STAR GAS PARTNERS LP
Form DEFA14A
March 14, 2006

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of

the Securities Exchange Act of 1934

Filed by the Registrant x

Filed by a Party other than the Registrant ¨

Check the appropriate box

¨ Preliminary Proxy Statement

¨ Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

¨ Definitive Proxy Statement

x Definitive Additional Materials

¨ Soliciting Material Pursuant to §240.14a-12

STAR GAS PARTNERS, L.P.

(Name of Registrant as Specified in its Charter)

Not applicable

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box) x No filing fee required.

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1) Title of each class of securities to which transaction applies:

2) Aggregate number of securities to which transaction applies:

3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11:

4) Proposed maximum aggregate value of transaction:

5) Total fee paid:

¨ Fee paid previously with preliminary materials.

¨ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

6) Amount Previously Paid:

7) Form, Schedule or Registration Statement No.:

8) Filing Party:

9) Date Filed:

March 13, 2006

Dear Star Gas Unitholder:

I am writing to advise you of some important developments relating to the upcoming special meeting of Star Gas (the Partnership or Star) unitholders. The meeting has been postponed one week from Friday, March 17, 2006 to Friday, March 24, 2006. The postponed Special Meeting will be held at the offices of Phillips Nizer LLP, 660 Fifth Avenue, New York, New York 10103 at 11:00 a.m. local time on March 24, 2006. An amended notice of the special meeting is included with this letter.

I am also writing to advise you of certain developments in connection with Star s proposed recapitalization with Kestrel Energy Partners (Kestrel) and the unsolicited competing proposal made by a group consisting of Soros Fund Management, LLC, Atticus Capital, LP and Almeida Oil Co., Inc. (collectively the Soros Group).

On March 9, 2006, Star entered into a letter agreement with Kestrel which contemplated an amendment to the Kestrel Unit Purchase Agreement pursuant to which Kestrel would agree to increase the price it is paying to purchase its new common units from $2.00 to $2.25 and to increase the price of the rights offering which is fully back stopped by Kestrel from $2.00 to $2.25. As a result of this amendment, the Partnership would obtain cash of $56.25 million, resulting in additional cash to the Partnership of $6.25 million (before any incremental transaction expenses) compared to the original Kestrel transaction. A more detailed description regarding this letter agreement is contained in the Press Release, issued on March 9, 2006, attached hereto as Exhibit A.

Following the execution of this letter agreement, two of Star s senior noteholders refused to grant their consent to amending the Kestrel agreement. As described more fully in the Press Release issued on March 13, 2006, attached hereto as Exhibit B, the Partnership has entered into a Contingent Amendment with Kestrel which will only become effective upon the satisfaction of certain conditions. The Contingent Amendment will become effective if the Partnership receives the consent of the holders of 2/3 of Star s outstanding senior notes prior to the close of business on March 28, 2006. The Contingent Amendment will also become effective if Star and Kestrel mutually agree to its effectiveness. The Partnership is currently in discussions with Kestrel and certain of Star s senior noteholders who have indicated a willingness to consent to the improved Kestrel transaction regarding ways to proceed with the improved transaction regardless of whether the consent of noteholders is obtained. There can be no assurances that Star will be able to resolve this matter with the noteholders in a sufficiently timely fashion such that the Contingent Amendment becomes effective.

I am also writing to advise you of certain additional developments related to the unsolicited competing proposal made by the Soros Group. As disclosed in the supplemental proxy materials dated March 1, 2006, the Partnership received an unsolicited proposal from the Soros Group on February 15, 2006. The Star Gas Board concluded that the original Soros Group proposal did not constitute a Superior Proposal under the terms of the Kestrel Unit Purchase Agreement. Subsequent to the Star Gas Board s determination that the original Soros Group proposal did not constitute a Superior Proposal , the Soros Group submitted a revised improved proposal.

The revised Soros Group proposal includes, among other things, a proposed commitment by the Soros Group of $32.5 million of new equity capital at a price of $3.25 per common unit, and a standby commitment in a $37.5 million rights offering to Star s common unitholders at a price of $2.50 per common unit, resulting in the aggregate issuance of 25 million new common units (exclusive of new common units to be issued to noteholders in the notes for units exchange and new common units to be issued to existing holders of Star s senior subordinated and junior subordinated units). The revised Soros Group proposal would result in cash to the

Partnership of $70 million. When compared to the original Kestrel agreement, the revised Soros Group proposal would provide the Partnership with an additional $20 million of gross equity capital, before deducting certain termination fee, expense reimbursement, incremental transaction expenses and interest costs which are estimated to aggregate approximately $9.5 million, resulting in additional available cash of approximately $10.5 million to the Partnership. When compared to the Kestrel transaction contemplated by the Contingent Amendment, the revised Soros Group proposal would provide the Partnership with an additional $13.75 million of gross equity capital, which would result in additional available cash of approximately $4.25 million after deducting the same $9.5 million of estimated incremental fees, expenses and interest costs.

Pursuant to the revised Soros Group proposal, the Soros Group would become the new general partner of the Partnership. The revised Soros Group proposal assumes that the Partnership maintains the current arrangements with the holders of approximately 94% in principal amount of Star s senior notes, including the conversion of $26.9 million of senior notes into common units at $2.00 per common unit. The revised Soros Group proposal is similar in structure to the Kestrel transaction, and is described in the Press Release issued on March 6, 2006, attached hereto as Exhibit C. The Star Gas Board is continuing to review this revised unsolicited proposal made by the Soros Group and, in light of the additional complications raised by the above-mentioned actions of two of Star s senior noteholders and other factors, has not yet made a determination as to whether such proposal would constitute a Superior Proposal under the Kestrel Unit Purchase Agreement and related Contingent Amendment.

Should the Star Gas Board determine that the revised Soros Group proposal constitutes a Superior Proposal under the terms of the Kestrel Unit Purchase Agreement, the Partnership would be able to enter into discussions with the Soros Group. The Partnership is prevented, by the terms of the Kestrel Unit Purchase Agreement, from entering into discussions with, or providing information to, the Soros Group until such time as a proposal received from the Soros Group is determined to be a Superior Proposal. In determining whether any competing proposal constitutes a Superior Proposal, the Star Gas Board must consider whether such proposal is reasonably likely to be consummated. If the Star Gas Board were to conclude that a proposal received by the Soros Group constituted a Superior Proposal, and after entering into discussions and negotiations determined to enter into a definitive agreement for the recapitalization of the Partnership with the Soros Group, the Partnership would incur the approximately $9.5 million in fees, costs and interest referred to above and would need to solicit new proxies for any such Soros Group transaction under a new proxy statement. Any transaction with the Soros Group would be contingent on obtaining the agreement of the holders of the Partnership s senior notes, or upon the Soros Group providing satisfactory alternate arrangements to reduce the Partnership s outstanding amount of senior notes by $100 million and providing permanent financing to the Partnership on satisfactory terms in an amount sufficient to pay off all remaining senior notes at 101% of par.

Prior to receiving the Kestrel proposal which the Partnership is pursuing in the form of the Contingent Amendment, on March 8, 2006 Star received an alternate proposal from Kestrel for the recapitalization of the Partnership. The substantive terms of Kestrel s alternate proposal are described in the Press Release, issued on March 9, 2006 and attached hereto as Exhibit D. As announced in the Press Release issued later in the day on March 9, 2006 (Exhibit A), the Star Gas Board rejected the alternate Kestrel proposal due to its requirement that the Star Gas Board eliminate its fiduciary out in the Kestrel Unit Purchase Agreement, which would have forced the Star Gas Board to forego the opportunity to consider alternative proposals which may provide additional value to the Partnership and its unitholders.

In the meanwhile, **the Partnership s Board continues to recommend that you vote in favor of the Kestrel transaction.**

Additional information concerning the Contingent Amendment (attached hereto as Exhibit E) relating to the Kestrel transaction and the revised unsolicited proposal from the Soros Group are set forth in the press releases attached hereto.

Enclosed is an amended proxy card for the special meeting. The proxy card that accompanied the original proxy statement will remain valid. If you already returned a validly executed proxy card, your votes will be recorded unless you submit a subsequent proxy or you otherwise revoke your prior proxy. If you have not voted or wish to change your vote, please mark, date and execute the enclosed proxy card and mail it promptly in the enclosed envelope.

Enclosed is also an Amended Notice of Special Meeting of unitholders, containing amended proposals to be approved at the Special Meeting of Star s unitholders, which has been postponed from March 17, 2006 to March 24, 2006. The amended proposals to be voted on at the Special Meeting are designed to provide the Star Gas Board with additional flexibility in the event that the Board determines it is in the best interests of Star and its unitholders to further amend the terms of the Kestrel recapitalization transaction. Once again, thank you for your continued support, and we will continue to keep you apprised of all future material developments.

Regards,

Joseph P. Cavanaugh

Chief Executive Officer

PS Should you have any question or concerns about the vote, feel free to call Georgeson Shareholder, the firm assisting us in this solicitation, toll-free at **800/960-7546** and speak with a representative who should be able to address your inquiry.

STAR GAS PARTNERS, L.P.

2187 Atlantic Street

Stamford, CT 06902

AMENDED NOTICE OF SPECIAL MEETING OF UNITHOLDERS

TO BE HELD ON MARCH 24, 2006

To our Unitholders:

We, the board of directors of Star Gas LLC (Star Gas), the general partner of Star Gas Partners, L.P. (the Partnership or Star Gas Partners) give notice that a special meeting of our unitholders that was originally scheduled for Friday, March 17, 2006, has been postponed and rescheduled for Friday, March 24, 2006. The meeting will be held at the offices of Phillips Nizer LLP, 666 Fifth Avenue, New York, New York 10103, at 11:00 a.m. local time. At the meeting, our unitholders will act on the following matters:

Proposal 1. Approval of the issuance of:

- 7,500,000 new common units to Kestrel Heat and M2, wholly owned subsidiaries of Kestrel, on the terms and subject to the conditions set forth in the unit purchase agreement dated as of December 5, 2005 by and among Star Gas Partners, Star Gas, Kestrel Energy Partners, LLC (Kestrel), Kestrel Heat, LLC (Kestrel Heat) and KM2, LLC (M2) in the form attached to the proxy statement as Annex A, as proposed to be amended pursuant to an amendment thereto dated as of March 12, 2006, as such agreement may be further amended from time to time in the discretion of our Board, to the extent that the Board determines that such amendments are in the best interests of the Partnership and its unitholders. The purchase price shall be $2.25 per unit if the Contingent Amendment (described in the attached letter and Exhibit B hereto and which is included as Exhibit E hereto) becomes effective; otherwise the purchase price shall be $2.00 per unit or such other price as the Board in its discretion determines to be in the best interests of the Partnership and its unitholders. A copy of the Contingent Amendment is attached hereto as Exhibit E.

- 17,500,000 new common units in an offering of non-transferable rights to our common unitholders, with a standby commitment from M2 to purchase all units that are not subscribed for in the rights offering as such terms may be further amended from time to time in the discretion of our Board, to the extent that the Board determines that such amendments are in the best interests of the Partnership and our unitholders. The exercise price shall be $2.25 per unit if the Contingent Amendment becomes effective; otherwise the exercise price shall be $2.00 per unit or such other price as the Board in its discretion determines to be in the best interests of the Partnership and its unitholders.

- 13,433,962 (subject to adjustment based on rounding) new common units upon the conversion by certain holders of Star Gas Partners 10.25% senior notes due 2013 of approximately $26.9 million in principal amount of senior notes at a conversion price of $2.00 per unit; and

- 3,737,346 new common units upon the conversion of each outstanding senior subordinated unit and each outstanding junior subordinated unit into one common unit in accordance with the terms and conditions of the second amended and restated agreement of limited partnership submitted to unitholders for approval in Proposal 3.

Proposal 2. Approval of the election of Kestrel Heat as successor general partner upon the withdrawal of Star Gas; and

Proposal 3. The adoption of a second amended and restated agreement of limited partnership of Star Gas Partners, substantially in the form attached to the proxy statement as Annex B, that will, among other matters, reflect the election of Kestrel Heat as successor general partner upon the withdrawal of Star Gas and revise the terms and distribution rights of our partnership securities as further described in this proxy statement, including the conversion of each outstanding senior subordinated units and junior subordinated unit into one common unit, as indicated in Proposal 1 above.

Proposal 1 has been revised to reflect the terms of a proposed amendment (the Contingent Amendment) to the Kestrel unit purchase agreement, that was entered into on March 12, 2006, and which is described in the attached letter and Exhibit B hereto and which is included as Exhibit E hereto. In addition, Proposal 1 has been revised to grant the Board the discretion to further amend the terms of the Kestrel unit purchase agreement and the rights offering to the extent that the Board determines that such amendments are in the best interests of the Partnership and its unitholders.

For more information on voting, please call our proxy solicitor, Georgeson Shareholder, at 800-960-7546.

Representation of your units at the meeting is very important. Your vote is important, no matter how many or how few units you hold. If you fail to vote by proxy or in person, it will have the same effect as a vote against the recapitalization. Please vote by completing and mailing the enclosed proxy card if you have not already done so.

FOR UNITHOLDERS WHO HAVE NOT ALREADY VOTED

Enclosed for your convenience is an amended proxy card (and a return envelope) for your use. You may use any of the proxy cards which were previously sent to you with the original proxy statement, or subsequent mailings, or you may use the amended proxy card enclosed with this additional proxy material.

Unless you give other instructions on your proxy card, the persons named as proxy holders on the proxy card will vote all executed proxy cards in accordance with the recommendations of the board of directors of Star Gas, which is to vote FOR all three proposals to effect the Kestrel recapitalization. With respect to any other matter that properly comes before the special meeting the proxy holders will vote as recommended by the board of directors of Star Gas, or, if no recommendation is given, in their own discretion. See The Recapitalization Reasons for the Recapitalization that the Board Considered; Recommendations of the Board in the proxy statement.

FOR UNITHOLDERS WHO HAVE ALREADY VOTED

We have enclosed an amended proxy card (and a return envelope) for your use reflecting the revised proposals, in case you wish to change your vote. If you have already submitted your proxy and you do not wish to change your vote, you do not need to return this amended proxy card which will continue to remain valid. If we receive the enclosed proxy card, duly executed and dated, prior to the date of the special meeting, any proxy previously granted by you will be, without further action on your part, revoked, and the enclosed proxy card will be voted as indicated.

Unless you give other instructions on your proxy card, the persons named as proxy holders on the proxy card will vote all executed proxy cards in accordance with the recommendations of the Board of Directors of Star Gas, which is to vote FOR all three proposals to effect the Kestrel recapitalization. With respect to any other matter that properly comes before the special meeting, the proxy holders will vote as recommended by the board of directors of Star Gas, or, if no recommendation is given, in their own discretion. See The Recapitalization Reasons for the Recapitalization that the Board Considered; Recommendations of the Board in the proxy statement.

FOR UNITHOLDERS WHO WISH TO REVOKE THEIR PREVIOUSLY SUBMITTED PROXY

You may revoke your proxy at any time before it is voted. A proxy may be voted in any of the following ways:

(1) by submitting a written revocation to the Secretary of Star Gas Partners, L.P., 2187 Atlantic Street, Stamford, CT 06902 (which must be received by the Secretary of Star Gas prior to the special meeting);

(2) by submitting a later-dated proxy by mail or telephone or through the internet (which must be received by the Secretary of Star Gas prior to the special meeting); or

(3) by voting in person at the special meeting.

However, simply attending the special meeting (without voting) will not revoke a proxy.

If you do not hold your units in your own name, you may revoke a previously given proxy by following the revocation instructions provided by the bank, broker or other person who is the registered owner of your units.

Throughout this additional proxy material, we refer to ourselves, Star Gas Partners, L.P., as we or us or Star Gas Partners. We sometimes refer to the board of directors of our general partner, Star Gas, as our board of directors, our board, the Board, Star Gas board or Star Gas Partners

The Board of Directors of

Star Gas LLC, the general partner of

Star Gas Partners, L.P.

The date of this amended notice is March 13, 2006 and it is first being mailed to unitholders on or about March 14, 2006.

Exhibit A

AGREEMENT TO AMEND EXISTING KESTREL AGREEMENT ANNOUNCED

- Postpones Special Meeting to March 24, 2006 -

STAMFORD, CT (March 9, 2006) Star Gas Partners, L.P. (the Partnership or Star) (NYSE: SGU, SGH), a home energy distributor and services provider specializing in heating oil, announced today that it had entered into a binding letter agreement with Kestrel Energy Partners, LLC (Kestrel) to amend the existing agreement with Kestrel and its affiliates for the strategic recapitalization of the Partnership.

As previously announced earlier today, the Partnership received a revised proposal from Kestrel providing for certain amendments to the original Kestrel Unit Purchase Agreement, entered into on December 5, 2005. The revised Kestrel proposal contained in the letter agreement includes an increased equity investment by Kestrel to $16.875 million of new equity capital in which Kestrel will purchase 7.5 million common units at a price of $2.25 per common unit, and an increased $39.375 million rights offering to Star s holders of common units at a price of $2.25 per common unit. The amendments to the existing Kestrel Unit Purchase Agreement set forth in the letter agreement result in the aggregate issuance of 25 million new common units (exclusive of new common units to be issued to noteholders in the notes for units exchange and new common units to be issued to existing holders of Star s senior subordinated and junior subordinated units) and cash to the Partnership of $56.25 million. No other changes will be made to the terms of the original Unit Purchase Agreement in the amendment to the Unit Purchase Agreement contemplated by the letter agreement, which the Partnership and Kestrel expect to enter into shortly.

The Partnership had also received an alternate proposal from Kestrel, which provided for increased consideration above the terms of the letter agreement but also contained a provision which eliminated the fiduciary out provision of the exisiting agreement with Kestrel. After reviewing the alternate proposal, and upon the advice of its legal and financial advisors, the board of Star s general partner (the Board) rejected the alternate proposal. The Board is not prepared, under the current circumstances, to forego the opportunity to consider alternative proposals which may provide additional value to the Partnership and its unitholders. The terms of the alternative proposal were contained in the Partnership s press release issued earlier today.

The Board is still in the process of reviewing the revised Soros Group proposal in light of the revised Kestrel transaction, and has not yet made a determination whether the revised Soros Group proposal is a Superior Proposal under the terms of the Kestrel agreement. The terms of the revised Soros Group proposal were set forth in the Partnership s press release issued earlier this week, on March 6, 2006.

The special meeting of unitholders to vote on the Kestrel recapitalization which had been scheduled for March 17, 2006 has been postponed until Friday, March 24, 2006, and additional information regarding the postponed special meeting will be forwarded to unitholders shortly. At this time, the Board continues to recommend that unitholders vote in favor of the amended Kestrel transaction.

The Board has also announced that it has set the close of business on Tuesday, March 28, 2006, as the record date for the rights offering in the Kestrel recapitalization transaction.

Under the terms of the Kestrel Unit Purchase Agreement, the record date for the rights offering must be after the date of the special meeting, and accordingly, in view of the April 30, 2006 termination date in the Kestrel agreement and the agreements with Star s senior noteholders, the Partnership will not be able to adjourn the special meeting past Tuesday, March 28, 2006, absent a waiver of such provision by Kestrel.

The original Kestrel Unit Purchase Agreement provided for, among other things: the receipt by the Partnership of $50 million in new equity financing through the issuance to Kestrel of 7,500,000 common units at $2.00 per unit for an aggregate of $15 million and the issuance of an additional 17,500,000 common units in a rights offering to Star s common unitholders at an exercise price of $2.00 per unit for an aggregate of

$35 million. Pursuant to both the original and amended Kestrel transactions, the rights are non-transferable, and Kestrel has agreed to buy any common units not subscribed for in the rights offering. Pursuant to both the original and amended Kestrel transactions, Kestrel Heat, LLC, a wholly owned subsidiary of Kestrel, would become the new general partner of the Partnership.

As previously announced on December 5, 2005, the Partnership has entered into agreements with Kestrel and holders of approximately 94% in principal amount of its senior notes.

The agreements relating to the existing Kestrel transaction can be found as exhibits to the Partnership s Form 8-K, filed on December 5, 2005. The Partnership has also filed proxy material relating to the existing Kestrel transaction on January 24, 2006 and a supplement to the proxy statement relating to the original Soros Group proposal on March 1, 2006.

Forward Looking Information

This news release includes forward-looking statements which represent the Partnership s expectations or beliefs concerning future events that involve risks and uncertainties, including those associated with the approval of the recapitalization; the effect of weather conditions on our financial performance; anticipated proceeds from weather insurance; the price and supply of home heating oil; the consumption patterns of our customers; our ability to obtain satisfactory gross profit margins; our ability to obtain new customers and retain existing customers; our ability to effect strategic acquisitions or redeploy underperforming assets; the ultimate disposition of excess proceeds from the sale of the propane segment should the recapitalization not be consummated; the impact of litigation; the ongoing impact of the business process redesign project at the heating oil segment and our ability to address issues related to that project; natural gas conversions; future union relations and the outcome of current and future union negotiations; the impact of current and future environmental, health and safety regulations; customer creditworthiness; and marketing plans. All statements other than statements of historical facts included in this news release are forward-looking statements. Although the Partnership believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct. Important factors that could cause actual results to differ materially from the Partnership s expectations (Cautionary Statements) are disclosed in this news release and in the Partnership s Annual Report on Form 10-K for the year ended September 30, 2005 and its Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2005, including without limitation and in conjunction with the forward-looking statements included in this news release. All subsequent written and oral forward-looking statements attributable to the Partnership or persons acting on its behalf are expressly qualified in their entirety by the Cautionary Statements. Unless otherwise required by law, the Partnership undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise after the date of this news release.

About Star Gas Partners

Star Gas Partners, L.P. is the nation s largest retail distributor of home heating oil. Additional information is available by obtaining the Partnership s SEC filings and by visiting Star s website at *www.star-gas.com*

CONTACT:

Star Gas Partners

Investor Relations

203/328-7310

Robert Rinderman, Steven Hecht

Jaffoni & Collins Incorporated

212/835-8500 or SGU@jcir.com

Exhibit B

STAR GAS ENTERS INTO CONTINGENT AMENDMENT TO KESTREL UNIT PURCHASE AGREEMENT

- Two Senior Noteholders Decline to Consent -

STAMFORD, CT (March 13, 2006) Star Gas Partners, L.P. (the Partnership or Star) (NYSE: SGU, SGH), announced today it had entered into a contingent amendment to the Kestrel Unit Purchase Agreement (the Contingent Amendment) with Kestrel Energy Partners, LLC (Kestrel) and its affiliates. The Partnership further stated that both Star and Kestrel desire the Contingent Amendment to become fully effective, resulting in an effective amendment to the Kestrel Unit Purchase Agreement. Star is disappointed that two of its senior noteholders are jeopardizing the increased value of Kestrel s revised proposal to all of the Partnership s stakeholders by refusing to consent to the amendment.

As previously announced on March 9, 2006, the Partnership entered into a letter agreement with Kestrel which contemplated an amendment to the Kestrel Unit Purchase Agreement. The Contingent Amendment, which reflects the terms of that letter agreement, provides for an increased equity investment by Kestrel of $16.875 million at a price of $2.25 per common unit and an increased rights offering of $39.375 million to Star s common unitholders at a price of $2.25 per common unit. The Contingent Amendment results in the aggregate issuance of 25 million new common units (exclusive of new common units to be issued to noteholders in the notes for units exchange and new common units issued to existing holders of Star s senior subordinated and junior subordinated units) and cash to the Partnership of $56.25 million.

The Contingent Amendment will only become effective, and amend the existing Unit Purchase Agreement, upon the satisfaction of certain conditions. The Contingent Amendment will become effective if the Partnership receives the consent to the Contingent Amendment from holders of 2/3 of Star s outstanding senior notes prior to the close of business on Tuesday, March 28, 2006. The Contingent Amendment will also become effective if Kestrel and the Partnership mutually agree in writing to such effectiveness. In the event that neither of the conditions discussed above are satisfied, the Contingent Amendment will be of no further force and effect and the Partnership will proceed with the existing Unit Purchase Agreement, which will remain in effect without amendment thereto.

The Partnership is disappointed that two of its senior noteholders are withholding their consent to amending the Kestrel agreement, effectively prohibiting the Partnership from obtaining the increased value for all stakeholders provided by the revised Kestrel proposal. The Partnership believes that these noteholders are withholding their consent in order to obtain leverage to renegotiate their existing lockup agreements, so that they may obtain the opportunity to convert a portion of their senior notes to common units. These noteholders were both given the opportunity to convert notes to common units in connection with the negotiation of their existing agreements (at a conversion price of $2.00 per common unit when the Partnership s common units were trading at $1.39), and specifically rejected such an opportunity.

The board of directors (the Board) of Star Gas, LLC, the Partnership s general partner, believes that the amendments contained in the Contingent Amendment are not material to the agreements entered into by the Partnership s senior noteholders. The Partnership is engaged in discussions with Kestrel and certain of Star s noteholders who have indicated a willingness to consent to the Contingent Amendment regarding ways to proceed with the Contingent Amendment regardless of whether the consent of 2/3 of the noteholders is obtained. While there are strong arguments supporting the Board s view that the terms of the Contingent Amendment are not material to the noteholders, the risk of losing the important protections contained in the current agreements with the Partnership s noteholders required the Board to conclude that the Partnership could not proceed with an effective amendment to the Unit Purchase Agreement at this time, although, as noted above, the Partnership and Kestrel are pursuing alternatives which would allow the Partnership and Kestrel to declare the Contingent Amendment effective. The Partnership intends to continue discussions with Star s senior noteholders in an effort to ensure that the additional value contained in the Contingent Amendment can be realized for the Partnership and its stakeholders, and is not further jeopardized by the actions of two noteholders. There can be no assurances that Star will be able to resolve this matter with the noteholders in a sufficiently timely fashion such that the Contingent Amendment becomes effective.

In the event noteholder consent to the Contingent Amendment is not received, the Partnership continues to believe that the existing agreement with Kestrel has a high likelihood of closing, subject to unitholder approval, following the special meeting of Star s unitholders which, as previously announced, has been postponed to March 24, 2006. The Board continues to recommend that the Partnership s unitholders vote for approval and adoption of the Kestrel Unit Purchase Agreement.

As previously announced on December 5, 2005, the Partnership has entered into agreements with Kestrel and holders of approximately 94% in principal amount of its senior notes.

The Board is still reviewing the revised Soros Group proposal and has not yet made a determination as to whether such proposal would constitute a Superior Proposal under the Kestrel Unit Purchase Agreement and related Contingent Amendment.

The agreements relating to the Kestrel transaction can be found as exhibits to the Partnership s Form 8-K, filed on December 5, 2005. The Partnership also filed proxy material relating to the Kestrel transaction on January 24, 2006 and a supplement thereto relating to the initial Soros Group proposal on March 1, 2006.

Additional proxy materials relating to, among other things, the foregoing will be mailed to unitholders shortly.

Forward Looking Information

This news release includes forward-looking statements which represent the Partnership s expectations or beliefs concerning future events that involve risks and uncertainties, including those associated with the approval of the recapitalization; the effect of weather conditions on our financial performance; anticipated proceeds from weather insurance; the price and supply of home heating oil; the consumption patterns of our customers; our ability to obtain satisfactory gross profit margins; our ability to obtain new customers and retain existing customers; our ability to effect strategic acquisitions or redeploy underperforming assets; the ultimate disposition of excess proceeds from the sale of the propane segment should the recapitalization not be consummated; the impact of litigation; the ongoing impact of the business process redesign project at the heating oil segment and our ability to address issues related to that project; natural gas conversions; future union relations and the outcome of current and future union negotiations; the impact of current and future environmental, health and safety regulations; customer creditworthiness; and marketing plans. All statements other than statements of historical facts included in this news release are forward-looking statements. Although the Partnership believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct. Important factors that could cause actual results to differ materially from the Partnership s expectations (Cautionary Statements) are disclosed in this news release and in the Partnership s Annual Report on Form 10-K for the year ended September 30, 2005 and its Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2005, including without limitation and in conjunction with the forward-looking statements included in this news release. All subsequent written and oral forward-looking statements attributable to the Partnership or persons acting on its behalf are expressly qualified in their entirety by the Cautionary Statements. Unless otherwise required by law, the Partnership undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise after the date of this news release.

About Star Gas Partners

Star Gas Partners, L.P. is the nation s largest retail distributor of home heating oil. Additional information is available by obtaining the Partnership s SEC filings and by visiting Star s website at *www.star-gas.com.*

CONTACT:

Star Gas Partners

Investor Relations

203/328-7310

Robert Rinderman, Steven Hecht

Jaffoni & Collins Incorporated

212/835-8500 or SGU@jcir.com

Exhibit C

STAR GAS ANNOUNCES RECEIPT OF REVISED COMPETING PROPOSAL FROM SOROS GROUP

STAMFORD, CT (March 6, 2006) Star Gas Partners, L.P. (the Partnership or Star) (NYSE: SGU, SGH), a home energy distributor and services provider specializing in heating oil, announced today that it had received a revised unsolicited non-binding competing proposal by the consortium consisting of Soros Fund Management, LLC (Soros), Atticus Capital LP (Atticus) and Almeida Oil Co., Inc. (Almeida) for the strategic recapitalization of the Partnership. The revised proposal by this consortium contemplates the formation of a new company, referred to herein as the Soros Group, to effectuate the transactions contained in their revised proposal.

The revised Soros Group proposal includes, among other things, a proposed commitment by the Soros Group of $32.5 million of new equity capital (compared to their prior proposal of $30 million) in which they would purchase 10 million common units at a price of $3.25 per unit. The revised proposal contemplates a standby commitment in a $37.5 million (compared to the prior proposal of $35 million) rights offering to Star s common unitholders, at a price of $2.50 (compared to the prior proposal of $2.60) per common unit. The revised Soros Group proposal would result in the aggregate issuance of 25 million new common units (exclusive of new common units to be issued to noteholders in the notes for units exchange) and cash to the Partnership of $70 million (compared to the prior proposal of $65 million) prior to the payment of fees, expenses and other costs. Pursuant to the Soros Group proposal, the Soros Group would become the new general partner of the Partnership.

The revised Soros Group proposal contemplates maintaining the current arrangements with the holders of approximately 94% in principal amount of Star s senior notes, including the conversion of $26.9 million of senior notes into common units at $2.00 per common unit. The Soros Group s revised proposal also indicated that while it is not conditioned on any change to the arrangements with the Partnership s senior noteholders, the Soros Group would be prepared to explore a revised arrangement between the Partnership and its noteholders, which would include a bridge financing facility, provided by the Soros Group, to permit the Partnership to make an asset sales proceeds offer to the senior noteholders under the terms of their indenture.

The revised Soros Group proposal, like the original proposal, is subject to completion of a confirmatory due diligence review and negotiation and execution of definitive agreements.

The board of directors of Star s general partner, Star Gas LLC, will be evaluating the Soros Group s revised proposal in the near future. As previously announced on February 24, 2006, the Star Gas board had determined that the original Soros Group proposal was not a Superior Proposal within the meaning of the Unit Purchase Agreement with Kestrel.

As previously announced on December 5, 2005, the Partnership has entered into agreements with Kestrel Energy Partners, LLC (Kestrel) and holders of approximately 94% in principal amount of its senior notes. The Partnership has, in connection with the Kestrel transaction, scheduled a special meeting of unit holders which is scheduled to be held March 17, 2006.

The Kestrel transaction provides for, among other things: the receipt by the Partnership of $50 million in new equity financing through the issuance to Kestrel of 7,500,000 common units at $2.00 per unit for an aggregate of $15 million and the issuance of an additional 17,500,000 common units in a rights offering to Star s common unitholders at an exercise price of $2.00 per unit for an aggregate of $35 million. The rights in the Kestrel transaction agreements are non-transferable, and Kestrel has agreed to buy any common units not subscribed for in the rights offering. Pursuant to the Kestrel transaction, Kestrel Heat, LLC, a wholly owned subsidiary of Kestrel, would become the new general partner of the Partnership.

The agreements relating to the Kestrel transaction can be found as exhibits to the Partnership s Form 8-K, filed on December 5, 2005. The Partnership has also filed proxy material relating to the Kestrel transaction on January 24, 2006 and a supplement to the proxy statement relating to the original Soros Group proposal on March 1, 2006.

Forward Looking Information

This news release includes forward-looking statements which represent the Partnership s expectations or beliefs concerning future events that involve risks and uncertainties, including those associated with the approval of the recapitalization; the effect of weather conditions on our financial performance; anticipated proceeds from weather insurance; the price and supply of home heating oil; the consumption patterns of our customers; our ability to obtain satisfactory gross profit margins; our ability to obtain new customers and retain existing customers; our ability to effect strategic acquisitions or redeploy underperforming assets; the ultimate disposition of excess proceeds from the sale of the propane segment should the recapitalization not be consummated; the impact of litigation; the ongoing impact of the business process redesign project at the heating oil segment and our ability to address issues related to that project; natural gas conversions; future union relations and the outcome of current and future union negotiations; the impact of current and future environmental, health and safety regulations; customer creditworthiness; and marketing plans. All statements other than statements of historical facts included in this news release are forward-looking statements. Although the Partnership believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct. Important factors that could cause actual results to differ materially from the Partnership s expectations (Cautionary Statements) are disclosed in this news release and in the Partnership s Annual Report on Form 10-K for the year ended September 30, 2005 and its Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2005, including without limitation and in conjunction with the forward-looking statements included in this news release. All subsequent written and oral forward-looking statements attributable to the Partnership or persons acting on its behalf are expressly qualified in their entirety by the Cautionary Statements. Unless otherwise required by law, the Partnership undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise after the date of this news release.

About Star Gas Partners

Star Gas Partners, L.P. is the nation s largest retail distributor of home heating oil. Additional information is available by obtaining the Partnership s SEC filings and by visiting Star s website at *www.star-gas.com.*

CONTACT:

Star Gas Partners

Investor Relations

203/328-7310

Robert Rinderman, Steven Hecht Jaffoni & Collins Incorporated 212/835-8500 or SGU@jcir.com

Exhibit D

STAR GAS ANNOUNCES RECEIPT OF NEW PROPOSALS FROM

KESTREL TO AMEND EXISTING AGREEMENT

STAMFORD, CT (March 9, 2006) Star Gas Partners, L.P. (the Partnership or Star) (NYSE: SGU, SGH), a home energy distributor and services provider specializing in heating oil, announced today that it had received a proposal from Kestrel Energy Partners, LLC (Kestrel) to amend the existing agreements for the strategic recapitalization of the Partnership (the Kestrel Proposal) as well as a subsequent revised proposal from Kestrel (the Revised Kestrel Proposal).

The Kestrel Proposal includes, among other things, an increased commitment by Kestrel to $19.5 million of new equity capital (increased from the existing Kestrel agreement which provides for a $15 million equity investment) in which they would purchase 7.5 million common units at a price of $2.60 per unit. The Kestrel Proposal also contemplates increasing to $41.125 million the rights offering to Star s common unitholders, at a price of $2.35 per common unit (compared to the terms of the existing Kestrel agreement which provide for a $35 million rights offering at a price of $2.00 per common unit), which Kestrel would continue to backstop. The Kestrel Proposal would result in the same aggregate issuance of 25 million new common units (exclusive of new common units to be issued to noteholders in the notes for units exchange) as under the existing Kestrel transaction and cash to the Partnership of $60.625 million (compared to the existing commitment by Kestrel of $50 million) prior to the payment of other costs.

The Kestrel Proposal is conditioned on the elimination of the fiduciary out provisions set forth in Section 5.11 of the Kestrel Unit Purchase Agreement, which provisions, among other things, allow the board of directors of Star s general partner (the Board) to consider and approve proposals by third parties which may increase the value to Star and its unitholders.

The Kestrel Proposal indicated that, other than the terms set forth above, the terms and provisions of the existing agreement with Kestrel would remain in full force and effect.

The Kestrel Proposal will, by its terms, expire and be of no further force and effect, if not previously accepted by the Partnership, at the earlier of (i) 4:00 p.m. Eastern Time on March 9, 2006 or (ii) such time as the Partnership makes a public announcement with respect to its determination of whether the previously announced revised Soros Group proposal constitutes a Superior Proposal under the terms of the Kestrel Unit Purchase Agreement. Kestrel has indicated that they are considering an extension of the expiration time of the Kestrel Proposal to allow the Board additional time to consider the Kestrel Proposal.

The Board, together with its legal and financial advisors, is currently reviewing the Kestrel Proposal. While the Board has not made a final decision with respect to the Kestrel Proposal, it is not inclined, under current circumstances, to accept a proposal which eliminates the fiduciary out provision of its exisiting agreement with Kestrel, which could adversely affect the Board s ability to secure additional value for the Partnership and its unitholders.

In response to the Board s concerns regarding the elimination of the fiduciary out provision in the Kestrel Proposal, Kestrel advised the Partnership that if the Board rejected the Kestrel Proposal, Kestrel has made the Revised Kestrel Proposal which provides for an increase in Kestrel s equity investment to $16.875 million of new equity capital in which they would purchase 7.5 million common units at a price of $2.25 per common unit, and an increased $39.375 million rights offering to Star s holders of common units at a price of $2.25 per common unit. The Revised Kestrel Proposal would result in the same aggregate issuance of 25 million new common units (exclusive of new common units to be issued to noteholders in the notes for units exchange) as under the existing Kestrel transaction and cash to the Partnership of $56.25 million prior to the payment of certain costs and expenses.

The Revised Kestrel Proposal indicated that, other than the terms set forth above, the terms and provisions of the existing agreement with Kestrel (including the fiduciary out provision) would remain in full force and effect.

The Board, together with its legal and financial advisors, will be evaluating the Revised Kestrel Proposal in the near future.

Neither the expiration of the Kestrel Proposal or Revised Kestrel Proposal would terminate the Kestrel Unit Purchase Agreement.

The existing Kestrel transaction provides for, among other things: the receipt by the Partnership of $50 million in new equity financing through the issuance to Kestrel of 7,500,000 common units at $2.00 per unit for an aggregate of $15 million and the issuance of an additional 17,500,000 common units in a rights offering to Star s common unitholders at an exercise price of $2.00 per unit for an aggregate of $35 million. The rights in the existing Kestrel transaction agreements are non-transferable, and Kestrel has agreed to buy any common units not subscribed for in the rights offering. Pursuant to the existing Kestrel transaction, Kestrel Heat, LLC, a wholly owned subsidiary of Kestrel, would become the new general partner of the Partnership.

As previously announced on March 6, 2006, the Partnership received a revised proposal from the Soros Group for a strategic recapitalization consisting of an equity investment by the Soros Group of $32.5 million at a price of $3.25 per common unit, and a $37.5 million rights offering to Star s common unitholders at a price of $2.50 per common unit.

As previously announced on December 5, 2005, the Partnership has entered into agreements with Kestrel and holders of approximately 94% in principal amount of its senior notes.

The agreements relating to the existing Kestrel transaction can be found as exhibits to the Partnership s Form 8-K, filed on December 5, 2005. The Partnership has also filed proxy material relating to the existing Kestrel transaction on January 24, 2006 and a supplement to the proxy statement relating to the original Soros Group proposal on March 1, 2006.

Forward Looking Information

This news release includes forward-looking statements which represent the Partnership s expectations or beliefs concerning future events that involve risks and uncertainties, including those associated with the approval of the recapitalization; the effect of weather conditions on our financial performance; anticipated proceeds from weather insurance; the price and supply of home heating oil; the consumption patterns of our customers; our ability to obtain satisfactory gross profit margins; our ability to obtain new customers and retain existing customers; our ability to effect strategic acquisitions or redeploy underperforming assets; the ultimate disposition of excess proceeds from the sale of the propane segment should the recapitalization not be consummated; the impact of litigation; the ongoing impact of the business process redesign project at the heating oil segment and our ability to address issues related to that project; natural gas conversions; future union relations and the outcome of current and future union negotiations; the impact of current and future environmental, health and safety regulations; customer creditworthiness; and marketing plans. All statements other than statements of historical facts included in this news release are forward-looking statements. Although the Partnership believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct. Important factors that could cause actual results to differ materially from the Partnership s expectations (Cautionary Statements) are disclosed in this news release and in the Partnership s Annual Report on Form 10-K for the year ended September 30, 2005 and its Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2005, including without limitation and in conjunction with the forward-looking statements included in this news release. All subsequent written and oral forward-looking statements attributable to the Partnership or persons acting on its behalf are expressly qualified in their entirety by the Cautionary Statements. Unless otherwise required by law, the Partnership undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise after the date of this news release.

About Star Gas Partners

Star Gas Partners, L.P. is the nation s largest retail distributor of home heating oil. Additional information is available by obtaining the Partnership s SEC filings and by visiting Star s website at *www.star-gas.com.*

CONTACT:

Star Gas Partners

Investor Relations

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Robert Rinderman, Steven Hecht

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212/835-8500 or SGU@jcir.com

Exhibit E

AMENDMENT NO. 1

TO

UNIT PURCHASE AGREEMENT

THIS AMENDMENT NO. 1 TO UNIT PURCHASE AGREEMENT (this Amendment) is made and entered into this 12th day of March, 2006, by and among Star Gas Partners, L.P., a Delaware limited partnership (the Partnership) and its general partner, Star Gas LLC, a Delaware limited liability company (the Partnership GP and, together with the Partnership and their Subsidiaries, collectively referred to as the Partnership Entities); and Kestrel Energy Partners, LLC, a Delaware limited liability company (Kestrel), and its Subsidiaries Kestrel Heat, LLC, a Delaware limited liability company (Kestrel Heat), and KM2, LLC, a Delaware limited liability company (M2 and, together with Kestrel and Kestrel Heat, collectively referred to as the Kestrel Entities).

W I T N E S S E T H :

WHEREAS, the Partnership Parties and the Kestrel Entities are parties to that certain Unit Purchase Agreement dated as of December 5, 2005 (the Unit Purchase Agreement); and

WHEREAS, the parties hereto desire to enter into this Amendment to amend the Unit Purchase Agreement to (i) increase the purchase price per Common Unit for the 7,500,000 Common Units to be purchased by Buyers from $2.00 per Common Unit to $2.25 per Common Unit and (ii) increase the purchase price for the Common Units to be sold in the Rights Offering to $2.25 per Common Unit, in each case subject to the satisfaction of the Conditions (as defined below); and

WHEREAS, the parties desire that this Amendment shall only become effective upon the satisfaction of the Conditions;

NOW, THEREFORE, in consideration of the premises, the mutual covenants and agreements contained herein and in the Unit Purchase Agreement and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Partnership Parties and the Kestrel Entities agree as follows:

Section 1. *Conditions*. This Amendment shall become effective immediately upon, but *only* at such time, as the Partnership receives any required consent to enter into this Amendment to the Unit Purchase Agreement from its senior noteholders, as may be required by the terms of the lockup agreements entered into with such noteholders, so long as such consent is received prior to 5:00 p.m. Eastern Standard Time on Tuesday, March 28, 2006. Notwithstanding the foregoing, this Amendment shall become effective at such time as the Partnership and Kestrel mutually agree in writing that this Amendment is effective, it being understood that Kestrel and the Partnership shall mutually agree to such effectiveness if the requisite noteholder consent is received after 5:00 p.m. Eastern Standard Time on Tuesday, March 28, 2006 and, upon the advice of their respective counsel, Kestrel and the Partnership conclude that declaring this Amendment effective at such time would not prevent the transactions contemplated by the Unit Purchase Agreement as amended by this Amendment from being consummated on or prior to April 30, 2006. The conditions to the effectiveness of this Amendment contained in this paragraph are collectively referred to herein as the Conditions. For the purpose of clarity, in the event that neither of the Conditions in the first two sentences of this paragraph are satisfied, this Amendment shall not become effective and shall be of no further force and effect and the Unit Purchase Agreement shall remain in full force and effect without any amendment thereto. Kestrel and the Partnership agree to use their reasonable best efforts to work cooperatively with each other, and appropriate third parties, to pursue ways which would allow Kestrel and the Partnership to consummate the transactions contemplated by the Unit Purchase Agreement as amended by this Amendment upon its effectiveness.

Section 2. *Certain Definitions*. Terms used in this Amendment and not otherwise defined shall have the meanings set forth in the Unit Purchase Agreement. All references to the Agreement in the Unit Purchase Agreement shall be deemed to refer to the Unit Purchase Agreement as amended by this Amendment.

Section 3. *Purchase Price and Payment*. The Unit Purchase Agreement is hereby amended in order to delete Section 1.2 and to replace such section with a new Section 1.2, to read in its entirety as follows:

1.2. *Purchase Price and Payment*. The aggregate purchase price for the Common Units shall be equal to $2.25 per Common Unit times the total number of Common Units to be purchased by Buyers at the Closing pursuant to Section 1.1 (the Purchase Price). The Purchase Price payable by Buyers for the Units to be purchased by it shall be paid at the Closing in immediately available funds by confirmed wire transfer to a bank account to be designated by the Partnership (such designation to occur no later than the third Business Day prior to the Closing Date). As further acknowledged in Section 5.10, the New General Partner Units shall be issuable for no consideration.

Section 4. *Intent of the Parties*. The Unit Purchase Agreement is hereby amended in order to delete subsection (b) to Section 1.3 and to replace such subsection with a new subsection (b) to Section 1.3 to read in its entirety as follows:

(b) As used herein, the Rights Offering shall mean that certain distribution by the Partnership to each record holder of Common Units, as of a record date after the Special Meeting to be set by the Partnership, of the non-transferable right (the Rights) to purchase, at $2.25 per Common Unit, a pro-rata portion of 17,500,000 Common Units (subject to rounding as set forth below). It is currently anticipated that in the Rights Offering (i) the Partnership will distribute ..5441 non-transferable Rights with respect to each Common Unit outstanding as of the record date for the Rights Offering, at no cost to the record holders; (ii) one Right plus $2.25 in cash will entitle the holder to purchase one Common Unit; (iv) the Rights will be evidenced by non-transferable subscription certificates; (v) no fractional Rights or cash in lieu thereof will be issued or paid, and the number of Rights distributed to each holder of Common Units will be rounded up to the nearest whole number of Rights (provided that such rounding shall not cause the total purchase price of the Common Units issuable upon exercise of the Right to exceed $39,375,000); and (vi) brokers, dealers and other nominees holding Common Units on the record date for more than one beneficial owner will be entitled to obtain separate subscription certificates for their beneficial owners so that they may each receive the benefit of rounding.

Section 5. *Ratification of Unit Purchase Agreement*. The Unit Purchase Agreement, as amended by this Amendment, is hereby ratified and confirmed in all respects and shall remain in full force and effect.

Section 6. *Counterparts*. This Amendment may be executed in several counterparts, each of which shall be an original and all of which shall constitute but one and the same instrument.

[Remainder of Page Left Blank]

[Signature page follows]

IN WITNESS WHEREOF, the parties have executed this Amendment, or caused this Amendment to be executed by their duly authorized representatives, all as of the day and year first above written.

	THE PARTNERSHIP/PARTNERSHIP GP:
	STAR GAS PARTNERS, L.P.
Address: 2187 Atlantic Street Stamford, CT 06902 Attention: Joe Cavanaugh Fax: (203) 328-7393	By: STAR GAS LLC, its general partner
	By: /s/ Joseph P. Cavanaugh Name: Joseph P. Cavanaugh Title: CEO-Director
with a copy to:	STAR GAS LLC
Phillips Nizer LLP 666 Fifth Avenue 28th Floor New York, NY 10103 Attention: Alan Shapiro, Esq. Fax: (212) 262-5152	By: /s/ Joseph P. Cavanaugh Name: Joseph P. Cavanaugh Title: CEO-Director
	KESTREL/BUYERS:
	KESTREL ENERGY PARTNERS, LLC
Address: 2 Count Rumford Lane Huntington, NY 11743 Attention: Paul A. Vermylen, Jr. Fax: (631) 614-4238	By: /s/ Paul A. Vermylen, Jr. **Paul A. Vermylen, Jr., President**
	KESTREL HEAT, LLC
with a copy to: Thompson & Knight LLP Suite 3300 Dallas, Texas 75201 Attention: Jeffrey A. Zlotky, Esq. Fax: (214) 969-1751	By: /s/ Paul A. Vermylen, Jr. **Paul A. Vermylen, Jr., President**
	KM2, LLC
	By: /s/ Paul A. Vermylen, Jr. **Paul A. Vermylen, Jr., President**

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Total shareholders' equity	3,638	1,468
Total liabilities and shareholders' equity	$14,315	$13,778

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

ENERGY FOCUS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(amounts in thousands except per share amounts)
(unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Net sales	$7,672	$8,193	$12,974	$13,653
Cost of sales	5,968	6,645	10,485	10,946
Gross profit	1,704	1,548	2,489	2,707
Operating expenses:				
Research and development	(61)	(131)	(15)	134
Sales and marketing	1,390	1,636	2,661	3,571
General and administrative	1,114	1,044	2,268	2,622
Valuation of equity instruments	-	-	-	56
Total operating expenses	2,443	2,549	4,914	6,383
Loss from operations	(739)	(1,001)	(2,425)	(3,676)
Other income (expense):				
Other (expense) income	(44)	22	(72)	71
Interest income	-	2	1	3
Interest expense	(114)	(192)	(265)	(375)
Loss before income taxes	(897)	(1,169)	(2,761)	(3,977)
Provision for income taxes	(3)	(4)	(6)	(9)
Net loss	$(900)	$(1,173)	$(2,767)	$(3,986)
Net loss per share - basic and diluted	$(0.02)	$(0.04)	$(0.07)	$(0.16)
Shares used in computing net loss per share - basic and diluted	44,513	24,754	38,067	24,490

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

ENERGY FOCUS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(amounts in thousands)
(unaudited)

	Three months ended June 30, 2012	Three months ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
Net loss	$(900)	$(1,173)	$(2,767)	$(3,986)
Other comprehensive income:				
Foreign currency translation adjustments	(17)	(18)	11	29
Comprehensive loss	$(917)	$(1,191)	$(2,756)	$(3,957)

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

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ENERGY FOCUS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(amounts in thousands)
(unaudited)

	Six months ended June 30,	
	2012	2011
Cash flows from operating activities:		
Net loss	$(2,767)	$(3,986)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	315	333
Stock-based compensation	104	309
Valuation of equity instruments	-	56
Provision for doubtful accounts receivable	76	23
Amortization of intangible assets	210	325
Amortization of discounts on long-term borrowings and acquisition related liabilities	125	245
Deferred revenue	26	85
Gain on disposal of fixed assets	-	(10)
Changes in assets and liabilities:		
Accounts receivable, inventories, and other assets	(2,553)	133
Accounts payable and accrued liabilities	(2,264)	(1,270)
Total adjustments	(3,961)	229
Net cash used in operating activities	(6,728)	(3,757)
Cash flows from investing activities:		
Acquisition of property and equipment	(107)	(203)
Proceeds from the sale of property and equipment	-	9
Net cash used in investing activities	(107)	(194)
Cash flows from financing activities:		
Proceeds from issuances of common stock, net	4,820	450
Proceeds from other borrowings	-	355
Payments on other borrowings	(861)	(8)
Net proceeds on credit line borrowings	1,363	-
Net cash provided by financing activities	5,322	797
Effect of exchange rate changes on cash	4	16
Net decrease in cash and cash equivalents	(1,509)	(3,138)
Cash and cash equivalents at beginning of period	2,136	4,107
Cash and cash equivalents at end of period	$627	$969
Classification of cash and cash equivalents:		
Cash and cash equivalents	$554	$906
Restricted cash held	73	63
Cash and cash equivalents at end of period	$627	$969

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

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ENERGY FOCUS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2012
(Unaudited)

NOTE 1. NATURE OF OPERATIONS

Energy Focus, Inc. and its subsidiaries (the "Company") engage in the design, development, manufacturing, marketing, and installation of energy-efficient lighting systems and solutions where the Company serves two segments:

- solutions-based sales providing turnkey, high-quality, energy-efficient lighting application alternatives primarily to the existing public-sector building market; and
- product-based sales providing military, general commercial and industrial lighting and pool lighting offerings, each of which markets and sells energy-efficient lighting systems.

The Company continues to evolve its business strategy to include providing its customers with turnkey, comprehensive energy-efficient lighting solutions, which use, but are not limited to, its patented and proprietary technology. Company product-based solutions include light-emitting diode ("LED"), fiber optic, high-intensity discharge ("HID"), fluorescent tube and other highly energy-efficient lighting technologies. Typical savings related to the current technology of the Company approximates 80% in electricity costs, while providing full-spectrum light closely simulating daylight colors. The Company's strategy also incorporates continued investment into the research of new and emerging energy sources including, but not limited to, LED and solar energy applications.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies of the Company, which are summarized below, are consistent with generally accepted accounting principles and reflect practices appropriate to the business in which it operates.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates include, but are not limited to, the establishment of reserves for accounts receivable, sales returns, inventory obsolescence and warranty claims; the useful lives for property, equipment, and intangible assets; revenues recognized on a percentage-of-completion basis; and stock-based compensation. In addition, estimates and assumptions associated with the determination of the fair value of financial instruments and evaluation of goodwill and long-lived assets for impairment requires considerable judgment. Actual results could differ from those estimates and such differences could be material.

Reclassifications

Certain prior year amounts have been reclassified within the Condensed Consolidated Financial Statements ("financial statements"), and related notes thereto, to be consistent with the current year presentation.

Basis of Presentation

The financial statements include the accounts of the Company and its subsidiaries, Stones River Companies, LLC ("SRC") in Nashville, Tennessee, and Crescent Lighting Limited ("CLL") located in the United Kingdom. All significant inter-company balances and transactions have been eliminated.

Interim Financial Statements (unaudited)

Although unaudited, the interim financial statements in this report reflect all adjustments, consisting only of all normal recurring adjustments, which are, in the opinion of management, necessary for a fair statement of financial position, results of operations, and cash flows for the interim periods covered and of the financial condition of the Company at the interim balance sheet date. The results of operations for the interim periods presented are not necessarily indicative of the results expected for the entire year.

ENERGY FOCUS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2012
(Unaudited)

The Company's independent public accounting firm has issued an opinion in connection with its 2011 Annual Report on Form 10-K raising substantial doubt as to its ability to continue as a going concern. The interim financial statements have been prepared assuming the Company will continue to operate as a going concern, which contemplates the realization of assets and the settlement of liabilities in the normal course of business. The interim financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from uncertainty related to our ability to continue as a going concern.

Year-end Balance Sheet

The year-end balance sheet information was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles. These financial statements should be read in conjunction with the Company's audited financial statements and notes thereto for the year ended December 31, 2011, which are contained in the Company's 2011 Annual Report on Form 10-K and amendments thereof ("Form 10-K").

Recent Accounting Pronouncements

In May 2011, the FASB amended fair value measurement and disclosure guidance to achieve convergence with International Financial Reporting Standards ("IFRS"). The amended guidance modifies the measurement of fair value, clarifies verbiage and changes disclosure or other requirements in U.S. GAAP and IFRS. The guidance is effective during the interim and annual periods beginning on or after December 15, 2011. The adoption of this guidance did not have a material impact on the financial statements of the Company.

In June 2011, the FASB issued guidance related to the presentation of comprehensive income. The guidance was issued to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. The guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Its adoption did not have a material impact on the Company's financial statements.

In September 2011, the FASB amended guidance relating to the goodwill impairment test. The changes are intended to reduce the cost and complexity of the annual test by providing entities and option to perform a qualitative assessment to determine whether further impairment testing is necessary. The revised guidance includes examples of events and circumstances that might indicate that a reporting unit's fair value is less than its carrying amount. The changes are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The Company adopted this guidance as stipulated.

Retainage Receivable

The Company's solutions-based sales are normally subject to a holdback of a percentage of the sale as retainage. This holdback is recorded on the Company's Condensed Consolidated Balance Sheets as "Retainage receivable". Retainage is a portion of the total bid price of a project that is held back by the customer until the project is complete and functioning satisfactorily according to the contract terms. Retainage percentages typically range from 5% to 10% and are collected anywhere from three to eighteen months from the inception of the project. At June 30, 2012 and December 31, 2011, the Company had a Retainage receivable from its customers totalling $0.4 million and $0.5

million, respectively.

Collateralized Assets

The Company maintains $1.0 million of cash collateral related to its surety bonding program associated with SRC. This cash is pledged to the surety carrier until such time as the Company is able to provide sufficient alternative means of collateralization satisfactory to the surety carrier.

Earnings (Loss) per Share

Basic loss per share is computed by dividing the net loss available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted loss per share is computed giving effect to all dilutive potential common shares that were outstanding during the period. Dilutive potential common shares consist of incremental shares upon exercise of stock options and warrants, unless the effect would be anti-dilutive.

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A reconciliation of basic and diluted loss per share is provided as follows (in thousands, except per share amounts):

	Three months ended June 30, 2012	Three months ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
Basic and diluted loss per share:				
Net loss	$ (900)	$ (1,173)	$ (2,767)	$ (3,986)
Basic and diluted loss per share:				
Weighted average shares outstanding	44,513	24,754	38,067	24,490
Basic and diluted net loss per share	$ (0.02)	$ (0.04)	$ (0.07)	$ (0.16)

Options and warrants to purchase approximately 15,296,000 and 5,254,000 shares of common stock, were outstanding at June 30, 2012 and 2011, respectively, but were not included in the calculation of diluted net loss per share because their inclusion would have been anti-dilutive.

Stock-Based Compensation

The Company's stock-based compensation plan is described in detail in its 2011 Form 10-K for the year ended December 31, 2011. The following table summarizes the Company's stock-based compensation (in thousands):

	Three months ended June 30, 2012	Three months ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
Stock option expense	$ 46	$ 73	$ 104	$ 96
Executive & Director stock-based compensation	-	53	-	107
Employee incentive stock-based compensation	-	-	-	106
Total stock-based compensation	$ 46	$ 126	$ 104	$ 309

Total unearned compensation of $0.3 million related to stock options remains at June 30, 2012 compared to $0.4 million at June 30, 2011. These costs will be charged to expense and amortized on a straight line basis in future periods through the first quarter of 2016. The weighted average period over which this unearned compensation is expected to be recognized is approximately 1.6 years.

The fair value of each stock option is estimated on the date of grant using the Black-Scholes option pricing model. Estimates utilized in the calculation include the expected life of the option, risk-free interest rate, and expected volatility, and are further comparatively detailed as follows:

	Six months ended June 30,					
	2012			2011		
Fair value of options issued	$	0.21		$	0.59	
Exercise price	$	0.39		$	1.07	
Expected life of option (years)		6.1			6.1	
Risk-free interest rate		1.48	%		2.40	%
Expected volatility		58.05	%		56.72	%
Dividend yield		0	%		0	%

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The Company granted 1,000,000 performance-based stock options during the year ended December 31, 2010. These performance-based stock options are exercisable by the grantees if, and only if, the Company achieves required revenue and cash-flow generation targets as reported in the Company's 2010 Form 10-K. Of the 1,000,000 performance-based stock options awarded in 2010, 850,000 stock options were canceled in the first half of 2011 as a result of these defined targets not being achieved during the year ended December 31, 2010.

In addition to the above, the Company granted 615,000 stock options, 115,000 restricted stock options, had stock option exercises of 7,500 shares, and had cancellations of 363,000 stock options for the period ended June 30, 2011. The Company granted 10,000 stock options and had cancellations of 89,000 stock options for the period ended June 30, 2012.

Product Warranties

The Company warrants finished goods against defects in material and workmanship under normal use and service for periods of one to five years for products and labor. Settlement costs consist of actual amounts expensed for warranty services which are largely a result of third-party service calls and the costs of replacement products. A liability for the estimated future costs under product warranties is maintained for products outstanding under warranty and is included in "Accrued liabilities" in the Condensed Consolidated Balance Sheets. The warranty activity for the respective periods is as follows (in thousands):

	Three months ended June 30, 2012	Three months ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
Balance at the beginning of the period	$ 110	$ 116	$ 100	$ 126
Accruals for warranties issued	27	15	58	22
Settlements made during the period (in cash or in kind)	(12)	(31)	(33)	(48)
Balance at the end of the period	$ 125	$ 100	$ 125	$ 100

NOTE 3. INVENTORIES

Inventories are stated at the lower of standard cost (which approximates actual cost determined using the first-in, first-out cost method) or market and consist of the following, net of reserves (in thousands):

	June 30, 2012	December 31, 2011
Raw materials	$ 1,457	$ 1,517
Finished goods	905	912
Inventories, net	$ 2,362	$ 2,429

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NOTE 4. PROPERTY AND EQUIPMENT

Property and equipment is stated at cost and depreciated using the straight-line method over the estimated useful lives of the related assets and consists of the following (in thousands):

	June 30, 2012	December 31, 2011
Equipment (useful life 3 - 15 years)	$ 5,837	$ 5,831
Tooling (useful life 2 - 5 years)	2,470	2,440
Furniture and fixtures (useful life 5 years)	132	129
Computer software (useful life 3 years)	432	431
Leasehold improvements (the shorter of useful life or lease life)	630	630
Construction in progress	96	27
Property and equipment at cost	9,597	9,488
Less: accumulated depreciation	(7,699)	(7,383)
Property and equipment, net	$ 1,898	$ 2,105

NOTE 5. GOODWILL AND INTANGIBLE ASSETS

The following table summarizes information related to net carrying value of intangible assets (in thousands):

	Amortization Life (in years)	June 30, 2012	December 31, 2011
Goodwill	n/a	$ 672	$ 672
Definite-lived intangible assets:			
Tradenames	10	375	400
Customer relationships	5	442	627
Total definite-lived intangible assets		817	1,027
Total intangible assets, net		$ 1,489	$ 1,699

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Amortization expense for intangible assets subject to amortization was $0.1 million for the three months ended June 30, 2012, as compared to $0.2 million for the three months ended June 30, 2011. Amortization expense for the six months ended June 30, 2012 and 2011 was $0.2 million and $0.3 million, respectively. The Company amortizes Tradenames on a straight-line basis over the estimated useful lives of the intangible assets. Customer relationships are amortized over their expected useful lives on an accelerated method that approximates the cash flows associated with those relationships. Based on the carrying value of amortized intangible assets the Company estimates amortization expense for future years to be as follows (in thousands):

Year ending December 31,		Amount
2012 July through December	$	210
2013		253
2014		104
2015		50
2016		50
2017 and thereafter		150
Total amortization expense	$	817

As of June 30, 2012, the Company had $0.7 million of goodwill recorded on its financial statements related to the acquisition of SRC.

NOTE 6. CONTRACTS IN PROGRESS

Costs and estimated earnings on contracts in progress as of the periods indicated are summarized in the following table (in thousands):

		June 30, 2012		December 31, 2011
Costs incurred on uncompleted contracts	$	6,772	$	3,193
Estimated earnings		1,729		855
Total revenues		8,501		4,048
Less: billings to date		8,940		4,031
Total	$	(439)	$	17
Balance sheet classification:				
Costs in excess of billings on uncompleted contracts	$	66	$	171
Billings in excess of costs on uncompleted contracts		(505)		(154)
Total	$	(439)	$	17

NOTE 7. DEBT

Credit Facilities

On December 22, 2011, the Company entered into a $4.5 million revolving line of credit (“credit facility”) with Rosenthal & Rosenthal. The total loan amount available to the Company under the line of credit is equal to 85% of its net amount of eligible receivables, plus available inventory (the lesser of 50% of the lower of cost or market value of eligible inventory, or $0.3 million). The credit facility is secured by a lien on the domestic assets of the Company. The interest rate for borrowing on accounts receivable is 8.5%, on inventories 10.0% and on overdrafts 13.0%. Additionally, there is an annual 1% facility fee on the entire amount of the credit facility, $4.5 million, payable at the beginning of the year. The credit facility is a three year agreement, expiring on December 31, 2014, unless terminated sooner. There are liquidated damages if the credit facility is terminated prior to December 31, 2014, which are based on the maximum credit facility amount then in effect. The damages are: 3% if terminated prior to the first anniversary of the closing date, 2% if terminated prior to the second anniversary of the closing date, and 1% if terminated prior to the third anniversary of the closing date. The Company is required to comply with certain financial covenants, measured quarterly, including, as defined in the agreement: a tangible net worth amount and a working capital amount. The Company was in compliance with the financial covenants at June 30, 2012. Borrowings under the revolving line of credit were $2.1 million at June 30, 2012, and are recorded in the Company’s Condensed Consolidated Balance Sheets as a current liability under the caption “Credit line borrowings.”

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The Company maintained a British pounds sterling-denominated bank overdraft facility with Lloyds Bank Plc through its United Kingdom subsidiary in the amount of £100,000, which had been renewed on an annual basis in May. However, in May of 2012, this facility was not been renewed. The interest rate on the facility at December 31, 2011 was 3.60%, and there were no borrowing against it at that time.

Borrowings

The components of the Company's debt at June 30, 2012 and December 31, 2011 were as follows (in thousands):

	June 30, 2012	December 31, 2011
Letter of Credit Agreement - Mark Plush	$ 250	250
Cognovit Note - Keystone Ruby, LLC	300	325
Secured Subordinated Promissory Note - EF Energy Partners LLC	-	287
Convertible Promissory Note - TLC Investments LLC	500	500
Letter of Credit Agreement - John Davenport	-	250
Letter of Credit Agreement - Quercus Trust	-	300
Unsecured Promissory Note - Quercus Trust	70	70
Discounts on long-term debt, net of discounts	(94)	(172)
Subtotal	1,026	1,810
Less: Current maturities of long-term debt	(474)	(855)
Long-term debt	$ 552	$ 955

For a full description of the Company's debt financing, reference is made to Note 10 of the Company's 2011 Form 10-K.

Future maturities of remaining borrowings are (in thousands):

Year ending December 31,	Debt
2012 July through December	$ 25
2013	803
2014	59
2015	65
2016	72
2017 and thereafter	96
Gross long-term borrowings	1,120
Less: discounts on long-term borrowings	(94)
Total commitment, net	1,026
Less: portion classified as current	(474)
Long-term borrowings, net	$ 552

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NOTE 8. SEGMENTS AND GEOGRAPHIC INFORMATION

The Company has two reportable segments: product-based sales, featuring military, general commercial and industrial lighting, and pool lighting, each of which markets and sells lighting systems, and solutions-based sales providing turnkey, high-quality, energy-efficient lighting application alternatives. The Company's products are sold through a combination of direct sales employees, independent sales representatives, and various distributors in different geographic markets throughout the world. The Company's solutions-based sales are designed to enhance total value by positively impacting customers' profitability, the environment, and the communities it serves. These solutions are sold through the Company's direct sales employees as well as our SRC subsidiary, and include not only its proprietary energy-efficient lighting solutions, but also sourced lighting systems, energy audits, and service agreements.

The following summarizes the Company's reportable segment data for periods indicated (in thousands):

	Three months ended June 30, 2012	Three months ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
Solutions:				
Net sales	$ 2,105	$ 3,344	$ 3,745	$ 5,946
Cost of sales	1,678	2,947	3,240	5,000
Gross profit	427	397	505	946
Operating expenses:				
Sales and marketing	370	372	684	721
General and administrative	164	238	314	475
Total operating expenses	534	610	998	1,196
Segment loss	$ (107)	$ (213)	$ (493)	$ (250)
Products:				
Net sales	$ 5,567	$ 4,849	$ 9,229	$ 7,707
Cost of sales	4,290	3,698	7,245	5,946
Gross profit	1,277	1,151	1,984	1,761
Operating expenses (income):				
Research and development	(61)	(131)	(15)	134
Sales and marketing	890	1,213	1,751	2,732
General and administrative	61	66	142	172
Total operating expenses	890	1,148	1,878	3,038
Segment income (loss)	$ 387	$ 3	$ 106	$ (1,277)
Reconciliation of segment income (loss) to net loss:				
Segment income (loss):				
Solutions	$ (107)	$ (213)	$ (493)	$ (250)
Products	387	3	106	(1,277)
Total segment income (loss)	280	(210)	(387)	(1,527)
Operating expenses:				

Sales and marketing	130	51	226	118
General and administrative	889	740	1,812	1,975
Valuation of equity instruments	-	-	-	56
Total operating expenses	1,019	791	2,038	2,149
Other expense	(158)	(168)	(336)	(301)
Loss before income taxes	(897)	(1,169)	(2,761)	(3,977)
Provision for income taxes	(3)	(4)	(6)	(9)
Net loss	$ (900)	$ (1,173)	$ (2,767)	$ (3,986)

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The following table provides additional business unit gross profitability detail for the Company's product-based business segment for the periods indicated (in thousands):

	Three months ended June 30, 2012	Three months ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
Products segment net sales:				
Pool and commercial products	$ 4,905	$ 3,674	$ 7,195	$ 6,022
Government products/R&D services	662	1,175	2,034	1,685
Total products segment net sales	5,567	4,849	9,229	7,707
Products segment cost of sales:				
Pool and commercial products	3,554	2,564	5,185	4,364
Government products/R&D services	736	1,134	2,060	1,582
Total products segment cost of sales	4,290	3,698	7,245	5,946
Products segment gross profit (loss):				
Pool and commercial products	1,351	1,110	2,010	1,658
Government products/R&D services	(74)	41	(26)	103
Total products segment gross profit	$ 1,277	$ 1,151	$ 1,984	$ 1,761

A geographic summary of net sales is as follows (in thousands):

	Three months ended June 30, 2012	Three months ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
United States	$ 6,937	$ 6,960	$ 11,724	$ 11,513
International	735	1,233	1,250	2,140
Net sales	$ 7,672	$ 8,193	$ 12,974	$ 13,653

A geographic summary of long-lived assets, which consists of fixed assets, goodwill, and intangible assets, is as follows (in thousands):

	June 30, 2012	December 31, 2011
United States	$ 3,328	$ 3,747
International	59	57
Long-lived assets, net	$ 3,387	$ 3,804

NOTE 9. INCOME TAXES

At June 30, 2012, the Company has recorded a full valuation allowance against its deferred tax asset in the United States, due to uncertainties related to the Company's ability to utilize its deferred tax assets, primarily consisting of certain net operating losses carried forward. The valuation allowance is based upon the Company's estimates of taxable income by jurisdiction and the period over which its deferred tax assets will be recoverable.

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NOTE 10. COMMITMENTS AND CONTINGENCIES

In connection with the acquisition of SRC in December 2010, the Company recorded a performance-related contingent obligation related to a 2.5% payout payable over 42 months commencing January 1, 2010 and based upon the fair value of projected annual billings of the acquired business, and a $0.5 million fee if the market price of the Company's common stock is not equal to or greater than $2.00 per share for at least twenty trading days between June 30, 2010 and June 30, 2013. The Company accrued for each of these contingent liabilities at their respective fair values at the time of the acquisition. For the three and six months ended June 30, 2012, the Company paid $54 thousand and $0.1 million, respectively, relating to the 2.5% payout. For the three and six months ended June 30, 2011, the Company paid $0.1 million and $0.2 million, respectively, relating to the payout.

In the fourth quarter of 2011, the Company reassessed the carrying value of the contingent liability related to the 2.5% payout and, based upon revised projected future billings, subsequently recorded a reduction to the contingent liability of $0.4 million. At June 30, 2012, the Company has recorded a current liability related to these contingent obligations of $0.9 million, which is recorded under the caption "Accrued liabilities" in its Condensed Consolidated Balance Sheets.

NOTE 11. RELATED PARTY TRANSACTIONS

On December 29, 2009, and in conjunction with the acquisition of SRC, the Company entered into Letter of Credit Agreements ("LOC's") with John Davenport, President of the Company, and with Quercus, for $0.3 million each. In March 2012, both of these LOC's were paid in full. Additionally, on August 11, 2011, the Company entered into a LOC agreement with Mark Plush, Chief Financial Officer of the Company, for $0.3 million. For a full description of the terms of these LOC's, reference is made to Note 10 of the Company's 2011 Form 10-K.

The former Vice President of SRC, who resigned on December 31, 2011, is a minority owner in TLC Investments, LLC ("TLC"), a Tennessee limited liability company, as well as in Woodstone Energy, LLC ("Woodstone"), a Tennessee limited liability company, both of which are located in Nashville, Tennessee.

SRC renders lighting design and lighting solution services to these parties within the scope of their ordinary business activities. Conversely, these parties, operating as electrical subcontractors, provide installation support services to SRC as part of their normal business. During the three and six months ended June 30, 2011, the Company recorded revenue of $0.5 million and $0.8 million, respectively. The receivable from these parties, including retainage, was $0.4 million at December 31, 2011. Subcontractor installation support services provided by these parties totaled $2.5 million in the second quarter of 2011, and $4.1 million for the first half of 2011. The payable to these parties was $1.2 million at December 31, 2011.

With the acquisition of SRC, the Company entered into an agreement with the seller, TLC, whereby, SRC would be guaranteed a profit percentage of 25% on certain projects which were begun prior to the acquisition or were out for bid at the time the acquisition occurred on December 31, 2009. During 2012, a small number of SRC projects continue to be subject to this guarantee, as the majority of these projects have been completed.

In conjunction with the acquisition of SRC on December 31, 2009, the Company entered into an agreement with TLC whereby a Convertible Promissory Note ("Convertible Note") was issued for the principal amount of $0.5 million. This Convertible Note bears interest at a rate of the Wall Street Journal Prime Rate plus two percent (2%), which along with the principal, is due and payable on June 30, 2013. Additionally, TLC has the right to convert the principal of the Convertible Note, in whole, into 500,000 shares of the Company's common stock at any time during the period commencing on June 30, 2010 and ending on the maturity date.

Additionally, as a provision to the Convertible Note, if the reported closing price of a share of the Company's common stock is not equal to or greater than $2.00 for at least twenty (20) trading days between June 30, 2010 and June 30, 2013, the Company shall pay TLC an additional fee of $0.5 million on the maturity date.

On December 31, 2009, the Company issued to Woodstone, warrants to purchase up to 600,000 shares of the Company's common stock at an original exercise price of $0.65 per share, later re-priced to $0.49 during the first quarter of 2012, and with a term ending on December 31, 2014. The warrants become exercisable only if SRC receives from Woodstone firm contracts or purchase orders for at least $10.0 million by June 30, 2013. The warrants vest in two tranches: 400,000 shares when contracts or purchase orders between SRC and Woodstone reach $10.0 million and an additional 200,000 shares when contracts or purchase orders between SRC and Woodstone reach an additional $5.0 million. As of June 30, 2012, warrants to purchase 400,000 shares of the Company's common stock have vested but have not been exercised.

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The Company, in the agreement for the acquisition of SRC, provided for payment of a management fee of 8% in support of billings, on projects that were pending at the date of acquisition, for which TLC provided installation support services. For the first three and six months ended June 30, 2011, SRC incurred $0.2 million and $0.3 million of management fees, respectively.

NOTE 12. SHAREHOLDERS EQUITY

Between February 29, 2012 and March 2, 2012, the Company entered into Securities Purchase Agreements with ten investors, under which it sold 19,600,000 units, each of which consists of one share of the Company's common stock, par value $0.0001 per share, and one-half warrant to purchase one share of common stock, and raised $4.9 million. The purchase price of each unit was $0.25, based on a formula involving the stock's 30 day average price prior to February 24, 2012. Each warrant entitles the holder to purchase one share of common stock at an exercise price of $0.54. Each warrant is immediately separable from the unit and immediately exercisable, and expires three years from the date of issuance. The Company used the proceeds of the offering to retire debt and for working capital purposes. Eight of the ten investors are new investors and the largest single investment was $1.0 million.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the Condensed Consolidated Financial Statements ("financial statements") and related notes included in Item 1 of this report and the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended December 31, 2011.

All references to "Energy Focus," "we," "us," "our," or "the Company" means Energy Focus, Inc. and its subsidiaries, except where it is made clear that the term means only the parent company.

When used in this discussion, the words "believes," "expects," "anticipates," "intends," "assumes," "estimates," "evaluates," "opinions," "forecasts," "may," "could," "future," "forward," "plans," "potential," "probable," and similar expressions are inte identify forward-looking statements. These statements, which include statements as to our expected sales and gross profit margins, expected operating expenses and capital expenditure levels, our sales and marketing expenses, our general and administrative expenses, expected expenses related to compliance with the Sarbanes-Oxley Act of 2002, the adequacy of capital resources and necessity to raise additional funds, our critical accounting policies, expected benefits from our consolidation and statements regarding pending litigation are subject to risks and uncertainties that could cause actual results to differ materially from those projected. These risks and uncertainties include, but are not limited to, those risks discussed below, as well as our ability to manage expenses, our ability to reduce manufacturing overhead and general and administrative expenses as a percentage of sales, our ability to collect on doubtful accounts receivable, our ability to increase cash balances in future quarters, the cost of enforcing or defending intellectual property, unforeseen adverse competitive, economic or other factors that may impact our cash position, risks associated with raising additional funds, and risks associated with our pending litigation. These forward-looking statements speak only as of the date hereof. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Overview

Energy Focus, Inc. and its subsidiaries engage in the design, development, manufacturing, marketing, and installation of energy-efficient lighting systems and solutions where we serve two segments:

- solutions-based sales providing turnkey, high-quality, energy-efficient lighting application alternatives primarily to the existing public-sector building market; and
- product-based sales providing military, general commercial and industrial lighting, and pool lighting offerings, each of which markets and sells energy-efficient lighting systems.

We continue to evolve our business strategy to include providing our customers with turnkey, comprehensive energy-efficient lighting solutions, which use, but are not limited to, our patented and proprietary technology. Our product-based solutions include light-emitting diode ("LED"), fiber optic, high-intensity discharge ("HID"), fluorescent tube and other highly energy-efficient lighting technologies. Typical savings related to our current technology approximates 80% in electricity costs, while providing full-spectrum light closely simulating daylight colors. Our strategy also incorporates continued investment into the research of new and emerging energy sources including, but not limited to, LED and solar energy applications.

Results of Operations

The following table sets forth the percentage of net sales represented by certain items reflected on our Consolidated Statements of Operations for the following periods:

	Three months ended June 30, 2012		Three months ended June 30, 2011		Six months ended June 30, 2012		Six months ended June 30, 2011	
Net sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of sales	77.8		81.1		80.8		80.2	
Gross profit	22.2		18.9		19.2		19.8	
Operating expenses (income):								
Research and development	(0.8	)	(1.6	)	(0.1	)	1.0	
Sales and marketing	18.1		20.0		20.5		26.1	
General and administrative	14.5		12.7		17.5		19.2	
Valuation of equity instruments	-		-		-		0.4	
Total operating expenses	31.8		31.1		37.9		46.7	
Loss from operations	(9.6	)	(12.2	)	(18.7	)	(26.9	)
Other income (expense):								
Other (expense) income	(0.6	)	0.3		(0.6	)	0.5	
Interest expense, net	(1.5	)	(2.3	)	(2.0	)	(2.7	)
Loss before income taxes	(11.7	)	(14.2	)	(21.3	)	(29.1	)
Provision for income taxes	(0.0	)	(0.1	)	(0.0	)	(0.1	)
Net loss	(11.7	) %	(14.3	) %	(21.3	) %	(29.2	) %

Net Sales

Our sales breakdown by business segment are as follows (in thousands):

	Three months ended June 30, 2012	Three months ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
Solutions:				
Net sales - solutions	$ 2,105	$ 3,344	$ 3,745	$ 5,946
Products:				
Net sales - pool and commercial	4,905	3,674	7,195	6,022
Net sales - government products/R&D services	662	1,175	2,034	1,685
Total net sales - product segment	5,567	4,849	9,229	7,707

Total net sales	$ 7,672	$ 8,193	$ 12,974	$ 13,653

Total net sales of $7.7 million and $13.0 million for the three and six months ended June 30, 2012, decreased 6 percent and 5 percent, respectively, from the same periods last year. The decline was due to lower net sales in the solutions segment, for the three and six months ended June 30, 2012, which was partially offset by a 15 percent and a 20 percent increase in products segment sales from the prior year's three and six months, respectively. Solutions sales decreased primarily as a result of lower sales at a major customer. Sales for the products segment increased primarily as a result of higher U.S. sales for pool and commercial products. Our solutions segment backlog at June 30, 2012 and 2011was $1.0 million and $1.7 million, respectively.

Revenues from our product-based business include, but are not limited to, revenues recognized upon shipping and service at completion of installation. Revenues from our lighting solutions-based business include, but are not limited to, revenues recognized from long-term contracts on a percentage-of-completion basis or the fair value of certain contract deliverables. For a detailed discussion on our revenue recognition policy, see our Annual Report on Form 10-K for the year ended December 31, 2011.

Gross Profit

Total gross profit was $1.7 million, 22.2 percent of net sales, for the three months ended June 30, 2012 compared to $1.5 million, 18.9 percent of net sales, for the three months ended June 30, 2011. The $0.2 million increase in gross profit was primarily the result of an improvement in the solutions segment gross margins, 20.3 percent compared to the prior year's comparable period of 11.9 percent. Additionally, the products segment net sales were a higher percentage of total sales and that segment has higher gross margins than the solutions segment. Gross profit for the products segment was 22.9 percent of net sales for the three months ended June 30, 2012 compared to 23.7 percent for the three months ended June 30, 2011. Total gross profit for the six months ended June 30, 2012 was $2.5 million, 19.2 percent of net sales, compared to $2.7 million, 19.8 percent of net sales, for the prior year's comparable period. The decrease in gross margins was due primarily to lower net sales, $2.2 million, in the solutions segment. This was partially offset by a $1.5 million net sales increase in the products segment. Gross profit margins for the solutions segment was 13.5 percent of net sales and 15.9 percent of net sales for the six months ended June 30, 2012 and June 30, 2011, respectively. Gross profit margins for the products segment was 21.5 percent of net sales for the six months ended June 30, 2012, compared to 22.8 percent of net sales for last year's comparable period.

Operating Expenses

Research and Development

Gross research and development expenses were $0.7 million for the three months ended June 30, 2012, a 39 percent decrease from $1.2 million for the three months ended June 30, 2011. The decrease was due primarily to lower project related expenses. For the six months ended June 30, 2012, gross research and development expenses were $1.9 million compared to $2.1 million for the prior year's comparable period.

Research and development expenses include salaries, contractor and consulting fees, supplies and materials, as well as costs related to other overhead such as depreciation and facilities costs. Research and development costs are expensed as they are incurred.

Total government reimbursements are the combination of revenues and credits from government contracts.

The gross and net research and development expense along with credits from government contracts is shown in the following table (in thousands):

	Three months ended June 30,		Six months ended June 30,	
Net Research & Development Expense	2012	2011	2012	2011
Total gross research and development expenses	709	1,160	1,888	2,051
Cost recovery through cost of sales	(500)	(675)	(1,394)	(1,103)
Cost recovery and other credits	(270)	(616)	(509)	(814)
Net research and development expense	$(61)	$(131)	$(15)	$134

Sales and Marketing

Sales and marketing expenses were $1.4 million or 18.1 percent of net sales in the three months ended June 30, 2012, compared to $1.6 million or 20.0 percent of net sales in last year's comparable period, a decrease of 15 percent. The decrease is due to lower salary costs, and lower discretionary spending. For the six months ended June 30, 2012, sales and marketing expenses were $2.7 million, a 25 percent decrease from the prior year's six month period. The decrease was due primarily to lower salaries, lower commission expense and lower discretionary spending.

General and Administrative

General and administrative expenses were $1.1 million, 14.5 percent of net sales, for the three months ended June 30, 2012 compared to $1.0 million, 12.7 percent of net sales for the three months ended June 30, 2011. For the six months ended June 30, 2012, general and administrative expenses were $2.3 million compared to $2.6 million in last year's comparable period, a 14 percent decrease. The decrease was due to lower amortization expense, legal fees and directors fees.

Valuation of Equity Instruments

During the first quarter of 2011, we recognized a non-cash charge of $56 thousand related to the valuation of our common stock upon the issuance of 412,000 shares to Lincoln Park Capital Partners, LLC. No valuation adjustments were made in 2012.

Other Income and Expenses

For the three months ended June 30, 2012 and 2011, interest expense was $0.1 million and $0.2 million, respectively. For the six months ended June 30, 2012 and 2011, interest expense was $0.3 million and $0.4 million, respectively. Interest expense is primarily related to our debt, which includes the amortization of debt discounts and, in 2012, interest on our line of credit facility.

Net Loss

For the three months ended June 30, 2012 and 2011, the net loss was $0.9 million and $1.2 million, respectively. For the six months ended June 30, 2012, we recorded a net loss of $2.8 million, compared $4.0 million in last year's comparable period; a $1.2 million improvement on $0.7 million lower sales.

Liquidity and Capital Resources

Cash and Cash Equivalents

At June 30, 2012, our cash and cash equivalents were $0.6 million, compared to $2.1 million at December 31, 2011; a decrease of $1.5 million. The balance at June 30, 2012 includes restricted cash of $73 thousand, compared to $19 thousand of restricted cash at December 31, 2011. The restricted cash relates to funds received from a grant from/for a branch of the United States government. We had $3.1 million in total borrowings as of June 30, 2012 and $2.5 million as of December 31, 2011.

Cash Used in Operating Activities

For the six months ended June 30, 2012, net cash used in operating activities was $6.7 million compared to net cash used of $3.8 million in 2011. Cash used in operating activities primarily consists of net losses adjusted for non-cash items, including depreciation, amortization, and stock-based compensation; and the effect of changes in working capital.

Cash Used in Investing Activities

Net cash used in investing activities was $0.1 million for the six months ended June 30, 2012, and $0.2 million for the same period in 2011, and consisted primarily of the purchase of property and equipment.

Cash Provided by Financing Activities

Net cash provided by financing activities was $5.3 million for the six months ended June 30, 2012, compared to $0.8 million for the six months ended June 30, 2011. For the six months ended June 30, 2012, our credit line borrowings provided $1.4 million of cash proceeds, and net cash proceeds from stock issuances provided $4.8 million. Between February 29, 2012 and March 2, 2012, we entered into Securities Purchase Agreements with ten investors, under which we sold 19,600,000 units, each of which consists of one share of our common stock, par value $0.0001 per share, and one-half warrant to purchase one share of common stock. The purchase price of each unit was $0.25, based on a formula involving the stock's 30 day average price prior to February 24, 2012. Each warrant entitles the holder to purchase one share of common stock at an exercise price of $0.54. Each warrant is immediately separable from the unit and immediately exercisable, and expires three years from the date of issuance. We used the proceeds of the offering to retire $0.9 million of debt and for working capital purposes. The cash provided for the six months ended June 30, 2011, was primarily due to the issuance of 412,000 shares of our common stock to Lincoln Park Capital Fund, LLC. For details of the Lincoln Park Capital Fund, LLC Purchase Agreement, reference is made to Note 12, Shareholders' Equity, of the Company's Form 10-K. The agreement with Lincoln Park Capital, LLC expired as of July 23, 2012, by the terms of the Purchase Agreement.

Debt

Credit Facilities

On December 22, 2011, we entered into a $4.5 million revolving line of credit ("credit facility") with Rosenthal & Rosenthal. The total loan amount available to us under the line of credit is equal to 85% of our net amount of eligible receivables, plus available inventory (the lesser of 50% of the lower of cost or market value of eligible inventory, or $0.3 million). The credit facility is secured by a lien on our domestic assets. The interest rate for borrowing on accounts receivable is 8.5%, on inventories 10.0% and on overdrafts 13.0%. Additionally, there is an annual 1% facility fee on the entire amount of the credit facility, $4.5 million, payable at the beginning of the year. The credit facility is a three year agreement, expiring on December 31, 2014, unless terminated sooner. There are liquidated damages if the credit facility is terminated prior to December 31, 2014, which are based on the maximum credit facility amount then in effect. The damages are: 3% if terminated prior to the first anniversary of the closing date, 2% if terminated prior to the second anniversary of the closing date, and 1% if terminated prior to the third anniversary of the closing date. We are required to comply with certain financial covenants, measured quarterly, including, as defined in the agreement: a tangible net worth amount and a working capital amount. We were in compliance with the financial covenants at June 30, 2012. Borrowings under the revolving line of credit were $2.1 million at June 30, 2012, and $0.7 million at December 31, 2011, and are recorded in our Condensed Consolidated Balance Sheets as a current liability under the caption "Credit line borrowings."

Borrowings

Long-term debt, including current maturities, totaled $1.0 million at June 30, 2012 and $1.9 million at December 31, 2011. The change in long-term debt resulted from $861 thousand in payments and $77 thousand from the amortization of discounts on long-term debt. We were able to pay down debt with the proceeds from the Securities Purchase Agreement described in the "Cash Provided by Financing Activities" section above.

For details of a full description of the Company's debt financing, reference is made to Note 10 of the Company's 2011 Form 10-K.

Liquidity

Historically, we have incurred losses attributable to operational performance which has negatively impacted cash flows. As of June 30, 2012, we have an accumulated deficit of $77.7 million. Although management continues to address many of the legacy issues that have historically burdened our financial performance, we still face challenges in order to reach profitability. In order for us to attain profitability and growth, we will need to successfully address these challenges, including the continuation of cost reductions throughout our organization, improvement in gross margins, execution of our marketing and sales plans for our turnkey energy-efficient lighting solutions business, execution of the $23.1 million U.S. Navy supply contract, the development of new technologies into sustainable product lines and continued improvements in our supply chain performance.

We remain optimistic about obtaining the funding necessary to meet on-going tactical and strategic capital requirements; however, there can be no assurances that this objective will be successful. As such, we continue to review and pursue selected external funding sources, if necessary, to execute these objectives including, but not limited to, the following:

- obtain financing from traditional and non-traditional investment capital organizations or individuals,
- potential sale or divestiture of one or more operating units, and
- obtain funding from the sale of common stock or other equity or debt instruments.

Obtaining financing through the above-mentioned mechanisms contains risks, including:

- loans or other debt instruments may have terms and/or conditions, such as interest rate, restrictive covenants, and control or revocation provisions, which are not acceptable to management or the Board of Directors,
- the current environment in capital markets combined with our capital constraints may prevent us from being able to obtain any debt financing,
- financing may not be available for parties interested in pursuing the acquisition of one or more of our operating units, and
- additional equity financing may not be available in the current capital environment and could lead to further dilution of shareholder value for current shareholders of record.

Critical Accounting Policies

The preparation of our financial statements requires that we make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingencies, and the reported amounts of net sales and expenses in the financial statements. Material differences may result in the amount and timing of net sales and expenses if different judgments or different estimates were utilized. Critical accounting policies, judgments, and estimates which we believe have the most significant impact on our financial statements include, but are not limited to, the establishment of reserves for accounts receivable, sales returns, inventory obsolescence, and warranty claims; the useful lives for property, equipment, and intangible assets; revenues recognized on a percentage-of-completion basis; and stock-based compensation. In addition, estimates and assumptions associated with the determination of fair value of financial instruments and evaluation of goodwill and long-lived assets for impairment requires considerable judgment. For the detailed discussion of the application of policies critical to our business operations, see our Annual Report on Form 10-K for the year ended December 31, 2011.

Recent Accounting Pronouncements

In May 2011, the FASB amended fair value measurement and disclosure guidance to achieve convergence with International Financial Reporting Standards (“IFRS”). The amended guidance modifies the measurement of fair value, clarifies verbiage and changes disclosure or other requirements in U.S. GAAP and IFRS. The guidance is effective during the interim and annual periods beginning on or after December 15, 2011. The adoption of this guidance did not have a material impact on our financial statements.

In June 2011, the FASB issued guidance related to the presentation of comprehensive income. The guidance aims to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. The guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Its adoption did not have a material impact on our financial statements.

In September 2011, the FASB amended guidance relating to the goodwill impairment test. The changes are intended to reduce the cost and complexity of the annual test by providing entities an option to perform a qualitative assessment to determine whether further impairment testing is necessary. The revised guidance includes examples of events and circumstances that might indicate that a reporting unit’s fair value is less than its carrying amount. The changes are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. We adopted this guidance as stipulated.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As of June 30, 2012, we had British pounds sterling-denominated cash valued at $0.2 million held in the United Kingdom, based on the exchange rate at that date. The balances for cash held in the United Kingdom are subject to exchange rate risk. We have a policy of maintaining cash balances in local currency unless an amount of cash is occasionally transferred in order to repay inter-company debts.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures

We maintain “disclosure controls and procedures,” as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”), that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Our disclosure controls and procedures have been designed to meet, and management believes that they meet, reasonable assurance standards. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. Any design of disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer have concluded that, subject to the limitations noted above, our disclosure controls and procedures were effective to ensure that material information relating to us, including our consolidated subsidiaries, is made known to them by others within those entities, particularly during the period in which this Quarterly Report on Form 10-Q was being prepared.

(b) Changes in internal control over financial reporting

There were no changes in our internal controls over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the quarter. Further, there were no other items identified in connection with our internal evaluations that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1A. RISK FACTORS

Reference is made to the Risk Factors set forth in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2011 (the "Annual Report"). There have been no significant changes in those risk factors as set forth in the Annual Report.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Between February 29, 2012 and March 2, 2012, we entered into Securities Purchase Agreements with ten investors, under which we sold 19,600,000 units, each of which consists of one share of our common stock, par value $0.0001 per share, and one-half warrant to purchase one share of common stock, and raised $4.9 million. The purchase price of each unit was $0.25, based on a formula involving the stock's 30 day average price prior to February 24, 2012. Each warrant entitles the holder to purchase one share of common stock at an exercise price of $0.54. Each warrant is immediately separable from the unit and immediately exercisable, and expires three years from the date of issuance. We used the proceeds of the offering to retire debt and for working capital purposes. Eight of the ten investors are new investors and the largest single investment was $1.0 million. During the third quarter of 2012, the Company registered the shares by filing an S-1 Registration Statement that was effective on August 13, 2012.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

The information required by this Item is set forth on the Exhibit Index that follows the signature page of this report.

SIGNATURES

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.

ENERGY FOCUS, INC.

Date: August 14, 2012

By: /s/ Joseph G. Kaveski
Joseph G. Kaveski
Chief Executive Officer

By: /s/ Mark J. Plush
Mark J. Plush
Chief Financial Officer

EXHIBIT INDEX

Exhibit Number	Description of Documents
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Vice President of Finance and Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Vice President of Finance and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*101	The following financial information from the Company's Quarterly Report on Form 10-Q for the quarter ended June30, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets at June 30, 2012 and December 31, 2011, (ii) Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2012 and 2011, (iii) Condensed Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended June 30, 2012 and 2011, (iv) Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2012 and 2011, (vi) the Notes to Condensed Consolidated Financial Statements.

*Pursuant to Regulation S-T, this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.