Teekay LNG Partners L.P.
Form 20-F
April 14, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F

(Mark One)

[ ] **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) or (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

[X] **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2005

OR

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

OR

[ ] **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 1- 32479

TEEKAY LNG PARTNERS L.P.
(Exact name of Registrant as specified in its charter)

Republic of The Marshall Islands
(Jurisdiction of incorporation or organization)

Bayside House, Bayside Executive Park, West Bay Street & Blake Road, P.O. Box AP-59212, Nassau, Commonwealth of the Bahamas
(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of each class	**Name of each exchange on which registered**
Common Units	New York Stock Exchange

Securities registered or to be registered pursuant to Section 12(g) of the Act.

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

None

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report.

20,238,072 Common Units
14,734,572 Subordinated Units

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes [ ] No [X]

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes [ ] No [X]

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

Yes [X] No [ ]

Indicate by check mark whether the registrant is 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 [ ] Accelerated Filer [ ] Non-Accelerated Filer [X]

Indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 [ ] Item 18 [X]

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

TEEKAY LNG PARTNERS L.P.

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PART I.

PART I

This Annual Report should be read in conjunction with the consolidated financial statements and accompanying notes included in this report.

In addition to historical information, this Annual Report contains forward-looking statements that involve risks and uncertainties. Such forward-looking statements relate to future events and our operations, objectives, expectations, performance, financial condition and intentions. When used in this Annual Report, the words expect, intend, plan, believe, anticipate, estimate and variations of such words and similar expressions are intended to identify forward-looking statements. Forward-looking statements in this Annual Report include, in particular, statements regarding:

our ability to make cash distributions on our units or any increases in the quarterly distributions;

our future financial condition and results of operations and our future revenues and expenses;

global growth prospects of the LNG shipping and tanker markets;

LNG and tanker market fundamentals, including the balance of supply and demand in the LNG and tanker market;

the expected lifespan of a new LNG carrier and Suezmax tanker;

planned and estimated future capital expenditures and availability of capital resources to fund capital expenditures;

our ability to maintain long-term relationships with major LNG importers and exporters and major crude oil companies;

our ability to leverage to our advantage Teekay Shipping Corporation s relationships and reputation in the shipping industry;

our continued ability to enter into long-term, fixed-rate time charters with our LNG customers;

obtaining LNG projects that we or Teekay Shipping Corporation bid on or have been awarded;

our ability to maximize the use of our vessels, including the re-deployment or disposition of vessels no longer under long-term charter;

expected purchases and deliveries of newbuilding vessels and commencement of service of newbuildings under long-term contracts, including those relating to the RasGas II, RasGas 3 and Tangguh LNG projects;

the expected timing, amount and method of financing for the purchase of five of our existing Suezmax tankers;

our expected financial flexibility to pursue acquisitions and other expansion opportunities;

the expected cost of, and our ability to comply with, governmental regulations and maritime self-regulatory organization standards applicable to our business;

the expected impact of heightened environmental and quality concerns of insurance underwriters, regulators and charterers;

the anticipated taxation of our partnership and its subsidiaries;

entering into credit facilities or vessel financing arrangements or U.K lease arrangements for the RasGas II vessels, and the effects of such arrangements; and

our business strategy and other plans and objectives for future operations.

Forward-looking statements include, without limitation, any statement that may predict, forecast, indicate or imply future results, performance or achievements, and may contain the words believe, anticipate, expect, estimate, project, will be, will continue, will likely result, or words or phrases of similar meanings. These statements involve known and unknown risks and are based upon a number of assumptions and estimates that are inherently subject to significant uncertainties and contingencies, many of which are beyond our control. Actual results may differ materially from those expressed or implied by such forward-looking statements. Important factors that could cause actual results to differ materially include, but are not limited to: changes in production of LNG or oil; greater or less than anticipated levels of vessel newbuilding orders or greater or less than anticipated rates of vessel scrapping; changes in trading patterns; changes in applicable industry laws and regulations and the timing of implementation of new laws and regulations; LNG infrastructure constraints and community and environmental group resistance to new LNG infrastructure; potential development of an active short-term or spot LNG shipping market; potential inability to implement our growth strategy; competitive factors in the markets in which we operate; potential for early termination of long-term contracts and our potential inability to renew or replace long-term contracts; loss of any customer, time charter or vessel; shipyard production or vessel delivery delays; our potential inability to raise financing to purchase additional vessels; our exposure to currency exchange rate fluctuations; conditions in the public equity markets; and other factors detailed from time to time in our periodic reports.

Forward-looking statements in this Annual Report are necessarily estimates reflecting the judgment of senior management and involve known and unknown risks and uncertainties. These forward-looking statements are based upon a number of assumptions and estimates that are inherently subject to significant uncertainties and contingencies, many of which are beyond our control. Actual results may differ materially from those expressed or implied by such forward-looking statements. Accordingly, these forward-looking statements should, be considered in light of various important factors, including those set forth in this Annual Report under the heading Risk Factors .

We do not intend to revise any forward-looking statements in order to reflect any change in our expectations or events or circumstances that may subsequently arise. You should carefully review and consider the various disclosures included in this Annual Report and in our other filings made with the SEC that attempt to advise interested parties of the risks and factors that may affect our business, prospects and results of operations.

Item 1. Identity of Directors, Senior Management and Advisors

Not applicable.

Item 2. Offer Statistics and Expected Timetable

Not applicable.

Item 3. Key Information

Selected Financial Data

The following tables present, in each case for the periods and as of the dates indicated, summary:

historical financial and operating data of Teekay Shipping Spain S.L. and its subsidiaries (or *Teekay Spain*), which was named Naviera F. Tapias S.A. prior to its acquisition by Teekay Shipping Corporation through its subsidiary, Teekay Luxembourg S.a.r.l. (or *Luxco*), on April 30, 2004; and

historical financial and operating data of Teekay LNG Partners L.P. and its subsidiaries (sometimes referred to as the *Partnership, we* or *us*) since its initial public offering on May 10, 2005, in connection with which it acquired Luxco from Teekay Shipping Corporation.

The summary historical financial and operating data has been prepared on the following basis:

the historical financial and operating data of Teekay Spain excludes financial information related to three businesses previously held in separate subsidiaries and unrelated to the marine transportation of LNG and crude oil, which were disposed of prior to Teekay Shipping Corporation s acquisition of Teekay Spain;

the historical financial and operating data of Teekay Spain as at and for the year ended December 31, 2001 is derived from the unaudited consolidated financial statements of Teekay Spain;

the historical financial and operating data of Teekay Spain as at and for the years ended December 31, 2002 and 2003 and the four months ended April 30, 2004 are derived from the audited consolidated financial statements of Teekay Spain;

the historical financial and operating data of Luxco as at December 31, 2004 and for the eight months ended December 31, 2004 and the period from January 1, 2005 to May 9, 2005 reflect the acquisition of Teekay Spain by Teekay Shipping Corporation through Luxco and are derived from the audited consolidated financial statements of the Partnership; and

the historical financial and operating data of Teekay LNG Partners L.P. as at December 31, 2005 and for the period from May 10, 2005 to December 31, 2005 reflect its initial public offering and related acquisition of Luxco and are derived from the audited consolidated financial statements of the Partnership.

Our historical operating results include the historical results of Luxco for the nine months ended December 31, 2004 and the period from January 1, 2005 to May 9, 2005 (or the *2005 Pre-IPO Period*). During these periods, Luxco had no revenues, expenses or income, or assets or liabilities, other than:

advances (including accrued interest) of $465.7 million as of December 31, 2004, from Teekay Shipping Corporation that Luxco used to purchase Teekay Spain and to prepay certain debt of Teekay Spain;

net interest expense related to the advances of $9.8 million and $7.3 million for the nine months ended December 31, 2004 and for the 2005 Pre-IPO Period, respectively;

an unrealized foreign exchange loss of $44.7 million for the nine months ended December 31, 2004 related to the advances, which are Euro-denominated, and a $23.8 million unrealized foreign exchange gain related to the advances for the 2005 Pre-IPO Period;

other expenses of $1.1 million and $0.1 million for those respective periods;

cash and cash equivalents of $2.2 million as of December 31, 2004; and

its ownership interest in Teekay Spain and certain purchase rights and obligations for Suezmax tankers operated by Teekay Spain under capital lease arrangements, which it acquired from Teekay Spain on December 30, 2004.

Luxco s results relate solely to the financing of the acquisition of Teekay Spain and repayment of Teekay Spain debt by Teekay Shipping Corporation and do not relate to the historical results of Teekay Spain. In addition, because the capital stock of Luxco and the advances from Teekay Shipping Corporation were contributed to us in connection with our initial public offering, these advances and their related effects were eliminated on consolidation in the periods subsequent to May 9, 2005. Consequently, certain of our historical financial and operating data for 2005 Pre-IPO Period may not be comparable to subsequent periods.

The following tables should be read together with, and are qualified in their entirety by reference to, (a) "Item 5. Operating and Financial Review and Prospects," included herein, and (b) the historical consolidated financial statements and the accompanying notes and the Report of Independent Registered Public Accounting Firm therein, with respect to the consolidated financial statements for the years ended December 31, 2005, 2004 and 2003 aggregated as follows:

Year ended December 31, 2005

January 1 to May 9, 2005
May 10 to December 31, 2005

Year ended December 31, 2004

January 1 to April 30, 2004
May 1 to December 31, 2004

Year ended December 31, 2003

January 1 to December 31, 2003

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States.

	Years Ended December 31, 2001 (unaudited)	2002 (audited)	2003 (audited)	Years Ended Decemb 2004 January 1 to April 30, 2004 (audited)	May 1 to December 31, 2004 (audited)	Janua t May 20
	(in thousands, except per unit and flee					
Income Statement Data:						
Voyage revenues...............	$ 60,326	$ 59,866	$ 86,709	$ 40,718	$ 83,115	$ 50
Operating expenses:						
Voyage expenses (1)..........	5,092	5,334	4,911	1,842	3,090	
Vessel operating expenses (2).	12,403	16,104	26,440	10,302	20,315	10
Depreciation and amortization.	16,094	17,689	23,390	8,585	26,275	14

General and administrative	5,061	6,501	8,799	2,103	4,375	2
Total operating expenses	38,650	45,628	63,540	22,832	54,055	28
Income from vessel operations	21,676	14,238	23,169	17,886	29,060	21
Interest expense	(20,104)	(18,109)	(34,862)	(21,475)	(50,485)	(35
Interest income	3,752	5,248	8,431	8,692	13,519	9
Foreign currency exchange gain (loss) (3)	3,462	(44,310)	(71,502)	18,010	(78,831)	52
Interest rate swaps gain (loss)(4)	(7,618)	(71,400)	14,715	3,985	--	
Other income (loss) (5)	5,327	563	617	(10,934)	2,342	(17
Net income (loss) before change in accounting principle	6,495	(113,770)	(59,432)	16,164	(84,395)	29
Change in accounting principle(6)	(4,366)	--	--	--	--	
Net income (loss)	$ 2,129	$(113,770)	$ (59,432)	$ 16,164	$ (84,395)	$ 29
General partner's interest in net income	$ --	$ --	$ --	$ --	$ --	$
Limited partners' interest:						
Net income (loss)	2,129	(113,770)	(59,432)	16,164	(84,395)	29
Net income (loss) per:						
Common unit (basic and diluted) (7)	0.09	(4.85)	(2.53)	0.69	(3.60)	
Subordinated unit (basic and diluted) (7)	0.09	(4.85)	(2.53)	0.69	(3.60)	
Total unit (basic and diluted) (7)	0.09	(4.85)	(2.53)	0.69	(3.60)	
Cash distributions declared per unit	--	--	--	--	--	
Balance Sheet Data (at end of period):						
Cash and marketable securities	$ 24,625	$ 20,141	$ 22,533	$ 11,289	$ 156,410	
Restricted cash deposits (8)	70,051	106,399	398,038	385,564	435,112	
Vessels and equipment (10)(11)	368,951	705,010	602,550	602,055	1,045,068	
Total assets (8)(10)	491,058	882,604	1,069,081	1,021,695	1,885,366	
Total debt and capital lease obligations (8)(9)	444,865	882,027	1,129,426	1,072,379	1,853,869	
Total debt related to newbuilding vessels to be acquired (11)	--	--	--	--	--	
Total stockholders'/partners' equity (deficit)	29,849	(106,105)	(164,809)	(144,186)	(123,002)	
Common units outstanding (7)	8,734,572	8,734,572	8,734,572	8,734,572	8,734,572	8,734
Subordinated units outstanding (7)	14,734,572	14,734,572	14,734,572	14,734,572	14,734,572	14,734
Cash Flow Data:						
Net cash provided by (used in):						
Operating activities	$ 24,770	$ 20,418	$ 18,318	$ 14,808	$ 10,268	$ 11
Financing activities	31,852	176,316	(277,616)	(25,846)	393,149	(159
Investing activities	(55,695)	(199,218)	262,766	901	(258,198)	19
Other Financial Data:						
Net voyage revenues (12)	$ 55,234	$ 54,532	$ 81,798	$ 38,876	$ 80,025	$ 49
EBITDA (13)	33,912	(81,056)	(6,578)	36,887	(20,187)	73
Capital expenditures:						
Expenditures for vessels and equipment	110,097	186,755	133,628	5,522	83,703	43

Expenditures for drydocking...	--	984	4,711	--	4,085
LNG Fleet Data:					
Calendar-ship-days (14)........	--	93	518	242	660
Average age of our fleet (in years at end of period)........	--	0.3	0.8	1.2	1.1
Vessels at end of period.......	--	1.0	2.0	2.0	4.0
Suezmax Fleet Data:					
Calendar-ship-days (14)........	2,085	2,190	2,190	726	1,134
Average age of our fleet (in years at end of period).......	4.3	5.3	6.3	6.6	3.2
Vessels at end of period.......	6.0	6.0	6.0	6.0	4.0

(1) Voyage expenses are all expenses unique to a particular voyage, including any bunker fuel expenses, port fees, cargo loading and unloading expenses, canal tolls, agency fees and commissions.

(2) Vessel operating expenses include crewing, repairs and maintenance, insurance, stores, lube oils and communication expenses.

(3) Substantially all of these foreign currency exchange gains and losses were unrealized and not settled in cash. Under U.S. accounting guidelines, all foreign currency-denominated monetary assets and liabilities, such as cash and cash equivalents, accounts receivable, restricted cash, accounts payable, long-term debt and capital lease obligations, are revalued and reported based on the prevailing exchange rate at the end of the period. Our primary source for the foreign currency gains and losses is our Euro-denominated term loans, which totaled 294.8 million Euros ($372.4 million) at December 31, 2003, 325.8 million Euros ($443.7 million) at December 31, 2004 and 318.5 million Euros ($377.4 million) at December 31, 2005, and Euro-denominated advances from Teekay Shipping Corporation, which totaled 341.9 million Euros ($465.7 million) at December 31, 2004.

(4) We have entered into interest rate swaps to hedge our interest rate risk from our floating-rate debt used to purchase our LNG carriers. These interest rate swaps were not designated as hedges under U.S. accounting guidelines until April 30, 2004. Consequently, the changes in the fair values of these swaps that occurred during periods prior to April 30, 2004 above have been recorded in earnings as interest rate swaps gain (loss) for those periods. Had these interest rate swaps been designated as hedges prior to 2003, any subsequent changes in fair value would have been recognized in accumulated other comprehensive income (loss) to the extent the hedge was effective and until the hedged item was recognized as income.

(5) The $10.9 million other loss in the four months ended April 30, 2004 primarily resulted from a $11.9 million loss on the sale of non-shipping assets by Teekay Spain prior to its April 30, 2004 acquisition by Teekay Shipping Corporation. The $17.9 million other loss in the period from January 1, 2005 to May 9, 2005 primarily resulted from a write-off of capitalized loan costs and a loss on cancellation of interest rate swaps.

(6) In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133 (or *SFAS 133*), Accounting for Derivative Instruments and Hedging Activities, which establishes new standards for recording derivatives in interim and annual financial statements. We adopted SFAS 133 on January 1, 2001. We recognized the fair value of our derivatives as liabilities of $4.4 million on our consolidated balance sheet as of January 1, 2001. This amount was recorded as a change in accounting principle in our consolidated statement of income for the year ended December 31, 2001.

(7) Net income (loss) per unit is determined by dividing net income (loss), after deducting the amount of net income (loss) allocated to our general partner s interest from the issuance date of the units of May 10, 2005, by the weighted average number of units outstanding during the period. For periods prior to May 10, 2005, such units are deemed equal to the common and subordinated units received by Teekay Shipping Corporation in exchange for net assets contributed to us.

(8) We operate two of our LNG carriers under Spanish tax lease arrangements. Under these arrangements, we borrow under term loans and deposit the proceeds into restricted cash accounts. Concurrently, we enter into capital leases for the vessels, and the vessels are recorded as assets on our balance sheet. The restricted cash deposits, plus the interest earned on the deposits, will equal the remaining amounts we owe under the capital lease arrangements, including our obligations to purchase the vessels at the end of the lease term. Therefore,

the payments under our capital leases are fully funded through our restricted cash deposits, and our continuing obligation is the repayment of the term loans. However, under GAAP we record both the obligations under the capital leases and the term loans as liabilities, and both the restricted cash deposits and our vessels under capital leases as assets. This accounting treatment has the effect of overstating our assets and liabilities by the amount of restricted cash deposits relating to the corresponding capital lease obligations. As at December 31, 2004 and December 31, 2005, our total assets and total debt each included $413.3 million and $289.1 million, respectively, of such amount.

(9) As at December 31, 2004, total debt and capital lease obligations included advances and accrued interest of $465.7 million from Teekay Shipping Corporation that Luxco used to purchase Teekay Spain and to prepay certain debt of Teekay Spain. Because the advances from Teekay Shipping Corporation were contributed to us in connection with our initial public offering, these advances were eliminated on consolidation in the periods subsequent to May 9, 2005.

(10) Vessels and equipment consist of (a) our vessels, at cost less accumulated depreciation, (b) vessels under capital leases, at cost less accumulated depreciation, and (c) advances on our newbuildings.

(11) During May 2005, we entered into an agreement with Teekay Shipping Corporation to purchase its 70% interest in Teekay Nakilat Corporation (or *Teekay Nakilat*), which owns three LNG newbuildings and the related 20-year time charters. Qatar Gas Transport Company Ltd. (Nakilat) owns the remaining 30% interest in Teekay Nakilat. The purchase will occur upon the delivery of the first newbuilding, which is scheduled during the fourth quarter of 2006. As a result of this agreement, under current U.S. accounting guidelines we are required to consolidate Teekay Nakilat even though we do not yet have an ownership interest in Teekay Nakilat. As at December 31, 2005, the assets of Teekay Nakilat included three LNG newbuildings, which had a carrying value of $316.9 million, and other assets of $2.7 million. These assets have been financed with $205.9 of term loans and $113.7 million of loans from Teekay Shipping Corporation and Qatar Gas Transport Company Ltd. (Nakilat).

(12) Consistent with general practice in the shipping industry, we use net voyage revenues (defined as voyage revenues less voyage expenses) as a measure of equating revenues generated from voyage charters to revenues generated from time charters, which assists us in making operating decisions about the deployment of our vessels and their performance. Under time charters the charterer pays the voyage expenses, whereas under voyage charter contracts the ship owner pays these expenses. Some voyage expenses are fixed, and the remainder can be estimated. If we, as the ship owner, pay the voyage expenses, we typically pass the approximate amount of these expenses on to our customers by charging higher rates under the contract or billing the expenses to them. As a result, although voyage revenues from different types of contracts may vary, the net revenues after subtracting voyage expenses, which we call net voyage revenues, are comparable across the different types of contracts. We principally use net voyage revenues, a non-GAAP financial measure, because it provides more meaningful information to us than voyage revenues, the most directly comparable GAAP financial measure. Net voyage revenues are also widely used by investors and analysts in the shipping industry for comparing financial performance between companies and to industry averages. The following table reconciles net voyage revenues with voyage revenues.

					Years Ended December 3	
				2004		
				January 1 to	May 1 to	January 1 t
	Years Ended December 31,			April 30,	December 31,	May 9,
	2001	2002	2003	2004	2004	2005
	(unaudited)	(audited)		(audited)		(aud
Voyage revenues......	$ 60,326	$ 59,866	$ 86,709	$ 40,718	$ 83,115	$ 50,129
Voyage expenses......	(5,092)	(5,334)	(4,911)	(1,842)	(3,090)	(251)
Net voyage revenues..	$ 55,234	$ 54,532	$ 81,798	$ 38,876	$ 80,025	$ 49,878

(13) EBITDA is used as a supplemental financial measure by management and by external users of our financial statements, such as investors, as discussed below:

Financial and operating performance. EBITDA allows us to measure the financial and operating performance of our assets without regard to financing methods, capital structure or historical cost basis. For instance, our net income is affected by whether we finance assets or operations with debt or equity and by changing interest rates. Likewise, our net income is affected by how much we pay for an asset and that asset s depreciation or amortization schedule. By reviewing our earnings before the impact of interest, taxes, depreciation and amortization, we, our investors and others can understand the performance of our assets and operations on a more comparable basis from period to period and against the performance of other companies in our industry.

Liquidity. EBITDA allows us to assess the ability of our assets to generate cash sufficient to service debt, make distributions to our unitholders and undertake capital expenditures. For example, reviewing our earnings before the impact of non-cash depreciation and amortization charges, and before the payment of interest on debt we incur, provides us an understanding of how much cash is available to pay interest.

EBITDA should not be considered an alternative to net income, operating income, cash flow from operating activities or any other measure of financial performance or liquidity presented in accordance with GAAP. EBITDA excludes some, but not all, items that affect net income and operating income, and these measures may vary among other companies. Therefore, EBITDA as presented below may not be comparable to similarly titled measures of other companies.

	Years Ended December 31,			Years Ended December		
				2004		
	2001	2002	2003	January 1 to April 30, 2004	May 1 to December 31, 2004	January May 9 2005
	(unaudited)	(audited)		(audited)		
Reconciliation of "EBITDA" to "Net income (loss)":						
Net income (loss).......	$ 2,129	$(113,770)	$(59,432)	$ 16,164	$ (84,395)	$ 29,2
Depreciation and amortization..........	16,094	17,689	23,390	8,585	26,275	14,7
Interest expense, net...	16,352	12,861	26,431	12,783	36,966	26,5
Provision (benefit) for income taxes......	(663)	2,164	3,033	(645)	967	2,6
EBITDA.................	$ 33,912	$ (81,056)	$ (6,578)	$ 36,887	$ (20,187)	$ 73,1
Reconciliation of "EBITDA" to "Net operating cash flow":						
Net operating cash flow.	$ 24,470	$ 20,418	$ 18,318	$ 14,808	$ 10,268	$ 11,8
Expenditures for drydocking...........	--	984	4,711	--	4,085	
Interest expense, net...	16,352	12,861	26,431	12,783	36,966	26,5
Gain(loss) on sale of assets................	2,661	490	1,576	(11,837)	3,428	(15,2
Change in working capital...............	(846)	(253)	(237)	(911)	(7,719)	(
Interest rate swaps gain(loss) and change in accounting principle............	(11,984)	(71,400)	14,715	3,985	--	
Foreign currency exchange gain (loss)						

and other, net........	3,259	(44,156)	(72,093)	18,059	(67,215)	50,1
EBITDA.................	$ 33,912	$ (81,056)	$ (6,578)	$ 36,887	$ (20,187)	$ 73,1

EBITDA includes our foreign currency exchange and interest rate swap gains and losses, substantially all of which were unrealized, as follows:

	Years Ended December 31,			Years Ended December		
				2004		
				January 1 to April 30,	May 1 to December 31,	January May 9
	2001	2002	2003	2004	2004	2005
	(unaudited)	(audited)		(audited)		(
Foreign currency exchange gain (loss)..	$ 3,462	$ (44,310)	$ (71,502)	$ 18,010	$ (78,831)	$ 52,2
Interest rate swaps gain (loss)...........	(7,618)	(71,400)	14,715	3,985	--	
	$ (4,156)	$(115,710)	$ (56,787)	$ 21,995	$ (78,831)	$ 52,2

(14) Calendar-ship-days are equal to the aggregate number of calendar days in a period that our vessels were in our possession during that period.

Risk Factors

We may not have sufficient cash from operations to enable us to pay the minimum quarterly distribution on our common units following the establishment of cash reserves and payment of fees and expenses.

We may not have sufficient cash available each quarter to pay the minimum quarterly distribution. The amount of cash we can distribute on our common units principally depends upon the amount of cash we generate from our operations, which may fluctuate based on, among other things:

- the rates we obtain from our charters;
- the level of our operating costs, such as the cost of crews and insurance;
- the continued availability of LNG production, liquefaction and regasification facilities;
- the number of unscheduled off-hire days for our fleet and the timing of, and number of days required for, scheduled drydocking of our vessels;
- delays in the delivery of newbuildings and the beginning of payments under charters relating to those vessels;
- prevailing global and regional economic and political conditions;
- currency exchange rate fluctuations; and
- the effect of governmental regulations and maritime self-regulatory organization standards on the conduct of our business.

The actual amount of cash we will have available for distribution also will depend on factors such as:

- the level of capital expenditures we make, including for maintaining vessels, building new vessels, acquiring existing vessels and complying with regulations;
- our debt service requirements and restrictions on distributions contained in our debt instruments;
- fluctuations in our working capital needs;
- our ability to make working capital borrowings, including to pay distributions to unitholders; and
- the amount of any cash reserves, including reserves for future capital expenditures and other matters, established by our general partner in its discretion.

The amount of cash we generate from our operations may differ materially from our profit or loss for the period, which will be affected by non-cash items. As a result of this and the other factors mentioned above, we may make cash distributions during periods when we record losses and may not make cash distributions during periods when we record net income.

We make substantial capital expenditures to maintain the operating capacity of our fleet, which reduce our cash available for distribution. In addition, each quarter our general partner is required to deduct estimated maintenance capital expenditures from operating surplus, which may result in less cash available to unitholders than if actual maintenance capital expenditures were deducted.

We must make substantial capital expenditures to maintain, over the long term, the operating capacity of our fleet. These maintenance capital expenditures include capital expenditures associated with drydocking a vessel, modifying an existing vessel or acquiring a new vessel to the extent these expenditures are incurred to maintain the operating capacity of our fleet. These expenditures could increase as a result of changes in:

- the cost of labor and materials;
- customer requirements;
- increases in the size of our fleet;
- governmental regulations and maritime self-regulatory organization standards relating to safety, security or the environment; and
- competitive standards.

Our significant maintenance capital expenditures will reduce the amount of cash we have available for distribution to our unitholders.

In addition, our actual maintenance capital expenditures vary significantly from quarter to quarter based on, among other things, the number of vessels drydocked during that quarter. Our partnership agreement requires our general partner to deduct estimated, rather than actual, maintenance capital expenditures from operating surplus each quarter in an effort to reduce fluctuations in operating surplus. The amount of estimated maintenance capital expenditures deducted from operating surplus is subject to review and change by the conflicts committee at least once a year. In years when estimated maintenance capital expenditures are higher than actual maintenance capital expenditures as we expect will be the case in the years we are not required to make expenditures for mandatory drydockings the amount of cash available for distribution to unitholders will be lower than if actual maintenance capital expenditures were deducted from operating surplus. If our general partner underestimates the appropriate level of estimated maintenance capital expenditures, we may have less cash available for distribution in future periods when actual capital expenditures begin to exceed our previous estimates.

We will be required to make substantial capital expenditures to expand the size of our fleet. We generally will be required to make significant installment payments for acquisitions of newbuilding vessels prior to their delivery and generation of revenue. Depending on whether we finance our expenditures through cash from operations or by issuing debt or equity securities, our ability to make cash distributions may be diminished or our financial leverage could increase or our unitholders could be diluted.

We intend to make substantial capital expenditures to increase the size of our fleet, particularly the number of LNG carriers we own.

We have agreed to purchase from Teekay Shipping Corporation its 70% interest in Teekay Nakilat, which owns three LNG newbuildings and related long-term, fixed-rate time charters, for an estimated purchase price of approximately $53.0 million, plus the assumption of approximately $327.7 million of long-term debt. This purchase will take place in connection with the delivery of the first newbuilding scheduled for the fourth quarter of 2006.

In addition, we are obligated to purchase five of our existing Suezmax tankers upon the termination of the related capital leases, which will occur at various times from 2007 to 2011, seven years from the respective commencement dates of the capital leases. The purchase price will be based on the unamortized portion of the vessel construction financing costs for the vessels, which we expect to range from $39.4 million to $41.9 million per vessel, which we expect to accomplish by assuming the existing vessel financing.

We and Teekay Shipping Corporation regularly evaluate and pursue opportunities to provide the marine transportation requirements for new or expanding LNG projects. Teekay Shipping Corporation currently has submitted bids to provide transportation solutions for LNG projects and we and Teekay Shipping Corporation may submit additional bids from time to time. The award process relating to LNG transportation opportunities typically involves various stages and takes several months to complete. The award process for some of the projects upon which Teekay Shipping Corporation has bid are in advanced stages. Neither we nor Teekay Shipping Corporation may be awarded charters relating to any of the projects we or it pursues. If any LNG project charters are awarded to Teekay Shipping Corporation, it must offer them to us pursuant to the terms of the omnibus agreement. In July and August 2005, Teekay Shipping Corporation announced the awards to it of a 70% interest in two LNG carriers and related long-term, fixed-rate time charters to service the Tangguh LNG project in Indonesia and a 40% interest in four LNG carriers and related long-term, fixed-rate time charters to service an LNG project in Qatar. In connection with these awards, Teekay Shipping Corporation has (a) exercised shipbuilding options to construct two 155,000 cubic meter LNG carriers at a total delivered cost of approximately $450 million, which vessels are scheduled to deliver in late 2008 and early 2009, respectively, and (b) entered into agreements to construct four 217,000 cubic meter LNG carriers at a total delivered cost of approximately $1.1 billion, which vessels are scheduled to deliver in the first half of 2008.

If we elect pursuant to the omnibus agreement to obtain Teekay Shipping Corporation s interests in either or both of these LNG projects or any other projects Teekay Shipping Corporation may be awarded, or if we bid on and are awarded contracts relating to any LNG project, we will need to incur significant capital expenditures to buy Teekay Shipping Corporation s interest in these LNG projects or to build the LNG carriers.

To fund the remaining portion of these and other capital expenditures, we will be required to use cash from operations or incur borrowings or raise capital through the sale of debt or additional equity securities. Use of cash from operations will reduce cash available for distributions to unitholders. Our ability to obtain bank financing or to access the capital markets for future offerings may be limited by our financial condition at the time of any such financing or offering as well as by adverse market conditions resulting from, among other things, general economic conditions and contingencies and uncertainties that are beyond our control. Our failure to obtain the funds for necessary future capital expenditures could have a material adverse effect on our business, results of operations and financial condition and on our ability to make cash distributions. Even if we are successful in obtaining necessary funds, the terms of such financings could limit our ability to pay cash distributions to unitholders. In addition, incurring additional debt may significantly increase our interest expense and financial leverage, and issuing additional equity securities may result in significant unitholder dilution and would increase the aggregate amount of cash required to meet our minimum quarterly distribution to unitholders, which could have a material adverse effect on our ability to make cash distributions.

If we were unable to obtain financing required to complete payments on any future newbuilding orders, we could effectively forfeit all or a portion of the progress payments previously made.

Our substantial debt levels may limit our flexibility in obtaining additional financing and in pursuing other business opportunities.

As of December 31, 2005, our consolidated debt, capital lease obligations and debt related to newbuilding vessels to be acquired totaled $1.2 billion. In addition, we have the capacity to borrow additional amounts under our credit facilities. During December 2005, we entered into a $137.5 million nine-year revolving credit facility, which became available to us in January 2006. These facilities may be used by us for general partnership purposes. If we are awarded contracts for new LNG projects, our consolidated debt and capital lease obligations will increase, perhaps significantly. We will continue to have the ability to incur additional debt, subject to limitations in our credit facilities. Our level of debt could have important consequences to us, including the following:

- our ability to obtain additional financing, if necessary, for working capital, capital expenditures, acquisitions or other purposes may be impaired or such financing may not be available on favorable terms;

we will need a substantial portion of our cash flow to make principal and interest payments on our debt, reducing the funds that would otherwise be available for operations, future business opportunities and distributions to unitholders;

our debt level will make us more vulnerable than our competitors with less debt to competitive pressures or a downturn in our business or the economy generally; and

our debt level may limit our flexibility in responding to changing business and economic conditions.

Our ability to service our debt will depend upon, among other things, our future financial and operating performance, which will be affected by prevailing economic conditions and financial, business, regulatory and other factors, some of which are beyond our control. If our operating results are not sufficient to service our current or future indebtedness, we will be forced to take actions such as reducing distributions, reducing or delaying our business activities, acquisitions, investments or capital expenditures, selling assets, restructuring or refinancing our debt, or seeking additional equity capital or bankruptcy protection. We may not be able to affect any of these remedies on satisfactory terms, or at all.

We derive a substantial majority of our revenues from a limited number of customers, and the loss of any customer, time charter or vessel could result in a significant loss of revenues and cash flow.

We have derived, and believe that we will continue to derive, a significant portion of our revenues and cash flow from a limited number of customers. Compania Espanola de Petroleos, S.A. (or *CEPSA)*, an international oil company, accounted for approximately 47%, 36% and 30% of our revenues during 2003, 2004 and 2005, respectively. In addition, two other customers, Spanish energy companies Repsol YPF, S.A. and Gas Natural SDG, S.A., accounted for 26% and 11% of our revenues in 2003, 18% and 21% of our revenues in 2004 and 33% and 18% of our revenues in 2005, respectively. In addition, Unión Fenosa Gas, S.A. accounted for 16% of our revenues in 2005. Collectively, CEPSA, Repsol YPF, S.A. and Gas Natural SDG, S.A. accounted for approximately 84% and 75% of our revenues during 2003 and 2004, respectively, and, together with Unión Fenosa Gas, S.A., 97% of our revenues in 2005. No other customer accounted for 10% or more of our revenues during any of these periods. As a result of our acquisition of the three Suezmax tankers (or the *ConocoPhillips Tankers*) from Teekay Shipping Corporation upon the closing of our follow-on pubic offering on November 23, 2005, we will derive a significant portion of our revenues in 2006 from a ConocoPhillips subsidiary, the customer under the related time charter contracts. Likewise, Ras Laffan Liquefied Natural Gas Co. Limited (II) (or *RasGas II*) will be a significant customer following the delivery in 2006 and 2007 of the three LNG newbuildings we have agreed to purchase from Teekay Shipping Corporation and commencement of payments by RasGas II under the related time charters.

We could lose a customer or the benefits of a time charter if:

the customer fails to make charter payments because of its financial inability, disagreements with us or otherwise;

the customer exercises certain rights to terminate the charter, purchase or cause the sale of the vessel or, under some of our charters, convert the time charter to a bareboat charter (some of which rights are exercisable at any time);

the customer terminates the charter because we fail to deliver the vessel within a fixed period of time, the vessel is lost or damaged beyond repair, there are serious deficiencies in the vessel or prolonged periods of off-hire, or we default under the charter; or

under some of our time charters, the customer terminates the charter because of the termination of the charterer s LNG sales agreement supplying the LNG designated for our services, or a prolonged force majeure event affecting the customer, including damage to or destruction of relevant LNG production or regasification facilities, war or political unrest preventing us from performing services for that customer.

If we lose a key LNG time charter, we may be unable to re-deploy the related vessel on terms as favorable to us due to the long-term nature of most LNG time charters and the lack of an established LNG spot market. If we are unable to re-deploy an LNG carrier, we will not receive any revenues from that vessel, but we may be required to pay expenses necessary to maintain the vessel in proper operating condition. In addition, if a customer exercises its right to purchase a vessel, we would not receive any further revenue from the vessel and may be unable to obtain a substitute vessel and charter. This may cause us to receive decreased revenue and cash flows from having fewer vessels operating in our fleet.

Any compensation under our charters for a purchase of the vessels may not adequately compensate us for the loss of the vessel and related time charter.

If we lose a key Suezmax tanker customer, we may be unable to obtain other long-term Suezmax charters and may become subject to the volatile spot market, which is highly competitive and subject to significant price fluctuations. If a customer exercises its right under some charters to purchase or force a sale of the vessel, we may be unable to acquire an adequate replacement vessel or may be forced to construct a new vessel. Any replacement newbuilding would not generate revenues during its construction and we may be unable to charter any replacement vessel on terms as favorable to us as those of the terminated charter.

The loss of any of our customers, time charters or vessels, or a decline in payments under our charters, could have a material adverse effect on our business, results of operations and financial condition and our ability to make cash distributions.

We depend on Teekay Shipping Corporation to assist us in operating our business, competing in our markets, and providing interim financing for certain vessel acquisitions.

Pursuant to certain services agreements between us and certain of our operating subsidiaries, on the one hand, and certain subsidiaries of Teekay Shipping Corporation, on the other hand, the Teekay Shipping Corporation subsidiaries provide to us administrative services and to our operating subsidiaries significant operational services (including vessel maintenance, crewing for some of our vessels, purchasing, shipyard supervision, insurance and financial services) and other technical, advisory and administrative services. Our operational success and ability to execute our growth strategy depend significantly upon Teekay Shipping Corporation s satisfactory performance of these services. Our business will be harmed if Teekay Shipping Corporation fails to perform these services satisfactorily or if Teekay Shipping Corporation stops providing these services to us.

Our ability to compete for the transportation requirements of LNG projects and to enter into new time charters and expand our customer relationships depends largely on our ability to leverage our relationship with Teekay Shipping Corporation and its reputation and relationships in the shipping industry. If Teekay Shipping Corporation suffers material damage to its reputation or relationships it may harm our ability to:

- renew existing charters upon their expiration;
- obtain new charters;
- successfully interact with shipyards during periods of shipyard construction constraints;
- obtain financing on commercially acceptable terms; or
- maintain satisfactory relationships with our employees and suppliers.

If our ability to do any of the things described above is impaired, it could have a material adverse effect on our business, results of operations and financial condition and our ability to make cash distributions.

Teekay Shipping Corporation is also incurring all costs for the construction and delivery of the three RasGas II LNG newbuildings, which we refer to as warehousing. Upon their delivery, we will purchase all of the interest of Teekay Shipping Corporation in the vessels at a price that will reimburse Teekay Shipping Corporation for these costs and compensate it for its average weighted cost of capital on the construction payments. We may enter into similar arrangements with Teekay Shipping Corporation in the future. If Teekay Shipping Corporation fails to make construction payments for the RasGas II newbuildings or other vessels that Teekay Shipping Corporation warehouses for us, we could lose access to the vessels as a result of the default or we may need to finance these vessels before they begin operating and generating voyage revenues, which could harm our business and reduce our ability to make cash distributions.

Our growth depends on continued growth in demand for LNG and LNG shipping.

Our growth strategy focuses on continued expansion in the LNG shipping sector. Accordingly, our growth depends on continued growth in world and regional demand for LNG and LNG shipping, which could be negatively affected by a number of factors, such as:

- increases in the cost of natural gas derived from LNG relative to the cost of natural gas generally;

- increases in the production of natural gas in areas linked by pipelines to consuming areas, the extension of existing, or the development of new, pipeline systems in markets we may serve, or the conversion of existing non-natural gas pipelines to natural gas pipelines in those markets;
- decreases in the consumption of natural gas due to increases in its price relative to other energy sources or other factors making consumption of natural gas less attractive;
- availability of new, alternative energy sources, including compressed natural gas; and
- negative global or regional economic or political conditions, particularly in LNG consuming regions, which could reduce energy consumption or its growth.

Reduced demand for LNG and LNG shipping would have a material adverse effect on our future growth and could harm our business, results of operations and financial condition.

Growth of the LNG market may be limited by infrastructure constraints and community environmental group resistance to new LNG infrastructure over concerns about the environment, safety and terrorism.

A complete LNG project includes production, liquefaction, regasification, storage and distribution facilities and LNG carriers. Existing LNG projects and infrastructure are limited, and new or expanded LNG projects are highly complex and capital-intensive, with new projects often costing several billion dollars. Many factors could negatively affect continued development of LNG infrastructure or disrupt the supply of LNG, including:

- increases in interest rates or other events that may affect the availability of sufficient financing for LNG projects on commercially reasonable terms;
- decreases in the price of LNG, which might decrease the expected returns relating to investments in LNG projects;
- the inability of project owners or operators to obtain governmental approvals to construct or operate LNG facilities;
- local community resistance to proposed or existing LNG facilities based on safety, environmental or security concerns;
- any significant explosion, spill or similar incident involving an LNG facility or LNG carrier;
- labor or political unrest affecting existing or proposed areas of LNG production; and
- capacity constraints at existing shipyards, which are expected to continue until at least the end of 2008.

If the LNG supply chain is disrupted or does not continue to grow, or if a significant LNG explosion, spill or similar incident occurs, it could have a material adverse effect on our business, results of operations and financial condition and our ability to make cash distributions.

Our growth depends on our ability to expand relationships with existing customers and obtain new customers, for which we will face substantial competition.

One of our principal objectives is to enter into additional long-term, fixed-rate LNG time charters. The process of obtaining new long-term LNG time charters is highly competitive and generally involves an intensive screening process and competitive bids, and often extends for several months. LNG shipping contracts are awarded based upon a variety of factors relating to the vessel operator, including:

- shipping industry relationships and reputation for customer service and safety;
- LNG shipping experience and quality of ship operations (including cost effectiveness);
- quality and experience of seafaring crew;
- the ability to finance LNG carriers at competitive rates and financial stability generally;
- relationships with shipyards and the ability to get suitable berths;
- construction management experience, including the ability to obtain on-time delivery of new vessels according to customer specifications;
- willingness to accept operational risks pursuant to the charter, such as allowing termination of the charter for force majeure events; and
- competitiveness of the bid in terms of overall price.

We compete for providing marine transportation services for potential LNG projects with a number of experienced companies, including state-sponsored entities and major energy companies affiliated with the LNG project requiring LNG shipping services. Many of these competitors have significantly greater financial resources than we do or Teekay Shipping Corporation does. We anticipate that an increasing number of marine transportation companies including many with strong reputations and extensive resources and experience will enter the LNG transportation sector. This increased competition may cause greater price competition for time charters. As a result of these factors, we may be unable to expand our relationships with existing customers or to obtain new customers on a profitable basis, if at all, which would have a material adverse effect on our business, results of operations and financial condition and our ability to make cash distributions.

Delays in deliveries of newbuildings could harm our operating results and lead to the termination of related time charters.

We have agreed to purchase Teekay Shipping Corporation s 70% interest in Teekay Nakilat, which owns the three RasGas II LNG newbuilding carriers, in connection with their deliveries scheduled for the fourth quarter of 2006 and the first half of 2007. The delivery of these vessels, or any other newbuildings we may order or otherwise acquire, could be delayed, which would delay our receipt of revenues under the time charters for the vessels. In addition, under some of our charters if our delivery of a vessel to our customer is delayed, we may be required to pay liquidated damages in amounts equal to or, under some charters, almost double, the hire rate during the delay. For prolonged delays, the customer may terminate the time charter and, in addition to the resulting loss of revenues, we may be responsible for additional, substantial liquidated damages.

Our receipt of newbuildings could be delayed because of:

- quality or engineering problems;
- changes in governmental regulations or maritime self-regulatory organization standards;
- work stoppages or other labor disturbances at the shipyard;
- bankruptcy or other financial crisis of the shipbuilder;
- a backlog of orders at the shipyard;
- political or economic disturbances in South Korea or other locations, where our vessels are being or may be built;
- weather interference or catastrophic event, such as a major earthquake or fire;
- our requests for changes to the original vessel specifications;

shortages of or delays in the receipt of necessary construction materials, such as steel;

our inability to finance the purchase of the vessels; or

our inability to obtain requisite permits or approvals.

If delivery of a vessel is materially delayed, it could adversely affect our results or operations and financial condition and our ability to make cash distributions.

We may have more difficulty entering into long-term, fixed-rate time charters if an active short-term or spot LNG shipping market develops.

LNG shipping historically has been transacted with long-term, fixed-rate time charters, usually with terms ranging from 20 to 25 years. One of our principal strategies is to enter into additional long-term, fixed-rate LNG time charters. However, the number of spot and short-term charters has been increasing, with LNG charters under 12 months in duration growing from less than 2% of the market in the late 1990s to almost 12% in 2004. For example, substantially all LNG shipped into the Lake Charles, Louisiana terminal in 2004 was shipped under short-term charters.

If an active spot or short-term market continues to develop, we may have increased difficulty entering into long-term, fixed-rate time charters for our LNG vessels and, as a result, our cash flow may decrease and be less stable. In addition, an active short-term or spot LNG market may require us to enter into charters based on changing market prices, as opposed to contracts based on a fixed rate, which could result in a decrease in our cash flow in periods when the market price for shipping LNG is depressed or insufficient funds are available to cover our financing costs for related vessels.

Over time, vessel values may fluctuate substantially and, if these values are lower at a time when we are attempting to disposeof a vessel, we may incur a loss.

Vessel values for LNG carriers and Suezmax oil tankers can fluctuate substantially over time due to a number of different factors, including:

prevailing economic conditions in natural gas, oil and energy markets;

a substantial or extended decline in demand for natural gas, LNG or oil;

increases in the supply of vessel capacity, and

the cost of retrofitting or modifying existing vessels, as a result of technological advances in vessel design or equipment, changes in applicable environmental or other regulation or standards, or otherwise.

If a charter terminates, we may be unable to re-deploy the vessel at attractive rates and, rather than continue to incur costs to maintain and finance it, may seek to dispose of it. Our inability to dispose of the vessel at a reasonable value could result in a loss on its sale and adversely affect our results of operations and financial condition.

We may be unable to make or realize expected benefits from acquisitions, and implementing our growth strategy through acquisitions may harm our business, financial condition and operating results.

Our growth strategy includes selectively acquiring existing LNG carriers or LNG shipping businesses. Historically, there have been very few purchases of existing vessels and businesses in the LNG shipping industry. Factors that may contribute to a limited number of acquisition opportunities in the LNG industry in the near term include the relatively small number of independent LNG fleet owners and the limited number of LNG carriers not subject to existing long-term charter contracts. In addition, competition from other companies could reduce our acquisition opportunities or cause us to pay higher prices.

Any acquisition of a vessel or business may not be profitable to us at or after the time we acquire it and may not generate cash flow sufficient to justify our investment. In addition, our acquisition growth strategy exposes us to risks that may harm our business, financial condition and operating results, including risks that we may:

- fail to realize anticipated benefits, such as new customer relationships, cost-savings or cash flow enhancements;
- be unable to hire, train or retain qualified shore and seafaring personnel to manage and operate our growing business and fleet;
- decrease our liquidity by using a significant portion of our available cash or borrowing capacity to finance acquisitions;
- significantly increase our interest expense or financial leverage if we incur additional debt to finance acquisitions;
- incur or assume unanticipated liabilities, losses or costs associated with the business or vessels acquired; or
- incur other significant charges, such as impairment of goodwill or other intangible assets, asset devaluation or restructuring charges.

Unlike newbuildings, existing vessels typically do not carry warranties as to their condition. While we generally inspect existing vessels prior to purchase, such an inspection would normally not provide us with as much knowledge of a vessel s condition as we would possess if it had been built for us and operated by us during its life. Repairs and maintenance costs for existing vessels are difficult to predict and may be substantially higher than for vessels we have operated since they were built. These costs could decrease our cash flow and reduce our liquidity.

Terrorist attacks, increased hostilities or war could lead to further economic instability, increased costs and disruption of our business.

Terrorist attacks, such as the attacks that occurred in the United States on September 11, 2001 and the bombings in Spain on March 11, 2004 and in England on July 7, 2005, and the current conflicts in Iraq and Afghanistan and other current and future conflicts, may adversely affect our business, operating results, financial condition, ability to raise capital and future growth. Continuing hostilities in the Middle East may lead to additional armed conflicts or to further acts of terrorism and civil disturbance in the United States, Spain or elsewhere, which may contribute further to economic instability and disruption of LNG and oil production and distribution, which could result in reduced demand for our services.

In addition, LNG and oil facilities, shipyards, vessels, pipelines and oil and gas fields could be targets of future terrorist attacks. Any such attacks could lead to, among other things, bodily injury or loss of life, vessel or other property damage, increased vessel operational costs, including insurance costs, and the inability to transport LNG, natural gas and oil to or from certain locations. Terrorist attacks, war or other events beyond our control that adversely affect the distribution, production or transportation of LNG or oil to be shipped by us could entitle our customers to terminate our charter contracts, which would harm our cash flow and our business.

Terrorist attacks, or the perception that LNG facilities and LNG carriers are potential terrorist targets, could materially and adversely affect expansion of LNG infrastructure and the continued supply of LNG to the United States and other countries. Concern that LNG facilities may be targeted for attack by terrorists has contributed to significant community and environmental resistance to the construction of a number of LNG facilities, primarily in North America. If a terrorist incident involving an LNG facility or LNG carrier did occur, in addition to the possible effects identified in the previous paragraph, the incident may adversely affect construction of additional LNG facilities in the United States and other countries or the temporary or permanent closing of various LNG facilities currently in operation.

Our substantial operations outside the United States expose us to political, governmental and economic instability, which could harm our operations.

Because our operations are primarily conducted outside of the United States, they may be affected by economic, political and governmental conditions in the countries where we are engaged in business or where our vessels are registered. Any disruption caused by these factors could harm our business. In particular, we derive a substantial portion of our revenues from shipping LNG and oil from politically unstable regions. Past political conflicts in these regions, particularly in the Arabian Gulf, have included attacks on ships, mining of waterways and other efforts to disrupt shipping in the area. In addition to acts of terrorism, vessels trading in this and other regions have also been subject, in limited instances, to piracy.

Future hostilities or other political instability in the Arabian Gulf or other regions where we operate or may operate could have a material adverse effect on the growth of our business, results of operations and financial condition and our ability to make cash distributions. In addition, tariffs, trade embargoes and other economic sanctions by Spain, the United States or other countries against countries in the Middle East, Southeast Asia or elsewhere as a result of terrorist attacks, hostilities or otherwise may limit trading activities with those countries, which could also harm our business and ability to make cash distributions.

Marine transportation is inherently risky, and an incident involving significant loss of or environmental contamination by any of our vessels could harm our reputation and business.

Our vessels and their cargoes are at risk of being damaged or lost because of events such as:

- marine disasters;
- bad weather;
- mechanical failures;
- grounding, fire, explosions and collisions;
- piracy;
- human error; and
- war and terrorism.

An accident involving any of our vessels could result in any of the following:

- death or injury to persons, loss of property or environmental damage;
- delays in the delivery of cargo;
- loss of revenues from or termination of charter contracts;
- governmental fines, penalties or restrictions on conducting business;
- higher insurance rates; and
- damage to our reputation and customer relationships generally.

Any of these results could have a material adverse effect on our business, financial condition and operating results.

Our insurance may be insufficient to cover losses that may occur to our property or result from our operations.

The operation of LNG carriers and oil tankers is inherently risky. Although we carry hull and machinery (marine and war risks) and protection and indemnity insurance, all risks may not be adequately insured against, and any particular claim may not be paid. In addition, we do not carry insurance on our oil tankers covering the loss of revenues resulting from vessel off-hire time based on its cost compared to our off-hire experience. Commencing January 1, 2006, Teekay Shipping Corporation began providing off-hire insurance for our LNG carriers. Any claims covered by insurance would be subject to deductibles, and since it is possible that a large number of claims may be brought, the aggregate amount of these deductibles could be material. Certain of our insurance coverage is maintained through mutual protection and indemnity associations, and as a member of such associations we may be required to make additional payments over and above budgeted premiums if member claims exceed association reserves.

We may be unable to procure adequate insurance coverage at commercially reasonable rates in the future. For example, more stringent environmental regulations have led in the past to increased costs for, and in the future may result in the lack of availability of, insurance against risks of environmental damage or pollution. A catastrophic oil spill or marine disaster could result in losses that exceed our insurance coverage, which could harm our business, financial condition and operating results. Any uninsured or underinsured loss could harm our business and financial condition. In addition, our insurance may be voidable by the insurers as a result of certain of our actions, such as our ships failing to maintain certification with applicable maritime self-regulatory organizations.

Changes in the insurance markets attributable to terrorist attacks may also make certain types of insurance more difficult for us to obtain. In addition, the insurance that may be available may be significantly more expensive than our existing coverage.

The marine energy transportation industry is subject to substantial environmental and other regulations, which may significantly limit our operations or increase our expenses.

Our operations are affected by extensive and changing environmental protection laws and other regulations and international conventions. We have incurred, and expect to continue to incur, substantial expenses in complying with these laws and regulations, including expenses for vessel modifications and changes in operating procedures. Additional laws and regulations may be adopted that could limit our ability to do business or further increase our costs. In addition, failure to comply with applicable laws and regulations may result in administrative and civil penalties, criminal sanctions or the suspension or termination of our operations.

The United States Oil Pollution Act of 1990 (or *OPA 90*), for instance, increased expenses for us and others in our industry. OPA 90 provides for potentially unlimited joint, several and strict liability for owners, operators and demise or bareboat charterers for oil pollution and related damages in U.S. waters, which include the U.S. territorial sea and the 200-nautical mile exclusive economic zone around the United States. OPA 90 applies to discharges of any oil from a vessel, including discharges of oil tanker cargoes and discharges of fuel and lubricants from an oil tanker or LNG carrier. To comply with OPA 90, vessel owners generally incur increased costs in meeting additional maintenance and inspection requirements, in developing contingency arrangements for potential spills and in obtaining required insurance coverage. OPA 90 requires vessel owners and operators of vessels operating in U.S. waters to establish and maintain with the U.S. Coast Guard evidence of insurance or of qualification as a self-insurer or other acceptable evidence of financial responsibility sufficient to meet certain potential liabilities under OPA 90 and the U.S. Comprehensive Environmental Response, Compensation, and Liability Act (or *CERCLA*), which imposes similar liabilities upon owners, operators and bareboat charterers of vessels from which a discharge of hazardous substances (other than oil) occurs. While LNG should not be considered a hazardous substance under CERCLA, additives to fuel oil or lubricants used on LNG carriers might fall within its scope. Under OPA 90 and CERCLA, owners, operators and bareboat charterers are jointly, severally and strictly liable for costs of cleanup and damages resulting from a discharge or threatened discharge within U.S. waters. This means we may be subject to liability even if we are not negligent or at fault.

Most states in the United States bordering on a navigable waterway have enacted legislation providing for potentially unlimited strict liability without regard to fault for the discharge of pollutants within their waters. An oil spill or other event could result in significant liability, including fines, penalties, criminal liability and costs for natural resource damages. The potential for these releases could increase to the extent we increase our operations in U.S. waters.

OPA 90 and CERCLA do not preclude claimants from seeking damages for the discharge of oil and hazardous substances under other applicable law, including maritime tort law. Such claims could include attempts to characterize seaborne transportation of LNG as an ultra-hazardous activity, which attempts, if successful, would lead to our being strictly liable for damages resulting from that activity.

In addition, we believe that the heightened environmental, quality and security concerns of insurance underwriters, regulators and charterers will generally lead to additional regulatory requirements, including enhanced risk assessment and security requirements and greater inspection and safety requirements on all vessels in the LNG carrier and oil tanker markets.

Exposure to currency exchange rate fluctuations will result in fluctuations in our cash flows and operating results.

We are paid in Euros under some of our charters, and a majority of our vessel operating expenses and general and administrative expenses currently are denominated in Euros, which is primarily a function of the nationality of our crew and administrative staff. We also make payments under two Euro-denominated term loans. If the amount of our Euro-denominated obligations exceeds our Euro-denominated revenues, we must convert other currencies, primarily the U.S. Dollar, into Euros. An increase in the strength of the Euro relative to the U.S. Dollar would require us to convert more U.S. Dollars to Euros to satisfy those obligations, which would cause us to have less cash available for distribution. In addition, if we do not have sufficient U.S. Dollars, we may be required to convert Euros into U.S. Dollars for distributions to unitholders. An increase in the strength of the U.S. Dollar relative to the Euro could cause us to have less cash available for distribution in this circumstance. We have not entered into currency swaps or forward contracts or similar derivatives to mitigate this risk.

Because we report our operating results in U.S. Dollars, changes in the value of the U.S. Dollar relative to the Euro also result in fluctuations in our reported revenues and earnings. In addition, under U.S. accounting guidelines, all foreign currency-denominated monetary assets and liabilities such as cash and cash equivalents, accounts receivable, restricted cash, accounts payable, long-term debt and capital lease obligations are revalued and reported based on the prevailing exchange rate at the end of the period. This revaluation historically has caused us to report significant non-monetary foreign currency exchange gains or losses each period. The primary source for these gains and losses is our Euro-denominated term loans. In 2003 and 2004, we reported foreign currency exchange losses of $71.5 million and $60.8 million, respectively. In 2005, we reported a foreign currency exchange gain of $81.8 million.

Many of our seafaring employees are covered by collective bargaining agreements and the failure to renew those agreements or any future labor agreements may disrupt our operations and adversely affect our cash flows.

A significant portion of our seafarers, and the seafarers employed by Teekay Shipping Corporation and its other affiliates that crew our vessels, are employed under collective bargaining agreements, which expire at varying times through 2008. The collective bargaining agreement for our Spanish Suezmax tanker crew members (covering five Suezmax tankers) expires at the end of 2008. We may be subject to similar labor agreements in the future. We may be subject to labor disruptions in the future if our relationships deteriorate with our seafarers or the unions that represent them. Our collective bargaining agreements may not prevent labor disruptions, particularly when the agreements are being renegotiated. Any labor disruptions could harm our operations and could have a material adverse effect on our business, results of operations and financial condition and our ability to make cash distributions.

Due to our lack of diversification, adverse developments in our LNG or oil marine transportation business could reduce our ability to make distributions to our unitholders.

We rely exclusively on the cash flow generated from our LNG carriers and Suezmax oil tankers that operate in the LNG and oil marine transportation business. Due to our lack of diversification, an adverse development in the LNG or oil shipping industry would have a significantly greater impact on our financial condition and results of operations than if we maintained more diverse assets or lines of business.

Teekay Shipping Corporation and its affiliates may engage in competition with us.

Teekay Shipping Corporation and its affiliates may engage in competition with us. Pursuant to the omnibus agreement, Teekay Shipping Corporation and its controlled affiliates (other than us and our subsidiaries) generally will agree not to own, operate or charter LNG carriers without the consent of our general partner. The omnibus agreement, however, allows Teekay Shipping Corporation or any of such controlled affiliates to:

- acquire LNG carriers and related time charters as part of a business if a majority of the value of the total assets or business acquired is not attributable to the LNG carriers and time charters, as determined in good faith by the board of directors of Teekay Shipping Corporation; however, if at any time Teekay Shipping Corporation completes such an acquisition, it must offer to sell the LNG carriers and related time charters to us for their fair market value plus any additional tax or other similar costs to Teekay Shipping Corporation that would be required to transfer the LNG carriers and time charters to us separately from the acquired business; or

- own, operate and charter LNG carriers that relate to a bid or award for a proposed LNG project that Teekay Shipping Corporation or any of its subsidiaries has submitted or hereafter submits or receives; however, at least 180 days prior to the scheduled delivery date of any such LNG carrier, Teekay Shipping Corporation must offer to sell the LNG carrier and related time charter to us, with the vessel valued at its fully-built-up cost, which represents the aggregate expenditures incurred (or to be incurred prior to delivery to us) by Teekay Shipping Corporation to acquire or construct and bring such LNG carrier to the condition and location necessary for our intended use.

If we decline the offer to purchase the LNG carriers and time charters described above, Teekay Shipping Corporation may own and operate the LNG carriers, but may not expand that portion of its business.

In addition, pursuant to the omnibus agreement, Teekay Shipping Corporation or any of its controlled affiliates (other than us and our subsidiaries) may:

- acquire, operate or charter LNG carriers if our general partner has previously advised Teekay Shipping Corporation that the board of directors of our general partner has elected, with the approval of its conflicts committee, not to cause us or our subsidiaries to acquire or operate the carriers;

- own and operate the three RasGas II LNG newbuilding carriers and related time charters if we fail to perform our obligation to purchase such vessels under our agreement with Teekay Shipping Corporation;

- acquire up to a 9.9% equity ownership, voting or profit participation interest in any publicly traded company that owns or operate LNG carriers; and

- provide ship management services relating to LNG carriers.

If there is a change of control of Teekay Shipping Corporation, the non-competition provisions of the omnibus agreement may terminate, which termination could have a material adverse effect on our business, results of operations and financial condition and our ability to make cash distributions.

Our general partner and its other affiliates have conflicts of interest and limited fiduciary duties, which may permit them to favor their own interests to those of unitholders.

Teekay Shipping Corporation, which owns and controls our general partner, indirectly owns the 2% general partner interest and currently owns a 65.8% limited partner interest in us. Conflicts of interest may arise between Teekay Shipping Corporation and its affiliates, including our general partner, on the one hand, and us and our unitholders, on the other hand. As a result of these conflicts, our general partner may favor its own interests and the interests of its affiliates over the interests of our unitholders. These conflicts include, among others, the following situations:

- neither our partnership agreement nor any other agreement requires our general partner or Teekay Shipping Corporation to pursue a business strategy that favors us or utilizes our assets, and Teekay Shipping Corporation s officers and directors have a fiduciary duty to make decisions in the best interests of the stockholders of Teekay Shipping Corporation, which may be contrary to our interests;

- the executive officers and three of the directors of our general partner also currently serve as executive officers or directors of Teekay Shipping Corporation and another director of our general partner is employed by an affiliate of Teekay Shipping Corporation;

- our general partner is allowed to take into account the interests of parties other than us, such as Teekay Shipping Corporation, in resolving conflicts of interest, which has the effect of limiting its fiduciary duty to our unitholders;

- our general partner has limited its liability and reduced its fiduciary duties under the laws of the Marshall Islands, while also restricting the remedies available to our unitholders, and as a result of purchasing common units, unitholders are treated as having agreed to the modified standard of fiduciary duties and to certain actions that may be taken by our general partner, all as set forth in the partnership agreement;

- our general partner determines the amount and timing of asset purchases and sales, capital expenditures, borrowings, issuances of additional partnership securities and reserves, each of which can affect the amount of cash that is available for distribution to our unitholders;

- in some instances, our general partner may cause us to borrow funds in order to permit the payment of cash distributions, even if the purpose or effect of the borrowing is to make a distribution on the subordinated units or to make incentive distributions or to accelerate the expiration of the subordination period;

our general partner determines which costs incurred by it and its affiliates are reimbursable by us;

our partnership agreement does not restrict our general partner from causing us to pay it or its affiliates for any services rendered to us on terms that are fair and reasonable or entering into additional contractual arrangements with any of these entities on our behalf;

our general partner controls the enforcement of obligations owed to us by it and its affiliates; and

our general partner decides whether to retain separate counsel, accountants or others to perform services for us.

Item 4. Information on the Partnership

A. Overview, History and Development

Overview and History

We are an international provider of liquefied natural gas (or *LNG*) and crude oil marine transportation services. We were formed on November 3, 2004 by Teekay Shipping Corporation, the world s largest owner and operator of medium-sized crude oil tankers, to expand its operations in the LNG shipping sector. Our growth strategy focuses on expanding our fleet of LNG carriers under long-term, fixed-rate charters. We view our Suezmax tanker fleet primarily as a source of stable cash flow as we expand our LNG operations. We seek to leverage the expertise, relationships and reputation of Teekay Shipping Corporation and its affiliates to pursue growth opportunities in the LNG shipping sector. As of December 31, 2005, Teekay Shipping Corporation, which owned and controls our general partner, owned a 67.8% limited partner interest in us.

Our fleet, excluding newbuildings, currently consists of four LNG carriers and eight Suezmax class crude oil tankers, all of which are double-hulled. Our fleet is young, with an average age of approximately two years for our LNG carriers and approximately three years for our existing Suezmax tankers, compared to world averages of 12.6 years and 8.1 years, respectively, as of December 31, 2005.

These vessels operate under long-term, fixed-rate time charters with major energy and utility companies. The average remaining term for these charters is approximately 20 years for our LNG carriers and approximately 14 years for our Suezmax tankers, subject, in certain circumstances, to termination or vessel purchase rights.

Our fleet of existing LNG carriers currently has 557,000 cubic meters of total capacity, which will increase to approximately 1.0 million cubic meters by mid-2007 upon delivery of three RasGas II LNG newbuilding carriers described below. The aggregate capacity of our Suezmax tanker fleet is 1,252,700 deadweight tonnes.

Our original fleet was established by Naviera F. Tapias S.A. (or *Tapias*), a private Spanish company founded in 1991 to ship crude oil. Tapias began shipping LNG with the acquisition of its first LNG carrier in 2002. Teekay Shipping Corporation acquired Tapias in April 2004 and changed its name to Teekay Shipping Spain S.L. (or *Teekay Spain*). As part of the acquisition, Teekay Spain retained Tapias s senior management, including its chief executive officer, and other personnel, who continue to manage the day-to-day operations of Teekay Spain with input on strategic decisions from our general partner. Teekay Spain also obtains strategic consulting, advisory, ship management, technical and administrative services from affiliates of Teekay Shipping Corporation.

We were formed in connection with our initial public offering. Upon the closing of that offering on May 10, 2005, we acquired Teekay Spain, among other assets, and began operating as a publicly traded limited partnership.

We are incorporated under the laws of the Republic of The Marshall Islands as Teekay LNG Partners L.P. and maintain our principal executive headquarters at Bayside House, Bayside Executive Park, West Bay Street & Blake Road, P.O. Box AP-59212, Nassau, The Bahamas. Our telephone number at such address is (242) 502-8820.

Agreement to Purchase RasGas II Interest

We have agreed to acquire from Teekay Shipping Corporation its 70% interest in Teekay Nakilat, which owns three 151,700 cubic meter, double-hulled LNG newbuilding carriers. We expect to take delivery of these LNG newbuildings during the fourth quarter of 2006 and the first half of 2007. Upon their deliveries, the vessels will provide transportation services under 20-year, fixed-rate time charters to RasGas II, a joint venture between Qatar Petroleum and ExxonMobil RasGas Inc., a subsidiary of ExxonMobil Corporation, established for the purpose of expanding LNG production in Qatar.

During January 2006, Teekay Shipping Corporation completed a 30-year U.K. lease arrangement that will be used to finance the purchase of the three RasGas II LNG newbuilding carriers owned by Teekay Nakilat. The tax benefits of this lease arrangement are expected to reduce the equity portion of our purchase of Teekay Shipping Corporation s 70% interest in Teekay Nakilat by approximately $40 million, from approximately $93 million to approximately $53 million. We also expect to assume approximately $328 million of long-term debt as part of this purchase.

Potential Additional LNG Projects

We have the contractual right to acquire from Teekay Shipping Corporation its interest in LNG projects it is awarded. These include the following projects that were awarded to Teekay Shipping Corporation in July and August 2005:

> *Tangguh LNG Project.* Corporation has been awarded a 70% interest in two LNG carriers and related 20-year, fixed-rate time charters to service the Tangguh LNG project in Indonesia. The customer will be The Tangguh Production Sharing Contractors, a consortium led by BP Berau Ltd., a subsidiary of BP plc. Teekay Shipping Corporation has contracted to construct two double-hulled LNG carriers of 155,000 cubic meters each at a total delivered cost of approximately $450 million. Teekay Shipping Corporation will finance its 70% share of such amount. The charters will commence upon vessel deliveries, which are scheduled for late 2008 and early 2009. Teekay Shipping Corporation will have operational responsibility for the vessels in this project. The remaining 30% interest in the project is held by BLT LNG Tangguh Corporation, a subsidiary of PT Berlian Laju Tanker Tbk.

> *RasGas 3 LNG Project*. Teekay Shipping Corporation has been awarded a 40% interest in four LNG carriers and related 25-year, fixed-rate time charters (with options to extend up to an additional 10 years) to service expansion of the LNG project in Qatar. The customer will be Ras Laffan Liquefied Natural Gas Co. Limited (3), a joint venture company between Qatar Petroleum and a subsidiary of ExxonMobil Corporation. Teekay Shipping Corporation has contracted to construct four double-hulled LNG carriers of 217,000 cubic meters each at a total delivered cost of approximately $1.1 billion. Teekay Shipping Corporation will finance its 40% share of such amount. The charters will commence upon vessel deliveries, which are scheduled for the first half of 2008. The remaining 60% interest in the project will be held by Qatar Gas Transport Company Ltd. (Nakilat). Teekay Shipping Corporation will have operational responsibility for the vessels in this project, although our partner may assume operational responsibility beginning 10 years following delivery of the vessels.

Teekay Shipping Corporation is obligated to offer us the opportunity to pursue these projects no later than 180 days before the respective scheduled delivery dates of the vessels. The conflicts committee of our general partner s board of directors must approve any decision to pursue or decline such an opportunity. Our management may recommend not pursuing either of these opportunities, our conflicts committee may not approve pursuing them or we may not have the financial ability to pursue them. If we decline an LNG project awarded to Teekay Shipping Corporation and offered to us, Teekay Shipping Corporation may pursue the project and we will have no further rights in the project.

B. Operations

LNG Carrier Segment

The vessels in our fixed-rate LNG segment compete in the LNG market. LNG carriers are usually chartered to carry LNG pursuant to time charter contracts, where a vessel is hired for a fixed period of time, usually between 20 and 25 years, and the charter rate is payable to the owner on a monthly basis. LNG shipping historically has been transacted with these long-term, fixed-rate time charter contracts. LNG projects require significant capital expenditures and typically involve an integrated chain of dedicated facilities and cooperative activities. Accordingly, the overall success of an LNG project depends heavily on long-range planning and coordination of project activities, including marine transportation. Although most shipping requirements for new LNG projects continue to be provided on a long-term basis, spot voyages (typically consisting of a single voyage) and short-term time charters of less than 12 months duration have grown from 1% of the market in 1992 to 12% in 2004.

In the LNG market, we compete principally with other private and state-controlled energy and utilities companies that generally operate captive fleets, and independent ship owners and operators. Many major energy companies compete directly with independent owners by transporting LNG for third parties in addition to their own LNG. Given the complex, long-term nature of LNG projects, major energy companies historically have transported LNG through their captive fleets. However, independent fleet operators have been obtaining an increasing percentage of charters for new or expanded LNG projects as major energy companies have continued to divest non-core businesses.

LNG carriers transport LNG internationally between liquefaction facilities and import terminals. After natural gas is transported by pipeline from production fields to a liquefaction facility, it is supercooled to a temperature of approximately negative 260 degrees Fahrenheit. This process reduces its volume to approximately 1/600th of its volume in a gaseous state. The reduced volume facilitates economical storage and transportation by ship over long distances, enabling countries with limited natural gas reserves or limited access to long-distance transmission pipelines to import natural gas. LNG carriers include a sophisticated containment system that holds and insulates the LNG so it maintains its liquid form. LNG is transported overseas in specially built tanks on double-hulled ships to a receiving terminal, where it is offloaded and stored in heavily insulated tanks. In regasification facilities at the receiving terminal, the LNG is returned to its gaseous state (or *regasified)* and then shipped by pipeline for distribution to natural gas customers.

Most new vessels, including all of our vessels, are being built with a membrane containment system. These systems are built inside the carrier and consist of insulation between thin primary and secondary barriers that are designed to accommodate thermal expansion and contraction without overstressing the membrane. New LNG carriers are generally expected to have a lifespan of approximately 35 to 40 years. Unlike the oil tanker industry, there currently are no regulations that require the phase-out from trading of LNG carriers after they reach a certain age. As of December 31, 2005, our LNG carriers had an average age of approximately two years, compared to the world LNG carrier fleet average age of approximately 13 years. In addition, as at that date, there were approximately 194 vessels in the world LNG fleet and approximately 127 additional LNG carriers under construction or on order for delivery through 2010.

The following table provides additional information about our LNG vessels as of December 31, 2005.

Vessel	Capacity (cubic meters)	Delivery	Our Ownership	Charterer	Remaining
Operating LNG carriers:					
Hispania Spirit	140,500	Sept. 2002	100%	Repsol YPF	17 y
Catalunya Spirit	138,000	Aug. 2003	Capital lease (2)	Gas Natural SDG	18 y
Galicia Spirit	140,500	July 2004	100%	Union Fenosa Gas	24 y
Madrid Spirit	138,000	Dec. 2004	Capital lease (2)	Repsol YPF	19 y
Newbuildings:					
Hull No. 2238	151,700	Oct. 2006	Teekay-owned (3)	RasGas II	20 y
Hull No. 2239	151,700	Jan. 2007	Teekay-owned (3)	RasGas II	20 y
Hull No. 2240	151,700	Apr. 2007	Teekay-owned (3)	RasGas II	20 y
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Total Capacity:	1,012,100				
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(1) Each of our time charters are subject to certain termination and purchase obligations.

(2) We lease the vessel under a Spanish tax lease arrangement and will purchase the vessel when the lease terminates in 2006 for the *Catalunya Spirit* and 2011 for the *Madrid Spirit.* Please read Item 18 Financial Statements: Note 5 Capital Lease Obligations and Restricted Cash.

(3) These newbuilding vessels are currently owned by subsidiaries of Teekay Shipping Corporation. Upon the delivery of the first vessel, we will purchase Teekay Shipping Corporation s 70% interest in Teekay Nakilat, which owns the vessels. Until delivery, Teekay Shipping Corporation has agreed to finance the construction of these three vessels, which allows us to defer our need to finance them. The delivery dates for the newbuildings are based on current shipyard schedules. Please read Item 18 Financial Statements: Note 13(e) Related Party Transactions, Note 15 Commitments and Contingencies, and Note 18 Subsequent Events.

(4) The charterer has two options to extend the term for an additional five years each.

(5) The charterer has one option to extend the term for an additional five years.

(6) The charterer has three options to extend the term for an additional five years each.

Repsol and Gas Natural accounted for 26% and 11% of our 2003 revenues, 18% and 21% of our 2004 revenues and 33% and 18% of our 2005 revenues, respectively. In addition, Unión Fenosa Gas, S.A. accounted for 16% of our 2005 revenues. No other LNG customer accounted for 10% or more of our revenues during any of these periods. The loss of any significant customer or a substantial decline in the amount of services requested by a significant customer could harm our business, financial condition and results of operations.

Each LNG carrier that is owned by us or Teekay Shipping Corporation, other than the *Galicia Spirit*, is encumbered by a mortgage relating to the vessel s financing. Each of the *Catalunua Spirit* and the *Madrid Spirit* is subject to a capital lease and a mortgage associated with our financing of the restricted cash deposits associated with the vessel.

For 2005, 2004 and 2003, approximately 67.4%, 49.7% and 39.7%, respectively, of our net voyage revenues were earned by the vessels in the LNG carrier segment. Please see Item 5 Operating and Financial Review and Prospects: Results of Operations.

Suezmax Tanker Segment

Oil has been the world s primary energy source for a number of decades. Seaborne crude oil transportation is a mature industry. The two main types of oil tanker operators are major oil companies (including state-owned companies) that generally operate captive fleets, and independent operators that charter out their vessels for voyage or time-charter use. Most conventional oil tankers controlled by independent fleet operators are hired for one or a few voyages at a time at fluctuating market rates based on the existing tanker supply and demand. These charter rates are extremely sensitive to this balance of supply and demand, and small changes in tanker utilization have historically led to relatively large short-term rate changes. Long-term, fixed-rate charters for crude oil transportation, such as those applicable to our Suezmax tanker fleet, are less typical in the industry. As used in this discussion, conventional oil tankers exclude those vessels that can carry dry bulk and ore, tankers that currently are used for storage purposes and shuttle tankers that are designed to transport oil from offshore production platforms to onshore storage and refinery facilities.

Oil tanker demand is primarily a function of several factors, including the locations of oil production, refining and consumption and world oil demand and supply while oil tanker supply is primarily a function of new vessel deliveries, vessel scrapping and the conversion or loss of tonnage.

The majority of crude oil tankers range in size from approximately 80,000 to approximately 320,000 deadweight tonnes (or *dwt*). Suezmax tankers are the mid-size of the various primary oil tanker types, typically sized from 120,000 to 200,000 dwt. As of December 31, 2005, the world tanker fleet included 279 conventional Suezmax vessels, representing approximately 12% of worldwide oil tanker capacity, excluding tankers under 10,000 dwt.

As of December 31, 2005, our Suezmax tankers had an average age of approximately three years, compared to the average age of 8.1 years for the world Suezmax conventional tanker fleet. New Suezmax tankers generally are expected to have a lifespan of approximately 25 to 30 years, based on estimated hull fatigue life. However, United States and international regulations require the phase-out of double-hulled vessels by 25 years. All of our Suezmax tankers are double-hulled.

The following table provides additional information about our Suezmax oil tankers as of December 31, 2005.

Tanker	Capacity (dwt)	Delivery	Our Ownership	Charterer
Operating Suezmax tankers:				
Tenerife Spirit	159,500	July 2000	Capital lease (1)	CEPSA
Algeciras Spirit	159,500	Oct. 2000	Capital lease (1)	CEPSA
Huelva Spirit	159,500	Mar. 2001	Capital lease (1)	CEPSA
Teide Spirit	159,500	Oct. 2004	Capital lease (1)	CEPSA
Toledo Spirit	159,500	July 2005	Capital lease (1)	CEPSA
European Spirit	151,800	Sept. 2003	100%	ConocoPhillips
African Spirit	151,700	Nov. 2003	100%	ConocoPhillips
Asian Spirit	151,700	Jan. 2004	100%	ConocoPhillips
Total Capacity:	1,252,700			

(1) We are the lessee under a capital lease arrangement and are required to purchase the vessel seven years after the commencement of the capital lease, which we expect to accomplish by assuming the existing vessel financing. Please read Item 18 Financial Statements: Note 5 Capital Lease Obligations and Restricted Cash.

(2) CEPSA has the right to terminate the time charter 13 years after the original delivery date, in which case we are generally expected to sell the vessel, subject to our right of first refusal to purchase the vessel.

(3) The term of the time charter is 12 years from the original delivery date, which may be extended at the customer s option for up to an additional six years. In addition, the customer has the right to terminate the time

charter upon notice and payment of a cancellation fee. Either party also may require the sale of the vessel at any time, subject to the other party s right of first refusal to purchase the vessel.

CEPSA accounted for 47%, 36%, and 30% of our 2003, 2004 and 2005 revenues, respectively. No other Suezmax tanker customer accounted for 10% or more of our revenues during either of these periods. The loss of any significant customer or a substantial decline in the amount of services requested by a significant customer could harm our business, financial condition and results of operations.

For 2005, 2004 and 2003, approximately 32.6%, 50.3% and 60.3%, respectively, of our net voyage revenues were earned by the vessels in the Suezmax tanker segment. Please see Item 5 Operating and Financial Review and Prospects: Results of Operations.

Business Strategies

Our primary business objective is to increase distributable cash flow per unit by executing the following strategies:

Acquire new LNG carriers built to project specifications after long-term, fixed-rate time charters have been awarded for an LNG project. Our LNG carriers (including the three RasGas II vessels) were built or will be built to customer specifications included in the related long-term, fixed-rate time charters for the vessels. We intend to continue our practice of acquiring LNG carriers as needed for approved projects only after the long-term, fixed-rate time charters for the projects have been awarded, rather than ordering vessels on a speculative basis. We believe this approach is preferable to speculative newbuilding because it:

- eliminates the risk of incremental or duplicative expenditures to alter our LNG carriers to meet customer specifications;
- facilitates the financing of new LNG carriers based on their anticipated future revenues; and
- ensures that new vessels will be employed upon acquisition, which should generate more stable cash flow.

Expand our LNG operations globally. We seek to capitalize on opportunities emerging from the global expansion of the LNG sector by selectively targeting:

- long-term, fixed-rate time charters wherever significant LNG liquefaction and regasification facilities are being built or expanded;
- joint ventures and partnerships with companies that may provide increased access to opportunities in attractive LNG importing and exporting geographic regions; and
- strategic vessel and business acquisitions.

Provide superior customer service by maintaining high reliability, safety, environmental and quality standards. LNG project operators seek LNG transportation partners that have a reputation for high reliability, safety, environmental and quality standards. We seek to leverage our own and Teekay Shipping Corporation s operational expertise to create a sustainable competitive advantage with consistent delivery of superior customer service by our:

- responsiveness, reliability, professionalism and integrity;
- adoption of responsible environmental practices and strict adherence to environmental regulations;
- dedication to safe operations, commencing with our care in selecting and training our sea and office personnel; and
- use of customer feedback and industry and internal performance measures to drive continuous improvements.

Manage our Suezmax tanker fleet to provide stable cash flows. The remaining terms for our existing long-term Suezmax tanker charters are 10 to 20 years. We believe the fixed-rate time charters for our oil tanker fleet provide us stable cash flows during their terms and a source of funding for expanding our LNG operations. Depending on prevailing market conditions during and at the end of each existing charter, we may seek to extend the charter, enter into a new charter, operate the vessel on the spot market or sell the vessel, in order to maximize returns on our Suezmax fleet while managing residual risk.

While our primary business objective is to increase distributable cash flow per unit by executing the previously mentioned strategies, we may consider other opportunities to which our competitive strengths are well suited.

Competitive Strengths

We believe that we are well positioned to execute our business strategies successfully because of the following competitive strengths:

We have a strategic platform from which to expand our presence in the rapidly growing LNG marine transportation sector. We currently operate four LNG carriers and are scheduled to receive deliveries of the three RasGas II LNG newbuildings beginning in the fourth quarter of 2006 through the first half of 2007. Our LNG fleet, combined with our existing relationships with leading energy and utility companies in Spain, a significant importer of LNG, and our new relationship, through RasGas II, to the important LNG exporting nation of Qatar, give us a significant presence in the rapidly growing LNG marine transportation sector. We believe this platform provides a strategic base from which we will seek to expand existing relationships and attract new customers.

Our management and the personnel of Teekay Shipping Corporation s subsidiaries who provide services to us have extensive experience in fleet expansion. The Chief Executive Officer and Chief Financial Officer of our general partner, key employees of our subsidiary Teekay Spain and personnel of other subsidiaries of Teekay Shipping Corporation who provide services to us pursuant to advisory and administrative services agreements have extensive experience in fleet expansion through a combination of newbuildings, vessel and business acquisitions and, in some cases, joint ventures. These individuals have overseen all aspects of the construction of over 50 newbuildings, including:

identifying and pre-qualifying shipyards with reputations for quality workmanship and timely vessel completion;

advising customers about technical vessel specifications and suggested improvements, and conducting related negotiations with the shipyard; and

supervising construction quality and shipyard progress toward identified budgetary constraints and completion milestones.

We believe our relationship with Teekay Shipping Corporation and its prominence and customer relationships in the shipping industry significantly enhances our growth opportunities. Established in 1973, Teekay Shipping Corporation has achieved a global brand name in the shipping industry, developed an extensive network of long-standing relationships with major energy companies and earned a reputation for reliability, safety and excellence. We believe that our relationship with Teekay Shipping Corporation significantly enhances our growth opportunities and that we are able to leverage this relationship to our advantage in competing for the transportation requirements of LNG projects and in attracting and retaining long-term charter contracts throughout the world. We also believe that Teekay Shipping Corporation s established relationships with leading shipyards and the high number of newbuilding orders it places with these shipyards will facilitate our interactions with these shipyards during periods of shipyard production constraints, which is anticipated over the next few years.

We supplement our operational experience through continued access to Teekay Shipping Corporation s expertise in various functions critical to our vessel operations. The key employees of our primary operating subsidiary, Teekay Spain, bring to us significant technical, financial and commercial capabilities relating to vessel operations and other business matters. Through Teekay Shipping Corporation s extensive experience operating its large fleet and its commitment to exceptional customer service, it has developed specialized core competencies addressing various functions critical to its and our operations, has adopted best practices in the shipping industry and has developed an infrastructure to efficiently coordinate and implement these skills and practices.

We believe these services complement our existing operational experience and provide strict quality and cost controls and effective safety monitoring.

We have financial flexibility to pursue acquisitions and other expansion opportunities through additional debt borrowings and the issuance of additional partnership units. As of March 31, 2006, our existing revolving credit facilities provided us access to $214.5 million for working capital and acquisition purposes. We believe that borrowings available under our revolving credit facilities, access to other bank financing facilities and the debt capital markets, and our ability to issue additional partnership units will provide us with financial flexibility to pursue acquisition and expansion opportunities.

Safety, Management of Ship Operations and Administration

Safety and environmental compliance are our top operational priorities. We operate our vessels in a manner intended to protect the safety and health of our employees, the general public and the environment. We actively manage the risks inherent in our business and are committed to eliminating incidents that threaten the safety, environment and integrity of our vessels. We are also committed to reducing our emissions and waste generation.

We established key performance indicators to facilitate regular monitoring of our operational performance. We set targets on an annual basis to drive continuous improvement, and we review performance indicators monthly to determine if remedial action is necessary to reach our targets.

Teekay Shipping Corporation, through its subsidiaries, assists us in managing our ship operations. Teekay Shipping Corporation has obtained through Det Norske Veritas, the Norwegian classification society, approval of its safety management system as in compliance with the International Safety Management Code (or *ISM Code*), and this system has been implemented for our Bahamian-flagged vessels. Spain s flag administration has approved this safety management system for our Spanish-flagged vessels. As part of Teekay Shipping Corporation s ISM Code compliance, all of our vessels safety management certificates are being maintained through ongoing internal audits performed by Teekay Shipping Corporation s certified internal auditors and intermediate external audits performed by Det Norske Veritas or Spain s flag administration.

In addition to our operational experience, Teekay Shipping Corporation s in-house global shore staff performs, through its subsidiaries, the full range of technical, commercial and business development services for our LNG operation. This staff also provides administrative support to our operations in finance, accounting and human resources. This affords a safe, efficient and cost-effective operation and, pursuant to administrative services agreements with certain subsidiaries of Teekay Shipping Corporation, access to human resources, financial and other administrative functions.

Critical ship management functions that Teekay Shipping Corporation has agreed to provide to us through its Teekay Marine Services division located in various offices around the world include:

- vessel maintenance;
- crewing;
- purchasing;
- shipyard supervision;
- insurance; and
- financial services.

These functions are supported by onboard and onshore systems for maintenance, inventory, purchasing and budget management.

In addition, Teekay Shipping Corporation s day-to-day focus on cost control is applied to our operations. In 2003, Teekay Shipping Corporation and two other shipping companies established a purchasing alliance, Teekay Bergesen Worldwide, which leverages the purchasing power of the combined fleets, mainly in such commodity areas as lube oils, paints and other chemicals. Through our arrangements with Teekay Shipping

Corporation, we benefit from this purchasing alliance.

We believe that the generally uniform design of some of our existing and newbuilding vessels and the adoption of common equipment standards provides operational efficiencies, including with respect to crew training and vessel management, equipment operation and repair, and spare parts ordering.

Risk of Loss, Insurance and Risk Management

The operation of any ocean-going vessel carries an inherent risk of catastrophic marine disasters, death or injury of persons and property losses caused by adverse weather conditions, mechanical failures, human error, war, terrorism, piracy and other circumstances or events. In addition, the transportation of LNG and crude oil is subject to the risk of spills and to business interruptions due to political circumstances in foreign countries, hostilities, labor strikes and boycotts. The occurrence of any of these events may result in loss of revenues or increased costs.

We carry hull and machinery (marine and war risks) and protection and indemnity insurance coverage to protect against most of the accident-related risks involved in the conduct of our business. Hull and machinery insurance covers loss of or damage to a vessel due to marine perils such as collisions, grounding and weather. Protection and indemnity insurance indemnifies us against liabilities incurred while operating vessels, including injury to our crew or third parties, cargo loss and pollution. The current available amount of our coverage for pollution is $1 billion per vessel per incident. We also carry insurance policies covering war risks (including piracy and terrorism) and, for our LNG carriers, loss of revenues resulting from vessel off-hire time due to a marine casualty or an officer or crew strike. Commencing January 1, 2006, Teekay Shipping Corporation has provided off-hire insurance for our LNG carriers. We believe that our current insurance coverage is adequate to protect against most of the accident-related risks involved in the conduct of our business and that we maintain appropriate levels of environmental damage and pollution insurance coverage. However, we cannot assure that all covered risks are adequately insured against, that any particular claim will be paid or that we will be able to procure adequate insurance coverage at commercially reasonable rates in the future. More stringent environmental regulations have resulted in increased costs for, and may result in the lack of availability of, insurance against risks of environmental damage or pollution.

We use in our operations Teekay Shipping Corporation s thorough risk management program that includes, among other things, computer-aided risk analysis tools, maintenance and assessment programs, a seafarers competence training program, seafarers workshops and membership in emergency response organizations. We believe we benefit from Teekay Shipping Corporation s commitment to safety and environmental protection as certain of its subsidiaries assist us in managing our vessel operations.

Classification, Audits and Inspections

The hull and machinery of all our vessels is classed by one of the major classification societies: Det Norske Veritas or Lloyd s Register of Shipping. The classification society certifies that the vessel has been built and maintained in accordance with its rules. Each vessel is inspected by a classification society surveyor annually, with either the second or third annual inspection being a more detailed survey (or an *Intermediate Survey*) and the fourth or fifth annual inspection being the most comprehensive survey (or a *Special Survey*). The inspection cycle resumes after each Special Survey. Vessels also may be required to be drydocked at each Intermediate and Special Survey for inspection of the underwater parts of the vessel in addition to a more detailed inspection of the hull and machinery. Many of our vessels have qualified with their respective classification societies for drydocking every four or five years in connection with the Special Survey and are no longer subject to drydocking at Intermediate Surveys. To qualify, we were required to enhance the resiliency of the underwater coatings of each vessel and mark the hull to accommodate underwater inspections by divers.

The vessel s flag state, or the vessel s classification society if nominated by the flag state, also inspects our vessels to ensure they comply with applicable rules and regulations of the country of registry of the vessel and the international conventions of which that country is a signatory.

In addition to the classification inspections, many of our customers regularly inspect our vessels as a condition to chartering, and regular inspections are standard practice under long-term charters as well.

Port state authorities, such as the U.S. Coast Guard, also inspect our vessels when they visit their ports.

We believe that our relatively new, well-maintained and high-quality vessels provide us with a competitive advantage in the current environment of increasing regulation and customer emphasis on quality of service.

Our vessels are also regularly inspected by our seafaring staff, who perform much of the necessary routine maintenance. Shore-based operational and technical specialists also inspect our vessels at least twice a year. Upon completion of each inspection, action plans are developed to address any items requiring improvement. All plans are monitored until they are completed. The objectives of these inspections are to:

- ensure our operating standards are being adhered to;

maintain the structural integrity of the vessel;

maintain machinery and equipment to give full reliability in service;

optimize performance in terms of speed and fuel consumption; and

ensure the vessel s appearance will support our brand and meet customer expectations.

To achieve our vessel structural integrity objective, we use a comprehensive Structural Integrity Management System developed by Teekay Shipping Corporation. This system is designed to closely monitor the condition of our vessels and to ensure that structural strength and integrity are maintained throughout a vessel s life.

Teekay Shipping Corporation, who assists us in managing our ship operations, through its subsidiaries, has obtained approval for its safety management system as being in compliance with the ISM Code. Teekay Shipping Corporation s safety management system has also been certified as being compliant with the International Standards Organization s (or ISO) 9001 for quality assurance, ISO 14001 for environment management systems, OHSAS 18001 for Occupational Health and Safety, and the IMO s International Management Code for the Safe Operation of Ships and Pollution Prevention on a fully integrated basis. To maintain compliance, the system is audited regularly by either the vessels flag state or, when nominated by the flag state, a classification society. Certification is valid for five years subject to satisfactorily completing internal and external audits.

Properties

Other than our vessels, we do not have any material property.

Organizational Structure

The following is a list of the Partnership s significant subsidiaries as at December 31, 2005, all of which we wholly own:

Name of Significant Subsidiary	State or Jurisdiction of Incorporation
Naviera Teekay Gas, SL	Spain
Naviera Teekay Gas II, SL	Spain
Naviera Teekay Gas III, SL	Spain
Naviera Teekay Gas IV, SL	Spain
Single Ship Limited Liability Companies	Marshall Islands
Teekay Luxembourg Sarl	Luxembourg
Teekay Shipping Spain SL	Spain

C. Regulations

General

Our business and the operation of our vessels are significantly affected by international conventions and national, state and local laws and regulations in the jurisdictions in which our vessels operate, as well as in the country or countries of their registration. Because these conventions, laws and regulations change frequently, we cannot predict the ultimate cost of compliance or their impact on the resale price or useful life of our vessels. Additional conventions, laws, and regulations may be adopted that could limit our ability to do business or increase the cost of our doing business and that may materially adversely affect our operations. We are required by various governmental and quasi-governmental agencies to obtain permits, licenses and certificates with respect to our operations. Subject to the discussion below and to the fact that the kinds of permits, licenses and certificates required for the operations of the vessels we own will depend on a number of factors, we believe that we will be able to continue to obtain all permits, licenses and certificates material to the conduct of our operations.

We believe that the heightened environmental and quality concerns of insurance underwriters, regulators and charterers will generally lead to greater inspection and safety requirements on all vessels in the LNG carrier and oil tanker markets and will accelerate the scrapping of older vessels throughout these industries.

Regulation International Maritime Organization (or IMO)

IMO regulations include the International Convention for Safety of Life at Sea (or *SOLAS*), including amendments to SOLAS implementing the International Security Code for Ports and Ships (or *ISPS*), the ISM Code, the International Convention on Prevention of Pollution from Ships (the *MARPOL Convention*), the International Convention on Civil Liability for Oil Pollution Damage of 1969, the International Convention on Load Lines of 1966, and, specifically with respect to LNG carriers, the International Code for Construction and Equipment of Ships Carrying Liquefied Gases in Bulk (the *IGC Code*). SOLAS provides rules for the construction of and equipment required for commercial vessels and includes regulations for safe operation. Flag states which have ratified the convention and the treaty generally employ the classification societies, which have incorporated SOLAS requirements into their class rules, to undertake surveys to confirm compliance.

SOLAS and other IMO regulations concerning safety, including those relating to treaties on training of shipboard personnel, lifesaving appliances, radio equipment and the global maritime distress and safety system, are applicable to our operations. Non-compliance with IMO regulations, including SOLAS, the ISM Code, ISPS and the IGC Code, may subject us to increased liability or penalties, may lead to decreases in available insurance coverage for affected vessels and may result in the denial of access to or detention in some ports. For example, the Coast Guard and European Union authorities have indicated that vessels not in compliance with the ISM Code will be prohibited from trading in U.S. and European Union ports.

The ISM Code requires vessel operators to obtain a safety management certification for each vessel they manage, evidencing the shipowner s compliance with requirements of the ISM Code relating to the development and maintenance of an extensive Safety Management System. Such a system includes, among other things, the adoption of a safety and environmental protection policy setting forth instructions and procedures for safe operation and describing procedures for dealing with emergencies. Each of the existing vessels in our fleet currently is ISM Code-certified, and we expect to obtain safety management certificates for each newbuilding vessel upon delivery.

ISPS was adopted in December 2002 in the wake of heightened concern over worldwide terrorism and became effective on July 1, 2004. The objective of ISPS is to enhance maritime security by detecting security threats to ships and ports and by requiring the development of security plans and other measures designed to prevent such threats. The United States implemented ISPS with the adoption of the Maritime Transportation Security Act of 2002 (or *MTSA*), which requires vessels entering U.S. waters to obtain certification of plans to respond to emergency incidents there, including identification of persons authorized to implement the plans. Each of the existing vessels in our fleet currently complies with the requirements of ISPS and MTSA, and we expect all relevant newbuildings to comply upon delivery.

LNG carriers are also subject to regulation under the IGC Code. Each LNG carrier must obtain a certificate of compliance evidencing that it meets the requirements of the IGC Code, including requirements relating to its design and construction. Each of our LNG carriers currently is in substantial compliance with the IGC Code, and each of our LNG newbuilding shipbuilding contracts requires compliance prior to delivery.

Under IMO regulations, an oil tanker must be of double-hull construction, be of a mid-deck design with double-side construction or be of another approved design ensuring the same level of protection against oil pollution in the event that such tanker:

- is the subject of a contract for a major conversion or original construction on or after July 6, 1993;
- commences a major conversion or has its keel laid on or after January 6, 1994; or
- completes a major conversion or is a newbuilding delivered on or after July 6, 1996.

In December 2003, the IMO revised its regulations relating to the prevention of pollution from oil tankers. These regulations, which became effective April 5, 2005, accelerate the mandatory phase-out of single-hull tankers and impose a more rigorous inspection regime for older tankers. All of our oil tankers are double-hulled and were delivered after July 6, 1996, so our tankers will not be affected directly by these IMO regulations.

Annex VI to MARPOL, which became effective internationally on May 19, 2005, sets limits on sulfur dioxide and nitrogen oxide emissions from ship exhausts and prohibits deliberate emissions of ozone depleting substances. Annex VI also imposes a global cap on the sulfur content of fuel oil and allows for specialized areas to be established internationally with more stringent controls on sulfur emissions. For vessels over 400 gross tons, Annex VI imposes various survey and certification requirements. The United States has not yet ratified Annex VI. Vessels operated internationally, however, are subject to the requirements of Annex VI in those countries that have implemented its provisions. We believe that the cost of our complying with Annex VI will not be material.

Environmental Regulations The United States Oil Pollution Act of 1990 (or OPA 90)

OPA 90 established an extensive regulatory and liability regime for the protection and cleanup of the environment from oil spills, including discharges of oil cargoes, fuel (or *bunkers*) or lubricants. OPA 90 affects all owners and operators whose vessels trade to the United States or its territories or possessions or whose vessels operate in United States waters, which include the U.S. territorial sea and 200-mile exclusive economic zone around the United States.

Under OPA 90, vessel owners, operators and bareboat charters are responsible parties and are jointly, severally and strictly liable (unless the spill results solely from the act or omission of a third party, an act of God or an act of war and the responsible party reports the incident and reasonably cooperates with the appropriate authorities) for all containment and cleanup costs and other damages arising from discharges or threatened discharges of oil from their vessels. These other damages are defined broadly to include:

- natural resources damages and the related assessment costs;
- real and personal property damages;
- net loss of taxes, royalties, rents, fees and other lost revenues;
- lost profits or impairment of earning capacity due to property or natural resources damage;
- net cost of public services necessitated by a spill response, such as protection from fire, safety or health hazards; and
- loss of subsistence use of natural resources.

OPA 90 limits the liability of responsible parties to the greater of $1,200 per gross ton or $10 million per tanker that is over 3,000 gross tons per incident, subject to possible adjustment for inflation. These limits of liability would not apply if the incident were proximately caused by violation of applicable U.S. federal safety, construction or operating regulations, including IMO conventions to which the United States is a signatory, or by the responsible party s gross negligence or willful misconduct, or if the responsible party fails or refuses to report the incident or to cooperate and assist in connection with the oil removal activities. We currently plan to continue to maintain for each of our vessel s pollution liability coverage in the amount of $1 billion per incident. A catastrophic spill could exceed the coverage available, which could harm our business, financial condition and results of operations.

Under OPA 90, with limited exceptions, all newly built or converted tankers delivered after January 1, 1994 and operating in United States waters must be built with double-hulls. All of our existing tankers are, and all of our newbuildings will be, double-hulled.

In December 1994, the United States Coast Guard (or *Coast Guard*) implemented regulations requiring evidence of financial responsibility in the amount of $1,500 per gross ton for tankers, coupling the OPA limitation on liability of $1,200 per gross ton with the Comprehensive Environmental Response, Compensation, and Liability Act (or *CERCLA*) liability limit of $300 per gross ton. Under the regulations, such evidence of financial responsibility may be demonstrated by insurance, surety bond, self-insurance, guaranty or an alternate method subject to agency approval. Under OPA 90, an owner or operator of a fleet of vessels is required only to demonstrate evidence of financial responsibility in an amount sufficient to cover the vessel in the fleet having the greatest maximum limited liability under OPA 90 and CERCLA.

The Coast Guard s regulations concerning certificates of financial responsibility (or *COFR*) provide, in accordance with OPA 90, that claimants may bring suit directly against an insurer or guarantor that furnishes COFR. In addition, in the event that such insurer or guarantor is sued directly, it is prohibited from asserting any contractual defense that it may have had against the responsible party and is limited to asserting those defenses available to the responsible party and the defense that the incident was caused by the willful misconduct of the responsible party. Certain organizations, which had typically provided COFR under pre-OPA 90 laws, including the major protection and indemnity organizations, have declined to furnish evidence of insurance for vessel owners and operators if they are subject to direct actions or required to waive insurance policy defenses.

The Coast Guard s financial responsibility regulations may also be satisfied by evidence of surety bond, guaranty or by self-insurance. Under the self-insurance provisions, the shipowner or operator must have a net worth and working capital, measured in assets located in the United States against liabilities located anywhere in the world, that exceeds the applicable amount of financial responsibility. We have complied with the Coast Guard regulations by obtaining financial guaranties from a third party. If other vessels in our fleet trade into the United States in the future, we expect to obtain additional guaranties from third-party insurers or to provide guaranties through self-insurance.

OPA 90 and CERCLA permit individual states to impose their own liability regimes with regard to oil or hazardous substance pollution incidents occurring within their boundaries, and some states have enacted legislation providing for unlimited strict liability for spills. We intend to comply with all applicable state regulations in the ports where our vessels call.

Owners or operators of tank vessels operating in United States waters are required to file vessel response plans with the Coast Guard, and their tank vessels are required to operate in compliance with their Coast Guard approved plans. Such response plans must, among other things:

- address a worst case scenario and identify and ensure, through contract or other approved means, the availability of necessary private response resources to respond to a worst case discharge ;
- describe crew training and drills; and
- identify a qualified individual with full authority to implement removal actions.

We have filed vessel response plans with the Coast Guard for the tankers we own and have received approval of such plans for all vessels in our fleet to operate in United States waters. In addition, we conduct regular oil spill response drills in accordance with the guidelines set out in OPA 90. The Coast Guard has announced it intends to propose similar regulations requiring certain vessels to prepare response plans for the release of hazardous substances.

OPA 90 allows U.S. state legislatures to pre-empt associated regulation if the state s regulations are equal or more stringent. Several coastal states such as California, Washington and Alaska require state-specific COFR and vessel response plans.

CERCLA contains a similar liability regime to OPA 90, but applies to the discharge of hazardous substances rather than oil. Petroleum products and LNG should not be considered hazardous substances under CERCLA, but additives to oil or lubricants used on LNG carriers might fall within its scope. CERCLA imposes strict joint and several liability upon the owner, operator or bareboat charterer of a vessel for cleanup costs and damages arising from a discharge of hazardous substances.

OPA 90 and CERCLA do not preclude claimants from seeking damages for the discharge of oil and hazardous substances under other applicable law, including maritime tort law. Such claims could include attempts to characterize the transportation of LNG aboard a vessel as an ultra-hazardous activity under a doctrine that would impose strict liability for damages resulting from that activity. The application of this doctrine varies by jurisdiction. There can be no assurance that a court in a particular jurisdiction will not determine that the carriage of oil or LNG aboard a vessel is an ultra-hazardous activity, which would expose us to strict liability for damages we cause to injured parties even when we have not acted negligently.

Environmental Regulation Other Environmental Initiatives

Although the United States is not a party, many countries have ratified and follow the liability scheme adopted by the IMO and set out in the International Convention on Civil Liability for Oil Pollution Damage, 1969, as amended (or *CLC*), and the Convention for the Establishment of an International Fund for Oil Pollution of 1971, as amended. Under these conventions, which are applicable to vessels that carry persistent oil (not LNG) as cargo, a vessel s registered owner is strictly liable for pollution damage caused in the territorial waters of a contracting state by discharge of persistent oil, subject to certain complete defenses. Many of the countries that have ratified the CLC have increased the liability limits through a 1992 Protocol to the CLC. The liability limits in the countries that have ratified this Protocol are currently approximately $6.5 million plus approximately $899 per gross registered tonne above 5,000 gross tonnes with an approximate maximum of $128 million per vessel and the exact amount tied to a unit of account which varies according to a basket of currencies. The right to limit liability is forfeited under the CLC when the spill is caused by the owner s actual fault or privity and, under the 1992 Protocol, when the spill is caused by the owner s intentional or reckless conduct. Vessels trading to contracting states must provide evidence of insurance covering the limited liability of the owner. In jurisdictions where the CLC has not been adopted, various legislative schemes or common law governs, and liability is imposed either on the basis of fault or in a manner similar to the CLC.

In addition, the IMO, various countries and states, such as Australia, the United States and the State of California, and various regulators, such as port authorities, the U.S. Coast Guard and the U.S. Environmental Protection Agency, have either adopted legislation or regulations, or are separately considering the adoption of legislation or regulations, aimed at regulating the transmission, distribution, supply and storage of LNG, the discharge of ballast water and the discharge of bunkers as potential pollutants, and requiring the installation on ocean-going vessels of pollution prevention equipment such as oily water separators and bilge alarms.

D. Taxation of the Partnership

Marshall Islands Taxation

Because we and our subsidiaries do not, and we do not expect that we and our subsidiaries will, conduct business or operations in the Republic of the Marshall Islands, neither we nor our subsidiaries will be subject to income, capital gains, profits or other taxation under current Marshall Islands law. As a result, distributions by our subsidiaries to us will not be subject to Marshall Islands taxation.

United States Taxation

This section is based upon provisions of the U.S. Internal Revenue Code of 1986 (or the *IRC*) as in effect on the date of this Annual Report, existing final, temporary and proposed regulations thereunder and current administrative rulings and court decisions, all of which are subject to change. Changes in these authorities may cause the tax consequences to vary substantially from the consequences described below. Unless the context otherwise requires, references in this section to we , our or us are references to Teekay LNG Partners L.P. and its direct or indirect wholly owned subsidiaries that have properly elected to be disregarded as entities separate from Teekay LNG Partners L.P. for U.S. federal tax purposes.

Classification as a Partnership. For purposes of U.S. federal income taxes, a partnership is not a taxable entity, and although it may be subject to withholding taxes on behalf of its partners under certain circumstances, a partnership itself incurs no U.S. federal income tax liability. Instead, each partner of a partnership is required to take into account his share of items of income, gain, loss, deduction and credit of the partnership in computing his U.S. federal income tax liability, regardless of whether cash distributions are made to him by the partnership.

Section 7704 of the IRC provides that publicly traded partnerships will, as a general rule, be treated as corporations for U.S. federal income tax purposes. However, an exception, referred to as the Qualifying Income Exception, exists with respect to publicly traded partnerships whose qualifying income represents 90% or more of their gross income for every taxable year. Qualifying income includes income and gains derived from the transportation and storage of crude oil, natural gas and products thereof, including liquefied natural gas. Other types of qualifying income include interest (other than from a financial business), dividends, gains from the sale of real property and gains from the sale or other disposition of capital assets held for the production of qualifying income, including stock. We recently received a ruling from the IRS that we requested in connection with our initial public offering to the effect that the income we derive from transporting LNG and crude oil pursuant to time charters existing at the time of our initial public offering is qualifying income within the meaning of Section 7704. A ruling from the IRS, while generally binding on the IRS, may under certain circumstances be revoked or modified by the IRS retroactively.

We estimate that less than 5% of our current income is not qualifying income; however, this estimate could change from time to time. There are a number of factors that could cause the percentage of our income that is qualifying income to vary. For example, we have not received an IRS ruling or an opinion of counsel that any income or gain we recognize from foreign currency transactions or from interest rate swaps is qualifying income. Under some circumstances, such as a significant increase in interest rates, the percentage of such income or gain in relation to our total gross income could be substantial. However, we do not expect income or gains from foreign currency transactions or interest rate swaps to constitute a significant percentage of our current or future gross income for U.S. federal income tax purposes.

Possible Classification as a Corporation. If we fail to meet the Qualifying Income Exception described previously with respect to our classification as a partnership for U.S. federal income tax purposes, other than a failure that is determined by the IRS to be inadvertent and that is cured within a reasonable time after discovery, we will be treated as a non-U.S. corporation for U.S. federal income tax purposes. If previously treated as a partnership, our change in status would be deemed to have been effected by our transfer of all of our assets, subject to liabilities, to a newly formed non-U.S. corporation, in return for stock in that corporation, and then our distribution of that stock to our unitholders and other owners in liquidation of their interests in us.

If we were treated as a corporation in any taxable year, either as a result of a failure to meet the Qualifying Income Exception or otherwise, our items of income, gain, loss, deduction and credit would not pass through to unitholders. Instead, we would be subject to U.S. federal income tax based on the rules applicable to foreign corporations, not partnerships, and such items would be treated as our own. Any distribution made to a unitholder would be treated as either taxable dividend income, to the extent of our current or accumulated earnings and profits, or, in the absence of earnings and profits, a nontaxable return of capital, to the extent of the unitholder s tax basis in his common units, or taxable capital gain, after the unitholder s tax basis in his common units is reduced to zero.

Taxation of Operating Income. In the event we were treated as a corporation, our operating income may be subject to U.S. federal income taxation under one of two alternative tax regimes (the 4% gross basis tax or the net basis tax, as described below).

The 4% Gross Basis Tax. We may be subject to a 4% U.S. federal income tax on the U.S. source portion of our gross income (without benefit of deductions) attributable to transportation that begins or ends (but not both) in the United States, unless the Section 883 Exemption applies (as more fully described below under The Section 883 Exemption) and we file a U.S. federal income tax return to claim that exemption. For this purpose, gross income attributable to transportation (or transportation income) includes income from the use, hiring or leasing of a vessel to transport cargo, or the performance of services directly related to the use of any vessel to transport cargo, and thus includes time charter or bareboat charter income. The U.S. source portion of our transportation income is deemed to be 50% of the income attributable to voyages that begin or end (but not both) in the United States. Generally, no amount of the income from voyages that begin and end outside the United States is treated as U.S. source, and consequently none of the transportation income attributable to such voyages is subject to U.S. federal income tax. Although the entire amount of transportation income from voyages that begin and end in the United States would be fully taxable in the United States, we currently do not expect to have any transportation income from voyages that begin and end in the United States; however, there is no assurance that such voyages will not occur.

Net Income Tax and Branch Tax Regime. We currently do not expect to have a fixed place of business in the United States. Nonetheless, if this were to change or we otherwise were treated as having such a fixed place of business involved in earning U.S. source transportation income, such transportation income may be treated as effectively connected with the conduct of a trade or business in the United States. Any income that we earn that is treated as U.S. effectively connected income would be subject to U.S. federal corporate income tax (the highest statutory rate is currently 35%), unless the Section 883 Exemption (as discussed below) applied. The 4% U.S. federal income tax described above is inapplicable to U.S. effectively connected income, however.

Unless the Section 883 Exemption applied, a 30% branch profits tax imposed under Section 884 of the IRC also would apply to our earnings that result from U.S. effectively connected income, and a branch interest tax could be imposed on certain interest paid or deemed paid by us. Furthermore, on the sale of a vessel that has produced U.S. effectively connected income, we could be subject to the net basis corporate income tax and to the 30% branch profits tax with respect to our gain not in excess of certain prior deductions for depreciation that reduced U.S. effectively connected income. Otherwise, we would not be subject to U.S. federal income tax with respect to gain realized on sale of a vessel because it is expected that any sale of a vessel will be structured so that it is considered to occur outside of the United States and so that it is not attributable to an office or other fixed place of business in the United States.

The Section 883 Exemption. In general, if a non-U.S. corporation satisfies the requirements of Section 883 of the IRC and the regulations thereunder (or the *Final Section 883 Regulations*), it will not be subject to the 4% gross basis tax or the net basis tax described above on its U.S. source transportation income attributable to voyages that begin or end (but not both) in the United States (or *U.S. Source International Shipping Income*).

A non-U.S. corporation will qualify for the Section 883 Exemption if, among other things, it is organized in a jurisdiction outside the United States that grants an equivalent exemption from tax to corporations organized in the United States (or an *Equivalent Exemption*) and it meets one of three ownership tests (or the *Ownership Test*) described in the Final Section 883 Regulations.

The U.S. Treasury Department has recognized the Republic of The Marshall Islands as a jurisdiction that grants an Equivalent Exemption. Consequently, in the event we were treated as a corporation for U.S. federal income tax purposes, our U.S. Source International Shipping Income (including for this purpose, any such income earned by our subsidiaries that have properly elected to be treated as partnerships or disregarded as entities separate from us for U.S. federal income tax purposes), would be exempt from U.S. federal income taxation provided we meet the Ownership Test. We believe that we should satisfy the Ownership Test. However, the determination of whether we will satisfy the Ownership Test at any given time depends upon a multitude of factors, including Teekay Shipping Corporation s ownership of us, whether Teekay Shipping Corporation s stock is publicly traded, the concentration of ownership of Teekay Shipping Corporation s own stock and the satisfaction of various substantiation and documentation requirements. There can be no assurance that we will satisfy these requirements at any given time and thus that our U.S. Source International Shipping Income would be exempt from U.S. federal income taxation by reason of Section 883 in any of our taxable years if we were treated as a corporation.

Consequences of Possible PFIC Classification. A non-United States entity treated as a corporation for U.S. federal income tax purposes will be a PFIC in any taxable year in which, after taking into account the income and assets of the corporation and certain subsidiaries pursuant to a look through rule, either (1) at least 75% of its gross income is passive income or (2) at least 50% of the average value of its assets is attributable to assets that produce passive income or are held for the production of passive income.

Based upon our current assets and operations, we do not believe that we would be considered to be a PFIC even if we were treated as a corporation. There are, however, legal uncertainties involved and, in addition, there is no assurance that the nature of our assets, income and operations will remain the same in the future.

Consequences of Possible Controlled Foreign Corporation Classification. If more than 50% of either the total combined voting power of our outstanding units entitled to vote or the total value of all of our outstanding units were owned, actually or constructively, by citizens or residents of the United States, U.S. partnerships or corporations, or U.S. estates or trusts (as defined for U.S. federal income tax purposes), each of which owned, actually or constructively, 10% or more of the total combined voting power of our outstanding units entitled to vote, we could be treated as a controlled foreign corporation (or *CFC*) at any such time as we are properly classified as a corporation for U.S. federal income tax purposes. However, we believe we are not a CFC.

Luxembourg Taxation

The following discussion is based upon the current tax laws of Luxembourg and regulations, the Luxembourg tax administrative practice and judicial decisions thereunder, all subject to possible change on a retroactive basis. The following discussion is for general information purposes only and does not purport to be a comprehensive description of all of the Luxembourg income tax considerations applicable to us.

Our operating subsidiary, Teekay LNG Operating L.L.C. (a Marshall Islands company), through its direct Luxembourg subsidiary, Teekay Luxembourg S.a.r.l. (or *Luxco*), and other intermediary subsidiaries, indirectly holds all of our operating assets. Luxco is considered a Luxembourg resident company for Luxembourg tax purposes subject to taxation in Luxembourg on its income regardless. Luxco is capitalized with equity and loans from Teekay LNG Operating L.L.C. Luxco, in turn, has re-lent a substantial portion of the loan proceeds received from Teekay LNG Operating L.L.C. to Teekay Spain S.L. (or *Spainco*). Luxco used the remaining proceeds from the loans from and equity purchases by Teekay LNG Operating L.L.C. to purchase shares in Spainco.

Luxco is considered a Luxembourg resident company for Luxembourg tax purposes subject to taxation in Luxembourg on its income regardless of where the income is derived. The generally applicable Luxembourg income tax rate is approximately 30%.

Taxation of Interest Income. Luxco s loans to Spainco generate interest income. However, because this interest income is offset substantially by interest expense on the loan made Teekay LNG Operating L.L.C. to Luxco, we believe that any taxation of that income will be immaterial.

Taxation of Interest Payments. Luxembourg does not levy a withholding tax on interest paid to corporate entities non-resident of Luxembourg, such as Teekay LNG Operating L.L.C., unless the interest represents an unlimited right to participate in profits of the interest-paying entity, or the interest payment relates to the portion of debt used to acquire share capital and the debt exceeds a Luxembourg thin capitalization threshold or the interest rate is not regarded as arm s length. Based on guidance received by Teekay Shipping Corporation from the Luxembourg taxing authority, we believe interest paid by Luxco on the types of loans made to it by Teekay LNG Operating L.L.C. do not represent a right to participate in its profits and are consistent with Luxembourg transfer pricing rules. In addition, we have capitalized Luxco in a manner we believe meets the thin capitalization threshold. Accordingly, we believe that interest payments made by Luxco to Teekay LNG Operating L.L.C. are not subject to Luxembourg withholding tax.

Taxation of Spainco Dividends and Capital Gains. Pursuant to Luxembourg law, dividends received by Luxco from Spainco and capital gains realized on any disposal of Spainco shares generally will be exempt from Luxembourg taxation if certain requirements are met. We believe that Luxco will meet these requirements and that any dividend received on or any capital gain resulting from the disposition of the shares of Spainco will be exempt from taxation in Luxembourg. Notwithstanding this exemption, Luxembourg law does not permit the deduction of interest expense on loans specifically used to purchase shares eligible for the dividend exemption, to the extent of any dividends received the same year and derived from the shares financed by the loans. Similarly, capital gains are tax exempt only for the portion exceeding the interest expense generated by the loan financing the purchase of shares and previously deducted. We currently do not intend to dispose of the shares of Spainco. However, we believe that any taxation on any gain resulting from any disposition of the shares of Spainco would not be material.

Taxation of Luxco Dividends. Luxembourg levies a 20% withholding tax on dividends paid by a Luxembourg company to a non-resident of the European Union (absent a tax treaty), which would apply to dividends paid by Luxco to Teekay LNG Operating L.L.C. However, we do not expect to cause Luxco to pay dividends, but to distribute all of its available cash through the payment of interest and principal on its loans owing to Teekay LNG Operating L.L.C., for at least the next ten years. We may also recapitalize another Luxembourg company in the future to continue this arrangement, as is permitted under current Luxembourg tax rules.

Spanish Taxation

The following discussion is based upon the tax laws of Spain and regulations, rulings and judicial decisions thereunder, and is subject to possible change on a retroactive basis. The following discussion is for general information purposes only and does not purport to be a comprehensive description of all of the Spanish income tax considerations applicable to us.

Spainco owns, directly and indirectly, a number of other Spanish subsidiaries, including those operating five of our Suezmax tankers and all of our LNG carriers.

Taxation of Spanish Subsidiaries Engaged in Shipping Activities. Spain imposes income taxes on income generated by our operating Spanish subsidiaries shipping related activities at a rate of 35%. Two alternative Spanish tax regimes provide incentives for Spanish companies engaged in shipping activities; the Canary Islands Special Ship Registry (or *CISSR*) and the Spanish Tonnage Tax Regime (or *TTR*). As at December 31, 2005, the vessels operated by our operating Spanish subsidiaries were subject to the CISSR; however, we have applied for all but two of these vessels to be taxed under the TTR commencing with the 2006 tax year.

To qualify under the CISSR, the Spanish company s vessels must be registered in the Canary Islands Special Ship Registry. Under this registry, the Master and First Officer for the vessel must be Spanish nationals and at least 50% of the crew must be European Union nationals. All of the vessels of our operating Spanish subsidiaries currently are registered in the Canary Islands Special Ship Registry and meet these ship personnel requirements. As a result, we believe that these subsidiaries qualify for the tax benefits associated with the first regime, representing a credit equal to 90% against the tax otherwise payable on income from the commercial operation of the vessels. This credit effectively reduces the Spanish tax rate on this income to 3.5%. This deduction does not apply to gains from vessel dispositions.

The TTR applies to Spanish companies that own or operate vessels, but does not depend upon the registry of the vessels. Consequently, there is no requirement for the vessel to maintain the Spanish or Canary Island flag or to follow the crewing requirements that correspond to these flags. However, under a proposal currently under discussion in the Spanish Parliament, it is possible that the TTR regime will be modified to require that a certain percentage (measured in terms of net tonnage) of the vessels owned or operated under the TTR regime should be flagged in a European Union member state. If granted, the TTR regime will apply to the shipping company for an initial period of 10 years, which may be extended for successive 10-year periods upon application by the company.

Under this regime, the applicable income tax is based on the weight (measured as net tonnage) of the vessel and the number of days during the taxable period that the vessel is at the company s disposal, excluding time required for repairs. The tax base currently ranges from 0.20 to 0.90 Euros per day per 100 tonnes, against which the generally applicable tax rate of 35% will apply. If the shipping company also engages in activities other than those subject to the TTR regime, income from those other activities will be subject to tax at the generally applicable rate of 35%.

If a vessel is acquired and disposed of by a company while it is subject to the TTR regime, any gain on the disposition of the vessel generally is not subject to Spanish taxation. If the company acquired the vessel prior to becoming subject to the TTR regime or if the company acquires a used vessel after becoming subject to the TTR regime, the difference between the fair market value of the vessel at the time it enters into the TTR and the tax value of the vessel at that time is added to the taxable income in Spain when the vessel is disposed of and generally remains subject to Spanish taxation at the rate of 35%.

We believe that the TTR regime provides several advantages over the first ship registry regime described above, including increased flexibility on registering and crewing vessels, a lower overall tax payable and a possible reduction in the Spanish tax on any gain from the disposition of the vessels.

Taxation on Distributions by Spanish Entities. Income distributed to non-residents of Spain by our Spanish subsidiaries as dividends may be subject to a 15% Spanish withholding tax, unless the dividends are paid to an entity resident in a European Union member state, subject to certain requirements, or to an entity resident in a tax treaty jurisdiction. In addition, interest paid by Spanish entities on debt owed to non-residents of Spain is generally subject to a 15% withholding tax.

Spainco has obtained shareholder approval for itself and its subsidiaries to file a consolidated tax return for the 2005 tax year. As a result, no withholding taxes should apply to any interest or dividend payments made between Spainco and its Spanish subsidiaries.

As described above, Spainco is capitalized with debt and equity from Luxco, which owns 100% of Spainco. We expect that Spainco will not pay dividends but will distribute all of its available cash through the payment of interest and principal on its loans owing to Luxco for at least the next ten years. Once these loans are fully repaid, Spainco will distribute all of its available cash to Luxco through dividends.

Pursuant to Spanish law, interest paid by Spainco to Luxco is not subject to Spanish withholding tax if our Spanish subsidiaries respect the debt-equity provisions applicable to direct and indirect debt borrowed from non-European Union resident related parties and if Luxco is a resident of Luxembourg, Luxco does not have a permanent establishment in Spain, and Luxco is not a company qualifying as a tax-exempt 1929 holding company under Luxembourg legislation. We believe Luxco meets the Spanish law requirements. Consequently, we believe that interest paid by Spainco to Luxco should not be subject to withholding tax in Spain.

Pursuant to the European Union Parent-Subsidiary Directive, dividends paid by Spainco to Luxco will not be subject to Spanish withholding taxes if Luxco meets an ownership requirement and a Luxembourg presence requirement. We believe that Luxco has satisfied both the ownership and Luxembourg presence requirements and has qualified for the Spanish withholding tax exemption on any dividends that Spainco has paid to Luxco.

Qatar Taxation

The following discussion is based upon our knowledge of the tax laws of Qatar and regulations, rulings and judicial decisions thereunder. The following discussion is for general information purposes only and does not purport to be a comprehensive description of all of the Qatar income tax considerations applicable to us.

The Qatar Public Revenue and Tax Department s (or *QPRTD*) has confirmed that foreign entities are subject to tax in Qatar on income earned from international shipping within Qatari waters. Qatar income tax is usually determined on a consolidated basis for multiple foreign entities owned by a common parent. In our case, the three RasGas II LNG carriers we plan to operate in Qatar beginning in late 2006 will be operated by separate shipowning subsidiaries owned by Teekay Nakilat, of which we will own a 70% interest.

Based on the QPRTD s confirmation, we believe that Teekay Nakilat s income earned from activity in Qatar will be taxable. Because the time charter revenue we will earn from the Qatari voyages will be earned on a daily or time use basis, we believe it is more likely than not that this revenue will be taxable in Qatar only in relation to the time the vessels operate in Qatari waters. Expenses specifically and demonstrably related to the revenue taxable in Qatar should be deductible in calculating income subject to Qatari tax.

Based on our anticipated operation of the three RasGas II LNG carriers, we believe that the allocation and deduction of operating expenses, tax depreciation and interest expense to the revenue taxable in Qatar should result in no taxation in Qatar for the first ten years of operation. Furthermore, because our time charters with RasGas II provide for a gross up payment for any Qatari tax Teekay Nakilat must pay with respect to its operation of the LNG carriers in Qatari waters, we believe any Qatari taxes will not affect our financial results. However, during January 2006, Teekay Shipping Corporation entered into finance leases with a U.K. lessor for the three RasGas II vessels and will have to separately reimburse the U.K. lessor for any Qatari taxes.

Item 4A. Unresolved Staff Comments

Not applicable.

Item 5. Operating and Financial Review and Prospects

Management s Discussion and Analysis of Financial Condition and Results of Operations

General

Teekay LNG Partners L.P. is an international provider of liquefied natural gas (or *LNG*) and crude oil marine transportation services. Our growth strategy focuses on expanding our fleet of LNG carriers under long-term, fixed-rate time charters. We intend to continue our practice of acquiring LNG carriers as needed for approved projects only after the long-term charters for the projects have been awarded to us, rather than ordering vessels on a speculative basis. We seek to capitalize on opportunities emerging from the global expansion of the LNG sector by selectively targeting long-term, fixed-rate time charters. We may enter into joint ventures and partnerships with companies that may provide increased access to these opportunities or may engage in vessel or business acquisitions. We plan to leverage the expertise, relationships and reputation of Teekay Shipping Corporation and its affiliates to pursue these growth opportunities in the LNG sector and may consider other opportunities to which our competitive strengths are well suited. We view our Suezmax tanker fleet primarily as a source of stable cash flow as we expand our LNG operations.

We manage our business and analyze and report our results of operations on the basis of the following two business segments:

> ***LNG Carrier Segment***. We have four LNG carriers, including one vessel delivered in July 2004 and one vessel delivered in December 2004, all of which operate under long-term, fixed-rate charters.
>
> In 2005 and 2004, our LNG carrier segment generated 67.4% and 49.7%, respectively, of our total net voyage revenues.
>
> In addition, we have entered into an agreement with Teekay Shipping Corporation to purchase its 70% interest in Teekay Nakilat Corporation (or *Teekay Nakilat*), which owns three LNG newbuilding carriers and the related 20-year time charters. The estimated purchase price for the 70% interest in Teekay Nakilat is $92.8 million, plus the assumption of $327.7 million of long-term debt. The purchase will occur upon the delivery of the first newbuilding, which is scheduled during the fourth quarter of 2006. The remaining two newbuildings are scheduled for delivery in the first half of 2007. Upon their deliveries, these vessels will commence service under existing charters with Ras Laffan Liquefied Natural Gas Co. Limited (II) (or *RasGas II*), a joint venture between Qatar Petroleum and ExxonMobil RasGas Inc., a subsidiary of ExxonMobil Corporation, established for the purpose of expanding LNG production in Qatar.
>
> During January 2006, Teekay Shipping Corporation completed a 30-year U.K. lease arrangement that will be used to finance the purchase of the three RasGas II LNG newbuilding carriers owned by Teekay Nakilat. The tax benefits of this lease arrangement are expected to reduce the equity portion of our purchase of Teekay Shipping Corporation s 70% interest in Teekay Nakilat by approximately $40 million, from approximately $93 million to approximately $53 million. Under the terms of the U.K. leases, we will be required to have on deposit with financial institutions an amount of cash that, together with interest earned on the deposits, will equal the remaining

amounts owing under the leases. These restricted cash deposits will be used for capital lease payments and will be fully funded with term loans and loans from the joint venture partners. Please read Item 18 Financial Statements: Note 15 Commitments and Contingencies.

Suezmax Tanker Segment. We have eight Suezmax class crude oil tankers, including a new tanker, the *Toledo Spirit*, that delivered in July 2005 and three double-hulled Suezmax tankers we acquired from Teekay Shipping Corporation in November 2005. In May 2005, we sold our only single-hulled Suezmax tanker, the *Granada Spirit*. During most of 2004, we had six Suezmax tankers, while during most of 2005, we had five Suezmax tankers. Please read Follow-On Offering and Acquisition of Three Suezmax Tankers below. We describe our Suezmax tanker dispositions and deliveries in more detail under Results of Operations below. All of our Suezmax tankers operate under long-term, fixed-rate time charters.

In 2005 and 2004, our Suezmax tanker segment generated 32.6% and 50.3%, respectively, of our total net voyage revenue.

Our original fleet was established by Naviera F. Tapias S.A. (or *Tapias*), a Spanish company founded in 1991. Teekay Shipping Corporation, through its subsidiary Teekay Luxembourg S.a.r.l. (or *Luxco*), acquired Tapias on April 30, 2004 and changed its name to Teekay Shipping Spain S.L. (or *Teekay Spain*). Teekay Shipping Corporation acquired Tapias for $298.2 million in cash, plus the assumption of existing debt and newbuilding commitments. Please read Item 18 Financial Statements: Note 3 Acquisition of Teekay Shipping Spain S.L.

Our Initial Public Offering

On November 3, 2004, Teekay Shipping Corporation formed us to own and operate the LNG and Suezmax crude oil marine transportation businesses conducted by Luxco and its subsidiaries. On May 6, 2005, Teekay Shipping Corporation contributed to us all of the outstanding shares of Luxco, all but $54.9 million of notes receivable from Luxco, and all of the equity interests of Granada Spirit L.L.C., which owned the Suezmax tanker, the *Granada Spirit*, to us in connection with our initial public offering on May 10, 2005. We subsequently repaid the $54.9 million note receivable.

In exchange for these shares, equity interests and assets, Teekay Shipping Corporation received 8,734,572 common units and 14,734,572 subordinated units, which represented a 75.7% limited partner interest in us. Our general partner, Teekay GP L.L.C. received a 2% general partner interest and all of the incentive distribution rights in us. Teekay GP L.L.C. is a wholly-owned subsidiary of Teekay Shipping Corporation. We sold 6.9 million of our common units, which represent limited partner interest, in our initial public offering at a price of $22.00 per unit, for proceeds of $151.8 million before underwriting costs and offering expenses. Please read Item 18 Financial Statements: Note 2 Public Offerings.

New Long-Term, Fixed-Rate LNG Contracts Awarded

In July and August 2005, Teekay Shipping Corporation announced that it has been awarded new long-term, fixed-rate time charter contracts to transport LNG and has entered into agreements to construct a total of six LNG carriers in connection with these awards. Two of the LNG carriers will be chartered for a period of 20 years to The Tangguh Production Sharing Contractors, and four will be chartered for a period of 25 years (with options to extend up to an additional 10 years) to Ras Laffan Liquefied Natural Gas Co. Limited (3). Partners in each of these projects will participate in the ownership of the time charters and related vessels, and Teekay Shipping Corporation will offer to us its interest in these charters and vessels. Please read Item 18 Financial Statements: Note 19 Other Information.

Follow-On Offering and Acquisition of Three Suezmax Tankers

In November 2005, we completed our follow-on public offering of 4.6 million common units at a price of $27.40 per unit. Net proceeds from the offering were $120.2 million, net of an estimated $5.8 million of commissions and offering expenses. In addition, our general partner contributed $2.6 million to us to maintain its 2% general partner interest. Please read Item 18 Financial Statements: Note 2 Public Offerings.

Concurrently with the closing of the offering, we acquired from Teekay Shipping Corporation three double-hulled Suezmax oil tankers and related long-term, fixed-rate time charters for an aggregate price of $180.0 million. These vessels, the *African Spirit*, the *Asian Spirit* and the *European Spirit* (collectively, the *ConocoPhillips Tankers*), are similar in size to our five existing crude oil tankers. The vessels have an average age of two years and are chartered to a subsidiary of ConocoPhillips, an international, integrated energy company. Each time charter has a remaining scheduled term of approximately 10 years, subject to termination and vessel sale and purchase rights. In addition, ConocoPhillips has the option to extend the charters for up to an additional six years. Please read Item 18 Financial Statements: Note 2 Public Offerings and Note 13(i) Related Party Transactions.

Our Charters

We generate revenues by charging customers for the transportation of their LNG and crude oil using our vessels. Historically, we generally have provided these services under the following basic types of contractual relationships:

- Time charters, where vessels are chartered to customers for a fixed period of time at rates that are generally fixed but may contain a variable component, based on inflation, interest rates or current market rates; and

- Voyage charters, which are charters for shorter intervals, usually a single round trip, that are priced on a current, or spot, market rate.

During 2005 and 2004, we derived 100.0% and 84.3%, respectively, of our revenues from time charters. During 2004, 15.7% of our revenues were derived from voyage charters. During these periods, all our vessels were employed on long-term time charters, except the *Granada Spirit*, which operated under voyage charters in the spot market during 2004. We do not anticipate earning revenues from voyage charters in the foreseeable future.

Hire rate refers to the basic payment from the customer for the use of a vessel. Hire is payable monthly, in advance, in U.S. Dollars or Euros, as specified in the charter. The hire rate generally includes two components a capital cost component and an operating expense component. The capital component typically approximates the amount we are required to pay under vessel financing obligations and, for our existing Suezmax tankers (other than for the ConocoPhillips Tankers), adjusts for changes in the floating interest rates relating to the underlying vessel financing. The operating component, which adjusts annually for inflation, is intended to compensate us for vessel operating expenses and provide us a profit.

The time charters for the ConocoPhillips Tankers include a fixed monthly rate for their initial 12-year term, which increases to another fixed amount for any extensions of the initial term. These time charters do not include capital or operating components or adjust for inflation.

For our charters, other than the charters for the RasGas II vessels and the ConocoPhillips Tankers, we earn a profit from a margin built into the operating component. Under the RasGas II charters, this margin is built into the capital component.

In addition, we may receive additional revenues beyond the fixed hire rate when current market rates exceed specified amounts under our time charter for one Suezmax tanker, the *Teide Spirit*.

Hire payments may be reduced or, under some charters, we must pay liquidated damages, if the vessel does not perform to certain of its specifications, such as if the average vessel speed falls below a guaranteed speed or the amount of fuel consumed to power the vessel under normal circumstances exceeds a guaranteed amount. Historically, we have had few instances of hire rate reductions and none that have had a material impact on our operating results.

When a vessel is off-hire or not available for service generally the customer is not required to pay the hire rate and we are responsible for all costs. Prolonged off-hire may lead to vessel substitution or termination of the time charter. A vessel will be deemed to be off-hire if it is in drydock. We must periodically drydock each of our vessels for inspection, repairs and maintenance and any modifications to comply with industry certification or governmental requirements. In addition, a vessel generally will be deemed off-hire if there is a loss of time due to, among other things: operational deficiencies; equipment breakdowns; delays due to accidents, crewing strikes, certain vessel detentions or similar problems; or our failure to maintain the vessel in compliance with its specifications and contractual standards or to provide the required crew.

The average remaining term of our existing long-term, fixed-rate time charters is approximately 19 years for our LNG carriers and 14 years for our Suezmax tankers, subject, in certain circumstances, to termination or purchase rights. The initial term of each of our three LNG newbuilding charters is 20 years, in each case from delivery of the vessel.

Important Financial and Operational Terms and Concepts

We use a variety of financial and operational terms and concepts when analyzing our performance. These include the following:

Voyage Revenues. Voyage revenues currently include revenues only from time charters. Prior to our transfer of the *Granada Spirit* to Teekay Shipping Corporation in December 2004, our voyage revenues also included revenues from voyage charters. Voyage revenues are affected by hire rates and the number of calendar-ship-days a vessel operates. Voyage revenues are also affected by the mix of business between time and voyage charters. Hire rates for voyage charters are more volatile, as they are typically tied to prevailing market rates at the time of a voyage.

Voyage Expenses. Voyage expenses are all expenses unique to a particular voyage, including any bunker fuel expenses, port fees, cargo loading and unloading expenses, canal tolls, agency fees and commissions. Voyage expenses are typically paid by the customer under time charters and by us under voyage charters. When we pay voyage expenses, we typically add them to our hire rates at an approximate cost.

Net Voyage Revenues. Net voyage revenues represent voyage revenues less voyage expenses. Because the amount of voyage expenses we incur for a particular charter depends upon the form of the charter, we use net voyage revenues to improve the comparability between periods of reported revenues that are generated by the different forms of charters. We principally use net voyage revenues, a non-GAAP financial measure, because it provides more meaningful information to us about the deployment of our vessels and their performance than voyage revenues, the most directly comparable financial measure under accounting principles generally accepted in the United States (or *GAAP*).

Vessel Operating Expenses. We are responsible for vessel operating expenses, which include crewing, repairs and maintenance, insurance, stores, lube oils and communication expenses. The two largest components of vessel operating expenses are crews and repairs and maintenance.

Crews. Crews represented approximately 56% and 53% of our vessel operating expenses for 2005 and 2004, respectively. A substantial majority of our crewing expenses are denominated in Euros, which is primarily a function of the nationality of our crew. Fluctuations in the Euro relative to the U.S. Dollar have caused, and will continue to cause, fluctuations in our operating results.

Repairs and Maintenance. Repairs and maintenance represented approximately 23% and 30% of vessel operating expenses for 2005 and 2004, respectively. Expenses for repairs and maintenance tend to fluctuate from period to period because most repairs and maintenance typically occur during periodic drydockings. Please read Drydocking below. Because vessel operating expenses such as repairs and maintenance are lower for newer vessels, and our fleet is relatively new, we expect these expenses to increase as our fleet matures.

Income from Vessel Operations. To assist us in evaluating our operations by segment, we sometimes analyze the income we receive from each segment after deducting operating expenses, but prior to the deduction of interest expenses, taxes, foreign currency and interest rate swap gains or losses and other income and losses. For more information, please read Item 18 Financial Statements: Note 4 Segment Reporting.

Drydocking. We must periodically drydock each of our vessels for inspection, repairs and maintenance and any modifications to comply with industry certification or governmental requirements. Generally, we drydock each of our vessels every five years. In addition, a shipping society classification intermediate survey is performed on our LNG carriers between the second and third year of a five-year drydocking period. We capitalize a substantial portion of the costs incurred during drydocking and for the survey and amortize those costs on a straight-line basis from the completion of a drydocking or intermediate survey to the estimated completion of the next drydocking. We expense costs related to routine repairs and maintenance incurred during drydocking or intermediate survey that do not improve or extend the useful lives of the assets. The number of drydockings undertaken in a given period, and the nature of the work performed determine the level of drydocking expenditures.

Depreciation and Amortization. Our depreciation and amortization expense typically consists of the following three components:

- charges related to the depreciation of the historical cost of our fleet (less an estimated residual value) over the estimated useful lives of our vessels;

- charges related to the amortization of drydocking expenditures over the estimated number of years to the next scheduled drydocking; and

- charges related to the amortization of the fair value of the time charters acquired in the Teekay Spain acquisition (over the remaining terms of the charters), which was initially determined at approximately $183 million in April 2004 when Teekay Shipping Corporation acquired Teekay Spain.

Revenue Days. Revenue days are the total number of calendar days our vessels were in our possession during a period less the total number of off-hire days during the period associated with major repairs, drydockings or special or intermediate surveys. Consequently, revenue days represents the total number of days available for the vessel to earn revenue. Idle days, which are days when the vessel is available for the vessel to earn revenue, yet is not employed, are included in revenue days. We use revenue days to explain changes in our net voyage revenues between periods.

Calendar-Ship-Days. Calendar-ship-days are equal to the total number of calendar days that our vessels were in our possession during a period. As a result, we use calendar-ship-days primarily in explaining changes in vessel operating expenses and depreciation and amortization.

Utilization. An indicator of the use of our fleet during a given period, which is determined by dividing our revenue days by our calendar-ship-days for the period.

Restricted Cash Deposits. Under capital lease arrangements for two of our LNG carriers, we (a) borrowed under term loans and deposited the proceeds into restricted cash accounts and (b) entered into capital leases, also referred to as bareboat charters, for the vessels. The restricted cash deposits, together with interest earned on the deposits, will equal the remaining amounts we owe under the lease arrangements, including our obligation to purchase the vessels at the end of the lease terms. During vessel construction, we borrowed under the term loans and made restricted cash deposits equal to construction installment payments. We also maintain restricted cash deposits relating to certain term loans and other obligations. For more information, please read Item 18 Financial Statements: Note 5 Capital Lease Obligations and Restricted Cash.

Foreign Currency Fluctuations. Our results of operations are affected by fluctuations in currency exchange rates. The volatility in our financial results due to currency exchange rate fluctuations are attributed primarily to the following factors:

> *Unrealized end-of-period revaluations*. Under U.S. accounting guidelines, all foreign currency-denominated monetary assets and liabilities, such as cash and cash equivalents, restricted cash, long-term debt and capital lease obligations, are revalued and reported based on the prevailing exchange rate at the end of the period. A substantial majority of our foreign currency gains and losses are attributable to this revaluation in respect of our Euro-denominated term loans. Substantially all of these gains and losses are unrealized.
>
> *Foreign currency revenues and expenses*. A portion of our voyage revenues are denominated in Euros. A substantial majority of our vessel operating expenses and general and administrative expenses are denominated in Euros, which is primarily a function of the nationality of our crew and administrative staff. We also have Euro-denominated interest expense and interest income related to our Euro-denominated loans and Euro-denominated restricted cash deposits, respectively. As a result, fluctuations in the Euro relative to the U.S. Dollar have caused, and are likely to continue to cause, fluctuations in our reported voyage revenues, vessel operating expenses, general and administrative expenses, interest expense and interest income.

Our Euro-denominated revenues currently generally approximate our Euro-denominated expenses and Euro-denominated loan and interest payments. For this reason, we have not entered into any forward contracts or similar arrangements to protect against the risk of foreign currency-denominated revenues, expenses or monetary assets or liabilities. If our foreign currency-denominated revenues and expenses become sufficiently disproportionate in the future, we may engage in hedging activities. For more information, please read Quantitative and Qualitative Disclosures About Market Risk.

Items You Should Consider When Evaluating Our Results of Operations

Some factors that have affected our historical financial performance or will affect our future performance are listed below:

> ***Our financial results reflect changes in our capital structure***. Prior to the closing of our initial public offering on May 10, 2005, we repaid $337.3 million of term loans on two LNG carriers and settled related interest rate swaps. We also settled other interest rate swaps associated with 322.8 million Euros ($390.5 million) of other term loans and entered into new swaps of the same amount with a lower fixed interest rate. In addition, on May 6, 2005, Teekay Shipping Corporation contributed to us all but $54.9 million of its notes receivable from Luxco, among other assets. We subsequently repaid the $54.9 million note receivable. These reductions in our debt and effective interest rates have decreased the amount of our interest expense.
>
> ***Our financial results reflect the revaluation of our assets and liabilities***. On April 30, 2004, Teekay Shipping Corporation acquired 100% of the issued and outstanding shares of Teekay Spain through Luxco, which Teekay Shipping Corporation subsequently contributed to us in May 2005. Results for periods subsequent to April 30, 2004 reflect the comprehensive revaluation of all assets, including intangible assets and goodwill, and liabilities of Teekay Spain at their fair values on the date of acquisition by Teekay Shipping Corporation. This

revaluation primarily increased depreciation and amortization expense. Please read Item 18 Financial Statements: Note 1 Basis of Presentation.

We have disposed of certain assets included in our historical results of operations. Immediately prior to its acquisition by Teekay Shipping Corporation in April 2004, Tapias disposed of certain assets unrelated to the marine transportation operations purchased by Teekay Shipping Corporation. These unrelated assets included certain investments in marketable securities and other non-shipping assets, including real estate and a yacht. Since these unrelated assets were held in Tapias ship-owning subsidiaries acquired by Teekay Shipping Corporation, the financial impact of the assets is included in our historical operating results discussed below through the date of their disposition (as opposed to three unrelated businesses previously held in separate subsidiaries not acquired in the Tapias acquisition, which are not included in our historical operating results). Excluding expenses associated with the yacht, none of the unrelated assets had a significant impact on our operating results. Please read Item 18 Financial Statements: Note 1 Basis of Presentation.

***Our historical operating results include the historical results of Luxco for the nine months ended December 31, 2004 and the period from January 1, 2005 to May 9, 2005* (or the *2005 Pre-IPO Period*).** Teekay Shipping Corporation formed Luxco in April 2004 to acquire and hold Teekay Spain. From its formation until our initial public offering, Luxco had no revenues, expenses or income, or assets or liabilities, other than:

- advances (including accrued interest) of $465.7 million as of December 31, 2004, from Teekay Shipping Corporation that Luxco used to purchase Teekay Spain and to prepay certain debt of Teekay Spain;

- net interest expense related to the advances of $9.8 million and $7.3 million for the nine months ended December 31, 2004 and for the 2005 Pre-IPO Period, respectively;

- an unrealized foreign exchange loss of $44.7 million for the nine months ended December 31, 2004 related to the advances, which are Euro-denominated, and a $23.8 million unrealized foreign exchange gain related to the advances for the 2005 Pre-IPO Period;

- other expenses of $1.1 million and $0.1 million for those respective periods;

- cash and cash equivalents of $2.2 million as of December 31, 2004; and

- its ownership interest in Teekay Spain and certain purchase rights and obligations for Suezmax tankers operated by Teekay Spain under capital lease arrangements, which it acquired from Teekay Spain on December 30, 2004.

Luxco s results relate solely to the financing of the acquisition of Teekay Spain and repayment of Teekay Spain debt by Teekay Shipping Corporation and do not relate to the historical results of Teekay Spain. In addition, because the capital stock of Luxco and the advances from Teekay Shipping Corporation were contributed to us in connection with our initial public offering, these advances and their related effects were eliminated on consolidation in the periods subsequent to May 9, 2005. Consequently, certain of our historical financial and operating data for 2005 Pre-IPO Period may not be comparable to subsequent periods.

Our financial results reflect the consolidation of Teekay Nakilat, a variable interest entity for which we are the primary beneficiary. In January 2003, the Financial Accounting Standards Board (or *FASB*) issued FASB Interpretation 46, *Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51* (or *FIN 46*). In general, a variable interest entity (or *VIE*) is a corporation, partnership, limited-liability corporation, trust, or any other legal structure used to conduct activities or hold assets that either (1) has an insufficient amount of equity to carry out its principal activities without additional subordinated financial support, (2) has a group of equity owners that are unable to make significant decisions about its activities, or (3) has a group of equity owners that do not have the obligation to absorb losses or the right to receive returns generated by its operations. If a party with an ownership, contractual or other financial interest in the VIE (a variable interest holder) is obligated to absorb a majority of the risk of loss from the VIE s activities, is entitled to receive a majority of the VIE s residual returns (if no party absorbs a majority of the VIE s losses), or both, then FIN 46 requires that this party consolidate the VIE. We have consolidated Teekay Nakilat in our consolidated financial statements, as Teekay Nakilat is a VIE and we are its primary beneficiary. The assets and liabilities of Teekay Nakilat in our financial statements are recorded at historical cost as we and Teekay Nakilat are under common control. As at December 31, 2005, the assets of Teekay Nakilat included three LNG newbuildings, which had a carrying value of $316.9 million and other assets of $2.7 million. These assets have been financed with $205.9 of term loans and $113.7 million of loans from Teekay Shipping Corporation and Qatar Gas Transport Company Ltd. (Nakilat). Please read Item 18 Financial Statements: Note 1 Basis of Presentation and Note 15 Commitments and Contingencies.

The size of our LNG carrier and Suezmax tanker fleets has changed. Our historical results of operations reflect changes in the size and composition of our fleet due to certain vessel deliveries and vessel dispositions. In particular, during most of 2004, we had six Suezmax tankers, while during most of 2005, we had five Suezmax tankers, and we have increased the size of our LNG carrier fleet from two carriers in early 2004 to four in 2005. Please read Results of Operations LNG Carrier Segment and Suezmax Tanker Segment below for further details about our vessel dispositions and deliveries.

We do not anticipate earning revenues from voyage charters in the foreseeable future. Since December 2004, all of our vessels have operated under fixed-rate time charters, and we do not anticipate earning revenues from voyage charters in the foreseeable future. Our 2004 results reflect relatively high voyage charter rates earned by the *Granada Spirit*, which operated under voyage charters based on spot market rates and which was part of our fleet until December 2004, when we sold it to Teekay Shipping Corporation. Teekay Shipping Corporation contributed the *Granada Spirit* back to us on May 6, 2005 and we concurrently chartered it to Teekay Shipping Corporation under a short-term, fixed-rate time charter until we disposed of it on May 26, 2005.

The time charters for two of our Suezmax tankers, the *Sevilla Spirit*, prior to being sold in the fourth quarter of 2004, and the *Teide Spirit*, which began operating in the fourth quarter of 2004, contain a component providing for additional revenues to us beyond the fixed hire rate when current market rates exceed certain threshold amounts. Accordingly, even though declining spot market rates will not result in our receiving less than the fixed hire rate, our results will continue to be influenced, in part, by the variable component of the *Teide Spirit* charter. During 2005 and 2004, we earned $4.5 million and $4.2 million, respectively, in additional revenue from this variable component.

We have designated our interest rate swaps as hedges. We have entered into interest rate swaps to hedge our interest rate risk from our floating-rate debt used to purchase our LNG carriers. These interest rate swaps were not designated as hedges under U.S. accounting guidelines until April 30, 2004. Consequently, the changes in the fair values of these swaps that occurred during 2003 and the four months ended April 30, 2004 have been recorded in earnings as interest rate swaps gain (loss) for those periods. Had these interest rate swaps been designated as hedges prior to 2003, any subsequent changes in fair value would have been recognized in accumulated other comprehensive income (loss) to the extent the hedge was effective and until the hedged item was recognized as income. Because the swaps have been highly effective, the change in fair value after April 30, 2004 has been reflected in accumulated other comprehensive income (loss) and, because we expect the swaps, or replacement swaps, to continue to be highly effective, we expect that most of the change in value will continue to be reflected in accumulated other comprehensive income (loss). For more information, please read Item 18 Financial Statements: Note 14 Derivative Instruments and Hedging Activities. In addition, as mentioned above, in April 2005 we settled interest rate swaps in connection with prepayment of debt associated with two of our LNG carriers, and settled and replaced the interest rate swaps associated with our other two LNG carriers.

We are incurring additional general and administrative expenses following our initial public offering. In connection with the closing of our initial public offering, we and certain of our subsidiaries entered into services agreements with certain subsidiaries of Teekay Shipping Corporation pursuant to which those subsidiaries provide us and our subsidiaries certain services, including strategic consulting, advisory, ship management, technical and administrative services. Our cost for these services depends on the amount and type of services provided during each period. The services are valued at a reasonable, arm s-length rate that includes reimbursement of reasonable direct or indirect expenses incurred to provide the services. We also reimburse our general partner for all expenses it incurs on our behalf. We may also pay incentive fees to Teekay Shipping Corporation to reward and motivate it for pursuing LNG projects that we may elect to undertake, and we may grant equity compensation that would result in an expense to us. In addition, since our initial public offering on May 10, 2005, we have begun to incur expenses as a result of being a publicly-traded limited partnership, including costs associated with annual reports to unitholders and SEC filings, investor relations, incremental director and officer liability insurance costs and director compensation.

We Have Derived, and We Expect to Continue to Derive, a Substantial Majority of Our Revenues From a Limited Number of Customers.

Our customers include major energy companies and their affiliates. We derive a substantial majority of our revenues from a limited number of customers. During 2005 and 2004, we derived 98% and 84%, respectively, of our revenues from four customers Compania Espanola de Petroleos, S.A. (30% and 36%), Repsol YPF, S.A. (34% and 18%), Gas Natural SDG, S.A. (18% and 21%) and Unión Fenosa Gas, S.A (16% and 9%). As a result of our acquisition of the ConocoPhillips Tankers and related time charters from Teekay Shipping Corporation upon the closing of our follow-on public offering on November 23, 2005, we expect to derive a significant amount of revenues in 2006 from a subsidiary of ConocoPhillips; we also expect that RasGas II will be a significant customer following our acquisition of the RasGas II LNG carriers and related time-charter contracts.

We have long-term, fixed-rate time charters with each of our existing customers and expect to continue to derive a substantial majority of our revenue and cash flows from them. The loss of any customer or time charter, or a significant decline in payments under our time charters, could materially and adversely affect our revenues, cash flows and operating results.

We could lose one of these customers or another customer or the benefits of a time charter if:

the customer exercises certain rights to terminate the charter, purchase or cause the sale of the vessel or, under some of our charters, convert the time charter to a bareboat charter (some of which rights are exercisable at any time);

the customer terminates the charter because we fail to deliver the vessel within a fixed period of time, the vessel is lost or damaged beyond repair, there are serious deficiencies in the vessel or prolonged periods of off-hire, or we default under the charter; or

under some of our time charters, the customer terminates the charter because of (a) the termination of the charter s LNG sales agreement supplying the LNG designated for our services or (b) a prolonged force majeure event affecting the customer, including damage to or destruction of relevant LNG production or regasification facilities, war or political unrest preventing us from performing services for that customer.

Our customers primary obligation under the time charter contracts is to pay us for our services, and the contracts provide narrow exceptions to this payment obligation for force majeure events and, in limited circumstances as described above, LNG supply disruptions. However, we could lose the benefits of a time charter if the customer fails to make charter payments because of its financial inability, disagreements with us or otherwise. Our customers include major energy companies and their affiliates. Factors materially and adversely affecting the supply of or demand for LNG or crude oil or the financial condition and operating results of our customers could affect their ability to make charter payments to us.

Results of Operations

The following tables present our operating results by reportable segment for 2005, 2004 and 2003, and compare our net voyage revenues, a non-GAAP financial measure, for those periods to voyage revenues, the most directly comparable GAAP financial measure. For ease of comparison in the following tables and the discussion below, we have combined our results of the various time periods set forth in our consolidated statements of income (loss).

	2005			2004			
(in thousands of U.S. dollars, except Operating Data)	LNG Carrier Segment	Suezmax Tanker Segment	Total	LNG Carrier Segment	Suezmax Tanker Segment	Total	LNG Carrier Segment
Voyage revenues...........	97,645	47,814	145,459	59,395	64,438	123,833	32,607
Voyage expenses...........	50	608	658	254	4,678	4,932	123
Net voyage revenues.......	97,595	47,206	144,801	59,141	59,760	118,901	32,484
Vessel operating expenses.	15,622	13,183	28,805	10,615	20,002	30,617	5,856
Depreciation and amortization............	30,360	12,811	43,171	15,391	19,469	34,860	5,630
General and administrative (1)	4,689	5,268	9,957	1,962	4,516	6,478	1,683
Income from vessel operations......	46,924	15,944	62,868	31,173	15,773	46,946	19,315
Operating Data:							
Revenue Days (A)........	1,445	1,714	3,159	902	2,042	2,944	518
Calendar-Ship-Days (B)..	1,460	1,754	3,214	902	2,073	2,975	518
Utilization (A)/(B).....	99%	98%	98%	100%	99%	99%	100%

(1) Includes direct general and administrative expenses and indirect general and administrative expenses (allocated to each segment based on estimated use of resources).

Year Ended December 31, 2005 versus Year Ended December 31, 2004

LNG Carrier Segment

We operated four LNG carriers during 2005 and two LNG carriers during most of 2004. These additional LNG carriers were delivered in July 2004 and December 2004 (collectively, the *LNG Deliveries*). Accordingly, our total revenue days increased by 60.2%, from 902 days in 2004 to 1,445 days in 2005.

Net Voyage Revenues. Net voyage revenues increased 65.1% to $97.6 million for 2005, from $59.1 million for 2004. This increase was the result of:

- an increase of $38.6 million relating to the LNG Deliveries; and
- an increase of $0.7 million due to the effect on our Euro-denominated revenue from the strengthening of the Euro against the U.S. Dollar during 2005;

partially offset by

- a decrease of $0.8 million from 15.2 days of off-hire for one of our LNG carriers during February 2005.

Vessel Operating Expenses. Vessel operating expenses increased 47.2% to $15.6 million for 2005, from $10.6 million for 2004. This increase was the result of:

an increase of $4.7 million relating to the LNG Deliveries;

an increase of $0.8 million relating to repair and maintenance work (net of insurance proceeds) completed on one of our LNG carriers in early 2005; and

an increase of $0.3 million due to the effect on our Euro-denominated vessel operating expenses from the strengthening of the Euro against the U.S. Dollar during 2005 (a majority of our vessel operating expenses are denominated in Euros, which is primarily a function of the nationality of our crew);

partially offset by

a decrease of $0.8 million relating to lower insurance, service and other operating costs in 2005, primarily as a result of Teekay Shipping Corporation s volume purchasing cost savings from which we benefit.

Depreciation and Amortization. Depreciation and amortization increased 97.4% to $30.4 million for 2005, from $15.4 million for 2004. This increase was the result of:

an increase of $12.7 million relating to the LNG Deliveries;

an increase of $1.4 million from the amortization, as an intangible asset, of the value of the Teekay Spain time charters acquired on April 30, 2004; and

an increase of $0.9 million resulting from an increase in the book values of the Teekay Spain vessels acquired on April 30, 2004 to their respective fair values.

Suezmax Tanker Segment

During most of 2004, we had six Suezmax tankers, while during most of 2005, we had five Suezmax tankers. The results of our Suezmax tanker segment reflect the following fleet changes during 2004 and 2005:

the delivery of two Suezmax tanker newbuildings *(*the *Teide Spirit* and the *Toledo Spirit)* in November 2004 and July 2005, respectively (collectively, the *Suezmax Deliveries*);

the sale of two Suezmax tankers (the *Sevilla Spirit* and the *Leon Spirit*) in the fourth quarter of 2004 (collectively, the *Suezmax Dispositions*);

the sale of the *Granada Spirit* to Teekay Shipping Corporation in December 2004, in connection with a significant drydocking and re-flagging of the vessel, the contribution of this vessel to us on May 6, 2005, and the subsequent sale back to Teekay Shipping Corporation on May 26, 2005 (collectively, the *Granada Spirit Transactions*);

the delivery and concurrent sale of the Suezmax tanker newbuilding (the *Santiago Spirit*) to Teekay Shipping Corporation in March 2005; and

the acquisition of the ConocoPhillips Tankers from Teekay Shipping Corporation in November 2005.

As a result, our total revenue days decreased by 16.1% from 2,042 days in 2004 to 1,714 days in 2005.

Net Voyage Revenues. Net voyage revenues decreased 21.1% to $47.2 million for 2005, from $59.8 million for 2004. This decrease was the result of:

a decrease of $16.6 million relating to the Suezmax Dispositions; and

a decrease of $15.5 million relating to the Granada Spirit Transactions, which include the change in employment of the *Granada Spirit* from operating on voyage charters in the spot market during 2004 to operating under a lower fixed-rate time charter during the period from May 6, 2005 to May 26, 2005, when we disposed of the vessel;

partially offset by

an increase of $14.3 million relating to the Suezmax Deliveries;

an increase of $2.9 million relating to the acquisition of the ConocoPhillips Tankers; and

an increase of $2.3 million due to adjustments to the daily charter rate based on inflation and increases from rising interest rates in accordance with the time charter contracts for all Suezmax tankers other than the *Granada* Spirit. However, under the terms of our capital leases for our tankers subject to these charter rate fluctuations, we had a corresponding increase in our lease payments, which is reflected as an increase to interest expense. Therefore, these interest rate adjustments, which will continue, did not affect our cash flow or net income.

Vessel Operating Expenses. Vessel operating expenses decreased 34.0% to $13.2 million for 2005, from $20.0 million for 2004. This decrease was the result of:

a decrease of $9.5 million relating to the Suezmax Dispositions and the Granada Spirit Transactions;

a decrease of $0.7 million relating to lower insurance, service and other operating costs in 2005, primarily as a result of Teekay Shipping Corporation s volume purchasing cost savings, from which we benefit; and

a decrease of $0.6 million relating to insurance proceeds received during the second half of 2005 in respect of repair costs previously incurred;

partially offset by

an increase of $3.1 million relating to the Suezmax Deliveries;

an increase of $0.6 million relating to the ConocoPhillips Tankers; and

an increase of $0.3 million due to the effect on our Euro-denominated vessel operating expenses from the strengthening of the Euro against the U.S. Dollar during 2005 (a majority of our vessel operating expenses are denominated in Euros, which is primarily a function of the nationality of our crew).

Depreciation and Amortization. Depreciation and amortization decreased 34.4% to $12.8 million for 2005, from $19.5 million for 2004. This decrease was the result of:

a decrease of $10.9 million relating to the Suezmax Dispositions and the Granada Spirit Transactions;

partially offset by

an increase of $3.1 million relating to the Suezmax Deliveries;

an increase of $0.7 million relating to the ConocoPhillips Tankers; and

an increase of $0.4 million during 2005 resulting from an increase in the book values of the Teekay Spain vessels acquired on April 30, 2004 to their respective fair values.

Other Operating Results

General and Administrative Expenses. General and administrative expenses increased 53.8% to $10.0 million for 2005, from $6.5 million for 2004. This increase was the result of:

an increase of $2.5 million associated with (a) services agreements we and certain of our subsidiaries entered into with subsidiaries of Teekay Shipping Corporation in connection with our initial public offering, (b) fees and cost reimbursements of our general partner and (c) additional expenses as a result of being a publicly-traded limited partnership;

an increase of $0.7 million relating to the legal costs associated with the repayment of term loans, settlement of interest rate swaps made in connection with our initial public offering and restructuring of loans; and

a number of smaller factors that increased general and administrative expenses by $0.3 million.

Interest Expense. Interest expense increased 1.8% to $73.3 million for 2005, from $72.0 million for 2004. This increase was the result of:

an increase of $11.0 million relating to an increase in debt used to finance the LNG Deliveries, Suezmax Deliveries, the acquisition of the ConocoPhillips Tankers and an increase in interest rates in our capital leases for our Suezmax tankers, partially offset by the reduction in interest expense from the repayments of debt with the proceeds of the Suezmax Dispositions and the Granada Spirit Transactions; and

an increase of $8.9 million relating to the increase in capital lease obligations in connection with the delivery of one LNG carrier in December 2004, partially offset by lower interest expense resulting from scheduled capital lease repayments on a second LNG carrier which delivered in August 2003 (these LNG vessels have been financed pursuant to Spanish tax lease arrangements, under which we borrowed under term loans and deposited the proceeds into restricted cash accounts and entered into capital leases for the vessels; as a result, these increases in interest expense are offset by a corresponding increase in the interest income from restricted cash);

partially offset by

a decrease of $15.9 million resulting from the repayment of $337.3 million of term loans and the settlement of related interest rate swaps prior to our initial public offering; and

a decrease of $2.7 million resulting from Teekay Shipping Corporation s contribution to us of the interest-bearing loans in connection with our initial public offering.

Interest Income. Interest income increased 4.5% to $23.2 million for 2005, from $22.2 million for 2004. Interest income primarily reflects interest earned on restricted cash deposits that approximate the present value of the remaining amounts we owe under lease arrangements on two of our LNG carriers. This increase was the result of:

- an aggregate increase of $3.0 million primarily from $54.5 million of additional cash being placed in restricted cash deposits in December 2004;

- an increase of $0.6 million primarily from temporary investments held during 2005; and

- an increase of $0.6 million from interest earned on overnight deposits in our bank accounts;

partially offset by

- a decrease of $3.2 million resulting from $76.3 million of cash withdrawals during December 2004 used to make scheduled repayments of capital lease obligations.

Foreign Currency Exchange Gains. Foreign currency exchange gains were $81.8 million for 2005, compared to foreign currency exchange losses of $60.8 million for 2004. These foreign currency exchange gains and losses, substantially all of which were unrealized, are due substantially to the relevant period-end revaluation of Euro-denominated term loans for financial reporting purposes. The gains reflect a stronger U.S. Dollar against the Euro on the date of revaluation. The losses reflect a weaker U.S. Dollar against the Euro on the date of revaluation.

Other Loss. Other loss of $15.0 million for 2005 resulted from:

- a $7.8 million loss from the settlement of interest rate swaps in April 2005 that were being used to hedge the interest rate risk on two of our term loans that were repaid at that time;

- a $7.5 million loss from the write-off of capitalized loan costs relating to the two term loans we repaid in April 2005; and

- $0.2 million of other miscellaneous expense;

partially offset by

- $0.3 million of income tax recoveries; and

- a $0.2 million gain from the sale of the Granada Spirit to Teekay Shipping Corporation during May 2005.

Other loss of $4.6 million for 2004 resulted from:

- a $11.9 million loss on the sale of non-shipping assets by Tapias prior to its acquisition on April 30, 2004 by Teekay Shipping Corporation; and

- $0.3 million of income taxes;

partially offset by

- $4.0 million of gains resulting from changes in the fair values of our interest rate swaps (these interest rate swaps were not designated as hedges under U.S. accounting guidelines until April 30, 2004; consequently, the changes in fair values of these swaps that occurred prior to April 30, 2004 were recorded in earnings);

$3.4 million of gains on the sale of vessels and equipment; and

$0.2 million of other miscellaneous income and gains on the sale of marketable securities.

Net Income (Loss). As a result of the foregoing factors, net income was $79.5 million for 2005, compared to a net loss of $68.2 million for 2004.

Year Ended December 31, 2004 Versus Year Ended December 31, 2003

LNG Carrier Segment

Our four LNG carriers were delivered into our fleet in September 2002, August 2003, July 2004 and December 2004. Accordingly, our total revenue days increased by 74.1% from 518 days in 2003 to 902 days in 2004.

Net Voyage Revenues. Net voyage revenues increased 82.1% to $59.1 million for 2004, from $32.5 million for 2003, which was attributable to the addition of our LNG carriers during 2003 and 2004 and higher rates earned by more recently delivered LNG carriers.

Vessel Operating Expenses. Vessel operating expenses increased 81.3% to $10.6 million for 2004, compared to $5.9 million for 2003. Approximately $4.4 million of the increase was attributable to the delivery of our LNG carriers during 2003 and 2004, and approximately $0.3 million of the increase was attributable to the strengthening of the Euro against the U.S. Dollar in 2004. A majority of our vessel operating expenses are denominated in Euros, which is primarily a function of the nationality of our crew.

Depreciation and Amortization. Depreciation and amortization increased 173.4% to $15.4 million for 2004, from $5.6 million for 2003, primarily due to the following factors:

the addition of our three LNG carriers in August 2003 and July and December 2004;

the amortization, as an intangible asset, of the value of the Tapias time charters acquired on April 30, 2004; and

increased depreciation resulting from recording the Tapias vessels at their acquisition cost as compared to their depreciated value prior to the acquisition.

Suezmax Tanker Segment

During 2003, we operated six Suezmax tankers. During the fourth quarter of 2004, we took delivery of one Suezmax newbuilding and sold three Suezmax tankers. As a result, our total revenue days decreased by 0.2% from 2,047 days in 2003 to 2,042 days in 2004.

Net Voyage Revenues. Net voyage revenues increased 21.2% to $59.8 million for 2004, from $49.3 million for 2003. The increase was primarily the result of:

a $5.1 million increase in net voyage revenues for 2004 compared to 2003 due to increases in average spot market rates earned by the *Granada Spirit;*

a $4.2 million increase in net voyage revenues for 2004 compared to 2003 due to an increase in the voyage revenues earned from a charter with a variable component based on spot market rates; and

a $2.9 million increase in net voyage revenues due to fewer off-hire days from drydocking in 2004 compared to 2003.

These increases were partially offset by a decrease of $1.2 million in net voyage revenues due to a net reduction in fleet size and corresponding reduction in calendar-ship-days in 2004, and by a $0.5 million decrease in net voyage revenues in 2004 from three time charters that fluctuate based on changes in interest rates. However, under the terms of our capital leases for the three vessels with fluctuating charter rates, we had a corresponding reduction in our lease payments, which is reflected as a reduction of interest expense.

Vessel Operating Expenses. Vessel operating expenses decreased 2.8% to $20.0 million for 2004, compared to $20.6 million for 2003, primarily due to the reduction in calendar-ship-days, partially offset by strengthening of the Euro against the U.S. Dollar.

Depreciation and Amortization. Depreciation and amortization increased 9.6% to $19.5 million for 2004, from $17.8 million for 2003. The increase was primarily due to the following factors:

- the amortization, as an intangible asset, of the value of the Tapias time charters acquired on April 30, 2004; and
- increased depreciation resulting from recording the Tapias vessels at their acquisition cost as compared to their depreciated value prior to the acquisition.

Other Operating Results

General and Administrative Expenses. General and administrative expenses decreased 26.1% to $6.5 million for 2004, from $8.8 million for 2003, primarily due to a $3.0 million decrease in expenses resulting from four months of expenses associated with a yacht and certain other non-shipping assets disposed of by Tapias immediately prior to its acquisition on April 30, 2004 by Teekay Shipping Corporation, compared to a full year of these expenses included in our results for 2003. The decrease in general and administrative expenses in 2004 was partially offset by an increase of $0.7 million in shore-staff performance-based bonuses.

Interest Expense. Interest expense increased 106.3% to $72.0 million for 2004, from $34.9 million for 2003. This increase primarily reflects increases in interest-bearing debt and capital lease obligations associated with the delivery of one LNG carrier in each of August 2003 and July 2004 and interest-bearing loans from Teekay Shipping Corporation during April 2004 for the purchase of Teekay Spain, partialy offset by the repayment of certain term loans commencing in December 2004.

Interest Income. Interest income increased 164.3% to $22.2 million for 2004, from $8.4 million for 2003. This increase was primarily due to interest earned on increased restricted cash deposits.

Foreign Currency Exchange Loss. Foreign currency exchange loss decreased to $60.8 million for 2004 from $71.5 million for 2003. These foreign currency exchange losses, substantially all of which were unrealized, are due substantially to the period-end revaluation of Euro-denominated term loans for financial reporting purposes. The higher loss in 2003 reflects the greater weakening of the U.S. Dollar against the Euro during 2003 compared to 2004.

Other Income (Loss). Other loss of $4.6 million for 2004 resulted from:

- a $11.9 million loss on the sale of non-shipping assets by Tapias prior to its acquisition on April 30, 2004 by Teekay Shipping Corporation; and
- $0.3 million of income taxes;

partially offset by

- $4.0 million of gains resulting from changes in the fair values of our interest rate swaps (these interest rate swaps were not designated as hedges under U.S. accounting guidelines until April 30, 2004; consequently, the changes in fair values of these swaps that occurred prior to April 30, 2004 were recorded in earnings);
- $3.4 million of gains on the sale of vessels and equipment; and
- $0.2 million of other miscellaneous income and gains on the sale of marketable securities.

Other income of $15.3 million for 2003 resulted from:

- $14.7 million of gains resulting from changes in the fair values of our interest rate swaps (these interest rate swaps were not designated as hedges under U.S. accounting guidelines until April 30, 2004; consequently, the changes in fair values of these swaps that occurred prior to April 30, 2004 were recorded in earnings);

a $1.6 million gain on the sale of marketable securities; and

$2.2 million of other miscellaneous income;

partially offset by

$3.0 million of income taxes; and

$0.2 million of minority interest expense.

The marketable securities, other miscellaneous income and minority interest expense all relate to non-shipping assets disposed of by Tapias prior to its acquisition by Teekay Shipping Corporation.

Net Loss. As a result of the foregoing factors, net loss decreased to $68.2 million for 2004 from $59.4 million for 2003.

Liquidity and Capital Resources

Liquidity and Cash Needs

As at December 31, 2005, our total cash and cash equivalents totaled $34.5 million, compared to $156.4 million at December 31, 2004. Our total liquidity including cash, cash equivalents and undrawn long-term borrowings, was $105.5 million as at December 31, 2005, compared to $156.4 million as at December 31, 2004. Total liquidity as at December 31, 2005 includes $71.0 million of availability under our $100 million senior secured revolving credit facility as discussed below. Total liquidity as at December 31, 2005 does not include our additional $137.5 million nine-year revolving credit facility that we entered into during December 2005, as the facility was not available to us until after year end.

Our primary short-term liquidity needs are to pay quarterly distributions on our outstanding units and to fund general working capital requirements and drydocking expenditures, while our long-term liquidity needs primarily relate to expansion and maintenance capital expenditures and debt repayment. Expansion capital expenditures primarily represent the purchase or construction of vessels to the extent the expenditures increase the operating capacity or revenue generated by our fleet, while maintenance capital expenditures primarily consist of drydocking expenditures and expenditures to replace vessels in order to maintain the operating capacity or revenue generated by our fleet. We anticipate that our primary sources of funds for our short-term liquidity needs will be cash flows from operations while our long-term sources of funds will be from cash from operations, term loans and other debt or equity financings.

We believe that cash flows from operations will be sufficient to meet our short-term liquidity needs for at least the next 12 months. We may need to raise additional capital to finance the purchase of our five Suezmax tankers that we are required to purchase at the end of their capital lease terms, which will be at various times from 2007 to 2011. We anticipate that we will be able to purchase these five tankers by assuming the outstanding financing obligations that relate to them; however, we may be required to obtain separate debt or equity financing to complete the purchases if the lenders do not consent to our assuming the financing obligations. We may be unable to raise additional funds on favorable terms, if at all.

Cash Flows. The following table summarizes our sources and uses of cash for the periods presented:

	Years Ended Dece 2005 ($000's)
Sources of Cash:	
Operating activities:	65,718
Financing activities:	
Advances from affiliate	354,277
Proceeds from issuance of common units	259,289
Proceeds from long-term debt	291,189
Decrease in restricted cash	80,365
Other	-

Investing activities:	
Proceeds from sale of vessels and equipment	133,270
Other	-
	1,184,108
Uses of Cash:	
Financing activities:	
Repayments of debt and capital lease obligations	486,525
Advances to affiliate	252,929
Interest rate swap settlement costs	143,295
Cash distributions paid	20,090
Other	628
Investing activities:	
Expenditures for vessels and equipment	222,582
Purchase of three Suezmax tankers from Teekay Shipping Corporation	180,000
Purchase of Teekay Shipping Spain S.L., net of cash acquired of $11,191	-
Other	-
	1,306,049
Net Increase (Decrease) in Cash and Cash Equivalents	(121,941)

Operating Cash Flows. Net cash flow from operating activities increased to $65.7 million in 2005, from $25.1 million in 2004, primarily reflecting the increase in the size of our LNG fleet. Net cash flow from operating activities depends upon the timing and amount of drydocking expenditures, repairs and maintenance activity, vessel additions and dispositions, foreign currency rates, changes in interest rates, fluctuations in working capital balances and spot market hire rates (to the extent we have vessels operating in the spot tanker market or our hire rates are partially affected by spot market rates). The number of vessel drydockings tends to be uneven between years.

The capital component of the hire rate for our Suezmax time charters (other than for the ConocoPhillips Tankers) fluctuates with the floating interest rates for the debt used to finance the related vessels. If interest rates increase or decrease, the amount we pay under the capital leases relating to the chartered vessels increases or decreases by the amount of the additional or reduced interest payments, and the capital component we receive from the related time charters correspondingly changes. Consequently, the fluctuating portion of the capital component has no net effect on our cash flows or net income, but does affect our recorded voyage revenues and interest expense.

Financing Cash Flows. Our investments in vessels and equipment have been financed primarily with term loans and capital lease arrangements. Net proceeds from long-term debt were $291.2 million and $133.7 million, respectively, for 2005 and 2004. We used these funds to make newbuilding installment payments.

In December 2004, Teekay Shipping Corporation advanced to us $409.1 million primarily for the purchase of Teekay Spain and to prepay debt associated with two of the LNG carriers. During 2005, Teekay Shipping Corporation advanced a further $353.1 million to us and we used these funds, along with existing cash balances, to repay certain term loans and settle certain interest rate swaps. Teekay Shipping Corporation contributed to us all but $54.9 million of these loans and other assets in connection with our initial public offering in exchange for notes payable of $129.4 million, which were repaid from the proceeds of the offering and partnership interests in us.

Scheduled debt repayments were $9.5 million during 2005 compared to $70.5 million during 2004. Repayments of capital lease obligations were $77.7 million in 2005 compared to $66.7 million in 2004. Debt prepayments were $399.3 million during 2005 compared to $61.9 million during 2004. Prior to our initial public offering, we repaid $337.3 million of term loans associated with two LNG carriers. Please read Item 18 Financial Statements: Note 8 Long-Term Debt.

As at December 31, 2005, our total debt was $406.4 million, compared to $787.1 million as at December 31, 2004. As at December 31, 2005, our revolving credit facility provided for borrowings of up to $100.0 million, of which $71.0 million was undrawn. As at December 31, 2005, we had term loans outstanding that totaled 318.5 million Euros ($377.4 million) of Euro-denominated loans, compared to $343.4 million of U.S. Dollar-denominated loans and 325.8 million Euros ($443.7 million) of Euro-denominated loans as at December 31, 2004. Our Euro-denominated term loans reduce in monthly payments with varying maturities through 2023. Please read Item 18 Financial Statements: Note 8 Long-Term Debt. The Euro-denominated loans were used to make restricted cash deposits that fully fund payments under capital leases. Please read Item 18 Financial Statements: Note 5 Capital Lease Obligations and Restricted Cash.

We entered into a $100 million revolving credit facility in connection with our initial public offering, of which $71.0 million was undrawn at December 31, 2005. We may use this facility for general partnership purposes and to fund cash distributions. Under the credit facility, we are required to reduce all borrowings used to fund cash distributions to zero for a period of at least 15 consecutive days during any 12-month period. Interest payments are based on LIBOR plus a margin. The credit facility is available to us until September 2009. Our obligations under this facility are secured by a first-priority mortgage on one of our LNG carriers, the *Hispania Spirit*, and a pledge of certain shares of the subsidiary operating the carrier.

During December 2005, we entered into a $137.5 million nine-year revolving credit facility, which became available to us in 2006. This facility may be used by us for general partnership purposes. Our obligations under this facility are secured by a first-priority mortgage on three of our Suezmax tankers and a pledge of certain shares of the subsidiaries operating the Suezmax tankers. The credit facility bears interest at a rate of LIBOR plus a margin. This facility contains covenants that require us to maintain a minimum free liquidity, minimum tangible net worth and a maximum leverage ratio.

As at December 31, 2005, our total debt related to newbuilding vessels to be acquired was $319.6 million, which consists of $205.9 million of U.S. Dollar-denominated term loans of Teekay Nakilat, $111.7 million of interest-bearing loans from Teekay Shipping Corporation and Qatar Gas Transport Company Ltd. (Nakilat), and $2.0 million of non-interest bearing loans from Teekay Shipping Corporation. Interest costs on debt related to newbuilding vessels are capitalized to advances on newbuilding contracts. Please read Item 18 Financial Statements: Note 15 Commitments and Contingencies.

Interest payments on the term loans in Teekay Nakilat are based on LIBOR plus a margin. The term loans reduce in quarterly payments commencing three months after delivery of each LNG newbuilding. Once fully drawn, the loans have approximately $56.0 million per vessel in bullet repayments, due at maturity. Interest payments on the loans from Teekay Shipping Corporation and Qatar Gas Transport Company Ltd. (Nakilat) are based on a fixed interest rate of 4.84%, commencing a year after the delivery of the third LNG carrier. These loans are unsecured and are repayable on demand.

The RasGas II term loan agreements, which we expect to assume, currently require Teekay Shipping Corporation s guaranty and require Teekay Shipping Corporation to maintain at least $100.0 million of free liquidity (excluding the portion attributable to us). The amount of Teekay Shipping Corporation s consolidated free liquidity (as defined above) plus any undrawn revolving credit facilities (excluding that portion attributable to us and excluding undrawn committed revolving credit lines with less than six months to maturity) is required to equal at least 7.5% of Teekay Shipping Corporation s total debt (excluding non-recourse debt).

As at December 31, 2005 and 2004, the margins on our term loans and revolving credit facilities ranged from 0.5% to 1.3%.

All of our existing vessel financing is arranged on a vessel-by-vessel basis, and each financing is secured by first-preferred mortgages on the applicable vessel, together with other related collateral. Our capital leases do not contain financial or restrictive covenants other than those relating to operation and maintenance of the vessels. In addition, our ship-owning subsidiaries may not pay dividends or distributions if we are in default under our loan agreements and revolving credit facilities.

The term loan agreements for our LNG carriers, including the RasGas II financing arrangements we expect to assume, are with separate shipowning subsidiaries, although Teekay Spain guarantees the payments under the term loan agreements for all of our existing LNG carriers (or Teekay Shipping Corporation in the case of the RasGas II loan agreements). These agreements and the agreements that govern our revolving credit facilities contain covenants and other restrictions typical of debt financing secured by vessels, including, but not limited to, one or more of the following that restrict the shipowning subsidiaries from:

- incurring or guaranteeing indebtedness;
- changing ownership or structure, including mergers, consolidations, liquidations and dissolutions;
- making dividends or distributions if we are in default;
- making capital expenditures in excess of specified levels;
- making certain negative pledges and granting certain liens;
- selling, transferring, assigning or conveying assets;
- making certain loans and investments; and

entering into a new line of business.

The term loan for one of our LNG carriers, the *Catalunya Spirit*, contains covenants that require the maintenance of a minimum liquidity of 5.0 million Euros and annual restricted cash deposits of 1.2 million Euros.

We conduct our funding and treasury activities within corporate policies designed to minimize borrowing costs and maximize investment returns while maintaining the safety of the funds and appropriate levels of liquidity for our purposes. We hold cash and cash equivalents primarily in U.S. dollars, with some balances held in Euros.

We are exposed to the impact of interest rate changes primarily through our unhedged floating-rate borrowings. As at December 31, 2005, our unhedged floating-rate borrowings totaled $29.0 million. Significant increases in interest rates could adversely affect our operating margins, results of operations and our ability to service our debt. We use interest rate swaps to reduce our exposure to market risk from changes in interest rates. Please read Item 11 Quantitative and Qualitative Disclosures About Market Risk.

Commencing after the date of our initial public offering, cash distributions declared during 2005 were $20.1 million, or $0.4125 per unit per quarter. For the quarter ended June 30, 2005, cash distributions declared were prorated for the period of May 10, 2005 to June 30, 2005.

Investing Cash Flows. During 2005, we sold two Suezmax tankers (the *Granada Spirit* and the *Santiago Spirit*) to Teekay Shipping Corporation for gross proceeds of $83.6 million. In addition, immediately after the delivery of the *Toledo Spirit* in July 2005, we sold this vessel for gross proceeds of $49.7 million and leased it back under a capital lease arrangement similar to those in place for our Suezmax tankers other than the ConocoPhillips Tankers.

During 2005, we incurred capital expenditures for vessels and equipment of $222.6 million. These capital expenditures represent construction installment payments for three LNG newbuildings owned by Teekay Nakilat and two Suezmax tankers, the *Toledo Spirit* and the *Santiago Spirit*. In November 2005, we acquired the ConocoPhillips Tankers from Teekay Shipping Corporation for $180.0 million.

Net cash used in investing activities for 2004 consisted primarily of $89.2 million of construction costs relating to three Suezmax tankers and four LNG carriers we had under construction. In April 2004, Luxco acquired all of the outstanding shares of Teekay Spain S.L. for $298.2 million in cash, plus the assumption of debt and remaining newbuilding commitments.

In 2004, we sold three Suezmax tankers for proceeds of $74.3 million and also sold and leased back one Suezmax tanker for proceeds of $49.4 million. One of these Suezmax tankers, the *Granada Spirit*, was sold to another subsidiary of Teekay Shipping Corporation. Upon the closing of our initial public offering, Teekay Shipping Corporation contributed the *Granada Spirit* back to us and chartered it under a short-term, fixed-rate time charter until we disposed of the vessel on May 26, 2005.

We have agreed to acquire from Teekay Shipping Corporation its 70% interest in Teekay Nakilat, which owns three LNG newbuilding carriers. We expect to take delivery of the three LNG newbuildings between the fourth quarter of 2006 and the first half of 2007. Upon their delivery, the three LNG carriers will provide transportation services to RasGas II. Please read Item 18 Financial Statements: Note 15 Commitments and Contingencies.

We are obligated to purchase five of our existing Suezmax tankers upon the termination of the related capital leases, which will occur at various times from 2007 to 2011, seven years from the respective commencement dates of the capital leases. The purchase price will be based on the unamortized portion of the vessel construction financing costs for the vessels, which we expect to range from $39.4 million to $41.9 million per vessel. We expect to satisfy the purchase price by assuming the existing vessel financing. We are also obligated to purchase two of our existing LNG carriers upon the termination of the related capital leases in 2006 for the *Catalunya Spirit* and 2011 for the *Madrid Spirit*, both of which purchase obligations have been fully funded with restricted cash deposits. Please read Item 18 Financial Statements: Note 5 Capital Lease Obligations and Restricted Cash.

Contractual Obligations and Contingencies

The following table summarizes our long-term contractual obligations as at December 31, 2005:

	Total	1 year	1 – 3 years	3 y
		(in millions of U.S. D		
U.S. Dollar-Denominated Obligations:				

Long-term debt (1)	29.0	-	-	2
Commitments under capital leases (2)	275.8	25.5	153.7	9
Long-term debt relating to newbuilding vessels to be acquired (3)	319.6	-	17.4	2
Total U.S. Dollar-denominated obligations	624.4	25.5	171.1	14
Euro-Denominated Obligations: (4)				
Long-term debt (5)	377.4	8.1	18.0	2
Commitments under capital leases (2) (6)	341.5	146.0	56.4	6
Total Euro-denominated obligations	718.9	154.1	74.4	8
Totals	1,343.3	179.6	245.5	23

(1) Excludes interest payments which are based on LIBOR plus a margin.

(2) Includes amounts we are required to pay to purchase the vessels at the end of the lease terms. Please read Item 18 Financial Statements: Note 5 Capital Lease Obligations and Restricted Cash.

(3) During May 2005, we entered into an agreement with Teekay Shipping Corporation to purchase its 70% interest in Teekay Nakilat, which owns three LNG newbuildings and the related 20-year time charters. The purchase will occur upon the delivery of the first newbuilding, which is scheduled during the fourth quarter of 2006. As a result of this agreement, under current U.S. accounting guidelines we are required to consolidate Teekay Nakilat even though we do not yet have an ownership interest in Teekay Nakilat. As at December 31, 2005, the assets of Teekay Nakilat included the three LNG newbuildings, which had a carrying value of $316.9 million, and other assets of $2.7 million. These assets have been financed with $205.9 of term loans and $113.7 million of loans from Teekay Shipping Corporation and Qatar Gas Transport Company Ltd. (Nakilat).

Our 70% responsibility for the total cost for the three vessels, including shipyard payments, capitalized financing cost and the other costs, is estimated to be approximately $420.5 million. Long-term vessel financing will cover approximately $327.7 million of this amount. We will be required to fund the remaining approximately $92.8 million of the purchase price for Teekay Shipping Corporation s interest in Teekay Nakilat. During January 2006, Teekay Shipping Corporation completed a 30-year U.K. lease arrangement that will be used to finance the purchase of the three newbuildings owned by Teekay Nakilat. The tax benefits of this lease arrangement are expected to reduce the equity portion of our purchase of Teekay Shipping Corporation s 70% interest in Teekay Nakilat by approximately $40 million, from approximately $93 million to approximately $53 million. Please read Item 18 Financial Statements: Note 13(e) Related Party Transactions.

(4) Euro-denominated obligations are presented in U.S. Dollars and have been converted using the prevailing exchange rate as of December 31, 2005.

(5) Excludes interest payments which are based on EURIBOR plus a margin.

(6) Existing restricted cash deposits, together with the interest earned on the deposits, will equal the remaining amounts we owe under the lease arrangements, including our obligation to purchase the vessels at the end of the lease terms.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements that have or are reasonably likely to have, a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Critical Accounting Policies

We prepare our consolidated financial statements in accordance with GAAP, which require us to make estimates in the application of our accounting policies based on our best assumptions, judgments and opinions. Following is a discussion of the accounting policies that involve a high degree of judgment and the methods of their application. For a further description of our material accounting policies, please read Item 18 Financial Statements: Note 1 Summary of Significant Accounting Policies.

Revenue Recognition

We recognize revenues from time charters daily over the term of the charter as the applicable vessel operates under the charter. We do not recognize revenues during days that the vessel is off-hire.

Prior to 2005, we generated a portion of our revenues from voyage charters. Within the shipping industry, the two methods used to account for voyage revenues and expenses from voyage charters are the percentage of completion and the completed voyage methods. Most shipping companies, including us, use the percentage of completion method. For each method, voyages may be calculated on either a load-to-load or discharge-to-discharge basis. In other words, revenues are recognized ratably either from the beginning of when product is loaded for one voyage to when it is loaded for another voyage, or from when product is discharged (unloaded) at the end of one voyage to when it is discharged after the next voyage.

In applying the percentage of completion method, we believe that, in most cases, the discharge-to-discharge basis of calculating voyages more accurately reflects voyage results than the load-to-load basis. At the time of cargo discharge, we generally have information about the next load port and expected discharge port, whereas at the time of loading we are normally less certain what the next load port will be. We have used this method of revenue recognition for all spot voyages. However, we did not begin recognizing voyage revenue until a charter had been agreed to by the customer and us, even if the vessel had discharged its cargo and was sailing to the anticipated load port on its next voyage.

Vessel Lives and Impairment

The carrying value of each of our vessels represents its original cost at the time of delivery or purchase less depreciation or impairment charges. We depreciate our vessels on a straight-line basis over a vessel s estimated useful life, less an estimated residual value. Depreciation is calculated using an estimated useful life of 25 years for Suezmax tankers and 35 years for LNG carriers, from the date the vessel was originally delivered from the shipyard, or a shorter period if regulations prevent us from operating the vessels to 25 years or 35 years, respectively. In the shipping industry, the use of a 25-year vessel life for Suezmax tankers has become the prevailing standard. In addition, the use of a 30 to 40 year vessel life for LNG carriers is typical. However, the actual life of a vessel may be different, with a shorter life potentially resulting in an impairment loss. We are not aware of any regulatory changes or environmental liabilities that we anticipate will have a material impact on our current or future operations.

The carrying values of our vessels may not represent their fair market value at any point in time since the market prices of second-hand vessels tend to fluctuate with changes in charter rates and the cost of newbuildings. Both charter rates and newbuilding costs tend to be cyclical in nature. We review vessels and equipment for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. We measure the recoverability of an asset by comparing its carrying amount to future undiscounted cash flows that the asset is expected to generate over its remaining useful life. If we consider a vessel or equipment to be impaired, we recognize impairment in an amount equal to the excess of the carrying value of the asset over its fair market value.

Drydocking

Generally, we drydock each LNG carrier and Suezmax tanker every five years. In addition, a shipping society classification intermediate survey is performed on our LNG carriers between the second and third year of the five-year drydocking period. We capitalize a substantial portion of the costs we incur during drydocking and for the survey and amortize those costs on a straight-line basis from the completion of a drydocking or intermediate survey to the estimated completion of the next drydocking. We expense costs related to routine repairs and maintenance incurred during drydocking that do not improve or extend the useful lives of the assets. When significant drydocking expenditures occur prior to the expiration of this period, we expense the remaining unamortized balance of the original drydocking cost and any unamortized intermediate survey costs in the month of the subsequent drydocking.

Derivative Instruments

We utilize derivative financial instruments to reduce interest rate risks. We do not hold or issue derivative financial instruments for trading purposes. Statement of Financial Accounting Standards (or *SFAS*) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, which was amended in June 2000 by SFAS No. 138 and in May 2003 by SFAS No. 149, establishes accounting and reporting standards for derivative instruments and hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial condition and measure those instruments at fair value. Derivatives that are not hedges or are not designated as hedges are adjusted to fair value through income. If the derivative is a hedge, depending upon the nature of the hedge, changes in the fair value of the derivatives are either offset against the fair value of assets, liabilities or firm commitments through income, or recognized in other comprehensive income until the hedged item is recognized in income. The ineffective portion of a derivative s change in fair value is immediately recognized into income.

Goodwill and Intangible Assets

We allocate the cost of acquired companies to the identifiable tangible and intangible assets and liabilities acquired, with the remaining amount being classified as goodwill. Certain intangible assets, such as time charter contracts, are being amortized over time. Our future operating performance will be affected by the amortization of intangible assets and potential impairment charges related to goodwill. Accordingly, the allocation of purchase price to intangible assets and goodwill may significantly affect our future operating results. The allocation of the purchase price of acquired companies to intangible assets and goodwill requires management to make significant estimates and assumptions, including estimates of future cash flows expected to be generated by the acquired assets and the appropriate discount rate to value these cash flows.

Goodwill and indefinite lived assets are not amortized, but reviewed for impairment annually, or more frequently if impairment indicators arise. The process of evaluating the potential impairment of goodwill and intangible assets is highly subjective and requires significant judgment at many points during the analysis. The fair value of our reporting units was estimated based on discounted expected future cash flows using a weighted-average cost of capital rate. The estimates and assumptions regarding expected cash flows and the discount rate require considerable judgment and are based upon existing contracts, historical experience, financial forecasts and industry trends and conditions.

Item 6. Directors, Senior Management and Employees

Management of Teekay LNG Partners L.P.

Teekay GP L.L.C., our general partner, manages our operations and activities. Unitholders are not entitled to elect the directors of our general partner or directly or indirectly participate in our management or operation.

Our general partner owes a fiduciary duty to our unitholders. Our general partner is liable, as general partner, for all of our debts (to the extent not paid from our assets), except for indebtedness or other obligations that are expressly nonrecourse to it. Whenever possible, our general partner intends to cause us to incur indebtedness or other obligations that are nonrecourse to it.

The directors of our general partner oversee our operations. The day-to-day affairs of our business are managed by the officers of our general partner and key employees of certain of our operating subsidiaries. Employees of certain subsidiaries of Teekay Shipping Corporation provide assistance to us and our operating subsidiaries pursuant to services agreements. Please read Item 7 Major Unitholders and Related Party Transactions.

The Chief Executive Officer and Chief Financial Officer of our general partner, Peter Evensen, allocates his time between managing our business and affairs and the business and affairs of Teekay Shipping Corporation. Mr. Evensen is the Executive Vice President and Chief Financial Officer of Teekay Shipping Corporation. The amount of time Mr. Evensen allocates between our business and the businesses of Teekay Shipping Corporation varies from time to time depending on various circumstances and needs of the businesses, such as the relative levels of strategic activities of the businesses. Mr. Evensen devotes sufficient time to our business and affairs as is necessary for their proper conduct.

Officers of Teekay LNG Projects Ltd., a subsidiary of Teekay Shipping Corporation, allocate their time between providing LNG strategic consulting and advisory services to certain of our operating subsidiaries and pursuing LNG project opportunities for Teekay Shipping Corporation, which projects, if awarded to Teekay Shipping Corporation, are offered to us pursuant to the non-competition provisions of the omnibus agreement. This agreement has previously been filed with the SEC. Please see Item 19. The omnibus agreement also permits us to pay to Teekay Shipping Corporation any incentive fees approved by the conflicts committee of our general partner s board of directors, in its sole discretion, and relating to LNG projects provided to us by Teekay Shipping Corporation. Any such fee would be intended to reward Teekay Shipping Corporation for obtaining, and to further motivate it in pursuing additional, LNG projects. Teekay Shipping Corporation, in turn, may pay incentive fees to Teekay LNG Projects Ltd. for LNG projects awarded to it as a result of the efforts of Teekay LNG Projects Ltd.

Officers of our general partner and those individuals providing services to us or our subsidiaries may face a conflict regarding the allocation of their time between our business and the other business interests of Teekay Shipping Corporation. Our general partner seeks to cause its officers to devote as much time to the management of our business and affairs as is necessary for the proper conduct of our business and affairs.

Directors, Executive Officers and Key Employees

The following table provides information about the directors and executive officers of our general partner and key employees of our operating subsidiary Teekay Spain as of December 31, 2005. Directors are elected for one-year terms. The business address of each of our directors and executive officers listed below is c/o Bayside House, Bayside Executive Park, West Bay Street and Blake Road, Nassau, Commonwealth of The Bahamas. The business address of each of our key employees of Teekay Spain is Musgo Street 5 28023, Madrid, Spain.

Name	Age	Position
C. Sean Day.............	56	Chairman
Bjorn Moller............	48	Vice Chairman and Director
Peter Evensen...........	47	Chief Executive Officer, Chief Financial Officer and Director
Robert E. Boyd..........	65	Director (1) (2)
Ida Jane Hinkley........	55	Director (1)
Ihab J.M. Massoud.......	37	Director (2)
George Watson...........	58	Director (1) (2)
Bruce C. Bell...........	58	Secretary
Andres Luna.............	49	Managing Director, Teekay Spain
Pedro Solana............	49	Director, Finance and Accounting, Teekay Spain

(1) Member of Audit Committee and Conflicts Committee.

(2) Member of Corporate Governance Committee.

Certain biographical information about each of these individuals is set forth below:

C. Sean Day has served as Chairman of Teekay GP L.L.C. since it was formed in November 2004. Mr. Day has served as Chairman of Teekay Shipping Corporation s board of directors since 1999. From 1989 to 1999, he was President and Chief Executive Officer of Navios Corporation, a large bulk shipping company based in Stamford, Connecticut. Prior to this, Mr. Day held a number of senior management positions in the shipping and finance industry. He is currently serving as a director of Kirby Corporation. Mr. Day also serves as the Chairman of Resolute Investments, Inc., the largest stockholder of Teekay Shipping Corporation.

Bjorn Moller has served as the Vice Chairman and a Director of Teekay GP L.L.C. since it was formed in November 2004. Mr. Moller is the President and Chief Executive Officer and a director of Teekay Shipping Corporation and has held those positions since April 1998. Mr. Moller has over 25 years experience in the shipping industry and has served in senior management positions with Teekay Shipping Corporation for more than 20 years. He has headed its overall operations since January 1997, following his promotion to the position of Chief Operating Officer. Prior to this, Mr. Moller headed Teekay Shipping Corporation s global chartering operations and business development activities.

Peter Evensen has served as the Chief Executive Officer and Chief Financial Officer of Teekay GP L.L.C. since it was formed in November 2004 and as a Director of Teekay GP L.L.C. since January 2005. Mr. Evensen is also the Executive Vice President and Chief Financial Officer of Teekay Shipping Corporation. He joined Teekay Shipping Corporation in May 2003 as Senior Vice President, Treasurer and Chief Financial Officer. He was appointed to his current positions with Teekay Shipping Corporation in February 2004. Mr. Evensen has over 20 years experience in banking and shipping finance. Prior to joining Teekay Shipping Corporation, Mr. Evensen was Managing Director and Head of Global Shipping at J.P. Morgan Securities Inc. and worked in other senior positions for its predecessor firms. His international industry experience includes positions in New York, London and Oslo.

Robert E. Boyd has served as a Director of Teekay GP L.L.C. since January 2005. From May 1999 until his retirement in March 2004, Mr. Boyd was employed as the Senior Vice President and Chief Financial Officer of Teknion Corporation, a company engaged in the design, manufacture and marketing of office systems and office furniture products. From 1991 to 1999, Mr. Boyd was employed by The Oshawa Group Limited, a company engaged in the wholesale and retail distribution of food products and real estate activities, where his positions included Executive Vice President-Financial and Chief Financial Officer.

Ida Jane Hinkley has served as a Director of Teekay GP L.L.C. since January 2005. From 1998 to 2001, she served as Managing Director of Navion Shipping AS, a shipping company at that time affiliated with the Norwegian state-owned oil company Statoil ASA (and subsequently acquired by Teekay Shipping Corporation in 2003). From 1980 to 1997, Ms. Hinkley was employed by the Gotaas-Larsen Shipping

Corporation, an international provider of marine transportation services for crude oil and gas (including LNG), serving as its Chief Financial Officer from 1988 to 1992 and its Managing Director from 1993 to 1997.

Ihab J.M. Massoud has served as a Director of Teekay GP L.L.C. since January 2005. Since 1998, he has been President of The Compass Group International LLC, a private equity investment firm based in Westport, Connecticut and an affiliate of Teekay Shipping Corporation. From 1995 to 1998, Mr. Massoud was employed in management at Petroleum Heat and Power, Inc. From 1993 to 1995, Mr. Massoud was a Vice President of Colony Capital, Inc., a Los Angeles-based private equity firm specializing in acquiring distressed real estate and corporate assets. Since 2005, Mr. Massoud has been serving as a Director and Chairman of Patriot Captial Funding Inc., a Nasdaq listed specialty finance company.

George Watson has served as a Director of Teekay GP L.L.C. since January 2005. Since July 2002, he has served as Chief Executive Officer of CriticalControl Solutions Inc. (formerly WNS Emergent), a provider of information control applications for the energy sector. From February 2000 to July 2002, he served as Executive Chairman at VerticalBuilder.com Inc. Mr. Watson served as President and Chief Executive Officer of TransCanada Pipelines Ltd. from 1993 to 1999 and as its Chief Financial Officer from 1990 to 1993.

Bruce C. Bell has served as the Secretary of Teekay GP L.L.C. since it was formed in November 2004. Since March 1994, Mr. Bell has been employed as the Managing Director of Oceanic Bank and Trust Limited, a Bahamian bank and trust company and in August 2005 he was appointed Chairman. Prior to joining Oceanic Bank and Trust Limited, Mr. Bell was engaged in the private practice of law in Canada, specializing in corporate/commercial, banking and international business transactions. From May 2000 until May 2003, Mr. Bell served as the Corporate Secretary of Teekay Shipping Corporation. Mr. Bell is also a director of Teekay Shipping Corporation.

Andres Luna has served as the Managing Director of Teekay Spain since April 2004. Mr. Luna joined Alta Shipping, S.A., a former affiliate company of Naviera F. Tapias S.A., in September 1992 and served as its General Manager until he was appointed Commercial General Manager of Naviera F. Tapias S.A. in December 1999. He also served as Chief Executive Officer of Naviera F. Tapias S.A. from July 2000 until its acquisition by Teekay Shipping Corporation in April 2004, when it was renamed Teekay Spain. Mr. Luna s responsibilities with Teekay Spain have included business development, newbuilding contracting, project management, development of its LNG business and the renewal of its tanker fleet. He has been in the shipping business since his graduation as a naval architect from Madrid University in 1981.

Pedro Solana has served as the Director, Finance and Accounting of Teekay Spain since August 2004. Mr. Solana joined Naviera F. Tapias S.A. in 1991 and served as Deputy Financial Manager until its acquisition by Teekay Shipping Corporation. Mr. Solana s responsibilities with Teekay Spain have included oversight of its accounting department and arranging for financing of its LNG carriers and crude oil tankers. He has been in the shipping business since 1980.

Officers of Teekay LNG Projects Ltd.

The following table provides information about the officers of Teekay LNG Projects Ltd., which is a wholly owned subsidiary of Teekay Shipping Corporation. As described above, Teekay LNG Projects Ltd. provides certain LNG strategic consulting and advisory services to Teekay Spain and certain of our other operating subsidiaries pursuant to services agreements and pursues LNG projects on behalf of Teekay Shipping Corporation, which will be offered to us pursuant to the omnibus agreement.

Name	Age	Position
David Glendinning..........	51	President
Mark J. Kremin.............	35	Vice President
Roy E. Spires..............	59	Vice President, Finance

David Glendinning has served as the President of Teekay LNG Projects Ltd. since it was formed in November 2004. Mr. Glendinning is also the President of Teekay Shipping Corporation s Teekay Gas and Offshore division, and has held this position since November 2003. Since joining Teekay Shipping Corporation, Mr. Glendinning has worked in a number of other senior positions with Teekay Shipping Corporation, including Vice President, Marine and Commercial Operations from January 1995 until his promotion to Senior Vice President, Customer Relations and Marine Project Development in February 1999. Prior to joining Teekay Shipping Corporation, Mr. Glendinning, who is a Master Mariner, had 18 years sea service on oil tankers of various types and sizes.

Mark J. Kremin has served as Vice President for Teekay LNG Projects Ltd. since March 2006. Mr. Kremin was also appointed Vice President, Gas Services of Teekay Shipping Corporation in March 2006. Mr. Kremin joined Teekay Shipping Corporation in November 2000, and served as its Vice President and Associate General Counsel until he was appointed to his current position. Prior to joining Teekay Shipping Corporation, Mr. Kremin was an attorney with Burke & Parsons, an admiralty law firm in New York City. Prior to attending law school, he worked for Mediterranean Shipping Company.

Roy E. Spires has served as Vice President, Finance of Teekay LNG Projects Ltd. since it was formed in November 2004. Mr. Spires has served as Teekay Shipping Corporation s Vice President, Finance from February 2004 until the closing of our initial public offering. He also served as Teekay Shipping Corporation s Director of Finance from November 1999 until February 2004. Prior to joining Teekay Shipping Corporation, Mr. Spires spent seven years with a publicly traded Canadian corporation, where his positions included Treasurer and Corporate Secretary. His experience includes over 17 years of management positions in commercial and corporate banking.

Reimbursement of Expenses of Our General Partner

Our general partner does not receive any management fee or other compensation for managing us. Our general partner and its other affiliates are reimbursed for expenses incurred on our behalf. These expenses include all expenses necessary or appropriate for the conduct of our business and allocable to us, as determined by our general partner. During 2005, these expenses were comprised of a portion of compensation earned by the Chief Executive Officer and Chief Financial Officer of our general partner, directors fees and travel expenses, as discussed below.

Annual Executive Compensation

We and our general partner were formed in November 2004. Our general partner neither paid any compensation to its directors or officers nor accrued any obligations with respect to management incentive or retirement benefits for the directors and officers prior to our initial public offering. Because the Chief Executive Officer and Chief Financial Officer of our general partner, Peter Evensen, is an employee of Teekay Shipping Corporation, his compensation (other than any awards under the long-term incentive plan described below) is set and paid by Teekay Shipping Corporation, and we reimburse Teekay Shipping Corporation for time he spends on partnership matters.

Our general partner compensates Bruce Bell, the Secretary of our general partner, for time he spends on partnership matters and may grant Mr. Bell awards under the long-term incentive plan described below. The corporate governance committee of the board of directors of our general partner establishes the compensation for certain key employees of our operating subsidiary Teekay Spain. Officers and employees of our general partner or its affiliates may participate in employee benefit plans and arrangements sponsored by Teekay Shipping Corporation, our general partner or their affiliates, including plans that may be established in the future.

The aggregate compensation earned by the Chief Executive Officer and Chief Financial Officer of our general partner and the two key employees of Teekay Spain listed above (or the *Executive Officers*) for 2005 was $1.5 million. This is comprised of base salary ($0.8 million), annual bonus ($0.6 million) and pension and other benefits ($0.1 million). These amounts were paid primarily in Canadian Dollars or in Euros, but are reported here in U.S. Dollars using an exchange rate of 1.16 Canadian Dollars for each U.S. Dollar and 0.85 Euro for each U.S. Dollar, the exchange rates on December 31, 2005. Teekay Shipping Corporation s annual bonus plan considers both company performance, through comparison to established targets and financial performance of peer companies, and individual performance. We have reimbursed our general partner for the portion of time that Mr. Evensen spent providing services to us. Please read Item 7. Major Unitholders and Related Party Transactions.

Compensation of Directors

Officers of our general partner or Teekay Shipping Corporation who also serve as directors of our general partner do not receive additional compensation for their service as directors. Each non-management director receives compensation for attending meetings of the board of directors, as well as committee meetings. Non-management directors receive a director fee of $30,000 per year and 700 common units subject to reverse vesting over a three-year period. Members of the audit and conflicts committees each receive a committee fee of $5,000 per year, and the chair of the audit committee receives an additional fee of $5,000 for serving in that role. In addition, each director is reimbursed for out-of-pocket expenses in connection with attending meetings of the board of directors or committees. Each director is fully indemnified by us for actions associated with being a director to the extent permitted under Marshall Islands law.

During 2005, the five non-employee directors received, in the aggregate, $170,000 in director and committee fees and reimbursement of $54,000 of their out-of-pocket expenses from our general partner. We reimbursed our general partner for these expenses as they were incurred for the conduct of our business. Please read Item 7. Major Unitholders and Related Party Transactions. During 2005, the five non-employee directors also received, in the aggregate, 3,500 common units of the Partnership.

2005 Long-Term Incentive Plan

Our general partner has adopted the Teekay LNG Partners L.P. 2005 Long-Term Incentive Plan for employees and directors of and consultants to our general partner and employees and directors of and consultants to its affiliates, who perform services for us. The plan provides for the award of restricted units, phantom units, unit options, unit appreciation rights and other unit or cash-based awards. Other than the previously mentioned 3,500 common units awarded to our general partner s directors, we have not made any awards under the 2005 long-term incentive plan.

Board Practices

Teekay GP L.L.C., our general partner, manages our operations and activities. Unitholders are not entitled to elect the directors of our general partner or directly or indirectly participate in our management or operation.

Our general partner s board of directors (or *the Board*) currently consists of seven members. Directors are appointed to serve until their successor is appointed or until they resign or are removed.

There are no service contracts between us and any of our directors providing for benefits upon termination of their employment or service.

The Board has the following three committees: Audit Committee, Conflicts Committee, and Corporate Governance Committee. The membership of these committees during 2005 and the function of each of the committees are described below. Each of the committees is currently comprised of independent members and operates under a written charter adopted by the Board. The committee charters for the Audit Committee and Corporate Governance Committee are available under Other Information Corporate Governance in the Investor Centre of our web site at www.teekaylng.com. During 2005, the Board held three meetings. Each director attended all Board meetings and all applicable committee meetings.

The Audit Committee of our general partner is composed of three or more directors, each of whom must meet the independence standards of the NYSE and the SEC. This committee is currently comprised of directors Robert E. Boyd (Chair), Ida Jane Hinkley and George Watson. All members of the committee are financially literate and the Board has determined that Mr. Boyd qualifies as an audit committee financial expert.

The Audit Committee assists the Board in fulfilling its responsibilities for general oversight of:

- the integrity of our financial statements;
- our compliance with legal and regulatory requirements;
- the independent auditors qualifications and independence; and
- the performance of our internal audit function and independent auditors.

The Conflicts Committee of our general partner is composed of the same directors constituting the Audit Committee, being George Watson (Chair), Robert E. Boyd and Ida Jane Hinkley. The members of the Conflicts Committee may not be officers or employees of our general partner or directors, officers or employees of its affiliates, and must meet the independence standards established by the NYSE to serve on an audit committee of a board of directors and certain other requirements.

The Conflicts Committee:

- reviews specific matters that the Board believes may involve conflicts of interest; and
- determines if the resolution of the conflict of interest is fair and reasonable to us.

Any matters approved by the Conflicts Committee will be conclusively deemed to be fair and reasonable to us, approved by all of our partners, and not a breach by our general partner of any duties it may owe us or our unitholders.

The Corporate Governance Committee of our general partner is composed of at least two or more directors, a majority of whom must meet the independence standards established by the NYSE. This committee is currently comprised of directors Ihab J.M. Massoud (Chair), Robert E. Boyd and George Watson.

The Corporate Governance Committee:

oversees the operation and effectiveness of the Board and its corporate governance;

develops and recommends to the Board corporate governance principles and policies applicable to us and our general partner and monitors compliance with these principles and policies and recommends to the Board appropriate changes; and

oversees director compensation and the long-term incentive plan described above.

Crewing and Staff

As of December 31, 2005, we employed approximately 376 seagoing staff who serve on our vessels and approximately 32 shore staff. Teekay Shipping Corporation and its subsidiaries may employ additional seagoing staff to assist us as we grow and has staffed the three Suezmax tankers we acquired in connection with our follow-on offering. Certain subsidiaries of Teekay Shipping Corporation provide advisory, operational and administrative support to us pursuant to services agreements. Please read Item 7 Major Unitholders and Related Party Transactions.

We regard attracting and retaining motivated seagoing personnel as a top priority. Like Teekay Shipping Corporation, we offer our seafarers competitive employment packages and comprehensive benefits and opportunities for personal and career development, which relates to a philosophy of promoting internally.

Teekay Shipping Corporation has entered into a Collective Bargaining Agreement with the Philippine Seafarers Union, an affiliate of the International Transport Workers Federation (or *ITF*), and a Special Agreement with ITF London, which cover substantially all of the officers and seamen that operate our Bahamian-flagged vessels. Our officers and seamen for our Spanish-flagged vessels are covered by a collective bargaining agreement with Spain s Union General de Trabajadores and Comisiones Obreras. We believe our relationships with these labor unions are good.

Our commitment to training is fundamental to the development of the highest caliber of seafarers for our marine operations. Teekay Shipping Corporation has agreed to allow our personnel to participate in its training programs. Teekay Shipping Corporation s cadet training approach is designed to balance academic learning with hands-on training at sea. Teekay Shipping Corporation has relationships with training institutions in Canada, Croatia, India, Latvia, Norway, Philippines, Turkey and the United Kingdom. After receiving formal instruction at one of these institutions, our cadets training continues on board on one of our vessels. Teekay Shipping Corporation also has a career development plan that we follow, which was designed to ensure a continuous flow of qualified officers who are trained on its vessels and familiarized with its operational standards, systems and policies. We believe that high-quality crewing and training policies will play an increasingly important role in distinguishing larger independent shipping companies that have in-house or affiliate capabilities from smaller companies that must rely on outside ship managers and crewing agents on the basis of customer service and safety.

Unit Ownership

The following table sets forth certain information regarding beneficial ownership, as of March 31, 2006, of our units by all directors and officers of our general partner and key employees as a group. The information is not necessarily indicative of beneficial ownership for any other purpose. Under SEC rules a person or entity beneficially owns any units that the person or entity has the right to acquire as of May 30, 2006 (60 days after March 31, 2006) through the exercise of any unit option or other right. Unless otherwise indicated, each person or entity has sole voting and investment power (or shares such powers with his or her spouse) with respect to the units set forth in the following table. Information for certain holders is based on information delivered to us.

Identity of Person or Group	Common Units Owned	Percentage of Common Units Owned	Subordinated Units Owned	Percentage of Subordinated Units Owned	Perc Tota Subo Units
All executive officers, key employees and directors as a group (10 persons) (1) (2)....	254,336	1.26%	-	-	

(1) Excludes units owned by Teekay Shipping Corporation, on the board of which serve the directors of our general partner, C. Sean Day and Bjorn Moller, and our general partner s Secretary, Bruce C. Bell. In addition, Mr. Moller is Teekay Shipping Corporation s Chief Executive Officer, and Peter Evensen, our

general partner s Chief Executive Officer, Chief Financial Officer and Director, is Teekay Shipping Corporation s Chief Financial Officer. Messrs. Day and Bell, also serve as directors and as the Chairman and Vice President, respectively, of Teekay Shipping Corporation s largest stockholder.

(2) Each director, executive officer and key employee beneficially owns less than one percent of the outstanding common and subordinated units.

(3) Excludes the 2% general partner interest held by our general partner, a wholly owned subsidiary of Teekay Shipping Corporation.

Item 7. Major Unitholders and Related Party Transactions

Major Unitholders

The following table sets forth information regarding beneficial ownership, as of March 31, 2006, of the Partnership s common and subordinated units by each person we know to beneficially own more than 5% of the common or subordinated units. The number of units beneficially owned by each person is determined under SEC rules and the information is not necessarily indicative of beneficial ownership for any other purpose. Under SEC rules a person beneficially owns any units as to which the person has or shares voting or investment power. In addition, a person beneficially owns any units that the person or entity has the right to acquire as of May 30, 2006 (60 days after March 31, 2006) through the exercise of any unit option or other right. The unitholder listed below has sole voting and investment power with respect to the units set forth in the following table.

Identity of Person or Group	Common Units Owned	Percentage of Common Units Owned	Subordinated Units Owned	Percentage of Subordinated Units Owned	an
Teekay Shipping Corporation (1)................	8,734,572	43.2%	14,734,572	100.0%	

(1) Excludes the 2% general partner interest held by our general partner, a wholly owned subsidiary of Teekay Shipping Corporation.

Our majority unitholder has the same voting rights as our other unitholders. The Partnership is directly controlled by Teekay Shipping Corporation. We are not aware of any arrangements, the operation of which may at a subsequent date result in a change in control of the Partnership.

Related Party Transactions

a) Pursuant to a Contribution, Conveyance and Assumption Agreement, on May 6, 2005, Teekay Shipping Corporation contributed all of the outstanding shares of Luxco, all but $54.9 million of the notes receivable from Luxco, and aR='FLANGST',CD='12-JUN-2004;04:11' -->

Option Plan for Non-Employee Directors, which we refer to as the "Directors' Plan," or our 1996 Stock Option Plan for Non-Employee Directors, which we refer to as the "1996 Directors' Plan."

In addition beginning in 1996, each current Non-Employee director receives a grant of an option under our 1996 Directors' Plan to acquire an additional 5,000 shares of our common stock each April beginning at the later of 1996 or five years after first elected as a director at exercise prices ranging from $5.375 per share to $12.875 per share. Under the Director's Plan and the 1996 Directors' Plan, options are granted to any director who is not an officer or employee of us or any of our subsidiaries or affiliates and who has not been such for a period of one year prior to his first being elected to the board, which we refer to as a "Non-Employee Director."

Options issued under the Directors' Plan and 1996 Directors' Plan are intended to be non-qualified stock options, not entitled to special tax treatment under Section 422A of the Internal Revenue Code of 1986, as amended, from time to time. The Directors' Plan and the 1996 Directors' Plan are administered by our board of directors, which has the sole responsibility for construing and interpreting those plans. Each option granted is evidenced by an option agreement between the optionee and us and, subject to the provisions of the Directors' Plan or the 1996 Directors' Plan, contains such terms and conditions as may be approved by the board. The purchase price of each share that may be purchased upon exercise of an option is the fair market value of the share on the date the option is granted. These options are exercisable for a period of approximately ten years. Under the Directors' Plan, any new Non-Employee Director elected or appointed was granted an option to purchase 25,000 shares of our common stock on the date such director took office. All options granted under the Directors' Plan vest over a five-year period from the date of grant with 20% of the option shares becoming first exercisable on each anniversary of the grant date.

The Directors' Plan was terminated with respect to future grants on April 10, 1996. Under the 1996 Directors' Plan, any new Non-Employee Director elected or appointed after April 30, 1996 is granted an option to purchase 25,000 shares of our common stock on the date such director takes office. All such options granted to new Non-Employee Directors vest over a five-year period from the date of grant with 20% of the option shares becoming first exercisable on the anniversary of the grant date. On each April 30 (after April 30, 1996), which is on or after the fifth anniversary of a Non-Employee Director's initial election as a director, such director is granted an additional option for 5,000 shares (subject to adjustment). Unless earlier terminated by the board, the 1996 Directors' Plan will terminate on June 1, 2006.

The Directors' Plan and the 1996 Directors' Plan provide, among other things, that the option of any optionee, whose status as a director terminates because of retirement, or removal from the board within one year after a change of control, as defined in such plans, will become fully exercisable with respect to all shares covered thereby and not previously purchased upon exercise of the option and will remain fully exercisable until the option expires by its terms.

Mr. Allen has non-qualified stock options for 11,781 shares of common stock and 11,782 shares of Class B common stock at an exercise price of $12.95 per share. Mr. Allen has been a management consultant to us and presently provides management consulting services to us. In fiscal 2004, he received payments of $14,000 from us. We expect to continue to retain Mr. Allen as a management consultant in fiscal 2005.

EXECUTIVE COMPENSATION

The following table sets forth the annual and long-term compensation for our chief executive officer and our four highest paid executive officers (named executive officers) during fiscal 2004, as well as the total compensation paid to each such individual for our two prior fiscal years.

Summary Compensation Table

					Long-Term Compensation			
		Annual Compensation			Awards		Payouts	
Name and Principal Position	Year	Salary	Bonus	Other Annual Compensation[2]	Restricted Stock Awards[3]	Stock Options/SARs	Long-Term Incentive Payouts	All Other Compensation[4]
Edward J.	2004	$ 444,845						
Richardson	2003	436,980	$ 38,600					$ 4,000
CEO and Chairman	2002	436,295	354,680					4,806
of the Board								
Bruce W. Johnson	2004	399,392	(1)		$ 129,000			
President and Chief	2003	391,263	80,575		85,800			4,000
Operating Officer	2002	372,397			70,600	25,000		4,806
Dario Sacomani	2004	284,738	(1)					
Senior Vice	2003	258,462	72,415		150,003	50,000		4,000
President and Chief	2002							
Financial Officer								
William G. Seils	2004	212,352	(1)					
Senior Vice	2003	209,142	70,014					4,000
President, General	2002	201,098	66,321			13,950		4,806
Counsel and								
Secretary								
Robert L. Prince	2004	211,239	(1)					
Executive Vice	2003	205,250	73,806					4,000
President,	2002	193,615	68,266			15,000		4,806
Worldwide Sales								

(1) As of June 10, 2004, the following bonuses have been paid for fiscal 2004: Mr. Johnson $108,303; Mr. Sacomani $93,910; Mr. Seils $84,106; and Mr. Prince $88,509. Upon completion of our fiscal 2004 financial statements, we will determine the remaining amounts of these bonuses based on specified performance goals.

(2) While officers enjoy certain perquisites, such perquisites do not exceed the lesser of $50,000 or 10% of such officer's salary and bonus except as shown.

(3) The restricted stock issued to Bruce W. Johnson vested at the date of grant and that issued to Mr. Sacomani vests in three equal annual installments. The number of shares and fair market value of unvested restricted stock as of May 31, 2004 held by Mr. Sacomani was 4,699 shares and $53,149, respectively, based on a closing price of $11.31 per share of our common stock on The Nasdaq National Market on May 28, 2004, the last trading day before May 31, 2004. Holders of restricted stock are entitled to vote such shares and receive dividends.

(4)

These amounts represent our discretionary and 401(k) matching contributions to our profit sharing plan. These amounts have not been finalized for fiscal 2004.

Stock Option Awards

There were no options granted during fiscal 2004 to the named executive officers.

Stock Option Exercises and Holdings

The following table summarizes options exercised during fiscal year 2004 and presents the value of the unexercised options held by the named executive officers as of May 31, 2004:

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR AND FISCAL YEAR END OPTION VALUES

	Options Exercised(1)		Number of Securities Underlying Unexercised Options held at May 31, 2004		Value of Unexercised, In-the-money Options at May 31, 2004(2)	
Name	Shares Acquired	Value Realized	Exercisable	Unexercisable	Exercisable	Unexercisable
Edward J. Richardson						
Bruce W. Johnson			133,000	37,000	$ 422,830	$ 72,870
Dario Sacomani			16,666	33,334	11,166	22,334
William G. Seils			67,580	16,370	227,895	44,693
Robert L. Prince			83,000	17,000	281,205	47,370

(1) We permit broker-assisted cashless exercise of options by all optionees, including executive officers.

(2) Represents the difference between $11.31 per share, which was the closing price of our common stock on May 28, 2004, the last trading day before May 31, 2004, and the exercise price of the options.

Employment Agreements

Bruce W. Johnson became our president and chief operating officer on November 12, 1996 pursuant to an agreement dated as of November 7, 1996, which provides for an annual base salary subject to adjustment in certain circumstances, and a bonus if our earnings per share (excluding extraordinary charges) for the fiscal year exceeds our earnings per share for the prior fiscal year with the amount of such bonus, if any, determined by our actual earnings per share performance in relation to our budgeted earnings per share for the fiscal year. Mr. Johnson's cash bonus for fiscal 2003 was $80,575. See the Summary Compensation Table above for information regarding Mr. Johnson's fiscal 2004 base salary and cash bonus. The agreement also provides for payments to Mr. Johnson for one year equal to his salary and bonus and other employee benefits if his employment is terminated under certain circumstances, including, if he is terminated without cause or as a result of a change of control, or a breach by us. During his employment term and for two years after termination for any reason, Mr. Johnson is prohibited from contacting any individual or entity that was one of our customers or suppliers during his last 12 months of employment with us. The agreement is for an indefinite term, during which Mr. Johnson is employed on an at-will basis.

Pursuant to a three-year employment agreement dated May 31, 2002, Dario Sacomani became our senior vice president and chief financial officer. Mr. Sacomani's annual base salary is $280,000, and he receives a bonus of up to 50% of his base salary if performance goals are met. 50% of the bonus is determined by our earning performance and 50% is determined by Mr. Sacomani meeting goals for the year established by our chief executive officer.
Mr. Sacomani also received an option for 50,000 shares (with an exercise price equal to 100% of fair market value on the date of grant) and a restricted stock award for 14,098 shares that will vest in equal amounts over the next three years. See the Summary Compensation Table above for information regarding Mr. Sacomani's fiscal 2004 base salary and cash bonus. The agreement provides for payments to Mr. Sacomani for one year equal to his salary and bonus for the 12-month period prior to termination and immediate vesting of options and restricted stock awards in the event of termination of employment without cause or by Mr. Sacomani for certain specified reasons and if the termination by Mr. Sacomani occurs within two years of a change of

control, the salary and bonus payment amount is doubled. The agreement also provides that Mr. Sacomani will be a member of our board of directors. During his employment term and, if we terminate Mr. Sacomani's employment for cause or he terminates his employment without good reason, for a period of one year after such termination, he is prohibited from competing against us.

Robert L. Prince is employed as our executive vice president of worldwide sales pursuant to an employment agreement dated June 6, 2000 pursuant to which he receives a base salary which is reviewed annually and a bonus of 50% of his base salary if performance goals established annually by us are met. Mr. Prince's base salary and cash bonus for fiscal 2003 were $205,250 and $73,806, respectively. See the Summary Compensation Table above for information regarding Mr. Prince's fiscal 2004 base salary and cash bonus. The agreement provides for payment to Mr. Prince for one year equal to his salary and bonus for the 12-month period prior to termination in the event of termination of employment without cause or by Mr. Prince within 180 days after a sale to or merger into another company or a change of control. During his employment term and for one year after termination for any reason, Mr. Prince is prohibited from competing against us. The agreement is for an indefinite term, during which Mr. Prince is employed on an at-will basis.

Compensation Committee Interlocks and Insider Participation

The members of the Compensation Committee during fiscal 2004 were Jacques Bouyer, Scott Hodes, and Samuel Rubinovitz. The members of the Stock Option Committee during fiscal 2004 were Jacques Bouyer and Samuel Rubinovitz. See " Related Party Transactions" below.

Related Party Transactions

Mr. Hodes is a partner in the law firm of Bryan Cave LLP, which firm provided legal services to us in fiscal 2004 and continues to provide legal services to us in fiscal 2005. Mr. Hodes was a partner in the law firm of McGuire Woods Ross & Hardies, which firm provided legal services to us in fiscal 2002, 2003 and 2004.

On August 6, 2001, we loaned $75,000 to Bruce W. Johnson, president and chief operating officer and a director for personal financial purposes. This loan was repaid in full on May 13, 2002 together with interest at the rate of 5.45% per year.

Prior to her employment as Vice President and General Manager of our Security Systems Division, Ms. Diddell provided management consulting services to our security systems division pursuant to a management consulting contract. Under the contract, we paid Ms. Diddell approximately $16,000 monthly from July 2003 to May 2004.

PRINCIPAL STOCKHOLDERS

The following table sets forth certain information, as of June 10, 2004 (except as noted), concerning the beneficial ownership of our common stock and Class B common stock, before and as adjusted to reflect the sale of shares offered by this prospectus, for:

each of our named executive officers;

each of our directors;

all of our directors and executive officers as a group; and

each person who is known by us to be the beneficial owner of more than 5% of our common stock.

Because Class B common stock is convertible into common stock, the number of shares listed as owned under the common stock column in the table also includes the number of shares listed under the Class B common stock column. Except as otherwise indicated below, each of the entities or persons named in the table has sole voting and investment power with respect to all shares of common stock beneficially owned by him, her or it. To the extent any of the persons listed below purchase shares of common stock in this offering or exchange any of their outstanding debentures in the potential exchange offer, the number of shares they will be deemed to own will increase.

							Percent of Total Voting if Class Voting Not Applicable	
	Number of Shares of Common(1)(2)	**Percent of Class Before Offering**	**Percent of Class After Offering**	**Number of Shares of Class B Common(3)**	**Percent of Class Before Offering**	**Percent of Class After Offering**	**Before Offering(3)**	**After Offering(3)**
Edward J. Richardson	3,295,250(4)	22.96%	18.99%	3,157,442	99.57%	99.57%	74.01%	69.17%
Bruce W. Johnson	186,119(5)	1.66%	1.31%		*	*	*	*
Dario Sacomani	30,766(6)	*	*		*	*	*	*
Arnold R. Allen	25,000(7)	*	*	11,782	*	*	*	*
Jacques Bouyer	53,250(8)	*	*		*	*	*	*
Scott Hodes	78,424(9)	*	*	3,712	*	*	*	*
Ad Ketelaars		*	*		*	*	*	*
John R. Peterson	25,000(10)	*	*		*	*	*	*
Harold L. Purkey	52,000(11)	*	*		*	*	*	*
Samuel Rubinovitz	50,431(12)	*	*	825	*	*	*	*
William G. Seils	78,873(13)	*	*		*	*	*	*
Robert Prince	101,577(14)	*	*		*	*	*	*
Royce & Associates, LLC	2,102,889(15)	16.02%	13.04%		*	*	4.69%	4.40%
DePrince, Race & Zollo, Inc.	1,838,400(16)	14.29%	11.59%		*	*	4.12%	3.86%

							Percent of Total Voting if Class Voting Not Applicable	
Loomis Sayles & Company, L.P.	825,353(17)	6.96%	5.56%		*	*	%	1.77%
T. Rowe Price Associates, Inc.	1,166,646(18)	10.37%	8.19%		*	*	1.89 2.74%	2.54%
Executive Officers and Directors as a group (20 persons)	4,184,669(19)	30.94%	25.27%	3,173,761(20)	99.72%	99.72%	76.08%	71.11%

(*) Less than 1%.

(1) Includes the number of shares listed under the column "Number of Shares of Class B Common."

(2) Except as noted, beneficial ownership of each of the shares listed is comprised of either sole investment and sole voting power, or investment power and voting power that is shared with the spouse of the director or officer, or voting power that is shared with the trustee of our Employee Stock Ownership Plan, or "ESOP," with respect to shares identified as allocated to the individual's ESOP account.

(3) Common stock is entitled to one vote per share and Class B common stock is entitled to ten votes per share. Computation assumes that Class B common stock held or subject to acquisition pursuant to stock options is not converted.

(4) Includes 3,157,442 shares of common stock which would be issued upon conversion of Mr. Richardson's Class B common stock, 26,351 shares of common stock allocated to the account of Mr. Richardson under the ESOP and 43,797 shares of common stock which would be issued upon conversion of $926,000 principal amount of our 7 1/4% debentures, and 47,444

shares of common stock which would be issued upon conversion of $854,000 principal amount of our 8 1/4% debentures owned by Mr. Richardson and 9,271 shares of common stock which would be issued upon conversion of $196,000 principal amount of our 7 1/4% debentures, and 4,611 shares of common stock which would be issued upon conversion of $83,000 principal amount of our 8 1/4% debentures owned by a trust of which Mr. Richardson is a co-trustee and as co-trustee Mr. Richardson has shared investment and voting power with respect to these 8 1/4% debentures. Does not include 18,035 shares of common stock held by William G. Seils as custodian for Mr. Richardson's sons, Alexander and Nicholas, 4,920 shares of common stock held by Mr. Richardson's wife or 6,333 shares of common stock which would be issued upon conversion of $114,000 principal amount of our 8 1/4% debentures owned by Mr. Richardson's wife, as to which Mr. Richardson disclaims beneficial ownership. Mr. Richardson's business address is 40W267 Keslinger Road, P.O. Box 393, LaFox, Illinois 60147-0393

(5) Includes 133,000 shares of common stock for which Mr. Johnson holds stock options exercisable within 60 days. Also includes 1,519 shares of common stock allocated to the account of Mr. Johnson under the ESOP.

(6) Includes 14,098 shares of common stock Mr. Sacomani holds as a Restricted Stock Award that vest in three annual installments beginning June 17, 2003. Also includes 16,666 shares of common stock as to which Mr. Sacomani holds stock options exercisable within 60 days and 2 shares of common stock allocated to the account of Mr. Sacomani under the ESOP.

(7) Includes 11,781 shares of common stock to which Mr. Allen holds stock options exercisable within 60 days and an additional 11,782 shares of common stock which would be issued upon conversion of 11,782 shares of Class B common stock as to which he also holds stock options exercisable within 60 days.

(8) Includes 45,000 shares of common stock to which Mr. Bouyer holds stock options exercisable within 60 days.

(9) Includes 3,712 shares of common stock which would be issued upon conversion of Mr. Hodes' Class B common stock. Also includes 40,000 shares of common stock to which Mr. Hodes holds stock options exercisable within 60 days.

(10) Includes 20,000 shares of common stock to which Mr. Peterson holds stock options exercisable within 60 days.

(11) Includes 25,000 shares of common stock as to which Mr. Purkey holds stock options exercisable within 60 days.

(12) Includes 825 shares of common stock which would be issued upon conversion of Mr. Rubinovitz' Class B common stock. Also includes 45,000 shares of common stock to which Mr. Rubinovitz holds stock options exercisable within 60 days.

(13) Includes 67,580 shares of common stock as to which Mr. Seils holds stock options exercisable within 60 days. Also includes 10,110 shares of common stock allocated to the account of Mr. Seils under the ESOP. Does not include shares held as custodian see footnote (4).

(14) Includes 83,000 shares of common stock as to which Mr. Prince holds stock options exercisable within 60 days. Also includes 7,055 shares of common stock allocated to the account of Mr. Prince under the ESOP.

(15) Charles M. Royce may be deemed a controlling person of Royce & Associates, Inc. ("Royce") and Royce Management Company ("RMC") and as such may be deemed to beneficially own the shares of common stock beneficially owned by Royce and RMC. Mr. Royce does not own any shares outside of Royce and RMC, and disclaims beneficial ownership of the shares held by Royce and RMC. On October 1, 2001, Royce & Associates, Inc., The Royce Funds' investment adviser, became an indirect wholly-owned subsidiary of Legg Mason, Inc., or "Legg Mason." On March 31, 2002, Royce & Associates, Inc. was merged into Royce Holdings, LLC, a wholly-owned subsidiary of Legg Mason, which then changed its name to Royce & Associates, LLC. As a result of this merger, Royce & Associates, LLC became The Royce Funds' investment adviser and a direct wholly-owned subsidiary of Legg Mason. Information disclosed in this table was obtained from a Schedule 13G filed by Royce with the SEC dated February 6, 2004. The address for Royce is 1414 Avenue of the Americas, New York, NY 10019.

(16) DePrince, Race & Zollo, Inc. is an investment advisor having sole power to vote and dispose of these shares. Information disclosed in this table was obtained from a Schedule 13G filed by DePrince, Race & Zollo with the SEC dated January 28, 2003. The address for DePrince, Race & Zollo, Inc. is 201 S. Orange Ave., Suite 850, Orlando, FL 32801.

(17)

Loomis Sayles & Company, L.P. ("Loomis"), an investment advisor, has the sole power to vote 591,295 and has sole power to dispose of 825,353 shares held by Loomis (6.52%). Clients of Loomis have the economic interest but no one client has such an interest relating to more than 5% of the class. Loomis indicates that the shares reported for Loomis relate to such party's ownership of the Company's outstanding debentures. Information disclosed in this table was obtained from a Schedule 13G for Loomis dated December 31, 2003. The address for Loomis is One Financial Center, Boston, MA 02111.

(18)

Includes 2,211 shares of common stock which would be issued on conversion of our 7 1/4% debentures. These securities are owned by various individuals and institutional investors including the T. Rowe Price Small Cap Value Fund, Inc. (which owns 728,000 shares, and all of the 7 1/4% debentures), which T. Rowe Price Associates, Inc., or "Price Associates," serves as investment advisor with power to direct investments and/or power to vote the securities. For purposes of the reporting requirements of the Exchange Act, Price Associates is deemed to be a beneficial owner of such securities; however, Price

Associates expressly disclaims that it is, in fact, the beneficial owner of such securities. Price Associates has sole dispositive power for the entire holding of 1,166,646 shares and has sole voting power for 217,500 shares of common stock and T. Rowe Price Small Cap Value Fund has sole voting power for the shares which it owns. Information disclosed in this table was obtained from a Schedule 13G/A for T. Rowe Price Associates dated May 10, 2004. The address for T. Rowe Price Associates is 100 East Pratt Street, Baltimore, MD 21202.

(19) Does not include 18,035 shares of common stock held by certain members of such group as custodians under Uniform Gift to Minors Acts or 7,510 shares of common stock held by spouses of members of the group. Includes 3,171,320 shares of common stock which would be issuable on conversion of Class B common stock, 751,561 shares of common stock issuable upon options exercisable within 60 days, 11,782 shares of common stock which would be issuable on conversion of Class B common stock issuable upon options exercisable within 60 days, 43,797 shares of common stock which would be issued upon conversion of $926,000 principal amount of our 7$^{1}/_{4}$% debentures, and 47,444 shares of common stock which would be issued upon conversion of $854,000 principal amount of our 8$^{1}/_{4}$% debentures. Includes 62,398 shares of common stock held in trust for the benefit of our profit sharing trust and ESOP allocated to the accounts of all executive officers and directors as a group; such shares are ratably forfeitable in the event the officer leaves our employ prior to completing six years of service.

(20) Includes 11,782 shares of Class B common stock issuable upon exercise of options exercisable within 60 days.

DESCRIPTION OF OUR CAPITAL STOCK

Our certificate of incorporation authorizes the issuance of up to 30,000,000 shares of common stock, par value $.05 per share, 10,000,000 shares of Class B common stock, par value $.05 per share, and 5,000,000 shares of preferred stock, par value $1.00 per share. As of June 10, 2004, there were 11,084,747 shares of common stock outstanding, 3,170,931 shares of Class B common stock outstanding and no shares of preferred stock outstanding.

The following summary is qualified by reference to the applicable provisions of Delaware law and our certificate of incorporation and by-laws. This is not a complete description of the important terms of Delaware law, our certificate of incorporation or by-laws. If you would like more information on the provisions of our certificate of incorporation or by-laws, you may review our certificate of incorporation and our by-laws, each of which is incorporated by reference as an exhibit to the registration statement we have filed with the SEC. See "Where You Can Find More Information."

Common Stock

The holders of our common stock are entitled to one vote for each share they own and vote together with holders of Class B common stock and preferred stock on all matters voted on by our stockholders. In addition, holders of our common stock vote separately as a class on any proposed amendment to our restated certificate of incorporation that would:

- change the aggregate number of authorized shares of common stock or the par value of those shares; or

- alter or change the powers, preferences or special rights of shares of the common stock so as to affect the holders thereof adversely.

The common stock does not have cumulative voting rights. As a result, stockholders voting a majority of the votes (including Edward J. Richardson, who owned shares having approximately 74% of the voting power at June 10, 2004) at any annual meeting are able to elect all of the directors to be elected.

Subject to any preferential or other rights of any outstanding series of preferred stock that may be designated by our board of directors and subject to the right of the holders of the Class B common stock to receive a dividend when the holders of common stock receive a dividend, the holders of common stock are entitled to dividends as may be declared by our board of directors. With respect to cash dividends, the Class B common stock is limited to a dividend equal to 90% of any dividend on the common stock. Any stock dividend on common stock shall be paid in additional shares of common stock and a stock dividend of an equal number of shares of Class B common stock shall be paid on the Class B common stock. Upon liquidation, holders of common stock are entitled to receive their pro rata portion of our assets available for distribution to the holders of common stock and Class B common stock on an equal basis with the holders of Class B common stock. All of the outstanding shares of common stock are fully paid and nonassessable. Holders of common stock have no preemptive rights to purchase or subscribe for any stock or other securities and there are no conversion rights or redemption or sinking fund provisions with respect to our common stock.

The transfer agent and registrar for our common stock is LaSalle Bank, 135 South LaSalle Street, Chicago, Illinois 60603.

Class B Common Stock

The holders of our Class B common stock are entitled to ten votes for each share they own and vote together with holders of common stock and preferred stock on all matters voted on by our stockholders. In addition, holders of our Class B common stock vote separately as a class on any proposed amendment to our restated certificate of incorporation that would:

- change the aggregate number of authorized shares of Class B common stock or par value of those shares; or

- alter or change the powers, preferences or special rights of the Class B common stock so as to affect the holders thereof adversely.

The Class B common stock does not have cumulative voting rights. Subject to any preferential or other rights of any outstanding series of preferred stock that may be designated by our board of directors and subject to the right of the holders of the common stock to receive a dividend when the holders of Class B common stock receive a dividend, the holders of Class B common stock are entitled to the dividends declared by our board of directors. With respect to cash dividends, the holders of Class B common stock are subject to the further limitation that dividends on a share of Class B common stock equal only 90% of any dividend on a share of common stock. Any stock dividend on Class B common stock shall be paid in additional shares of Class B common stock and a stock dividend of an equal number of shares of common stock shall be paid on the common stock. Upon liquidation, holders of Class B common stock are entitled to receive their pro rata portion of our assets available for distribution to the holders of Class B common stock and common stock on an equal basis with the holders of common stock. All of the outstanding shares of Class B common stock are fully paid and nonassessable. Holders of Class B common stock have no preemptive rights to purchase or subscribe for any stock or other securities and there are no redemption or sinking fund provisions with respect to our Class B common stock. The Class B common stock is subject to transfer and conversion restrictions described below.

The transfer agent and registrar for our Class B common stock is LaSalle Bank, 135 South LaSalle Street, Chicago, Illinois 60603.

Restrictions On Transfer

Shares of Class B common stock are not freely transferable. A holder of shares of Class B common stock may transfer those shares (whether by sale, assignment, gift, bequest, appointment or otherwise) only to a "Permitted Transferee" (as defined below). A transfer of Class B common stock to any person or entity other than a "Permitted Transferee" will result in the automatic conversion of those shares of Class B common stock into shares of common stock on a share-for-share basis. Accordingly, no trading market will develop in the Class B common stock.

The "Permitted Transferees" of an individual holder of shares of Class B common stock are generally described as follows:

- that stockholder's spouse;

- any lineal descendant of a grandparent of that stockholder, including adopted children, and any spouse of that lineal descendant (we refer to these descendants and their spouses, together with the stockholders in question and their spouses, as the "Class B stockholder's family members");

- a trust for the sole benefit of that stockholder, that Class B stockholder's family members and certain charitable organizations;

- certain charitable organizations established by that stockholder or that Class B stockholder's family members;

a partnership or corporation all of the beneficial ownership of which is owned (and continues to be owned) by that stockholder and/or that Class B stockholder's family

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members or a trust for the sole benefit of that stockholder, that Class B stockholder's family members, and certain charitable organizations;

the estate of that stockholder; and

an employee stock ownership plan of ours.

Shares of Class B common stock held by a partnership or corporation may be transferred to a person who had transferred those shares to that partnership or corporation (and to that person's Permitted Transferees) or, if record and beneficial ownership of those shares of Class B common stock were acquired by that partnership or corporation on or prior to December 10, 1986, to the partners or stockholders as of that date, and to the Permitted Transferees of those partners or stockholders. Shares held by trusts that are irrevocable on December 10, 1986 may be transferred to any person to whom or for whose benefit the principal of the trust may be distributed under the terms of the trust and that person's Permitted Transferees. Shares held by all other trusts (whether or not in existence as of December 10, 1986) may be transferred to the person who transferred those shares of Class B common stock to the trust and that person's Permitted Transferees. Shares held by the estate of a holder of Class B common stock may be transferred to Permitted Transferees of that holder of Class B common stock. Shares held in any of our employee benefit plans may be transferred to the participant for whose account the shares were held or his Permitted Transferee.

Shares of Class B common stock may only be registered in the name of the beneficial owner thereof and not in a "street" or "nominee" name. The "beneficial owner" of shares of Class B common stock is defined as the person or persons who, or the entity or entities which, possess the power to direct the voting or the disposition of such shares.

Conversion

Shares of Class B common stock are convertible into common stock on a share-for-share basis at all times at the option of the holder without cost to the holder (except to the extent of any stamp or similar tax payable where the converting holder of Class B common stock desires that the certificate representing the resulting common stock be issued in a name other than that of the holder of the converted Class B common stock). In general, the conversion will be effective as of the date the Class B common stock is surrendered to us for conversion.

Any transfer, pledge or other disposition of shares of Class B common stock other than to a Permitted Transferee will result in an automatic conversion to common stock, on a share-for-share basis.

If at any time the number of issued and outstanding shares of Class B common stock falls below 10% of the aggregate number of issued and outstanding shares of common stock, Class B common stock and preferred stock, all the outstanding shares of Class B common stock immediately and automatically will be converted into shares of common stock. In the event of such a conversion, certificates formerly representing outstanding shares of Class B common stock will thereafter be deemed to represent a like number of shares of common stock. Currently the outstanding Series B common stock represents 20.2% of the aggregate number of issued and outstanding shares of common stock, Class B common stock and preferred stock.

All shares of Class B common stock received by the Company upon conversion thereof into common stock will be returned to the status of authorized but unissued shares of Class B common stock.

Future Issuance

Except for shares of Class B common stock reserved for issuance under outstanding options or issued in connection with stock splits, stock dividends, reclassifications or other subdivisions, we cannot issue additional shares of Class B common stock without the authorization of the holders of a majority of the outstanding shares of common stock and Class B common stock, each voting separately as a class.

Description of Debt Securities

We will not establish the terms of the notes until shortly before we commence the exchange offer. While we expect the terms of the notes to reflect those described below, we cannot assure you that the terms will not change from those described below.

We expect that the notes will mature in 2011 unless earlier converted, redeemed, or repurchased, and will be our unsecured obligations, senior to the $7^1/_4$% debentures, the $8^1/_4$% debentures, and future indebtedness that is expressly made subordinate to the notes.

The notes will be subordinate to amounts borrowed under our credit agreement and future indebtedness that is not expressly subordinate to the notes. In addition, the notes will be structurally subordinate to any indebtedness of our subsidiaries. The notes will be convertible into common stock at a set conversion price per share, subject to adjustment if we pay cash dividends in excess of $.16 per share of common stock on an annual basis, and in certain other events. The notes will not be redeemable at any time prior to a certain date. On or after that date, we will be able to redeem the notes at 100% of the principal amount of the notes to be redeemed plus accrued and unpaid interest if the closing price of our common stock has been above a specified price for 20 of 30 consecutive trading days. On or after a certain date, we will be able to redeem the notes at 100% of the principal amount of the notes to be redeemed plus accrued and unpaid interest. Upon a change of control, holders of notes will have the right to require us to repurchase the notes at 101% of the principal amount thereof plus accrued and unpaid interest to the date of redemption. We will be able to pay the repurchase price in cash, or in shares of our common stock based on a discounted formula price. See "The Exchange Offer."

The indenture that will govern the notes will not contain any financial covenants or restrictions on the payment of dividends or the issuance or repurchase of securities by us. Neither we nor our subsidiaries will be prohibited from incurring additional debt under the indenture governing the notes.

The $7^1/_4$% debentures mature on December 15, 2006. The $8^1/_4$% debentures mature on June 15, 2006. Interest on the $7^1/_4$% debentures accrues at $7^1/_4$% per year and is payable on June 15 and December 15 in each year. Interest on the $8^1/_4$% debentures accrues at $8^1/_4$% per year and is payable on June 15 and December 15 in each year. As of February 28, 2004, there are $30,825,000 principal amount of the $7^1/_4$% debentures outstanding and $40,000,000 principal amount of the $8^1/_4$% debentures outstanding. Neither we nor our subsidiaries are prohibited from incurring additional debt under either the $7^1/_4$% indenture or $8^1/_4$% indenture.

The outstanding debentures are our unsecured obligations, senior to future indebtedness that is expressly made subordinate to the outstanding debentures. The outstanding debentures are not listed on any securities exchange or Nasdaq. The $7^1/_4$% debentures would be subordinate to the notes (if any are issued in the exchange offer), and are subordinate to the $8^1/_4$% debentures, amounts borrowed under our credit agreement and future indebtedness that is not expressly subordinate to the $7^1/_4$% debentures. The $8^1/_4$% debentures would be subordinate to the notes (if any are issued in the exchange offer), and are subordinate to amounts borrowed under our credit agreement and future indebtedness that is not expressly subordinate to the $8^1/_4$% debentures. In addition, the outstanding debentures are structurally subordinate to any indebtedness of our subsidiaries. The $7^1/_4$% debentures are convertible into our common stock at a conversion price equal to $21.14 per share, subject to adjustment in certain events. The $8\frac{1}{4}\%$ debentures are convertible into our common stock at a conversion price equal to $18.00 per share, subject to adjustment in certain events. We may redeem the outstanding debentures at any time at 100% of the principal amount of the $7\frac{1}{4}\%$ debentures or $8\frac{1}{4}\%$ debentures, as applicable, to be redeemed plus accrued and unpaid interest. On each December 15, we are obligated to redeem the $7\frac{1}{4}\%$ debentures with a principal amount equal to $7\frac{1}{2}\%$ of the aggregate principal amount (or $6.225 million) of $7\frac{1}{4}\%$ debentures originally issued, at 100% of the principal amount thereof plus accrued and unpaid interest. Our redemption obligations may be reduced by an amount equal to the principal amount of $7\frac{1}{4}\%$ debentures redeemed by us other than pursuant to a sinking fund, purchased by us in the open market or converted or exchanged by us; provided, however, that we may effect such a reduction only once. As a result of prior acquisitions of the $7\frac{1}{4}\%$ debentures, we satisfied our sinking fund obligations through December 2003. As a result, we are obligated to make sinking fund payments on December 15, 2004 and December 15, 2005 of $3.85 million and $6.225 million, respectively. The $8\frac{1}{4}\%$ debentures have no such sinking fund provision.

Under the indentures governing the outstanding debentures, we may not declare or pay any dividend or make any distribution on our capital stock or to our stockholders (other than dividends or distributions payable into our capital stock) or purchase, redeem or otherwise acquire or retire for value, or permit any subsidiary to purchase or otherwise acquire for value, any of our capital stock (1) if at the time an event of default has occurred and is continuing or (2) if, upon giving effect to the dividend, distribution, purchase, redemption, other acquisition or retirement, the aggregate amount expended subsequent to May 31, 1996 will exceed the sum of the aggregate consolidated net income subsequent to May 31, 1996, the aggregate net proceeds of property other than cash received by us from the issue or sale of our capital stock, other than to a subsidiary, after May 31, 1996, the aggregate net proceeds from the issue or sale, other than to a subsidiary, of any indebtedness issued after May 31, 1996, and $20,000,000 in the case of the $7\frac{1}{4}\%$ debentures and $30,000,000 in the case of the $8\frac{1}{4}\%$ debentures. In addition, we may not merge into, consolidate with or transfer all or substantially all of our assets unless the corporation with which we are merging is a United States corporation which expressly assumes our outstanding obligations under the indentures governing the outstanding debentures, the corporation with which we are merging has a consolidated tangible net worth at least equal to ours, and after the merger we are not in default under the $7\frac{1}{4}\%$ indenture or $8\frac{1}{4}\%$ indenture, as applicable.

Preferred Stock

Our board of directors has the authority to issue preferred stock in one or more series and to fix certain of the rights, preferences, privileges, and restrictions applicable to such series, including the annual dividend rate, the time of payment for dividends, whether those dividends will be cumulative or non-cumulative, and the date or dates from which any cumulative dividends will begin to accrue, redemption terms (including sinking fund provisions), redemption price or prices, liquidation preferences, the extent of the voting powers, if any, and conversion rights.

Certain Provisions of Delaware Law, Our Certificate of Incorporation and By-Laws

General

Delaware general corporate law, our certificate of incorporation, and our by-laws contain provisions that could make it more difficult for someone to acquire control of us by means of a tender offer, open market purchases, a proxy contest or otherwise.

Class B Common Stock

The holders of our Class B common stock are entitled to 10 votes for each share they own and as of June 10, 2004 represented approximately 74% of our aggregate voting power. As a result, the holders of Class B common stock have the ability to elect our board of directors. So long as the holders of Class B common stock constitute more than 50% of our voting power, they have the ability to control any possible merger, consolidation, or sale of assets involving us.

Removal of Directors

Our by-laws provide that we will have ten directors and we currently have no vacancies. We have a single class of directors, with each director standing for election at each annual meeting of stockholders. Pursuant to our by-laws, a director or the entire board of directors may be removed for or without cause at any time by the affirmative vote of holders of at least a majority of the outstanding shares of common stock and Class B common stock entitled to vote.

Filling Vacancies on the Board

Our by-laws provide that, subject to the rights of holders of any shares of preferred stock, vacancies on the board of directors may be filled only by a majority of the board of directors then in office, even if less than a quorum, or by the sole remaining director. Accordingly, the board of directors could temporarily prevent any stockholder from obtaining majority representation on the board of directors by enlarging the board of directors and filling the new directorships with its own nominees.

Special Meetings

Special meetings of stockholders may be called only by the chairman of the board of directors, president or secretary or upon the request of a majority of the entire board of directors. Business conducted at any special meeting is limited to the purposes specified in the written notice of the meeting.

Authorized but Unissued Stock

We may issue additional shares of common stock or preferred stock without stockholder approval, subject to applicable rules of The Nasdaq National Market, for a variety of corporate purposes, including raising additional capital, corporate acquisitions, and employee benefit plans. The existence of unissued and unreserved common stock and preferred stock may enable us to issue shares to persons who are friendly to current management, which could discourage an attempt to obtain control of us through a merger, tender offer, proxy contest, or otherwise, and protect the continuity of management and possibly deprive you of opportunities to sell your shares at prices higher than the prevailing market prices. We could also issue additional shares to dilute the stock ownership of persons seeking to obtain control of us. At June 10, 2004, we had 17,419,298 authorized but unissued shares of common stock and 1,495,955 shares of treasury stock. In addition, depending upon the rights associated with any preferred stock we might issue, we could further inhibit a change of control by making the removal of directors more difficult or restricting the payment of dividends and other distributions to the holders of common stock.

Delaware Anti-Takeover Law

We are subject to Section 203 of the Delaware General Corporation Law regulating corporate takeovers. Section 203, subject to certain exceptions, prohibits a Delaware corporation from engaging in any "business combination" with any "interested stockholder" for a period of three years following the date that that stockholder became an interested stockholder unless:

- prior to that date, the board of directors of the corporation approved either the business combination or the transaction that resulted in the stockholder becoming an interested stockholder;

- upon consummation of the transaction that resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced, excluding those shares owned by persons who are directors and also officers, and employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer; or

- on or subsequent to that date, the business combination is approved by the board of directors and authorized at an annual or special meeting of stockholders, and not by written consent, by the affirmative vote of at least two-thirds of the outstanding voting stock that is not owned by the interested stockholder.

In general, Section 203 defines "business combination" to include mergers or consolidations between a Delaware corporation and an interested stockholder, transactions with an interested stockholder involving the assets or stock of the corporation or its majority-owned subsidiaries and transactions which increase an interested stockholder's percentage ownership of stock. In general, Section 203 defines an "interested stockholder" as any entity or person beneficially owning 15% or more of the outstanding voting stock of the corporation and any entity or person affiliated with or controlling or controlled by that entity or person. We believe that Mr. Richardson is not subject to the restrictions of Section 203 because he has owned 15% or more of our voting stock for more than three years.

MATERIAL UNITED STATES FEDERAL INCOME TAX CONSEQUENCES TO NON-UNITED STATES HOLDERS

The following summary describes the material United States federal income tax consequences relating to the ownership and disposition of our common stock applicable to non-United States holders, as defined below. The summary is based on the Internal Revenue Code of 1986, as amended to the date hereof (the "Code"), final, temporary and proposed Treasury regulations, interpretative rulings of the Internal Revenue Service, and judicial decisions, all of which are subject to change, possibly with retroactive effect. The summary only applies to non-United States holders who will hold the common stock as capital assets within the meaning of Section 1221 of the Code.

The summary does not purport to be a complete analysis of all the potential tax consequences that may be material to a non-United States holder based on his or her particular tax situation. The discussion does not address the tax treatment of partnerships or persons who hold their interests through a partnership or another pass-through entity. It also does not consider the effect of any applicable state, local or foreign tax laws or any income tax treaty.

When we refer to a non-United States holder, we mean a beneficial owner of our common stock that for United States federal income tax purposes, is other than:

- a citizen or resident of the United States;

- a corporation, or other entity taxable as a corporation, that was created or organized in or under the laws of the United States or any political subdivision thereof;

an estate the income of which is subject to United States federal income taxation regardless of its source; or a trust that is subject to the primary supervision of a United States court and to the control of one or more United States persons, or that has a valid election in effect under applicable United States Treasury regulations to be treated as a United States person.

It should be noted that certain "single member entities" are disregarded for United States federal income tax purposes and the income, gain, loss and deductions of such an entity are attributed to its owner. The discussion below may not apply to single member disregarded entities that are treated as owned by a United States holder. Holders that are single member disregarded entities should consult with their own tax advisors to determine the United States federal, state, local and other tax consequences that may be relevant to them.

Taxation of Dividends and Dispositions

Dividends on Common Stock

In general, if distributions are made with respect to our common stock, such distributions will be treated as dividends (subject to withholding as described below) to the extent of our current and accumulated earnings and profits as determined under the Code. Any portion of a distribution that exceeds our current and accumulated earnings and profits will first be applied in reduction of the non-United States holder's basis in the common stock, and to the extent such portion exceeds the non-United States holder's basis, the excess will be treated as gain from the disposition of the common stock, the tax treatment of which is discussed below under "Disposition of Common Stock."

Dividends paid to a non-United States holder of common stock generally will be subject to withholding tax at a 30% rate or a reduced rate specified by an applicable income tax treaty. In order to obtain a reduced rate of withholding, a non-United States holder will be required to provide an Internal Revenue Service Form W-8BEN certifying its entitlement to benefits under a treaty.

The withholding tax does not apply to dividends paid to a non-United States holder who provides an Internal Revenue Service Form W-8ECI, certifying that the dividends are effectively connected with the non-United States holder's conduct of a trade or business within the United States. Instead, the effectively connected dividends will be subject to regular United States federal income tax as if the non-United States holder were a United States holder. A non-United States corporation receiving effectively connected dividends may also be subject to an additional "branch profits tax" imposed at a rate of 30% (or a lower rate specified in an applicable treaty).

Disposition of Common Stock

Generally, a non-United States holder will not be subject to United States federal income tax with respect to gain recognized upon the disposition of such holder's shares of common stock unless:

the non-United States holder is an individual who is present in the United States for 183 days or more in the taxable year of disposition and certain other conditions are met;

such gain is effectively connected with the conduct by the non-United States holder of a trade or business within the United States and, if certain tax treaties apply, is attributable to a United States permanent establishment maintained by the non-United States holder;

the non-United States holder is subject to the Code provisions applicable to certain United States expatriates; or

we are or have been a United States real property holding corporation, within the meaning of Section 897 of the Code, at any time within the five-year period preceding the disposition or the non-United States holder's holding period, whichever period is shorter, and (except in the case of persons who hold more than five percent of our common stock) our common

stock has ceased to be traded on an established securities market prior to the beginning of the calendar year in which the sale or disposition occurs.

We do not believe we have been or currently are, and we do not anticipate becoming, a "United States real property holding corporation" for United States federal income tax purposes.

Special rules may apply to certain non-United States holders, such as "controlled foreign corporations," "passive foreign investment companies," "foreign personal holding companies" and corporations that accumulate earnings to avoid United States federal income tax. Such entities should consult their own tax advisors to determine the United States federal, state, local and other tax consequences that may be relevant to them.

Federal Estate Tax

An individual non-United States holder who is treated as the owner of, or has made certain lifetime transfers of, an interest in common stock will be required to include the value of the stock in his or her gross estate for United States federal estate tax purposes, and may be subject to United States federal estate tax unless an applicable estate tax treaty provides otherwise.

Information Reporting and Backup Withholding

Under currently applicable Treasury regulations, information reporting on IRS Form 1099 and backup withholding will not apply to dividends paid on our common stock if a non-United States holder certifies as to its non-United States status under penalties of perjury or otherwise establishes an exemption, provided that the payor does not have actual knowledge that such holder is not an exempt recipient or that the conditions of the exemption are not satisfied.

We must report annually to the IRS on IRS Form 1042 and to each non-United States holder on IRS Form 1042-S the entire amount of any distribution regardless of any estimate of the portion of the distribution that represents a taxable dividend. This information may also be made available to the tax authorities in the country in which the non-United States holder resides under the provisions of an applicable income tax treaty.

Information returns may be filed in connection with the proceeds from a sale or other disposition of the common stock under certain circumstances. A non-United States holder may be subject to United States backup withholding tax on these payments unless the holder complies with certification procedures to establish that it is not a United States person or is otherwise exempt from backup withholding.

Non-United States holders should consult their tax advisors concerning the application of information reporting and backup withholding in their particular situations, the availability of an exemption therefrom, and the procedure for obtaining such an exemption, if available. The amount of any backup withholding from a payment to a non-United States holder will be allowed as a credit against the holder's United States federal income tax liability and may entitle the holder to a refund, provided that the required information is timely furnished to the Internal Revenue Service.

You are urged to consult your own tax advisor regarding the particular United States federal, state, local, and foreign tax consequences to you, in your particular situation, of owning and disposing of our common stock.

UNDERWRITING

General

Under the terms and subject to the conditions contained in an underwriting agreement, the underwriters named below, for whom Jefferies & Company, Inc., which we refer to as Jefferies, William Blair & Company, L.L.C., and KeyBanc Capital Markets, a division of McDonald Investments Inc., are acting as representatives, have severally agreed to purchase, and we have agreed to sell to them, the number of shares of common stock indicated below:

Name	Number of Shares
Jefferies & Company, Inc.	
William Blair & Company, L.L.C.	
KeyBanc Capital Markets	
Total	3,000,000

The underwriters are offering the shares subject to their acceptance of the shares from us. The underwriting agreement provides that the obligations of the several underwriters to pay for and accept delivery of the shares of common stock offered by this prospectus are subject to the approval of certain legal matters by their counsel and to certain other conditions. The underwriters are obligated to take and pay for all of the shares of common stock offered by this prospectus if any shares are taken. However, the underwriters are not required to take or pay for the shares covered by the underwriters' over-allotment option described below.

The underwriters initially propose to offer part of the shares directly to the public at the public offering price listed on the cover page of this prospectus and part to certain dealers at a price that represents a concession not in excess of $ a share under the public offering price. The offering price and other selling terms may from time to time be varied by the representatives of the underwriters.

Over-Allotment Option

We have granted to the underwriters an option, exercisable for 30 days from the date of this prospectus, to purchase up to an aggregate of 450,000 additional shares of common stock at the public offering price listed on the cover page of this prospectus, less underwriting discounts and commissions. The underwriters may exercise this option solely for the purpose of covering over-allotments, if any, made in connection with the sale and distribution of the shares of common stock offered by this prospectus. To the extent the option is exercised, each underwriter will become obligated, subject to various conditions, to purchase the same percentage of the additional shares of common stock as the number listed next to the name of that underwriter in the preceding table bears to the number of shares of common stock listed next to the names of all underwriters in the preceding table.

Compensation and Expenses

We will pay all of our fees and expenses associated with this offering, which we estimate to be approximately $475,000, which includes legal, accounting and printing costs, and various other fees associated with the registration of the shares (including the reasonable fees and expenses of the underwriters as outlined in the following paragraph) and excludes the underwriting discounts and commissions.

The following table summarizes the compensation we will pay to the underwriters in connection with this offering. These amounts are shown assuming both no exercise and full exercise of the underwriters' over-allotment option to purchase additional shares of common stock.

	Per Share	Without Option	With Option
Public offering price	$	$	$
Underwriting discount	$	$	$
Proceeds, before expenses, to us	$	$	$

We have agreed to pay Jefferies a fee for its role as dealer manager in the exchange offer, if commenced and completed, that is equal to 1% of the principal amount of outstanding debentures that are exchanged for notes in the exchange offer.

We have agreed to reimburse Jefferies for all of its reasonable fees, disbursements, and out-of-pocket expenses (including, without limitation, the reasonable fees and disbursements of their counsel and other customary expenditures) incurred in connection with the exchange offer; *provided*, *however*, that the reimbursement of expenses will not exceed $200,000 in the aggregate.

Notwithstanding any of the foregoing, we have agreed with Jefferies that the fee payable to Jefferies in connection with this offering and the exchange offer will not be less than $1,000,000; provided that the difference between the $1,000,000 and the 1% fee payable in connection with the exchange offer and the underwriting discounts and commissions provided to Jefferies in connection with this offering will be credited against any fee payable to Jefferies in connection with its investment banking services for us in a subsequent equity transaction commenced on or prior to March 22, 2005.

Lock-up Agreements

We have agreed that, without the prior written consent of Jefferies, we will not, directly or indirectly, from the date of this prospectus and continuing and including the date 90 days after the date of this prospectus:

- sell, offer, contract or grant any option to sell, pledge, transfer or establish an open "put equivalent position" within the meaning of the Exchange Act;
- otherwise dispose of, transfer or announce the offering of common stock; or
- file any registration statement under the Securities Act in respect of common stock, options or warrants to acquire common stock or securities exchangeable or exercisable for or convertible into common stock (other than as contemplated by the underwriting agreement).

We may, however:

- file registration statements on Form S-8;
- conduct the exchange offer and file the related Form S-4; and
- issue common stock or options to purchase common stock, or common stock upon the exercise of options pursuant to any stock option, stock bonus or other stock plan or arrangement, but only if such common stock, options or common stock issued upon exercise of such options are issued to directors, officers or our employees consistent with our past practices.

In addition, each of our directors and executive officers has agreed that, without the prior written consent of Jefferies, he or she will not, directly or indirectly, from the date of this prospectus and continuing to and including the date 90 days after the date of this prospectus:

- sell, offer, contract or grant any option to sell (including without limitation any short sale), pledge, transfer or establish an open "put equivalent position" within the meaning of the Exchange Act with respect to any common stock;
- otherwise dispose of any common stock, options or warrants to acquire common stock or securities exchangeable or exercisable for or convertible into common stock; or
- publicly announce any intent to do any of the foregoing.

Our directors and executive officers may, however:

- transfer securities by bona fide gift, will or intestate succession;
- exercise any options to purchase common stock, provided that if such options are exercised for common stock, such common stock issued upon exercise are still subject to the restrictions;
- surrender any shares to us in payment of the exercise price of any options to purchase shares, and/or have any shares issuable upon such exercise withheld in respect of tax obligations;
- tender and exchange any $7^1/_4$% debentures or $8^1/_4$% debentures in the exchange offer, if commenced; and
- have any debentures redeemed by us.

Nasdaq National Market Listing

Our common stock is quoted on The Nasdaq National Market under the symbol "RELL."

Stabilization, Short Positions and Penalty Bids

We are aware that the anti-manipulation rules of Regulation M under the Exchange Act may apply to sales of shares in the market and to our activities and the activities of our affiliates.

Under applicable rules and regulations under the Exchange Act, persons engaged in the distribution of the shares may be limited in their ability to engage in market activities with respect to such shares. In addition, we will be subject to applicable provisions of the Exchange Act and the associated rules and regulations under the Exchange Act, including Regulation M, which provisions may limit the timing of purchases and sales of shares of our common stock.

In connection with the offering the underwriters may engage in stabilizing transactions, over-allotment transactions, syndicate covering transactions and penalty bids in accordance with Regulation M under the Exchange Act.

- Stabilizing transactions permit bids to purchase the underlying security so long as the stabilizing bids do not exceed a specified maximum.

Over-allotment involves sales by the underwriters of shares in excess of the number of shares the underwriters are obligated to purchase, which creates a syndicate short position. The short position may be either a covered short position or a naked short position. In a covered short position, the number of shares over-allotted by the underwriters is not greater than the number of shares that they may purchase in the over-allotment option. In a naked short position, the number of shares involved is greater than the number of shares in the

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over-allotment option. The underwriters may close out any covered short position by either exercising their over-allotment option and/or purchasing shares in the open market.

Syndicate covering transactions involve purchases of the common stock in the open market after the distribution has been completed in order to cover syndicate short positions. In determining the source of shares to close out the short position, the underwriters will consider, among other things, the price of shares available for purchase in the open market as compared to the price at which they may purchase shares through the over-allotment option. If the underwriters sell more shares than could be covered by the over-allotment option, a naked short position, the position can only be closed out by buying shares in the open market. A naked short position is more likely to be created if the underwriters are concerned that there could be downward pressure on the price of shares in the open market after pricing that could adversely affect investors who purchase shares in the offering.

Penalty bids permit the representative to reclaim a selling concession from a syndicate member when the common stock originally sold by the syndicate member is purchased in a stabilizing or syndicate covering transaction to cover syndicate short positions.

These stabilizing transactions, syndicate covering transactions and penalty bids may have the effect of raising or maintaining the market price of our common stock or preventing or retarding a decline in the market price of our common stock. As a result, the price of our common stock may be higher than the price that might otherwise exist in the open market. These transactions may be effected on The Nasdaq National Market or otherwise and, if commenced, may be discontinued at any time.

Passive Market Making

In connection with this offering, certain underwriters who are qualified market makers on The Nasdaq National Market may engage in passive market making transactions in our common stock on The Nasdaq National Market in accordance with Rule 103 of Regulation M under the Exchange Age. In general, a passive market maker must display its bid at a price not in excess of the highest independent bid for such security; if all independent bids are lowered below the passive market maker's bid, however, such bid must then be lowered when certain purchase limits are exceeded.

Indemnification

We and the underwriters have agreed to indemnify each other against certain liabilities, including liabilities under the Securities Act.

Other

It is expected that delivery of the shares of common stock will be made to investors on or about , 2004.

As noted above, Jefferies is acting as dealer manager in connection with the exchange offer. From time to time in the ordinary course of their respective businesses, Jefferies and some of the underwriters and their affiliates may in the future engage in commercial banking and/or investment banking transactions with us and our affiliates.

LEGAL MATTERS

Bryan Cave LLP, as our counsel, will pass upon the legality of the common stock. Scott Hodes, a partner in Bryan Cave LLP, is also one of our directors and, as of June 10, 2004, beneficially owned 78,424 shares of common stock and 3,712 shares of Class B common stock. Certain legal matters will be passed upon for the underwriters by King & Spalding LLP.

EXPERTS

The consolidated financial statements and schedule of Richardson Electronics, Ltd. at May 31, 2002 and 2003 and for each of the three years in the period ended May 31, 2003, appearing in this prospectus and registration statement have been audited by Ernst & Young LLP, independent auditors, as set forth in their report thereon appearing elsewhere herein, and are included in reliance upon such report given on the authority of such firm as experts in accounting and auditing.

On August 22, 2003, we chose not to renew the engagement of Ernst & Young LLP and appointed KPMG LLP as our principal accountants for the fiscal year ending May 31, 2004, which engagement was effective August 29, 2003. The decision to change accountants was made by the audit committee of the board of directors and the board of directors.

During the two fiscal years ended May 31, 2003, there were no disagreements between us and Ernst & Young LLP on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to Ernst & Young LLP's satisfaction, would have caused them to make reference in connection with their opinion to the subject matter of the disagreement.

Ernst & Young LLP's reports on our consolidated financial statements for the years ended May 31, 2003 and 2002 did not contain any adverse opinion or disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope or accounting principles.

Ernst & Young LLP was provided with a copy of the foregoing disclosures. A copy of Ernst & Young LLP's letter, dated August 23, 2003, stating their agreement with such statements is attached as Exhibit 16.1 to our Current Report on Form 8-K filed on August 22, 2003. See "Where You Can Find More Information." There have been no "reportable events," as such term is used in Item 304(a)(1)(v) of Regulation S-K, during those years.

WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and current reports, proxy statements, and other information with the SEC. You may read and copy any of these documents at the SEC's public reference room at 450 Fifth Street, N.W., Washington, D.C. 20549. You can also obtain copies of the documents at prescribed rates by writing to the Public Reference Section of the SEC at 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the SEC at (800) SEC-0330 for further information on the public reference rooms. Our SEC filings are also available to the public at the SEC's Internet website at *www.sec.gov*.

You may receive a copy of any of these filings, other than an exhibit to a filing unless that exhibit is specifically incorporated by reference into that filing, at no cost, by writing or calling the Investor Relations Department, Richardson Electronics, Ltd., 40W267 Keslinger Road, P.O. Box 393, LaFox, Illinois 60147-0393, telephone (630) 208-2371. You can also find information about the Company at our Internet website at *www.rell.com*. Information contained on our website does not constitute part of this prospectus.

We have filed with the SEC a registration statement to register the securities offered by this prospectus under the Securities Act. This prospectus is part of that registration statement, but omits certain information contained in the registration statement, as permitted by SEC rules. For further information with respect to our company and this offering, reference is made to the registration statement and the exhibits and any schedules filed with the registration statement. Statements contained in this prospectus as to the contents of any document referred to are not necessarily complete and in each instance, if the document is filed as an exhibit, reference is made to the copy of the document filed as an exhibit to the registration statement, each statement being qualified in all respects by that reference. You may obtain copies of the registration statement, including exhibits, as noted in the first paragraph above.

RICHARDSON ELECTRONICS, LTD.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT AUDITORS

Stockholders and Directors
Richardson Electronics, Ltd.
LaFox, Illinois

We have audited the accompanying consolidated balance sheets of Richardson Electronics, Ltd. and subsidiaries as of May 31, 2003 and 2002, and the related consolidated statements of operations and comprehensive income (loss), cash flows and stockholders' equity for each of the three years in the period ended May 31, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Richardson Electronics, Ltd. and subsidiaries at May 31, 2003 and 2002, and the consolidated results of their operations and cash flows for each of the three years in the period ended May 31, 2003, in conformity with accounting principles generally accepted in the United States.

As discussed in the Notes to the consolidated financial statements, effective June 1, 2002, the Company changed its method for accounting for goodwill and other intangible assets to conform with SFAS No. 142, *Goodwill and Other Intangible Assets*. Effective June 1, 2001, the Company changed its method for accounting for derivative financial instruments to conform with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities.*

/s/ Ernst & Young LLP

Chicago, Illinois
July 2, 2003, except as to Note B
as to which the date is January 22, 2004

RICHARDSON ELECTRONICS, LTD.

Consolidated Balance Sheets

(in thousands, except per share amounts, as restated (See Note B))

	As of May 31	
	2002	**2003**
ASSETS		
Current Assets		
Cash and equivalents	$ 15,296	$ 16,874
Receivables, less allowance of $2,646 and $3,350	84,156	85,355
Inventories	107,159	95,896
Prepaid expenses	4,880	6,919
Deferred income taxes	16,119	19,401
Total current assets	227,610	224,445
Property, plant and equipment, net	28,827	31,088
Goodwill, net of amortization of $3,939 and $2,745	24,914	5,137
Other assets	5,296	4,261
Total assets	$ 286,647	$ 264,931
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	$ 27,387	$ 23,660
Accrued liabilities	13,631	16,880
Current portion of long-term debt	38	46
Total current liabilities	41,056	40,586
Long-term debt	132,218	138,396
Deferred income taxes	8,764	5,269
Non-current liabilities	5,195	5,049
Total liabilities	187,233	189,300
Stockholders' Equity		
Common stock, $.05 par value; issued 12,144 shares at May 31, 2002 and 12,258 shares at May 31, 2003	607	613
Class B common stock, convertible, $.05 par value; issued 3,207 shares at May 31, 2002 and May 31, 2003	160	160
Preferred stock, $1.00 par value, no shares issued		
Additional paid-in capital	91,013	91,962
Common stock in treasury, at cost; 1,584 shares at May 31, 2002 and 1,506 shares at May 31, 2003	(9,386)	(8,922)
Retained earnings	36,231	6,079
Accumulated other comprehensive loss	(19,211)	(14,261)
Total stockholders' equity	99,414	75,631

	As of May 31	
Total liabilities and stockholders' equity	$ 286,647	$ 264,931

See notes to consolidated financial statements.

RICHARDSON ELECTRONICS, LTD.

Consolidated Statements of Operations And Comprehensive Income (Loss)

(in thousands, except per share amounts, as restated (See Note B))

	Year ended May 31		
	2001	**2002**	**2003**
Net sales	$ 502,369	$ 443,492	$ 464,517
Cost of products sold	370,819	349,326	365,427
Gross margin	131,550	94,166	99,090
Selling, general and administrative expenses	94,444	94,519	100,749
Loss from disposition of a business		4,551	
Operating income (loss)	37,106	(4,904)	(1,659)
Other (income) expense:			
Interest expense	11,146	12,386	10,352
Investment income	(575)	(352)	(124)
Foreign exchange and other, net	145	860	1,256
Total other (income) expense	10,716	12,894	11,484
Income (loss) before income tax and cumulative effect of accounting change	26,390	(17,798)	(13,143)
Income tax provision (benefit)	8,656	(6,339)	(3,012)
Income (loss) before cumulative effect of accounting change	17,734	(11,459)	(10,131)
Cumulative effect of accounting change, net of tax of $3,725			(17,862)
Net income (loss)	$ 17,734	$ (11,459)	$ (27,993)
Net income (loss) per share basic:			
Net income (loss) per share before cumulative effect of accounting change	$ 1.33	$ (.84)	$ (.73)
Cumulative effect of accounting change, net of tax			(1.30)
Net income (loss) per share	$ 1.33	$ (.84)	$ (2.03)
Net income (loss) per share diluted:			
Net income (loss) per share before cumulative effect of accounting change	$ 1.21	$ (.84)	$ (.73)
Cumulative effect of accounting change, net of tax			(1.30)
Net income (loss) per share	$ 1.21	$ (.84)	$ (2.03)
Dividends per common share	$ ..16	$ ..16	$ ..16

Statement of comprehensive income

	Year ended May 31		
Net income (loss)	$ 17,734	$ (11,459)	$ (27,993)
Foreign currency translation	(5,452)	1,297	5,097
FAS 133 transition adjustment		(971)	
Fair value adjustment cash flow hedges		320	(147)
Comprehensive income (loss)	$ 12,282	$ (10,813)	$ (23,043)

See notes to consolidated financial statements.

RICHARDSON ELECTRONICS, LTD.

Consolidated Statements of Cash Flows

(in thousands, as restated (See Note B))

	Year Ended May 31		
	2001	**2002**	**2003**
Operating activities:			
Net income (loss)	$ 17,734	$ (11,459)	$ (27,993)
Adjustments to reconcile net income (loss) to cash provided by (used in) operating activities:			
Depreciation	4,956	5,182	5,093
Amortization of intangibles and financing costs	820	693	271
Deferred income taxes	885	(5,780)	(1,825)
Loss from disposition of a business		4,551	
Provision for inventory obsolescence		15,279	10,037
Other charges			6,041
Goodwill and other intangible assets impairment, net of tax			17,862
Other non-cash items in net income	1,310	2,465	1,494
Net adjustments	7,971	22,390	38,973
Changes in working capital, net of currency translation effects and business acquisitions:			
Receivables	(9,370)	15,089	4,297
Inventories	(25,094)	14,455	2,484
Other current assets	(4,589)	732	(3,054)
Accounts payable	(5,443)	(2,927)	(8,252)
Other liabilities	126	(5,192)	1,319
Net changes in working capital	(44,370)	22,157	(3,206)
Net cash provided by (used in) operating activities	(18,665)	33,088	7,774
Financing activities:			
Proceeds from borrowings	53,580	23,258	41,880
Payments on debt	(16,948)	(49,619)	(40,982)
Proceeds from issuance of common stock	4,044	1,606	1,134
Cash dividends	(2,084)	(1,609)	(2,694)
Other			(304)
Net cash provided by (used in) financing activities	38,592	(26,364)	(966)
Investing activities:			
Capital expenditures	(7,883)	(5,727)	(6,125)
Business acquisitions	(8,316)	(8,785)	(1,108)
Proceeds from sales of available-for-sale securities	6,700	5,490	5,217
Purchases of available-for-sale securities	(6,700)	(5,490)	(5,217)
Proceeds from disposition of business		6,261	
Other	1,283	480	(23)

	Year Ended May 31		
Net cash used in investing activities	(14,916)	(7,771)	(7,256)
Effect of exchange rate changes on cash	(897)	397	2,026
Increase (decrease) in cash and equivalents	4,114	(650)	1,578
Cash and equivalents at beginning of year	11,832	15,946	15,296
Cash and equivalents at end of year	$ 15,946	$ 15,296	$ 16,874

Certain amounts in prior periods were reclassified to conform to the 2003 presentation.

See notes to consolidated financial statements.

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RICHARDSON ELECTRONICS, LTD.

Consolidated Statements of Stockholders' Equity

(in thousands, as restated (See Note B))

	Shares Issued							
	Common	**Class B Common**	**Par Value**	**Additional Paid-In Capital**	**Treasury Stock**	**Retained Earnings**	**Accumulated Other Comprehensive Income (Loss)**	**Total**
Balance May 31, 2000	11,670	3,232	$ 745	$ 84,514	$ (11,045)	$ 34,184	$ (14,405)	$ 93,993
Shares issued under ESPP and stock option plan	276		14	3,513	517			4,044
Shares contributed to ESOP				850	460			1,310
Conversion of Class B shares to common shares	25	(25)						
Dividends						(2,084)		(2,084)
Currency translation							(5,452)	(5,452)
Net income						17,734		17,734
Balance May 31, 2001	11,971	3,207	759	88,877	(10,068)	49,834	(19,857)	109,545
Shares issued under ESPP and stock option plan	173		8	1,676	256			1,940
Shares contributed to ESOP				460	426			886
Dividends						(2,144)		(2,144)
Currency translation							1,297	1,297
SFAS 133 transition adjustment							(971)	(971)
Fair value adjustments cash flow hedges							320	320
Net loss						(11,459)		(11,459)
Balance May 31, 2002	12,144	3,207	767	91,013	(9,386)	36,231	(19,211)	99,414
Shares issued under ESPP and stock option plan	112		6	949	464			1,419
Dividends						(2,159)		(2,159)
Currency translation							5,097	5,097
Fair value adjustments cash flow hedges							(147)	(147)
Net loss						(27,993)		(27,993)
Balance May 31, 2003	12,256	3,207	$ 773	$ 91,962	$ (8,922)	$ 6,079	$ (14,261)	$ 75,631

Shares Issued

See notes to consolidated financial statements.

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RICHARDSON ELECTRONICS, LTD.

Notes to Consolidated Financial Statements

(in thousands, except per share amounts)

Note A Significant Accounting Policies

Principles of Consolidation: The consolidated financial statements include the accounts and operations of the Company and its subsidiaries. All significant intercompany transactions are eliminated. The Company accounts for its results of operations on a 52/53 week year, ending on the Saturday nearest May 31. Fiscal 2001, 2002, and 2003 contained 52 weeks.

Use of Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires the Company's management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications: Certain amounts in the prior year's financial statements have been reclassified to conform to the 2003 presentation.

Cash Equivalents: The Company considers short-term investments that have a maturity of three months or less, when purchased, to be cash equivalents. The carrying amounts reported in the balance sheet for cash and equivalents approximate the fair market value of these assets.

Inventories: Inventories are stated at the lower of cost or market. Inventory costs determined using the last-in, first-out (LIFO) method represent 80% of total inventories at May 31, 2002 and 78% at May 31, 2003. For the remaining inventories, cost is determined on the first-in, first-out (FIFO) method. If the FIFO method had been used for all inventories, the total amount of gross inventories would have decreased by $2,413 at May 31, 2002 and $3,980 at May 31, 2003. The reduction in FIFO value relative to LIFO reflects lowering costs in the electronics industry. Substantially all inventories represent finished goods held for sale.

Property, Plant and Equipment: Property, plant and equipment are stated at cost. Provisions for depreciation are computed principally using the straight-line method over the estimated useful life of the asset. Property, plant and equipment consist of the following:

	May 31	
	2002	**2003**
Land and improvements	$ 2,864	$ 2,964
Buildings and improvements	16,367	18,074
Computer and communications equipment	18,044	20,465
Machinery and other equipment	17,957	22,145
Property, at cost	55,232	63,648
Accumulated depreciation	(26,405)	(32,560)
Property, plant and equipment, net	$ 28,827	$ 31,088

The Company is in the application development stage of implementing enterprise resource management software (PeopleSoft). In accordance with Accounting Standards Executive Committee (AcSEC) Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use,* the Company capitalizes all direct costs associated with the application development of this software including software acquisition costs, consulting costs, and internal payroll

costs. The Statement requires these costs to be depreciated once the application development stage is complete. The unamortized balance of the aforementioned capitalized costs, included within computer and communications equipment, is $6,162 and $8,102 at May 31, 2002 and May 31, 2003, respectively. Depreciation expense for capitalized software costs that relate to PeopleSoft in the post-application development stage was $558, $709, and $786 in 2001, 2002, and 2003, respectively.

Other Assets: Other assets consist of the following:

	May 31	
	2002	**2003**
Investments (at market)	$ 2,836	$ 2,587
Notes receivable	1,425	786
Deferred financing costs, net	517	544
Other deferred charges, net	518	344
Other assets	$ 5,296	$ 4,261

The Company's investments are primarily equity securities, all of which are classified as available-for-sale and are carried at their fair value based on the quoted market prices. Proceeds from the sale of the securities were $5,949 and $5,217 during fiscal 2002 and 2003, respectively, all of which were consequently reinvested. Gross realized gains on those sales were $634 in 2002 and $351 in 2003. Gross realized losses on those sales were $584 in 2002 and $412 in 2003. Net unrealized holding gain of $95 and net unrealized holding loss of $96 have been included in accumulated comprehensive income for fiscal 2002 and 2003, respectively.

Deferred financing costs and other deferred charges are amortized using the straight-line method.

Goodwill and Other Intangible Assets: Effective June 1, 2002, the Company adopted FASB Statement No. 142, *Goodwill and Other Intangible Assets* (SFAS 142*),* which requires that goodwill and intangible assets deemed to have indefinite lives are no longer amortized but are subject to annual impairment testing. Intangible assets with finite lives are amortized over their estimated useful lives.

Accordingly, the Company discontinued amortization of goodwill and certain intangible assets. Management reviews the valuation of goodwill and intangible assets not subject to amortization at least annually. The Company utilizes the comparison of reporting units fair value derived by discounted cash flow analysis and their book value as an indicator of potential impairment. The application of SFAS 142 transitional accounting provisions and the annual impairment test are discussed in Note C.

Accrued Liabilities: Accrued liabilities consist of the following:

	May 31	
	2002	2003
Compensation and payroll taxes	$ 4,284	$ 7,431
Interest	2,912	2,754
Income taxes	1,831	745
Warranty reserve	47	672
Other accrued expenses	4,557	5,278
Accrued liabilities	$ 13,631	$ 16,880

Warranties: The Company offers warranties for specific products it manufactures. The Company also provides extended warranties for some products it sells that lengthen the period of coverage specified in the manufacturer's original warranty. Terms generally range from one to three years.

The Company estimates the cost to perform under its warranty obligation and recognizes this estimated cost at the time of the related product sale. The Company reports this expense as an element of cost of products sold in its statement of operations and comprehensive income (loss). Each quarter, the Company assesses actual warranty costs incurred, on a product-by-product basis, as compared to its estimated obligation. The estimates with respect to new products are based generally on knowledge of the manufacturers' experience and are extrapolated to reflect the extended warranty period, and are refined each quarter as better information with respect to warranty experience becomes known.

Warranty reserves are established for costs that are expected to be incurred after the sale and delivery of products under warranty. The warranty reserves are determined based on known product failures, historical experience, and other currently available evidence. Changes in the warranty reserve for fiscal 2003 were as follows (in thousands):

	Warranty Reserve
Balance at May 31, 2002	$ 47
Accruals for warranties issued during the period	846
Utilization	(221)
Balance at May 31, 2003	$ 672

The increase in the warranty accrual primarily represents warranties related to a new product offering by the Company's Display Systems Group beginning in the third quarter of fiscal 2003.

Non-current Liabilities: Non-current liabilities of $5,195 at May 31, 2002 and $5,049 at May 31, 2003 represent guaranteed payments for acquisitions made during fiscal 2001 as discussed in Note E.

Foreign Currency Translation: Foreign currency balances and financial statements are translated into U. S. dollars at end-of-period rates. Revenues and expenses are translated at the current rate on the date of the transaction. Gains and losses resulting from foreign currency transactions are included in income. Foreign currency transaction losses reflected in operations are $151, $95 and $688 in 2001, 2002, and 2003, respectively. Gains and losses resulting from translation of foreign subsidiary financial statements are credited or charged directly to stockholders' equity.

Revenue Recognition: The Company's product sales are recognized as revenue generally upon shipment, when title passes to the customer, delivery has occurred or services have been rendered, and collectibility is reasonably assured. The Company's terms are generally FOB shipping point and sales are recorded net of discounts, rebates and returns based on the Company's historical experience. The Company's products are often manufactured to meet the specific design needs of its customers' applications. Its engineers work closely with customers in ensuring that the product the Company seeks to provide them will meet their needs, but its customers are under no obligation to compensate the Company for designing the products it sells; the Company retains the rights to its designs.

Shipping and Handling Fees and Costs: Shipping and handling costs billed to customers are reported as sales and the related costs in cost of sales.

Income Taxes: Deferred tax assets and liabilities are established for differences between financial reporting and tax accounting of assets and liabilities and are measured using the marginal tax rates. U.S. income taxes have not been provided on the undistributed earnings of foreign subsidiaries and affiliates as the Company intends to permanently reinvest such earnings.

Stock-Based Compensation: The Company accounts for its stock option plans in accordance with Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. As such, compensation expense would be recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. However, the exercise price of all grants under the Company's option plans has been equal to the fair market value on the date of grant. Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*, requires estimation of the fair value of options granted to employees. Had the Company's option plans and stock purchase plan been treated as compensatory under the provisions of

SFAS No. 123, the Company's net income (loss) and net income (loss) per share would have been affected as follows (see Note J for underlying assumptions):

	2001	2002	2003
Net income (loss), as reported	$ 17,734	$ (11,459)	$ (27,993)
Add: Stock-based compensation expense included in reported net income (loss), net of taxes	222	241	307
Deduct: Stock-based compensation expense determined under fair value-based method for all awards, net of taxes	(1,374)	(1,838)	(1,922)
Pro-forma net income (loss)	$ 16,582	$ (13,056)	$ (29,608)
Net income (loss) per share, basic:			
Reported net income (loss)	$ 1.33	$ (0.84)	$ 2.03
Pro-forma compensation expense, net of taxes	(0.09)	(0.13)	(0.11)
Pro-forma net income (loss) per share	$ 1.24	$ (0.97)	$ (2.14)
Net income (loss) per share, diluted:			
Reported net income (loss)	$ 1.21	$ (0.84)	$ (2.03)
Pro-forma compensation expense, net of taxes	(0.07)	(0.13)	(0.11)
Pro-forma net income (loss) per share	$ 1.14	$ (0.97)	$ (2.14)

Earnings per Share: Basic earnings per share is calculated by dividing net income by the weighted average number of Common and Class B Common shares outstanding. Diluted earnings per share is calculated by dividing net income, adjusted for interest savings, net of tax, on assumed bond conversions, by the actual shares outstanding and share equivalents that would arise from the exercise

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of stock options and the assumed conversion of convertible bonds when dilutive. The per share amounts presented in the Consolidated Statement of Operations are based on the following amounts:

	2001	2002	2003
Numerator for basic EPS:			
Net income (loss)	$ 17,734	$ (11,459)	$ (27,993)
Denominator for basic EPS:			
Shares outstanding, June 1	12,987	13,470	13,767
Additional shares issued	346	147	42
Average shares outstanding	13,333	13,617	13,809
Numerator for diluted EPS:			
Net income (loss)	$ 17,734	$ (11,459)	$ (27,993)
Interest savings, net of tax, on assumed conversion of bonds	3,459		
Adjusted net income (loss)	$ 21,193	$ (11,459)	$ (27,993)
Denominator for diluted EPS:			
Average shares outstanding	13,333	13,617	13,809
Effect of dilutive stock options	555		
Assumed conversion of bonds	3,680		
Average shares outstanding	17,568	13,617	13,809

Out-of-the-money (exercise price higher than market price) stock options are excluded from the calculation. The Company's $8^1/_4$% and $7^1/_4$% convertible debentures and common stock equivalent options are excluded from the calculation in 2002 and 2003 as assumed conversion would be anti-dilutive.

Derivatives and Hedging Activities: Effective June 1, 2001, the Company adopted Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), which establishes accounting and reporting standards for derivative instruments and hedging activities. SFAS 133 requires that the Company recognize all derivatives as either assets or liabilities on the Consolidated Balance Sheets and measure those instruments at fair value.

The Company has interest rate exchange agreements to convert approximately $37.2 million of its floating rate debt to an average fixed rate of 8% for the term of the debt through July 2004. At June 1, 2001, in connection with the adoption of SFAS No. 133, the Company recorded a transition adjustment relating to these agreements, which reduced other accumulated comprehensive income in shareholders' equity by $971, after tax. As a result of interest rate fluctuations, the Company recorded $1,926 in 2002 and $789 in 2003 as additional interest expense in the statement of operations.

Note B Restatement

In the second quarter of fiscal 2004, the Company identified an accounting error that occurred in a foreign subsidiary, which affected previously reported interest expense for the prior seven quarters beginning with the quarter ended February 29, 2002. The financial statements for fiscal 2002 and 2003 have been restated to correct this error. The restatement increased net loss for fiscal 2002 and 2003 from $11,270 and $27,558 to $11,459 and $27,993, respectively.

Note C Goodwill and Other Intangible Assets

As discussed in Note A, the Company adopted the new rules on accounting for goodwill and other intangible assets effective June 1, 2002, and, accordingly, discontinued the amortization of goodwill and other intangible assets not subject to amortization.

The following table presents a reconciliation of reported net income (loss) to adjusted net income (loss) excluding amortization of goodwill and other intangible assets not subject to amortization, net of tax:

	2001	2002	2003
Reported net income (loss)	$ 17,734	$ (11,459)	$ (27,993)
Add back amortization of goodwill	411	369	
Add back amortization of other intangible assets not subject to amortization	63	54	
Adjusted net income (loss)	$ 18,208	$ (11,036)	$ (27,993)
Basic earning per share	$ 1.33	$ (0.84)	$ (2.03)
Add back amortization of goodwill	0.03	0.03	
Add back amortization of other intangible assets not subject to amortization	0.01		
Adjusted basic earning per share	$ 1.37	$ (0.81)	$ (2.03)
Diluted earning per share	$ 1.21	$ (0.84)	$ (2.03)
Add back amortization of goodwill	0.02	0.03	
Add back amortization of other intangible assets not subject to amortization			
Adjusted diluted earning per share	$ 1.23	$ (0.81)	$ (2.03)

During the second quarter of fiscal 2003, the Company completed both steps of the required impairment tests of goodwill and indefinite life intangible assets for each of the reporting units as required under the transitional accounting provisions of SFAS 142. In identifying reporting units, the Company evaluated its reporting structure as of June 1, 2002. The Company concluded that the following operating segments and their components qualified as reporting units: RF & Wireless Communications, Broadcast, Display Systems Group, Industrial Power Group, Burtek, and Security Systems Division excluding Burtek. The first step in the process of goodwill impairment testing is a screen for potential impairment of the goodwill and other long lived assets, while the second step measures the amount of the impairment. The Company used a discounted cash flow valuation (income approach) to determine the fair value of each of the reporting units. Sales, net income, and EBITDA multiples (market approaches) were used as a check against the impairment implications derived under the income approach. The first step indicated that goodwill and other long lived assets of RF & Wireless Communications, Broadcast and Security Systems Division excluding Burtek were impaired. In evaluating the amount of impairment, it was determined that all goodwill and other long lived assets were impaired for the aforementioned reporting units. Consequently, the Company recorded, effective at the beginning of fiscal 2003, an impairment loss of $21.6 million of which $21.5 million related to goodwill with the balance attributable to other intangible assets with indefinite useful lives. The impairment loss of $17.9 million, net of tax of $3.7 million, was recorded as a cumulative effect of a change in accounting principle.

The Company performed its annual impairment test during the fourth quarter of fiscal 2003. The same methodology was employed in completing the annual impairment test as in applying transitional accounting provisions of SFAS 142. The Company did not find any indication that additional impairment existed and, therefore, no additional impairment loss was recorded as a result of completing the annual impairment test.

The table below provides changes in carrying value of goodwill by reportable segment:

Goodwill

	Reportable segments				
	RFWC	**IPG**	**SSD**	**DSG**	**Total**
Balance at May 31, 2002	$ 20,342	$ 864	$ 2,297	$ 1,411	$ 24,914
Additions				1,548	1,548
Cumulative effect of change in accounting principle	(20,345)		(1,131)		(21,476)
Foreign currency translation	3	9	139		151
Balance at May 31, 2003	$	$ 873	$ 1,305	$ 2,959	$ 5,137

The addition to goodwill during fiscal 2003 represents additional consideration for the Pixelink acquisition made in fiscal 1999 due to the acquired business achieving certain targeted operating levels.

The following table provides changes in carrying value of other intangible assets not subject to amortization which represent incorporation and acquisition costs:

Other intangible assets not subject to amortization

	Reportable segments				
	RFWC	**IPG**	**SSD**	**DSG**	**Total**
Balance at May 31, 2002	$ 111	$ 9	$ 373	$	$ 493
Cumulative effect of change in accounting principle	(111)				(111)
Foreign currency translation			36		36
Balance at May 31, 2003	$	$ 9	$ 409	$	$ 418

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Intangible assets subject to amortization as well as amortization expense are as follows:

Intangible assets subject to amortization as of May 31

	2001	2002	2003
Gross amounts:			
Deferred financing costs	$ 1,735	$ 1,883	$ 2,191
Patents & trademarks	478	478	478
Total gross amounts	2,213	2,361	2,669
Accumulated amortization:			
Deferred financing costs	1,215	1,366	1,647
Patents & trademarks	423	436	448
Total accumulated amortization	$ 1,638	$ 1,802	$ 2,095

Amortization of intangible assets subject to amortization

	2001	2002	2003
Deferred financing costs	$ 120	$ 148	$ 261
Patents & trademarks	35	13	12
Total	$ 155	$ 161	$ 273

The amortization expense associated with the intangible assets subject to amortization is expected to be $302, $183, $79, and $10 in fiscal 2004, 2005, 2006, and 2007, respectively. The weighted average number of years of amortization expense remaining is 2.3.

Note D Charges

During the fourth quarter of fiscal 2003, the Company took certain actions to align its inventory and cost structure to current sales levels amid continued weakness in the global economy and limited demand visibility. As a result, the Company recorded a non-cash inventory write-down charge of $13.8 million, a restructuring charge of $1.7 million, and other charges of $0.6 million. In addition, a valuation allowance tax provision in the amount of $1.6 million was established related to deferred income tax assets attributable to net operating losses in certain foreign subsidiaries. The net of tax effect of the aforementioned charges was $11.9 million on the Company's results of operations.

The restructuring charge consisted of $1,536 for employee severance and $210 lease breakage costs and was included in fiscal 2003 selling, general and administrative expense (SG&A). The severance costs of $328 were paid in 2003 with the remaining balance payable in fiscal 2004. Terminations affected over 70 employees across various business functions, operating units and geographic regions. All terminations and termination benefits were communicated to the affected employees prior to 2003 year-end. Management has estimated annual savings of $3 million in SG&A expense beginning in fiscal 2004 as a direct result of the restructuring program.

In the fourth quarter of fiscal 2002, the Company reevaluated its inventory reserve estimate in light of the industry wide decline in sales, a prolonged recovery period, and changes in the Company's mix of business toward higher technology products particularly in the telecommunications market. An inventory obsolescence and overstock adjustment of $15,279, or $9,778 net of tax, was included in cost of sales. Also in the fourth quarter of 2002, the Company recorded a provision for uncollectable accounts receivable and severance due to recent management changes. The charge was $794, or $509 net of tax, recorded in SG&A and other expense.

Note E Acquisitions

Fiscal 2001: In June 2000, the Company acquired the assets and liabilities of Celti Electronics, a French distributor of fiber optic communications products with annual sales of $3,600. In January 2001, the Company also acquired the assets and liabilities of Aviv Electronics of Israel, a distributor specializing in design-in services for active and passive electronic components with annual sales of $10,000. Baron Electronics, a distributor of electronic components in Latin America, was acquired in May 2001, with annual sales of $2,000.

The aggregate cash outlay in 2001 for business acquisitions was $8,316.

Fiscal 2002: In July 2001, the Company acquired Sangus Holdings AB (Sangus) which serves the Nordic countries of Sweden, Finland, Denmark and Norway. Sangus is a specialist in RF & microwave technology with annual revenues at the time of purchase of $9,600. The aggregate cash outlay in 2002 for this and all previous business acquisitions (earnout payments) was $8,785.

Fiscal 2003: The aggregate cash outlay in 2003 for business acquisitions was $1,108 representing additional consideration paid for certain business acquisitions made in prior periods due to the acquired businesses achieving certain targeted operating levels.

Each of the acquisitions was accounted for by the purchase method, and accordingly, their results of operations are included in the consolidated statements of operations from the respective dates of acquisition. The impact of these acquisitions on results of operations was not significant and would not have been significant if they had been included for the entire year. If each of these acquisitions had occurred at the beginning of the year, consolidated sales would have increased by approximately $14,000 and $900 in 2001 and 2002, respectively.

The terms of certain of the Company's acquisition agreements provide for additional consideration to be paid if the acquired entity's results of operations exceed certain targeted levels. Such amounts are paid in cash and recorded when earned as additional consideration, and amounted to $2,638, $1,274, and $1,108 in 2001, 2002 and 2003, respectively. Assuming the goals established in all agreements outstanding at May 31, 2003 were met, additional consideration aggregating approximately $7,277 would be payable through July of 2004.

Note F Disposal of Product Line

On February 22, 2002, the Company sold certain assets of its Medical Systems Group (MSG), specifically, inventory and other assets related to its Medical Glassware product line (MG) used in the reloading and distribution of X-ray, CT, and image intensifier tubes, amid continued decline in the product lines sales and gross margins due to increased competition in the replacement market and production inefficiencies in tube reloading. The book value of the assets sold was $10.9 million. Proceeds from the sale were $6.3 million resulting in a loss on the sale of $4.6 million or $2.9 million, net of tax.

The MG product line at the time of sale represented more than half of the Company's MSG revenues with medical monitors and associated display products making up the majority of the balance. The MG sales were $15,966, $12,940, and $1,269 in fiscal 2001, 2002, and 2003.

Note G Debt Financing

Long-term debt consists of the following:

	May 31	
	2002	**2003**
$8\frac{1}{4}$% Convertible debentures, due June 2006	$ 40,000	$ 40,000
$7\frac{1}{4}$% Convertible debentures, due December 2006	30,825	30,825
Floating-rate multi-currency revolving credit facility, due September 2005 (4.24% at May 31, 2003)	59,388	65,802
Financial instruments	1,949	1,753
Other	94	62
Total debt	132,256	138,442
Less current portion	(38)	(46)
Long-term debt	$ 132,218	$ 138,396

The $7\frac{1}{4}$% convertible debentures are unsecured and subordinated to other long-term debt, including the $8\frac{1}{4}$% convertible debentures. Each $1 of the $7\frac{1}{4}$% debenture is convertible into the Company's Common Stock at any time prior to maturity at $21.14 per share and the $8\frac{1}{4}$% convertible debentures are convertible at $18.00 per share. The Company is required to make sinking fund payments of $3,850 in fiscal 2005 and $6,225 in fiscal 2006.

The Company has a multi-currency revolving credit facility agreement in the amount of $102.0 million. The agreement matures in September of 2005 and bears interest at applicable LIBOR rates plus a margin, varying with certain financial performance criteria. At May 31, 2003, the margin was 225 basis points and $36.2 million was available under this facility.

In the following table, the fair values of the Company's 7 1/4% and 8 1/4% convertible debentures are based on quoted market prices at the end of the fiscal year. The fair values of the bank term loans are based on carrying value.

	2002		2003	
	Carrying Value	Fair Value	Carrying Value	Fair Value
8 1/4% Convertible debentures	$ 40,000	$ 36,250	$ 40,000	$ 37,200
7 1/4% Convertible debentures	30,825	26,240	30,825	28,051
Floating-rate multi-currency revolving credit facility	59,388	59,388	65,802	65,802
Financial instruments	1,949	1,949	1,753	1,753
Other	94	94	62	62
Total	132,256	123,921	138,442	132,868
Less current portion	(38)	(38)	(46)	(46)
Total	$ 132,218	$ 123,883	$ 138,396	$ 132,822

The loan and debenture agreements contain financial covenants with which the Company was in full compliance at May 31, 2003. These covenants include benchmark levels for tangible net worth, a borrowing base, senior funded debt to cash flow and annual debt service coverage.

Aggregate maturities of debt during the next five years are: $46 in 2004, $3,866 in 2005, $72,027 in 2006, and $60,750 in 2007. Cash payments for interest were $11,230, $11,336, and $10,246 in 2001, 2002, and 2003, respectively.

Note H Facility Lease Obligations and Other Commitments

The Company leases certain warehouse and office facilities under non-cancelable operating leases. Rent expense for fiscal 2001, 2002, and 2003 was $3,189, $3,337 and $3,608, respectively. At May 31,2003, future lease commitments for minimum rentals, including common area maintenance charges and property taxes, were $3,378 in 2004, $2,447 in 2005, $1,573 in 2006, $703 in 2007, $527 in 2008, and $661 thereafter.

As of May 31, 2003, the Company has several performance bonds outstanding that were required by certain African and Latin American customers. The total amount of the bonds was $645 with expiration dates between July and December of 2003.

Note I Income Taxes

The components of income (loss) before income taxes are:

	Year Ended May 31		
	2001	2002	2003
United States	$ 19,730	$ (18,634)	$ (14,724)
Foreign	6,660	836	1,581
Income (loss) before taxes	$ 26,390	$ (17,798)	$ (13,143)

Note I Income Taxes (Continued)

The provision for income taxes differs from income taxes computed at the federal statutory tax rate of 35% in 2001 and 34% in 2002 and 2003 and as a result of the following items:

	Year Ended May 31		
	2001	2002	2003
Federal statutory rate	35.0%	(34.0)%	(34.0)%
Effect of:			
State income taxes, net of federal tax benefit	1.4	(2.3)	(2.1)
Export benefit	(2.2)	(2.9)	(4.7)
Foreign taxes at other rates	(2.7)	(0.2)	1.6
Valuation allowance for foreign net oper. loss carryforwards			12.1
Other	1.3	3.8	4.2
Effective tax rate	32.8%	(35.6)%	(22.9)%

The provisions for income taxes consist of the following:

	Year Ended May 31		
	2001	2002	2003
Currently payable:			
Federal	$ 5,622	$ (1,075)	$ (2,111)
State	133	(158)	(464)
Foreign	2,016	674	2,169
Total currently payable	7,771	(559)	(406)
Deferred:			
Federal	443	(4,651)	(1,534)
State	430	(519)	(252)
Foreign	12	(610)	(820)
Total deferred	885	(5,780)	(2,606)
Income tax provision (benefit)	$ 8,656	$ (6,339)	$ (3,012)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities as of May 31, 2002 and 2003 are as follows:

	Year Ended May 31	
	2002	**2003**
Deferred tax assets:		
Intercompany profit in inventory	$ 1,075	$ 1,264
NOL carryforward foreign		4,615
Inventory valuation	10,652	12,329
Goodwill	(661)	2,690
Alternative minimum tax credit		1,189
Other	3,955	1,928
	15,021	24,015
Deferred tax liabilities:		
Accelerated depreciation	(3,339)	(3,022)
Other	(4,327)	(5,721)
	(7,666)	(8,743)
Net deferred tax assets	7,355	15,272
Valuation allowance		(1,586)
Net deferred tax assets after valuation allowance	$ 7,355	$ 13,686

As of May 31, 2003, the Company has net operating losses (NOL) totaling $12,819 in various foreign jurisdictions. The majority of the NOL can be carried forward from 5 years to indefinitely. During fiscal 2003, the Company recorded a valuation allowance of $1,586 relating to deferred tax assets in certain foreign subsidiaries which sustained consecutive years of losses. As required by FAS 109, these subsidiaries should not continue to accrue future benefits. The Company also has an alternative minimum tax credit carryforward as of May 31, 2003, in the amount of $1,189 which has an indefinite carryforward period.

Income taxes paid, including foreign estimated tax payments, were $7,125, $952, and $2,657 in 2001, 2002, and 2003, respectively.

All current year positive earnings of the Company's foreign subsidiaries are considered permanently reinvested pursuant to APB 23. The current net earnings of these subsidiaries amount to $4,572.

Note J Stockholders' Equity

The Company has authorized 30,000 shares of Common Stock, 10,000 shares of Class B Common Stock, and 5,000 shares of Preferred Stock. The Class B Common Stock has ten votes per share. The Class B Common Stock has transferability restrictions; however, it may be converted into Common Stock on a share-for-share basis at any time. With respect to dividends and distributions, shares of common stock and Class B Common Stock rank equally and have the same rights, except that Class B Common Stock is limited to 90% of the amount of common stock cash dividends.

Total Common Stock issued and outstanding, excluding Class B at May 31, 2003, was 10,750 shares, net of treasury shares of 1,506. An additional 9,576 shares of Common Stock have been reserved for the potential conversion of the convertible debentures and Class B Common Stock and for future issuance under the Employee Stock Purchase Plan and Employee and Non-Employee Director Stock Option Plans.

The Employee Stock Purchase Plan (ESPP) provides substantially all employees an opportunity to purchase Common Stock of the Company at 85% of the stock price at the beginning or the end of the year, whichever is lower. At May 31, 2003, the plan had 16 shares reserved for future issuance.

The Employees' 2001 Incentive Compensation Plan authorizes the issuance of up to 900 shares as incentive stock options, non-qualified stock options or stock awards. Under this plan and predecessor plans, 2,434 shares are reserved for future issuance. The Plan authorizes the granting of incentive stock options at the fair market value at the date of grant. Generally, these options become exercisable over staggered periods and expire up to ten years from the date of grant.

Under the 1996 Stock Option Plan for Non-Employee Directors and a predecessor plan, at May 31, 2003, 238 shares of Common Stock have been reserved for future issuance relating to stock options exercisable based on the passage of time. Each option is exercisable over a period from its date of grant at the market value on the grant date and expires after ten years.

The Company applies APB Opinion No. 25 and related interpretations in accounting for its option plans and, accordingly, has not recorded compensation expense for such plans. SFAS No. 123 requires the calculation of the fair value of each option granted. This fair value is estimated on the date of grant using the Black-Scholes option-pricing model with the assumptions indicated below:

Assumptions used in estimating options fair values

	2001	2002	2003
Risk-free interest rate	5.9%	4.0%	2.9%
Annual standard deviation of stock price	56%	50%	49%
Average expected life (years)	5.1	5.2	5.1
Annual dividend rate	$ .16	$ .16	$ .16
Average fair value per option	$ 7.07	$ 2.95	$ 4.12
Option value of ESPP per share	$ 2.55	$ 1.96	$ 1.91
Fair value of options granted during the year	$ 3,253	$ 1,206	$ 297

A summary of the share activity and weighted average exercise prices for the Company's option plans is as follows:

	Outstanding		Exercisable	
	Shares	Price	Shares	Price
At May 31, 2000	1,559	$ 7.82	755	$ 7.82
Granted	460	13.75		
Exercised	(277)	7.24		
Cancelled	(120)	10.96		
At May 31, 2001	1,622	9.39	667	7.73
Granted	417	7.21		
Exercised	(173)	7.24		
Cancelled	(21)	10.49		
At May 31, 2002	1,845	9.09	802	8.52
Granted	72	9.83		
Exercised	(112)	6.75		
Cancelled	(88)	9.69		
At May 31, 2003	1,717	$ 9.25	1,111	$ 9.08

The following table summarizes information about stock options outstanding as of May 31, 2003:

	Outstanding			Exercisable		
Exercise Price Range	**Shares**	**Price**	**Life**	**Shares**	**Price**	**Life**
$3.75 to $5.38	30	$ 4.57	3.5	30	$ 4.57	3.5
$6.00 to $7.50	828	7.01	6.4	448	7.01	5.3
$7.90 to $8.97	280	8.25	4.4	280	8.25	4.4
$10.64 to $13.81	579	13.16	7.2	353	12.75	7.1
Total	1,717			1,111		

Note K Employee Retirement Plans

The Company's domestic employee retirement plans consist of a profit sharing plan and a stock ownership plan (ESOP). Annual contributions in cash or Company stock are made at the discretion of the Board of Directors. In addition, the profit sharing plan has a 401(k) provision whereby the Company matches 50% of employee contributions up to 4% of base pay. Charges to expense for discretionary and matching contributions to these plans were $2,403, $926, and $660 for fiscal 2001, 2002, and 2003, respectively. Such amounts included contributions in stock of $887 for 2001, based on the stock price at the date contributed. Shares are included in the calculation of earnings per share and dividends are paid to the ESOP from the date the shares are contributed. Foreign employees are covered by a variety of government mandated programs.

Note L Segment and Geographic Information

The following disclosures are made in accordance with the SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*. The Company's strategic business units (SBU's) in 2003 were: RF & Wireless Communications Group (RFWC), Industrial Power Group (IPG), Security Systems Division (SSD), and Display Systems Group (DSG).

RFWC serves the voice and data telecommunications market and the radio and television broadcast industry predominately for infrastructure applications.

IPG serves a broad range of customers including the steel, automotive, textile, plastics, semiconductor manufacturing, and transportation industries.

SSD provides security systems and related design services which includes such products as closed circuit television (CCTV), fire, burglary, access control, sound and communica-tion products and accessories.

DSG provides system integration and custom display solutions for the public information, financial, point-of-sale, and medical imaging markets.

Medical Glassware (MG) represents a portion of the former Medical Systems Group (MSG). MG was sold in February of 2002.

Each SBU is directed by a Vice President and General Manager who reports to the President and Chief Operating Officer. The President evaluates performance and allocates resources, in part, based on the direct operating contribution of each SBU. Direct operating contribution is defined as gross margin less product management and direct selling expenses.

Accounts receivable, inventory, and goodwill are identified by SBU. Cash, net property and other assets are not identifiable by SBU. Operating results for each SBU are summarized in the following table:

	Sales	Gross Margin	Contribution	Assets
Fiscal 2001				
RFWC	$ 244,381	$ 63,593	$ 42,395	$ 127,005
IPG	89,053	30,650	24,567	45,276
SSD	82,352	18,932	9,235	34,038
DSG	59,476	14,553	7,110	27,118
MG	15,966	3,765	1,852	15,050
Total	$ 491,228	$ 131,493	$ 85,159	$ 248,487
Fiscal 2002				
RFWC	$ 202,409	$ 47,467	$ 24,876	$ 114,801
IPG	74,578	24,356	17,643	37,037
SSD	85,087	20,080	10,248	32,401
DSG	60,697	15,864	8,528	22,889
MG	12,940	2,727	1,267	1,868
Total	$ 435,711	$ 110,494	$ 62,562	$ 208,996
Fiscal 2003				
RFWC	$ 222,448	$ 49,889	$ 25,255	$ 85,350
IPG	77,487	25,321	17,844	37,377
SSD	92,090	22,939	12,539	31,906
DSG	64,191	16,218	9,674	22,217
MG	1,269	164	(80)	276
Total	$ 457,485	$ 114,531	$ 65,232	$ 177,126

A reconciliation of sales, gross margin, direct operating contribution and assets to the relevant consolidated amounts is as follows. Other assets not identified include miscellaneous receivables, manufacturing inventories and other assets.

	Year ended May 31		
	2001	**2002**	**2003**
Segment sales	$ 491,228	$ 435,711	$ 457,485
Corporate	11,141	7,781	7,032
Sales	$ 502,369	$ 443,492	$ 464,517
Segment gross margin	$ 131,493	$ 110,494	$ 114,531
Inventory charges		(15,282)	(13,810)
Manufacturing variances and other costs	57	(1,046)	(1,631)
Gross margin	$ 131,550	$ 94,166	$ 99,090
Segment contribution	$ 85,159	$ 62,562	$ 65,232
Inventory charges		(15,282)	(13,810)
Manufacturing variances and other costs	57	(1,046)	(1,631)
Regional selling expenses	(16,697)	(15,380)	(17,336)
Administrative expenses	(31,413)	(31,207)	(34,114)
Loss from disposition of a business		(4,551)	
Operating income (loss)	$ 37,106	$ (4,904)	$ (1,659)
Segment assets	$ 248,487	$ 208,996	$ 177,126
Cash and equivalents	15,946	15,296	16,874
Other current assets	19,329	20,999	26,320
Net property	28,753	28,827	31,088
Other assets	8,999	12,529	13,523
Total assets	$ 321,514	$ 286,647	$ 264,931

Geographic sales information is primarily grouped by customer destination into five areas: North America, Europe, Asia/Pacific, Latin America, and Direct Export. Sales to Mexico are included as part of Latin America. Direct Export includes sales to export distributors in countries where the Company does not have sales offices.

Sales and long-lived assets (net property and other assets, excluding investments) are presented in the table below.

	Year ended May 31		
	2001	2002	2003
Sales			
United States	$ 246,319	$ 188,473	$ 197,184
Canada	56,569	53,294	58,732
North America	302,888	241,767	255,916
Europe	99,215	92,351	100,388
Asia/Pacific	51,411	65,534	74,746
Latin America	28,012	28,943	20,506
Direct Export	9,702	7,116	5,929
Total	$ 491,228	$ 435,711	$ 457,485
Assets			
United States	$ 36,726	$ 37,608	$ 30,060
Canada	2,085	2,408	2,659
North America	38,811	40,016	32,719
Europe	8,394	13,953	3,192
Asia/Pacific	1,613	788	794
Latin America	622	1,445	1,194
Total	$ 49,440	$ 56,202	$ 37,899

The sharp decrease in long-lived assets from 2002 to 2003 is primarily due to the goodwill impairment recorded in 2003.

The Company sells its products to companies in diversified industries and performs periodic credit evaluations of its customers' financial condition. Terms are generally on open account, payable net 30 days in North America, and vary throughout Europe, Asia/Pacific, and Latin America. Estimates of credit losses are recorded in the financial statements based on periodic reviews of outstanding accounts and actual losses have been consistently within management's estimates.

Note M Litigation

While the Company has several litigation matters pending against it that arose in the ordinary course of business, it is believed that, in the aggregate, they would not have a material adverse effect on the Company.

In fiscal 2003, the Company received notice that two customers of one of its subsidiaries are asserting claims against it in connection with product it sold to them by the subsidiary that the Company acquired pursuant to a distribution agreement with the manufacturer of the product. The claims are based on the product not meeting the specification provided by the manufacturer. The Company has notified the manufacturer and the Company's insurance carrier of these claims. The

Company is unable to evaluate the outcome of these claims or the recovery from the manufacturer or insurance carrier as the investigation has not been completed. The Company intends to vigorously defend these claims and prosecute its claims against the manufacturer and insurer if it should have any liability.

The Company is engaged in litigation it has filed, *Richardson Electronics, Ltd. v. Signal Technology Corporation*, 03 L 002661 (Circuit Court, Cook County, Illinois) and *Signal Technology Corporation v. Richardson Electronics, Ltd.*, C.A. No. 03-0335 (Superior Court Boston, Massachusetts). The Company filed suit in Illinois claiming damages in the amount of approximately $2.0 million resulting from Signal's refusal to take delivery of product on six purchase orders it had placed with the Company. Signal has filed a declaratory judgment suit in Massachusetts seeking a ruling that it has no liability to the Company. Signal has not asserted any claim against the Company.

The Company has asserted a claim against a former vendor in the amount of $593 for inventory it sought to return to the vendor pursuant to the terms of a Distribution Agreement between the two parties, that the vendor has refused to accept as of this time.

Note N Selected Quarterly Financial Data (Unaudited)

Summarized quarterly financial data for 2002 and 2003 follow.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2002:				
Net sales	$ 104,681	$ 115,499	$ 109,431	$ 113,881
Gross margin	26,474	28,381	26,280	13,031
Net income (loss)	(354)	902	(2,823)	(9,184)
Net income (loss) per share:				
Basic and Diluted	(0.03)	0.07	(0.21)	(0.67)
2003:				
Net sales	$ 108,614	$ 118,958	$ 118,010	$ 118,935
Gross margin	27,154	28,913	28,202	14,821
Income (loss) before cumulative effect of accounting change	166	1,078	(102)	(11,271)
Per share:				
Basic & Diluted	0.01	0.08	(0.01)	(0.82)
Net income (loss)	(17,696)	1,078	(102)	(11,271)
Net income (loss) per share:				
Basic and Diluted	(1.29)	0.08	(0.01)	(0.82)

A reconciliation of reported net income (loss) to amended net income (loss) including the additional interest expense for the affected quarters (See Note B) is provided in the following table:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2002:				
Reported Net Income (Loss)	$ (354)	$ 902	$ (2,743)	$ (9,075)
Additional Interest Expense			(80)	(109)
Amended Net Income	(354)	902	(2,823)	(9,184)
Income Per Share:				
Reported Basic and Diluted	(0.03)	0.07	(0.20)	(0.66)
Additional Interest Expense	0.00	0.00	(0.01)	(0.01)
Amended Net Income (Loss) Per share: Basic and Diluted	(0.03)	0.07	(0.21)	(0.67)
2003:				
Reported Net Income (Loss)	$ (17,578)	$ 1,190	$ (5)	$ (11,163)
Additional Interest Expense	(118)	(112)	(97)	(108)
Amended Net Income	(17,696)	1,078	(102)	(11,271)
Income Per Share:				
Reported Basic and Diluted	(1.28)	0.09	0.00	(0.81)
Additional Interest Expense	(0.01)	(0.01)	(0.01)	(0.01)
Amended Net Income (Loss) Per share: Basic and Diluted	(1.29)	0.08	(0.01)	(0.82)

The first quarter of fiscal 2003 includes a cumulative effect of accounting change of $17,862, net of tax (see Note C). The third quarter of fiscal 2002 contains a net of tax loss of $2.9 million for the disposal of the Medical Glassware business (see Note F). The fourth quarters of fiscal 2002 and 2003 include charges of $10.3 million and $11.9 million, net of tax, respectively, primarily related to inventory write-downs (see Note D).

RICHARDSON ELECTRONICS, LTD.

Condensed Consolidated Balance Sheets

(in thousands, except per share amounts)

	As of	
	May 31, 2003	**February 28, 2004**
	(as restated, see Note B)	**(unaudited)**
ASSETS		
Current Assets		
Cash and cash equivalents	$ 16,874	$ 19,727
Receivables, less allowance of $3,350 and $3,306	85,355	96,302
Inventories	95,896	93,207
Prepaid expenses	6,919	4,051
Deferred income taxes, net	19,401	20,506
Total current assets	224,445	233,793
Property, plant and equipment, net	31,088	30,747
Goodwill and intangible assets, net	6,129	5,891
Other assets	3,269	4,705
Total assets	$ 264,931	$ 275,136
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	$ 23,660	$ 30,724
Accrued liabilities	17,421	21,122
Current portion of long-term debt	46	4,488
Total current liabilities	41,127	56,334
Long-term debt	138,396	127,455
Deferred income taxes, net	5,269	8,282
Other non-current liabilities	5,049	127
Total liabilities	189,841	192,198
Stockholders' Equity		
Common stock ($.05 par value; issued 12,258 shares at May 31, 2003 and 12,500 shares at February 28, 2004)	613	625
Class B common stock, convertible ($.05 par value; issued 3,207 shares at May 31, 2003 and 3,171 shares at February 28, 2004)	160	159
Preferred stock ($1.00 par value; no shares issued)		
Additional paid-in capital	91,962	93,886
Common stock in treasury, at cost (1,506 shares at May 31, 2003 and 1,496 shares at February 28, 2004)	(8,922)	(8,864)
Retained earnings	6,079	8,026

	As of			
Unearned compensation		(541)		(368)
Accumulated other comprehensive loss		(14,261)		(10,526)
Total stockholders' equity		75,090		82,938
Total liabilities and stockholders' equity	$	264,931	$	275,136

See notes to condensed consolidated financial statements.

RICHARDSON ELECTRONICS, LTD.

Condensed Consolidated Statements Of Operations And Comprehensive Income (Loss)
For The Three- And Nine-Month Periods Ended February 28, 2003 And February 28, 2004

(unaudited, in thousands, except per share amounts)

	Three months ended		Nine months ended	
	February 28, 2003	February 28, 2004	February 28, 2003	February 28, 2004
	(as restated, see Note B)		(as restated, see Note B)	
Net sales	$ 118,010	$ 127,338	$ 345,582	$ 374,695
Cost of products sold	89,808	95,802	261,313	283,102
Gross margin	28,202	31,536	84,269	91,593
Selling, general and administrative expenses	25,451	27,101	74,155	78,441
Operating income	2,751	4,435	10,114	13,152
Other (income) expense				
Interest expense	2,634	2,577	7,757	7,682
Other, net	224	365	390	252
Total other (income) expense	2,858	2,942	8,147	7,934
Income before income tax and cumulative effect of accounting change	(107)	1,493	1,967	5,218
Income tax	(5)	493	825	1,621
Income before cumulative effect of accounting change	(102)	1,000	1,142	3,597
Cumulative effect of accounting change, net of tax (Note E)			(17,862)	
Net income (loss)	$ (102)	$ 1,000	$ (16,720)	$ 3,597
Net income (loss) per share basic:				
Net income per share before cumulative effect of accounting change	$ (0.01)	$ 0.07	$ 0.08	$ 0.26
Cumulative effect of accounting change, net of tax (Note E)			(1.30)	
Net income (loss) per share	$ (0.01)	$ 0.07	$ (1.22)	$ 0.26
Average shares outstanding	13,759	14,102	13,742	14,002
Net income (loss) per share diluted:				
Net income per share before cumulative effect of accounting change	$ (0.01)	$ 0.07	$ 0.08	$ 0.25
			(1.28)	

	Three months ended		Nine months ended	
Cumulative effect of accounting change, net of tax (Note E)				
Net income (loss) per share	$ (0.01)	$ 0.07	$ (1.20)	$ 0.25
Average shares outstanding	13,759	14,560	13,989	14,374
Dividends per common share	$ 0.04	$ 0.04	$ 0.12	$ 0.12
Statement of comprehensive income (loss):				
Net income (loss)	$ (102)	$ 1,000	$ (16,720)	$ 3,597
Foreign currency translation	2,124	2,149	380	2,803
Unrealized gain (loss) on investments	(90)	201	(293)	413
Fair value adjustments cash flow hedges	(44)	174	(297)	519
Comprehensive income (loss)	$ 1,888	$ 3,524	$ (16,930)	$ 7,332

See notes to condensed consolidated financial statements.

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RICHARDSON ELECTRONICS, LTD.

Condensed Consolidated Statements Of Cash Flows
For The Nine-Month Periods Ended February 28, 2003 And February 28, 2004

(unaudited, in thousands)

	Nine months ended	
	February 28, 2003	February 28, 2004
	(as restated, see Note B)	
Operating Activities		
Net income (loss)	$ (16,720)	$ 3,597
Non-cash charges to income (loss):		
Depreciation	4,072	3,788
Amortization of intangibles and financing costs	201	225
Deferred income taxes, net	(66)	1,621
Goodwill impairment charge	17,862	
Other, net	884	665
Total non-cash charges	22,953	6,299
Changes in working capital, net of effects of currency translation:		
Accounts receivable	3,312	(8,864)
Inventories	(3,218)	4,324
Other current assets	(628)	(511)
Accounts payable	(6,980)	7,593
Other liabilities	(1,233)	1,753
Net changes in working capital	(8,747)	4,295
Net cash provided by (used in) operating activities	(2,514)	14,191
Financing Activities		
Proceeds from borrowings	29,538	29,105
Payments on debt	(23,847)	(36,713)
Proceeds from stock issuance	203	1,537
Cash dividends	(2,151)	(1,651)
Net cash provided by (used in) financing activities	3,743	(7,722)
Investing Activities		
Capital expenditures	(4,958)	(3,861)
Earnout payment related to acquisitions	(764)	(1,008)
Proceeds from sales of available-for-sale securities	3,440	3,369
Purchases of available-for-sale securities	(3,440)	(3,369)
Other	(407)	
Net cash used in investing activities	(6,129)	(4,869)

	Nine months ended	
Effect of exchange rate changes on cash and cash equivalents	1,471	1,253
Net increase (decrease) in cash and cash equivalents	(3,429)	2,853
Cash and cash equivalents at beginning of period	15,296	16,874
Cash and cash equivalents at end of period	$ 11,867	$ 19,727

See notes to condensed consolidated financial statements.

RICHARDSON ELECTRONICS, LTD.

Notes To Condensed Consolidated Financial Statements

(in thousands, except per share amounts)

Note A Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements (Statements) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and notes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments necessary for a fair presentation of the results of interim periods have been made and such adjustments were of a normal and recurring nature. The results of operations and cash flows for the three- and nine-month periods ended February 28, 2004 are not necessarily indicative of the results that may be expected for the year ended May 31, 2004.

For further information, refer to the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2003. Certain fiscal 2003 balances have been reclassified to conform to the fiscal 2004 presentation.

Note B Restatement

The Company identified an accounting error in a foreign subsidiary which affected previously reported interest expense for seven quarters beginning with the third quarter of fiscal 2002 and ending with the first quarter of fiscal 2004. The correction of the error, which aggregated to $738, is presented as a restatement of these prior periods. The restatement increases diluted earnings per share to $0.15 for the second quarter of fiscal 2004 versus the $0.11 published in the December 18, 2003 earnings release. The Company filed a Form 10-K/A for fiscal 2003 and a Form 10-Q/A for the first quarter of fiscal 2004 on January 30, 2004 to reflect these changes. A reconciliation of reported net income (loss) to amended net income (loss) including the additional interest expense for the affected quarters is provided in the following table:

	FY 2002		FY 2003				FY 2004
	3rd Qtr	4th Qtr	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	1st Qtr
Reported net income (loss)	$ (2,743.0)	$ (9,075.0)	$ (17,578.0)	$ 1,190.0	$ (5.0)	$ (11,163.0)	$ 506.0
Additional interest expense	(80.2)	(108.9)	(118.3)	(112.1)	(96.8)	(107.6)	(113.9)
Amended net income (loss)	$ (2,823.2)	$ (9,183.9)	$ (17,696.3)	$ 1,077.9	$ (101.8)	$ (11,270.6)	$ 392.1
Reported basic and diluted income (loss) per share	$ (0.20)	$ (0.66)	$ (1.28)	$ 0.09	$	$ (0.81)	$ 0.04
Additional interest expense	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)
Amended basic and diluted net income (loss) per share	$ (0.21)	$ (0.67)	$ (1.29)	$ 0.08	$ (0.01)	$ (0.82)	$ 0.03

Note C Change in Accounting Principle

At February 28, 2004, the Company's worldwide inventories were stated at the lower of cost or market using the first-in, first-out (FIFO) method. Effective June 1, 2003, the North American operations, which represent a majority of the Company's operations and approximately 76% of the Company's inventories, changed from the last-in, first-out (LIFO) method to the FIFO method. All other inventories were consistently stated at the lower of cost or market using FIFO method. The Company believes that the FIFO method is preferable because it provides a better matching of revenue and expenses. The accounting change was not material to the financial statements for any of the periods presented, and accordingly, no retroactive restatement of prior years' financial statements was made. Inventories include material, labor and overhead associated with such inventories. Substantially all inventories represent finished goods held for sale.

Note D Restructuring Charges

As a result of the Company's fiscal 2003 restructuring initiative, a restructuring charge, including severance and lease termination costs of $1,730, was recorded in selling, general and administrative expenses for the year ended May 31, 2003. Severance costs of $328 were paid in fiscal 2003 with the remaining balance payable in fiscal 2004. The following table depicts the amounts associated with the activity related to the restructuring initiative through February 28, 2004:

	Restructuring liability May 31, 2003	Paid through February 28, 2004	Reversal of accrual	Unpaid balance as of February 28, 2004
Employee severance and related costs	$ 1,192	$ 891	$ 292	$ 9
Lease termination costs	210		210	
Total	$ 1,402	$ 891	$ 502	$ 9

The reversal of the employee severance and related costs resulted from the difference between the estimated severance costs and the actual payouts and was recorded in the quarter ended November 29, 2003. All employees originally notified were terminated. The lease termination did not occur as the agreement for the replacement facility was not finalized. The lease termination reversal was recorded in the quarter ended August 30, 2003.

Note E Goodwill and Other Intangible Assets

Effective June 1, 2002, the Company adopted SFAS No. 142, *Goodwill and Other Intangible Assets*. This statement changed the accounting for goodwill and indefinite-lived intangible assets from an amortization approach to an impairment-only approach. As a result of the adoption of SFAS No. 142, the Company recorded a transitional impairment charge during the first quarter of fiscal 2003 of $21,587 ($17,862 net of tax), presented as a cumulative effect of accounting change. This charge related to the Company's segments as follows: RF & Wireless Communications Group (RFWC), $20,456; and Security Systems Division (SSD), $1,131.

The Company periodically reviews the carrying amount of goodwill to determine whether an additional impairment may exist. A fair value approach is used to test goodwill for impairment. An impairment charge is recognized for the amount, if any, by which the carrying amount of the goodwill exceeds its fair value. Management establishes fair values using discounted cash flows. When available and as appropriate, management uses comparative market multiples to corroborate discounted cash flow results. The Company performed its annual impairment test during the fourth quarter of fiscal 2003. The Company did not find any indication that additional impairment existed and, therefore, no additional impairment loss was recorded.

The table below provides changes in the carrying values of goodwill and intangible assets not subject to amortization by reportable segment:

Goodwill and intangible assets not subject to amortization

	RFWC	IPG	SSD	DSG	Total
Balance at May 31, 2003	$	$ 882	$ 1,714	$ 2,959	$ 5,555
Modification of earnout payment				(58)	(58)
Foreign currency translation		7	46		53
Balance at February 28, 2004	$	$ 889	$ 1,760	$ 2,901	$ 5,550

Intangible assets subject to amortization as of May 31, 2003 and February 28, 2004 are as follows:

	May 31, 2003		February 28, 2004	
	Gross Amount	Accumulated Amortization	Gross Amount	Accumulated Amortization
Intangible assets subject to amortization:				
Deferred financing costs	$ 2,191	$ 1,647	$ 2,192	$ 1,863
Patents and trademarks	478	448	470	458
Total	$ 2,669	$ 2,095	$ 2,662	$ 2,321

Amortization expense for the third quarter and nine months is as follows:

	Amortization expense for the			
	Third Quarter		Nine Months	
	FY 2003	FY 2004	FY 2003	FY 2004
Intangible assets subject to amortization:				
Deferred financing costs	$ 56	$ 71	$ 191	$ 215
Patents and trademarks	4	4	10	10
Total	$ 60	$ 75	$ 201	$ 225

The amortization expense associated with the existing intangible assets subject to amortization is expected to be $299, $180, $75 and $20 in fiscal 2004, 2005, 2006, and 2007, respectively. The weighted average number of years of amortization expense remaining is 1.5.

Note F Warranties

The Company offers warranties for specific products it manufactures. The Company also provides extended warranties for some products it sells that lengthen the period of coverage specified in the manufacturer's original warranty. Terms generally range from one to three years.

The Company estimates the cost to perform under its warranty obligation and recognizes this estimated cost at the time of the related product sale and comprehensive income (loss). The Company reports this expense as an element of cost of products sold in its statement of operations. Each quarter,

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the Company assesses actual warranty costs incurred, on a product-by-product basis, as compared to its estimated obligation. The estimates with respect to new products are based generally on knowledge of the manufacturers' experience and are extrapolated to reflect the extended warranty period, and are refined each quarter as better information with respect to warranty experience becomes known.

Warranty reserves are established for costs that are expected to be incurred after the sale and delivery of the products subject to warranty. Such costs are accrued at the time revenue is recognized. The warranty reserves are determined based on known product failures, historical experience, and other currently available evidence. The reserve is included in "Accrued Liabilities" on the Condensed Consolidated Balance Sheets.

Changes in the warranty reserve for the nine months ended February 28, 2004 were as follows:

	Warranty Reserve
Balance at May 31, 2003	$ 672
Accruals for products sold	369
Utilization	(76)
Balance at February 28, 2004	$ 965

The increase in the warranty accrual represents warranties related to a new product offering by the Company's Display Systems Group beginning in the third quarter of fiscal 2003.

Note G Contractual Obligations and Other Commitments

The following table represents contractual obligations and other commercial commitments as of February 28, 2004 by fiscal period.

	Payments due by fiscal period as of February 28, 2004						
	2004	2005	2006	2007	2008	Beyond	Total
Convertible debentures	$	$ 3,850	$ 6,225	$ 60,750	$	$	$ 70,825
Floating-rate multi-currency revolving credit facility			60,435				60,435
Financial instruments	448	149					597
Facility lease obligations	991	2,971	1,973	1,037	711	740	8,423
Performance bonds		645					645
Contingent and earnout payments	5,979	1,084					7,063
Other	15	70					85
Total	$ 7,433	$ 8,769	$ 68,633	$ 61,787	$ 711	$ 740	$ 148,073

Convertible debentures consist of $8^1/4$% debentures with principal of $40,000, due June 2006 and $7^1/4$% debentures with principal of $30,825, due December 2006. The Company is required to make sinking fund payments of $3,850 in fiscal 2005 and $6,225 in fiscal 2006. The floating-rate multi-currency revolving credit facility matures in September of 2005 and bears interest at applicable LIBOR rates plus a 225 basis point margin. Financial instruments represent remaining liability associated with the Company's interest rate exchange agreements. Facility lease obligations are related to certain warehouse and office facilities under non-cancelable operating leases. Certain African and Latin American customers require performance bonds with expiration dates between July and December of

2004, renewable annually. Contingent and earnout payments represent additional consideration to be paid pursuant to certain of the Company's acquisition agreements assuming certain operation performance criteria are met. The Company acquired Pixelink Corporation (Pixelink) during fiscal year 1999 and Celti Electronics (Celti) and AVIV Electronics (AVIV) during fiscal year 2001. The terms of these acquisition agreements provide for additional consideration to be paid if the acquired entities results of operations exceed certain targeted levels or other criteria. For Aviv, additional consideration will be paid on a percentage of operating income with a guaranteed minimum. For Pixelink, additional consideration will be paid on a percentage of operating income and in the case of Celti, additional consideration will be paid on a percentage of operating income once a minimum threshold is achieved. Such amounts are paid in cash and recorded when earned as additional consideration and amounted to $764 and $1,008 for the nine months ended February 28, 2003 and 2004, respectively. Contingent and earnout payments, including the amounts paid during fiscal 2004 to date, associated with these acquisitions amount to $5,979 and will be payable in fiscal 2004, assuming the goals established in all agreements are met. The $1,084 fiscal year 2005 contingent and earnout payment will be payable in fiscal 2005 assuming the goals established in the acquisition agreement are met.

Note H Income Taxes

The income tax provisions for the nine-month periods ended February 28, 2003 and February 28, 2004 are based on the estimated annual effective tax rate of 41.9% and 31.1%, respectively. The difference between the effective tax rate and the U.S. statutory rate of 35% primarily results from the Company's geographic distribution of taxable income and losses, certain non-tax deductible charges, and the Company's foreign sales corporation benefit on export sales, net of state income taxes.

Income tax refund, net of foreign estimated tax payments, was $2,801 for the nine months ended February 28, 2004.

Note I Calculation of Earnings per Share

Basic income (loss) per share is calculated by dividing net income by the weighted average number of Common and Class B Common shares outstanding. Diluted income (loss) per share is calculated by dividing net income (loss) (adjusted for interest savings, net of tax, on assumed conversion of bonds) by the actual shares outstanding and share equivalents that would arise from the exercise of stock options, certain restricted stock awards, and the assumed conversion of convertible bonds when such assumptions have a dilutive effect on the calculation. The Company's $8^1/_4$% and $7^1/_4$% convertible debentures are excluded from the calculation in both fiscal 2003 and 2004, as assumed conversion and effect of interest savings would be anti-dilutive. The per share amounts presented in the

Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) are based on the following amounts:

	Third Quarter		Nine Months	
	FY 2003	FY 2004	FY 2003	FY 2004
Numerator for basic and diluted EPS:				
Income (loss) before cumulative effect of accounting change	$ (102)	$ 1,000	$ 1,142	$ 3,597
Cumulative effect of accounting change			(17,862)	
Net income (loss)	$ (102)	$ 1,000	$ (16,720)	$ 3,597
Denominator:				
Denominator for basic EPS				
Weighted average common shares outstanding	13,759	14,102	13,742	14,002
Effect of dilutive securities:				
Unvested restricted stock awards		31	49	35
Dilutive stock options		427	198	337
Shares applicable to diluted income (loss) per common share	13,759	14,560	13,989	14,374

The effect of potentially dilutive stock options is calculated using the treasury stock method. Certain stock options are excluded from the calculations because the average market price of the Company's stock during the period did not exceed the exercise price of those options. For the three-month period ended February 28, 2004, there were 446 such options. However, some or all of the above mentioned options may be potentially dilutive in the future.

Note J Stock-Based Compensation

The Company has stock-based compensation plans under which stock options are granted to key managers at the market price on the date of grant. Most of these new grants are fully exercisable after five years and have a ten-year life. Three such grants were issued during the nine months ended February 28, 2004.

The Company applies the intrinsic value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations including FASB interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation, an interpretation of APB Opinion 25,* issued in March 2000, to account for its stock options. Under this method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeds the exercise price. Statement of Financial Accounting Standard ("SFAS") No. 123, *Accounting for Stock-Based Compensation*, established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123, the Company has elected to continue to apply the intrinsic value-based method of accounting described above, and has adopted only the disclosure requirements of SFAS No. 123. The following table illustrates the pro-forma effect on net income (loss) attributable to common stockholders if the fair value-based method had been applied to all outstanding and unvested awards in each period.

	Third Quarter		Nine Months	
	FY 2003	FY 2004	FY 2003	FY 2004
Net income (loss), as reported	$ (102)	$ 1,000	$ (16,720)	$ 3,597
Add: Stock-based compensation expense included in reported net income (loss), net of tax	76	74	198	193
Deduct: Stock-based compensation expense determined under fair value-based method for all awards, net of taxes	(316)	(279)	(917)	(805)
Pro-forma net income (loss)	$ (342)	$ 795	$ (17,439)	$ 2,985
Net income (loss) per share, basic:				
Reported net income (loss)	$ (0.01)	$ 0.07	$ (1.22)	$ 0.26
Pro-forma compensation expense, net of taxes	(0.01)	(0.01)	(0.05)	(0.05)
Pro-forma net income (loss) per share	$ (0.02)	$ 0.06	$ (1.27)	$ 0.21
Net income (loss) per share, diluted:				
Reported net income (loss)	$ (0.01)	$ 0.07	$ (1.20)	$ 0.25
Pro-forma compensation expense, net of taxes	(0.01)	(0.02)	(0.05)	(0.04)
Pro-forma net income (loss) per share	$ (0.02)	$ 0.05	$ (1.25)	$ 0.21

Note K Segment Information

The marketing, sales, product management, and purchasing functions of the Company consist of four strategic business units (SBU's): RF & Wireless Communications Group (RFWC), Industrial Power Group (IPG), Security Systems Division (SSD), and Display Systems Group (DSG).

RFWC serves the expanding global RF and wireless communications market, including infrastructure and wireless networks, as well as the fiber optics market. The Company's team of RF and wireless engineers assists customers in designing circuits, selecting cost effective components, planning reliable and timely supply, prototype testing, and assembly. The group offers its customers and vendors complete engineering and technical support from the design-in of RF and wireless components to the development of engineered solutions for their system requirements.

IPG serves the industrial market's need for both vacuum tube and solid-state technologies. The group provides replacement products for systems using electron tubes as well as design and assembly services for new systems employing power semiconductors. As electronic systems increase in functionality and become more complex, the Company believes the need for intelligent, efficient power management will continue to increase and drive power conversion demand growth.

SSD is a global provider of closed circuit television, fire, burglary, access control, sound, and communication products and accessories for the residential, commercial, and government markets. The division specializes in closed circuit television design-in support, offering extensive expertise with applications requiring digital technology. SSD products are primarily used for security and access control purposes but are also utilized in industrial applications, mobile video, and traffic management.

DSG is a global provider of integrated display products and systems to the public information, financial, point-of-sale, and medical imaging markets. The group works with leading hardware vendors to offer the highest quality liquid crystal display, plasma, cathode ray tube, and customized display monitors. DSG engineers design custom display solutions that include touch screens, protective panels, custom enclosures, specialized finishes, application specific software, and privately branded products.

Each SBU is directed by a Vice President and General Manager who reports to the President and Chief Operating Officer. The President evaluates performance and allocates resources, in part, based on the direct operating contribution of each SBU. Direct operating contribution is defined as gross margin less product management and direct selling expenses.

Accounts receivable, inventory, goodwill, and some intangible assets are identified by SBU. Cash, net property and other assets are not identifiable by SBU. Operating results for each SBU are summarized in the following table:

	Sales	Gross Margin	Direct Operating Contribution	Assets	Goodwill and Intangibles
Third Quarter					
FY 2003					
RFWC	$ 51,499	$ 11,293	$ 5,560	$ 86,699	$
IPG	23,371	7,156	4,722	47,594	880
SSD	23,205	5,859	3,217	33,614	1,581
DSG	18,047	4,381	2,730	26,075	2,175
Total	$ 116,122	$ 28,689	$ 16,229	$ 193,982	$ 4,636
FY 2004					
RFWC	$ 55,973	$ 13,162	$ 6,787	$ 81,052	$
IPG	27,514	8,383	5,872	49,687	889
SSD	25,260	6,394	3,495	38,031	1,760
DSG	16,813	4,146	2,294	21,170	2,901
Total	$ 125,560	$ 32,085	$ 18,448	$ 189,940	$ 5,550
Nine Months					
FY 2003					
RFWC	$ 152,377	$ 34,079	$ 17,258	$ 86,699	$
IPG	71,149	22,236	15,227	47,594	880
SSD	69,601	17,306	9,671	33,614	1,581
DSG	46,169	11,977	7,110	26,075	2,175
Total	$ 339,296	$ 85,598	$ 49,266	$ 193,982	$ 4,636
FY 2004					
RFWC	$ 163,493	$ 37,190	$ 19,514	$ 81,052	$
IPG	81,232	24,730	17,570	49,687	889
SSD	76,541	19,419	10,829	38,031	1,760
DSG	47,756	12,132	6,648	21,170	2,901
Total	$ 369,022	$ 93,471	$ 54,561	$ 189,940	$ 5,550

Fiscal 2003 data has been reclassified to conform with the current presentation, which includes the reclassification of the broadcast tubes product line from RFWC to the IPG business unit. Fiscal 2003 quarterly sales for the broadcast tubes were $4,685, $4,625, $4,717, and $3,995 for the first, second, third, and fourth quarters, respectively.

A reconciliation of sales, gross margin, direct operating contribution and assets to the relevant consolidated amounts follows. Freight, Medical Glassware business, Logistics business, and miscellaneous sales are included in "Other sales". "Other assets" primarily represent miscellaneous receivables, manufacturing and other inventories, intangible assets subject to amortization and investments.

	Third Quarter		Nine Months	
	FY 2003	FY 2004	FY 2003	FY 2004
Sales segments total	$ 116,122	$ 125,560	$ 339,296	$ 369,022
Other sales	1,888	1,778	6,286	5,673
Sales	$ 118,010	$ 127,338	$ 345,582	$ 374,695
Gross margin segments total	$ 28,689	$ 32,085	$ 85,598	$ 93,471
Gross margin on other sales	(487)	(549)	(1,329)	(1,878)
Gross margin	$ 28,202	$ 31,536	$ 84,269	$ 91,593
Segment profit contribution	$ 16,229	$ 18,448	$ 49,266	$ 54,561
Gross margin on other sales	(487)	(549)	(1,329)	(1,878)
Regional selling expenses	(4,388)	(4,693)	(12,776)	(13,624)
Administrative expenses	(8,603)	(8,771)	(25,047)	(25,907)
Operating income	$ 2,751	$ 4,435	$ 10,114	$ 13,152
Segment assets	$ 193,982	$ 189,940		
Cash and cash equivalents	11,867	19,727		
Other current assets	21,212	24,557		
Net property	30,588	30,747		
Other assets	8,488	10,165		
Total assets	$ 266,137	$ 275,136		

The Company sells its products to companies in diversified industries and performs periodic credit evaluations of its customers' financial condition. Terms are generally on open account, payable net 30 days in North America, and vary throughout Europe, Asia/Pacific and Latin America. Estimates of credit losses are recorded in the financial statements based on periodic reviews of outstanding accounts and actual losses have been consistently within management's estimates.

Note L Recently Issued Pronouncements

On December 23, 2003, the FASB issued FASB Statement No. 132 (Revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits*. This standard increases the existing GAAP disclosure requirements by requiring more details about pension plan assets, benefit obligations, cash flows, benefit costs and related information. Companies will be required to segregate plan assets by category, such as debt, equity and real estate, and to provide certain expected rates of return and other informational disclosures. Statement 132(R) also requires companies to disclose various elements of pension and postretirement benefit costs in interim-period financial statements for quarters beginning after December 15, 2003. The Company does not expect the new pronouncement to have a material impact on the Company's disclosure requirements.

PART II
INFORMATION NOT REQUIRED IN PROSPECTUS

Item 13. Other Expenses of Issuance and Distribution.*

The following table sets forth estimated expenses in connection with the issuance and distribution of the securities being registered, assuming one issuance of securities:

Registration Fee	$ 5,716
NASD Fee	5,011
Printing and Engraving	25,000
Accounting Fees	25,000
Legal Fees	175,000
Underwriting Expenses	200,000
Miscellaneous	39,273
Total	$ 475,000

* All expenses, other than the registration fee, are estimated.

Item 14. Indemnification of Directors and Officers.

The Delaware General Corporation Law permits the indemnification by a Delaware corporation of its directors, officers, employees, and other agents against expenses (including attorneys' fees), judgments, fines, and amounts paid in settlement in connection with specified actions, suits or proceedings, whether civil, criminal, administrative or investigative (other than derivative actions which are by or in the right of the corporation) if they acted in good faith and in a manner they reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe their conduct was unlawful. A similar standard of care is applicable in the case of derivative actions, except that indemnification only extends to expenses (including attorneys' fees) incurred in connection with defense or settlement of such an action and requires court approval before there can be any indemnification where the person seeking indemnification has been found liable to the corporation.

Section 145 of the Delaware General Corporation Law also provides that the rights conferred thereby are not exclusive of any other right to which any person may be entitled under any by-law, agreement, vote of stockholders or disinterested directors or otherwise, and permits a corporation to advance expenses to or on behalf of a person entitled to be indemnified upon receipt of an undertaking to repay the amounts advanced if it is determined that the person is not entitled to be indemnified.

Our certificate of incorporation provides that to the full extent permitted by Section 145 of the General Corporation Law of Delaware, as amended from time to time, indemnify, advance payment of expenses on behalf of and purchase and maintain insurance against liability on behalf of all persons for whom it may take each such respective action pursuant to such Section. The certificate of incorporation also provides that no director will be personally liable to us or our stockholders for monetary damages for any breach of fiduciary duty by such a director as a director to the full extent authorized or permitted by Delaware law. A director, however, will be liable to the extent provided by applicable law for:

1. any breach of the director's duty of loyalty to us or our stockholders;

2. acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law;

3.

violations of Section 174 of the Delaware General Corporation Law; or

4. any transaction from which the director derived an improper personal benefit.

Article VII of our by-laws contains additional provisions regarding indemnification.

We maintain a liability insurance policy for our directors and officers and for us providing coverage of claims in excess of certain minimum retained limits.

We expect any underwriting or other agreement we sign in connection with an offering of securities pursuant to this registration statement will contain certain provisions for the indemnification by the agents, underwriters or dealers of us and our directors and officers who signed the registration statement, and other controlling persons, against certain liabilities, including liabilities under the Securities Act, or for contribution by such agents, underwriters or dealers with respect to payments which we or our directors or officers may be required to make, and that any agents, underwriters and dealers, and their respective controlling persons may be entitled to indemnification by us against certain liabilities, including liabilities under the Securities Act, or to any contribution with respect to payments which such agents, underwriters and dealers, or controlling persons, may be required to make.

Item 15. Recent Sales of Unregistered Securities.

Not applicable.

Item 16. Exhibits and Financial Statement Schedules.

1.1 Form of Underwriting Agreement.

3.1 Restated Certificate of Incorporation of Richardson Electronics, Ltd., as amended, incorporated by reference to Appendix B to the Proxy Statement/Prospectus dated November 13, 1986, which is included in the Company's Registration Statement on Form S-4, Commission File No. 33-8696.

3.2 By-Laws of Richardson Electronics, Ltd., as amended, incorporated by reference to Exhibit 3(b) to the Company's Annual Report on Form 10-K, dated May 31, 1997, Commission File No. 00-12906.

4.1 Form of Convertible Senior Subordinated Indenture between the Company and J.P. Morgan Trust Company, National Association, as Trustee, relating to convertible debt securities (including form of note), incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-4/A, Commission File No. 333-113569.

4.2 Specimen forms of Common Stock and Class B Common Stock certificates of the Company incorporated by reference to Exhibit 4(a) to the Company's Registration Statement on Form S-1, Commission File No. 33-10834.

4.3 Indenture dated December 15, 1986 between the Company and Continental Illinois National Bank and Trust Company of Chicago, as Trustee, for $7^1/_4$% Convertible Subordinated Debentures due December 15, 2006 (including form of $7^1/_4$% Convertible Subordinated Debentures due December 15, 2006) incorporated by reference to Exhibit 4(b) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1987.

4.4 First Amendment to Indenture between the Company and First Trust National Association, as successor trustee to Continental Illinois National Bank and Trust Company of Chicago dated February 18, 1997, incorporated by reference to Exhibit 4(a) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 28, 1997.

4.5	Indenture dated December 16, 1996 between the Company and American National Bank and Trust Company, as Trustee, for $8^1/_4$% Convertible Senior Subordinated Debentures due June 15, 2006 (including form of $8^1/_4$% Convertible Senior Subordinated Debentures due June 15, 2006), incorporated by reference to Exhibit 10 of the Company's Schedule 13E-4 dated December 18, 1996.
5.1	Opinion of Bryan Cave LLP, counsel to the Registrant, as to the validity of the Securities being registered.**
10.1	The Corporate Plan for Retirement The Profit Sharing / 401(k) Plan Fidelity Basic Plan Document No. 07 effective June 1, 1996, incorporated by reference to Exhibit 10(d) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1996.
10.2	Amendment to the Company's Employees' Profit Sharing Plan and Trust Agreement, incorporated by reference to Exhibit 10(a)(1) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2003, filed with the SEC August 29, 2003.
10.3	The Company's Amended and Restated Employees' Incentive Stock Option Plan effective April 8, 1987, incorporated by reference to Exhibit 10(m) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1987.
10.4	First Amendment to the Company's Amended and Restated Employees' Incentive Stock Option Plan effective April 11, 1989, incorporated by reference to Exhibit 10(l)(1) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1989.
10.5	Second Amendment to the Company's Amended and Restated Employees Incentive Stock Option Plan dated July 30, 1991, incorporated by reference to Exhibit 10(l)(2) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1991.
10.6	Third Amendment to the Company's Amended and Restated Incentive Stock Option Plan dated August 15, 1996, incorporated by reference to Exhibit 10(e)(3) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1996.
10.7	The Company's Employees 1996 Stock Purchase Plan, incorporated by reference to Exhibit A of the Company's Proxy Statement dated September 3, 1996 for its Annual Meeting of Stockholders held on October 1, 1996.
10.8	Employees Stock Ownership Plan, effective as of June 1, 1987, restated effective as of June 1, 1989, as amended July 14, 1994, incorporated by reference to Exhibit 10(f) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1994.
10.9	Amendment No. 1 to Employees Stock Ownership Plan dated July 12, 1995, incorporated by reference to Exhibit 10(g)(1) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1995.
10.10	Second Amendment to Employees Stock Ownership Plan, dated April 10, 1996, incorporated by reference to Exhibit 10(h)(2) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1996.
10.11	Third Amendment to Employees Stock Ownership Plan, effective June 1, 1989, as amended and restated July 14, 1994, dated April 9, 1997 incorporated by reference to Exhibit 10(g)(3) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1998.
10.12	Employees 1999 Stock Purchase Plan, incorporated by reference to Exhibit 10(h)

to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1999.

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10.13 Amendment to the Company's Employees 1999 Stock Purchase Plan, incorporated by reference to Exhibit B to the Company's Proxy Statement dated September 4, 2001, for its Annual Meeting of Stockholders held October 16, 2001.

10.14 The Company's Stock Option Plan for Non-Employee Directors, effective August 1, 1999, incorporated by reference to Exhibit A to the Company's Proxy Statement dated August 30, 1989 for its Annual Meeting of Stockholders held on October 18, 1989.

10.15 The Company's 1996 Stock Option Plan for Non-Employee Directors, incorporated by reference to Exhibit C of the Company's Proxy Statement dated September 3, 1996 for its Annual Meeting of Stockholders held on October 1, 1996.

10.16 The Company's Employees' Incentive Compensation Plan effective July 24, 1990, incorporated by reference to Exhibit A to the Company's Proxy Statement dated August 31, 1990 for its Annual Meeting of Stockholders held on October 9, 1990.

10.17 First Amendment to Employees Incentive Compensation Plan dated July 30, 1991, incorporated by reference to Exhibit 10(p)(1) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1991.

10.18 Second Amendment to Employees Incentive Compensation Plan dated August 15, 1996, incorporated by reference to Exhibit 10(k)(2) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1996.

10.19 The Company's Employees' 1994 Incentive Compensation Plan, incorporated by reference to Exhibit A to the Company's Proxy Statement dated August 31, 1994 for its Annual Meeting of Stockholders held on October 11, 1994.

10.20 First Amendment to the Company's Employees' 1994 Incentive Compensation Plan dated August 15, 1996, incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1996.

10.21 The Company's Employees 1996 Incentive Compensation Plan, incorporated by reference to Exhibit B of the Company's Proxy Statement dated September 3, 1996 for its Annual Meeting of Stockholders held on October 1, 1996.

10.22 The Company's Employees 1998 Incentive Compensation Plan, incorporated by reference to Exhibit A of the Company's Proxy Statement dated September 3, 1998 for its Annual Meeting of Stockholders held on October 6, 1998.

10.23 Letter dated April 1, 1993 between the Company and Arnold R. Allen regarding Mr. Allen's engagement as consultant by the Company, incorporated by reference to Exhibit 10(i)(2) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1993.

10.24 Employment, Nondisclosure and Non-Compete Agreement dated NA June 1, 1998 between the Company and Flint Cooper, incorporated by reference to Exhibit 10(p) to the Company's Annual Report on Form 10-K for the fiscal year ended on May 31, 1998.

10.25 Employment, Nondisclosure and Non-Compete Agreement dated June 6, 2000 between the Company and Robert Prince, incorporated by reference to Exhibit 10(n) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2003, filed with the SEC August 29, 2003.

10.26 Agreement dated August 6, 2002 between the Company and William J. Garry, incorporated by reference to Exhibit 10(hh) of the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2002.

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10.27	Employment and Bonus Agreement dated November 7, 1996 between the Company and Bruce W. Johnson, incorporated by reference to Exhibit 9 of the Company's Schedule 13 E-4 dated December 18, 1996.
10.28	Employment Agreement dated May 10, 1993, as amended March 23, 1998, between Richardson Electronics Italy s.r.l. and Pierluigi Calderone, incorporated by reference to Exhibit 10(d) of the Company's Quarterly Report on Form 10-Q for the quarter ended February 28, 1998.
10.29	Employment, Nondisclosure and Non-Compete Agreement dated September 26, 1999 between the Company and Murray Kennedy, incorporated by reference to Exhibit 10(w) of the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2000.
10.30	Employment, Nondisclosure and Non-Compete Agreement dated November 22, 1999 between the Company and Gregory Peloquin, incorporated by reference to Exhibit 10(x) of the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2000.
10.31	Employment, Nondisclosure and Non-Compete Agreement dated May 30, 2000 between the Company and Robert Heise, incorporated by reference to Exhibit 10(z) of the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2000.
10.32	Employment, Nondisclosure and Non-Compete Agreement dated May 31, 2002 between the Company and Dario Sacomani, incorporated by reference to Exhibit 10(gg) of the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2002.
10.33	The Company's Directors and Officers Executive Liability and Indemnification Insurance Policy renewal issued by Chubb Group of Insurance Companies Policy Number 8125-64-60J ILL, incorporated by reference to Exhibit 10(v)(1) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2003, filed with the SEC August 29, 2003.
10.34	The Company's Directors and Officers Liability Insurance Policy issued by CNA Insurance Companies Policy Number DOX600028634, incorporated by reference to Exhibit 10(v)(2) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2003, filed with the SEC August 29, 2003.
10.35	The Company's Excess Directors and Officers Liability and Corporate Indemnification Policy issued by St. Paul Mercury Insurance Company Policy Number S12CM0138, incorporated by reference to Exhibit 10(v)(3) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2003, filed with the SEC August 29, 2003.
10.36	Distributor Agreement, executed August 8, 1991, between the Company and Varian Associates, Inc., incorporated by reference to Exhibit 10(d) of the Company's Current Report on Form 8-K for September 30, 1991.
10.37	Amendment dated September 30, 1991 between the Company and Varian Associates, Inc., incorporated by reference to Exhibit 10(e) of the Company's Current Report on Form 8-K for September 30, 1991.
10.38	First Amendment to Distributor Agreement between Varian Associates, Inc. and the Company dated April 10, 1992, incorporated by reference to Exhibit 10(v)(5) of the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1992.
10.39	Consent to Assignment and Assignment dated August 4, 1995 between the Company and Varian Associates, Inc., incorporated by reference to

Exhibit 10(s)(4) of the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1995.

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10.40	Trademark License Agreement dated May 1, 1991 between North American Philips Corporation and the Company, incorporated by reference to Exhibit 10(w)(3) of the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1991.
10.41	Agreement among Richardson Electronics, Ltd., Richardson Electronique S.A., Covelec S.A. (now known as Covimag S.A.), and Messrs. Denis Dumont and Patrick Pertzborn, delivered February 23, 1995, translated from French, incorporated by reference to Exhibit 10(b) to the Company's Report on Form 8-K dated February 23, 1995.
10.42	Amended and Restated Revolving Credit Agreement, dated November 26, 2002, by and among the Company, Burtek Systems, Inc., Richardson Electronics Canada, Ltd., Richardson Electronics Limited, RESA, SNC, Richardson Electronique sNC, Richardson Electronics Iberica, S.A., Richardson Electronics GmbH, Richardson Electronics Benelux B.V., Richardson Sweden Holding AB, Richardson Electronics KK, Bank One, NA, London Branch, Bank One, NA, Canada Branch, Bank One, NA, Tokyo Branch and Bank One, NA, incorporated by reference to the Company's Reports on Form 8-K dated December 18, 2002 and on Form 8-K dated December 9, 2002.
10.43	First Amendment to Amended and Restated Revolving Credit Agreement, dated April 30, 2003, by and among the Company, Burtek Systems, Inc., Richardson Electronics Canada, Ltd., Richardson Electronics Limited, RESA, SNC, Richardson Electronique sNC, Richardson Electronics Iberica, S.A., Richardson Electronics GmbH, Richardson Electronics Benelux B.V., Richardson Sweden Holding AB, Richardson Electronics KK, Bank One, NA, London Branch, Bank One, NA, Canada Branch, Bank One, NA, Tokyo Branch and Bank One, NA., incorporated by reference to Exhibit 10(aa)(1) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2003, filed with the SEC August 29, 2003.
10.44	Second Amendment to Amended and Restated Revolving Credit Agreement, dated April 30, 2003, by and among the Company, Burtek Systems, Inc., Richardson Electronics Canada, Ltd., Richardson Electronics Limited, RESA, SNC, Richardson Electronique SNC, Richardson Electronics Iberica, S.A., Richardson Electronics GmbH, Richardson Electronics Benelux B.V., Richardson Sweden Holding AB, Richardson Electronics KK, Bank One, NA, London Branch, Bank One, NA, Canada Branch, Bank One, NA, Tokyo Branch and Bank One, NA., incorporated by reference to Exhibit 10(aa)(2) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2003, filed with the SEC August 29, 2003.
10.45	Consent and Third Amendment to Amended and Restated Revolving Credit Agreement dated as of May 3, 2004 by and among the Company, Burtek Systems, Inc., Richardson Electronics Canada, Ltd., Richardson Electronics Limited, RESA, SNC, Richardson Electronique SNC, Richardson Electronics Iberica, S.A., Richardson Electronics GmbH, Richardson Electronics Benelux B.V., Richardson Sweden Holding AB, Richardson Electronics KK, the lenders party thereto, Bank One, NA, London Branch as Eurocurrency Agent, Bank One, NA, Canada Branch as Canada Agent, Bank One, NA, Tokyo Branch as Japan Agent, and Bank One, NA, as administrative agent, incorporated by reference to Exhibit 10.45 to the Company's Registration Statement on Form S-4/A, Commission File No. 333-113569.
10.46	Employment, Nondisclosure and Non-Compete Agreement dated June 1, 2004 by and between the Company and George Solas.
10.47	Employment, Nondisclosure and Non-Compete Agreement dated June 1, 2004 by and between the Company and Wendy Diddell.

10.48	Real Estate Sale Contract dated June 8, 2004 between the Company and Shodeen Construction Company, L.L.C.

21.1	Subsidiaries of the Company.**
23.1	Consent of Ernst & Young LLP.
23.2	Consent of Bryan Cave LLP (included in Exhibit 5.1).**
24.1	Powers of Attorney executed by certain of the officers and directors of the Registrant (included in signature pages).**

* To be filed by amendment.

** Previously filed.

Item 17. Undertakings.

The undersigned registrant hereby undertakes that:

(1) For purposes of determining any liability under the Securities Act of 1933, the information omitted from the form of prospectus filed as a part of this registration statement in reliance upon 430A and contained in a form of prospectus filed by the registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this registration statement as of the time it was declared effective.

(2) For the purpose of determining any liability under the Securities Act of 1933, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers, and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, the registrant has duly caused this Amendment No. 4 to the registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the County of Kane, State of Illinois, on June 14, 2004.

RICHARDSON ELECTRONICS, LTD.

By: /s/ DARIO SACOMANI

Name: Dario Sacomani
Title: Senior Vice President and Chief Financial Officer

Pursuant to the requirements of the Securities Act of 1933, this Amendment No. 4 to the registration statement has been signed below by the following persons in the capacities and on the dates indicated.

Signature	Title	Date
/s/ EDWARD J. RICHARDSON* Edward J. Richardson	Chairman of the Board and Chief Executive Officer (principal executive officer)	June 14, 2004
/s/ DARIO SACOMANI Dario Sacomani	Senior Vice President and Chief Financial Officer (principal financial and accounting officer)	June 14, 2004
/s/ BRUCE W. JOHNSON* Bruce W. Johnson	President, Chief Operating Officer and Director	June 14, 2004
/s/ ARNOLD R. ALLEN* Arnold R. Allen	Director	June 14, 2004
/s/ JACQUES BOUYER* Jacques Bouyer	Director	June 14, 2004
/s/ SCOTT HODES* Scott Hodes	Director	June 14, 2004
/s/ AD KETELAARS* Ad Ketelaars	Director	June 14, 2004

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/s/ JOHN R. PETERSON* John R. Peterson	Director	June 14, 2004
/s/ HAROLD L. PURKEY* Harold L. Purkey	Director	June 14, 2004
/s/ SAMUEL RUBINOVITZ* Samuel Rubinovitz	Director	June 14, 2004

*By /s/ DARIO SACOMANI

Attorney-in-fact

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INDEX TO EXHIBITS

Exhibit Number	Description of Exhibit
1.1	Form of Underwriting Agreement.
3.1	Restated Certificate of Incorporation of Richardson Electronics, Ltd., as amended, incorporated by reference to Appendix B to the Proxy Statement/Prospectus dated November 13, 1986, which is included in the Company's Registration Statement on Form S-4, Commission File No. 33-8696.
3.2	By-Laws of Richardson Electronics, Ltd., as amended, incorporated by reference to Exhibit 3(b) to the Company's Annual Report on Form 10-K, dated May 31, 1997, Commission File No. 00-12906.
4.1	Form of Convertible Senior Subordinated Indenture between the Company and J.P. Morgan Trust Company, National Association, as Trustee, relating to convertible debt securities (including form of note), incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-4/A, Commission File No. 333-113569.
4.2	Specimen forms of Common Stock and Class B Common Stock certificates of the Company incorporated by reference to Exhibit 4(a) to the Company's Registration Statement on Form S-1, Commission File No. 33-10834.
4.3	Indenture dated December 15, 1986 between the Company and Continental Illinois National Bank and Trust Company of Chicago, as Trustee, for $7^1/_4$% Convertible Subordinated Debentures due December 15, 2006 (including form of $7^1/_4$% Convertible Subordinated Debentures due December 15, 2006) incorporated by reference to Exhibit 4(b) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1987.
4.4	First Amendment to Indenture between the Company and First Trust National Association, as successor trustee to Continental Illinois National Bank and Trust Company of Chicago dated February 18, 1997, incorporated by reference to Exhibit 4(a) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 28, 1997.
4.5	Indenture dated December 16, 1996 between the Company and American National Bank and Trust Company, as Trustee, for $8^1/_4$% Convertible Senior Subordinated Debentures due June 15, 2006 (including form of $8^1/_4$% Convertible Senior Subordinated Debentures due June 15, 2006), incorporated by reference to Exhibit 10 of the Company's Schedule 13E-4 dated December 18, 1996.
5.1	Opinion of Bryan Cave LLP, counsel to the Registrant, as to the validity of the Securities being registered.**
10.1	The Corporate Plan for Retirement The Profit Sharing / 401(k) Plan Fidelity Basic Plan Document No. 07 effective June 1, 1996, incorporated by reference to Exhibit 10(d) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1996.
10.2	Amendment to the Company's Employees' Profit Sharing Plan and Trust Agreement, incorporated by reference to Exhibit 10(a)(1) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2003, filed with the SEC August 29, 2003.
10.3	The Company's Amended and Restated Employees' Incentive Stock Option Plan effective April 8, 1987, incorporated by reference to Exhibit 10(m) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1987.

10.4	First Amendment to the Company's Amended and Restated Employees' Incentive Stock Option Plan effective April 11, 1989, incorporated by reference to Exhibit 10(l)(1) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1989.
10.5	Second Amendment to the Company's Amended and Restated Employees Incentive Stock Option Plan dated July 30, 1991, incorporated by reference to Exhibit 10(l)(2) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1991.
10.6	Third Amendment to the Company's Amended and Restated Incentive Stock Option Plan dated August 15, 1996, incorporated by reference to Exhibit 10(e)(3) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1996.
10.7	The Company's Employees 1996 Stock Purchase Plan, incorporated by reference to Exhibit A of the Company's Proxy Statement dated September 3, 1996 for its Annual Meeting of Stockholders held on October 1, 1996.
10.8	Employees Stock Ownership Plan, effective as of June 1, 1987, restated effective as of June 1, 1989, as amended July 14, 1994, incorporated by reference to Exhibit 10(f) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1994.
10.9	Amendment No. 1 to Employees Stock Ownership Plan dated July 12, 1995, incorporated by reference to Exhibit 10(g)(1) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1995.
10.10	Second Amendment to Employees Stock Ownership Plan, dated April 10, 1996, incorporated by reference to Exhibit 10(h)(2) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1996.
10.11	Third Amendment to Employees Stock Ownership Plan, effective June 1, 1989, as amended and restated July 14, 1994, dated April 9, 1997 incorporated by reference to Exhibit 10(g)(3) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1998.
10.12	Employees 1999 Stock Purchase Plan, incorporated by reference to Exhibit 10(h) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1999.
10.13	Amendment to the Company's Employees 1999 Stock Purchase Plan, incorporated by reference to Exhibit B to the Company's Proxy Statement dated September 4, 2001, for its Annual Meeting of Stockholders held October 16, 2001.
10.14	The Company's Stock Option Plan for Non-Employee Directors, effective August 1, 1999, incorporated by reference to Exhibit A to the Company's Proxy Statement dated August 30, 1989 for its Annual Meeting of Stockholders held on October 18, 1989.
10.15	The Company's 1996 Stock Option Plan for Non-Employee Directors, incorporated by reference to Exhibit C of the Company's Proxy Statement dated September 3, 1996 for its Annual Meeting of Stockholders held on October 1, 1996.
10.16	The Company's Employees' Incentive Compensation Plan effective July 24, 1990, incorporated by reference to Exhibit A to the Company's Proxy Statement dated August 31, 1990 for its Annual Meeting of Stockholders held on October 9, 1990.
10.17	First Amendment to Employees Incentive Compensation Plan dated July 30, 1991, incorporated by reference to Exhibit 10(p)(1) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1991.
10.18	Second Amendment to Employees Incentive Compensation Plan dated August 15, 1996, incorporated by reference to Exhibit 10(k)(2) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1996.

10.19	The Company's Employees' 1994 Incentive Compensation Plan, incorporated by reference to Exhibit A to the Company's Proxy Statement dated August 31, 1994 for its Annual Meeting of Stockholders held on October 11, 1994.
10.20	First Amendment to the Company's Employees' 1994 Incentive Compensation Plan dated August 15, 1996, incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1996.
10.21	The Company's Employees 1996 Incentive Compensation Plan, incorporated by reference to Exhibit B of the Company's Proxy Statement dated September 3, 1996 for its Annual Meeting of Stockholders held on October 1, 1996.
10.22	The Company's Employees 1998 Incentive Compensation Plan, incorporated by reference to Exhibit A of the Company's Proxy Statement dated September 3, 1998 for its Annual Meeting of Stockholders held on October 6, 1998.
10.23	Letter dated April 1, 1993 between the Company and Arnold R. Allen regarding Mr. Allen's engagement as consultant by the Company, incorporated by reference to Exhibit 10(i)(2) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1993.
10.24	Employment, Nondisclosure and Non-Compete Agreement dated NA June 1, 1998 between the Company and Flint Cooper, incorporated by reference to Exhibit 10(p) to the Company's Annual Report on Form 10-K for the fiscal year ended on May 31, 1998.
10.25	Employment, Nondisclosure and Non-Compete Agreement dated June 6, 2000 between the Company and Robert Prince, incorporated by reference to Exhibit 10(n) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2003, filed with the SEC August 29, 2003.
10.26	Agreement dated August 6, 2002 between the Company and William J. Garry, incorporated by reference to Exhibit 10(hh) of the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2002.
10.27	Employment and Bonus Agreement dated November 7, 1996 between the Company and Bruce W. Johnson, incorporated by reference to Exhibit 9 of the Company's Schedule 13 E-4 dated December 18, 1996.
10.28	Employment Agreement dated May 10, 1993, as amended March 23, 1998, between Richardson Electronics Italy s.r.l. and Pierluigi Calderone, incorporated by reference to Exhibit 10(d) of the Company's Quarterly Report on Form 10-Q for the quarter ended February 28, 1998.
10.29	Employment, Nondisclosure and Non-Compete Agreement dated September 26, 1999 between the Company and Murray Kennedy, incorporated by reference to Exhibit 10(w) of the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2000.
10.30	Employment, Nondisclosure and Non-Compete Agreement dated November 22, 1999 between the Company and Gregory Peloquin, incorporated by reference to Exhibit 10(x) of the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2000.
10.31	Employment, Nondisclosure and Non-Compete Agreement dated May 30, 2000 between the Company and Robert Heise, incorporated by reference to Exhibit 10(z) of the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2000.
10.32	Employment, Nondisclosure and Non-Compete Agreement dated May 31, 2002 between the Company and Dario Sacomani, incorporated by reference to Exhibit 10(gg) of the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2002.

10.33	The Company's Directors and Officers Executive Liability and Indemnification Insurance Policy renewal issued by Chubb Group of Insurance Companies Policy Number 8125-64-60J ILL, incorporated by reference to Exhibit 10(v)(1) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2003, filed with the SEC August 29, 2003.
10.34	The Company's Directors and Officers Liability Insurance Policy issued by CNA Insurance Companies Policy Number DOX600028634, incorporated by reference to Exhibit 10(v)(2) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2003, filed with the SEC August 29, 2003.
10.35	The Company's Excess Directors and Officers Liability and Corporate Indemnification Policy issued by St. Paul Mercury Insurance Company Policy Number S12CM0138, incorporated by reference to Exhibit 10(v)(3) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2003, filed with the SEC August 29, 2003.
10.36	Distributor Agreement, executed August 8, 1991, between the Company and Varian Associates, Inc., incorporated by reference to Exhibit 10(d) of the Company's Current Report on Form 8-K for September 30, 1991.
10.37	Amendment dated September 30, 1991 between the Company and Varian Associates, Inc., incorporated by reference to Exhibit 10(e) of the Company's Current Report on Form 8-K for September 30, 1991.
10.38	First Amendment to Distributor Agreement between Varian Associates, Inc. and the Company dated April 10, 1992, incorporated by reference to Exhibit 10(v)(5) of the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1992.
10.39	Consent to Assignment and Assignment dated August 4, 1995 between the Company and Varian Associates, Inc., incorporated by reference to Exhibit 10(s)(4) of the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1995.
10.40	Trademark License Agreement dated May 1, 1991 between North American Philips Corporation and the Company, incorporated by reference to Exhibit 10(w)(3) of the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1991.
10.41	Agreement among Richardson Electronics, Ltd., Richardson Electronique S.A., Covelec S.A. (now known as Covimag S.A.), and Messrs. Denis Dumont and Patrick Pertzborn, delivered February 23, 1995, translated from French, incorporated by reference to Exhibit 10(b) to the Company's Report on Form 8-K dated February 23, 1995.
10.42	Amended and Restated Revolving Credit Agreement, dated November 26, 2002, by and among the Company, Burtek Systems, Inc., Richardson Electronics Canada, Ltd., Richardson Electronics Limited, RESA, SNC, Richardson Electronique sNC, Richardson Electronics Iberica, S.A., Richardson Electronics GmbH, Richardson Electronics Benelux B.V., Richardson Sweden Holding AB, Richardson Electronics KK, Bank One, NA, London Branch, Bank One, NA, Canada Branch, Bank One, NA, Tokyo Branch and Bank One, NA, incorporated by reference to the Company's Reports on Form 8-K dated December 18, 2002 and on Form 8-K dated December 9, 2002.

10.43	First Amendment to Amended and Restated Revolving Credit Agreement, dated April 30, 2003, by and among the Company, Burtek Systems, Inc., Richardson Electronics Canada, Ltd., Richardson Electronics Limited, RESA, SNC, Richardson Electronique sNC, Richardson Electronics Iberica, S.A., Richardson Electronics GmbH, Richardson Electronics Benelux B.V., Richardson Sweden Holding AB, Richardson Electronics KK, Bank One, NA, London Branch, Bank One, NA, Canada Branch, Bank One, NA, Tokyo Branch and Bank One, NA., incorporated by reference to Exhibit 10(aa)(1) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2003, filed with the SEC August 29, 2003.
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