Energy Transfer Partners, L.P.
Form 10-Q
July 11, 2005
Table of Contents

FORM 10-Q

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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

For the Quarterly Period Ended May 31, 2005

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

ENERGY TRANSFER PARTNERS, L.P.

(Exact name of registrant as specified in its charter)

Delaware	**73-1493906**
(State or other jurisdiction or	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**

2838 Woodside Street

Dallas, Texas 75204

(Address of principal executive offices and zip code)

(214) 981-0700

(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 x No ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes x No ¨

At July 1, 2005, the registrant had units outstanding as follows:

Energy Transfer Partners, L.P.	103,884,572	Common Units

FORM 10-Q

INDEX TO FINANCIAL STATEMENTS

Energy Transfer Partners, L.P. and Subsidiaries

(Formerly Energy Transfer Company and surviving legal entity in the Energy Transfer Transactions)

Table of Contents

Forward-Looking Statements

Certain matters discussed in this report, excluding historical information, as well as some statements by Energy Transfer Partners, L.P., (Energy Transfer Partners or the Partnership) in periodic press releases and some oral statements of Energy Transfer Partners 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 the Partnership 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 subject to uncertainties and risks, difficult to predict, and beyond management s control. For additional discussion of risks, uncertainties and assumptions, see the Partnership s Annual Report on Form 10-K for the fiscal year ended August 31, 2004 filed with the Securities and Exchange Commission on November 15, 2004.

Definitions

The following is a list of certain acronyms and terms generally used in the energy industry and throughout this document:

/d	per day
Bbls	barrels
Btu	British thermal unit, an energy measurement
Mcf	thousand cubic feet
MMBtu	million British thermal unit
MMcf	million cubic feet
Bcf	billion cubic feet
NGL	natural gas liquid, such as propane, butane and natural gasoline
LIBOR	London Interbank Offered Rate
NYMEX	New York Mercantile Exchange
Reservoir	A porous and permeable underground formation containing a natural accumulation of producible natural gas and/or oil that is confined by impermeable rock or water barriers and is separate from other reservoirs.

Table of Contents

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except unit data)

(unaudited)

	May 31, 2005	August 31, 2004
		(see note 4)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 21,320	$ 81,745
Marketable securities	2,658	2,464
Accounts receivable, net of allowance for doubtful accounts	729,261	251,346
Accounts receivable from related companies	171	34
Exchanges receivable	19,819	8,639
Inventories	261,413	53,261
Assets held for sale, net		47,317
Deposits paid to vendors	46,441	3,023
Price risk management assets	36,307	4,615
Prepaid expenses and other	59,684	7,401
Total current assets	1,177,074	459,845
PROPERTY, PLANT AND EQUIPMENT, net	2,375,265	1,424,095
LONG - TERM PRICE RISK MANAGEMENT ASSETS	18,824	
INVESTMENT IN AFFILIATES	40,854	8,010
GOODWILL	321,732	313,720
INTANGIBLES AND OTHER ASSETS, net	102,103	100,844
Total assets	$ 4,035,852	$ 2,306,514

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

.

Table of Contents

ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except unit data)

(unaudited)

	May 31, 2005	August 31, 2004
		(see note 4)
LIABILITIES AND PARTNERS CAPITAL		
CURRENT LIABILITIES:		
Working capital facility	$	$ 14,550
Accounts payable	786,936	252,541
Accounts payable to related companies	3,480	4,276
Exchanges payable	20,612	2,657
Customer deposits	24,978	11,378
Accrued and other current liabilities	105,244	56,574
Price risk management liabilities	38,736	1,262
Income taxes payable	1,075	2,252
Current maturities of long-term debt	33,362	30,957
Total current liabilities	1,014,423	376,447
LONG-TERM DEBT, net of discount, less current maturities	1,563,333	1,070,871
LONG-TERM PRICE RISK MANAGEMENT LIABILITIES	18,860	
DEFERRED TAXES	114,567	109,896
OTHER NONCURRENT LIABILITIES	16,660	845
MINORITY INTERESTS	17,238	1,475
	2,745,081	1,559,534
COMMITMENTS AND CONTINGENCIES		
PARTNERS CAPITAL:		
Common Unitholders (102,244,572 and 89,118,062 units authorized, issued and outstanding at May 31, 2005 and August 31, 2004, respectively)	1,226,537	720,187
Class C Unitholders (1,000,000 units authorized, issued and outstanding at May 31, 2005 and August 31, 2004 , respectively)		
Class E Unitholders (8,853,832 authorized, issued and outstanding at May 31, 2005 and August 31, 2004, respectively held by subsidiary and reported as treasury units)		
General Partner	45,049	26,761
Accumulated other comprehensive income	19,185	32
Total partners capital	1,290,771	746,980
Total liabilities and partners capital	$ 4,035,852	$ 2,306,514

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

Table of Contents

ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per unit and unit data)

(unaudited)

	Three Months Ended May 31, 2005	Three Months Ended May 31, 2004	Nine Months Ended May 31, 2005	Nine Months Ended May 31, 2004
		(See notes 2 and 4)		(See notes 2 and 4)
REVENUES:				
Midstream and Transportation and Storage	$ 1,849,518	$ 461,435	$ 3,673,730	$ 1,314,176
Propane	164,797	122,850	604,996	255,303
Other	17,434	13,634	57,065	22,177
Total revenues	2,031,749	597,919	4,335,791	1,591,656
COSTS AND EXPENSES:				
Cost of products sold	1,816,998	486,960	3,756,078	1,345,847
Operating expenses	90,372	51,403	224,122	86,622
Depreciation and amortization	25,229	15,884	67,123	28,426
Selling, general and administrative	20,282	9,183	42,919	19,116
Total costs and expenses	1,952,881	563,430	4,090,242	1,480,011
OPERATING INCOME	78,868	34,489	245,549	111,645
OTHER INCOME (EXPENSE):				
Interest expense	(26,407)	(12,294)	(66,762)	(25,114)
Loss on extinguishment of debt	(1,554)		(9,550)	
Equity in earnings (losses) of affiliates	(307)	179	(161)	506
Loss on disposal of assets	(138)	(263)	(665)	(235)
Other, net	(354)	(8)	14	400
INCOME FROM CONTINUING OPERATIONS BEFORE MINORITY INTERESTS AND INCOME TAX EXPENSE	50,108	22,103	168,425	87,202
Minority interests	(422)	(67)	(937)	(242)
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAX EXPENSE	49,686	22,036	167,488	86,960
Income tax expense	3,182	2,369	7,341	4,827
INCOME FROM CONTINUING OPERATIONS	46,504	19,667	160,147	82,133
DISCONTINUED OPERATIONS:				

Income from discontinued operations	930	1,663	5,498	4,129
Gain on sale of discontinued operations, net of income tax expense	142,076		142,076	
Total income from discontinued operations	143,006	1,663	147,574	4,129
NET INCOME	189,510	21,330	307,721	86,262
GENERAL PARTNER S INTEREST IN NET INCOME	15,124	2,698	31,669	5,315
LIMITED PARTNERS INTEREST IN NET INCOME	$ 174,386	$ 18,632	$ 276,052	$ 80,947
BASIC NET INCOME PER LIMITED PARTNER UNIT				
Income from continuing operations	$ 0.40	$ 0.24	$ 1.51	$ 1.86
Income from discontinued operations	1.31	0.02	1.39	0.09
NET INCOME PER LIMITED PARTNER UNIT	$ 1.71	$ 0.26	$ 2.90	$ 1.95
BASIC AVERAGE NUMBER OF UNITS OUTSTANDING	102,244,572	71,274,812	95,251,619	41,406,546
DILUTED NET INCOME PER LIMITED PARTNER UNIT				
Income from continuing operations	$ 0.40	$ 0.24	$ 1.50	$ 1.86
Income from discontinued operations	1.30	0.02	1.39	0.09
NET INCOME PER LIMITED PARTNER UNIT	$ 1.70	$ 0.26	$ 2.89	$ 1.95
DILUTED AVERAGE NUMBER OF UNITS OUTSTANDING	102,534,208	71,331,404	95,494,351	41,459,674

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

Table of Contents

ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(unaudited)

	Three Months Ended May 31, 2005	Three Months Ended May 31, 2004	Nine Months Ended May 31, 2005	Nine Months Ended May 31, 2004
		(See Note 2)		(See Note 2)
Net income	$ 189,510	$ 21,330	$ 307,721	$ 86,262
Other comprehensive income				
Reclassification adjustment for losses (gains) on derivative instruments included in net income accounted for as hedges	(1,890)	2,766	8,845	(3,134)
Change in value of derivative instruments	7,736	(3,762)	10,114	4,968
Change in value of available-for-sale securities	(1,032)	520	194	141
Comprehensive income	$ 194,324	$ 20,854	$ 326,874	$ 88,237
Reconciliation of Accumulated Other Comprehensive Income				
Balance, beginning of period	$ 14,371	$ 2,451	$ 32	$
Current period reclassification to earnings	(1,890)	2,766	8,845	(3,134)
Current period change	6,704	(3,242)	10,308	5,109
Balance, end of period	$ 19,185	$ 1,975	$ 19,185	$ 1,975

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

4

Table of Contents

ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF PARTNERS CAPITAL

(in thousands, except unit data)

(unaudited)

	Number of Common Units	Common	Class C	Class E	General Partner	Accumulated Other Comprehensive Income	Total
Balance, August 31, 2004	89,118,062	$ 720,187	$	$	$ 26,761	$ 32	$ 746,980
Unit distribution		(123,157)			(20,575)		(143,732)
General Partner capital contribution					7,194		7,194
Issuance of Common Units in connection with certain acquisitions	120,550	2,500					2,500
Issuance of Common Units	12,962,960	349,749					349,749
Issuance of restricted Common Units	43,000						
Net change in accumulated other comprehensive income per accompanying statement						19,153	19,153
Deferred compensation on restricted units and long term incentive plan		1,206					1,206
Net income		276,052			31,669		307,721
Balance, May 31, 2005	102,244,572	$ 1,226,537	$	$	$ 45,049	$ 19,185	$ 1,290,771

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

5

Table of Contents

ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine Months Ended	
	May 31, 2005	May 31, 2004
		(See Note 2)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 307,721	$ 86,262
Reconciliation of net income to net cash provided by operating activities:		
Depreciation and amortization	67,123	28,426
Amortization of deferred finance costs charged to interest expense	2,982	4,073
Write off of deferred financing fees	9,550	
Provision for loss on accounts receivable	4,781	996
Loss on disposal of assets	665	235
Gain on sale of discontinued operations before income tax expense	(143,951)	
Non-cash compensation on restricted units and long-term incentive plan	1,206	
Undistributed earnings of affiliates	161	(359)
Deferred income taxes	4,670	(827)
Minority interests	634	155
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	(111,889)	(60,044)
Accounts receivable from related companies	(138)	(298)
Inventories	(76,089)	50,255
Deposits paid to vendors	(43,419)	17,506
Exchanges receivable	(1,339)	(888)
Prepaid expenses and other	2,530	2,271
Intangibles and other assets	(281)	(2,391)
Accounts payable	218,411	32,230
Accounts payable to related companies	(796)	(58)
Exchanges payable	(4,568)	(614)
Deposits from customers	12,782	(1,243)
Accrued and other current liabilities	12,245	(2,171)
Other long-term liabilities	9,105	
Income taxes payable	(1,177)	(177)
Price risk management assets and liabilities, net	24,766	332
Net cash provided by operating activities	295,685	153,671
CASH FLOWS FROM INVESTING ACTIVITIES:		
Cash paid for acquisitions, net of cash acquired	(1,117,864)	(181,305)
Investment in unconsolidated subsidiaries	(51)	(250)
Capital expenditures	(118,577)	(88,261)
Proceeds from the sale of discontinued operations	191,606	

Proceeds from the sale of assets	3,610	631
Net cash used in investing activities	(1,041,276)	(269,185)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from borrowings	2,071,393	364,238
Proceeds from short-term borrowings from affiliates	174,624	
Principal payments on debt	(1,583,487)	(360,659)
Payments on borrowings from affiliates	(174,624)	
Net proceeds from issuance of Common Units	349,749	334,330
Capital contribution from General Partner	7,194	15,540
Distributions to parent		(196,708)
Debt issuance costs	(15,951)	(4,236)
Unit distributions	(143,732)	(26,868)
Net cash provided by financing activities	685,166	125,637
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(60,425)	10,123
CASH AND CASH EQUIVALENTS, beginning of period	81,745	53,122
CASH AND CASH EQUIVALENTS, end of period	$ 21,320	$ 63,245

Table of Contents

ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine Months Ended	
	May 31, 2005	May 31, 2004
NONCASH FINANCING ACTIVITIES:		
Notes payable incurred on noncompete agreements	$ 1,149	$
Issuance of Common Units in connection with certain acquisitions	$ 2,500	$
General Partner capital contribution	$	$ 1,311
Distributions payble to parent	$	$ 12,556
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for interest	$ 48,274	$ 21,249
Cash paid during the period for income taxes	$ 5,586	$ 4,988

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

ENERGY TRANSFER 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 unaudited consolidated financial statements and notes thereto of the Partnership have been prepared in accordance with accounting principles generally accepted in the United States of America for interim consolidated financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete consolidated financial statements. Due to the seasonal nature of the Partnership s operations and the effect of acquisitions, the results of operations for interim periods are not necessarily indicative of the results to be expected for a full year. For information regarding the pro forma effects of certain transactions occurring during the periods presented on the historical results of operations, see Note 2.

On January 26, 2005, the Partnership completed its acquisition of the Houston Pipeline System and related storage facilities (HPL). For additional information regarding this acquisition and other acquisitions, see Note 3.

In the opinion of management, all adjustments (all of which are normal and recurring) have been made that are necessary to fairly state the consolidated financial position of Energy Transfer Partners and subsidiaries as of May 31, 2005 and the results of operations for the three-month and nine-month periods ended May 31, 2005 and 2004, respectively, and cash flows for the nine-month periods ended May 31, 2005 and May 31, 2004, respectively. The unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto of Energy Transfer Partners presented in the Partnership s Annual Report on Form 10-K as filed with the Securities and Exchange Commission on November 15, 2004 for the fiscal year ended August 31, 2004.

Certain prior period amounts have been reclassified to conform with the 2005 presentation. These reclassifications have no impact on net income or total partners capital.

Energy Transfer Transactions

On January 20, 2004, Heritage Propane Partners, L.P., (Heritage) and La Grange Energy, L.P. (now known as Energy Transfer Company, L.P. (ETC)) completed the series of transactions whereby ETC contributed its subsidiary, La Grange Acquisition, L.P. and its subsidiaries and affiliates who conduct business under the assumed name of Energy Transfer Company, (ETC OLP) to Heritage in exchange for cash, Common Units, Class D Units and Special Units of Heritage. Simultaneously, ETC acquired the General Partner of Heritage, Energy Transfer Partners GP, L.P. (formerly U.S. Propane, L.P.) and Energy Transfer Partners, L.L.C. (formerly U.S. Propane, L.L.C.) from their owners, and coupled with the Heritage Limited Partner interests ETC received, thereby gained control of Heritage. Simultaneous with these transactions, Heritage purchased the outstanding stock of Heritage Holdings, Inc. (HHI) from the owners of Energy Transfer Partners GP, L.P.

Accounting Treatment of the Energy Transfer Transactions

The Energy Transfer Transactions were accounted for as a reverse acquisition in accordance with Statement of Financial Accounting Standard (SFAS) No. 141, *Business Combinations* (SFAS 141). Although Heritage is the surviving parent entity for legal purposes, ETC OLP is the acquiror for accounting purposes. As a result, ETC OLP s historical financial statements are now the historical financial statements of the registrant. The operations of Heritage prior to the Energy Transfer Transactions are referred to as Heritage. The assets and liabilities of Heritage were initially recorded at fair value to the extent acquired by ETC through its acquisition of the General Partner and limited partner interests of Heritage of approximately 35.4%, determined in accordance with Emerging Issues Task Force (EITF) 90-13 *Accounting for Simultaneous Common Control Mergers* and SFAS 141. The assets and liabilities of ETC OLP have been recorded at historical cost. Although the partners capital accounts of ETC OLP became the capital accounts of the Partnership, Heritage s

Table of Contents

partnership structure and partnership units survive. Accordingly, the partners capital accounts of ETC OLP were restated based on the general partner interests and units received by ETC in the Energy Transfer Transactions.

The acquisition of Heritage Holdings by Heritage was accounted for as a capital transaction as the primary asset held by Heritage Holdings was 4,426,916 Common Units of Heritage. Following the acquisition of Heritage Holdings by Heritage, these Common Units were converted to Class E Units. The Class E Units are recorded as treasury units in the consolidated financial statements. Following the two-for-one unit split completed on March 15, 2005, there are 8,853,832 Class E Units outstanding, all owned by Heritage Holdings.

ETC received Special Units in the Energy Transfer Transaction as consideration for the East Texas Pipeline project which was in progress at that time. Upon completion of the East Texas Pipeline in June 2004, the Special Units, which initially had no value assigned, were converted to Common Units, which resulted in additional consideration being recorded. The additional consideration adjusted the percent of Heritage acquired to 41.5% and resulted in an additional fair value step-up to Heritage s assets of approximately $38,000 as determined in accordance with EITF 90-13.

The excess purchase price over Heritage s cost was determined as follows:

Net book value of Heritage at January 20, 2004	$ 239,102
Historical goodwill at January 20, 2004	(170,500)
Equity investment from public offering	355,948
Treasury Class E Unit purchase	(157,340)
	267,210
Percent of Heritage acquired by ETC	41.5%
Equity interest acquired	$ 110,892
Fair market value of Limited Partner Units	668,534
Purchase price of General Partner Interest	30,000
Equity investment from public offering	355,948
Treasury Class E Unit purchase	(157,340)
	897,142
Percent of Heritage acquired by ETC	41.5%
Fair value of equity acquired	372,314
Net book value of equity acquired	110,892
Excess purchase price over Heritage cost	$ 261,422

The excess purchase price over Heritage cost was allocated as follows:

Property, plant and equipment (25 year life)	$ 35,269
Customer lists (15 year life)	18,926
Trademarks	19,251
Goodwill	187,976
	$ 261,422

Management obtained an independent valuation and has made the final modifications to the purchase price. The table above reflects the final adjustments made to the allocation of the purchase price during the first quarter of fiscal year 2005.

Business Operations

In order to simplify the obligations of Energy Transfer Partners under the laws of several jurisdictions in which it conducts business, the Partnership s activities are conducted through two subsidiary operating partnerships, ETC OLP, a Texas limited partnership which is engaged in a variety of natural gas operations, and Heritage Operating L.P., (HOLP), a Delaware limited partnership, which is engaged in retail and wholesale propane operations (collectively the Operating Partnerships). The Partnership, the Operating Partnerships, and their other subsidiaries are collectively referred to in this report as Energy Transfer.

As of May 31, 2005, ETC OLP owns an interest in and operates approximately 11,700 miles of natural gas gathering and transportation pipelines, three natural gas processing plants, two of which are currently connected to its gathering systems, fourteen natural gas treating facilities and three natural gas storage facilities. As a

Table of Contents

result of the HPL acquisition, the Partnership has redefined its reportable operating segments as discussed in Note 21. The midstream segment focuses on the transportation, gathering, compression, treating, processing and marketing of natural gas. Its operations are currently concentrated in the Austin Chalk trend of southeast Texas, the Permian Basin of west Texas, the Barnett Shale in north Texas and the Bossier Sands in east Texas. The transportation and storage segment focuses on the transportation of natural gas through the Oasis Pipeline, the East Texas Pipeline, the natural gas pipeline and storage assets that are referred to as the ET Fuel System, and the natural gas pipeline and storage assets of the recently acquired HPL System. The Oasis Pipeline is a 583-mile natural gas pipeline that directly connects the Waha Hub, a major natural gas trading center located in the Permian Basin of west Texas, to the Katy Hub, a major natural gas trading center near Houston, Texas. The East Texas Pipeline connects natural gas supplies in east Texas to the Katy Pipeline. The ET Fuel System, which serves some of the most active drilling areas in the United States, is comprised of approximately 2,000 miles of intrastate natural gas pipeline and related natural gas storage facilities located in Texas. With approximately 460 receipt and/or delivery points, including interconnects with pipelines providing direct access to power plants and interconnects with other intrastate and interstate pipelines, the ET Fuel System is strategically located near high-growth production areas and major markets such as the Waha Hub, the Katy Hub and the Carthage Hub, three major natural gas trading centers located in Texas. The transportation and storage segment also includes the recently acquired HPL System which is comprised of approximately 4,200 miles of intrastate natural gas pipeline, 65 Bcf of working gas underground Bammel storage reservoir and related transportation assets. The HPL System has access to multiple sources of historically significant natural gas supply reserves from south Texas, the Gulf Coast, east Texas and the western Gulf of Mexico and is directly connected to major gas distribution, electric and industrial load centers in Houston, Corpus Christi, Texas City, Baytown, Beaumont and Port Arthur. The HPL System consists of six main transportation pipelines and three market area loops and has direct access to multiple market hubs at Katy, the Houston Ship Channel, Ague Dulce and through its operations of the Bammel storage facility. The Partnership also recently announced the completion of the Fort Worth Basin Pipeline. The 55-mile, 24 inch natural gas pipeline connects to our existing pipelines in North Texas and provides transportation for natural gas production from the Barnett Shale producing area. The construction costs were financed entirely with cash from operations. Results of operations for the three months ended May 31, 2005 from the Fort Worth Basin Pipeline were not significant.

HOLP sells propane and propane-related products to more than 700,000 active residential, commercial, industrial, and agricultural customers in 34 states. HOLP is also a wholesale propane supplier in the United States and in Canada, the latter through its participation in MP Energy Partnership. MP Energy Partnership, a Canadian partnership in which the Partnership owns a 60% interest, is engaged in lower-margin wholesale distribution and in supplying HOLP s northern U.S. locations. HOLP enters into forward purchases and sales agreements for its own account through its wholly-owned subsidiary, Heritage Energy Resources, L.L.C. (Resources).

Other Developments

On June 20, 2005, the Partnership completed the sale of 1,640,000 Common Units to a group of executive managers of the Partnership. The proceeds were approximately $52,000, of which $30,000 was used to pay outstanding debt and the remaining proceeds will be used for general partnership purposes.

New Accounting Standards

FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations (FIN 47). In March 2005, the Financial Accounting Standards Board (FASB) published FIN 47, which requires companies to record a liability for those asset retirement obligations in which the timing or amount of settlement of the obligation are uncertain. These conditional obligations were not addressed by SFAS 143. FIN 47 will require the Partnership to accrue a liability when a range of scenarios can be determined. Management intends to adopt FIN 47 no later than the end of the fiscal year ending August 31, 2006, and has not yet determined the impact, if any, that this pronouncement will have on the Partnership s financial statements.

SFAS No. 123 (Revised 2004) (SFAS 123R), Share-Based Payment **.** In December 2004, the FASB issued SFAS 123R, which replaces SFAS 123 and supercedes Accounting Principles Board (APB) Opinion No. 25. SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values beginning with the first interim or annual period after June 15, 2005. The Partnership does not expect SFAS 123R to have a material impact on its consolidated results of operations, cash flows or financial position.

Table of Contents

SFAS No. 153 (SFAS 153), Exchanges of Nonmonetary Assets-an amendment of APB Opinion No. 29. In December 2004, the FASB issued SFAS 153, which amends APB Opinion No. 29 by eliminating the exception to the fair-value principle for exchanges of similar productive assets, which were accounted for under APB Opinion No. 29 based on the book value of the asset surrendered with no gain or loss recognition. SFAS 153 also eliminates APB 29 s concept of culmination of an earnings process. SFAS 153 is effective for nonmonetary transactions occurring in fiscal periods beginning after June 15, 2005. The impact of SFAS 153 will depend on the nature and extent of any exchanges of nonmonetary assets after the effective date, but management does not currently expect SFAS 153 to have a material impact on the Partnership s consolidated results of operations, cash flows or financial position.

SFAS No. 154 (SFAS 154), Accounting Changes and Error Correction a replacement of APB Opinion No. 20 and FASB Statement No. 3. In May 2005, the FASB issued SFAS 154 which requires that the direct effect of voluntary changes in accounting principle be applied retrospectively with all prior period financial statements presented on the new accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. Indirect effects of a change should be recognized in the period of the change. SFAS 154 is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005. The impact of SFAS 154 will depend on the nature and extent of any voluntary accounting changes and correction of errors after the effective date, but management does not currently expect SFAS 154 to have a material impact on the Partnership s consolidated results of operations, cash flows or financial position.

EITF Issue No. 03-13 (EITF 03-13), Applying the Conditions in Paragraph 42 of SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets, in Determining Whether to Report Discontinued Operations. In November 2004, the EITF reached a consensus with respect to evaluating whether the criteria in SFAS 144 has been met for classifying as a discontinued operation a component of an entity that either has been disposed of or is classified as held for sale. To qualify as a discontinued operation, SFAS 144 requires that the cash flows of the disposed component be eliminated from the operations of the ongoing entity and that the ongoing entity not have any significant continuing involvement in the operations of the disposed component after the disposal transaction. The consensus is to be applied prospectively to a component of an entity that is either disposed or classified held for sale in fiscal periods beginning after December 15, 2004. The Partnership accounted for the sale of its discontinued operations in accordance with SFAS 144 and EITF 03-13 as of May 31, 2005.

2. PRESENTATION OF FINANCIAL INFORMATION:

The accompanying financial statements for the three months and nine months ended May 31, 2005 include the results of operations for ETC OLP, consolidated with the results of operations of HOLP and HHI. In addition, the Partnership acquired the controlling interests in HPL on January 26, 2005. The results of operations for the ET Fuel System and HPL are included in the consolidated statement of operations since their respective acquisition dates. The accompanying financial statements for the nine month period ended May 31, 2004 include the results of operations for ETC OLP beginning September 1, 2003, consolidated with the results of operations of HOLP and HHI beginning January 20, 2004 after the elimination of significant intercompany balances and transactions. Additionally, on June 2, 2004, ETC OLP acquired the ET Fuel System from TXU Fuel Company, a subsidiary of TXU Corp.

As stated previously, the financial statements of ETC OLP are the financial statements of the registrant, as ETC OLP was deemed the accounting acquiror as a result of the Energy Transfer Transactions.

The following pro forma consolidated results of operations for the nine months ended May 31, 2005 are presented as if the HPL acquisition had been made on September 1, 2004. The pro forma consolidated results of operations for the three and nine months ended May 31, 2004 are presented as if the ET Fuel System acquisition, the HPL acquisition, and the Energy Transfer Transactions had been made on September 1, 2003. The pro forma consolidated results of operations includes the income from discontinued operations as presented on the consolidated income statements for the three and nine months ended May 31, 2004 and the nine months ended May 31, 2005.

Table of Contents

	Nine Months Ended May 31, 2005	Three Months Ended May 31, 2004	Nine Months Ended May 31, 2004
Revenues	$ 6,004,015	$ 1,610,684	$ 4,728,117
Net income	$ 334,642	$ 33,630	119,614
Basic earnings per Limited Partner Unit	$ 2.95	$ 0.36	$ 1.34
Diluted earnings per Limited Partner Unit	$ 2.94	$ 0.36	$ 1.34

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 pro forma consolidated results of operations do not include the effects of the Texas Chalk and Madison Systems acquired in November 2004 or the acquisition of seven propane businesses that were acquired during the nine months ended May 31, 2005 or propane acquisitions that were completed during the nine months ended May 31, 2004. The 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. ACQUISITIONS:

In November 2004, the Partnership acquired the Texas Chalk and Madison Systems from Devon Gas Services for $64,632 in cash which was principally financed with $60,000 from the then existing ETC OLP Revolving Credit Facility. The total purchase price was $66,667 which included $64,632 of cash paid and liabilities assumed of $2,035. These assets include approximately 1,800 miles of gathering and mainline pipeline systems, four natural gas treating plants, condensate stabilization facilities and an 80 MMcf/d gas processing plant. These assets will be integrated into the Southeast Texas System and are expected to provide increased throughput capacity to our existing midstream assets. The acquisition was not material for pro forma disclosure purposes.

In January 2005, the Partnership acquired the controlling interests in HPL from American Electric Power Corporation (AEP) for approximately $825,000 subject to working capital adjustments. This acquisition was financed by the Partnership through a combination of cash on hand, borrowings under its current credit facilities and a private placement with institutional investors of $350,000 of Partnership Common Units. In addition, the Partnership acquired working inventory of natural gas stored in the Bammel storage facilities and financed it through a short-term borrowing from an affiliate. The total purchase price of $1,410,189 which included $1,039,358 of cash paid, net of cash acquired and liabilities assumed of $413,270, including $800 in estimated acquisition costs, was allocated to the assets acquired and liabilities assumed. Included in prepaid expenses and other on the consolidated balance sheet as of May 31, 2005 is $42,439 in receivable due from AEP related to the HPL acquisition. Under the terms of the transaction, the Partnership through ETC OLP, its wholly-owned subsidiary, acquired all but a 2% limited partner interest in HPL. The HPL System is comprised of approximately 4,200 miles of intrastate pipeline with aggregate capacity of 2.4Bcf/d, substantial storage facilities and related transportation assets. The acquisition enables the Partnership to expand its current transportation systems into areas where it previously did not have a presence, and in combination with the Partnership s current midstream assets, provides the premier producing basins in Texas with direct access to the Houston Ship Channel corridor. HPL is included in the transportation and storage operating segment.

During the nine months ended May 31, 2005, HOLP acquired substantially all of the assets of seven propane businesses. The aggregate purchase price for these acquisitions totaled $18,109 which included $13,875 of cash paid, net of cash acquired, 120,550 Common Units on a post-split basis issued valued at $2,500 and liabilities assumed of $1,734. In the aggregate, these acquisitions are not material for pro forma disclosure purposes. The cash paid for acquisitions was financed primarily with the HOLP Senior Revolving Acquisition Facility.

Each of these acquisitions was accounted for as a business combination using the purchase method of accounting in accordance with the provisions of SFAS 141, and each purchase price has been initially allocated based on the estimated fair value of the individual assets acquired and the liabilities assumed at the date of the respective acquisition. The results of operations for these acquisitions are included in the Consolidated Statement of Operations from the date of the respective acquisition.

Table of Contents

The following table presents the allocation of the acquisition cost to the assets acquired and liabilities assumed based on their fair values for these acquisitions (in thousands):

	Texas Chalk and Madison Systems November 2004	HPL January 2005	HOLP acquisitions (aggregated)
Cash and equivalents	$	$ 191	$ 5
Accounts receivable		370,378	429
Inventory		130,280	243
Other current assets		23,567	184
Investments in unconsolidated affiliate		32,940	
Price risk management assets		28,638	
Property, plant, and equipment	66,667	824,386	11,074
Intangibles			3,740
Goodwill			2,439
Total assets acquired	66,667	1,410,380	18,114
Accounts payable	(525)	(313,469)	(233)
Accrued expenses	(1,510)	(36,077)	(352)
Other current liabilities		(13,247)	
Other liabilities		(6,710)	
Price risk management liabilities		(28,638)	
Long-term debt			(1,149)
Minority interest		(15,129)	
Total liabilities assumed	(2,035)	(413,270)	(1,734)
Net assets acquired	$ 64,632	$ 997,110	$ 16,380

The purchase prices have been allocated based on the fair values of the assets acquired and liabilities assumed at the date of acquisition. The preliminary allocation may be adjusted to reflect the final purchase price allocation which will be based on an independent appraisal, if applicable. In addition, the Partnership continues to evaluate the acquisition of HPL and further adjustments may be necessary following an independent appraisal of fair market values, completion of the working capital settlement, and other adjustments under the purchase and sale agreement.

During the three months ended May 31, 2005 the Partnership completed a verification of the working gas inventory contained in the storage facilities it had acquired in two acquisitions and has adjusted the preliminary allocations of the purchase prices to reflect the verified amounts. AEP has notified the Partnership that it intends to review the results of the verification pertaining to the HPL acquisition, and further adjustments may be necessary based on the final outcome of AEP s review and any final determinations made in accordance with the purchase and sale agreement.

4. DISCONTINUED OPERATIONS:

On April 14, 2005, the Partnership completed the sale of its Oklahoma gathering, treating and processing assets, referred to as the Elk City System, for total cash proceeds of $191,606, including certain adjustments as defined in the purchase and sale agreement. The sale resulted in a gain of $142,076 net of income tax expense of $1,875, and the cash proceeds were used to repay a portion of the indebtedness incurred by the Partnership as a result of the acquisition of HPL. The sale of the Elk City System has been accounted for as discontinued operations. These results are presented as net amounts in the Consolidated Statements of Operations, with prior periods restated to conform to the current presentation. Selected operating results for these discontinued operations are presented in the following table:

	Three Months Ended		Nine Months Ended	
	May 31, 2005	May 31, 2004	May 31, 2005	May 31, 2004
Revenues	$ 21,347	$ 34,866	$ 105,542	$ 94,792
Cost and expenses	(20,417)	(33,203)	(100,044)	(90,663)
Net Income	$ 930	$ 1,663	$ 5,498	$ 4,129

Table of Contents

The August 31, 2004 Consolidated Balance Sheet was restated to present the net assets of the Elk City System as assets held for sale. The following amounts were reclassified to assets held for sale as of August 31, 2004:

Current assets	$ 24,354
Property and equipment, net	43,554
Current liabilities	20,591
Net assets held for sale	$ 47,317

5. USE OF ESTIMATES:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The natural gas industry conducts its business by processing actual transactions at the end of the month following the month of delivery. Consequently, the most current month s financial results for the midstream and transportation segments are estimated using volume estimates and market prices. Any difference between estimated results and actual results are recognized in the following month s financial statements. Management believes that the operating results estimated for the three and nine months ending May 31, 2005 represent the actual results in all material respects.

Some of the other more significant estimates made by management include, but are not limited to, allowances for doubtful accounts, the fair value of derivative instruments, useful lives for depreciation and amortization, purchase accounting allocations and subsequent realizability of intangible assets, settlement dates for purposes of estimating asset retirement obligations, and general business and medical self-insurance reserves. Actual results could differ from those estimates.

6. ACCOUNTS RECEIVABLE:

ETC OLP s operations deal with counterparties that are typically either investment grade or are otherwise secured with a letter of credit or other form of security (corporate guaranty prepayment or master set off agreement). Management reviews ETC OLP s accounts receivable balances each week. Credit limits are assigned and monitored for all counterparties of ETC OLP. Management believes that the occurrence of bad debt in the midstream and transportation and storage segments is not significant; therefore, an allowance for doubtful accounts for ETC OLP was not deemed necessary at May 31, 2005 or August 31, 2004. Bad debt expense related to these receivables is recognized at the time an account is deemed uncollectible. There was no bad debt expense recognized for the three or nine months ended May 31, 2005 and May 31, 2004 in the midstream or transportation and storage segments.

Table of Contents

ETC OLP enters into netting arrangements with certain counterparties to mitigate credit risk. Transactions are confirmed with the counterparty and the net amount is settled when due. Amounts outstanding under these netting arrangements are presented on a net basis in the consolidated balance sheets.

HOLP grants credit to its customers for the purchase of propane and propane-related products. Included in accounts receivable are trade accounts receivable arising from HOLP s retail and wholesale propane operations. Accounts receivable for retail and wholesale propane are recorded as amounts billed to customers less an allowance for doubtful accounts. The allowance for doubtful accounts for the retail and wholesale propane segments 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, historical trends in collectability, and any specific disputes. The accounts receivable for HOLP were marked to fair market value in connection with the Energy Transfer Transactions. Accounts receivable consisted of the following:

	May 31, 2005	August 31, 2004
Accounts receivable midstream and transportation	$ 665,966	$ 206,023
Accounts receivable propane	67,277	46,990
Less allowance for doubtful accounts	(3,982)	(1,667)
Total, net	$ 729,261	$ 251,346

The activity in the allowance for doubtful accounts for the retail and wholesale propane segments consisted of the following:

	Three Months Ended		Nine Months Ended	
	May 31, 2005	May 31, 2004	May 31, 2005	May 31, 2004
Balance, beginning of the period	$ 3,982	$ 84	$ 1,667	$
Provision for loss on accounts receivable	564	912	4,781	996
Accounts receivable written off, net of recoveries	(564)		(2,466)	
Balance, end of period	$ 3,982	$ 996	$ 3,982	$ 996

7. INVENTORIES:

ETC OLP s inventories consist principally of natural gas held in storage, which is valued at the lower of cost or market utilizing the weighted average cost method. Propane inventories are valued at the lower of cost or market. The cost of propane inventories is determined using weighted-average cost of propane 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:

	May 31, 2005	August 31, 2004
Natural gas and propane	$ 247,665	$ 40,926
Appliances, parts and fittings and other	13,748	12,335
Total inventories	$ 261,413	$ 53,261

15

Table of Contents

8. PROPERTY, PLANT AND EQUIPMENT

Components and useful lives of property, plant and equipment were as follows:

	May 31, 2005	August 31, 2004
Land and improvements	$ 37,597	$ 27,771
Buildings and improvements (10 to 30 years)	53,713	34,574
Pipelines and equipment (10 to 65 years)	1,533,682	788,025
Natural gas storage (40 years)	29,862	24,277
Bulk storage, equipment and facilities (3 to 30 years)	56,321	48,947
Tanks and other equipment (5 to 30 years)	353,591	328,026
Vehicles (5 to 10 years)	76,766	56,740
Right of way (20 to 65 years)	87,615	58,389
Furniture and fixtures (3 to 10 years)	10,249	7,323
Linepack	23,895	12,802
Pad gas	102,557	42,136
Other (5 to 10 years)	21,147	5,582
	2,386,995	1,434,592
Less Accumulated depreciation	(113,502)	(53,408)
	2,273,493	1,381,184
Plus Construction work-in-process	101,772	42,911