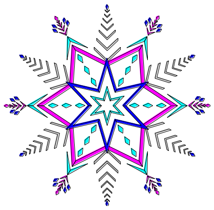
- Revenue growth is modest.
- However, the gross margin is expanding.

Installation and Service Expenses

	2005	2006	2007	2008	2009	2010	2011
Installations and service	$188,208	$187,180	$178,565	$189,143	$174,001	$184,353	$198,439
Cost of installation and service	(197,430)	(189,214)	(176,947)	(176,537)	(167,570)	(169,453)	(179,558)
Gross margin	($9,222)	($2,034)	$1,618	$12,606	$6,431	$14,900	$18,881
Margin as a % of installation and services	(4.9%)	(1.1%)	0.9%	6.7%	3.7%	8.1%	9.5%

Industry Characteristics:

There are several unique characteristics of the fuel oil industry. These characteristics allow investors to understand the industry and to see the opportunity to own bonds in this necessity-of-life business.



1. Seasonality;
2. Customers have choices; and
3. Suppliers and supply arrangements.

1. Seasonality:

The company's fiscal year ends on September 30. The business's seasonal nature results in the sale of approximately 30 percent of home heating oil volume in the first fiscal quarter and 50 percent in the second fiscal quarter of each fiscal year, the peak heating season.[1]

As a result, Star generally:

- Realizes net income in the first[2] and second[3] fiscal quarters; and
- Incurs net losses during the third[4] and fourth fiscal[5] quarters.

2. Customers have Choices:

Residential Customers:

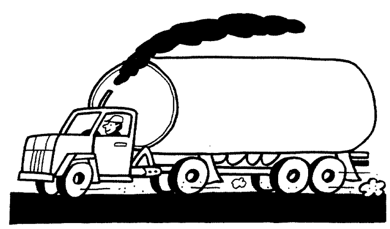
The majority of Star's customers are residential:

Customers by Type

	2007	2008	2009	2010	2011
Residential	96%	96%	97%	96%	96%
Commercial	4%	4%	3%	4%	4%
Total	100%	100%	100%	100%	100%

A typical Star Gas residential customer receives:

- Four or six deliveries per year.
- Average deliveries as shown by the following table:



Average Deliveries
(In Gallons)

2007	2008	2009	2010	2011
170	170	160	160	160

The customer has control over the entire relationship by choosing:

- To receive deliveries that are automatically scheduled based on on-going weather conditions and the customer's historical consumption pattern. The majority of customers choose this option.

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[1] The peak heating season is October 1 through March 31.
[2] First quarter: October through December of each fiscal year.
[3] Second quarter: January through March of each fiscal year.
[4] Third quarter: April through March of each fiscal year.
[5] Fourth quarter: June through September of each fiscal year.

Customer Delivery Preferences

	2007	2008	2009	2010	2011
Automatically scheduled deliveries	89%	92%	90%	97%	97%
Customer calls for delivery	11%	8%	10%	3%	3%
Total	100%	100%	100%	100%	100%

- The method for paying their bills.

Customer Delivery Preferences

	2007	2008	2009	2010	2011
Equal monthly payments	26%	36%	34%	38%	38%
Pay after delivery	74%	64%	66%	62%	62%
Total	100%	100%	100%	100%	100%

With the equal monthly payment plan, Star estimates the customer's annual oil purchase and service contract fees. The annual estimate is then divided into 12 monthly payments.

- The way to determine fuel price.

Several pricing alternatives are offered to residential home heating oil customers:

Variable pricing: The 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.

Price protected: Price protected programs are also offered, which establish either a ceiling or a fixed price per gallon that the customer would pay over a 12-month period.

As the price of fuel oil became more volatile, a higher percentage of customers chose a ceiling plan.

Programs Selected by Residential Home Heating Oil Customers

	2007	2008	2009	2010	2011
Variable	61.0%	48.6%	52.3%	55.8%	54.9%
Ceiling	23.2%	34.4%	44.6%	41.8%	41.5%
Fixed	15.8%	17.0%	3.1%	2.4%	3.6%
Total	100.0%	100.0%	100.0%	100.0%	100.0%

Commercial Customers:

A small percentage of Star sales are to commercial customers.

Commercial Customers Delivery and Sales Volume

	2006	2007	2008	2009	2010	2011
Average delivery in gallons		425	425	350	350	340
Total heating oil volume	16.7%	16.5%	14.7%	14.3%	13.8%	12.7%

3. Suppliers and Supply Arrangements

Some of the characteristics of Star's buying patterns include:

- Petroleum products for delivery are purchased in either barge, pipeline or truckload quantities.

Contracts with Third-Party Terminals for Storage

2007	2008	2009	2010	2011
70	70	60	80	70

- Home heating oil purchases are made under supply contracts or on the spot market. Including Star's physical storage, the company has entered into market-price-based contracts for approximately 70 percent of its retail home heating oil requirements for fiscal 2012. (The following table shows Star's three largest suppliers.)

Three Largest Suppliers of Star's Petroleum Products

	2007	2008	2009	2010	2011
BP North America	0%	0%	0%	11.1%	0%
Global Companies	11.7%	15.6%	13.5%	19.6%	21.6%,
NIC Holding Corp. (Northville Industries)	18.3%	15.0%	8.7%	11.2%	12.6%
Sunoco	19.2%	15.2%	15.1%	12.0%	10.9%
Total	49.2%	45.8%	37.3%	53.9%	45.1%

- 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 home heating oil.
- This price is based upon a published market index price at the time of delivery or pricing date plus an agreed-upon differential.
- The company believes that its policy of contracting for the majority of its anticipated supply needs with diverse and reliable sources will enable Star to obtain sufficient product should unforeseen shortages develop in worldwide supplies.

Explanation of "Limited Partnership:"

Star is a limited partnership. A *master limited partnership* is a variation of a traditional publicly traded company: In this case, the ownership of the company is set up as follows:

General Partner:

Kestrel Heat, LLC., provides the management for the organization and owns ½ of 1 percent of the company stock. This company is the general partner.

Limited Partners:

The common shareholders own 99½ percent of the company. They are the limited partners.

Stock Ownership:

Kestrel is a large shareholder of Star.

Kestrel Stock Ownership

Number of	2007	2008	2009	2010	2011
Common units	12,803,128	12,803,128	12,803,128	12,803,128	12,803,128
Percentage of common units	16.90%	16.90%	17.85%	19.09%	19.84%
General partner units	325,729	325,729	325,729	325,729	325,729
Percentage of general partner units	100.00%	100.00%	100.00%	100.00%	100.00%

Kestrel Heat is a private-entity investment partnership formed by Yorktown Energy Partners VI, L.P., Paul A. Vermylen and other investors. The company leases its corporate headquarters, which are located in Stamford, Connecticut.

The officers and directors are modest owners of Star Gas stock. The following table shows a summary of stock ownership.

Total Star Stock Ownership

Number of	2007	2008	2009	2010	2011
All officers and directors and Kestrel Heat, LLC as a group (11 persons)					
Number of Common Units	12,866,626	13,039,874	13,200,874	13,200,874	13,403,445
% of Class	16.98%	17.21%	18.41%	19.68%	20.77%
Kestrel					
Number of Common Units	12,803,128	12,803,128	12,803,128	12,803,128	12,803,128
% of Class	16.90%	16.90%	17.85%	19.09%	19.84%
Units owned by management					
Number of Common Units	63,498	236,746	397,746	397,746	600,317
% of Class	0.08%	0.31%	0.56%	0.59%	0.93%

Executives:

Key Management Changes from 2006 to the Present

April 2006
- Daniel P. Donovan named President of Star.

May 2007
- Mr. Donovan added the title of CEO to the President's position effective June 1.
- Steven J. Goldman was promoted to Senior Vice President of Operations.
- Joseph Cavanaugh retired.

May 2010
- Richard F. Ambury added the title Executive Vice President to his regular duties.
- Steven J. Goldman was promoted to Executive Vice President and Chief Operating Officer.

Executive Compensation:

Star executives are highly compensated.

Executive Compensation

Name/Position	Year	Salary	Bonus	Non-equity Incentive Plan	Change in Pension Value and Nonqualified Deferred Comp	All Other Comp	Total
Richard F. Ambury	2006	$236,333	$240,000	$0	$0	$12,492	$488,492
CFO, Treasurer	2007	286,333	0	0	(4,043)	22,624	590,914
Executive VP	2008	292,028	0	260,000	(19,423)	27,855	560,540
	2009	302,500	0	485,000	64,798	30,722	883,020
	2010	313,917	0	445,000	30,699	47,852	837,468
	2011	327,708	0	455,000	25,422	64,965	873,095
Joseph P. Cavanaugh CEO	2006	$275,000	$220,000	$0	$0	$34,040	$529,040
Daniel P. Donovan	2006	$300,000	$240,000	$0	$0	$12,985	$552,985
Pres, CEO	2007	325,288	375,000	0	6,665	32,905	739,858
	2008	377,667	0	330,000	(33,326)	33,321	707,662
	2009	388,333	0	615,000	181,947	38,004	1,223,284
	2010	395,667	0	565,000	85,384	55,760	1,101,811
	2011	412,367	0	570,598	67,949	89,722	1,140,636
Steven J.	2007	244,561	200,000	0	0	29,415	473,976
Goldman	2008	277,000	0	182,000	0	30.085	489,085
COO, Exec VP	2009	285,000	0	337,000	0	33,404	655,404
	2010	298,667	0	361,000	0	44,719	704,386
	2011	317,625	0	430,000	0	55,001	802,626
Richard G. Oakley	2006	162,730	$50,000	$0	$0	$7,729	$220,459
VP - Controller	2007	190,000	96,000	0	(6,595)	26,703	306,108
	2008	195,700	0	84,000	(27,678)	26,657	278,679
	2009	199,600	0	150,000	88,066	29,284	466,950
	2010	205,600	0	145,000	42,887	32,491	425,978
	2011	212,800	0	155,000	34,731	37,137	439,668

Conclusion:

Star Gas Partners, L.P. (“Star”) has an outstanding bond issue that LFS believes investors should consider purchasing to generate high current income. Star is the largest retail distributor of home heating oil in the United States based on sales volume.

Fuel oil is primarily used as a source of fuel to heat residences and businesses in the Northeast and Mid-Atlantic regions of the country. The fuel oil industry is stable, but in a slight decline. Natural gas, when available, is generally considered to be a more desirable method to heat a home or business.

Less Stability:

The industry has been less stable recently for three primary reasons:

1. Volatility of Fuel Prices:

There has been increased volatility in the price of fuel oil. Fuel oil prices are alternating between surging and plunging.

High and Low Fuel Oil Prices by Quarter

Quarter	2006	2007	2008	2009	2010	2011	2012
1[1]							
High	$2.08	$1.85	$2.71	$2.85	$2.12	$2.54	$3.17
Low	$1.61	$1.50	$2.16	$1.20	$1.78	$2.19	$2.72
2[2]							
High	$1.88	$1.88	$3.15	$1.63	$2.20	$3.09	$3.32
Low	$1.61	$1.47	$2.42	$1.13	$1.89	$2.49	$2.99
3[3]							
High	$2.10	$2.04	$3.97	$1.86	$2.35	$3.32	$3.25
Low	$1.86	$1.80	$2.88	$1.31	$1.87	$2.75	$2.53
4[4]							
High	$2.14	$2.26	$4.11	$1.96	$2.24	$3.13	TBD
Low	$1.65	$1.94	$2.72	$1.50	$1.92	$2.77	TBD

1. Quarter ends on December 31.
2. Quarter ends on March 31.
3. Quarter ends on June 30.
4. Quarter ends on September 30.

2. Poor Customer Service:

The company tried to change its method for providing customer service. However, this new method was producing an unacceptable customer experience. (Note that the company's customer service issues have been resolved. Star Gas customers are able to call a local number and can talk to a representative who is empowered to resolve any conflict.) Together, these two factors caused a larger number of consumers to convert from fuel oil to natural gas.

3. General Economy:

The company has also been affected by the general economy. Higher unemployment rates and lower real estate prices caused some of Star's customers to lose their homes.

Customer Attrition:

Customer losses are known as attrition. Star's attrition rate is stabilizing now. Additionally, Star's management has learned how to manage the volatility of fuel oil prices by using financial hedges, which is considered to be an acceptable and prudent strategy.

LFS believes that Star's attrition rate will continue to track lower.

Net Attrition Rate by Fiscal Year

2003	2004	2005	2006	2007	2008	2009	2010	2011
1.3%	6.6%	5.0%	6.6%	7.1%	4.3%	7.6%	5.0%	3.5%

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- ☐ **Bassett Industries, Inc. (BSET)**
- ☐ **Delphax Technologies, Inc. (DLPX)**
- ☐ **Deswell Industries Incorporated (DSWL)**
- ☐ **Jefferies Group, Inc. (JEF)**
- ☐ **Jinpan International, Ltd. (JST)**
- ☐ **Lakeland Industries, Inc. (LAKE)**
- ☐ **Perceptron (PRCP)**
- ☐ **RELM Wireless Corp. (RWC)**
- ☐ **Star Gas Partners, L.P. (SGU)**
- ☐ **21st Century Holdings (TCHC)**

Insurance:

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