DELCATH SYSTEMS INC
Form 10-Q
August 09, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2007

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ___________ to ___________

Commission file number: 001-16133

DELCATH SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware	06-1245881
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1100 Summer Street, 3rd Floor, Stamford, CT 06905
(Address of principal executive offices)

(203) 323-8668
(Registrant's telephone number, including area code)

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

Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

As of July 31, 2007, 21,408,007 shares of the Company's Common Stock, $0.01 par value, were issued and outstanding.

DELCATH SYSTEMS, INC.

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PART I:
FINANCIAL INFORMATION

Item 1: Condensed Financial Statements (Unaudited)

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DELCATH SYSTEMS, INC.
(A Development Stage Company)
Condensed Balance Sheets

	June 30, 2007 (Unaudited)	December 31, 2006 (Audited)
Assets		
Current assets		
Cash and cash equivalents	$ 6,416,755	$ 6,289,723
Certificates of deposit	548,587	2,408,302
Prepaid expenses	273,916	61,917
Total current assets	$ 7,239,258	$ 8,759,942
Property and equipment, net	10,522	3,719
Total assets	$ 7,249,780	$ 8,763,661
Liabilities and Stockholders’ Equity		
Current liabilities		
Accounts payable and accrued expenses	127,363	670,367
Total current liabilities	$ 127,363	$ 670,367
Commitments and contingencies	—	—
Stockholders’ equity		
Common stock, $.01 par value; 70,000,000 shares authorized	$ 213,830	$ 206,608
Additional paid-in capital	47,148,487	44,673,458
Deficit accumulated during development stage	(40,239,900)	(36,786,772)
Total stockholders’ equity	$ 7,122,417	$ 8,093,294
Total liabilities and stockholders’ equity	$ 7,249,780	$ 8,763,661

See accompanying notes to condensed financial statements.

DELCATH SYSTEMS, INC.
(A Development Stage Company)
Condensed Statements of Operations
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,		Cumulative from Inception (August 5, 1988) to
	2007	**2006**	**2007**	**2006**	**June 30, 2007**
Costs and expenses					
General and administrative expenses	$ 1,072,465	$ 1,090,967	$ 1,573,284	$ 1,652,517	$ 18,992,913
Research and development costs	1,194,439	635,217	2,083,390	1,401,857	21,860,954
Total costs and expenses	2,266,904	1,726,184	3,656,674	3,054,374	40,853,867
Operating loss	(2,266,904)	(1,726,184)	(3,656,674)	(3,054,374)	(40,853,867)
Interest income	87,890	160,465	203,546	304,517	2,157,545
Other income	—	—	—	—	126,500
Interest expense	—	—	—	—	(171,473)
Net loss	$ (2,179,014)	$ (1,565,719)	$ (3,453,128)	$ (2,749,857)	$ (38,741,295)
Common share data					
Basic and diluted loss per share	$ (0.10)	$ (0.08)	$ (0.16)	$ (0.14)	
Weighted average number of shares of common stock outstanding	21,352,219	19,633,405	21,179,540	19,418,425	

See accompanying notes to condensed financial statements.

DELCATH SYSTEMS, INC.
(A Development Stage Company)
Condensed Statements of Cash Flows
(Unaudited)

	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
Cash flows from operating activities:		
Net loss	$ (3,453,128)	$ (2,749,857)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock option compensation expense	1,040,498	505,282
Stock and warrant compensation expense issued for legal settlement, consulting services	98,750	—
Depreciation expense	1,937	2,143
Amortization of organization costs	—	—
Changes in assets and liabilities:		
Increase in prepaid expenses	(211,999)	(8,000)
Increase in interest receivable	—	(89,875)
(Decrease) increase in accounts payable and accrued expenses	(543,004)	558,902
Net cash used in operating activities	$ (3,066,946)	$ (1,781,405)
Cash flows from investing activities:		
Purchase of property and equipment	$ (8,740)	—
Purchase of short-term investments	—	$ (1,800,000)
Proceeds from maturities of short-term investments	1,859,715	5,606,790
Organization costs	—	—
Net cash provided by (used in) investing activities	$ 1,850,975	$ 3,806,790
Cash flows from financing activities:		
Net proceeds from sale of stock and exercise of stock options and warrants	$ 1,343,003	$ 2,783,282
Repurchases of common stock	—	—
Dividends paid	—	—
Proceeds from short-term borrowings	—	—
Net cash provided by financing activities	$ 1,343,003	$ 2,783,282
Increase in cash and cash equivalents	127,032	4,808,667
Cash and cash equivalents at beginning of period	6,289,723	1,704,131
Cash and cash equivalents at end of period	$ 6,416,755	$ 6,512,798
Supplemental cash flow information:		
Cash paid for interest	—	—
Supplemental non-cash activities:		
Cashless exercise of stock options	$ 400,498	—
Conversion of debt to common stock	—	—
Common stock issued for preferred stock dividends	—	—
Conversion of preferred stock to common stock	—	—
Common stock issued as compensation for stock sale	—	—

See accompanying notes to condensed financial statements.

DELCATH SYSTEMS, INC.
(A Development Stage Company)
Notes to Condensed Financial Statements

Note 1: Description of Business

Delcath Systems, Inc. (the Company) is a development stage company founded in 1988 for the purpose of developing and marketing a proprietary drug delivery system capable of introducing and removing high dose chemotherapy agents to a diseased organ system, while greatly inhibiting their entry into the general circulation system. It is hoped that the procedure will result in a meaningful treatment for cancer. In November 1989, the Company was granted an Investigational Device Exemption (IDE) and an Investigational New Drug (IND) status for its product by the Food and Drug Administration (FDA). The Company is seeking to complete clinical trials in order to obtain separate FDA pre-market approvals for the use of its delivery system using Melphalan, a chemotherapeutic agent, to treat malignant melanoma that has spread to the liver.

Note 2: Basis of Financial Statement Presentation

The accompanying condensed financial statements are unaudited and were prepared by the Company in accordance with accounting principles generally accepted in the United States of America (GAAP). Certain information and footnote disclosures normally included in the Companys annual financial statements have been condensed or omitted. The interim financial statements, in the opinion of management, reflect all adjustments (consisting of normal recurring accruals) necessary for a fair statement of the results for the interim periods ended June 30, 2007 and 2006, and cumulative from inception (August 5, 1988) to June 30, 2007.

The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the fiscal year. These interim financial statements should be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 2006, which are contained in the Companys Annual Report on Form 10-K for the year ended December 31, 2006 as filed with the Securities and Exchange Commission (the SEC) on March 16, 2007 (the 2006 Form 10-K).

Note 3: Costs and Expenses

Research and Development Costs

Research and development costs include the costs of materials, personnel, outside services and applicable indirect costs incurred in development of the Companys proprietary drug delivery system. All such costs are charged to expense when incurred.

General and Administrative Costs

General and administrative costs include the Companys general and administrative operating expenses.

Note 4: Stockholders Equity

The Company received a net amount of $1,343,004 upon the exercise of stock options for 611,850 shares of common stock, $0.01 par value per share (the Common Stock) during the six months ended June 30, 2007. Of those options: (i) 100,000 were exercised at a price of $0.71 per share, (ii) 120,000 were

DELCATH SYSTEMS, INC.
(A Development Stage Company)
Notes to Condensed Financial Statements

exercised at a price of $1.03 per share, (iii) 20,000 were exercised at a price of $1.32 per share, (iv) 200,000 were exercised at a price of $2.78 per share, (v) 100,000 were exercised at a price of $3.28 per share, and (vi) 71,850 were exercised at a price of $3.31 per share.

During the six months ended June 30, 2007, a cashless exercise of 70,000 options with an exercise price of $2.78 per share, 140,000 options with an exercise price of $3.59 per share, and 80,000 options with an exercise price of $3.28 per share collectively resulted in the issuance of 85,394 shares of Common Stock.

During the six months ended June 30, 2007, the Company issued 25,000 shares of Common Stock to its Chief Executive Officer that had an issuance value of $3.90 per share.

The per share weighted average fair value of five-year stock options granted to new members of the Board of Directors in May 2007 was $1.51 for those options with a grant date exercise price (options for an aggregate of 150,000 shares), and $.99 for those options with a 150% of grant date exercise price (options for an aggregate of 200,000 shares), estimated on the date of grant using the Black-Scholes option-pricing model. The expected term was estimated using a midpoint between the date of grant and the expiration date as required by the Simplified Method of term calculation in accordance with SFAS 123R (See Note 5). The weighted-average assumption of a risk free interest rate of 4.64% was based on the implied yield available on a U.S. Treasury note with a term equal to the estimated term of the underlying options as indicated above. The expected volatility of 58% was estimated based upon the historical volatility of the Company's share price. The Company used a dividend yield percentage of zero based on the fact that the Company has not paid dividends in the past nor does it expect to pay dividends in the future.

The per share weighted average fair value of five-year stock options granted to a new member of the Board of Directors in June 2007 was $1.85 for those options with a grant date exercise price (options for an aggregate of 50,000 shares) and $1.22 for those options with a 150% of grant date exercise price (options for an aggregate of 100,000 shares), estimated on the date of grant using the Black-Scholes option-pricing model. The expected term was estimated using a midpoint between the date of grant and the expiration date as required by the Simplified Method of term calculation in accordance with SFAS 123R (See Note 5). The weighted-average assumption of a risk free interest rate of 4.64% was based on the implied yield available on a U.S. Treasury note with a term equal to the estimated term of the underlying options as indicated above. The expected volatility of 58% was estimated based upon the historical volatility of the Company's share price. The Company used a dividend yield percentage of zero based on the fact that the Company has not paid dividends in the past nor does it expect to pay dividends in the future.

The following table sets forth changes in stockholders' equity during the six months ended June 30, 2007:

DELCATH SYSTEMS, INC.
(A Development Stage Company)
Notes to Condensed Financial Statements

	Common Stock, $0.01 Par Value Issued and Outstanding				
	No. of Shares	**Amount**	**Additional Paid in Capital**	**Deficit Accumulated During Development Stage**	**Total**
Balance at December 31, 2006	20,660,763	$ 206,608	$ 44,673,458	$ (36,786,772)	$ 8,093,294
Exercise of stock options	697,244	6,972	1,736,529	—	1,743,501
Shares issued as compensation	25,000	250	98,500	—	98,750
Issuance of stock options	—	—	640,000	—	640,000
Net loss for six months ended June 30, 2007	—	—	—	(3,453,128)	(3,453,128)
Balance at June 30, 2007	21,383,007	$ 213,830	$ 47,148,487	$ (40,239,900)	$ 7,122,417

Note 5: Stock Option Plan

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 123R, “Share-Based Payment” (SFAS 123R). This Statement is a revision of SFAS No. 123, “Accounting for Stock-Based Compensation” (SFAS 123), and supersedes Accounting Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees” (APB 25), and its related implementation guidance. SFAS 123R establishes accounting for equity instruments exchanged for employee services. Under the provisions of SFAS 123R, share-based compensation is measured at the grant date, based upon the fair value of the award, and is recognized as an expense over the option holders’ requisite service period (generally the vesting period of the equity grant). Prior to January 1, 2006, the Company accounted for share-based compensation to employees in accordance with APB 25, as permitted by SFAS No. 123, and, accordingly, did not recognize compensation expense for the issuance of options with an exercise price equal to or greater than the market price at the date of grant. The Company also followed the disclosure requirements of SFAS 123 as amended by SFAS 148, “Accounting for Stock-Based Compensation — Transition and Disclosure.” Effective January 1, 2006, the Company adopted the modified prospective approach and, accordingly, prior period amounts have not been restated. Under this approach, the Company is required to record compensation cost for all share-based payments granted after the date of adoption based upon the grant date fair value, estimated in accordance with the provisions of SFAS 123R, and for the unvested portion of all share-based payments previously granted that remain outstanding based on the grant date fair value, estimated in accordance with the original provisions of SFAS 123. The Company has expensed its share-based compensation for share-based payments granted after January 1, 2006 under the ratable method, which treats each vesting tranche as if it were an individual grant.

The Company periodically grants stock options for a fixed number of shares of Common Stock to its employees, directors and non-employee contractors, with an exercise price greater than or equal to the fair market value of our Common Stock at the date of the grant. The Company estimates the fair value of stock options using a Black-Scholes valuation model. Key inputs used to estimate the fair value of stock options include the exercise price of the award, the expected post-vesting option life, the expected volatility of our stock over the option’s expected term, the risk-free interest rate over the option’s expected term, and our expected annual dividend yield. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by persons who receive equity awards.

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Notes to Condensed Financial Statements

The required adoption of SFAS No. 123R as of January 1, 2006 has significantly increased compensation expense for future grants. The actual impact on future years will be dependent on a number of factors, including our stock price and the level of future grants and awards. In addition, costs related to accounting and valuation services of stock options currently outstanding in accordance with SFAS No. 123R would have been cost prohibitive to the Company if the Company had not adopted certain measures. Based on these considerations and after discussion of applicable accounting literature, the Compensation Committee of the Board of Directors approved accelerating the vesting of all unvested stock options effective January 1, 2006. The acceleration of vesting resulted in the recognition of a non-cash compensation expense of $505,282 on January 1, 2006 which is included in costs and expenses in the statements of operations for 2006.

The Company established its Incentive Stock Option Plan, Non-Incentive Stock Option Plan, 2000 Stock Option Plan, 2001 Stock Option Plan and 2004 Stock Incentive Plan (collectively, the “Plans”), under which stock options, stock appreciation rights, restricted stock, and stock grants may be awarded. A stock option grant allows the holder of the option to purchase a share of the Company’s Common Stock in the future at a stated price. The Plans are administered by the Compensation and Stock Option Committee of the Board of Directors, which determines the individuals to whom the options shall be granted as well as the terms and conditions of each option grant, the option price and the duration of each option.

During 2000, 2001 and 2004, respectively, the 2000 and 2001 Stock Option Plans and 2004 Stock Incentive Plan became effective. Options granted under the Plans vest as determined by the Company and expire over varying terms, but not more than five years from the date of grant. All currently outstanding options are fully vested. Stock option activity for the six-month period ended June 30, 2007 is as follows:

	The Plans			
	Stock Options	**Exercise Price per Share**	**Weighted Average Exercise Price**	**Weighted Average Remaining Life (Years)**
Outstanding at December 31, 2006	1,465,650	$ 0.71 – $3.59	$2.87	3.57
Granted	500,000	$ 3.90 – $7.14	$5.41	
Expired	202,500	$ 3.59	$3.59	
Exercised	901,850	$ 0.71 – $3.59	$2.55	
Outstanding at June 30, 2007	861,300	$ 1.03 – $7.14	$4.51	4.41

Note 6: Income Taxes

The Company adopted the provisions of FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 9” ("FIN No. 48"), on January 1, 2007. FIN No. 48 requires that the impact of tax positions be recognized in the financial statements if they are more likely than not of being sustained upon examination, based on the technical merits of the position. As discussed in the consolidated financial statements in the 2006 Form 10-K, the Company has a valuation allowance against the full amount of its net deferred tax assets. The Company currently provides a

DELCATH SYSTEMS, INC.
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Notes to Condensed Financial Statements

valuation allowance against deferred tax assets when it is more likely than not that some portion, or all of its deferred tax assets, will not be realized. The Company has not recognized any unrecognized tax benefits in their balance sheet under the provisions of FIN No. 48. In addition, there is no impact to accumulated deficit at the date of adoption as a result of the implementation of FIN No. 48 and there is no interest or penalties accrued as management believes the Company has no uncertain tax positions at June 30, 2007.

The Company is subject to U.S. federal income tax as well as income tax of certain state jurisdictions. The Company has not been audited by the I.R.S. or any states in connection with income taxes. The periods from 2003 - 2006 remain open to examination by the I.R.S. and state authorities.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

FORWARD LOOKING STATEMENTS

Certain statements in this Quarterly Report on Form 10-Q, including statements of our and management's expectations, intentions, plans, objectives and beliefs, including those contained in or implied by "Management's Discussion and Analysis of Financial Condition and Results of Operations," are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended, that is subject to certain events, risks and uncertainties that may be outside our control. These forward-looking statements may be identified by the use of words such as "expects," "anticipates," "intends," "plans" and similar expressions. They include statements of our future plans and objectives for our future operations and statements of future economic performance, information regarding our expansion and possible results from expansion, our expected growth, our capital budget and future capital requirements, the availability of funds and our ability to meet future capital needs, the realization of our deferred tax assets, and the assumptions described in this report underlying such forward-looking statements. Actual results and developments could differ materially from those expressed in or implied by such statements due to a number of factors, including without limitation, those described in the context of such forward-looking statements, our expansion strategy, our ability to achieve operating efficiencies, industry pricing and technology trends, evolving industry standards, domestic and international regulatory matters, general economic and business conditions, the strength and financial resources of our competitors, our ability to find and retain skilled personnel, the political and economic climate in which we conduct operations, the risks discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006 filed with the Securities and Exchange Commission (the "SEC") on March 16, 2007 (the "2006 Form 10-K"), under Item 1, "Description of Business," and other risk factors described from time to time in our other documents and reports filed with the SEC. We do not assume any responsibility to publicly update any of our forward-looking statements regardless of whether factors change as a result of new information, future events or for any other reason. We advise you to review any additional disclosures we make in our Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and Annual Reports on Form 10-K filed with the SEC.

Overview

Since our founding in 1988 by a team of physicians, we have been a development stage company engaged primarily in developing and testing the Delcath drug delivery system for the treatment of liver cancer. A substantial portion of our historical expenses have been for the development of our medical device and the clinical trials of our product, and the pursuit of patents worldwide, as described in our 2006 Form 10-K under Item 1, "Patents, Trade Secrets and Proprietary Rights." We expect to continue to incur significant losses from costs for product development, clinical studies, securing patents, regulatory activities, manufacturing and establishment of a sales and marketing organization without any significant revenues. A detailed description of the cash used to fund historical operations is in the financial statements and the notes thereto. Without an FDA-approved product and commercial sales, we will continue to be dependent upon existing cash and the sale of equity or debt to fund future activities. While the amount of future net losses and time required to reach profitability are uncertain, our ability to generate significant revenue and become profitable will depend on our success in commercializing our device.

During 2001, Delcath initiated the clinical trial of the drug delivery system for isolated liver perfusion using the chemotherapeutic agent Melphalan. Enrollment of new patients in the Phase I trial was completed in 2003.

In 2004, we commenced a Phase II clinical trial protocol for the study of the Delcath drug delivery system for inoperable primary liver cancer and adenocarcinomas and neuroendocrine cancers that have metastasized to the liver using Melphalan.

In 2006, we started enrolling and treating patients in a Phase III protocol for the study of the Delcath drug delivery system for inoperable melanoma in the liver using Melphalan under the FDA’s Fast Track and Special Protocol Assessment approved protocol.

Over the next 12 months, we expect to continue to incur substantial expenses related to the research and development of our technology, including Phase III and Phase II clinical trials using Melphalan with the Delcath system. Additional funds, when available, will be committed to pre-clinical and clinical trials for the use of other chemotherapy agents with the Delcath system for the treatment of liver cancer and other cancers, and the development of additional products and components. We will also continue efforts to qualify additional sources of the key components of our device, in an effort to further reduce manufacturing costs and minimize dependency on a single source of supply.

Results of Operations for the Six Months Ended June 30, 2007

The Company has operated at a loss for its entire history. We had a net loss for the six months ended June 30, 2007, of $3,453,128, which is $703,271 more than the net loss from continuing operations for the same period in 2006. This increase is primarily due to expenses relating to a five-year extension to the Company’s Cooperative Research and Development Agreement (“CRADA”) with the National Cancer Institute (“NCI”) that initially expired in December 2006. This extension was quite important in continuing and expanding the collaboration between the Company and the NCI, but will result in greater costs to the Company. The agreement with the NCI required that the annual payments to them be increased five-fold from the previous agreement.

General and administrative expenses decreased from $1,652,517 during the six months ended June 30, 2006, to $1,573,284 for the six months ended June 30, 2007. While legal fees incurred during the current period were substantially less than those incurred in 2006 and would have resulted in a greater reduction in period-to-period expenses due to the resolution of various legal matters, additional charges to general operations were incurred during this period by share-based compensation for options granted to new members of the Board of Directors in May and June 2007. Further, the cashless exercise of options by outgoing members of the Board of Directors resulted in additional charges to general operations.

During the six months ended June 30, 2007, we incurred $2,083,390 in research and development costs, as compared to $1,401,857 during the first six months of 2006. This increase is primarily due to increased expenses with the NCI, as discussed above, as well as accelerated clinical development costs relating to all facets of the Delcath system which has required greater expense but will hasten the progress toward final approval.

Interest income shown is from our money market accounts and certificate of deposit (“CD”) investments. During the six months ended June 30, 2007, the Company had interest income of $203,546, as compared to interest income of $304,517, or a 33.2% change, for the same period in 2006. This decrease is primarily due to a reduced cash position in 2007 from that in 2006. There was no other income during the six months ended June 30, 2007 or the comparable period in 2006.

Results of Operations for the Three Months Ended June 30, 2007

We had a net loss for the three months ended June 30, 2007, of $2,179,014, which is $613,295 more than the net loss from continuing operations for the same period in 2006. This increase is primarily due to expenses relating to the five-year CRADA extension discussed above.

General and administrative expenses decreased from $1,090,967 during the three months ended June 30, 2006, to $1,072,465 for the three months ended June 30, 2007. While legal fees incurred during the current period were substantially less than those incurred in 2006 and would have resulted in a greater reduction in period-to-period expenses due to the resolution of various legal matters, additional charges to general operations were incurred during this period by share-based compensation for options granted to new members of the Board of Directors in May and June 2007. Further, the cashless exercise of options by outgoing members of the Board of Directors in April 2007 resulted in additional charges to general operations.

During the three months ended June 30, 2007, we incurred $1,194,439 in research and development costs, as compared to $635,217 during the corresponding period in 2006. This increase is primarily due to increased expenses with the NCI, as discussed above, as well as accelerated clinical development costs relating to all facets of the Delcath drug delivery system which management believes will hasten the progress toward final approval.

Interest income shown is from our money market accounts and CD investments. During the three months ended June 30, 2007, the Company had interest income of $87,890, as compared to interest income of $160,465 for the same period in 2006. This decrease is primarily due to a reduced cash position in 2007 from that in 2006. There was no other income during the three months ended June 30, 2007 or the comparable period in 2006.

Liquidity and Capital Resources

The Company's future results are subject to substantial risks and uncertainties. The Company has operated at a loss for its entire history and there can be no assurance of its ever achieving consistent profitability. The Company is not projecting any capital expenditures that will significantly affect the Company's liquidity during the next 12 months. However, our future liquidity and capital requirements will depend on numerous factors, including the progress of our research and product development programs, including clinical studies; the timing and costs of making various United States and foreign regulatory filings, obtaining approvals and complying with regulations; the timing and effectiveness of product commercialization activities, including marketing arrangements overseas; the timing and costs involved in preparing, filing, prosecuting, defending and enforcing intellectual property rights; and the effect of competing technological and market developments. In addition, the Company intends to hire one additional employee.

At June 30, 2007, we had cash and cash equivalents of $6,416,755, as compared to $6,289,723 at December 31, 2006 and $6,512,798 at June 30, 2006. Because money market rates have been equal to or greater than what the Company could receive in CDs, nearly all of our funds are currently invested in money market accounts which are shown in our financial statements as part of "Cash and Cash Equivalents."

During the six months ended June 30, 2007, we used $3,066,946 of cash in our operating activities. This amount compares to $1,781,405 used in our operating activities during the comparable six-month period in 2006. The increase of $1,285,541 was primarily due to payments to NCI as part of our newly extended

CRADA agreement, final payments to various parties as part of the settlements of the lawsuits that had commenced in 2006, and payments to various medical consultants to accelerate our clinical trials.

We have funded our operations through a combination of private placements of our securities and through the proceeds of our public offerings in 2000 and 2003. Please see the detailed discussion of our various sales of securities described in Note 2 to our 2006 financial statements included in our 2006 Form 10-K. In addition, we received proceeds of approximately $5.6 million from private placements we completed in 2004, approximately $2.2 million on exercise of warrants and options in 2004, approximately $2.5 million from a private placement we completed in 2005, approximately $5.5 million on exercise of warrants and options in 2005, and approximately $5.1 million on exercise of warrants and options in 2006. In the six months ended June 30, 2007, we received approximately $1.3 million on exercise of warrants and options.

While the Company has sufficient capital to conduct its operations through the end of 2007, it requires additional capital for research and development and for additional clinical trials. Accordingly, on May 25, 2007, the Company filed a Registration Statement on Form S-3 (the "Registration Statement") to register a "shelf" offering of common stock, preferred stock, debt securities, warrants, stock purchase contracts and stock purchase units, as may from time to time be issued, with a maximum offering price of $30,000,000, in order to raise additional funds. This Registration Statement became effective on June 7, 2007. However, there are no assurances that the Company will successfully consummate any transactions under the offerings, nor can the Company estimate when, if such offerings are successful, these offerings may close and capital will become availn" style="font-size:1.0pt;">

$

(0.01)

Loss per unit basic and diluted

$

(0.01

)

See Notes to condensed consolidated financial statements.

BUCKEYE GP HOLDINGS L.P.
Condensed Consolidated Balance Sheets
(In thousands)
(Unaudited)

	September 30, 2006	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 31,655	$ 28,984
Trade receivables	40,690	38,864
Construction and pipeline relocation receivables	11,796	10,571
Inventories	13,985	12,997
Prepaid and other current assets	22,765	12,325
Total current assets	120,891	103,741
Property, plant and equipment, net	1,722,096	1,587,741
Restricted cash		5,117
Goodwill	234,603	234,603
Other non-current assets	98,367	109,630
Total assets	$ 2,175,957	$ 2,040,832
Liabilities and partners capital		
Current liabilities:		
Current portion of long-term debt	$ 6,060	$ 7,811
Accounts payable	17,108	18,648
Accrued and other current liabilities	59,243	48,824
Total current liabilities	82,411	75,283
Long-term debt	1,002,901	1,096,849
Other non-current liabilities	78,399	76,536
Non-controlling interest	769,922	711,722
Total liabilities	1,933,633	1,960,390
Commitments and contingent liabilities		
Partners capital:		
General Partner Common Units	7	
Limited Partners Common Units	234,036	
Management Units	6,799	
General Partner		7
Limited Partners A Units		74,132
Limited Partners B Units		3,473
Equity gains on issuance of Buckeye Partners, L.P. limited partnership units	1,482	1,316
Accumulated other comprehensive income		1,514
Total partners capital	242,324	80,442
Total liabilities and partners capital	$ 2,175,957	$ 2,040,832

See Notes to condensed consolidated financial statements.

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BUCKEYE GP HOLDINGS L.P.
Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Nine Months Ended September 30, 2006	**2005**
Cash flows from operating activities:		
Net income	$ 5,730	$ 5,618
Adjustments to reconcile net income to net cash provided by operating activities:		
Non-cash charge for Management Unit expense	3,326	
Value of ESOP shares released	3,047	3,895
Depreciation and amortization	29,445	23,747
Amortization of deferred compensation		2,638
Non-controlling interest	74,101	72,143
Equity earnings	(4,598)	(3,678)
Distributions from equity investments	4,460	2,428
Amortization of debt discount	38	28
Amortization of option grants	294	
Change in assets and liabilities, net of amounts related to acquisitions:		
Trade receivables	(1,826)	(403)
Construction and pipeline relocation receivables	(1,225)	1,729
Inventories	(317)	25
Prepaid and other current assets	(11,323)	5,075
Accounts payable	(1,540)	(6,655)
Accrued and other current liabilities	10,291	847
Other non-current assets	1,857	224
Other non-current liabilities	1,864	1,371
Total adjustments from operating activities	107,894	103,414
Net cash provided by operating activities	113,624	109,032
Cash flows from investing activities:		
Capital expenditures	(62,324)	(51,906)
Acquisitions	(93,330)	(178,813)
Net proceeds from disposal of property, plant and equipment	130	61
Release of (deposit to) restricted cash	5,117	(3,115)
Net cash used in investing activities	(150,407)	(233,773)
Cash flows from financing activities:		
Net proceeds from issuance of Limited Partner- Common Units	168,509	
Net proceeds from issuance of Buckeye Partners, L.P.units	64,092	156,101
Debt issuance costs		(1,282)
Proceeds from exercise of unit options	559	1,337
Proceeds from issuance of long-term debt	147,000	324,767
Payment of long-term debt	(242,737)	(283,493)
Distributions to non-controlling partners of Buckeye Partners, L.P.	(83,634)	(71,654)
Distributions to Limited Partner- common units	(14,335)	
Net cash provided by financing activities	39,454	125,776
Net increase in cash and cash equivalents	2,671	1,035
Cash and cash equivalents at beginning of period	28,984	21,352
Cash and cash equivalents at end of period	$ 31,655	$ 22,387
Supplemental cash flow information:		
Cash paid for interest (net of amount capitalized)	$ 49,818	$ 42,297
Capitalized interest	$ 1,271	$ 1,860
Cash paid for income taxes	$ 12	$ 1,095
Non-cash changes in assets and liabilities:		

Fair value hedge accounting	$	(176	)	$	1,396	
Environmental obligations related to acquisition of Northeast Pipelines and Terminals	$			$	(2,332	)

See Notes to condensed consolidated financial statements.

3

BUCKEYE GP HOLDINGS L.P.
Consolidated Statement of Changes in Partners Capital
(In thousands)
(Unaudited)

	General Partner Common Units	Limited Partner Common Units	Manage-ment Units	General Partner	Limited Partners A Units	Limited Partners B Units	Equity Gains on Issuance of Buckeye LP units	Accumu-lated Other Compre-hensive Income	Total
Partners capital at December 31, 2005	$	$	$	$ 7	$ 74,132	$ 3,473	$ 1,316	$ 1,514	$ 80,442
Net income through August 8, 2006					6,135				6,135
Net (loss) August 9, through September 30, 2006		(405)							(405)
Settlement of interest rate swaps								(1,514)	(1,514)
Comprehensive income		(405)			6,135		-	(1,514)	4,216
Exchange of GP Units and Limited Partner-A and B Units for General Partner and Limited Partner-Common and Management Units	7	80,267	3,473	(7)	(80,267)	(3,473)			
Issuance of Limited Partner Common Units		168,509							168,509
Recognition of value of Management Units			3,326						3,326
Distributions to Limted Partner-Common Units		(14,335)							(14,335)
Equity gains on issuance of Buckeye Partners, L.P. limited partnership units							166		166
Partners capital at September 30, 2006	$ 7	$ 234,036	$ 6,799	$	$	$	$ 1,482	$	$ 242,324

See Notes to condensed consolidated financial statements.

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BUCKEYE GP HOLDINGS L.P.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. BASIS OF PRESENTATION

In the opinion of management, the accompanying condensed consolidated financial statements of Buckeye GP Holdings L.P. (the Partnership), which are unaudited except that the Balance Sheet as of December 31, 2005 is derived from audited financial statements, include all adjustments necessary to present fairly the Partnership s financial position as of September 30, 2006, along with the results of the Partnership s operations for the three and nine months ended September 30, 2006 and 2005 and its cash flows for the nine months ended September 30, 2006 and 2005. The results of operations for the three and nine months ended September 30, 2006 are not necessarily indicative of the results to be expected for the full year ending December 31, 2006.

The Partnership is a limited partnership organized on June 15, 2006 under the laws of the state of Delaware. The Partnership owns 100% of Buckeye GP LLC (Buckeye GP), which is the general partner of Buckeye Partners, L.P. (Buckeye). Buckeye is a publicly traded (NYSE:BPL) master limited partnership organized in 1986 under the laws of the state of Delaware. The Partnership s limited partnership units are owned approximately 54% by affiliates of Carlyle/Riverstone Global Energy and Power Fund II, L.P. (Carlyle/Riverstone), approximately 9% by certain members of Buckeye GP s senior management and approximately 37% by the public. MainLine Management LLC, a Delaware limited liability company (MainLine Management), is the general partner of the Partnership, and is wholly owned by Carlyle/Riverstone. The Partnership s primary business is the management of Buckeye. The Partnership owns an approximate 2% overall general partner interest in Buckeye and its operating subsidiaries.

The Partnership s condensed consolidated financial results include Buckeye and its operating subsidiaries and Buckeye Pipe Line Services Company, a Pennsylvania corporation (Services Company). The limited partner interests in Buckeye not owned by the Partnership or Services Company are reflected as non-controlling interest expense or non-controlling interest in the condensed consolidated statements of income and balance sheets. The differences between the financial statements of the Partnership and Buckeye are primarily attributable to (a) amounts reported as non-controlling interests and (b) additional general and administrative expenses attributable to the Partnership.

Pursuant to the rules and regulations of the Securities and Exchange Commission, the condensed consolidated financial statements do not include all of the information and notes normally included with financial statements prepared in accordance with accounting principles generally accepted in the United States of America. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements of the Partnership and the notes thereto for the year ended December 31, 2005 included in the Partnership s registration statement on Form S-1, as amended (Registration No. 333-133433) and as filed with the Securities and Exchange Commission on July 25, 2006.

The Partnership s IPO and Related Transactions

The Partnership was formed on June 15, 2006 in order to facilitate the reorganization of MainLine L.P. (MainLine) and its affiliates and to effect an initial public offering (the IPO) of the Partnership s common units. The reorganization and IPO occurred on August 9, 2006, and prior to such date, the Partnership had no activity. Prior to the reorganization, MainLine owned and controlled Buckeye GP. On August 9, 2006, the Partnership sold 10.5 million common units in an underwritten IPO, the net proceeds of which were approximately $168.5 million. The Partnership used the net proceeds from the IPO, along with cash on hand, to repay all outstanding indebtedness under MainLine s Term Loan and to make distributions to its pre-IPO equity owners. The common units sold in the IPO represent approximately 37.1% of the outstanding equity of the Partnership, which includes common units (Common Units) and management units (Management Units).

Coincident with the IPO, the equity interests of MainLine were exchanged for the equity interests of the Partnership. MainLine s 149,950,000 A Units were exchanged for 16,438,000 Common Units of the Partnership. MainLine s 16,216,668 B Units were exchanged for 1,362,000 Management Units of the Partnership. The

Management Units are exchangeable for Common Units on a 1 to 1 basis at the option of the holder. This exchange of equity interests was accounted for as a transfer between entities under common control in accordance with Statement of Financial Accounting Standards No. 141, Business Combinations. Accordingly, the financial information for the Partnership included in this report includes the financial information of MainLine as the predecessor to the Partnership.

In connection with the closing of the IPO, the Partnership and Buckeye GP restructured the ownership of Buckeye GP. This restructuring will not have any impact on the amounts or timing of cash distributions paid to the unitholders of the Partnership. MainLine Sub LLC (MainLine Sub), which was then a wholly-owned subsidiary of the Partnership and the owner of Buckeye GP, assigned all of its rights under the Fourth Amended and Restated Incentive Compensation Agreement, dated as of December 15, 2004, between MainLine Sub and the Partnership to Buckeye GP. Thereafter, the Partnership and Buckeye GP amended and restated that agreement by entering into the Fifth Amended and Restated Incentive Compensation Agreement, dated as of August 9, 2006 (the Incentive Compensation Agreement). On August 9, 2006, the Partnership and Buckeye GP also entered into the Amended and Restated Agreement of Limited Partnership of Buckeye Partners, L.P. (the Partnership Agreement). The amendments to the Incentive Compensation Agreement and the Partnership Agreement reflect the assignment of the Incentive Compensation Agreement to Buckeye GP and recharacterize the payments Buckeye GP receives under the Incentive Compensation Agreement and the Partnership Agreement as distributions in respect of its general partner interest rather than compensation payments. On August 18, 2006, MainLine Sub was merged with and into the Partnership.

These amendments will result in certain prospective changes to the Partnership s financial statements. Prior to the IPO, MainLine recognized its share of Buckeye s income as the sum of (i) the incentive compensation payments received (to which it was contractually entitled and which were recorded by Buckeye as an expense in Buckeye s financial statements) and (ii) its proportionate share of Buckeye s income based on the general partner interests in Buckeye and certain of Buckeye s operating subsidiaries and distributions received on the 80,000 Buckeye LP Units that it owns. As a result of the above restructuring, including the recharacterization of the payments related to the Incentive Compensation Agreement and Partnership Agreement as distributions in respect of a general partner interest, in the fourth quarter of 2006, Buckeye will cease recording incentive compensation as an expense in its financial statements and, instead, will record incentive distribution payments as distributions from equity.

Commencing in the fourth quarter of 2006, the Partnership will recognize as its share of Buckeye s income the amount of incentive distributions and residual equity share of Buckeye s income that it would have received if Buckeye s income had been entirely distributed. Beginning in the fourth quarter, Buckeye s income will include the incentive distributions that previously would have been deducted. This change will not affect the timing or amounts of cash that the Partnership receives from Buckeye with respect to incentive distributions on its general or limited partner interests.

Also in connection with the IPO, in the third quarter of 2006, the Partnership:

- Incurred $3.3 million of non-cash compensation expense as a result of a change to its Unit Compensation Plan (see Note 8);

- Incurred $1.6 million in non-cash interest and debt expense related to the write-off of previously deferred financing costs associated with the repayment of all amounts outstanding under MainLines s previous term loan (see Note 4); and

- Realized a $1.9 million reduction in interest and debt expense on the liquidation of cash flow hedges as the result of the repayment of MainLine s previous term loan (see Note 4).

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Description of the Business

At September 30, 2006, the Partnership had no operating assets other than its general partner ownership interest in Buckeye and its operating subsidiaries. Buckeye s principal line of business is the transportation, terminalling and storage of petroleum products in the United States for major integrated oil companies, large refined product marketing companies and major end users of petroleum products on a fee basis through facilities owned and operated by Buckeye. Buckeye also operates and maintains pipelines owned by third parties under contracts with major integrated oil and chemical companies, and performs certain construction activities, generally for the owners of these third-party pipelines.

All of the employees who provide services to the Partnership and its subsidiaries, and Buckeye and its subsidiaries, are employed by Services Company. Pursuant to a services agreement, Services Company is reimbursed by Buckeye s subsidiaries for the cost of the employees who provide services to the Buckeye subsidiaries. The Partnership is responsible for the total compensation, including benefits, paid to the four highest salaried officers performing duties for Buckeye GP with respect to the functions of operations, finance, legal, marketing, business development, treasury, or performing the function of president of Buckeye GP. The four highest salaried officers are William H. Shea, Jr., Stephen C. Muther, Robert B. Wallace, and Eric A. Gustafson. Services Company is owned by an employee stock ownership plan (the ESOP). Services Company owned approximately 5.9% of the publicly traded limited partner units of Buckeye at September 30, 2006.

As of September 30, 2006 and 2005, Buckeye conducted all of its operations through subsidiary entities. These operating subsidiaries are Buckeye Pipe Line Company, L.P. (Buckeye Pipe Line), Laurel Pipe Line Company, L.P. (Laurel), Everglades Pipe Line Company, L.P. (Everglades), Buckeye Pipe Line Holdings L.P. (BPH), Wood River Pipe Lines LLC (Wood River), Buckeye Pipe Line Transportation LLC (BPL Transportation) and Buckeye NGL Pipe Lines LLC (Buckeye NGL). Buckeye NGL commenced operations on January 31, 2006 with the acquisition of a natural gas liquids pipeline located in Colorado and Kansas (See Note 3). These entities are hereinafter referred to individually as an Operating Subsidiary or collectively as the Operating Subsidiaries. Buckeye owns an approximate 99% ownership interest in each Operating Subsidiary and 100% interest in Wood River, BPL Transportation and Buckeye NGL.

Buckeye s Operating Subsidiaries conduct business in three reportable operating segments: Pipeline Operations, Terminalling and Storage and Other Operations. See Note 10 for a further discussion.

2. CONTINGENCIES

Claims and Proceedings

Buckeye and its Operating Subsidiaries in the ordinary course of business are involved in various claims and legal proceedings, some of which are covered by insurance. The Partnership is generally unable to predict the timing or outcome of these claims and proceedings. Based on its evaluation of existing claims and proceedings and the probability of losses relating to such contingencies, Buckeye has accrued certain amounts relating to such claims and proceedings, none of which are considered material.

Buckeye has received penalty assessments from the Internal Revenue Service (IRS) in the aggregate amount of $4.3 million based on a failure to file excise tax information returns relating to its terminal operations from January 2005 through February 2006. Buckeye filed the information returns with the IRS on May 10, 2006. The Partnership believes Buckeye had reasonable cause for the failure to file the information returns on a timely basis, and Buckeye intends to seek the elimination of the asserted penalties. The asserted penalties are for the failure to file information returns rather than any failure to pay taxes due as no taxes were owed by Buckeye in connection with such information returns. The timing or outcome of this claim, and the total costs to be incurred by Buckeye in connection therewith, cannot be reasonably estimated at this time.

Environmental Expenditures

In accordance with its accounting policy on environmental expenditures, Buckeye recorded operating expenses, net of insurance recoveries, of $1.5 million and $0.7 million for the three months ended September 30, 2006 and 2005, respectively, and $5.4 million and $6.3 million for the nine months ended September 30, 2006 and 2005, respectively, which were related to environmental expenditures unrelated to claims and proceedings. Expenditures, both capital and operating, relating to environmental matters are expected to continue due to Buckeye s commitment to maintaining high environmental standards and to increasingly strict environmental laws and government enforcement policies.

3. ACQUISITIONS

On January 1, 2006, Buckeye acquired a refined petroleum products terminal located in Niles, Michigan from affiliates of Shell Oil Products, U.S. (Shell) for $13.0 million. On January 31, 2006, Buckeye completed the acquisition of a natural gas liquids pipeline, which extends generally from Wattenberg, Colorado to Bushton, Kansas, from BP Pipelines (North America) Inc. for approximately $87.0 million, which includes a deposit of $7.7 million paid in December 2005. Buckeye NGL acquired the natural gas liquids pipeline and Buckeye Terminals, LLC, a subsidiary of BPH, acquired the refined petroleum products terminal. Buckeye also completed certain miscellaneous asset acquisitions during the first nine months of 2006 which approximated $1 million.

In connection with each of these acquisitions, Buckeye determined that the transaction represented the acquisition of various assets, and not the acquisition of a business, as that term is defined in Statement of Financial Accounting Standards No. 141 Business Combinations. Accordingly, Buckeye has allocated, on a preliminary basis, the cost of each acquisition to the various tangible assets acquired, principally property, plant and equipment. Buckeye is in the process of determining the final allocation.

In December 2005, Buckeye acquired a refined petroleum products terminal and related assets (including certain railroad offloading facilities) located in Taylor, Michigan for $20 million. Buckeye allocated, on a preliminary basis, the cost of the assets to the tangible terminal assets acquired, and is in the process of determining the final allocation.

4. DEBT AND CREDIT FACILITIES

Debt consists of the following:

	September 30, 2006 (In thousands)	December 31, 2005
MainLine L.P.:		
Term Loan	$	$ 173,250
Services Company:		
3.60% ESOP Notes due March 28, 2011	28,806	33,617
Retirement premium	(960)	(1,284)
Buckeye:		
4.625% Notes due June 15, 2013	300,000	300,000
6.750% Notes due August 15, 2033	150,000	150,000
5.30% Notes due October 15, 2014	275,000	275,000
5.125% Notes due July 1, 2017	125,000	125,000
Borrowings under Revolving Credit Facility	132,000	50,000
Total principal debt	1,009,846	1,105,583
Other, including unamortized discounts and changes in fair value (1)	(885)	(923)
Subtotal long-term debt	1,008,961	1,104,660
Less current maturities of debt	(6,060)	(7,811)
Long-term debt	$ 1,002,901	$ 1,096,849

(1) The September 30, 2006 amount includes $1,589,000 related to an adjustment to fair value associated with a hedge of fair value and $2,474,000 in unamortized discounts. The December 31, 2005 amount includes $1,765,000 related to an adjustment to fair value associated with a hedge of fair value and $2,688,000 in unamortized discounts.

The Partnership

On August 9, 2006, the Partnership entered into a five-year $10 million revolving credit facility with SunTrust Bank, as both administrative agent and lender (the Credit Agreement). At September 30, 2006, there were no borrowings against the Credit Agreement. The credit facility may be used for working capital and other partnership purposes. The Partnership has pledged all of the limited liability company interests in Buckeye GP to SunTrust Bank as security for its obligations under the Credit Agreement.

The Credit Agreement permits the Partnership to prepay all loans under the credit facility at any time without premium or penalty (other than customary LIBOR breakage costs). Borrowings under the Credit Agreement bear interest under one of two rate options, selected by the Partnership, equal to either:

- the greater of (1) the federal funds rate plus 0.5% and (2) SunTrust Bank s prime commercial lending rate; or

- LIBOR, plus a margin which can range from 0.40% to 1.40%, based on the ratings assigned by Standard & Poor s Rating Services and Moody s Investor Services to the senior unsecured non-credit enhanced long-term debt of Buckeye.

The Partnership s ability to borrow amounts under the Credit Agreement is subject to satisfaction of certain customary conditions precedent to revolving loans and compliance with terms and conditions included in the Credit Agreement.

The Credit Agreement defines Restricted Subsidiaries as certain of the Partnership s and certain of its wholly owned subsidiaries.

The Credit Agreement requires the Partnership to maintain leverage and funded debt coverage ratios. The leverage ratio covenant requires the Partnership to maintain, as of the last day of each fiscal quarter, a ratio of the total funded indebtedness of the Partnership and its Restricted Subsidiaries, measured as of the last day of each fiscal quarter, to the aggregate dividends and distributions received by the Partnership and its Restricted Subsidiaries from Buckeye, plus all other cash received by the Partnership and the Restricted Subsidiaries, measured for the preceding twelve months, less expenses, of not more than 2.50 to 1.00. The funded debt coverage ratio covenant requires the Partnership to maintain, as of the last day of each fiscal quarter, a ratio of total consolidated funded debt of the Partnership and all of its subsidiaries to the consolidated EBITDA, as defined in the Credit Agreement, of the Partnership and all of its subsidiaries, measured for the preceding twelve months, of not more than 5.25 to 1.00, subject to a provision for increases to 5.75 to 1.00 in connection with future acquisitions.

The Credit Agreement prohibits the Partnership from declaring dividends or distributions if any default or event of default, as defined in the Credit Agreement, has occurred or would result from such a declaration. In addition, the Credit Agreement contains covenants and provisions requiring the Partnership to adhere to certain covenants and limiting the ability of the Partnership and its Restricted Subsidiaries to, among other things:

- incur or guarantee indebtedness;
- make certain negative pledges and grant certain liens;
- make certain loans, acquisitions and investments;
- make any material changes to the nature of the Partnership or Restricted Subsidiaries business; or
- enter into a merger, consolidation or sale of assets.

If an event of default exists under the Credit Agreement, the lender will be able to terminate the Credit Agreement and accelerate the maturity of all outstanding loans, as well as exercise other rights and remedies. The following are some of the events which would constitute an event of default under the Credit Agreement:

- failure to pay any principal, interest, fees, expenses or other amounts when due;
- failure of any representation or warranty to be true and correct in any material respect;
- failure to perform or otherwise comply with the covenants in the Credit Agreement or other loan documents, subject to certain grace periods;
- default by the Partnership or any Restricted Subsidiary on the payment of any other indebtedness in excess of $5.0 million or default by Buckeye or any of its subsidiaries on the payment of any indebtedness in excess of $25.0 million, or any default in the performance of any obligation or condition with respect to such indebtedness beyond the applicable grace period if the effect of the default is to permit or cause the acceleration of the indebtedness;
- bankruptcy or insolvency events involving the Partnership;
- the entry against the Partnership of a judgment in excess of specified amounts, or otherwise having a material adverse effect, that is not stayed, discharged or deferred within specified periods;
- a change in control of the Partnership (as such term is defined in the Credit Agreement);

- the invalidity or unenforceability of any material provision in the Credit Agreement or related documents; and

- the occurrence of certain events with respect to employee benefit plans subject to ERISA.

MainLine L.P.

Prior to August 9, 2006, MainLine was party to a Senior Secured Credit Facility (Term Loan) with a consortium of financial institutions arranged by Goldman Sachs Credit Partners under which MainLine had $169.0 million outstanding. Borrowings under the Term Loan bore interest under one of two variable rate options selected by MainLine.

The Term Loan had replaced MainLine s $100,000,000 Senior Secured Credit Facility (the Prior Term Loan). In accordance with requirements under the Prior Term Loan, MainLine had purchased an interest rate cap from Goldman Sachs Capital Markets, L.P. on a notional amount of $50 million for $375,000. In accordance with requirements under the Term Loan, MainLine had entered into two interest rate swap agreements with Goldman Sachs Capital Markets L.P.

All amounts outstanding under the Term Loan of $169.0 million were repaid with proceeds of the Partnership s IPO, together with cash on hand, on August 9, 2006. In connection with the repayment of the Term Loan in the third quarter of 2006, the Partnership expensed $1.6 million of previously deferred financing costs, and recorded a reduction to interest and debt expense of $1.9 million as a result of liquidating the interest rate cap and the two interest rate swaps.

Services Company

Services Company s debt consists of 3.60% Senior Secured Notes (the 3.60% ESOP Notes) due March 28, 2011 payable by the ESOP to a third-party lender. The 3.60% ESOP Notes were issued May 4, 2004. The 3.60% ESOP Notes are collateralized by Services Company s common stock and are guaranteed by Services Company. In addition, Buckeye has committed that, in the event that the value of Buckeye s LP units owned by Services Company falls below 125% of the balance payable under the 3.60% ESOP Notes, Buckeye will fund an escrow account with sufficient assets to bring the value of the total collateral (the value of Buckeye s LP units owned by Services Company and the escrow account) up to the 125% minimum. Amounts deposited in the escrow account are returned to Buckeye when the value of Buckeye s LP units owned by Services Company s returns to an amount which exceeds the 125% minimum. At September 30, 2006, the value of Buckeye s LP units owned by Services Company exceeded the 125% requirement.

Buckeye

Buckeye has a $400 million 5-year revolving credit facility (Buckeye s Credit Facility) with a syndicate of banks led by SunTrust Bank. Buckeye s Credit Facility contains a one-time expansion feature to $550 million subject to certain conditions. Borrowings under Buckeye s Credit Facility are guaranteed by certain of Buckeye s subsidiaries. Buckeye s Credit Facility matures on August 6, 2009. The weighted average interest rate on amounts outstanding under Buckeye s Credit Facility at September 30, 2006 was 5.9%.

Borrowings under Buckeye s Credit Facility bear interest under one of two rate options, selected by Buckeye, equal to either (i) the greater of (a) the federal funds rate plus one half of one percent and (b) SunTrust Bank s prime rate or (ii) the LIBOR plus an applicable margin. The applicable margin is determined based on ratings assigned by Standard & Poor s and Moody s Investor Services for Buckeye s senior unsecured non-credit enhanced long-term debt. The applicable margin will increase during any period in which Buckeye s Funded Debt Ratio (described below) exceeds 5.25 to 1.0. At September 30, 2006 and December 31, 2005, Buckeye had $132 million and $50 million outstanding under Buckeye s Credit Facility, respectively, and had committed $1.7 million and $1.3 million in support of letters of credit, respectively.

Buckeye s Credit Facility contains covenants and provisions that:

- Restrict Buckeye and certain of its subsidiaries ability to incur additional indebtedness based on certain ratios described below;
- Prohibit Buckeye and certain of its subsidiaries from creating or incurring certain liens on their property;
- Prohibit Buckeye and certain of its subsidiaries from disposing of property material to their operations; and
- Limit consolidations, mergers and asset transfers by Buckeye and certain of its subsidiaries.

Buckeye s Credit Facility requires that Buckeye and certain of its subsidiaries maintain a maximum Funded Debt Ratio and a minimum Fixed Charge Coverage Ratio, both of which are calculated using Adjusted EBITDA. Prior to the restructuring of Buckeye GP on August 9, 2006, Buckeye s Credit Facility defined Adjusted EBITDA as earnings before interest, taxes, depreciation, depletion, amortization and incentive compensation payments to Buckeye GP, for the four preceding fiscal quarters. Incentive compensation payments were historically included in this definition because Buckeye accounted for them as an expense. Because Buckeye will no longer account for the incentive compensation as an expense, it amended its Credit Facility effective as of the restructuring to define Adjusted EBITDA as earnings before interest, taxes, depreciation, depletion and amortization, for the four preceding fiscal quarters. Accordingly, calculations of Buckeye s Funded Debt Ratio and Fixed Charge Coverage Ratio that include incentive compensation payments that are accounted for as an expense (i.e., those that became payable prior to August 9, 2006) were made using the prior definition of Adjusted EBITDA, and calculations of such ratios beginning in the fourth quarter of 2006 will be made using the current definition. See Note 1 to these condensed consolidated financial statements for a description of Buckeye GP s restructuring.

The Funded Debt Ratio equals the ratio of the long-term debt of Buckeye and certain of its subsidiaries (including the current portion, if any) to Adjusted EBITDA. As of the end of any fiscal quarter, the Funded Debt Ratio may not exceed 4.75 to 1.00, subject to a provision for increases to 5.25 to 1.00 in connection with future acquisitions. At September 30, 2006, Buckeye s Funded Debt Ratio was 4.50 to 1.00.

The Fixed Charge Coverage Ratio is defined as the ratio of Adjusted EBITDA to the sum of payments for interest and principal on debt plus certain capital expenditures required for the ongoing maintenance and operation of Buckeye s assets. Buckeye is required to maintain a Fixed Charge Coverage Ratio of greater than 1.25 to 1.00 as of the end of any fiscal quarter. As of September 30, 2006, Buckeye s Fixed Charge Coverage Ratio was 2.65 to 1.00.

Covenants. The Partnership and its subsidiaries, Services Company, and Buckeye and its Operating Subsidiaries are in compliance with the various covenants of the debt agreements at September 30, 2006.

Derivative Instruments. At September 30, 2006, the Partnership had no trading derivative instruments outstanding. In December 2004, Buckeye terminated an interest rate swap agreement associated with the 4.625% Notes due June 15, 2013 and received proceeds of $2.0 million. In accordance with FASB Statement No. 133 Accounting for Derivative Instruments and Hedging Activities, Buckeye has deferred the $2.0 million gain as an adjustment to the fair value of the hedged portion of its debt and is amortizing the gain as a reduction of interest expense over the remaining term of the hedged debt. Interest expense was reduced by $59 thousand during each of the three months ended September 30, 2006 and 2005 and $176 thousand during each of the nine months ended September 30, 2006 and 2005, related to the amortization of the gain on the interest rate swap.

Fair Value of Financial Instruments At September 30, 2006 and December 31, 2005, cash and cash equivalents, trade receivables, construction and pipeline relocation receivables, prepaid and other current assets, restricted cash, and all current liabilities are reported in the condensed consolidated balance sheets at amounts which approximate fair value due to the relatively short period to maturity of these financial instruments.

The fair value of the Partnership s debt was estimated to be $977 million and $1,114 million at September 30, 2006 and December 31, 2005 respectively. The value was calculated using interest rates currently available to the Partnership for issuance of debt with similar terms and remaining maturities and approximate market values on the respective dates.

During the period January 1 to August 9, 2006, the Partnership had no ineffectiveness with respect to its cash flow hedges and, accordingly, no change in the fair value of the hedge was reflected in net income. At December 31, 2005, the fair value of the interest rate swaps was a non-current asset of $1.5 million.

5. PREPAID AND OTHER CURRENT ASSETS

Prepaid and other current assets consist of the following:

	September 30, 2006 (In thousands)	December 31, 2005
Prepaid insurance	$ 1,456	$ 4,684
Insurance receivables	8,532	3,513
Ammonia receivable	5,877	
Other	6,900	4,128
Total	$ 22,765	$ 12,325

6. ACCRUED AND OTHER CURRENT LIABILITIES

Accrued and other current liabilities consist of the following:

	September 30, 2006 (In thousands)	December 31, 2005
Taxes other than income	$ 5,831	$ 6,569
Environmental liabilities	8,438	6,996
Interest	13,686	16,648
Retainage	744	639
Payable for ammonia purchase	5,650	
Compensation and vacation	7,910	8,751
Other	16,984	9,221
Total	$ 59,243	$ 48,824

7. (LOSS) PER UNIT

The loss per unit calculations for the periods ended September 30, 2006, reflect only the results since the closing of the Partnership s IPO on August 9, 2006. Accordingly, the results from January 1 through August 8, 2006, have been excluded from the calculation. The following table presents the number of units used in computing the loss per unit and the weighted average number of units outstanding (in thousands):

	September 30, 2006
Common units issued as part of IPO	16,438
Common units sold as part of IPO	10,500
Management units issued as part of IPO	1,362
Total units outstanding	28,300
*Weighted average number of units outstanding basic and diluted	27,891

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*For the periods ended September 30, 2006, 409,000 of non-vested Management Units were excluded from the calculation of the diluted loss per unit because their effect would be anti-dilutive.

8. UNIT-BASED COMPENSATION

Prior to January 1, 2006, management accounted for its unit-based compensation plans using the recognition and measurement provisions of Accounting Principles Board Opinion No. 25 (APB No. 25), and related interpretations, as permitted by Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS No. 123), as amended by Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation Transition and Disclosure (SFAS No. 148). Effective January 1, 2006, the Partnership adopted the fair value measurement and recognition provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R), for both of its unit option plans using the modified prospective basis transition method.

The Partnership has two unit-based compensation plans.

Option Plan

Buckeye has a Unit Option and Distribution Equivalent Plan (the Option Plan). The Option Plan grants options to purchase limited partner units (LP units) at 100% of the market price of the LP units on the date of grant. Generally the options vest three years from the date of grant and expire ten years from date of grant. Buckeye recognizes compensation expense for awards granted on or after January 1, 2006 at the grant-date fair value reduced by estimated forfeitures on a straight-line basis over the requisite service period. The impact of adopting the accounting provisions of SFAS No. 123R for the Option Plan is immaterial to the condensed consolidated financial statements.

Unit Compensation Plan

MainLine had a Unit Compensation Plan utilizing the B Units issued to senior management of MainLine. On May 4, 2004, MainLine issued 16,216,668 B Units to certain members of senior management for no consideration. The B Units were subordinate to the A Units. One half, or 8,108,334, of the B Units (Time Based B Units) vested ratably over five years. The remainder, or 8,108,334 of the B Units (Performance Based B Units) vested over five years only if certain performance targets based on the incentive compensation received by MainLine from Buckeye were met.

Coincident with the IPO, the equity interests of MainLine were exchanged for the equity interests of the Partnership. The total 149,950,000 of A Units and GP Units of MainLine were exchanged for 16,438,000 Common Units of the Partnership. The 16,216,668 B Units of MainLine were exchanged for 1,362,000 Management Units of the Partnership. The 9% cumulative annual return on MainLine s A Units and GP Units was eliminated as part of the exchange. The Management Units are exchangeable for Common Units on a 1 to 1 basis at the option of the holder. The vesting schedule of the Management Units of the Partnership varies from that of MainLine s B Units for which they were exchanged. Seventy percent, or 953,400 Management Units, were vested immediately upon their exchange, and the remaining 30% or 408,600 of the Management Units vest over a three year period with 136,200 of the Units vesting on each May 4, of 2007, 2008 and 2009.

MainLine recorded no compensation expense for the Time Based B Units for the three and nine month periods ended September 30, 2006 and 2005. Although the grant date of May 4, 2004 represented the measurement date for the Time Based B Units (the date both the number of units available for purchase and the purchase price (zero) were known), there was a nominal fair value for these units at the grant date. Under the modified prospective transition method permitted by SFAS No. 123R, compensation expense for the Time Based B Units subsequent to January 1, 2006 is measured based on the nominal fair value established at the grant date.

Prior to January 1, 2006, MainLine recognized deferred compensation for the Performance Based B Units when it was probable that the performance target specified in MainLine s partnership agreement would be met. The cost of this deferred compensation was recognized over the respective service periods of the performance targets until December 31, 2005. MainLine recorded compensation expense for the Performance Based B Units of $0.7 million and $2.6 million in general and administrative expenses in the condensed consolidated statements of income in the three and nine month periods ended September 30, 2005, respectively. Under the modified prospective transition method permitted by SFAS No. 123R, compensation expense for the Performance Based B Units subsequent to January 1, 2006 is measured based on the nominal fair value established at the grant date. Accordingly, MainLine recorded no compensation expense related to the Performance Based B Units subsequent to December 31, 2005.

As noted above, in connection with the IPO, on August 9, 2006 the holders of MainLine s B Units exchanged all of the B Units for 1,362,000 Management Units of the Partnership. Under the provisions of SFAS No. 123R, the Partnership recognized deferred compensation for the Management Units for which both (i) vesting was accelerated compared to the B Units, and (ii) were now deemed probable of vesting compared to the Partnership s previous estimates. The Partnership determined that these criteria applied to 272,400 Management Units, the fair value of which was $4.6 million at August 9, 2006. There are no additional Management Units available for grant in connection with the Unit Compensation Plan.

Of the total deferred compensation recognized of $4.6 million, the Partnership recognized approximately $3.3 million as an expense in the third quarter of 2006 (with an offsetting increase in Partners Capital) and will recognize the balance of $1.3 million as an expense ratably in future periods ending May 4, 2009.

9. PENSIONS AND OTHER POSTRETIREMENT BENEFITS

Services Company sponsors a retirement income guaranty plan (the Defined Benefit Plan), which is a defined benefit plan and generally guarantees employees hired before January 1, 1986 a retirement benefit at least equal to the benefit they would have received under a previously terminated defined benefit plan. Services Company s policy is to fund the Defined Benefit Plan with amounts necessary to at least meet the minimum funding requirements under ERISA.

Services Company also provides postretirement health care and life insurance benefits to certain of its retirees (Postretirement Benefit). To be eligible for these benefits, an employee must have been hired prior to January 1, 1991 with respect to health care benefits and January 1, 2002 with respect to life insurance benefits, and the employee must satisfy certain age and service requirements. Services Company does not pre-fund this postretirement benefit obligation.

In the three months ended September 30, 2006 and 2005, the components of the net periodic benefit cost recognized by the Partnership for the Defined Benefit Plan and postretirement health care and life insurance plan were as follows:

	Pension Benefits		**Postretirement Benefits**	
	2006	**2005**	**2006**	**2005**
	(In thousands)			
Components of net periodic benefit cost				
Service cost	$ 231	$ 258	$ 193	$ 203
Interest cost	250	264	709	689
Expected return on plan assets	(211)	(195)		
Amortization of prior service benefit	(113)	(120)	(208)	(86)
Amortization of unrecognized losses	152	213	469	144
Net periodic benefit cost	$ 309	$ 420	$ 1,163	$ 950

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In the nine months ended September 30, 2006 and 2005, the components of the net periodic benefit cost recognized by the Partnership for the Defined Benefit Plan and postretirement health care and life insurance plan were as follows:

	Pension Benefits		Postretirement Benefits	
	2006	2005	2006	2005
	(In thousands)			
Components of net periodic benefit cost				
Service cost	$ 692	$ 718	$ 643	$ 612
Interest cost	750	734	2,159	2,066
Expected return on plan assets	(634)	(543)		
Amortization of prior service benefit	(340)	(334)	(458)	(259)
Amortization of unrecognized losses	458	591	1,019	431
Net periodic benefit cost	$ 926	$ 1,166	$ 3,363	$ 2,850

The Partnership previously disclosed in its financial statements for the year ended December 31, 2005 that a minimum funding contribution was not required to be made during 2006. However, a voluntary contribution of approximately $575,000 was made to the plan in September of 2006.

10. SEGMENT INFORMATION

All of the Partnership s operations are conducted through Buckeye and its Operating Subsidiaries. Based on the financial information provided to senior management, Buckeye presents its operations in three reportable operating segments: Pipeline Operations, Terminalling and Storage and Other Operations. The Partnership also has certain consolidated-level assets, principally consisting of goodwill, which are not allocable to the individual reporting segments because they are not used by the chief operating decision maker to make operating decisions or to allocate resources. However, Buckeye has recorded approximately $11.4 million of goodwill in its Terminalling and Storage segment. The Partnership s reportable operating segments are:

Pipeline Operations

The Pipeline Operations segment receives petroleum products including gasoline, jet and diesel fuel and other distillates from refineries, connecting pipelines, and bulk and marine terminals and transports these products to other locations for a tariff charge. This segment owns and operates approximately 5,350 miles of pipelines in the following states: California, Colorado, Connecticut, Florida, Illinois, Indiana, Kansas, Massachusetts, Michigan, Missouri, New Jersey, Nevada, New York, Ohio, Pennsylvania and Tennessee. This segment also includes the operations of Buckeye NGL.

Terminalling and Storage

The Terminalling and Storage segment provides bulk storage and terminal throughput services. This segment owns and operates 45 terminals that have the capacity to store an aggregate of approximately 17.6 million barrels of refined petroleum products. The terminals are located in Illinois, Indiana, Massachusetts, Michigan, Missouri, New York, Ohio and Pennsylvania.

Other Operations

The Other Operations segment consists primarily of Buckeye s contract operation and maintenance of third-party pipelines, which are owned primarily by major petrochemical companies and are located in Texas. This segment also performs pipeline construction management services, typically for cost plus a fixed fee, for these same customers. The Other Operations segment also includes Buckeye s ownership and operation of interests in two petrochemical pipelines.

Financial information about each segment is presented below. Each segment uses the same accounting policies as those used in the preparation of the Partnership s condensed consolidated financial statements. All inter-segment revenues, operating income and assets have been eliminated. All periods are presented on a consistent basis.

	Three Months Ended September 30, 2006 (In thousands)	2005	Nine Months Ended September 30, 2006 (In thousands)	2005
Revenues:				
Pipeline Operations	$ 91,188	$ 79,563	$ 259,592	$ 226,938
Terminalling and Storage	18,661	15,774	55,271	47,921
Other Operations	6,670	7,029	18,896	25,312
Total	$ 116,519	$ 102,366	$ 333,759	$ 300,171
Operating income:				
Pipeline Operations	$ 35,440	$ 32,780	$ 101,106	$ 91,195
Terminalling and Storage	3,325	4,828	15,803	17,866
Other Operations	1,571	2,088	4,265	5,436
Total	$ 40,336	$ 39,696	$ 121,174	$ 114,497
Depreciation and amortization:				
Pipeline Operations	$ 8,365	$ 6,952	$ 24,454	$ 19,802
Terminalling and Storage	1,528	971	3,774	2,966
Other Operations	430	326	1,217	979
Total	$ 10,323	$ 8,249	$ 29,445	$ 23,747

	Nine Months Ended September 30, 2006 (In thousands)	2005
Capital expenditures:		
Pipeline Operations	$ 48,425	$ 48,104
Terminalling and Storage	11,038	3,449
Other Operations	2,755	353
Consolidating-level	106	
Total	$ 62,324	$ 51,906
Acquisitions:		
Pipeline Operations	$ 79,826	$ 153,592
Terminalling and Storage	13,504	25,221
Total	$ 93,330	$ 178,813

	September 30, 2006 (In thousands)	December 31, 2005
*Assets:		
Pipeline Operations	$ 1,580,655	$ 1,466,512
Terminalling and Storage	310,130	288,972
Other Operations	67,915	61,383
Consolidating-level	217,257	223,965
Total	$ 2,175,957	$ 2,040,832

* All equity investments are included in the assets of Pipeline Operations.

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11. CASH DISTRIBUTIONS

The Partnership generally makes quarterly cash distributions of substan−tially all of its available cash, generally defined as consolidated cash receipts less consolidated cash expenditures and such retentions for working capital, anticipated cash expenditures and contingencies as MainLine Management deems appropriate. On October 26, 2006, MainLine Management declared a cash distribution of $0.125 per unit (after the proration described below) payable on November 30, 2006 to Unitholders of record on November 6, 2006. As described in the prospectus contained in the Partnership s registration statement on Form S-1, as amended (Registration No. 333-133433), that was filed with the Securities and Exchange Commission on July 25, 2006, the initial quarterly distribution resulted from the Partnership s proration of its available cash from the third quarter based upon the portion of the third quarter beginning on the closing date of the Partnership s IPO, which was August 9, 2006, to the end of the quarter on September 30, 2006. The total cash distribution to Unitholders with respect to the distribution of $0.125 per unit will amount to approximately $3,537,500. As further described in the prospectus contained in the registration statement, the Partnership will use its available cash remaining after payment of the distribution to make distributions to its pre-IPO equity owners, and to pay cash bonuses of up to $2.0 million to officers of MainLine Management and to certain employees of Services Company. Included in these bonuses will be a one-time cash bonus of up to $700,000 payable to William H. Shea, Jr., a one-time cash bonus of up to $650,000 payable to Stephen C. Muther and a one-time cash bonus of up to $650,000 payable to Robert B. Wallace.

12. RECENT ACCOUNTING PRONOUNCEMENTS

In July 2006, the Financial Accounting Standards Board (FASB) adopted FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 sets forth a recognition threshold and measurement attribute for financial statement recognition of positions taken or expected to be taken in income tax returns. Only tax positions meeting a more-likely-than-not threshold of being sustained should be recognized under FIN 48. FIN 48 also provides guidance on derecognizing, classification of interest and penalties and accounting and disclosures for annual and interim financial statements. FIN 48 is effective for fiscal years beginning after December 15, 2006. The cumulative effect of the changes arising from the initial application of FIN 48 is required to be reported as an adjustment to the opening balance of retained earnings in the period of adoption. The Partnership does not expect that the adoption of FIN 48 will have a material impact on its financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). This statement clarifies the definition of fair value, establishes a framework for measuring fair value, and expands the disclosures on fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Partnership is still determining the impact, if any, of the adoption of SFAS No. 157 on its financial statements.

In September 2006, the FASB adopted Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 106, and 132(R) (SFAS No. 158). SFAS No. 158 requires companies to recognize a net liability or asset and an offsetting adjustment to accumulated other comprehensive income in connection with reporting on the funded status of defined benefit pension and other postretirement benefit plans. SFAS No. 158 requires prospective application, and the recognition and disclosure requirements are effective for the Partnership s fiscal year ending December 31, 2006. Additionally, SFAS No. 158 requires companies to measure plan assets and obligations at their year-end balance sheet date. This requirement is effective for fiscal years ending after December 15, 2008. It is estimated that upon adoption of SFAS No. 158, Buckeye will record an initial increase in liabilities, and an offsetting reduction to accumulated other comprehensive income and equity, in the range of $15.0 to $17.0 million in the fourth quarter of 2006 to record the funded status of its defined benefit pension and post retirement healthcare and life insurance benefit.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB No. 108). SAB No. 108 provides guidance on how prior year misstatements should be taken into consideration when quantifying misstatements in current year financial statements for purposes of determining whether the current year s financial statements are materially misstated. SAB No. 108 becomes effective for fiscal years ending after November 15, 2006. The Partnership does not expect that the adoption of SAB No. 108 will have an impact on its financial statements.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

RESULTS OF OPERATIONS

Overview

Buckeye GP Holdings L.P. (the Partnership) is a Delaware limited partnership formed on June 15, 2006 in order to facilitate the reorganization of MainLine L.P. (MainLine) and its affiliates and to effect an initial public offering (IPO) of Common Units of the Partnership. The reorganization and IPO occurred on August 9, 2006. Following the IPO, the Partnership s limited partnership units are owned approximately 54% by affiliates of Carlyle/Riverstone Global Energy and Power Fund II, L.P. (Carlyle/Riverstone), approximately 9% by certain members of Buckeye GP s senior management and approximately 37% by the public. The Partnership had no activity prior to the IPO. Prior to the IPO, MainLine owned and controlled Buckeye GP LLC (Buckeye GP), which is the general partner of Buckeye Partners, L.P. (Buckeye), a publicly traded Delaware master limited partnership.

Coincident with the IPO, the equity interests of MainLine were exchanged for the equity interests of the Partnership. MainLine s 149,950,000 A Units were exchanged for 16,438,000 Common Units of the Partnership. MainLine s 16,216,668 B Units were exchanged for 1,362,000 Management Units of the Partnership. The Management Units are exchangeable for Common Units on a 1 to 1 basis at the option of the holder. This exchange of equity interests was accounted for as a transfer between entities under common control in accordance with Statement of Financial Accounting Standards No. 141, Business Combinations. Accordingly, the financial information for the Partnership included in this report includes the financial information of MainLine as the predecessor to the Partnership.

On August 9, 2006, the Partnership sold 10.5 million common units in the IPO, the net proceeds of which were approximately $168.5 million. The Partnership used the net proceeds from the IPO, along with cash on hand, to repay all outstanding indebtedness under a Senior Secured Credit Facility with a consortium of financial institutions arranged by Goldman Sachs Credit Partners (the Term Loan) and to make distributions to its pre-IPO equity owners. The common units sold in the IPO represent approximately 37.1% of the outstanding equity of the Partnership, which included the Common Units and the Management Units.

As a result of the exchange of equity interests, the Partnership recorded non-cash compensation expense of approximately $3.3 million (with an offsetting increase in equity) in the third quarter of 2006 related to a change in the scheduled vesting of the Partnership s Management Units compared to the scheduled vesting of MainLine s B Units. The Partnership also anticipates annual charges of approximately $0.5 million per year during the new vesting period which ends May 4, 2009.

The Partnership also recorded non-cash interest and debt expense of approximately $1.6 million in the third quarter of 2006 related to the write-off of previously deferred financing costs associated with the Term Loan repaid on August 9, 2006.

The Partnership also recorded a $1.9 million reduction of interest and debt expense due to the liquidation of cash flow hedges resulting from the repayment of the Partnership s Term Loan.

The Partnership s only cash-generating asset is its ownership interest in Buckeye GP, which owns (i) general partner units, or GP Units, in Buckeye, (ii) incentive distribution rights in Buckeye, (iii) 80,000 limited partnership units, or LP Units, in Buckeye and (iv) an approximate one percent general partner interest in each of Buckeye s subsidiary operating partnerships. The Partnership s cash flow is, therefore, directly dependent upon the ability of Buckeye and its operating subsidiaries to make cash distributions to Buckeye s partners. The actual amount of cash that Buckeye will have available for distribution will depend primarily on Buckeye s ability to generate cash beyond its working capital requirements.

In connection with the IPO, the Partnership and Buckeye GP restructured the ownership of Buckeye GP. MainLine Sub LLC (MainLine Sub), which was then a wholly-owned subsidiary of the Partnership and the owner of Buckeye GP, assigned all of its rights under the Fourth Amended and Restated Incentive Compensation Agreement, dated as of December 15, 2004, between MainLine Sub and Buckeye to Buckeye GP. Thereafter, Buckeye and Buckeye GP amended and restated that agreement by entering into the Fifth Amended and Restated Incentive Compensation Agreement, dated as of August 9, 2006 (the Incentive Compensation Agreement). On August 9, 2006, Buckeye and Buckeye GP also entered into the Amended and Restated Agreement of Limited Partnership of Buckeye Partners, L.P. (the Partnership Agreement). The amendments to the Incentive Compensation Agreement and the Partnership Agreement reflect the assignment of the Incentive Compensation Agreement to Buckeye GP and recharacterize the payments Buckeye GP receives under the Incentive Compensation Agreement and the Partnership Agreement as distributions in respect of its general partner interest rather than compensation payments. On August 18, 2006, MainLine Sub was merged with and into the Partnership. However, Buckeye s recording of incentive payments as equity distributions rather than an expense will likely result in a relative increase in reported net income for Buckeye, and a change in the method of attribution of that income, for financial reporting purposes, between Buckeye GP and Buckeye s LP Unitholders.

As discussed above, none of these changes affect the amount or timing of cash distributions or incentive distributions from Buckeye to the Partnership. Buckeye s criteria for determining the amount of cash distributions and its policies regarding the timing of such cash distributions remain unchanged. Because the quarterly unit distribution was declared prior to August 9, 2006 and, therefore, the related incentive compensation attributable to Buckeye GP became payable prior to such date, incentive compensation paid in the third quarter of 2006 was recorded as an expense by Buckeye, consistent with Buckeye s prior practice. Commencing with the fourth quarter of 2006, Buckeye will cease recording incentive compensation payable to Buckeye GP as an expense and instead will record such payments as distributions from equity.

Overview of Buckeye

Buckeye is a master limited partnership which operates through subsidiary entities (the Operating Subsidiaries). These Operating Subsidiaries are Buckeye Pipe Line Company, L.P. (Buckeye Pipe Line), Laurel Pipe Line Company, L.P. (Laurel), Everglades Pipe Line Company, L.P. (Everglades), Buckeye Pipe Line Holdings, L.P. (BPH), Wood River Pipe Lines LLC (Wood River), Buckeye Pipe Line Transportation LLC (BPL Transportation) and Buckeye NGL Pipe Lines LLC (Buckeye NGL). Buckeye is principally engaged in the transportation, terminalling and storage of refined petroleum products on a fee basis through facilities owned and operated by Buckeye. Buckeye also operates and maintains pipelines owned by third parties under contracts with major integrated oil and chemical companies, and performs certain construction activities, generally for the owners of these third-party pipelines.

In May 2005, Buckeye acquired a refined petroleum products pipeline system comprising approximately 478 miles of pipeline and four refined products terminals with aggregate storage capacity of approximately 1.3 million barrels located in the northeastern United States from affiliates of ExxonMobil Corporation (the Northeast Pipelines and Terminals) for approximately $175.0 million. In December 2005, Buckeye acquired a refined petroleum products terminal and related assets (including certain railroad offloading facilities) located in Taylor, Michigan for $20 million. On January 1, 2006, Buckeye acquired a refined petroleum products terminal located in Niles, Michigan, with aggregate storage capacity of 630,000 barrels from affiliates of Shell for $13.0 million. On January 31, 2006, Buckeye acquired a natural gas liquids pipeline (the NGL Pipeline) with aggregate mileage of approximately 350 miles from BP Pipelines (North America) Inc. for approximately $87.0 million, which includes a deposit of $7.7 million paid in December 2005. The NGL Pipeline extends generally from Wattenberg, Colorado to Bushton, Kansas. The acquired assets have been included in Buckeye s operations from their dates of acquisition. The asset acquisitions completed in 2005 and 2006 added $4.4 million of revenue in the three months ended September 30, 2006 and $18.3 million of revenue in the nine months ended September 30, 2006.

The following discussion provides an analysis of the results for each of Buckeye s operating segments, an overview of its liquidity and capital resources and other items related to the Partnership, Buckeye and Services Company. The following discussion and analysis should be read in conjunction with (i) the accompanying interim condensed consolidated financial statements and related notes and (ii) the Partnership s consolidated financial statements, related notes and management s discussion and analysis of financial condition and results of operations for the year ended December 31, 2005 included in the Partnership s registration statement on Form S-1, as amended (Registration No. 333-133433) and as filed with the Securities and Exchange Commission on July 25, 2006.

Buckeye s business comprises three operating segments: Pipeline Operations, Terminalling and Storage and Other Operations. The business of each operating segment is:

Pipeline Operations

The Pipeline Operations segment receives petroleum products including gasoline, jet and diesel fuel and other distillates from refineries, connecting pipelines, and bulk and marine terminals and transports those products to other locations for a fee. As of September 30, 2006, this segment owned and operated approximately 5,350 miles of pipeline in the following states: California, Colorado, Connecticut, Florida, Illinois, Indiana, Kansas, Massachusetts, Michigan, Missouri, New Jersey, Nevada, New York, Ohio, Pennsylvania and Tennessee. This segment also includes the operations of the NGL Pipeline.

Terminalling and Storage

The Terminalling and Storage segment provides bulk storage and terminal throughput services. This segment owns and operates 45 active terminals with the capacity to store an aggregate of approximately 17.6 million barrels of refined petroleum products. The terminals are located in Illinois, Indiana, Massachusetts, Michigan, Missouri, New York, Ohio and Pennsylvania.

Other Operations

The Other Operations segment consists primarily of Buckeye s contract operation and maintenance of third-party pipelines, which are owned primarily by major petrochemical companies and are located in Texas. This segment also performs pipeline construction management services, typically for cost plus a fixed fee, for these same customers. The Other Operations segment also includes Buckeye s ownership and operation of interests in two petrochemical pipelines.

Results of Operations

Summary operating results for the Partnership were as follows:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2006	**2005**	**2006**	**2005**
	(In thousands)		**(In thousands)**	
Revenue	$ 116,519	$ 102,366	$ 333,759	$ 300,171
Costs and expenses	76,183	62,670	212,585	185,674
Operating income	40,336	39,696	121,174	114,497
Other income (expenses)	(14,623)	(13,710)	(45,941)	(40,414)
Income before equity income and non-controlling interest expense	25,713	25,986	75,233	74,083
Equity income	1,803	1,213	4,598	3,678
Non-controlling interest expense	(26,012)	(24,728)	(74,101)	(72,143)
Net income	$ 1,504	$ 2,471	$ 5,730	$ 5,618

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Revenues and operating income by operating segment for the three months ended September 30, 2006 and 2005 were as follows:

	Three Months Ended September 30, 2006 (In thousands)	2005
Revenues:		
Pipeline Operations	$ 91,188	$ 79,563
Terminalling and Storage	18,661	15,774
Other Operations	6,670	7,029
Total	$ 116,519	$ 102,366
Operating income:		
Pipeline Operations	$ 35,440	$ 32,780
Terminalling and Storage	3,325	4,828
Other Operations	1,571	2,088
Total	$ 40,336	$ 39,696

Third Quarter

Total revenues for the quarter ended September 30, 2006 were $116.5 million, $14.1 million or 13.8% greater than revenue of $102.4 million in 2005.

Pipeline Operations:

Revenue from Pipeline Operations was $91.2 million for the quarter ended September 30, 2006 compared to $79.6 million for the quarter ended September 30, 2005. The net increase in revenue from Pipeline Operations of $11.6 million was primarily the result of:

- Buckeye NGL revenue of $3.2 million (Buckeye NGL s assets were acquired on January 31, 2006);

- a 4.3%, or $1.9 million, increase in gasoline transportation revenue, even though gasoline volumes delivered declined by 1.1%;

- a 14.5%, or $1.9 million, increase in jet fuel transportation revenue on an 8.8% increase in jet fuel volumes delivered;

- an 8.6%, or $1.5 million increase in distillate transportation revenue, even though distillate volumes delivered declined by 3.5%;

- an increase in liquefied petroleum gas (LPG) and other product transportation revenue of $0.6 million as a result of higher tariffs and an increase in volumes delivered;

- a $1.0 million increase in incidental revenue and rental revenue primarily from increased revenues under a product supply arrangement in connection with WesPac PipeLines - Reno, LLC (WesPac-Reno) ;

- a $1.1 million increase in other revenues principally resulting from a pipeline and terminal project serving the Memphis International Airport (the Memphis Terminal), which was commissioned earlier in 2006;

- a $0.4 million increase in operating services revenue due to an increase in reimbursable maintenance and inspection activities under an operating services contract; and

- a $1.5 million decrease in transportation settlement revenue, representing primarily the settlement of overages and shortages on product deliveries.

Product deliveries for each of the quarters ended September 30, 2006 and 2005 were as follows:

	Barrels Per Day Three Months Ended September 30,	
Product	**2006**	**2005**
Gasoline	742,700	750,700
Distillate	295,700	306,400
Jet Fuel	361,500	332,400
LPGs	27,200	17,800
NGLs	21,300	
Other	8,700	4,200
Total	1,457,100	1,411,500

In the second and third quarters of 2006, certain of Buckeye s Operating Subsidiaries filed pipeline tariffs related to its interstate common carrier pipelines reflecting increased rates on average of approximately 6.1%. These tariff rate increases are expected to generate approximately $17 million in additional revenue on an annual basis. Buckeye also filed with the Federal Energy Regulatory Commission, effective June 1, 2006, a tariff rate surcharge to recover anticipated capital and operating costs associated with the pipeline transportation of ultra low sulfur diesel fuel. The tariff rate surcharge is expected to generate approximately $3 million in additional revenue on an annual basis. The tariff rate surcharge is designed to permit Buckeye to recover, over time, its capital investment (and a reasonable rate of return thereon) and its operating costs related to infrastructure improvements in connection with the transportation of ultra low sulfur diesel fuel.

Terminalling and Storage:

Terminalling and Storage revenues of $18.7 million for the quarter ended September 30, 2006 increased by $2.9 million from the comparable quarter in 2005.

Recent terminal acquisitions increased Terminalling and Storage revenues by $1.1 million for the quarter ended September 30, 2006 compared to the comparable period in 2005. The increase is related to periods during which the acquired terminals were owned compared to the comparable period in 2005 during which the acquired terminals were not owned.

Terminalling and Storage revenues at terminals that were owned by Buckeye during the third quarter of 2005 through the third quarter of 2006 were $17.6 million for the quarter ended September 30, 2006, an increase of $1.8 million from the third quarter of 2005, which is principally related to an increase in terminal throughput volumes.

Average daily throughput for the refined products terminals for quarters ended September 30 was as follows:

	Quarter Ended September 30,	
	2006	**2005**
Refined products throughput (bpd)	498,900	438,800

Other Operations:

Revenue from other operations of $6.7 million for the quarter ended September 30, 2006 decreased by $0.4 million from the comparable period in 2005.

Operating Expenses:

Costs and expenses for the three months ended September 30, 2006 and 2005 were as follows:

	Costs and Expenses	
	2006	**2005**
	(In thousands)	
Payroll and payroll benefits	$ 24,779	$ 21,085
Depreciation and amortization	10,323	8,249
Operating power	7,605	7,423
Outside services	10,148	6,499
Property and other taxes	5,169	4,112
Construction management	1,909	2,140
All other	16,250	13,162
Total	$ 76,183	$ 62,670

Payroll and payroll benefits were $24.8 million in the third quarter of 2006, an increase of $3.7 million compared to the third quarter of 2005. The Partnership incurred $3.3 million in payroll and payroll benefits related to its Management Units. Buckeye experienced an increase of $0.4 million in payroll and payroll benefit expenses due to additional employees hired as a result of acquisitions that occurred during the previous twelve months. Increases in salaries and wages of $1.8 million resulted from an increase in the number of employees and overtime pay due to Buckeye s expanded operations and higher wage rates. Buckeye also capitalized less payroll and payroll benefits in the third quarter of 2006 which resulted in an increase in payroll and payroll benefits expense of $0.5 million over the third quarter of 2005. These increases were partially offset by a reduction in ESOP related costs of $0.4 million. Payroll and payroll benefits expense in the third quarter of 2006, was also reduced by $0.9 million compared to the third quarter of 2005 as a result of a reversal in the third quarter of 2006 of approximately $0.3 million of Buckeye s annual accrual for Services Company s incentive compensation plan for employees. Buckeye also experienced a decrease in payroll benefits of $0.1 million during the third quarter of 2006. Payroll and payroll benefits expenses were also reduced by $0.7 million in unit-based compensation expense in the three months ended September 30, 2006 compared to the three months ended September 30, 2005, which was due to the adoption of Financial Accounting Standards No. 123R (revised 2004), Share Based Payment (FASB No. 123R) effective January 1, 2006.

Depreciation and amortization expense was $10.3 million in the third quarter of 2006, an increase of $2.1 million from the third quarter of 2005. Depreciation related to recent acquisitions was $0.9 million. Buckeye incurred depreciation expense of $0.2 million related to the Memphis Terminal which commenced operations earlier in 2006. The remaining increase resulted from assets placed into service during 2006.

Operating power costs were $7.6 million in the three months ended September 30, 2006, an increase of $0.2 million from the same period in 2005. Operating power consists primarily of electricity required to operate pumping facilities.

Outside services costs increased $3.6 million from $6.5 million in the third quarter of 2005 to $10.1 million in the third quarter of 2006. Outside services costs related to acquisitions that occurred during the previous twelve months added $0.3 million of outside services costs. Buckeye incurred an additional $0.1 million for pipeline inspection and maintenance costs related to an operating service contract. The remainder of the increase is due to additional pipeline and tank inspections and maintenance work that occurred during the third quarter of 2006. Outside services costs consist principally of third-party contract services for maintenance activities.

Property and other taxes increased by $1.1 million from $4.1 million in the third quarter of 2005 to $5.2 million for the same period in 2006. An increase of $0.5 million of property and other taxes was related to recent acquisitions. The remaining increase is a result of higher real property assessments over the same period in 2005.

Construction management costs were $1.9 million in the third quarter of 2006, which was consistent with costs incurred in the third quarter of 2005.

All other costs were $16.3 million in the three months ended September 30, 2006, an increase of $3.1 million compared to $13.2 million in the same period in 2005. The Partnership incurred an increase in professional fees of $0.2 million which was primarily due to the Partnership s IPO. The increase also reflects $0.5 million of costs associated with fuel purchases by WesPac Reno related to a product-supply arrangement; such costs have corresponding revenue included in Buckeye s incidental revenue. Other costs related to recent acquisitions were $0.3 million. Buckeye had an increase in other expenses of $0.2 million which was related to the Memphis Terminal which commenced operations earlier in 2006. Buckeye experienced an increase in casualty losses of $0.6 million in the third quarter of 2006, which loss related primarily to emergency response and environmental remediation expenditures in connection with a petroleum products release at a Buckeye terminal located in Harristown, Illinois. The remainder of the increase is due to increases in various costs resulting from Buckeye s expanded operations.

Costs and expenses by segment for the quarters ended September 30, 2006 and 2005 were as follows:

	Costs and Expenses by Segment	
	2006	**2005**
	(In thousands)	
Pipeline Operations	$ 55,749	$ 46,783
Terminalling and Storage	15,335	10,946
Other Operations	5,099	4,941
Total	$ 76,183	$ 62,670

Other income (expenses) for the three months ended September 30, 2006 and 2005 was as follows:

	Other Income (Expenses) 2006	2005
	(In thousands)	
Investment income	$ 317	$ 482
Interest and debt expense	(14,940)	(14,192)
Total	$ (14,623)	$ (13,710)
Equity income	$ 1,803	$ 1,213

Other income (expense) was a net expense of $14.6 million in the third quarter of 2006, compared to a net expense of $13.7 million during the same period in 2005. Investment income for the three months ended September 30, 2006 was consistent with investment income generated during the three months ended September 30, 2005.

Interest expense was $14.9 million in the three months ended September 30, 2006, an increase of $0.7 million from $14.2 million in the three months ended September 30, 2005. The increase is due to higher average balances outstanding under, and higher interest rates on, Buckeye s 5-year revolving credit facility. Also recorded in the third quarter of 2006 as part of the IPO and repayment of the Term Loan was a reduction in interest expense of $1.9 million related to the liquidation of two interest rate swaps and an interest rate cap, as well as a charge of $1.6 million related to the write-off of previously deferred financing costs (See Note 4 to the condensed consolidated financial statements for a further discussion).

Equity income increased by $0.6 million in the third quarter of 2006 compared to the third quarter in 2005. The increase is principally a result of equity income earned from Buckeye s approximate 40% interest in Muskegon Pipeline LLC which was acquired in December 2005.

Nine Months

Revenues and operating income by segment for the nine months ended September 30, 2006 and 2005 were as follows:

	Nine Months Ended September 30, 2006	2005
	(In thousands)	
<u>Revenues:</u>		
Pipeline Operations	$ 259,592	$ 226,938
Terminalling and Storage	55,271	47,921
Other Operations	18,896	25,312
Total	$ 333,759	$ 300,171
<u>Operating income:</u>		
Pipeline Operations	$ 101,106	$ 91,195
Terminalling and Storage	15,803	17,866
Other Operations	4,265	5,436
Total	$ 121,174	$ 114,497

Total revenue for the nine months ended September 30, 2006 was $333.8 million, $33.6 million, or 11.2%, greater than revenue of $300.2 million for the same period in 2005.

Pipeline Operations:

Revenue from Pipeline Operations was $259.6 million for the nine months ended September 30, 2006 compared to $226.9 million for the nine months ended September 30, 2005. The net increase of $32.7 million in Pipeline Operations revenue was primarily the result of:

- BPL Transportation revenue increase of $6.9 million (BPL Transportation s assets were acquired on May 5, 2005);
- Buckeye NGL revenue of $7.8 million (Buckeye NGL s assets were acquired on January 31, 2006);
- a 0.7% increase, or $0.8 million, net of BPL Transportation, in gasoline transportation revenue, even though gasoline volumes delivered declined by 2.4%;
- a 12.2% increase, or $4.5 million, net of BPL Transportation, in jet fuel transportation revenue on a 7.1% increase in jet fuel volumes delivered;
- a 6.4% increase, or $3.3 million, net of BPL Transportation, in distillate transportation revenue on comparable distillate volumes delivered;
- an increase in LPG transportation revenue of $1.1 million as a result of higher tariffs and an increase in volumes delivered;
- a $3.4 million increase in incidental revenue primarily from increased revenues under a product supply arrangement in connection with WesPac Reno;
- a $4.7 million increase in other revenues principally resulting from the Memphis terminal;
- a $1.8 million increase in operating services revenue due to an increase in reimbursable maintenance and inspection activities under an operating services contract;
- a $1.6 million increase in miscellaneous rental revenue; and
- a decrease in transportation settlement revenue, representing the settlement of overages and shortages on product deliveries, of $4.6 million.

Product deliveries for the nine months ended September 30, 2006 and 2005, including Buckeye NGL and BPL Transportation product deliveries were as follows:

	Barrels Per Day Nine Months Ended September 30,	
Product	**2006**	**2005**
Gasoline	722,900	717,200
Distillate	314,600	312,100
Jet Fuel	351,200	320,700
LPG s	24,900	17,900
NGL s	19,000	
Other	9,900	5,600
Total	1,442,500	1,373,500

Terminalling and Storage:

Terminalling and Storage revenues of $55.3 million for the nine months ended September 30, 2006 increased by $7.4 million from the comparable period in 2005.

Recent terminal acquisitions increased Terminalling and Storage revenues by $5.3 million for the nine months ended September 30, 2006 compared to the comparable period in 2005. The increase is related to periods which the acquired terminals were owned compared to the comparable period in 2005 during which the acquired terminals were not owned.

Terminalling and Storage revenues at existing terminals owned by Buckeye were $50.0 million for the nine months ended September 30, 2006, an increase of $2.1 million from the first nine months of 2005.

Average daily throughput for the refined products terminals for the nine months ended September 30, 2006 and 2005 was as follows:

	Nine Months ended September 30,	
	2006	**2005**
Refined products throughput (bpd)	490,800	420,000

Other Operations:

Other Operations revenues of $18.9 million for the nine months ended September 30, 2006 declined by $6.4 million from the comparable period in 2005 primarily as a result of the absence of a large construction project which provided approximately $7.5 million of revenue in the first nine months of 2005.

Operating Expenses:

Costs and expenses for the nine month periods ended September 30, 2006 and 2005 were as follows:

	Costs and Expenses	
	2006	**2005**
	(In thousands)	
Payroll and payroll benefits	$ 67,288	$ 63,115
Depreciation and amortization	29,445	23,747
Operating power	21,742	19,461
Outside services	22,383	15,962
Property and other taxes	14,368	12,312
Construction management	3,895	7,496
All other	53,464	43,581
Total	$ 212,585	$ 185,674

Payroll and payroll benefits were $67.3 million in the first nine months of 2006, an increase of $4.2 million compared to the third quarter of 2005. The Partnership incurred $3.3 million in payroll and payroll benefits related to its Management Units. Buckeye experienced an increase of $1.9 million in payroll and payroll benefit expenses due to additional employees hired as a result of acquisitions that occurred during the previous twelve months. Increases in salaries and wages of $4.3 million resulted from an increase in the number of employees and overtime pay due to Buckeye s expanded operations and higher wage rates. Buckeye experienced an increase in payroll benefits of $0.3 million in the first nine months of 2006. These increases were offset by an increase in capitalized payroll and payroll benefits in the first nine months of 2006, which resulted in a decrease in payroll and payroll benefits expense of $0.9 million over the same period in 2005. There also was a reduction in ESOP related costs of $0.8 million. Payroll and benefits expense was also reduced by $1.0 million in the nine months ended September

30, 2006 compared to the same period in 2005 as a result of lower incentive compensation accruals. In the first nine months of 2006, Buckeye accrued approximately $0.7 million in annual incentive compensation for employees, compared to approximately $1.7 million in the same period of 2005. Buckeye also experienced a decrease in severance pay of $0.6 million. Payroll and payroll benefits expenses were also reduced by $2.6 million in unit-based compensation expense in the nine months ended September 30, 2006 compared to the nine months ended September 30, 2005, which was due to the adoption of FASB No. 123R effective January 1, 2006.

Depreciation and amortization expense was $29.4 million for the nine months ended September 30, 2006, an increase of $5.7 million from the comparable period of 2005. Depreciation related to recent acquisitions was $2.8 million. Buckeye incurred depreciation expense of $0.4 million related to the Memphis Terminal which commenced operations earlier in 2006. The remaining increase resulted from assets placed into service during the nine months ended September 30, 2006.

Operating power costs of $21.7 million in the first nine months of 2006 were $2.3 million higher than the same period in 2005. Recent acquisitions added $1.8 million to operating power expense. The remainder of the increase is due to additional pipeline volumes in Buckeye s pipeline operations. Operating power consists primarily of electricity required to operate pumping facilities.

Outside services costs were $22.4 million in the first nine months of 2006, or $6.4 million greater than the same period in 2005. Outside services costs related to recent acquisitions were $0.7 million. Buckeye incurred an additional $1.0 million for pipeline inspection and maintenance costs related to an operating service contract. Buckeye also incurred additional expense of $0.3 million for public awareness programs. The remainder of the increase is due to additional pipeline and tank inspections and maintenance work that occurred during the first nine months of 2006.

Property and other taxes increased by $2.1 million from $12.3 million in the first nine months of 2005 to $14.4 million for the same period in 2006. Of this increase, $1.4 million related to recent acquisitions. This increase was offset by a reimbursement of $0.9 million in 2006 for certain property taxes under an operating service agreement. The remainder of the increase is due to higher real property assessments over the same period in 2005.

Construction management costs were $3.9 million in the nine months ended September 30, 2006, which is a decrease of $3.6 million from the same period in 2005. The decrease is a result of the absence of a significant construction contract that was completed in 2005.

All other costs were $53.5 million, an increase of $9.9 million, in the first nine months of 2006 compared to the first nine months of 2005. The Partnership incurred an increase in professional fees of $2.7 million which was primarily due to the Partnership s IPO. The increase also reflects $3.1 million of costs associated with fuel purchases by WesPac Reno related to a product-supply arrangement; such costs have corresponding revenue included in Buckeye s incidental revenue. Other costs related to recent acquisitions were $1.6 million. Buckeye had an increase in other expenses of $0.8 million which was related to the Memphis Terminal which commenced operations earlier in 2006. These increases were partially offset by a decrease in casualty losses of $1.1 million. The remainder of the increases related to various pipeline operating costs resulting from Buckeye s expanded operations.

Costs and expenses by segment for the nine months ended September 30, 2006 and 2005 were as follows:

	Costs and Expenses by Segment	
	2006	**2005**
	(In thousands)	
Pipeline Operations	$ 158,486	$ 135,743
Terminalling and Storage	39,468	30,055
Other Operations	14,631	19,876
Total	$ 212,585	$ 185,674

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Other income (expenses) for the nine month periods ended September 30, 2006 and 2005 was as follows:

	Other Income (Expenses) 2006	2005
	(In thousands)	
Investment income	$ 939	$ 830
Interest and debt expense	(46,880)	(41,244)
Total	$ (45,941)	$ (40,414)
Equity income	$ 4,598	$ 3,678

Other income (expense) was a net expense of $45.9 million during the nine months ended September 30, 2006, compared to a net expense of $40.4 million during the same period in 2005. Investment income for the nine months ended September 30, 2006 was consistent with investment income generated during the nine months ended September 30, 2005.

Interest expense was $46.9 million in the nine months ended September 30, 2006, an increase of $5.7 million from $41.2 million in the nine months ended September 30, 2005. Buckeye incurred approximately $3.2 million in interest related to the 5.125% Notes due 2017, which were issued in June 2005. The balance of the increase in interest expense resulted from higher average balances outstanding and interest rates on Buckeye s 5-year revolving credit facility. Also recorded in the nine months ended September 30, 2006 as part of the IPO and repayment of the Term Loan was a reduction in interest expense of $1.9 million related to the liquidation of two interest rate swaps and an interest rate cap, as well as a charge of $1.6 million related to the write-off of previously deferred financing costs (See Note 4 to the condensed consolidated financial statements for a further discussion).

Equity income increased by $0.9 million from the nine months ended September 30, 2005 to $4.6 million for the nine months ended September 30, 2006. The increase is a result of equity income earned from Buckeye s approximate 40% interest in Muskegon Pipeline LLC which was acquired in December 2005.

LIQUIDITY AND CAPITAL RESOURCES

Until the Partnership s IPO on August 9, 2006, the Partnership s only capital requirement, apart from Buckeye s capital requirements, was its debt service under its Term Loan. Concurrent with the Partnership s IPO, the Term Loan was repaid in full. Buckeye s capital requirements consist of maintenance and capital expenditures, expenditures for acquisitions and Buckeye s debt service requirements.

As noted in Overview above, the Partnership s only cash-generating asset is its ownership interest in Buckeye GP, which owns (i) general partner units, or GP Units, in Buckeye, (ii) incentive distribution rights in Buckeye, (iii) 80,000 limited partnership units, or LP Units, in Buckeye and (iv) an approximate one percent general partner interest in each of Buckeye s subsidiary operating partnerships. The Partnership s cash flow is, therefore, directly dependent upon the ability of Buckeye and its operating subsidiaries to make cash distributions to Buckeye s partners. The actual amount of cash that Buckeye will have available for distribution depends primarily on Buckeye s ability to generate cash beyond its working capital requirements. Buckeye s primary future sources of liquidity are operating cash flow, proceeds from borrowings under Buckeye s revolving credit facility and proceeds from the issuance of Buckeye s LP units.

As a result of the IPO, the Partnership anticipates that its principal use of cash will be the payment of its operating expenses and distributions to its unitholders.

The Partnership generally makes quarterly cash distributions of substantially all of its available cash, generally defined as consolidated cash receipts less consolidated cash expenditures and such retentions for working capital, anticipated cash expenditures and contingencies as MainLine Management deems appropriate. On October 26, 2006, MainLine Management declared a cash distribution of $0.125 per unit (after the proration described below) payable on November 30, 2006 to Unitholders of record on November 6, 2006. As described in the prospectus contained in the Partnership s registration statement on Form S-1, as amended (Registration No. 333-133433), that was filed with the Securities and Exchange Commission on July 25, 2006, the initial quarterly distribution resulted from the Partnership s proration of its available cash from the third quarter based upon the portion of the third quarter beginning on the closing date of the Partnership s IPO, which was August 9, 2006, to the end of the quarter on September 30, 2006. The total cash distribution to Unitholders with respect to the distribution of $0.125 per unit will amount to approximately $3,537,500. As further described in the prospectus contained in the registration statement, the Partnership will use its available cash remaining after payment of the distribution to make distributions to its pre-IPO equity owners, and to pay cash bonuses of up to $2.0 million to officers of MainLine Management and to certain employees of Services Company. Included in these bonuses will be a one-time cash bonus of up to $700,000 payable to William H. Shea, Jr., a one-time cash bonus of up to $650,000 payable to Stephen C. Muther and a one-time cash bonus of up to $650,000 payable to Robert B. Wallace.

Debt

The Partnership

On August 9, 2006, the Partnership entered into a five-year $10 million revolving credit facility with SunTrust Bank, as both administrative agent and lender (the Credit Agreement). The credit facility may be used for working capital and other partnership purposes. The Partnership has pledged all of the limited liability company interests in Buckeye GP LLC to SunTrust Bank as security for its obligations under the Credit Agreement.

The Credit Agreement permits the Partnership to prepay all loans under the credit facility at any time without premium or penalty (other than customary LIBOR breakage costs). Borrowings under the Credit Agreement bear interest under one of two rate options, selected by the Partnership, equal to either:

- the greater of (1) the federal funds rate plus 0.5% and (2) SunTrust Bank s prime commercial lending rate; or
- LIBOR, plus a margin which can range from 0.40% to 1.40%, based on the ratings assigned by Standard & Poor s Rating Services and Moody s Investor Services to the senior unsecured non-credit enhanced long-term debt of Buckeye.

The Partnership s ability to borrow amounts under the Credit Agreement is subject to satisfaction of certain customary conditions precedent to revolving loans and compliance with terms and conditions included in the Credit Agreement.

The Credit Agreement defines Restricted Subsidiaries as certain of the Partnership s wholly owned subsidiaries.

The Credit Agreement requires the Partnership to maintain leverage and funded debt coverage ratios. The leverage ratio covenant requires the Partnership to maintain, as of the last day of each fiscal quarter, a ratio of the total funded indebtedness of the Partnership and its Restricted Subsidiaries, measured as of the last day of each fiscal quarter, to the aggregate dividends and distributions received by the Partnership and its Restricted Subsidiaries from Buckeye, plus all other cash received by the Partnership and the Restricted Subsidiaries, measured for the preceding twelve months, less expenses, of not more than 2.50 to 1.00. The funded debt coverage ratio covenant requires the Partnership to maintain, as of the last day of each fiscal quarter, a ratio of total consolidated funded debt of the Partnership and all of its subsidiaries to the consolidated EBITDA, as defined in the Credit Agreement, of the Partnership and all of its subsidiaries, measured for the preceding twelve months, of not more than 5.25 to 1.00, subject to a provision for increases to 5.75 to 1.00 in connection with future acquisitions.

The Credit Agreement prohibits the Partnership from declaring dividends or distributions if any default or event of default, as defined in the Credit Agreement, has occurred or would result from such a declaration. In addition, the Credit Agreement contains covenants and provisions requiring the Partnership to adhere to certain covenants and limiting the ability of the Partnership and its Restricted Subsidiaries to, among other things:

- incur or guarantee indebtedness;
- make certain negative pledges and grant certain liens;
- make certain loans, acquisitions and investments;
- make any material changes to the nature of the Partnership or Restricted Subsidiaries business; or
- enter into a merger, consolidation or sale of assets.

If an event of default exists under the Credit Agreement, the lender will be able to terminate the Credit Agreement and accelerate the maturity of all outstanding loans, as well as exercise other rights and remedies. The following are some of the events which would constitute an event of default under the Credit Agreement:

- failure to pay any principal, interest, fees, expenses or other amounts when due;
- failure of any representation or warranty to be true and correct in any material respect;
- failure to perform or otherwise comply with the covenants in the Credit Agreement or other loan documents, subject to certain grace periods;
- default by the Partnership or any Restricted Subsidiary on the payment of any other indebtedness in excess of $5.0 million or default by Buckeye or any of its subsidiaries on the payment of any indebtedness in excess of $25.0 million, or any default in the performance of any obligation or condition with respect to such indebtedness beyond the applicable grace period if the effect of the default is to permit or cause the acceleration of the indebtedness;
- bankruptcy or insolvency events involving the Partnership;
- the entry against the Partnership of a judgment in excess of specified amounts, or otherwise having a material adverse effect, that is not stayed, discharged or deferred within specified periods;
- a change in control of the Partnership (as such term is defined in the Credit Agreement);
- the invalidity or unenforceability of any material provision in the Credit Agreement or related documents; and
- the occurrence of certain events with respect to employee benefit plans subject to ERISA.

MainLine L.P.

Prior to August 9, 2006, MainLine was party to a Senior Secured Credit Facility (Term Loan) with a consortium of financial institutions arranged by Goldman Sachs Credit Partners under which MainLine had $169.0 million outstanding. Borrowings under the Term Loan bore interest under one of two variable rate options selected by MainLine.

The Term Loan had replaced MainLine s $100,000,000 Senior Secured Credit Facility (the Prior Term Loan). In accordance with requirements under the Prior Term Loan, MainLine had purchased an interest rate cap from Goldman Sachs Capital Markets, L.P. on a notional amount of $50 million for $375,000. In accordance with requirements under the Term Loan, MainLine had entered into two interest rate swap agreements with Goldman Sachs Capital Markets L.P.

All amounts outstanding under the Term Loan of $169.0 million were repaid with proceeds of the Partnership s IPO, together with cash on hand, on August 9, 2006. In connection with the repayment of the loan in the third quarter of 2006, the Partnership expensed $1.6 million of previously deferred financing costs, and recorded a reduction to interest and debt expense of $1.9 million as a result of liquidating the interest rate cap and the two interest rate swaps.

Services Company

Services Company s debt consists of 3.60% Senior Secured Notes (the 3.60% ESOP Notes) due March 28, 2011 payable by the ESOP to a third-party lender. The 3.60% ESOP Notes were issued May 4, 2004. The 3.60% ESOP Notes are collateralized by Services Company s common stock and are guaranteed by Services

Company. In addition, Buckeye has committed that, in the event that the value of Buckeye s LP units owned by Services Company falls below 125% of the balance payable under the 3.60% ESOP Notes, Buckeye will fund an escrow account with sufficient assets to bring the value of the total collateral (the value of Buckeye s LP units owned by Services Company and the escrow account) up to the 125% minimum. Amounts deposited in the escrow account are returned to Buckeye when the value of Buckeye s LP units owned by Services Company s returns to an amount which exceeds the 125% minimum. At September 30, 2006, the value of Buckeye s LP units owned by Services Company exceeded the 125% requirement.

Buckeye

Buckeye has a $400 million 5-year revolving credit facility (Buckeye s Credit Facility) with a syndicate of banks led by SunTrust Bank. Buckeye s Credit Facility contains a one-time expansion feature to $550 million subject to certain conditions. Borrowings under Buckeye s Credit Facility are guaranteed by certain of Buckeye s subsidiaries. Buckeye s Credit Facility matures on August 6, 2009. The weighted average interest rate on amounts outstanding under Buckeye s Credit Facility at September 30, 2006 was 5.9%.

Borrowings under Buckeye s Credit Facility bear interest under one of two rate options, selected by Buckeye, equal to either (i) the greater of (a) the federal funds rate plus one half of one percent and (b) SunTrust Bank s prime rate or (ii) LIBOR plus an applicable margin. The applicable margin is determined based on ratings assigned by Standard & Poor s and Moody s Investor Services for Buckeye s senior unsecured non-credit enhanced long-term debt. The applicable margin will increase during any period in which Buckeye s Funded Debt Ratio (described below) exceeds 5.25 to 1.0. At September 30, 2006 and December 31, 2005, Buckeye had $132.0 million and $50 million outstanding under Buckeye s Credit Facility, respectively, and had committed $1.7 million and $1.3 million in support of letters of credit, respectively.

Buckeye s Credit Facility contains covenants and provisions that:

- Restrict Buckeye and certain of its subsidiaries ability to incur additional indebtedness based on certain ratios described below;
- Prohibit Buckeye and certain of its subsidiaries from creating or incurring certain liens on their property;
- Prohibit Buckeye and certain of its subsidiaries from disposing of property material to their operations; and
- Limit consolidations, mergers and asset transfers by Buckeye and certain of its subsidiaries.

Buckeye s Credit Facility requires that Buckeye and certain of its subsidiaries maintain a maximum Funded Debt Ratio and a minimum Fixed Charge Coverage Ratio, both of which are calculated using Adjusted EBITDA. Prior to the restructuring of Buckeye GP on August 9, 2006, Buckeye s Credit Facility defined Adjusted EBITDA as earnings before interest, taxes, depreciation, depletion, amortization and incentive compensation payments to Buckeye GP, for the four preceding fiscal quarters. Incentive compensation payments were historically included in this definition because Buckeye accounted for them as an expense. Because Buckeye will no longer account for incentive compensation as an expense, it amended its Credit Facility effective as of the restructuring to define Adjusted EBITDA as earnings before interest, taxes, depreciation, depletion and amortization, for the four preceding fiscal quarters. Accordingly, calculations of Buckeye s Funded Debt Ratio and Fixed Charge Coverage Ratio that include incentive compensation payments that are accounted for as an expense (i.e., those that became payable prior to August 9, 2006) were made using the prior definition of Adjusted EBITDA, and calculations of such ratios beginning in the fourth quarter of 2006 will be made using the current definition.

The Funded Debt Ratio equals the ratio of the long-term debt of Buckeye and certain of its subsidiaries (including the current portion, if any) to Adjusted EBITDA for the four preceding fiscal quarters. As of the end of any fiscal quarter, the Funded Debt Ratio may not exceed 4.75 to 1.00, subject to a provision for increases to 5.25 to 1.00 in connection with future acquisitions. At September 30, 2006, Buckeye s Funded Debt Ratio was 4.50 to 1.00.

The Fixed Charge Coverage Ratio is defined as the ratio of Adjusted EBITDA for the four preceding fiscal quarters to the sum of payments for interest and principal on debt plus certain capital expenditures required for the ongoing maintenance and operation of Buckeye s assets. Buckeye is required to maintain a Fixed Charge Coverage Ratio of greater than 1.25 to 1.00 as of the end of any fiscal quarter. As of September 30, 2006, Buckeye s Fixed Charge Coverage Ratio was 2.65 to 1.00.

At September 30, 2006, Buckeye had total fixed debt obligations at face value of $850 million, consisting of $125 million of the 5.125% Notes, $275 million of the 5.30% Notes, $300 million of the 4.625% Notes and $150 million of the 6.750% Notes. See Note 4 to the condensed consolidated financial statements for a more detailed discussion.

Covenants. The Partnership and its subsidiaries, Services Company, and Buckeye and its Operating Subsidiaries were in compliance with the various covenants of the debt agreements at September 30, 2006.

Derivative Instruments. At September 30, 2006, the Partnership had no trading derivative instruments outstanding. In December 2004, Buckeye terminated an interest rate swap agreement associated with the 4.625% Notes due June 15, 2013 and received proceeds of $2.0 million. In accordance with FASB Statement No. 133 Accounting for Derivative Instruments and Hedging Activities, Buckeye has deferred the $2.0 million gain as an adjustment to the fair value of the hedged portion of its debt and is amortizing the gain as a reduction of interest expense over the remaining term of the hedged debt. Interest expense was reduced by $59 thousand during each of the three months ended September 30, 2006 and 2005 and $176 thousand during each of the nine months ended September 30, 2006 and 2005, related to the amortization of the gain on the interest rate swap.

Cash Flows from Operations

The components of cash flows from operations for the nine months ended September 30, 2006 and 2005 were as follows:

	Cash Flows from Operations	
	2006	**2005**
	(In thousands)	
Net income	$ 5,730	$ 5,618
Value of ESOP shares released	3,047	3,895
Depreciation and amortization	29,445	23,747
Non-controlling interests	74,101	72,143
Changes in current assets and liabilities.	(5,940)	618
Changes in other assets and liabilities	3,721	1,595
Other	3,520	1,416
Total	$ 113,624	$ 109,032

Cash flows from operations were $113.6 million for the first nine months of 2006, an increase of $4.6 million over the first nine months of 2005. Net income was $5.7 million for the first nine months of 2006 and $5.6 million for the same period of 2005. Depreciation and amortization was $29.4 million for 2006 compared to $23.7 million during the same period in 2005. The increase principally resulted from recent acquisitions and an increase in assets placed into service during the first nine months of 2006. Cash used for working capital was $5.9 million compared to cash provided by working capital of $0.6 million in 2005.

During the nine months ended September 30, 2006, cash used for working capital resulted from increases in trade receivables of $1.8 million, construction and pipeline relocation receivables of $1.2 million and prepaid and other current assets of $11.3 million and a decrease in accounts payable of $1.5 million. The decreases in cash were partially offset by an increase in accrued and other current liabilities of $10.3 million. The increase in trade receivables is partly due to activity at Buckeye NGL which commenced operations in January 2006. The increase in construction and pipeline relocations receivables is due to an increase in relocation project activity. Prepaid and other current assets increased due to an increase in insurance receivables and an increase in a receivable for activity on a 29-mile ammonia pipeline acquired in November 2005. The decrease in accounts payable resulted from the timing of invoice payments at year end of 2005. The increase in accrued and other current liabilities is due to activity on the 29-mile ammonia pipeline as well as an increase in amounts accrued by Buckeye for environmental liabilities.

In the first nine months of 2005, cash provided by working capital resulted principally from reductions in construction and pipeline relocation receivables of $1.7 million and prepaid and other current assets of $5.1 million, which were offset by a decrease in accounts payable of $6.7 million. The reduction in construction and pipeline relocation receivables resulted from the timing of construction projects at year end 2004 compared to the third quarter of 2005. The reduction in prepaid and other current assets resulted principally from the collection of insurance receivables and amortization of prepaid insurance in the first nine months of 2005. The decrease in accounts payable resulted principally from the timing of invoice payments at year-end 2004.

Cash Flows from Investing Activities

Net cash used in investing activities for the nine months ended September 30, 2006 and 2005 are as follows:

	Investing Activities For the Nine Months Ended September 30, 2006	**2005**
	(In thousands)	
Capital expenditures	$ (62,324)	$ (51,906)
Investments and acquisitions	(93,330)	(178,813)
Other	5,247	(3,054)
Total	$ (150,407)	$ (233,773)

In the nine months ended September 30, 2006, Buckeye expended $93.3 million related to acquisitions, including $79.3 million related to Buckeye NGL, $12.5 million related to the acquisition of a Niles, Michigan terminal and approximately $1 million for miscellaneous asset acquisitions. In the nine months ended September 30, 2005, Buckeye spent approximately $178.8 million related to acquisitions, of which $176.3 million related to the acquisition of the Northeast Pipelines and Terminals and the remainder related to the purchase of the remaining 25% interest in WesPac Reno from Kealine LLC for $2.5 million.

Capital expenditures are summarized below:

	Capital Expenditures For the Nine Months Ended September 30, 2006	**2005**
	(In thousands)	
Sustaining capital expenditures	$ 17,735	$ 9,733
Expansion and cost reduction	44,589	42,173
Total	$ 62,324	$ 51,906

The Partnership incurred $17.7 million of sustaining capital expenditures and $44.6 million of expansion and cost reduction expenditures in the first nine months of 2006. Expansion projects at Buckeye in 2006 include the completion of an approximate 11-mile pipeline and related terminal facilities to serve the Memphis International Airport, the addition of pipelines, tankage and equipment to meet new handling requirements for ultra-low sulfur diesel, and a capacity expansion in Illinois to handle additional LPG volumes. Other expansion projects underway in 2006 include various ethanol-blending and butane-blending projects at pipeline stations and terminals owned by Buckeye, and an expansion of the recently completed pipeline and terminal infrastructure at the Memphis International Airport to accommodate a new generation of cargo planes for Federal Express Corporation. The

Memphis International Airport project is owned by WesPac Pipelines Memphis LLC, a 75%-owned subsidiary of Buckeye.

Buckeye incurred $9.7 million of sustaining capital expenditures and $42.2 million of expansion and cost reduction expenditures in the first nine months of 2005. Expansion projects at Buckeye in 2005 included a capacity expansion project related to the Laurel pipeline across Pennsylvania, and the construction of the pipeline and terminal facilities to serve the Memphis International Airport.

Buckeye estimates its sustaining capital expenditures will be approximately $25 million to $30 million for all of 2006.

Cash Flows from Financing Activities

As described above, the Partnership raised approximately $168.5 million, net of underwriters discount and expenses, in the IPO. The Partnership used the proceeds from the offering plus available cash from operations and the liquidation of MainLine s interest expense reserve account and its three derivative instruments, to repay principal and accrued interest on the Term Loan, as well as make a distribution of $7.7 million to the Partnership s pre-IPO equity owners.

Total distributions by the Partnership, all of which were paid to the pre-IPO equity owners, were $14.3 million, including the $7.7 million described above.

On March 7, 2006, Buckeye issued 1.5 million LP Units in an underwritten public offering at $44.22 per LP Unit. Proceeds from the offering, after underwriter s discount of $1.45 per LP Unit and offering expenses were approximately $64.1 million, and were used to reduce amounts outstanding under Buckeye s Credit Facility.

Payments on the ESOP Notes were $4.5 million for the nine months ended September 30, 2006. Buckeye borrowed $147 million under its Credit Facility and repaid $65 million, principally from the proceeds of the LP Unit offering during the first half of the year.

Distributions to non-controlling interests, consisting primarily of Buckeye s distributions to holders of its LP Units, were $83.6 million in the first nine months of 2006 compared to $71.7 million in the first nine months of 2005. The increase resulted principally from additional LP Units outstanding as a result of Buckeye s issuance of 2.5 million LP Units in May 2005, the issuance of 1.5 million LP Units in March 2006 and increases in the per-unit distribution amount.

OTHER MATTERS

Accounting Pronouncements

See Note 12 to the Partnership s unaudited condensed consolidated financial statements for a description of certain new accounting pronouncements issued in the three months ended September 30, 2006.

Forward Looking Statements

Some of the information in this report may contain forward-looking statements. All statements other than statements of historic fact are forward-looking statements. These statements can be identified by the use of forward-looking terminology including may, believe, will, expect, anticipate, estimate, continue or other similar words although some forward-looking statements are expressed differently. These statements discuss plans, strategies, events or developments that the Partnership expects or anticipates will or may occur in the future. Specific factors could cause the Partnership s actual results to differ materially from those contained in any forward-looking statement. These factors include, but are not limited to:

- the Partnership s ability to pay distributions to its Unitholders;

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- the Partnership s expected receipt of distributions and incentive distributions from Buckeye;
- anticipated trends in Buckeye s business;
- price trends and overall demand for petroleum products in the United States in general and in Buckeye s service areas in particular (economic activity, weather, alternative energy sources, conservation and technological advances may affect price trends and demands);
- changes, if any, in laws and regulations, including, among others, safety, tax and accounting matters or Federal Energy Regulatory Commission regulation of Buckeye s tariff rates;
- liability for environmental claims;
- security issues affecting Buckeye s assets, including, among others, potential damage to its assets caused by acts of war or terrorism;
- unanticipated capital expenditures and operating expenses to repair or replace Buckeye s assets;
- availability and cost of insurance on Buckeye s assets and operations;
- Buckeye s ability to successfully identify and complete strategic acquisitions and make cost saving changes in operations;
- expansion in the operations of Buckeye s competitors;
- Buckeye s ability to integrate any acquired operations into its existing operations;
- shut-downs or cutbacks at major refineries that use Buckeye s services;
- deterioration in Buckeye s labor relations;
- changes in real property tax assessments;
- disruptions to the air travel system;
- interest rate fluctuations and other capital market conditions;
- the Partnership s future results of operations;
- the Partnership s liquidity and ability to finance its activities;
- market conditions in Buckeye s industry;
- conflicts of interest among Buckeye, its general partner, the Partnership and its general partner;
- the treatment of Buckeye or the Partnership as a corporation for federal income tax purposes or if the Partnership or Buckeye become subject to entity-level taxation for state tax purposes; and
- the impact of governmental legislation and regulation on the Partnership and Buckeye.

A forward-looking statement may include a statement of the assumptions or bases underlying the forward-looking statement. The Partnership believes that it has chosen these assumptions or bases in good faith and that they are reasonable. However, you are cautioned that assumed facts or bases almost always vary from actual results, and the differences between assumed facts or bases and actual results can be material, depending on the circumstances.

When considering forward-looking statements, you should keep in mind the risk factors and other cautionary statements in this report and in the Partnership s registration statement on Form S-1, as amended (Registration No. 333-133433) as filed with the Securities and Exchange Commission, including those described in the Risk Factors section of the registration statement. The Partnership will not update these statements unless the securities laws require it to do so.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market Risk Trading Instruments

Currently the Partnership does not engage in hedging activity with respect to trading instruments.

Market Risk Other than Trading Instruments

The Partnership and Buckeye are exposed to risk resulting from changes in interest rates. Neither company has material commodity or foreign exchange risk. Buckeye is exposed to fair value risk with respect to the fixed portion of its financing arrangements (the 5.125% Notes, the 5.300% Notes, the 4.625% Notes and the 6.75% Notes), and Buckeye and the Partnership are exposed to cash flow risk with respect to their variable rate obligations (the Credit Agreement and Buckeye s Credit Facility). Fair value risk represents the risk that the value of the fixed portion of a company s financing arrangements will rise or fall depending on changes in interest rates. Cash flow risk represents the risk that interest costs related to the Credit Agreement and Buckeye s Credit Facility will rise or fall depending on changes in interest rates.

At September 30, 2006, Buckeye had total fixed debt obligations at face value of $850 million, consisting of $125 million of the 5.125% Notes, $275 million of the 5.30% Notes, $300 million of the 4.625% Notes and $150 million of the 6.750% Notes. Services Company had fixed debt obligations of approximately $28.8 million at September 30, 2006 of its 3.60% ESOP Notes. The fair value of these obligations at September 30, 2006 was approximately $845 million. A 1% decrease in rates for obligations of similar maturities would increase the fair value of these obligations by $66 million. The Partnership did not have any balances outstanding under its Credit Agreement. Buckeye s variable debt obligation under Buckeye s Credit Facility was $132 million. Based on the balances outstanding at September 30, 2006, a 1% increase or decrease in interest rates would increase or decrease consolidated annual interest expense by $1.3 million.

In accordance with requirements under the Prior Term Loan, MainLine had purchased an interest rate cap from Goldman Sachs Capital Markets, L.P. on a notional amount of $50 million for $375,000. In accordance with requirements under the Term Loan, MainLine had also entered into two interest rate swap agreements with Goldman Sachs Capital Markets L.P. MainLine designated these transactions as hedges of its cash flow risk associated with the Term Loan. In connection with the Partnership s IPO and the repayment of the $169.0 million Term Loan, the Partnership liquidated its interest rate cap and the two interest rate swaps which reduced interest and debt expense by $1.9 million in the third quarter of 2006.

In December 2004, Buckeye terminated an interest rate swap agreement associated with the 4.625% Notes due June 15, 2013 and received proceeds of $2.0 million. In accordance with FASB Statement No. 133 Accounting for Derivative Instruments and Hedging Activities , Buckeye has deferred the $2.0 million gain as an adjustment to the fair value of the hedged portion of its debt and is amortizing the gain as a reduction of interest expense over the remaining term of the hedged debt. Interest expense was reduced by $59 thousand during each of the three months ended September 30, 2006 and 2005 and $176 thousand during each of the nine months ended September 30, 2006 and 2005, related to the amortization of the gain on the interest rate swap

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures.

The management of the Partnership, with the participation of its Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of its disclosure controls and procedures for the Partnership as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Partnership s disclosure controls and procedures as of the end of the period covered by this report are functioning effectively to provide reasonable assurance that the information required to be disclosed by the Partnership in reports filed under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and (ii) accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure. A controls system cannot provide absolute assurance, however, that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

(b) Change in Internal Control over Financial Reporting

No change in the Partnership s internal control over financial reporting occurred during the Partnership s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Partnership s internal control over financial reporting.

Part II - OTHER INFORMATION

Item 1. Legal Proceedings

Buckeye has received penalty assessments from the Internal Revenue Service (IRS) in the aggregate amount of $4.3 million based on a failure to file excise tax information returns relating to its terminal operations from January 2005 through February 2006. Buckeye filed the information returns with the IRS on May 10, 2006. The Partnership believes Buckeye had reasonable cause for the failure to file the information returns on a timely basis, and Buckeye intends to seek the elimination of the asserted penalties. The asserted penalties are for the failure to file information returns rather than any failure to pay taxes due as no taxes were owed by Buckeye in connection with such information returns. The timing or outcome of this claim, and the total costs to be incurred by Buckeye in connection therewith, cannot be reasonably estimated at this time.

Item 1A. Risk Factors

Please carefully read the Risk Factors set forth in the Partnership s Registration Statement on Form S-1, as amended (Registration No. 333-133433) as filed with the Securities and Exchange Commission, which Risk Factors are hereby incorporated by reference into this report.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On August 2, 2006, the registration statement on Form S-1 (SEC File No. 333-133433) as amended, that the Partnership filed with the SEC relating to its IPO became effective. The managing underwriters were Goldman, Sachs & Co., Citigroup Global Markets Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated and UBS Securities LLC. Under the registration statement, the Partnership was offering up to 14.1 million common units with an aggregate price of up to $340,515,000. The closing date of the IPO was August 9, 2006, and on that date the Partnership sold 10.5 million common units at $17.00 per common unit, or $178.5 million in the aggregate. The Partnership used the proceeds from the offering to:

- pay the underwriting discount ($9.1 million);
- repay a portion of the MainLine term loan ($164.2 million);
- replenish working capital ($0.5 million); and
- pay a distribution to the pre-IPO equity owners of MainLine ($4.6 million, which constituted a direct or indirect payment to directors and officers of MainLine Management LLC, the general partner of the Partnership, or their associates or holders of 10 percent or more of classes of the Partnership s equity securities).

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From the effective date of the registration statement to September 30, 2006, the amount of expenses incurred for the Partnership s account in connection with the issuance and distribution of the common units for underwriting discounts and commissions, finders fees and expenses paid to or for underwriters is $9.1 million as specified in the first bullet point above, plus a reasonable estimate of $0.8 million for other expenses resulting in estimated total expenses of $9.9 million.

Item 6. Exhibits

(a) Exhibits

3.1*	First Amended and Restated Agreement of Limited Partnership of Buckeye GP Holdings L.P.
10.1*	Amended & Restated Contribution, Conveyance and Assumption Agreement, dated as of August 9, 2006, among the limited partners of MainLine L.P., MainLine L.P., Buckeye GP LLC, Buckeye GP Holdings L.P., MainLine Management LLC, and MainLine GP, Inc.
10.2*	Amended and Restated Agreement of Limited Partnership of Buckeye Partners, L.P., dated as of August 9, 2006
10.3*	Fifth Amended and Restated Incentive Compensation Agreement, dated as of August 9, 2006
10.4*	Amended and Restated Agreement of Limited Partnership of Buckeye Pipe Line Company, L.P., as amended and restated as of August 9, 2006
10.5*	Amended and Restated Management Agreement of Buckeye Pipe Line Company, L.P., as amended and restated as of August 9, 2006
10.6*	Fourth Amended and Restated Exchange Agreement, dated as of August 9, 2006
10.7*	Amended and Restated Executive Employment Agreement, dated as of August 9, 2006
10.8*	Credit Agreement, dated August 9, 2006, among Buckeye GP Holdings L.P., as borrower, SunTrust Bank, as administrative agent, and the lenders signatory thereto
10.9	Supplement to Pledge Agreement - Additional Pledgor, dated as of September 15, 2006, among Buckeye GP Holdings L.P., as borrower, SunTrust Bank, as administrative agent, and the lenders signatory thereto
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14 (a) under the Securities Exchange Act of 1934
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934
32.1	Certification of Chief Executive Officer, Pursuant to 18 U.S.C. Section 1350
32.2	Certification of Chief Financial Officer, Pursuant to 18 U.S.C. Section 1350

* Incorporated by reference to the like-numbered Exhibit of the Buckeye GP Holdings L.P. Current Report on Form 8-K, filed with the Commission on August 14, 2006

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SIGNATURE

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

	BUCKEYE GP HOLDINGS L.P.	
		(Registrant)
	By:	MainLine Management LLC as General Partner
Date: November 6, 2006	By:	ROBERT B. WALLACE Robert B. Wallace Senior Vice President, Finance and Chief Financial Officer *(Principal Accounting and Financial Officer)*