



**New Jersey  
Natural Gas**

**2007 ANNUAL REPORT**



## **NEW JERSEY NATURAL GAS**

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## INDEPENDENT AUDITORS' REPORT

To the Board of Directors of  
New Jersey Natural Gas Company

We have audited the accompanying balance sheets and statements of capitalization of New Jersey Natural Gas Company (the "Company") as of September 30, 2007 and 2006, and the related statements of income, common stock equity and comprehensive income, and cash flows for the years then ended. 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 generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (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. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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, such financial statements present fairly, in all material respects, the financial position of the Company as of September 30, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 6 to the financial statements, on September 30, 2006, the Company adopted Financial Accounting Standards Board Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations*.

As discussed in Note 8 to the financial statements, on September 30, 2007, the Company adopted Financial Accounting Standards Board Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postemployment Plans* (SFAS 158).

*Deloitte + Touche LLP*

December 27, 2007

# New Jersey Natural Gas

## STATEMENTS OF INCOME

*(Thousands)*

Fiscal years ended September 30,	2007	2006
<b>OPERATING REVENUES</b>	\$1,005,588	\$1,138,774
<b>OPERATING EXPENSES</b>		
Gas purchases	687,201	847,276
Operation and maintenance	97,006	84,907
Regulatory rider expenses	37,605	28,587
Depreciation and amortization	35,648	34,146
Energy and other taxes	59,600	55,829
Total operating expenses	917,060	1,050,745
<b>OPERATING INCOME</b>	88,528	88,029
Other income	3,468	3,448
Interest charges, net	21,182	16,456
<b>INCOME BEFORE INCOME TAXES</b>	70,814	75,021
Income tax provision	26,334	28,151
<b>NET INCOME</b>	\$ 44,480	\$ 46,870

The accompanying notes are an integral part of these statements.

# New Jersey Natural Gas

## STATEMENTS OF CASH FLOWS

(Thousands)

Fiscal years ended September 30,	2007	2006
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$44,480	\$ 46,870
<b>ADJUSTMENTS TO RECONCILE NET INCOME TO CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Depreciation and amortization	35,648	34,146
Impairment Charge	4,000	—
Amortization of deferred charges	301	301
Deferred income taxes	11,962	5,680
Manufactured gas plant remediation costs	(20,171)	(22,346)
Cost of removal – asset retirement obligation	(880)	—
Contributions to employee benefit plans	(447)	(11,317)
Restricted cash for natural gas purchases	(2,608)	—
Changes in:		
Components of working capital	(40,549)	(155,175)
Other noncurrent assets	30,166	(19,517)
Other noncurrent liabilities	(1,790)	43,920
Cash flows from (used in) operating activities	60,112	(77,438)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Payments of common stock dividends to parent	(41,869)	(39,446)
Proceeds from long-term debt	—	35,800
Payments of long-term debt	(4,031)	(24,276)
Capital contribution from parent	6,047	—
Payments of short-term debt, net of proceeds	34,729	151,500
Proceeds from sale-leaseback transaction	5,482	4,090
Cash flows from financing activities	358	127,668
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Expenditures for		
Utility plant	(60,747)	(53,060)
Cost of removal	(6,310)	(7,499)
Withdrawal from (investment in) restricted cash construction fund	4,300	(8,500)
Cash flows used in investing activities	(62,757)	(69,059)
Change in cash and temporary investments	(2,287)	(18,829)
Cash and temporary investments at beginning of year	4,365	23,194
Cash and temporary investments at end of year	\$ 2,078	\$ 4,365
<b>CHANGES IN COMPONENTS OF WORKING CAPITAL</b>		
Receivables	16,613	\$ 34,923
Inventories	(36,953)	(27,487)
Overrecovered gas costs	7,873	38,759
Accounts payable and other	8,675	(9,646)
Gas purchases payable	1,093	(50,820)
Prepaid and accrued taxes, net	(6,004)	(17,333)
Customers' credit balances and deposits	(33,763)	39,064
Restricted broker margin accounts	18,488	(153,077)
Other current assets	(16,571)	(9,558)
Total	\$ (40,549)	\$ (155,175)
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOWS INFORMATION</b>		
Cash paid for		
Interest (net of amounts capitalized)	\$18,659	\$13,598
Income taxes	\$17,346	\$38,369

The accompanying notes are an integral part of these statements

# New Jersey Natural Gas

## BALANCE SHEETS

### ASSETS

(Thousands)

September 30,	2007	2006
<b>PROPERTY, PLANT AND EQUIPMENT</b>		
Utility plant, at cost	\$1,273,928	\$1,214,456
Construction work in progress	25,517	29,160
	1,299,445	1,243,616
Accumulated depreciation and amortization	(347,418)	(326,298)
Property, plant and equipment, net	952,027	917,318
<b>CURRENT ASSETS</b>		
Cash and temporary investments	2,078	4,365
Restricted cash	2,608	—
Customer accounts receivable		
Billed	5,583	18,061
Unbilled revenues	8,895	12,543
Allowance for doubtful accounts	(3,166)	(2,679)
Regulatory assets	24,634	8,105
Gas in storage, at average cost	191,460	155,874
Materials and supplies, at average cost	4,155	2,788
Prepaid state taxes	28,239	26,343
Derivatives, at fair value	13,285	25,045
Broker margin account	12,345	30,833
Other	3,876	3,775
Total current assets	293,992	285,053
<b>NONCURRENT ASSETS</b>		
Regulatory assets	312,369	322,986
Derivatives, at fair value	381	10,431
Prepaid pension	—	18,583
Restricted cash construction fund	4,200	8,500
Other	9,460	24,063
Total noncurrent assets	326,410	384,563
<b>Total assets</b>	<b>\$1,572,429</b>	<b>\$1,586,934</b>

The accompanying notes are an integral part of these statements.

# New Jersey Natural Gas

## BALANCE SHEETS

### CAPITALIZATION AND LIABILITIES

(Thousands)

September 30,	2007	2006
<b>CAPITALIZATION</b>		
Common stock equity	\$ 472,833	\$ 464,742
Long-term debt	308,184	307,332
Total capitalization	781,017	772,074
<b>CURRENT LIABILITIES</b>		
Current maturities of long-term debt	4,338	3,739
Short-term debt	186,229	151,500
Gas purchases payable	40,337	39,244
Accounts payable and other	46,551	36,757
Deferred taxes	6,940	9,076
Regulatory liabilities	9,583	1,710
New Jersey clean energy program	8,832	8,244
Derivatives, at fair value	33,293	61,553
Customers' credit balances and deposits	27,182	60,945
Total current liabilities	363,285	372,768
<b>NONCURRENT LIABILITIES</b>		
Deferred income taxes	176,741	166,744
Deferred investment tax credits	7,513	7,835
Derivatives, at fair value	32,208	56,290
Manufactured gas plant remediation	105,340	105,400
Postemployment employee benefit liability	12,417	—
Regulatory liabilities	61,270	64,220
New Jersey clean energy and conservation incentive programs	3,992	13,138
Asset retirement obligation	23,895	23,293
Other	4,751	5,172
Total noncurrent liabilities	428,127	442,092
<b>Total capitalization and liabilities</b>	<b>\$1,572,429</b>	<b>\$1,586,934</b>

The accompanying notes are an integral part of these statements.

# New Jersey Natural Gas

## STATEMENTS OF CAPITALIZATION

(Thousands)

September 30,	2007	2006
<b>COMMON STOCK EQUITY</b>		
Common stock, \$5 par value; authorized 4,750,000 shares; outstanding 3,214,923 shares	\$ 16,075	\$ 16,075
Premium on common stock	11,269	11,269
Contribution from parent	252,800	246,753
Accumulated other comprehensive (loss), net of tax	(63)	(73)
Retained earnings	192,752	190,718
<b>Total common stock equity</b>	<b>472,833</b>	<b>464,742</b>
<b>LONG-TERM DEBT</b>		
<i>First mortgage bonds</i>	<i>Maturity date</i>	
6.27% Series X	November 1, 2008	30,000
Variable Series AA	August 1, 2030	25,000
Variable Series BB	August 1, 2030	16,000
6.88% Series CC	October 1, 2010	20,000
Variable Series DD	September 1, 2027	13,500
Variable Series EE	January 1, 2028	9,545
Variable Series FF	January 1, 2028	15,000
Variable Series GG	April 1, 2033	18,000
5% Series HH	December 1, 2038	12,000
4.5% Series II	August 1, 2023	10,300
4.6% Series JJ	August 1, 2024	10,500
4.9% Series KK	October 1, 2040	15,000
4.77% Unsecured senior notes	March 15, 2014	60,000
Capital lease obligation – Buildings	June 1, 2021	27,063
Capital lease obligation – Meters	October 1, 2012	30,614
Less: Current maturities of long-term debt		(4,338)
<b>Total long-term debt</b>		<b>308,184</b>
<b>Total capitalization</b>		<b>\$781,017</b>
		<b>307,332</b>

The accompanying notes are an integral part of these statements.

# New Jersey Natural Gas

## STATEMENTS OF COMMON STOCK EQUITY AND COMPREHENSIVE INCOME

<i>(Thousands)</i>	Number of Shares	Common Stock	Premium on Common Stock	Accum. Other Comprehensive Income (Loss)	Contrib. from Parent	Retained Earnings	Total
Balance at September 30, 2005	3,215	\$16,075	\$11,269	\$(9,795)	\$246,753	\$183,984	\$448,286
Net income						46,870	46,870
Other comprehensive income, net of tax:							
Change in fair value of derivatives, net of tax of \$(21)				31			31
Minimum pension liability adjustment, net of tax of \$(6,693)				9,691			9,691
Other comprehensive income							9,722
Comprehensive income							56,592
Cash dividend declared						(40,136)	(40,136)
Balance at September 30, 2006	3,215	\$16,075	\$11,269	\$ (73)	\$246,753	\$190,718	\$464,742
Net income						44,480	44,480
Other comprehensive income, net of tax:							
Change in fair value of derivatives, net of tax of \$(7)				10			10
Other comprehensive income							10
Comprehensive income							44,490
Contribution from parent					6,047		6,047
Cash dividend declared						(42,446)	(42,446)
<b>Balance at September 30, 2007</b>	<b>3,215</b>	<b>\$16,075</b>	<b>\$11,269</b>	<b>\$ (63)</b>	<b>\$252,800</b>	<b>\$192,752</b>	<b>\$472,833</b>

The accompanying notes are an integral part of these statements.

**NEW JERSEY NATURAL GAS**  
**NOTES TO FINANCIAL STATEMENTS**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Nature of the Business*

New Jersey Natural Gas (the Company) is a local natural gas distribution company that provides regulated retail natural gas service to more than 478,000 residential and commercial customers in central and northern New Jersey, and participates in the off-system sales and capacity release markets. The Company is the principal utility subsidiary of New Jersey Resources (NJR). The Company is subject to rate regulation by the New Jersey Board of Public Utilities (BPU).

*Regulatory Assets & Liabilities*

Under cost-based regulation, regulated utility enterprises generally are permitted to recover their operating expenses and earn a reasonable return on their utility investment.

The Company maintains its accounts in accordance with the Uniform System of Accounts as prescribed by the BPU. In accordance with the ratemaking process, the Company is required to follow Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation* (SFAS 71), and as a result, the accounting principles applied by the Company differ in certain respects from those applied by unregulated businesses.

*Gas in Storage*

Gas in Storage is reflected at average cost in the Balance Sheets, and represents natural gas that will be utilized in the ordinary course of business.

The following table summarizes Gas in storage as of September 30:

	2007		2006
<i>(\$ in thousands)</i>		<b>(Bcf)</b>	<b>(Bcf)</b>
Gas in storage	<b>\$191,460</b>	<b>23.0</b>	<b>\$155,874</b> <b>23.8</b>

*Demand Fees*

For the purpose of securing adequate storage and pipeline capacity, the Company enters into storage and pipeline capacity contracts, which require the payment of certain demand charges in order to maintain the ability to access such natural gas storage or pipeline capacity, during a fixed time period, which generally range from one to five years. Demand charges are based on established rates as regulated by Federal Energy Regulatory Commission (FERC). These demand charges represent commitments to pay storage providers or pipeline companies for the right to store and transport natural gas utilizing their respective assets.

Demand charges are recognized in the Statements of Income as incurred as part of Gas purchases as follows:

	2007	2006
<i>(\$ in Millions)</i>		
Total demand charges	<b>\$73.9</b>	<b>\$83.0</b>

The Company recovers its costs associated with demand fees as part of its wholesale gas commodity component of its Basic Gas Supply Service (BGSS), a component of its tariff.

### ***Derivative Instruments***

Derivative instruments associated with natural gas commodity contracts are recorded in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended (SFAS 133), under which the Company records the fair value of derivatives held as assets and liabilities. The Company's derivatives used to manage price risk on its natural gas purchasing activities are recoverable through its BGSS, a component of its tariff. Accordingly, the offset to the change in fair value of these derivatives is recorded as a Regulatory asset or liability on the Balance Sheets.

Fair values of exchange-traded instruments, principally futures, swaps and certain options, are based on actively quoted market prices. Fair values are subject to change in the near term and reflect management's best estimate based on various factors. In establishing the fair value of commodity contracts that do not have quoted prices, such as over-the-counter options and swaps, management uses available market data and pricing models to estimate fair values. Estimating fair values of instruments that do not have quoted market prices requires management's judgment in determining amounts which could reasonably be expected to be received from, or paid to, a third party in settlement of the instruments. These amounts could be materially different from amounts that might be realized in an actual sale transaction.

See *Note 5. Financial Instruments and Risk Management* for additional details regarding hedging activities.

The Company has not designated any derivatives as fair value hedges as of September 30, 2007 and 2006.

### ***Revenues***

Revenues from the sale of natural gas to customers of the Company are recognized in the period that gas is delivered and consumed by customers, including an estimate for unbilled revenue.

Natural gas sales to individual customers are based on their meter readings, which are performed on a systematic basis throughout the month. At the end of each month, the amount of natural gas delivered to each customer after the last meter reading is estimated and the Company recognizes unbilled revenues related to these amounts. The unbilled revenue estimates are based on monthly send-out amounts, estimated customer usage by customer type, weather effects, unaccounted-for gas and the most recent rates.

Revenues from all other activities are recorded in the period during which products or services are delivered and accepted by customers.

### ***Gas Purchases***

The Company's tariff includes a component for BGSS, which is normally revised on an annual basis. Under the BGSS, the Company projects its cost of natural gas, net of supplier refunds, the impact of hedging activities and credits from nonfirm sales and transportation activities, and recovering or refunding the difference, if any, of such projected costs compared with those included in prices through levelized charges to customers. Any underrecoveries or overrecoveries are deferred and, subject to BPU approval, reflected in the BGSS in subsequent years.

### ***Income Taxes***

The Company computes income taxes using the liability method, whereby deferred income taxes are generally determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse. Net deferred tax assets are recorded when it is more likely than not such tax benefits will be realized. See *Note 7. Income Taxes*

Investment tax credits have been deferred and are being amortized as a reduction to the tax provision over the average lives of the related properties.

### ***Capitalized and Deferred Interest***

The Company's capitalized interest totaled \$1.3 million in fiscal 2007 and \$1.1 million in fiscal 2006, with average interest rates of 5.4 percent and 4.7 percent, respectively. These amounts are included in Utility plant on the Balance Sheets and are reflected on the Statements of Income as a reduction to Interest charges, net. The Company does not capitalize the cost of equity for its utility plant construction activities.

Pursuant to a BPU order, NJNG is permitted to recover carrying costs on uncollected balances related to Societal Benefits Clause (SBC) program costs, which include expenditures related to the New Jersey Clean Energy Program (NJCEP), a Manufactured Gas Plant Remediation Adjustment Clause (RAC) and a Universal Service Fund rider (USF). See *Note 4. Regulation*. Accordingly, Other income included \$3.1 million and \$2.8 million of deferred interest related to these SBC program costs in fiscal 2007 and 2006, respectively.

***Sales Tax Accounting***

Sales tax and Transitional Energy Facilities Assessment (TEFA) are collected from customers and presented in both operating revenues and operating expenses on the Statements of Income as follows:

<i>(Thousands)</i>	<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>
Sales Tax	<b>\$47,900</b>	\$44,800
TEFA	<b>8,500</b>	8,100
<b>Total</b>	<b>\$56,400</b>	<b>\$52,900</b>

***Statements of Cash Flows***

For purposes of reporting cash flows, all temporary investments with maturities of three months or less are considered cash equivalents.

***Utility Plant and Depreciation***

Regulated property, plant and equipment is stated at original cost. Costs include direct labor, materials and third-party construction contractor costs, allowance for capitalized interest and certain indirect costs related to equipment and employees engaged in construction. Upon retirement, the cost of depreciable regulated property, plus removal costs less salvage, is charged to accumulated depreciation with no gain or loss recorded.

Depreciation is computed on a straight-line basis for financial statement purposes, using rates based on the estimated average lives of the various classes of depreciable property. The composite rate of depreciation was 3.02 percent of average depreciable property in fiscal 2007, and 3.03 percent in fiscal 2006.

Property classifications and estimated useful lives, as of September 30, 2007 and 2006, are as follows:

Property Classifications	Estimated Useful Lives
Distribution Facilities	31 to 63 years
Transmission Facilities	42 to 62 years
Storage Facilities	36 to 47 years

***Impairment of Long-Lived Assets***

The Company reviews the carrying amount of an asset for possible impairment whenever events or changes in circumstances indicate that such amount may not be recoverable.

In the fourth quarter of fiscal 2007, the Company signed a stipulation with the BPU and Rate Counsel, which resulted in the disallowance of certain costs that had previously been deferred as recoverable pursuant to a regulatory rider associated with the remediation of a former manufactured gas plant site. The pre-tax charge of \$4 million is reflected as a component of Operations and maintenance expense in the Statements of Income. See *Note 9. Commitments and Contingent Liabilities – Legal Proceedings – Manufactured Gas Plant Remediation*.

