

Edgar Filing: HERITAGE PROPANE PARTNERS L P - Form 10-Q/A

HERITAGE PROPANE PARTNERS L P  
Form 10-Q/A  
November 26, 2003

FORM 10-Q/A

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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

FOR THE QUARTERLY PERIOD ENDED FEBRUARY 28, 2003

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 1-11727

HERITAGE PROPANE PARTNERS, L.P.  
(Exact name of registrant as specified in its charter)

DELAWARE

73-1493906

(state or other jurisdiction or  
incorporation or organization)

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

8801 SOUTH YALE AVENUE, SUITE 310  
TULSA, OKLAHOMA 74137  
(Address of principal  
executive offices and  
zip code)

(918)492-7272

(Registrant's telephone number, including area code)

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

Yes  No

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

Yes  No

At April 11, 2003, the registrant had units outstanding as follows:

Heritage Propane Partners, L.P. 16,367,803 Common Units

EXPLANATORY NOTE

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We are filing this Amendment on Form 10-Q/A in conjunction with the filing of a Registration Statement on Form S-3 (File No. 333-107324). That Registration Statement incorporates our quarterly report on Form 10-Q for the quarterly period ended February 28, 2003, originally filed on April 14, 2003 (the "Original Filing"). This Form 10-Q/A amends and restates in its entirety our quarterly report on Form 10-Q for the quarterly period ended February 29, 2003.

This Amendment makes certain changes in the form of additional or supplemental disclosures as follows:

- Part I--Item 1. Financial Information and Notes to Consolidated Financial Statements, pages 2-16: As described in Note 2 to the Consolidated Financial Statements, we have revised our previously reported Consolidated Statements of Operations for the three months ended February 28, 2003 and 2002 and for the six months ended February 28, 2003 and 2002 and have made corresponding revisions to the Notes to Consolidated Financial Statements to make the presentations required by EITF 02-3. This information was previously shown in the Consolidated Statements of Operations on a gross basis in the separately presented line items of "Revenues-liquids marketing", "Revenues--other" and "Costs and expenses--liquids marketing", and is now presented on a net basis in a single line item as "Liquids marketing, net". The revisions had no effect on previously reported Operating Income or Net Income. In addition, we have provided additional and supplemental information regarding (i) the recording (loss) of the minority interests of all partially owned subsidiaries, (ii) a description of our Costs and Expenses, (iii) quarterly distributions, (iv) Heritage's buying and selling of derivative financial instruments and liquids marketing contracts, and (v) our adoption of EITF 02-3.
- We have revised our previously reported Consolidated Balance Sheet as of February 28, 2003 and the related Consolidated Statements of Operations, Other Comprehensive Income (Loss), Partners' Capital, and Cash Flows for the three and six months ended February 28, 2003 and have made corresponding revisions to the Notes to Consolidated Financial Statements to reflect the adoption of the fair value recognition provisions of Statement of Financial Accounting Standards No. 123 Accounting for Stock-based Compensation (SFAS 123) effective as of September 1, 2002. During the fourth quarter of 2003, Heritage adopted the fair value recognition provisions following the modified prospective method of adoption described in Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure (SFAS 148). Following adoption, deferred compensation expense that is recognized will be the same as that which would have been recognized had the fair value recognition provisions of SFAS 123 been applied to all awards granted under the Restricted Unit Plan and the Long Term Incentive Plan granted after its original effective date. Results from prior years have not been restated. It was our decision to adopt this preferable method of accounting for our stock-based employee compensation plans, as we believe it provides a better measurement of our compensation costs.
- Part I--Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, pages 19-26: We

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have revised to provide additional or supplemental disclosures about results of operations, the terms of our credit agreements and our long-term debt and other contractual obligations, our adoption of EITF 02-3, the recording of the minority interests of all partially owned subsidiaries and Heritage's buying and selling of derivative financial instruments. Additionally, we have retitled "EBITDA" as "EBITDA, as adjusted" and made clarifications regarding how we calculate EBITDA, as adjusted. These revisions did not change how we calculate EBITDA, as adjusted, and it is calculated in the same manner as we have historically presented such information.

- Part I--Item 3. Quantitative and Qualitative Disclosure about Market Risk, pages 28-30: We have provided additional or supplemental disclosures about Heritage's buying and selling of derivative financial instruments and liquids marketing contracts,

This report continues to speak as of the date of the Original Filing, and we have not updated the disclosure in this report to speak as of a later date. All information contained in this report and the Original Filing is subject to updating and supplementing as provided in our periodic reports filed with the Securities and Exchange Commission.

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FORM 10-Q

HERITAGE PROPANE PARTNERS, L.P.

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### PART I - FINANCIAL INFORMATION

#### ITEM 1. FINANCIAL STATEMENTS

##### HERITAGE PROPANE PARTNERS, L.P. AND SUBSIDIARIES

##### CONSOLIDATED BALANCE SHEETS (in thousands, except unit data) (unaudited)

|   | February 28,<br>2003 | August<br>2002 |
|---|----------------------|----------------|
|   | -----                | -----          |
| ASSETS  |                      |                |
| CURRENT ASSETS:   |                      |                |
| Cash and cash equivalents                                       | \$ 8,734             | \$             |
| Marketable securities   | 2,550                |                |
| Accounts receivable, net of allowance for doubtful accounts     | 93,506               | 3              |
| Inventories   | 29,047               | 4              |
| Assets from liquids marketing                                   | 596                  |                |
| Prepaid expenses and other                                      | 5,030                |                |
| Total current assets  | -----<br>139,463     | -----<br>9     |
| PROPERTY, PLANT AND EQUIPMENT, net                              | 430,913              | 40             |
| INVESTMENT IN AFFILIATES  | 9,041                |                |
| GOODWILL, net of amortization prior to adoption of SFAS No. 142 | 156,682              | 15             |
| INTANGIBLES AND OTHER ASSETS, net                               | 55,233               | 5              |
| Total assets  | -----<br>\$ 791,332  | -----<br>\$ 71 |
| LIABILITIES AND PARTNERS' CAPITAL                               |                      |                |
| CURRENT LIABILITIES:  |                      |                |
| Working capital facility  | \$ 19,300            | \$ 3           |
| Accounts payable  | 62,777               | 4              |
| Accounts payable to related companies                           | 6,162                |                |

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|  |            |       |
|--|------------|-------|
| Accrued and other current liabilities  | 20,354     | 2     |
| Liabilities from liquids marketing   | 584        |       |
| Current maturities of long-term debt   | 22,485     | 2     |
|  | -----      | ----- |
| Total current liabilities  | 131,662    | 12    |
| LONG-TERM DEBT, less current maturities  | 434,769    | 42    |
| MINORITY INTERESTS   | 4,176      |       |
|  | -----      | ----- |
| Total liabilities  | 570,607    | 54    |
|  | -----      | ----- |
| COMMITMENTS AND CONTINGENCIES  |            |       |
| PARTNERS' CAPITAL:   |            |       |
| Common Unitholders (16,367,803 and 15,815,847 units issued and outstanding at February 28, 2003 and August 31, 2002, respectively) | 219,431    | 17    |
| Class C Unitholders (1,000,000 units issued and outstanding at February 28, 2003 and August 31, 2002)                              | -          |       |
| General Partner  | 2,049      |       |
| Accumulated other comprehensive loss   | (755)      | (     |
|  | -----      | ----- |
| Total partners' capital  | 220,725    | 17    |
|  | -----      | ----- |
| Total liabilities and partners' capital  | \$ 791,332 | \$ 71 |
|  | =====      | ===== |

The accompanying notes are an integral part of these consolidated financial statements.

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HERITAGE PROPANE PARTNERS, L.P. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS  
(in thousands, except per unit and unit data)  
(unaudited)

|                        | Three Months<br>Ended February 28, |            | Six Months<br>Ended February |       |
|------------------------|------------------------------------|------------|------------------------------|-------|
|                        | 2003                               | 2002       | 2003                         |       |
|                        | -----                              | -----      | -----                        | ----- |
| REVENUES:              |                                    |            |                              |       |
| Retail fuel            | \$ 212,704                         | \$ 152,429 | \$ 296,754                   | \$    |
| Wholesale fuel         | 20,218                             | 14,534     | 31,565                       |       |
| Liquids marketing, net | 352                                | 1,693      | 1,059                        |       |
| Other                  | 16,535                             | 15,346     | 33,891                       |       |
|                        | -----                              | -----      | -----                        | ----- |
| Total revenues         | 249,809                            | 184,002    | 363,269                      |       |
|                        | -----                              | -----      | -----                        | ----- |
| COSTS AND EXPENSES:    |                                    |            |                              |       |
| Cost of products sold  | 128,420                            | 97,143     | 185,440                      |       |
| Operating expenses     | 45,237                             | 34,957     | 78,630                       |       |

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|   |            |            |            |       |
|---|------------|------------|------------|-------|
| Depreciation and amortization               | 9,447      | 9,606      | 18,713     |       |
| Selling, general and administrative         | 4,320      | 3,158      | 7,177      |       |
|   | -----      | -----      | -----      | ----- |
| Total costs and expenses                    | 187,424    | 144,864    | 289,960    |       |
|   | -----      | -----      | -----      | ----- |
| OPERATING INCOME                            | 62,385     | 39,138     | 73,309     |       |
| OTHER INCOME (EXPENSE):                     |            |            |            |       |
| Interest expense                            | (9,317)    | (9,503)    | (18,613)   |       |
| Equity in earnings of affiliates            | 970        | 1,040      | 1,183      |       |
| Gain on disposal of assets                  | 88         | 248        | 155        |       |
| Other                                       | (2,268)    | (94)       | (2,546)    |       |
|   | -----      | -----      | -----      | ----- |
| INCOME BEFORE MINORITY                      |            |            |            |       |
| INTERESTS AND INCOME TAXES                  | 51,858     | 30,829     | 53,488     |       |
| Minority interests                          | (821)      | (699)      | (947)      |       |
|   | -----      | -----      | -----      | ----- |
| INCOME BEFORE TAXES                         | 51,037     | 30,130     | 52,541     |       |
| Income taxes                                | 1,285      | -          | 1,285      |       |
|   | -----      | -----      | -----      | ----- |
| NET INCOME                                  | 49,752     | 30,130     | 51,256     |       |
| GENERAL PARTNER'S INTEREST IN NET INCOME    | 723        | 518        | 956        |       |
|   | -----      | -----      | -----      | ----- |
| LIMITED PARTNERS' INTEREST IN NET INCOME    | \$ 49,029  | \$ 29,612  | \$ 50,300  | \$    |
|   | =====      | =====      | =====      | ===== |
| BASIC NET INCOME PER LIMITED PARTNER UNIT   | \$ 3.03    | \$ 1.89    | \$ 3.15    | \$    |
|   | =====      | =====      | =====      | ===== |
| BASIC AVERAGE NUMBER OF UNITS OUTSTANDING   | 16,165,602 | 15,689,376 | 15,990,010 | 1     |
|   | =====      | =====      | =====      | ===== |
| DILUTED NET INCOME PER LIMITED PARTNER UNIT | \$ 3.03    | \$ 1.88    | \$ 3.14    | \$    |
|   | =====      | =====      | =====      | ===== |
| DILUTED AVERAGE NUMBER OF UNITS OUTSTANDING | 16,207,002 | 15,731,276 | 16,026,860 | 1     |
|   | =====      | =====      | =====      | ===== |

The accompanying notes are an integral part of these consolidated financial statements.

HERITAGE PROPANE PARTNERS, L.P. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(in thousands, unaudited)

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|  | Three Months Ended<br>February 28, |            | Six Months Ended<br>February 28, |            |
|--|------------------------------------|------------|----------------------------------|------------|
|  | 2003                               | 2002       | 2003                             | 2002       |
| Net income   | \$ 49,752                          | \$ 30,130  | \$ 51,256                        | \$ 25,130  |
| Other comprehensive income   |                                    |            |                                  |            |
| Reclassification adjustment for losses or<br>(gains) on derivative instruments included<br>in net income | (427)                              | 203        | (427)                            | (203)      |
| Reclassification adjustment for losses on<br>available-for-sale securities included in<br>net income     | 2,376                              | -          | 2,376                            | -          |
| Change in value of derivative instruments  | 957                                | -          | 957                              | -          |
| Change in value of available-for-sale<br>securities  | (9)                                | (991)      | (9)                              | (991)      |
| Comprehensive income   | \$ 52,649                          | \$ 29,342  | \$ 54,153                        | \$ 22,136  |
| RECONCILIATION OF ACCUMULATED OTHER COMPREHENSIVE LOSS   |                                    |            |                                  |            |
| Balance, beginning of period   | \$ (3,652)                         | \$ (7,329) | \$ (3,652)                       | \$ (6,657) |
| Current period reclassification to<br>earnings   | 1,949                              | 4,267      | 1,949                            | 5,134      |
| Current period change  | 948                                | (788)      | 948                              | (3,134)    |
| Balance, end of period   | \$ (755)                           | \$ (3,850) | \$ (755)                         | \$ (3,134) |

The accompanying notes are an integral part of these consolidated financial statements.

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HERITAGE PROPANE PARTNERS, L.P. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF PARTNERS' CAPITAL  
(in thousands, except unit data)  
(unaudited)

|                             | Number of Units |           |            |         | General<br>Partner |
|-----------------------------|-----------------|-----------|------------|---------|--------------------|
|                             | Common          | Class C   | Common     | Class C |                    |
| BALANCE, AUGUST 31, 2002    | 15,815,847      | 1,000,000 | \$ 173,677 | \$ -    | \$ 1,585           |
| Unit distribution           | -               | -         | (20,166)   | -       | (644)              |
| Conversion of phantom units | 500             | -         | -          | -       | -                  |

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|  |            |           |            |       |          |
|--|------------|-----------|------------|-------|----------|
| Issuance of Common Units in connection<br>with certain acquisitions                    | 551,456    | -         | 15,000     | -     | 152      |
| Other  | -          | -         | 620        | -     | -        |
| Net change in accumulated other<br>comprehensive income per<br>accompanying statements | -          | -         | -          | -     | -        |
| Net income   | -          | -         | 50,300     | -     | 956      |
|  | -----      | -----     | -----      | ----- | -----    |
| BALANCE, FEBRUARY 28, 2003   | 16,367,803 | 1,000,000 | \$ 219,431 | \$ -  | \$ 2,049 |
|  | =====      | =====     | =====      | ===== | =====    |

The accompanying notes are an integral part of these consolidated financial statements.

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### HERITAGE PROPANE PARTNERS, L.P. AND SUBSIDIARIES

#### CONSOLIDATED STATEMENTS OF CASH FLOWS (in thousands) (unaudited)

|   | Six Months Ended<br>February 28, |          |
|---|----------------------------------|----------|
|   | 2003                             | 2002     |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                  |                                  |          |
| Net income  | \$ 51,256                        | \$ 25,35 |
| Reconciliation of net income to net cash provided by<br>operating activities- |                                  |          |
| Depreciation and amortization   | 18,713                           | 18,66    |
| Provision for loss on accounts receivable                                     | 1,511                            | 52       |
| Loss on write down of marketable securities                                   | 2,400                            |          |
| Gain on disposal of assets  | (155)                            | (71      |
| Deferred compensation on restricted units and long-term<br>incentive plan     | 620                              | 97       |
| Undistributed earnings of affiliates  | (1,183)                          | (1,16    |
| Minority interests  | 582                              | 16       |
| Changes in assets and liabilities, net of effect of acquisitions:             |                                  |          |
| Accounts receivable   | (60,298)                         | (31,50   |
| Inventories   | 21,045                           | 14,13    |
| Assets from liquids marketing   | 1,705                            | 6,25     |
| Prepaid and other expenses  | 1,863                            | 8,80     |
| Intangibles and other assets  | (41)                             | (46      |
| Accounts payable  | 21,704                           | 1,09     |
| Accounts payable to related companies   | 1,160                            | (2,34    |
| Accrued and other current liabilities   | (4,654)                          | (9,51    |
| Liabilities from liquids marketing  | (1,234)                          | (6,40    |
|   | -----                            | -----    |
| Net cash provided by operating activities                                     | 54,994                           | 23,84    |
|   | -----                            | -----    |



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|  |           |          |
|--|-----------|----------|
| CASH FLOWS FROM INVESTING ACTIVITIES:                            |           |          |
| Cash paid for acquisitions, net of cash acquired                 | (21,170)  | (14,47   |
| Capital expenditures   | (16,510)  | (16,37   |
| Proceeds from the sale of assets                                 | 2,078     | 1,36     |
| Deposit on the subsequent sale of assets                         | -         | 9,73     |
| Other  | -         | 24       |
|  | -----     | -----    |
| Net cash used in investing activities                            | (35,602)  | (19,50   |
|  | -----     | -----    |
| CASH FLOWS FROM FINANCING ACTIVITIES:                            |           |          |
| Proceeds from borrowings   | 107,650   | 103,61   |
| Principal payments on debt                                       | (102,247) | (84,60   |
| Unit distributions   | (20,810)  | (20,35   |
| Other  | 153       | (5       |
|  | -----     | -----    |
| Net cash used in financing activities                            | (15,254)  | (1,39    |
|  | -----     | -----    |
| INCREASE IN CASH AND CASH EQUIVALENTS                            |           |          |
|  | 4,138     | 2,94     |
| CASH AND CASH EQUIVALENTS, beginning of period                   |           |          |
|  | 4,596     | 5,62     |
|  | -----     | -----    |
| CASH AND CASH EQUIVALENTS, end of period                         |           |          |
|  | \$ 8,734  | \$ 8,56  |
|  | =====     | =====    |
| NONCASH FINANCING ACTIVITIES:                                    |           |          |
| Notes payable incurred on noncompete agreements                  | \$ 772    | \$ 2,12  |
|  | =====     | =====    |
| Issuance of Common Units in connection with certain acquisitions | \$ 15,000 | \$       |
|  | =====     | =====    |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:                |           |          |
| Cash paid during the period for interest                         | \$ 18,302 | \$ 18,81 |
|  | =====     | =====    |

The accompanying notes are an integral part of these financial statements

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### HERITAGE PROPANE PARTNERS, L.P. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands, except unit and per unit data)  
(unaudited)

#### 1. OPERATIONS AND ORGANIZATION:

The accompanying financial statements should be read in conjunction with the consolidated financial statements of Heritage Propane Partners, L.P. and subsidiaries (the "Partnership") as of August 31, 2002, and the notes thereto included in the Partnership's consolidated financial statements included in Form 10-K as filed with the Securities and Exchange Commission on November 27, 2002. The accompanying financial statements include only normal recurring accruals and all adjustments that the Partnership considers necessary for a fair presentation. Due to the seasonal nature of the Partnership's business, the results of operations for interim periods are not necessarily indicative of the

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results to be expected for a full year.

In order to simplify the Partnership's obligations under the laws of several jurisdictions in which it conducts business, the Partnership's activities are conducted through a subsidiary operating partnership, Heritage Operating, L.P. (the "Operating Partnership"). The Partnership and the Operating Partnership are collectively referred to in this report as "Heritage." Heritage sells propane and propane-related products to more than 650,000 active residential, commercial, industrial, and agricultural customers in 29 states. Heritage is also a wholesale propane supplier in the United States and in Canada, the latter through participation in MP Energy Partnership. MP Energy Partnership is a Canadian partnership, in which Heritage owns a 60% interest, engaged in lower-margin wholesale distribution and in supplying Heritage's northern U.S. locations. Heritage buys and sells financial instruments for its own account through its wholly owned subsidiary, Heritage Energy Resources, L.L.C. ("Resources").

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND BALANCE SHEET DETAIL:

#### PRINCIPLES OF CONSOLIDATION

The consolidated financial statements of the Partnership include the accounts of its subsidiaries, including the Operating Partnership, MP Energy Partnership, Heritage Service Corp., Guilford Gas Service, Inc., and Resources. A minority interest liability and minority interest expense is recorded for all partially owned subsidiaries. Heritage accounts for its 50% partnership interest in Bi-State Propane, a propane retailer in the states of Nevada and California, under the equity method. All significant intercompany transactions and accounts have been eliminated in consolidation. For purposes of maintaining partner capital accounts, the Partnership Agreement of Heritage Propane Partners, L.P. (the "Partnership Agreement") specifies that items of income and loss shall be allocated among the partners in accordance with their percentage interests. Normal allocations according to percentage interests are made, however, only after giving effect to any priority income allocations in an amount equal to the incentive distributions that are allocated 100% to the General Partner. For the three months and six months ended February 28, 2003, the 1.0101% general partner interest in the Operating Partnership held by the General Partner, U.S. Propane, L.P. ("U.S. Propane"), was accounted for in the consolidated financial statements as a minority interest. On February 4, 2002, at a special meeting of the Partnership's Common Unitholders, the Common Unitholders approved the substitution of U.S. Propane as the successor General Partner of the Partnership and the Operating Partnership, replacing Heritage Holdings, Inc. ("Heritage Holdings"). For the three months and the six months ended February 28, 2002, the 1.0101% general partner interest of the former General Partner, Heritage Holdings, and U.S. Propane's 1.0101% limited partner interest in the Operating Partnership were accounted for in the consolidated financial statements as minority interests.

#### REVENUE RECOGNITION

Sales of propane, propane appliances, parts, and fittings are recognized at the later of the time of delivery of the product to the customer or the time of sale or installation. Revenue from service labor is recognized upon completion of the service and tank rent is recognized ratably over the period it is earned. The Partnership does not separately charge shipping and handling costs to customers.

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#### COSTS AND EXPENSES

Costs of products sold include actual cost of fuel sold adjusted for the effects

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of qualifying cash flow hedges, storage fees and inbound freight, and the cost of appliances, parts, and fittings. Operating expenses include all costs incurred to provide products to customers, including compensation for operations personnel, insurance costs, vehicle maintenance, advertising costs, shipping and handling costs, purchasing costs, and plant operations. Selling, general and administrative expenses include all corporate expenses and compensation for corporate personnel.

### ACCOUNTS RECEIVABLE

Heritage grants credit to its customers for the purchase of propane and propane-related products. Included in accounts receivable are trade accounts receivable arising from the Partnership's retail and wholesale propane operations and receivables arising from Resources' liquids marketing activities. Accounts receivable are recorded as amounts billed to customers less an allowance for doubtful accounts. The allowance for doubtful accounts is based on management's assessment of the realizability of customer accounts. Management's assessment is based on the overall creditworthiness of the Partnership's customers and any specific disputes. Receivables related to liquids marketing activities are \$9,863 and \$4,332 as of February 28, 2003 and August 31, 2002, respectively. Accounts receivable consisted of the following:

|  | February 28,<br>2003 | August 31,<br>2002 |
|--|----------------------|--------------------|
|  | -----                | -----              |
| Accounts receivable                    | \$ 97,010            | \$ 33,402          |
| Less - allowance for doubtful accounts | 3,504                | 2,504              |
|  | -----                | -----              |
| Total, net                             | \$ 93,506            | \$ 30,898          |
|  | =====                | =====              |

The activity in the allowance for doubtful accounts consisted of the following:

|  | For the Six Months Ended |                      |
|--|--------------------------|----------------------|
|  | February 28,<br>2003     | February 28,<br>2002 |
|  | -----                    | -----                |
| Balance, beginning of the period                   | \$ 2,504                 | \$ 3,576             |
| Provision for loss on accounts receivable          | 1,511                    | 523                  |
| Accounts receivable written off, net of recoveries | (511)                    | (504)                |
|  | -----                    | -----                |
| Balance, end of period                             | \$ 3,504                 | \$ 3,595             |
|  | =====                    | =====                |

### INVENTORIES

Inventories are valued at the lower of cost or market. The cost of fuel inventories is determined using weighted-average cost of fuel delivered to the customer service locations, and includes storage fees and inbound freight costs, while the cost of appliances, parts, and fittings is determined by the first-in, first-out method. Inventories consisted of the following:

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|                                | February 28,<br>2003 | August 31,<br>2002 |
|--------------------------------|----------------------|--------------------|
|                                | -----                | -----              |
| Fuel                           | \$ 18,621            | \$ 38,523          |
| Appliances, parts and fittings | 10,426               | 9,664              |
|                                | -----                | -----              |
| Total inventories              | \$ 29,047            | \$ 48,187          |
|                                | =====                | =====              |

INCOME TAXES

Heritage is a limited partnership. As a result, Heritage's earnings or losses for federal and state income tax purposes are included in the tax returns of the individual partners. Accordingly, no recognition has been given to income taxes in the accompanying financial statements of Heritage except those anticipated to be incurred by corporate subsidiaries of Heritage that are subject to income taxes. Net earnings for financial statement purposes may differ significantly from taxable income reportable to unitholders as a result of differences between the tax basis and

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financial reporting basis of assets and liabilities and the taxable income allocation requirements under the Partnership Agreement.

INCOME PER LIMITED PARTNER UNIT

Basic net income per limited partner unit is computed by dividing net income, after considering the General Partner's interest, by the weighted average number of Common Units outstanding. Diluted net income per limited partner unit is computed by dividing net income, after considering the General Partner's interest, by the weighted average number of Common Units outstanding and the weighted average number of restricted units ("Phantom Units") granted under the Restricted Unit Plan. A reconciliation of net income and weighted average units used in computing basic and diluted net income per unit is as follows:

|  | Three Months Ended<br>February 28, |            | Six Months Ended<br>February 28, |            |
|--|------------------------------------|------------|----------------------------------|------------|
|  | -----                              | -----      | -----                            | -----      |
|  | 2003                               | 2002       | 2003                             | 2002       |
|  | -----                              | -----      | -----                            | -----      |
| BASIC NET INCOME PER LIMITED PARTNER UNIT:   |                                    |            |                                  |            |
| Limited Partners' interest in net income     | \$ 49,029                          | \$ 29,612  | \$ 50,300                        | \$ 29,612  |
|  | =====                              | =====      | =====                            | =====      |
| Weighted average limited partner units       | 16,165,602                         | 15,689,376 | 15,990,010                       | 15,689,376 |
|  | =====                              | =====      | =====                            | =====      |
| Basic net income per limited partner unit    | \$ 3.03                            | \$ 1.89    | \$ 3.15                          | \$ 1.89    |
|  | =====                              | =====      | =====                            | =====      |
| DILUTED NET INCOME PER LIMITED PARTNER UNIT: |                                    |            |                                  |            |
| Limited partners' interest in net income     | \$ 49,029                          | \$ 29,612  | \$ 50,300                        | \$ 29,612  |
|  | =====                              | =====      | =====                            | =====      |

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|  |            |            |            |       |
|--|------------|------------|------------|-------|
| Weighted average limited partner units   | 16,165,602 | 15,689,376 | 15,990,010 | 15,   |
| Dilutive effect of phantom units   | 41,400     | 41,900     | 36,850     |       |
|  | -----      | -----      | -----      | ----  |
| Weighted average limited partner units, assuming<br>dilutive effect of phantom units | 16,207,002 | 15,731,276 | 16,026,860 | 15,   |
|  | =====      | =====      | =====      | ===== |
| Diluted net income per limited partner unit  | \$ 3.03    | \$ 1.88    | \$ 3.14    | \$    |
|  | =====      | =====      | =====      | ===== |

QUARTERLY DISTRIBUTIONS OF AVAILABLE CASH

The Partnership Agreement requires that the Partnership will distribute all of its Available Cash to its Unitholders and its General Partner within 45 days following the end of each fiscal quarter, subject to the payment of incentive distributions to the holders of Incentive Distribution Rights to the extent that certain target levels of cash distributions are achieved. The term Available Cash generally means, with respect to any fiscal quarter of the Partnership, all cash on hand at the end of such quarter, plus working capital borrowings after the end of the quarter, less reserves established by the General Partner in its sole discretion to provide for the proper conduct of the Partnership's business, to comply with applicable laws or any debt instrument or other agreement, or to provide funds for future distributions to partners with respect to any one or more of the next four quarters. Available Cash is more fully defined in the Partnership Agreement.

Prior to the Special Meeting on February 4, 2002, distributions by the Partnership in an amount equal to 100% of Available Cash were made 97% to the Common Unitholders, 1.0101% to U.S. Propane for its limited partner interest in the Operating Partnership, and 1.9899% to the former General Partner, Heritage Holdings. After the approval by the Common Unitholders of the substitution of U.S. Propane as the General Partner, distributions by the Partnership in an amount equal to 100% of Available Cash will generally be made 98% to the Common Unitholders and 2% to the General Partner, subject to the payment of incentive distributions to the holders of Incentive Distribution Rights to the extent that certain target levels of cash distributions are achieved.

On October 15, 2002, a quarterly distribution of \$0.6375 per unit, or \$2.55 per unit annually, was paid to Unitholders of record at the close of business on October 8, 2002. On January 14, 2003, a quarterly distribution of \$0.6375 per unit, or \$2.55 per unit annually, was paid to Unitholders of record at the close of business on December 30, 2002. On March 24, 2003, the Partnership declared a cash distribution for the second quarter ended February 28, 2003 of \$0.6375 per unit, or \$2.55 per unit annually, payable on April 14, 2003 to Unitholders of record at the close of business on April 4, 2003. In addition to these quarterly distributions, the General Partner received quarterly distributions for its general partner interest in the Partnership, its minority interest, and incentive

distributions to the extent the quarterly distribution exceeded \$0.55 per unit. The total amount of distributions for the second quarter ended February 28, 2003 on Common Units, the general partner interests and the Incentive Distribution Rights totaled \$10.4 million, \$0.2 million and \$0.2 million, respectively. The total amount of distributions for the six months ended February 28, 2003 on Common Units, the general partner interests and the Incentive Distribution Rights totaled \$20.5 million, \$0.4 million and \$0.4 million, respectively. All such distributions were made from Available Cash from Operating Surplus.

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### STOCK BASED COMPENSATION PLANS

During the fourth quarter of 2003, Heritage adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123 Accounting for Stock-based Compensation (SFAS 123) effective as of September 1, 2002. Heritage adopted the fair value recognition provisions following the modified prospective method of adoption described in Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure (SFAS 148). Following adoption, deferred compensation expense that is recognized in the financial statements will be the same as that which would have been recognized had the fair value recognition provisions of SFAS 123 been applied to all awards under the Restricted Unit Plan and the Long Term Incentive Plan granted after October 1, 1995.

### RESTRICTED UNIT PLAN

The General Partner has adopted the Amended and Restated Restricted Unit Plan dated August 10, 2000, amended February 4, 2002 as the Second Amended and Restated Restricted Unit Plan (the "Restricted Unit Plan"), for certain directors and key employees of the General Partner and its affiliates. The Restricted Unit Plan covers rights to acquire 146,000 Common Units. The right to acquire the Common Units under the Restricted Unit Plan, including any forfeiture or lapse of rights is available for grant to key employees on such terms and conditions (including vesting conditions) as the Compensation Committee of the General Partner shall determine. Each director shall automatically receive a Director's grant with respect to 500 Common Units on each September 1 that such person continues as a director. Newly elected directors are also entitled to receive a grant with respect to 2,000 Common Units upon election or appointment to the Board. Directors who are employees of U.S. Propane, TECO, Atmos Energy, Piedmont Natural Gas or AGL Resources or their affiliates are not entitled to receive a Director's grant of Common Units. Generally, the rights to acquire the Common Units will vest upon the later to occur of (i) the three-year anniversary of the grant date, or on such terms as the Compensation Committee may establish, which may include the achievement of performance objectives. In the event of a "change of control" (as defined in the Restricted Unit Plan), all rights to acquire Common Units pursuant to the Restricted Unit Plan will immediately vest.

The issuance of the Common Units pursuant to the Restricted Unit Plan is intended to serve as a means of incentive compensation for performance and not primarily as an opportunity to participate in the equity appreciation in respect of the Common Units. Therefore, no consideration will be payable by the plan participants upon vesting and issuance of the Common Units. As of November 30, 2002, 41,400 restricted units were outstanding and 15,800 were available for grants to non-employee directors and key employees.

Deferred compensation expense of \$81 and \$162 was recognized for the three and six months ended February 28, 2003, respectively. For the six months ended February 28, 2002, Heritage followed the disclosure only provisions of SFAS 123 as amended by SFAS 148 and APB Opinion No. 25 Accounting for Stock Issued to Employees (APB 25) for the six months ended February 28, 2002. Under APB 25, the Restricted Unit Plan was classified as a variable plan so that an estimate of compensation was required based on a combination of the fair market value of the Common Units as of the end of the reporting period and an assessment of meeting certain performance criteria. Deferred compensation expense of \$98 and \$196 was recognized for the three and six months ended February 28, 2002, respectively based on the fair value of such units at the end of each period.

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### LONG-TERM INCENTIVE PLAN

Effective September 1, 2000, Heritage adopted a long-term incentive plan whereby Common Units will be awarded based on achieving certain targeted levels of Distributed Cash (as defined in the Long Term Incentive Plan) per unit. Awards under the program will be made starting in 2003 based upon the average of the prior three years' Distributed Cash per unit. A minimum of 250,000 Common Units and if certain targeted levels are achieved, a maximum of 500,000 Common Units will be awarded.

Deferred compensation expense on this plan of \$229 and \$458 was recognized for the three and six months ended February 28, 2003, respectively. For the six months ended February 28, 2002, Heritage followed the disclosure only provisions of SFAS 123, as amended by SFAS 148, and APB 25. Under APB 25, the Long Term Incentive Plan was classified as a variable plan so that an estimate of compensation was required based on a combination of the fair market value of the Common Units as of the end of the reporting period and an assessment of meeting certain performance criteria. Deferred compensation expense of \$389 and \$778 was recognized for the three and six months ended February 28, 2002, respectively based on the fair value of such units at the end of each period. The expense was determined based on the Partnership achieving the minimum award available under the plan.

SFAS 123 requires that significant assumptions be used during the year to estimate the fair value, which includes the risk-free interest rate used, the expected life of the grants under each of the plans, the expected volatility, and the expected distributions on each of the grants. Heritage assumed a weighted average risk free interest rate of 5.72% for the three and six months ended February 28, 2003 and 5.90% for the three and six months ended February 28, 2002 in estimating the present value of the future cash flows of the distributions during the vesting period on the measurement date of each grant. Annual average cash distributions at the grant date were estimated to be \$2.39 for the three and six months ended February 28, 2003, and \$2.37 for the three and six months ended February 28, 2002. The expected life of each grant is assumed to be the minimum vesting period under certain performance criteria of each grant. The following table illustrates the effect on limited partners' interest in net income and the basic and diluted net income per limited partner unit if Heritage had applied the fair value recognition provisions of SFAS 123 to the Restricted Unit Plan and the Long-Term Incentive Plan for all periods presented.

|   | Three Months<br>Ended February 28, |            | S<br>Ende<br>2003 |
|---|------------------------------------|------------|-------------------|
|   | 2003                               | 2002       |                   |
| <b>BASIC NET INCOME PER LIMITED PARTNER UNIT:</b>                                       |                                    |            |                   |
| Limited Partners' interest in net income  | \$ 49,029                          | \$ 29,612  | \$ 50,            |
| Add: Deferred compensation expense included in limited partners' interest in net income | 303                                | 477        |                   |
| Deduct: Deferred compensation expense determined under the fair value based method      | (303)                              | (293)      | (                 |
|   | -----                              | -----      | -----             |
| Pro forma limited partners' interest in net income                                      | \$ 49,029                          | \$ 29,796  | \$ 50,            |
|   | =====                              | =====      | =====             |
| Weighted average limited partner units  | 16,165,602                         | 15,689,376 | 15,990,           |
|   | =====                              | =====      | =====             |

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|   |            |            |            |
|---|------------|------------|------------|
| Basic net income per limited partner unit as reported                             | \$ 3.03    | \$ 1.89    | \$ 3.03    |
| Basic net income per limited partner unit pro forma                               | \$ 3.03    | \$ 1.90    | \$ 3.03    |
| Weighted average limited partner units, assuming dilutive effect of phantom units | 16,207,002 | 15,731,276 | 16,026,000 |
| Diluted net income per limited partner unit as reported                           | \$ 3.03    | \$ 1.88    | \$ 3.03    |
| Diluted net income per limited partner unit pro forma                             | \$ 3.03    | \$ 1.89    | \$ 3.03    |

As stated above, during the fourth quarter of 2003, Heritage adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123 Accounting for Stock-based Compensation (SFAS 123) effective as of September 1, 2002. Accordingly, the following information compares the originally reported consolidated statement of operations, reclassified for the adoption of EITF 02-3 for the three and six months ended February 28, 2003 and as adjusted for the adoption of SFAS 123:

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|                                     | Three Months<br>Ended February 28, 2003 |  | En                |
|-------------------------------------|---|--|-------------------|
|                                     | As originally reported                  | As adjusted for the adoption of SFAS 123 | As origi<br>repor |
| <b>REVENUES:</b>                    |   |  |                   |
| Retail fuel                         | \$ 212,704                              | \$ 212,704                               | \$                |
| Wholesale fuel                      | 20,218                                  | 20,218                                   |                   |
| Liquids marketing, net              | 352                                     | 352                                      |                   |
| Other                               | 16,535                                  | 16,535                                   |                   |
| Total revenues                      | 249,809                                 | 249,809                                  |                   |
| <b>COSTS AND EXPENSES:</b>          |   |  |                   |
| Cost of products sold               | 128,420                                 | 128,420                                  |                   |
| Operating expenses                  | 45,270                                  | 45,237                                   |                   |
| Depreciation and amortization       | 9,447                                   | 9,447                                    |                   |
| Selling, general and administrative | 4,656                                   | 4,320                                    |                   |
| Total costs and expenses            | 187,793                                 | 187,424                                  |                   |
| OPERATING INCOME                    | 62,016                                  | 62,385                                   |                   |
| <b>OTHER INCOME (EXPENSE):</b>      |   |  |                   |
| Interest expense                    | (9,317)                                 | (9,317)                                  |                   |
| Equity in earnings of affiliates    | 970                                     | 970                                      |                   |
| Gain on disposal of assets          | 88                                      | 88                                       |                   |
| Other                               | (2,268)                                 | (2,268)                                  |                   |



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|   |            |            |    |
|---|------------|------------|----|
| INCOME BEFORE MINORITY INTERESTS AND INCOME TAXES | 51,489     | 51,858     |    |
| Minority interests                                | (817)      | (821)      |    |
| INCOME BEFORE TAXES                               | 50,672     | 51,037     |    |
| Income taxes                                      | 1,285      | 1,285      |    |
| NET INCOME  | 49,387     | 49,752     |    |
| GENERAL PARTNER'S INTEREST IN NET INCOME          | 719        | 723        |    |
| LIMITED PARTNERS' INTEREST IN NET INCOME          | \$ 48,668  | \$ 49,029  | \$ |
| BASIC NET INCOME PER LIMITED PARTNER UNIT         | \$ 3.01    | \$ 3.03    | \$ |
| BASIC AVERAGE NUMBER OF UNITS OUTSTANDING         | 16,165,602 | 16,165,602 | 15 |
| DILUTED NET INCOME PER LIMITED PARTNER UNIT       | \$ 3.00    | \$ 3.03    | \$ |
| DILUTED AVERAGE NUMBER OF UNITS OUTSTANDING       | 16,207,002 | 16,207,002 | 16 |

ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

Heritage applies Financial Accounting Standards Board ("FASB") Statement No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133). SFAS 133 requires that all derivatives be recognized in the balance sheet as either an asset or liability measured at fair value. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the statement of operations.

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Heritage was the holder of certain call options at February 28, 2003 that have been designated as cash flow hedging instruments in accordance with SFAS 133. The call options give Heritage the right, but not the obligation, to buy a specified number of gallons of propane at a specified price at any time until a specified expiration date. Heritage entered into these options to hedge pricing on the forecasted propane volumes to be purchased during each of the one-month periods ending February 2003 through March 2003. Heritage utilizes hedging transactions to provide price protection against significant fluctuations in propane prices. These call options had a fair value of \$572 as of February 28, 2003, which was recorded in accounts receivable on the balance sheet through other comprehensive income net of minority interest liability. There were no ineffective hedges or discontinued hedges as of February 28, 2003.

MARKETABLE SECURITIES

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Heritage's marketable securities are classified as available-for-sale securities and are reflected as a current asset on the consolidated balance sheet at their fair value. During the three months ended February 28, 2003, Heritage determined there was a non-temporary decline in the market value of its available-for-sale securities, and reclassified into earnings a loss of \$2,376, net of minority interest, which is recorded in other expense. Unrealized holding losses of \$9 for the three and six months ended February 28, 2003, and \$991 and \$615 for the three and six months ended February 28, 2002, respectively, were recorded through accumulated other comprehensive loss based on the market value of the securities.

### RECENTLY ISSUED ACCOUNTING STANDARDS

In June 2001, the FASB issued Statement No. 143, Accounting for Asset Retirement Obligations (SFAS 143). SFAS 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This statement requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. Heritage adopted the provisions of SFAS 143 on September 1, 2002. The adoption of SFAS 143 did not have a material impact on the Partnership's consolidated financial position or results of operations.

In August 2001, the FASB issued Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144). SFAS 144 supersedes FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of (SFAS 121), and the accounting and reporting provisions of APB Opinion No. 30, Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions. SFAS 144 retains the fundamental provisions of SFAS 121 for recognition and measurement of the impairment of long-lived assets to be held and used, and measurement of long-lived assets to be disposed of by sale. Heritage adopted the provisions of SFAS 144 on September 1, 2002. The adoption of SFAS 144 did not have a material impact on the Partnership's consolidated financial position or results of operations.

In April 2002, the FASB issued Statement No. 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections (SFAS 145). SFAS 145 rescinds FASB Statement No. 4, Reporting Gains and Losses from Extinguishment of Debt, and an amendment of that Statement, FASB Statement No. 64, Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements. SFAS 145 also rescinds FASB Statement No. 44, Accounting for Intangible Assets of Motor Carriers, amends FASB Statement No. 13, Accounting for Leases, to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions and also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. Heritage adopted the provisions of SFAS 145 on September 1, 2002. The adoption did not have a material impact on the Partnership's consolidated financial position or results of operations.

In June 2002, the FASB issued Statement No. 146, Accounting for Costs Associated with Exit or Disposal Activities (SFAS 146). SFAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and requires that a liability for a cost associated with an exit or disposal activity be recognized and measured initially at fair value only when the liability is incurred. Heritage adopted the provisions of SFAS 146 effective for exit or disposal activities that are initiated after December 31, 2002. The adoption did not have a material impact on the Partnership's consolidated

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financial position or results of operations.

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In October 2002, the EITF of the FASB discussed EITF Issue No. 02-3, Issues Related to Accounting for Contracts Involved in Energy Trading and Risk Management Activities (EITF 02-3). The EITF reached a consensus to rescind EITF Issue No. 98-10, Accounting for Contracts Involved in Energy Trading and Risk Management Activities (EITF 98-10), the impact of which is to preclude mark-to-market accounting for energy trading contracts not within the scope of SFAS 133. The EITF also reached a consensus that gains and losses on derivative instruments within the scope of SFAS 133 should be shown net in the statement of operations if the derivative instruments are held for trading purposes and what the disclosure requirements should be. This consensus was effective for financial statements issued for periods ending after July 15, 2002. Heritage adopted EITF 02-3 as of August 31, 2002, and upon application reclassified comparative financial statements for prior periods to conform to the consensus. This adoption did not have a material impact on Heritage's financial position or results of operations. The consensus regarding the rescission of EITF 98-10 is applicable for fiscal periods beginning after December 15, 2002. Energy trading contracts not within the scope of SFAS 133 purchased after October 25, 2002, but prior to the implementation of the consensus are not permitted to apply mark-to-market accounting. The adoption of EITF 02-3 as it relates to the rescission of EITF 98-10 is not expected to have a material impact on Heritage's financial position or results of operations.

The adoption of EITF 02-3 requires that realized and unrealized gains and losses be shown net for all periods presented. The following table summarizes the amounts that have been reclassified in the statement of operations:

|   | For the Three Months<br>Ended February 28,<br>2003 |           | For the Six Months Ended<br>February 28,<br>2003 |            |
|---|--|-----------|--|------------|
|   | 2002   | 2002      | 2002   | 2002       |
| Revenue - liquids marketing               | \$ 79,587  | \$ 47,326 | \$ 140,317                                       | \$ 98,146  |
| Costs and expenses - liquids<br>marketing | (79,235)   | (45,633)  | (139,258)  | (99,778)   |
| Net, as reclassified                      | \$ 352   | \$ 1,693  | \$ 1,059   | \$ (1,632) |

In November 2002, the FASB issued Financial Interpretation No. 45 "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN 45). FIN 45 expands the existing disclosure requirements for guarantees and requires that companies recognize a liability for guarantees issued after December 31, 2002. The implementation of FIN 45 is not expected to have a significant impact on Heritage's financial position or results of operations.

#### RECENTLY ISSUED ACCOUNTING STANDARDS NOT YET ADOPTED

In April 2003, the FASB issued Statement No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities (SFAS 149). SFAS 149 amends and clarifies financial accounting and reporting for derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under SFAS 133. SFAS 149 is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after

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June 30, 2003. Management does not believe that the adoption will have a material impact on the Partnership's consolidated financial position or results of operations.

In May 2003, the FASB issued Statement No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (SFAS 150). SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within the scope of SFAS 150 as a liability (or an asset in some circumstances). This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. Management does not believe that the adoption will have a material impact on the Partnership's consolidated financial position or results of operations.

### PROFORMA RESULTS

On January 2, 2003, Heritage purchased the propane assets of V-1 Oil Co. ("V-1") of Idaho Falls, Idaho for total consideration of \$34.2 million after post-closing adjustments. The acquisition price was payable \$19.2 million in cash, with \$17.3 million financed by the Acquisition Facility, and by the issuance of 551,456 Common Units of Heritage valued at \$15.0 million. V-1's propane distribution network included 35 customer service locations in Colorado, Idaho, Montana, Oregon, Utah, Washington, and Wyoming. The results of operations of V-1 from

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January 2, 2003 to February 28, 2003 are included in the consolidated statement of operations of Heritage for the three and six months ended February 28, 2003.

The following unaudited pro forma consolidated results of operations are presented as if the acquisition of V-1 had been made at the beginning of the periods presented:

|   | Three months ended<br>February 28, |            | Six months ended<br>February 28, |            |
|---|------------------------------------|------------|----------------------------------|------------|
|   | 2003                               | 2002       | 2003                             | 2002       |
| Total revenues                              | \$ 253,403                         | \$ 196,474 | \$ 374,483                       | \$ 311,483 |
| Limited partners' interest in net income    | \$ 49,661                          | \$ 31,141  | \$ 51,896                        | \$ 28,141  |
| Basic net income per limited partner unit   | \$ 3.07                            | \$ 1.92    | \$ 3.25                          | \$ 2.00    |
| Diluted net income per limited partner unit | \$ 3.06                            | \$ 1.91    | \$ 3.24                          | \$ 1.99    |

The pro forma consolidated results of operations include adjustments to give effect to depreciation on the step-up of property, plant and equipment, amortization of customer lists, interest expense on acquisition debt, and certain other adjustments. The unaudited pro forma information is not necessarily indicative of the results of operations that would have occurred had the transactions been made at the beginning of the periods presented or the future results of the combined operations.

### 3. WORKING CAPITAL FACILITY AND LONG-TERM DEBT:

Effective July 16, 2001, the Operating Partnership entered into the Fifth

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Amendment to the First Amended and Restated Credit Agreement. The terms of the Agreement as amended are as follows:

A \$65,000 Senior Revolving Working Capital Facility is available through June 30, 2004. The interest rate and interest payment dates vary depending on the terms Heritage agrees to when the money is borrowed. Heritage must be free of all working capital borrowings for 30 consecutive days each fiscal year. The weighted average interest rate was 3.13% for the amount outstanding at February 28, 2003. The maximum commitment fee payable on the unused portion of the facility is 0.50%. All receivables, contracts, equipment, inventory, general intangibles, cash concentration accounts, and the capital stock of Heritage's subsidiaries secure the Senior Revolving Working Capital Facility. As of February 28, 2003, the Senior Revolving Working Capital Facility had a balance outstanding of \$19,300.

A \$50,000 Senior Revolving Acquisition Facility is available through December 31, 2003, at which time the outstanding amount must be paid in ten equal quarterly installments beginning March 31, 2004. The interest rate and interest payment dates vary depending on the terms Heritage agrees to when the money is borrowed. The weighted average interest rate was 3.13% for the amount outstanding at February 28, 2003. The maximum commitment fee payable on the unused portion of the facility is 0.50%. All receivables, contracts, equipment, inventory, general intangibles, cash concentration accounts, and the capital stock of Heritage's subsidiaries secure the Senior Revolving Acquisition Facility. As of February 28, 2003, the Senior Revolving Acquisition Facility had a balance outstanding of \$32,300.

#### 4. REPORTABLE SEGMENTS:

The Partnership's financial statements reflect four reportable segments: the domestic retail operations of Heritage, the domestic wholesale operations of Heritage, the foreign wholesale operations of MP Energy Partnership, and the liquids marketing activities of Resources. Heritage's reportable retail and wholesale fuel segments are strategic business units that sell products and services to retail and wholesale customers. Intersegment sales by the foreign wholesale segment to the domestic segment are priced in accordance with the partnership agreement of MP Energy Partnership. Heritage manages these segments separately as each segment involves different distribution, sale, and marketing strategies. Heritage evaluates the performance of its operating segments based on operating income exclusive of selling, general, and administrative expenses of \$4,320 and \$3,158 for the three months ended February 28, 2003 and 2002, respectively, or \$7,177 and \$6,109 for the six months ended February 28, 2003 and 2002, respectively. Selling, general and administrative expenses, interest expense and other expenses are not allocated by segment. Investment in affiliates and equity in earnings (losses) of affiliates relates primarily to Heritage's investment in Bi-State Propane (see Note 5), and is part of the domestic retail fuel segment. The following table presents the unaudited financial information by segment for the following periods:

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| For the Three Months ended<br>February 28, |       | For the Six Months ended<br>February 28, |       |
|--|-------|--|-------|
| 2003                                       | 2002  | 2003                                     | 2002  |
| -----                                      | ----- | -----                                    | ----- |

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Gallons:

|                         |          |          |          |          |
|-------------------------|----------|----------|----------|----------|
| Domestic retail fuel    | 166,622  | 134,458  | 243,343  | 209,248  |
| Domestic wholesale fuel | 5,467    | 5,478    | 10,357   | 10,475   |
| Foreign wholesale fuel  |          |          |          |          |
| Affiliated              | 17,452   | 23,744   | 37,832   | 38,815   |
| Unaffiliated            | 25,358   | 24,728   | 42,553   | 42,992   |
| Elimination             | (17,452) | (23,744) | (37,832) | (38,815) |
|                         | -----    | -----    | -----    | -----    |
| Total                   | 197,447  | 164,664  | 296,253  | 262,715  |
|                         | =====    | =====    | =====    | =====    |

Revenues:

|                         |            |            |            |            |
|-------------------------|------------|------------|------------|------------|
| Domestic retail fuel    | \$ 212,704 | \$ 152,429 | \$ 296,754 | \$ 235,629 |
| Domestic wholesale fuel | 4,345      | 3,265      | 6,755      | 6,336      |
| Foreign wholesale fuel  |            |            |            |            |
| Affiliated              | 27,424     | 11,576     | 37,832     | 20,516     |
| Unaffiliated            | 15,873     | 11,269     | 24,810     | 20,791     |
| Elimination             | (27,424)   | (11,576)   | (37,832)   | (20,516)   |
| Liquids marketing, net  | 352        | 1,693      | 1,059      | (1,632)    |
| Other                   | 16,535     | 15,346     | 33,891     | 30,836     |
|                         | -----      | -----      | -----      | -----      |
| Total                   | \$ 249,809 | \$ 184,002 | \$ 363,269 | \$ 291,960 |
|                         | =====      | =====      | =====      | =====      |

For the Three Months ended  
February 28,

For the Six Months ended  
February 28,

|                             | -----     |           | -----     |           |
|-----------------------------|-----------|-----------|-----------|-----------|
|                             | 2003      | 2002      | 2003      | 2002      |
|                             | -----     | -----     | -----     | -----     |
| Operating Income            |           |           |           |           |
| Domestic retail             | \$ 66,277 | \$ 41,036 | \$ 79,713 | \$ 51,559 |
| Domestic wholesale fuel     | (885)     | (1,064)   | (1,369)   | (1,699)   |
| Foreign wholesale fuel      |           |           |           |           |
| Affiliated                  | 374       | 272       | 484       | 272       |
| Unaffiliated                | 1,121     | 713       | 1,627     | 1,051     |
| Elimination                 | (374)     | (272)     | (484)     | (272)     |
| Liquids marketing           | 192       | 1,611     | 515       | (1,794)   |
|                             | -----     | -----     | -----     | -----     |
| Total                       | \$ 66,705 | \$ 42,296 | \$ 80,486 | \$ 49,117 |
|                             | =====     | =====     | =====     | =====     |
| Gain on Disposal of Assets: |           |           |           |           |
| Domestic retail fuel        | \$ 84     | \$ 275    | \$ 164    | \$ 492    |
| Domestic wholesale fuel     | 4         | (27)      | (9)       | 223       |
|                             | -----     | -----     | -----     | -----     |
| Total                       | \$ 88     | \$ 248    | \$ 155    | \$ 715    |
|                             | =====     | =====     | =====     | =====     |
| Minority Interest Expense:  |           |           |           |           |
| Corporate                   | \$ 508    | \$ 521    | \$ 522    | \$ 422    |
| Foreign wholesale           | 313       | 178       | 425       | 208       |
|                             | -----     | -----     | -----     | -----     |
| Total                       | \$ 821    | \$ 699    | \$ 947    | \$ 630    |
|                             | =====     | =====     | =====     | =====     |

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Depreciation and amortization:

|                    |          |          |           |           |
|--------------------|----------|----------|-----------|-----------|
| Domestic retail    | \$ 9,318 | \$ 9,537 | \$ 18,451 | \$ 18,526 |
| Domestic wholesale | 124      | 65       | 252       | 129       |
| Foreign wholesale  | 5        | 4        | 10        | 9         |
|                    | -----    | -----    | -----     | -----     |
| Total              | \$ 9,447 | \$ 9,606 | \$ 18,713 | \$ 18,664 |
|                    | =====    | =====    | =====     | =====     |

|                    | As of<br>February 28,<br>2003 | As of<br>August 31,<br>2002 |
|--------------------|-------------------------------|-----------------------------|
|                    | -----                         | -----                       |
| Total Assets:      |                               |                             |
| Domestic retail    | \$ 739,075                    | \$ 667,978                  |
| Domestic wholesale | 8,488                         | 14,372                      |
| Foreign wholesale  | 16,789                        | 10,564                      |
| Liquids marketing  | 10,460                        | 6,919                       |
| Corporate          | 16,520                        | 17,431                      |
|                    | -----                         | -----                       |
| Total              | \$ 791,332                    | \$ 717,264                  |
|                    | =====                         | =====                       |

Additions to property, plant and equipment including acquisitions:

|                      |           |           |
|----------------------|-----------|-----------|
| Domestic retail fuel | \$ 46,723 | \$ 39,904 |
| Domestic wholesale   | 166       | -         |
| Foreign wholesale    | -         | 46        |
| Corporate            | 669       | 1,441     |
|                      | -----     | -----     |
| Total                | \$ 47,558 | \$ 41,391 |
|                      | =====     | =====     |

Corporate assets include vehicles, office equipment and computer software for the use of administrative personnel. These assets are not allocated to segments. Corporate minority interest expense relates to U.S. Propane's general partner interest in the Operating Partnership.

5. SIGNIFICANT INVESTEE:

Heritage holds a 50% interest in Bi-State Propane. Heritage accounts for this 50% interest in Bi-State Propane under the equity method. Heritage's investment in Bi-State Propane totaled \$7,691 and \$7,485 at February 28, 2003 and August 31, 2002 respectively. Heritage did not receive any distributions from Bi-State Propane for the six months ended February 28, 2003 or 2002. On March 1, 2002, the Operating Partnership sold certain assets acquired in the ProFlame acquisition to Bi-State Propane for approximately \$9,730 plus working capital. This sale was made pursuant to the provision in the Bi-State Propane partnership agreement that requires each partner to offer to sell any newly acquired businesses within Bi-State Propane's area of operations to Bi-State Propane. In conjunction with this sale, the Operating Partnership guaranteed \$5 million of debt incurred by Bi-State Propane to a financial institution. Based on the current financial condition of Bi-State Propane, management considers the likelihood of Heritage incurring a liability resulting from the guarantee to be

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remote. Heritage has not recorded a liability on the balance sheets as of February 28, 2003 or August 31, 2002 for this guarantee because the guarantee was in effect prior to the issuance of FIN 45, and there have been no amendments to the original guarantee. Bi-State Propane's financial position is summarized below:

|                   | February 28,<br>2003 | August 31,<br>2002 |
|-------------------|----------------------|--------------------|
|                   | -----                | -----              |
| Current assets    | \$ 4,676             | \$ 3,321           |
| Noncurrent assets | 23,048               | 23,105             |
|                   | -----                | -----              |
|                   | \$ 27,724            | \$ 26,426          |
|                   | =====                | =====              |

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|                     |           |           |
|---------------------|-----------|-----------|
| Current liabilities | \$ 3,225  | \$ 3,344  |
| Long-term debt      | 8,600     | 9,450     |
| Partners' capital:  |           |           |
| Heritage            | 8,624     | 7,485     |
| Other partner       | 7,275     | 6,147     |
|                     | -----     | -----     |
|                     | \$ 27,724 | \$ 26,426 |
|                     | =====     | =====     |

Bi-State Propane's results of operations for the three months and six months ended February 28, 2003 and 2002, respectively are summarized below:

|               | For the Three Months Ended<br>February 28, |          | For the Six Months Ended<br>February 28, |          |
|---------------|--|----------|--|----------|
|               | -----                                      | -----    | -----                                    | -----    |
|               | 2003                                       | 2002     | 2003                                     | 2002     |
|               | -----                                      | -----    | -----                                    | -----    |
| Revenues      | \$ 8,460                                   | \$ 6,497 | \$ 13,101                                | \$ 9,357 |
| Gross profit  | 3,981                                      | 3,329    | 6,266                                    | 4,784    |
| Net income:   |  |          |  |          |
| Heritage      | 933  | 1,015    | 1,139                                    | 1,141    |
| Other Partner | 913  | 1,031    | 1,128                                    | 1,174    |

### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Heritage Propane Partners, L.P. (the "Registrant" or "Partnership"), is a Delaware limited partnership. The Partnership's common units are listed on the New York Stock Exchange. The Partnership's business activities are primarily conducted through its subsidiary, Heritage Operating, L.P. (the "Operating Partnership"), a Delaware limited partnership. The Partnership is the sole limited partner of the Operating Partnership, with a 98.9899% limited partner



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interest. The Partnership and the Operating Partnership are sometimes referred to collectively in this report as "Heritage."

The following is a discussion of the historical financial condition and results of operations of the Partnership and its subsidiaries, and should be read in conjunction with the Partnership's historical consolidated financial statements and accompanying notes thereto included elsewhere in this Quarterly Report on Form 10-Q.

### FORWARD-LOOKING STATEMENTS

CERTAIN MATTERS DISCUSSED IN THIS REPORT, EXCLUDING HISTORICAL INFORMATION, AS WELL AS SOME STATEMENTS BY HERITAGE IN PERIODIC PRESS RELEASES AND SOME ORAL STATEMENTS OF HERITAGE OFFICIALS DURING PRESENTATIONS ABOUT THE PARTNERSHIP, INCLUDE CERTAIN "FORWARD-LOOKING" STATEMENTS WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933 AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934. STATEMENTS USING WORDS SUCH AS "ANTICIPATE," "BELIEVE," "INTEND," "PROJECT," "PLAN," "CONTINUE," "ESTIMATE," "FORECAST," "MAY," "WILL," OR SIMILAR EXPRESSIONS HELP IDENTIFY FORWARD-LOOKING STATEMENTS. ALTHOUGH HERITAGE BELIEVES SUCH FORWARD-LOOKING STATEMENTS ARE BASED ON REASONABLE ASSUMPTIONS AND CURRENT EXPECTATIONS AND PROJECTIONS ABOUT FUTURE EVENTS, NO ASSURANCE CAN BE GIVEN THAT EVERY OBJECTIVE WILL BE REACHED.

ACTUAL RESULTS MAY DIFFER MATERIALLY FROM ANY RESULTS PROJECTED, FORECASTED, ESTIMATED, OR EXPRESSED IN FORWARD-LOOKING STATEMENTS SINCE MANY OF THE FACTORS THAT DETERMINE THESE RESULTS ARE DIFFICULT TO PREDICT AND ARE BEYOND MANAGEMENT'S CONTROL. SUCH FACTORS INCLUDE:

- CHANGES IN GENERAL ECONOMIC CONDITIONS IN THE UNITED STATES OF AMERICA AS WELL AS CHANGES IN GENERAL ECONOMIC CONDITIONS AND CURRENCIES IN FOREIGN COUNTRIES;
  - WEATHER CONDITIONS THAT VARY SIGNIFICANTLY FROM HISTORICALLY NORMAL CONDITIONS WHICH MAY ADVERSELY AFFECT THE DEMAND FOR PROPANE AND HERITAGE'S FINANCIAL CONDITION;
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- HERITAGE'S SUCCESS IN HEDGING ITS PRODUCT SUPPLY POSITIONS;
  - THE EFFECTIVENESS OF RISK-MANAGEMENT POLICIES AND PROCEDURES AND THE ABILITY OF HERITAGE'S LIQUIDS MARKETING COUNTER-PARTIES TO SATISFY THEIR FINANCIAL COMMITMENTS;
  - THE GENERAL LEVEL OF PETROLEUM PRODUCT DEMAND AND THE AVAILABILITY AND PRICE OF PROPANE SUPPLIES;
  - SUDDEN AND SHARP PROPANE PRICE INCREASES AND MARKET VOLATILITY MAY ADVERSELY AFFECT HERITAGE'S OPERATING RESULTS;
  - THE POLITICAL AND ECONOMIC STABILITY OF PETROLEUM PRODUCING NATIONS;
  - HERITAGE'S ABILITY TO CONDUCT BUSINESS IN FOREIGN COUNTRIES;
  - HERITAGE'S ABILITY TO OBTAIN ADEQUATE SUPPLIES OF PROPANE FOR RETAIL SALE IN THE EVENT OF AN INTERRUPTION IN SUPPLY OR TRANSPORTATION;
  - ENERGY PRICES GENERALLY AND SPECIFICALLY, THE PRICE OF PROPANE TO THE CONSUMER COMPARED TO THE PRICE OF ALTERNATIVE AND

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### COMPETING FUELS;

- THE MATURITY OF THE PROPANE INDUSTRY AND COMPETITION FROM OTHER PROPANE DISTRIBUTORS AND OTHER ENERGY SOURCES;
- ENERGY EFFICIENCIES AND TECHNOLOGICAL TRENDS MAY AFFECT DEMAND FOR PROPANE;
- THE AVAILABILITY AND COST OF CAPITAL;
- HERITAGE'S ABILITY TO ACCESS CERTAIN CAPITAL SOURCES MAY REQUIRE IT TO OBTAIN A DEBT RATING;
- CHANGES IN LAWS AND REGULATIONS TO WHICH HERITAGE IS SUBJECT, INCLUDING TAX, ENVIRONMENTAL, TRANSPORTATION, AND EMPLOYMENT REGULATIONS;
- OPERATING RISKS INCIDENTAL TO TRANSPORTING, STORING, AND DISTRIBUTING PROPANE, INCLUDING LITIGATION RISKS WHICH MAY NOT BE COVERED BY INSURANCE;
- HERITAGE'S ABILITY TO GENERATE AVAILABLE CASH FOR DISTRIBUTIONS TO UNITHOLDERS;
- THE COSTS AND EFFECTS OF LEGAL AND ADMINISTRATIVE PROCEEDINGS AGAINST HERITAGE OR WHICH MAY BE BROUGHT AGAINST IT;
- HERITAGE'S ABILITY TO SUSTAIN HISTORICAL LEVELS OF INTERNAL GROWTH;
- HERITAGE'S ABILITY TO CONTINUE TO LOCATE AND ACQUIRE OTHER PROPANE COMPANIES AT PURCHASE PRICES THAT ARE ACCRETIVE TO ITS FINANCIAL RESULTS;
- CASH DISTRIBUTIONS TO UNITHOLDERS ARE NOT GUARANTEED AND MAY FLUCTUATE WITH HERITAGE'S PERFORMANCE AND OTHER EXTERNAL FACTORS, INCLUDING RESTRICTIONS IN HERITAGE'S DEBT AGREEMENTS; AND
- HERITAGE MAY SELL ADDITIONAL LIMITED PARTNER INTERESTS, THUS DILUTING THE EXISTING INTEREST OF UNITHOLDERS.

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### GENERAL

The retail propane business is a margin-based business in which gross profits depend on the excess of sales price over propane supply cost. The market price of propane is often subject to volatile changes as a result of supply or other market conditions over which Heritage will have no control. Product supply contracts are one-year agreements subject to annual renewal and generally permit suppliers to charge posted prices (plus transportation costs) at the time of delivery or the current prices established at major delivery points. Since rapid increases in the wholesale cost of propane may not be immediately passed on to retail customers, such increases could reduce gross profits. Heritage generally has attempted to reduce price risk by purchasing propane on a short-term basis. Heritage has on occasion purchased significant volumes of propane during periods of low demand, which generally occur during the summer months, at the then current market price, for storage both at its customer service locations and in major storage facilities for future resale.

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The retail propane business of Heritage consists principally of transporting propane purchased in the contract and spot markets, primarily from major fuel suppliers, to its customer service locations and then to tanks located on the customers' premises, as well as to portable propane cylinders. In the residential and commercial markets, propane is primarily used for space heating, water heating, and cooking. In the agricultural market, propane is primarily used for crop drying, tobacco curing, poultry brooding, and weed control. In addition, propane is used for certain industrial applications, including use as an engine fuel to power vehicles and forklifts and as a heating source in manufacturing and mining processes.

Since its formation in 1989, Heritage has grown primarily through acquisitions of retail propane operations and, to a lesser extent, through internal growth. Since its inception through August 31, 2002, Heritage completed 91 acquisitions for an aggregate purchase price approximating \$633 million. During the six months ended February 28, 2003, Heritage completed three acquisitions for an aggregate purchase price of \$37.4 million, which includes \$21.2 million in cash, \$15.0 million in Common Units issued, and \$1.2 million in notes payable on non-compete agreements and liabilities assumed. Heritage serves more than 650,000 customers from nearly 300 customer service locations in 29 states.

Heritage's propane distribution business is largely seasonal and dependent upon weather conditions in its service areas. Propane sales to residential and commercial customers are affected by winter heating season requirements. Historically, approximately two-thirds of Heritage's retail propane volume and in excess of 80% of Heritage's EBITDA, as adjusted is attributable to sales during the six-month peak-heating season of October through March. This generally results in higher operating revenues and net income during the period from October through March of each year and lower operating revenues and either net losses or lower net income during the period from April through September of each year. Consequently, sales and operating profits are concentrated in the first and second fiscal quarters, however, cash flow from operations is generally greatest during the second and third fiscal quarters when customers pay for propane purchased during the six-month peak-heating season. Sales to industrial and agricultural customers are much less weather sensitive.

A substantial portion of Heritage's propane is used in the heating-sensitive residential and commercial markets causing the temperatures realized in Heritage's areas of operations, particularly during the six-month peak-heating season, to have a significant effect on its financial performance. In any given area, sustained warmer-than-normal temperatures will tend to result in reduced propane use, while sustained colder-than-normal temperatures will tend to result in greater propane use. Heritage uses information on normal temperatures in understanding how temperatures that are colder or warmer than normal affect historical results of operations and in preparing forecasts of future operations.

Gross profit margins are not only affected by weather patterns, but also vary according to customer mix. For example, sales to residential customers generate higher margins than sales to certain other customer groups, such as commercial or agricultural customers. Wholesale margins are substantially lower than retail margins. In addition, gross profit margins vary by geographical region. Accordingly, a change in customer or geographic mix can affect gross profit without necessarily affecting total revenues.

Amounts discussed below reflect 100% of the results of MP Energy Partnership. MP Energy Partnership is a general partnership in which Heritage owns a 60% interest. Because MP Energy Partnership is primarily engaged in lower-margin wholesale distribution, its contribution to Heritage's net income is not significant and the minority interest of this partnership is excluded from the EBITDA, as adjusted calculation.

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As stated above, during the fourth quarter of 2003, Heritage adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123 Accounting for Stock-based Compensation (SFAS 123) effective as of September 1, 2002. Accordingly, the following information compares the originally reported consolidated statement of operations, reclassified for the adoption of EITF 02-3 for the three and six months ended February 28, 2003 and as adjusted for the adoption of SFAS 123:

|  | Three Months<br>Ended February 28, 2003 |  | Ende<br>As origina<br>reported |
|--|---|--|--------------------------------|
|  | As originally<br>reported               | As adjusted for<br>the adoption of<br>SFAS 123 |                                |
| <b>REVENUES:</b>                                     |   |  |                                |
| Retail fuel  | \$ 212,704                              | \$ 212,704                                     | \$ 29                          |
| Wholesale fuel                                       | 20,218                                  | 20,218   | 3                              |
| Liquids marketing, net                               | 352                                     | 352  |                                |
| Other  | 16,535                                  | 16,535   | 3                              |
| Total revenues                                       | 249,809                                 | 249,809  | 36                             |
| <b>COSTS AND EXPENSES:</b>                           |   |  |                                |
| Cost of products sold                                | 128,420                                 | 128,420  | 18                             |
| Operating expenses                                   | 45,270                                  | 45,237   | 7                              |
| Depreciation and amortization                        | 9,447                                   | 9,447  | 1                              |
| Selling, general and administrative                  | 4,656                                   | 4,320  |                                |
| Total costs and expenses                             | 187,793                                 | 187,424  | 29                             |
| OPERATING INCOME                                     | 62,016                                  | 62,385   | 7                              |
| <b>OTHER INCOME (EXPENSE):</b>                       |   |  |                                |
| Interest expense                                     | (9,317)                                 | (9,317)  | (1                             |
| Equity in earnings of affiliates                     | 970                                     | 970  |                                |
| Gain on disposal of assets                           | 88                                      | 88   |                                |
| Other  | (2,268)                                 | (2,268)  | (                              |
| INCOME BEFORE MINORITY<br>INTERESTS AND INCOME TAXES | 51,489                                  | 51,858   | 5                              |
| Minority interests                                   | (817)                                   | (821)  |                                |
| INCOME BEFORE TAXES                                  | 50,672                                  | 51,037   | 5                              |
| Income taxes   | 1,285                                   | 1,285  |                                |
| NET INCOME   | 49,387                                  | 49,752   | 5                              |
| GENERAL PARTNER'S INTEREST IN NET<br>INCOME          | 719                                     | 723  |                                |

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|   |            |            |       |
|---|------------|------------|-------|
| LIMITED PARTNERS' INTEREST IN NET INCOME    | \$ 48,668  | \$ 49,029  | \$ 4  |
| BASIC NET INCOME PER LIMITED PARTNER UNIT   | \$ 3.01    | \$ 3.03    | \$    |
| BASIC AVERAGE NUMBER OF UNITS OUTSTANDING   | 16,165,602 | 16,165,602 | 15,99 |
| DILUTED NET INCOME PER LIMITED PARTNER UNIT | \$ 3.00    | \$ 3.03    | \$    |
| DILUTED AVERAGE NUMBER OF UNITS OUTSTANDING | 16,207,002 | 16,207,002 | 16,02 |

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THREE MONTHS ENDED FEBRUARY 28, 2003 COMPARED TO THE THREE MONTHS ENDED FEBRUARY 28, 2002

Volume. Total retail gallons sold in the three months ended February 28, 2003 were 166.6 million, an increase of 32.1 million over the 134.5 million gallons sold in the three months ended February 28, 2002. Of the increase in volume, 9.1 million gallons reflects the benefits of the volume added through acquisitions and 23.0 million gallons reflects the increase due to more favorable weather conditions in some of Heritage's areas of operations, offset by warmer than normal weather conditions in other areas of operations. The Partnership also sold approximately 30.9 million wholesale gallons in this second quarter of fiscal 2003, an increase of 0.7 million gallons from the 30.2 million wholesale gallons sold in the second quarter of fiscal year 2002. U.S. wholesale volumes remained the same at 5.5 million gallons while the foreign volumes of MP Energy Partnership increased 0.7 million gallons to 25.4 million gallons for the second quarter.

Revenues. Total revenues for the three months ended February 28, 2003 were \$249.8 million, an increase of \$65.8 million, as compared to \$184.0 million in the three months ended February 28, 2002. The current period's domestic retail propane revenues increased \$60.3 million to \$212.7 million as compared to the prior year's revenues of \$152.4 million of which \$11.6 million was due to acquisitions, \$19.2 million was due to higher selling prices in the current period, and \$29.5 was due to the increased retail volumes described above. Selling prices in each of Heritage's reportable segments increased as compared to the same period last year as a result of higher supply costs. The U.S. wholesale revenues increased \$1.0 million to \$4.3 million for the three months ended February 28, 2003 as compared to \$3.3 million for the period ended February 28, 2002, due to higher selling prices. Other domestic revenues increased \$1.2 million to \$16.5 million, as compared to \$15.3 million in the prior year as a result of acquisitions. Foreign revenues increased \$4.6 million for the three months ended February 28, 2003 to \$15.9 million as compared to \$11.3 million for the three months ended February 28, 2002, of which \$4.2 million was a result of higher selling prices and \$0.4 million was due to the increased volumes described above. Net revenues from the liquids marketing activity conducted through Resources decreased \$1.3 million to \$0.4 million as compared to the prior year's activity of \$1.7 million due to less favorable movement in product prices in the current fiscal period.

Cost of Products Sold. Total cost of products sold increased to \$128.4 million for the three months ended February 28, 2003 as compared to \$97.1

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million for the three months ended February 28, 2002. The current period's domestic retail cost of sales increased \$25.2 million to \$104.9 million as compared to \$79.7 million in the prior year, of which \$20.3 million was due to increased volumes and \$4.9 million was due to higher supply costs of product as compared to the same period last year. The U.S. wholesale cost of sales increased \$0.7 million to \$3.9 million for the three months ended February 28, 2003 as compared to \$3.2 million for the period ended February 28, 2002, due to higher wholesale fuel costs. Foreign cost of sales increased \$4.2 million to \$14.8 million as compared to \$10.6 million in the prior year, of which \$3.8 million was due to an increase in wholesale fuel costs and \$0.4 million was due to higher volumes. Other cost of sales increased \$1.2 million to \$4.8 million as compared to \$3.6 million for the three months ended February 28, 2002 primarily due to acquisitions.

**Gross Profit.** Total gross profit for the three months ended February 28, 2003 was \$121.3 million as compared to \$86.9 million for the three months ended February 28, 2002. For the three months ended February 28, 2003, retail fuel gross profit was \$107.8 million, U.S. wholesale was \$0.4 million, and other gross profit was \$11.6 million. Foreign wholesale gross profit was \$1.1 million and liquids marketing gross profit was \$0.4 million. As a comparison, for the three months ended February 28, 2002, Heritage recorded retail fuel gross profit of \$72.7 million, U.S. wholesale of \$0.1 million and other gross profit of \$11.7 million. Foreign wholesale gross profit was \$0.7 million, and liquids marketing gross profit was \$1.7 million for the three months ended February 28, 2002. The increase in gross fuel profit is primarily attributable to increased volumes as described above and higher selling prices, partially offset by higher product costs.

**Operating Expenses.** Operating expenses were \$45.2 million an increase of \$10.2 million, for the three months ended February 28, 2003 as compared to \$35.0 million for the three months ended February 28, 2002. The increase is the result of various factors, which include a \$3.6 million increase in employee-related costs due to acquisitions, a \$2.4 million increase in incentive plan expense due to operating performance, a \$4.1 million general increase in operating expenses in certain areas of the Partnership's operations to accommodate increased winter demand, a \$0.1 million increase due to industry-wide increases in business insurance costs.

**Selling, General and Administrative.** Selling, general and administrative expenses were \$4.3 million for the three months ended February 28, 2003, a \$1.1 million increase from the \$3.2 million for the same three month

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period last year. This increase is primarily related to the performance-based compensation plan expense in 2003 that was not incurred in 2002, offset by a \$0.2 million decrease related to the adoption of SFAS 123.

**Depreciation and Amortization.** Depreciation and amortization was \$9.4 million in the three months ended February 28, 2003 a slight decrease as compared to \$9.6 million in the three months ended February 28, 2002.

**Operating Income.** For the three months ended February 28, 2003, Heritage had operating income of \$62.4 million as compared to operating income of \$39.1 million for the three months ended February 28, 2002. This increase is a combination of a \$0.2 million increase related to the adoption of SFAS 123 and the increased gross profit offset by increased operating expenses described above.

**Other Expense.** For the three months ended February 28, 2003, Heritage recorded other expense of \$2.3 million as compared to \$0.1 million for the three

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months ended February 28, 2002. This increase is primarily due to the reclassification into earnings of a loss on marketable securities in the six months ended February 28, 2003 that was previously recorded as accumulated other comprehensive loss on the balance sheet.

**Interest Expense.** Interest expense decreased \$0.2 million for the three months ended February 28, 2003 to \$9.3 million from \$9.5 million for the same three-month period last year.

**Taxes.** Taxes for the three months ended February 28, 2003 were \$1.3 million due to the tax expense anticipated to be incurred by Heritage's corporate subsidiaries. There was no tax expense in these subsidiaries for the three months ended February 28, 2002.

**Net Income.** For the three-month period ended February 28, 2003, Heritage recorded net income of \$49.8 million, an increase of \$19.7 million as compared to net income for the three months ended February 28, 2002 of \$30.1 million. The increase is primarily the result of a \$0.2 increase related to the adoption of SFAS 123 and the increase in operating income, partially offset by the increase in other expenses and taxes described above.

**EBITDA, as adjusted.** EBITDA, as adjusted increased \$22.8 million to \$73.0 million for the three months ended February 28, 2003, as compared to EBITDA, as adjusted of \$50.2 million for the period ended February 28, 2002. This increase is due to the operating performance described above and is a record level EBITDA, as adjusted for the second quarter results of Heritage. EBITDA, as adjusted for the three months ended February 28, 2003 and February 28, 2002 is computed as follows:

| NET INCOME RECONCILIATION<br>(in millions)           | Three Months<br>Ended February 28, |         |
|--|------------------------------------|---------|
|  | 2003                               | 2002    |
| Net income   | \$ 49.8                            | \$ 30.1 |
| Depreciation and amortization                        | 9.4                                | 9.6     |
| Interest   | 9.3                                | 9.5     |
| Taxes  | 1.3                                | -       |
| Non-cash compensation expense                        | 0.3                                | 0.5     |
| Other expense  | 2.3                                | 0.1     |
| Depreciation, amortization, and interest of investee | 0.2                                | 0.1     |
| Minority interest in the Operating Partnership       | 0.5                                | 0.5     |
| Less : Gain on disposal of assets                    | (0.1)                              | (0.2)   |
| EBITDA, as adjusted (a)                              | \$ 73.0                            | \$ 50.2 |

(a) EBITDA, as adjusted is defined as the Partnership's earnings before interest, taxes, depreciation, amortization and other non-cash items, such as compensation charges for unit issuances to employees, gain or loss on disposal of assets, and other expenses. We present EBITDA, as adjusted, on a Partnership basis which includes both the general and limited partner interests. Non-cash compensation expense represents charges for the value of the Common Units awarded under the Partnership's compensation plans that have not yet vested under the terms of those plans and are charges which do not, or will not, require cash settlement. Non-cash income such as the gain arising from our disposal of assets is not included when determining EBITDA, as

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adjusted. EBITDA, as adjusted (i) is not a measure of performance calculated in accordance with generally accepted accounting principles and (ii) should not be considered in isolation or as a substitute for net income, income from operations or cash flow as reflected in our consolidated financial statements.

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EBITDA, as adjusted is presented because such information is relevant and is used by management, industry analysts, investors, lenders and rating agencies to assess the financial performance and operating results of the Partnership's fundamental business activities. Management believes that the presentation of EBITDA, as adjusted is useful to lenders and investors because of its use in the propane industry and for master limited partnerships as an indicator of the strength and performance of the Partnership's ongoing business operations, including the ability to fund capital expenditures, service debt and pay distributions. Additionally, management believes that EBITDA, as adjusted provides additional and useful information to the Partnership's investors for trending, analyzing and benchmarking the operating results of the Partnership from period to period as compared to other companies that may have different financing and capital structures. The presentation of EBITDA, as adjusted allows investors to view the Partnership's performance in a manner similar to the methods used by management and provides additional insight to the Partnership's operating results.

EBITDA, as adjusted is used by management to determine our operating performance, and along with other data as internal measures for setting annual operating budgets, assessing financial performance of the Partnership's numerous business locations, as a measure for evaluating targeted businesses for acquisition and as a measurement component of incentive compensation. The Partnership has a large number of business locations located in different regions of the United States. EBITDA, as adjusted can be a meaningful measure of financial performance because it excludes factors which are outside the control of the employees responsible for operating and managing the business locations, and provides information management can use to evaluate the performance of the business locations, or the region where they are located, and the employees responsible for operating them. To present EBITDA, as adjusted on a full Partnership basis, we add back the minority interest of the general partner because net income is reported net of the general partner's minority interest. Our EBITDA, as adjusted includes non-cash compensation expense which is a non-cash expense item resulting from our unit based compensation plans that does not require cash settlement and is not considered during management's assessment of the operating results of the Partnership's business. By adding these non-cash compensation expenses in EBITDA, as adjusted allows management to compare the Partnership's operating results to those of other companies in the same industry who may have compensation plans with levels and values of annual grants that are different than the Partnership's. Other expenses include other finance charges and other asset non-cash impairment charges that are reflected in the Partnership's operating results but are not classified in interest, depreciation and amortization. We do not include gain on the sale of assets when determining EBITDA, as adjusted since including non-cash income resulting from the sale of assets increases the performance measure in a manner that is not related to the true operating results of the Partnership's business. In addition, Heritage's debt agreements contain financial covenants based on EBITDA, as adjusted. For a description of these covenants, please read "Item 7. Management's



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Discussion and Analysis of Financial Condition and Results of Operations-Description of Indebtedness" included in the Partnership's Form 10-K/A for the fiscal year ended August 31, 2002, as filed with the Securities and Exchange Commission on November 26, 2003.

There are material limitations to using a measure such as EBITDA, as adjusted, including the difficulty associated with using it as the sole measure to compare the results of one company to another, and the inability to analyze certain significant items that directly affect a company's net income or loss. In addition, Heritage's calculation of EBITDA, as adjusted may not be consistent with similarly titled measures of other companies and should be viewed in conjunction with measurements that are computed in accordance with GAAP. EBITDA, as adjusted for the periods described herein is calculated in the same manner as presented by Heritage in the past. Management compensates for these limitations by considering EBITDA, as adjusted in conjunction with its analysis of other GAAP financial measures, such as gross profit, net income (loss), and cash flow from operating activities.

We have provided a reconciliation of EBITDA, as adjusted to net income(loss).

SIX MONTHS ENDED FEBRUARY 28, 2003 COMPARED TO THE SIX MONTHS ENDED FEBRUARY 28, 2002

Volume. Total retail gallons sold in the six months ended February 28, 2003 were 243.3 million, an increase of 34.1 million over the 209.2 million gallons sold in the six months ended February 28, 2002. Of the \$34.1 million increase, \$10.7 million reflects the benefits of the volume added through acquisitions and \$ 23.4 million is due to more favorable weather conditions in some of Heritage's areas of operations, offset by warmer than normal weather conditions in other areas of operations. Heritage also sold approximately 53.0 million wholesale gallons in the six months ended February 28, 2003, a decrease of 0.5 million gallons from the 53.5 million wholesale gallons sold in the six months ended February 28, 2002. U.S. wholesale gallons decreased 0.1 million gallons to 10.4 million gallons and the foreign volumes of MP Energy Partnership decreased 0.4 million gallons to 42.6 million for the six months ended February 28, 2003.

Revenues. Total revenues for the six months ended February 28, 2003 were \$363.3 million, an increase of \$71.3 million, as compared to \$292.0 million in the six months ended February 28, 2002. The current period's

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domestic retail propane revenues increased \$61.2 million to \$296.8 million as compared to the prior year's revenues of \$235.6 million of which \$41.6 million was due to increased retail volumes and \$19.6 million was due to higher selling prices in the current period. The U.S. wholesale revenues increased to \$6.7 million, as compared to \$6.3 million for the six-month period ended February 28, 2002, due to higher selling prices. Foreign revenues increased \$4.0 million for the six months ended February 28, 2003 to \$24.8 million as compared to \$20.8 million for the six months ended February 28, 2002, also as a result of higher selling prices. The net liquids marketing activity conducted through Resources increased \$2.7 million to \$1.1 million as compared to the prior year's activity of \$(1.6) million due to more favorable movement in the product prices in the first quarter of fiscal year 2003, offset by the second quarter decrease. Other domestic revenues increased \$3.1 million to \$33.9 million as compared to \$30.8 million in the prior year as a result of acquisitions.

Cost of Products Sold. Total cost of products sold increased to \$185.4

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million for the six months ended February 28, 2003 as compared to \$157.4 million for the six months ended February 28, 2002. The current period's domestic retail cost of sales increased \$22.5 million to \$146.5 million as compared to \$124.0 million in the prior year of which \$20.6 million was due to increased volumes, and \$1.9 million was due to higher product costs compared to the same period last fiscal year. The U.S. wholesale cost of sales remained the same as last year at \$6.1 million. Foreign cost of sales increased \$3.5 million to \$23.2 million as compared to \$19.7 million in the prior year primarily due to an increase in foreign wholesale fuel costs. Other cost of sales increased \$2.0 million to \$9.6 million as compared to \$7.6 million for the six months ended February 28, 2002.

**Gross Profit.** Total gross profit for the six months ended February 28, 2003 increased by \$43.2 million to \$177.8 million as compared to \$134.6 million for the six months ended February 28, 2002. For the six months ended February 28, 2003, retail fuel gross profit was \$150.3 million, U.S. wholesale was \$0.6 million, and other gross profit was \$24.2 million. Foreign wholesale gross profit was \$1.6 million and liquids marketing gross profit was \$1.1 million. As a comparison, for the six months ended February 28, 2002, Heritage recorded retail fuel gross profit of \$111.6 million, U.S. wholesale of \$0.3 million, and other gross profit of \$23.3 million. Foreign wholesale gross profit was \$1.1 million and liquids marketing was a loss of \$1.7 million for the six months ended February 28, 2002. The increase in gross profit is primarily attributable to increased volumes and higher selling prices, offset by higher fuel costs.

**Operating Expenses.** Operating expenses were \$78.6 million for the six months ended February 28, 2003 as compared to \$66.8 million for the six months ended February 28, 2002. The increase of \$11.8 million is the result of various factors, which include a \$4.0 million increase in employee-related costs due to acquisitions, a \$2.8 million increase in incentive plan expense due to operating performance, a \$4.3 million general increase in operating expenses in certain areas of the Partnership's operations to accommodate increased winter demand and a \$0.7 million increase due to industry-wide increases in business insurance costs.

**Selling, General and Administrative.** Selling, general and administrative expenses were \$7.2 million for the six months ended February 28, 2003, a \$1.1 million increase from the \$6.1 million for the same six month period last year. This increase is primarily related to the performance-based compensation plan expense in 2003 that was not incurred in 2002, offset by a decrease of \$0.3 related to the adoption of SFAS 123.

**Depreciation and Amortization.** Depreciation and amortization was \$18.7 million in each of the six months ended February 28, 2003 and February 28, 2002.

**Operating Income.** For the six months ended February 28, 2003, Heritage had operating income of \$73.3 million as compared to operating income of \$43.0 million for the six months ended February 28, 2002. This increase is a combination of a \$0.3 increase related to the adoption of SFAS 123 and increased gross profit offset by increased operating expenses described above.

**Other Expense.** For the six months ended February 28, 2003, Heritage recorded other expense of \$2.5 million as compared to \$0.2 million for the six months ended February 28, 2002. This increase is primarily due to the reclassification into earnings of a loss on marketable securities in the six months ended February 28, 2003 that was previously recorded as accumulated other comprehensive income loss on the balance sheet.

**Interest Expense.** Interest expense decreased \$0.1 million for the six months ended February 28, 2003 to \$18.6 million from \$18.7 million for the same six-month period last year.

Taxes. Taxes for the six months ended February 28, 2003 were \$1.3 million due to the tax expense anticipated to be incurred by Heritage's corporate subsidiaries. There was no tax expense in these subsidiaries for the six months ended February 28, 2002.

Net Income. For the six month period ended February 28, 2003, Heritage had net income of \$51.3 million, an increase of \$25.9 million, as compared to a net income for the six months ended February 28, 2002 of \$25.4 million. The increase is primarily the result of a \$0.3 increase related to the adoption of SFAS 123 and the increase in operating income, partially offset by the increase in other expenses and taxes described above.

EBITDA, as adjusted. EBITDA, as adjusted increased \$29.9 million to \$93.8 million for the six months ended February 28, 2003, as compared to EBITDA, as adjusted of \$63.9 million for the six months ended February 28, 2002. This increase is due to the operating conditions described above and is a record level EBITDA, as adjusted for the six-month results of Heritage. EBITDA, as adjusted for the six months ended February 28, 2003 and February 28, 2002 is computed as follows:

| (in millions)  | Six Months<br>Ended February 28, |         |
|--|----------------------------------|---------|
|  | 2003                             | 2002    |
| NET INCOME RECONCILIATION                            |                                  |         |
| Net income   | \$ 51.3                          | \$ 25.4 |
| Depreciation and amortization                        | 18.7                             | 18.7    |
| Interest   | 18.6                             | 18.7    |
| Taxes  | 1.3                              | -       |
| Non-cash compensation expense                        | 0.6                              | 1.0     |
| Other expense  | 2.5                              | 0.2     |
| Depreciation, amortization, and interest of investee | 0.5                              | 0.2     |
| Minority interest in the Operating Partnership       | 0.5                              | 0.4     |
| Less : Gain on disposal of assets                    | (0.2)                            | (0.7)   |
| EBITDA, as adjusted                                  | \$ 93.8                          | \$ 63.9 |

#### LIQUIDITY AND CAPITAL RESOURCES

The ability of Heritage to satisfy its obligations will depend on its future performance, which will be subject to prevailing economic, financial, business and weather conditions, and other factors, many of which are beyond management's control. Future capital requirements of Heritage are expected to be provided by cash flows from operating activities. To the extent future capital requirements exceed cash flows from operating activities:

- a) working capital will be financed by the working capital line of credit and repaid from subsequent seasonal reductions in inventory and accounts receivable;
- b) growth capital expenditures, mainly for customer tanks, will be financed by the revolving acquisition bank line of credit; and

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- c) acquisition capital expenditures will be financed by the revolving acquisition bank line of credit; other lines of credit, long term debt, issuance of additional Common Units or a combination thereof.

Operating Activities. Cash provided by operating activities during the six months ended February 28, 2003, was \$55.0 million as compared to cash provided by operating activities of \$23.8 million for the same six-month period ended February 28, 2002. The net cash provided by operations for the six months ended February 28, 2003 consisted of net income of \$51.3 million and non-cash charges of \$22.4 million, principally depreciation and amortization, offset by the impact of an increase in working capital of \$18.7 million. Although the increase in working capital for the six months ended February 28, 2003 is comparable to the increase for the six months ended February 28, 2002, the changes in components of working capital varied significantly due to an increase in the demand for fuel resulting from the colder winter temperatures this fiscal year in various areas of Heritage's operations. The increase in fuel demand affects working capital as accounts receivable increases, inventory decreases, accounts payable to purchase product increases, and customer prebought gallons and prepayments decrease.

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Investing Activities. Heritage completed three acquisitions during the six months ended February 28, 2003 spending a net of \$21.2 million, after deducting cash received in such acquisitions. This capital expenditure amount is reflected in the cash used in investing activities of \$35.6 million along with \$16.5 million invested for maintenance needed to sustain operations at current levels and for customer tanks to support growth of operations. Cash used in investing activities also includes proceeds from the sale of idle property of \$2.1 million.

Financing Activities. Cash used in financing activities during the six months ended February 28, 2003 of \$15.2 million resulted mainly from a net decrease in the outstanding balance under the Working Capital Facility of \$10.9 million, cash distributions to Unitholders of \$20.8 million, and payments on other long-term debt of \$1.9 million. These decreases were offset by a net increase in the outstanding balance under the Acquisition Facility of \$18.3 million used to acquire other propane businesses and other financing activities of \$0.1 million.

### FINANCING AND SOURCES OF LIQUIDITY

Heritage has a Bank Credit Facility with various financial institutions, which includes a Working Capital Facility, providing for up to \$65.0 million of borrowings for working capital and other general partnership purposes, and an Acquisition Facility providing for up to \$50.0 million of borrowings for acquisitions and improvements. The weighted average interest rate was 3.13% for the amounts outstanding at February 28, 2003 on both the Working Capital Facility and the Acquisition Facility. As of February 28, 2003, the Working Capital Facility had \$45.7 million available for borrowings and the Acquisition Facility had \$17.7 million available to fund future acquisitions.

Heritage uses its cash provided by operating and financing activities to provide distributions to the Partnership's Unitholders and to fund acquisition, maintenance, and growth capital expenditures. Acquisition capital expenditures, which include expenditures related to the acquisition of retail propane operations and intangibles associated with such acquired businesses, were \$21.2 million for the six months ended February 28, 2003. In addition to the \$21.2 million of cash expended for acquisitions, \$15 million in Partnership units were issued, \$0.8 million for notes payable on non-compete agreements were issued,

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and liabilities of \$0.4 million were assumed in connection with certain acquisitions.

Under the Partnership Agreement, the Partnership will distribute to its partners within 45 days after the end of each fiscal quarter, an amount equal to all of its Available Cash for such quarter. Available cash generally means, with respect to any quarter of the Partnership, all cash on hand at the end of such quarter less the amount of cash reserves established by the General Partner in its reasonable discretion that is necessary or appropriate to provide for future cash requirements. The Partnership's commitment to its Unitholders is to distribute the increase in its cash flow while maintaining prudent reserves for the Partnership's operations. The Partnership paid quarterly distributions of \$0.6375 per unit (or \$2.55 annually) on October 15, 2002 for the fourth quarter ended August 31, 2002, and on January 14, 2003 for the quarter ended November 30, 2002. On March 24, 2003, the Partnership declared a distribution for the second quarter ended February 28, 2003 of \$0.6375 per unit (or \$2.55 annually) payable on April 14, 2003 to the unitholders of record at the close of business on April 4, 2003. In addition to these quarterly distributions, the General Partner received quarterly distributions for its general partner interest in the Partnership, its minority interest, and incentive distributions to the extent the quarterly distribution exceeded \$0.55 per unit (\$2.20 annually).

The assets utilized in the propane business do not typically require lengthy manufacturing process time or complicated, high technology components. Accordingly, the Partnership does not have any significant financial commitments for capital expenditures. In addition, the Partnership has not experienced any significant increases attributable to inflation in the cost of these assets or in its operations.

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### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Heritage has little cash flow exposure due to rate changes for long-term debt obligations. The Operating Partnership had \$51.6 million of variable rate debt outstanding as of February 28, 2003 through its Bank Credit Facility described elsewhere in this report. The balance outstanding in the Bank Credit Facility generally fluctuates throughout the year. A theoretical change of 1% in the interest rate on the balance outstanding at February 28, 2003 would result in an approximate \$516 thousand change in annual net income. Heritage primarily enters debt obligations to support general corporate purposes including capital expenditures and working capital needs. The Operating Partnership's long-term debt instruments were typically issued at fixed interest rates. When these debt obligations mature, Heritage may refinance all or a portion of such debt at then-existing market interest rates which may be more or less than the interest rates on the maturing debt.

Commodity price risk arises from the risk of price changes in the propane inventory that Heritage buys and sells. The market price of propane is often subject to volatile changes as a result of market conditions over which management will have no control. In the past, price changes have generally been passed along to Heritage's customers to maintain gross margins, mitigating the commodity price risk. In order to help ensure that adequate supply sources are available to Heritage during periods of high demand, Heritage will, from time to time, purchase significant volumes of propane during periods of low demand, which generally occur during the summer months, at the then current market price, for storage both at its customer service centers and in major storage facilities, and for future delivery.

Heritage also attempts to minimize the effects of market price fluctuations for its propane supply by entering into certain financial contracts. In order to

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manage a portion of its propane price market risk, Heritage uses contracts for the forward purchase of propane, propane fixed-price supply agreements, and derivative commodity instruments such as price swap and option contracts. Swap instruments are a contractual agreement to exchange obligations of money between the buyer and seller of the instruments as propane volumes during the pricing period are purchased. Swaps are tied to a fixed price bid by the buyer and a floating price determination for the seller based on certain indices at the end of the relevant trading period. Call options give the Heritage the right, but not the obligation, to buy a specified number of gallons of propane at a specified price at any time until a specified expiration date. Heritage enters into these financial instruments to hedge pricing on the projected propane volumes to be purchased during each of the one-month periods during the projected heating season.

At February 28, 2003, Heritage had outstanding propane hedges (call options) for a total of 2.1 million gallons of propane. The fair value of the call options is based on the market price of propane. At February 28, 2003, the fair value of the options was \$572,000 and is recorded in accounts receivable. Inherent in the portfolio from the liquids marketing activities are certain business risks, including market risk and credit risk. Market risk is the risk that the value of the portfolio will change, either favorably or unfavorably, in response to changing market conditions. Credit risk is the risk of loss from nonperformance by suppliers, customers, or financial counter parties to a contract. Heritage takes an active role in managing and controlling market and credit risk and has established control procedures, which are reviewed on an ongoing basis. Heritage monitors market risk through a variety of techniques, including routine reporting to senior management. Heritage attempts to minimize credit risk exposure through credit policies and periodic monitoring procedures.

### LIQUIDS MARKETING

Heritage buys and sells derivative financial instruments, which are within the scope of SFAS 133 and that are not designated as accounting hedges. Heritage also enters into energy trading contracts, which are not derivatives, and therefore are not within the scope of SFAS 133. EITF Issue No. 98-10, Accounting for Contracts Involved in Energy Trading and Risk Management Activities (EITF 98-10), applied to energy trading contracts not within the scope of SFAS 133 that were entered into prior to October 25, 2002. The types of contracts Heritage utilizes in its liquids marketing segment include energy commodity forward contracts, options, and swaps traded on the over-the-counter financial markets. In accordance with the provisions of SFAS 133, derivative financial instruments utilized in connection with Heritages' liquids marketing activity are accounted for using the mark-to-market method. Additionally, all energy trading contracts entered into prior to October 25, 2002 were accounted for using the mark-to-market method in accordance with the provisions of EITF 98-10. Under the mark-to-market method of accounting, forwards, swaps, options, and storage contracts are reflected at fair value, and are shown in the consolidated balance sheet as assets and liabilities from liquids marketing activities. As of August 31, 2002,

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Heritage adopted the applicable provisions of EITF Issue No. 02-3, Issues Related to Accounting for Contracts Involved in Energy Trading and Risk Management Activities (EITF 02-3), which requires that gains and losses on derivative instruments be shown net in the statement of operations if the derivative instruments are held for trading purposes. Net realized and unrealized gains and losses from the financial contracts and the impact of price movements are recognized in the statement of operations as liquids marketing revenue. Changes in the assets and liabilities from the liquids marketing activities result primarily from changes in the market prices, newly originated

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transactions, and the timing and settlement of contracts. EITF 02-3 also rescinds EITF 98-10 for all energy trading contracts entered into after October 25, 2002 and specifies certain disclosure requirements. Consequently, Heritage does not apply mark-to-market accounting for any contracts entered into after October 25, 2002, that are not within the scope of SFAS 133. Heritage attempts to balance its contractual portfolio in terms of notional amounts and timing of performance and delivery obligations. However, net unbalanced positions can exist or are established based on management's assessment of anticipated market movements.

The adoption of EITF 02-3 requires that realized and unrealized gains and losses be shown net for all periods presented. The following table summarizes the amounts that have been reclassified in the statement of operations:

|  | For the Three Months<br>Ended February 28, |           | For the Six Months<br>Ended February 28, |            |
|--|--|-----------|--|------------|
|  | 2003                                       | 2002      | 2003                                     | 2002       |
|  | ----                                       | ----      | ----                                     | ----       |
| Revenue - liquids marketing            | \$ 79,587                                  | \$ 47,326 | \$ 140,317                               | \$ 98,146  |
| Costs and expenses - liquids marketing | (79,235)                                   | (45,633)  | (139,258)                                | (99,778)   |
|  | -----                                      | -----     | -----                                    | -----      |
| Net, as reclassified                   | \$ 352                                     | \$ 1,693  | \$ 1,059                                 | \$ (1,632) |
|  | =====                                      | =====     | =====                                    | =====      |

The notional amounts and terms of these financial instruments as of February 28, 2003 and 2002 include fixed price payor for 65,000 barrels of propane and 355,000 barrels of propane and butane, respectively, and fixed price receiver of 65,000 barrels of propane and 225,000 barrels of propane and butane, respectively. Notional amounts reflect the volume of the transactions, but do not represent the amounts exchanged by the parties to the financial instruments. Accordingly, notional amounts do not accurately measure Heritage's exposure to market or credit risks.

The fair value of the financial instruments related to liquids marketing activities as of February 28, 2003 and August 31, 2002, was assets of \$0.6 and \$2.3 million, respectively, and liabilities of \$0.6 and \$1.8 million respectively

Estimates related to Heritage's liquids marketing activities are sensitive to uncertainty and volatility inherent in the energy commodities markets and actual results could differ from these estimates. A theoretical change of 10% in the underlying commodity value of the liquids marketing contracts would result in no change in the market value of the contracts as there are no net unbalanced positions at February 28, 2003.

Inherent in the resulting contractual portfolio are certain business risks, including market risk and credit risk. Market risk is the risk that the value of the portfolio will change, either favorably or unfavorably, in response to changing market conditions. Credit risk is the risk of loss from nonperformance by suppliers, customers, or financial counterparties to a contract. Heritage takes an active role in managing and controlling market and credit risk and has established control procedures, which are reviewed on an ongoing basis. Heritage monitors market risk through a variety of techniques, including routine reporting to senior management. Heritage attempts to minimize credit risk exposure through credit policies and periodic monitoring procedures.

The following table summarizes the fair value of Heritage's contracts,

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aggregated by method of estimating fair value of the contracts as of February 28, 2003 and August 31, 2002 where settlement had not yet occurred. Heritage's contracts all have a maturity of less than 1 year. The market prices used to value these transactions reflect management's best estimate considering various factors including closing average spot prices for the current and outer months plus a differential to consider time value and storage costs.

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| Source of Fair Value<br>-----  | February 28,<br>2003<br>----- | August 31,<br>2002<br>----- |
|--|-------------------------------|-----------------------------|
| Prices actively quoted   | \$ 596                        | \$ 1,276                    |
| Prices based on other valuation methods                                    | -                             | 1,025                       |
|  | -----                         | -----                       |
| Assets from liquids marketing  | \$ 596                        | \$ 2,301                    |
|  | =====                         | =====                       |
| Prices actively quoted   | \$ 584                        | \$ 669                      |
| Prices based on other valuation methods                                    | -                             | 1,149                       |
|  | -----                         | -----                       |
| Liabilities from liquids marketing   | \$ 584                        | \$ 1,818                    |
|  | =====                         | =====                       |
| Unrealized gains in fair value of contracts outstanding<br>as of August 31 | \$ 12                         | \$ 483                      |
|  | =====                         | =====                       |

The following table summarizes the changes in the unrealized fair value of Heritage's contracts where settlement had not yet occurred for the three and six months ended February 28, 2003 and 2002.

|  | Three Months Ended<br>February 28 |            | Six M<br>Fe |
|--|-----------------------------------|------------|-------------|
|  | 2003                              | 2002       | 2003        |
|  | -----                             | -----      | -----       |
| Unrealized gains (losses) in fair value of contracts<br>outstanding at the beginning of the period | \$ 41                             | \$ (2,524) | \$ 48       |
| Other unrealized gains (losses) recognized during the<br>period                                    | 352                               | 1,693      | 57          |
| Less: Realized gains (losses) recognized during the<br>period                                      | 381                               | (315)      | 1,04        |
|  | -----                             | -----      | -----       |
| Unrealized gains (losses) in fair value of contracts<br>outstanding at the end of the period       | \$ 12                             | \$ (516)   | \$ 1        |
|  | =====                             | =====      | =====       |

The following table summarizes the gross transaction volumes in barrels for liquids marketing contracts that were physically settled for the three and six months ended February 28, 2003, and 2002.



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| (in thousands)    | Three Months | Six Months |
|-------------------|--------------|------------|
| February 28, 2003 | 20           | 64         |
| February 28, 2002 | 133          | 245        |

### ITEM 4. CONTROLS AND PROCEDURES

The Partnership maintains controls and procedures designed to ensure that information required to be disclosed in the reports that the Partnership files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC. Within 90 days prior to the filing date of this report, an evaluation was performed under the supervision and with the participation of the Partnership's management, including the Chief Executive Officer and the Chief Financial Officer of the General Partner of the Partnership, of the effectiveness of the design and operation of the Partnership's disclosure controls and procedures (as such terms are defined in Rule 13a-14(c) and 15d-14(c) of the Exchange Act). Based upon that evaluation, management, including the Chief Executive Officer and the Chief Financial Officer of the General Partner of the Partnership, concluded that the Partnership's disclosure controls and procedures were adequate and effective as of February 28, 2003. There have been no significant changes in the Partnership's internal controls or in other factors subsequent to such evaluation, and there have been no corrective actions with respect to significant deficiencies and material weaknesses in our internal controls.

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## PART II - OTHER INFORMATION

### ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

On January 2, 2003, the Partnership issued 551,456 Common Units, with a total value of \$15 million, in exchange for certain assets acquired in connection with the acquisition of the propane distribution assets of V-1 Oil Co. The Units were issued utilizing the Partnership's Registration Statement No. 333-40407 on Form S-4.

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

#### (a) Exhibits

The exhibits listed on the following Exhibit Index are filed as part of this Report. Exhibits required by Item 601 of Regulation S-K, but which are not listed below, are not applicable.

| Exhibit<br>Number<br>----- | Description<br>-----  |
|----------------------------|---|
| (1)                        | 3.1 Agreement of Limited Partnership of Heritage Propane Partners, L.P.                               |
| (10)                       | 3.1.1 Amendment No. 1 to Amended and Restated Agreement of Limited Partnership Propane Partners, L.P. |
| (16)                       | 3.1.2 Amendment No. 2 to Amended and Restated Agreement of Limited Partnership Propane Partners, L.P. |

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Propane Partners, L.P.

- (19) 3.1.3 Amendment No. 3 to Amended and Restated Agreement of Limited Partnersh  
Propane Partners, L.P.
- (19) 3.1.4 Amendment No. 4 to Amended and Restated Agreement of Limited Partnersh  
Propane Partners, L.P.
- (1) 3.2 Agreement of Limited Partnership of Heritage Operating, L.P.
- (12) 3.2.1 Amendment No. 1 to Amended and Restated Agreement of Limited Partnersh  
Operating, L.P.
- (19) 3.2.2 Amendment No. 2 to Amended and Restated Agreement of Limited Partnersh  
Operating, L.P.
- (18) 3.3 Amended Certificate of Limited Partnership of Heritage Propane Partner
- (18) 3.4 Amended Certificate of Limited Partnership of Heritage Operating, L.P.
- (20) 4.1 Registration Rights Agreement for Limited Partner Interests of Heritag  
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- (7) 10.1 First Amended and Restated Credit Agreement with Banks Dated May 31, 1
- (8) 10.1.1 First Amendment to the First Amended and Restated Credit Agreement dat  
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- (9) 10.1.2 Second Amendment to First Amended and Restated Credit Agreement dated  
2000

30

| Exhibit<br>Number<br>----- | Description<br>-----  |
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| (10) 10.1.3                | Third Amendment dated as of August 10, 2000 to First Amended and Rest<br>Agreement  |
| (13) 10.1.4                | Fourth Amendment to First Amended and Restated Credit Agreement dated<br>28, 2000   |
| (16) 10.1.5                | Fifth Amendment to First Amended and Restated Credit Agreement dated a<br>2001      |
| (1) 10.2                   | Form of Note Purchase Agreement (June 25, 1996)                                     |
| (3) 10.2.1                 | Amendment of Note Purchase Agreement (June 25, 1996) dated as of July               |
| (4) 10.2.2                 | Amendment of Note Purchase Agreement (June 25, 1996) dated as of March              |
| (6) 10.2.3                 | Amendment of Note Purchase Agreement (June 25, 1996) dated as of Octob              |
| (8) 10.2.4                 | Second Amendment Agreement dated September 1, 1999 to June 25, 1996 No<br>Agreement |

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|      |        |   |
|------|--------|---|
| (11) | 10.2.5 | Third Amendment Agreement dated May 31, 2000 to June 25, 1996 Note Purchase Agreement and November 19, 1997 Note Purchase Agreement   |
| (10) | 10.2.6 | Fourth Amendment Agreement dated August 10, 2000 to June 25, 1996 Note Purchase Agreement and November 19, 1997 Note Purchase Agreement   |
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| (1)  | 10.3   | Form of Contribution, Conveyance and Assumption Agreement among Heritage Propane Partners, L.P., Heritage Propane Partners, L.P. and Heritage Operating, L.P.                           |
| (1)  | 10.6   | Restricted Unit Plan  |
| (4)  | 10.6.1 | Amendment of Restricted Unit Plan dated as of October 17, 1996  |
| (12) | 10.6.2 | Amended and Restated Restricted Unit Plan dated as of August 10, 2000   |
| (18) | 10.6.3 | Second Amended and Restated Restricted Unit Plan dated as of February 1, 2001   |
| (12) | 10.7   | Employment Agreement for James E. Bertelsmeyer dated as of August 10, 2000  |
| (18) | 10.7.1 | Consent to Assignment of Employment Agreement for James E. Bertelsmeyer dated as of February 3, 2002  |
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| (12) | 10.8   | Employment Agreement for R. C. Mills dated as of August 10, 2000  |
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31

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| (18) | 10.10.1                    | Consent to Assignment of Employment Agreement for H. Michael Krimbill dated as of February 3, 2002                         |
| (12) | 10.11                      | Employment Agreement for Bradley K. Atkinson dated as of August 10, 2000   |
| (18) | 10.11.1                    | Consent to Assignment of Employment Agreement for Bradley K. Atkinson dated as of February 3, 2002                         |
| (7)  | 10.12                      | First Amended and Restated Revolving Credit Agreement between Heritage Propane Partners, L.P. and Banks Dated May 31, 1999 |
| (16) | 10.12.1                    | First Amendment to First Amended and Restated Revolving Credit Agreement dated as of October 15, 1999                      |
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December 28, 2000

- (16) 10.12.4 Fourth Amendment to First Amended and Restated Revolving Credit Agreement dated December 16, 2001
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- (18) 10.13.1 Consent to Assignment of Employment Agreement for Mark A. Darr dated as of August 10, 2000
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- (18) 10.14.1 Consent to Assignment of Employment Agreement for Thomas H. Rose dated as of August 10, 2000
- (12) 10.15 Employment Agreement for Curtis L. Weishahn dated as of August 10, 2000
- (18) 10.15.1 Consent to Assignment of Employment Agreement for Curtis L. Weishahn dated as of August 10, 2002
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32

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| (10) 10.17                 | Contribution Agreement dated June 15, 2000 among U.S. Propane, L.P., Heritage Propane Partners, L.P. and Heritage Propane Partners, L.P. |
| (10) 10.17.1               | Amendment dated August 10, 2000 to June 15, 2000 Contribution Agreement  |
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- (15) 10.25.1 Amendment to Asset Purchase Agreement dated as of July 5, 2001 among WMJB, Inc., the Shareholders of WMJB, Inc. and Heritage Operating, L.P.
- (18) 10.26 Assignment, Conveyance and Assumption Agreement between U.S. Propane, Inc., Heritage Holdings, Inc., as the former General Partner of Heritage Propane, Inc. L.P. dated as of February 4, 2002
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33

| Exhibit<br>Number<br>----- | Description<br>-----   |
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| (22) 10.28                 | Assignment for Contribution of Assets in Exchange for Partnership Interest in V-1 Oil Co., December 9, 2002 amount V-1 Oil Co., the shareholders of V-1 Oil Co., Partners, L.P. and Heritage Operating, L.P. |
| (23) 10.29                 | Employment Agreement for Michael L. Greenwood dated as of July 1, 2002   |
| (21) 21.1                  | List of Subsidiaries   |
| (*) 31.1                   | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| (*) 31.2                   | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |

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- (\*) 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- (\*) 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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- (1) Incorporated by reference to the same numbered Exhibit to Registrant's Registration Statement of Form S-1, File No. 333-04018, filed with the Commission on June 21, 1996.
  - (2) Incorporated by reference to Exhibit 10.11 to Registrant's Registration Statement on Form S-1, File No. 333-04018, filed with the Commission on June 21, 1996.
  - (3) Incorporated by reference to the same numbered Exhibit to Registrant's Form 10-Q for the quarter ended November 30, 1996.
  - (4) Incorporated by reference to the same numbered Exhibit to Registrant's Form 10-Q for the quarter ended February 28, 1997.
  - (5) Incorporated by reference to the same numbered Exhibit to Registrant's Form 10-Q for the quarter ended May 31, 1998.
  - (6) Incorporated by reference to the same numbered Exhibit to the Registrant's Form 10-K for the year ended August 31, 1998.
  - (7) Incorporated by reference to the same numbered Exhibit to the Registrant's Form 10-Q for the quarter ended May 31, 1999.
  - (8) Incorporated by reference to the same numbered Exhibit to the Registrant's Form 10-K for the year ended August 31, 1999.
  - (9) Incorporated by reference to the same numbered Exhibit to the Registrant's Form 10-Q for the quarter ended May 31, 2000.
  - (10) Incorporated by reference to the same numbered Exhibit to the Registrant's Form 8-K dated August 23, 2000.
  - (11) File as Exhibit 10.16.3.

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- (12) Incorporated by reference to the same numbered Exhibit to the Registrant's Form 10-K for the year ended August 31, 2000.
- (13) Incorporated by reference to the same numbered Exhibit to the Registrant's Form 10-Q for the quarter ended February 28, 2001.
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- (17) Incorporated by reference to the same numbered Exhibit to the Registrant's Form 10-Q for the quarter ended November 30, 2001.
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- (19) Incorporated by reference to the same numbered Exhibit to the Registrant's Form 10-Q for the quarter ended May 31, 2002.
- (20) Incorporated by reference to the same numbered Exhibit to the Registrant's Form 8-K dated February 4, 2002.
- (21) Incorporated by reference to the same numbered Exhibit to the Registrant's Form 10-K for the year ended August 31, 2002.
- (22) Incorporated by reference to the same numbered Exhibit to the Registrant's Form 8-K dated January 6, 2003.
- (23) Incorporated by reference to the same numbered Exhibit to the Registrant's Form 10-Q for the quarter ended November 30, 2002.
- (\*) Filed herewith.
- (b) Reports on Form 8-K

The Partnership filed two reports on Form 8-K during the three months ended February 28, 2003:

Form 8-K dated December 11, 2002, was filed reporting the Partnership had entered into a definitive agreement to acquire the retail propane assets of V-1 Oil Co. of Idaho Falls, Idaho. Attached as an exhibit to the Form 8-K was the press release dated December 10, 2002 announcing the transaction.

Form 8-K dated January 6, 2003, was filed reporting the acquisition of the propane distribution assets of V-1 Oil Co. The report described the transaction and advised that the financial statements required to be filed in connection with the business acquisition would be filed within the prescribed time periods. Attached as exhibits to the Form 8-K were the Agreement for Contribution of Assets in Exchange for Partnership Interests dated December 9, 2002 among V-1 Oil Co., the shareholders of V-1 Oil Co., Heritage Propane Partners, L.P., and Heritage Operating L.P., and the Press Release dated January 6, 2003 announcing the completion of the acquisition.

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### SIGNATURE

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

HERITAGE PROPANE PARTNERS, L.P.

By: U.S. Propane, L.P., General Partner

By: U.S. Propane, L.L.C., General Partner

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Date: November 26, 2003

By: /s/ Michael L. Greenwood

-----  
 Michael L. Greenwood  
 (Vice President, Chief Financial Officer  
 and officer duly authorized to sign on  
 behalf of the registrant)

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## INDEX TO EXHIBITS

| Exhibit<br>Number<br>----- | Description<br>-----   |
|----------------------------|--|
| (1)                        | 3.1 Agreement of Limited Partnership of Heritage Propane Partners, L.P.                                |
| (10)                       | 3.1.1 Amendment No. 1 to Amended and Restated Agreement of Limited Partnersh<br>Propane Partners, L.P. |
| (16)                       | 3.1.2 Amendment No. 2 to Amended and Restated Agreement of Limited Partnersh<br>Propane Partners, L.P. |
| (19)                       | 3.1.3 Amendment No. 3 to Amended and Restated Agreement of Limited Partnersh<br>Propane Partners, L.P. |
| (19)                       | 3.1.4 Amendment No. 4 to Amended and Restated Agreement of Limited Partnersh<br>Propane Partners, L.P. |
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## Edgar Filing: HERITAGE PROPANE PARTNERS L P - Form 10-Q/A

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## Edgar Filing: HERITAGE PROPANE PARTNERS L P - Form 10-Q/A

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