



**New Jersey
Natural Gas**

2008 ANNUAL REPORT



NEW JERSEY NATURAL GAS

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INDEX

Independent Auditors' Report	1
Statements of Income for the fiscal years ended September 30, 2008 and 2007	2
Statements of Cash Flows for the fiscal years ended September 30, 2008 and 2007	3
Balance Sheets as of September 30, 2008 and 2007	4
Statements of Capitalization as of September 30, 2008 and 2007	6
Statements of Common Stock Equity and Comprehensive Income for the fiscal years ended September 30, 2008 and 2007	7
Notes to Financial Statements	8



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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
New Jersey Natural Gas Company

We have audited the accompanying consolidated balance sheet and statements of capitalization of New Jersey Natural Gas Company (the "Company") as of September 30, 2008 and 2007, and the related statements of income, common stock equity and comprehensive income, and cash flows for the year 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 the auditing standards generally accepted in the United States of America. 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 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, 2008 and 2007, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte + Touche LLP

December 19, 2008

New Jersey Natural Gas

STATEMENTS OF INCOME

(Thousands)

Fiscal years ended September 30,	2008	2007
OPERATING REVENUES	\$1,078,824	\$1,005,588
OPERATING EXPENSES		
Gas purchases	753,249	687,201
Operation and maintenance	98,035	97,006
Regulatory rider expenses	39,666	37,605
Depreciation and amortization	37,723	35,648
Energy and other taxes	62,015	59,600
Total operating expenses	990,688	917,060
OPERATING INCOME	88,136	88,528
Other income	3,460	3,468
Interest charges, net	21,277	21,182
INCOME BEFORE INCOME TAXES	70,319	70,814
Income tax provision	27,840	26,334
NET INCOME	\$ 42,479	\$ 44,480

The accompanying notes are an integral part of these statements.

New Jersey Natural Gas

STATEMENTS OF CASH FLOWS

(Thousands)

Fiscal years ended September 30,	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$42,479	\$44,480
ADJUSTMENTS TO RECONCILE NET INCOME TO CASH FLOWS FROM OPERATING ACTIVITIES		
Depreciation and amortization	37,723	35,648
Impairment Charge	—	4,000
Amortization of deferred charges	903	785
Deferred income taxes	20,239	11,962
Manufactured gas plant remediation costs	(18,958)	(20,171)
Cost of removal – asset retirement obligation	(969)	(880)
Contributions to employee benefit plans	(685)	(447)
Restricted cash for natural gas purchases	2,608	(2,608)
Changes in:		
Components of working capital	(27,080)	(40,549)
Other noncurrent assets	3,470	29,682
Other noncurrent liabilities	16,580	(1,790)
Cash flows from (used in) operating activities	76,310	60,112
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments of common stock dividends to parent	(44,027)	(41,869)
Proceeds from long-term debt	125,000	—
Payments of long-term debt	(5,565)	(4,031)
Capital contribution from parent	470	6,047
Payments of short-term debt, net of proceeds	(40,729)	34,729
Proceeds from sale-leaseback transaction	7,485	5,482
Cash flows from financing activities	42,634	358
CASH FLOWS FROM INVESTING ACTIVITIES		
Expenditures for		
Utility plant	(72,329)	(60,747)
Cost of removal	(6,833)	(6,310)
Withdrawal from (investment in) restricted cash construction fund	—	4,300
Cash flows used in investing activities	(79,162)	(62,757)
Change in cash and temporary investments	39,782	(2,287)
Cash and temporary investments at beginning of year	2,078	4,365
Cash and temporary investments at end of year	\$ 41,860	\$ 2,078
CHANGES IN COMPONENTS OF WORKING CAPITAL		
Receivables	\$(14,932)	\$ 16,613
Inventories	1,695	(36,953)
Overrecovered gas costs	(37,577)	7,873
Accounts payable and other	(3,894)	8,675
Gas purchases payable	14,858	1,093
Prepaid and accrued taxes, net	4,914	(6,004)
Customers' credit balances and deposits	36,188	(33,763)
Restricted broker margin accounts	(28,931)	18,488
Other current assets	599	(16,571)
Total	\$(27,080)	\$(40,549)
SUPPLEMENTAL DISCLOSURES OF CASH FLOWS INFORMATION		
Cash paid for		
Interest (net of amounts capitalized)	\$18,268	\$18,659
Income taxes	\$10,350	\$17,346

The accompanying notes are an integral part of these statements

New Jersey Natural Gas

BALANCE SHEETS

ASSETS

(Thousands)

September 30,	2008	2007
PROPERTY, PLANT AND EQUIPMENT		
Utility plant, at cost	\$1,336,960	\$1,273,928
Construction work in progress	29,277	25,517
	1,366,237	1,299,445
Accumulated depreciation and amortization	(368,172)	(347,418)
Property, plant and equipment, net	998,065	952,027
CURRENT ASSETS		
Cash and temporary investments	41,860	2,078
Restricted cash	—	2,608
Customer accounts receivable		
Billed	21,398	5,583
Unbilled revenues	9,417	8,895
Allowance for doubtful accounts	(4,571)	(3,166)
Regulatory assets	51,376	24,634
Gas in storage, at average cost	189,828	191,460
Materials and supplies, at average cost	4,092	4,155
Prepaid state taxes	37,271	28,239
Derivatives, at fair value	12,039	13,285
Broker margin account	41,276	12,345
Other	4,477	3,876
Total current assets	408,463	293,992
NONCURRENT ASSETS		
Regulatory assets	340,670	312,369
Derivatives, at fair value	751	381
Restricted cash construction fund	4,200	4,200
Other	9,814	9,460
Total noncurrent assets	355,435	326,410
Total assets	\$1,761,963	\$1,572,429

The accompanying notes are an integral part of these statements.

New Jersey Natural Gas

BALANCE SHEETS

CAPITALIZATION AND LIABILITIES

(Thousands)

September 30,	2008	2007
CAPITALIZATION		
Common stock equity	\$ 472,417	\$ 472,833
Long-term debt	405,117	308,184
Total capitalization	877,534	781,017
CURRENT LIABILITIES		
Current maturities of long-term debt	35,119	4,338
Short-term debt	145,500	186,229
Gas purchases payable	55,195	40,337
Accounts payable and other	49,091	46,551
Deferred taxes	26,572	6,940
Regulatory liabilities	—	9,583
New Jersey clean energy program	3,056	8,832
Derivatives, at fair value	42,842	33,293
Customers' credit balances and deposits	63,370	27,182
Total current liabilities	420,745	363,285
NONCURRENT LIABILITIES		
Deferred income taxes	190,128	176,741
Deferred investment tax credits	7,192	7,513
Derivatives, at fair value	19,558	32,208
Manufactured gas plant remediation	120,730	105,340
Postemployment employee benefit liability	34,089	12,417
Regulatory liabilities	63,419	61,270
New Jersey clean energy and conservation incentive programs	864	3,992
Asset retirement obligation	24,416	23,895
Other	3,288	4,751
Total noncurrent liabilities	463,684	428,127
Total capitalization and liabilities	\$1,761,963	\$1,572,429

The accompanying notes are an integral part of these statements.

New Jersey Natural Gas

STATEMENTS OF CAPITALIZATION

<i>(Thousands)</i>			
September 30,		2008	2007
COMMON STOCK EQUITY			
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		253,270	252,800
Accumulated other comprehensive (loss), net of tax		(34)	(63)
Retained earnings		191,837	192,752
Total common stock equity		472,417	472,833
LONG-TERM DEBT			
<i>First mortgage bonds</i>	<i>Maturity date</i>		
6.27% Series X	November 1, 2008	30,000	30,000
Variable Series AA	August 1, 2030	25,000	25,000
Variable Series BB	August 1, 2030	16,000	16,000
6.88% Series CC	October 1, 2010	20,000	20,000
Variable Series DD	September 1, 2027	13,500	13,500
Variable Series EE	January 1, 2028	9,545	9,545
Variable Series FF	January 1, 2028	15,000	15,000
Variable Series GG	April 1, 2033	18,000	18,000
5.00% Series HH	December 1, 2038	12,000	12,000
4.50% Series II	August 1, 2023	10,300	10,300
4.60% Series JJ	August 1, 2024	10,500	10,500
4.90% Series KK	October 1, 2040	15,000	15,000
5.60% Series LL	May 15, 2018	125,000	—
4.77% Unsecured senior notes	March 15, 2014	60,000	60,000
Capital lease obligation – Buildings	June 1, 2021	26,371	27,063
Capital lease obligation – Meters	October 1, 2012	34,020	30,614
Less: Current maturities of long-term debt		(35,119)	(4,338)
Total long-term debt		405,117	308,184
Total capitalization		\$877,534	\$781,017

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, 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
Tax benefit from exercise of parent company stock options					6,047		6,047
Cash dividend declared						(42,446)	(42,446)
Balance at September 30, 2007	3,215	16,075	11,269	(63)	252,800	192,752	472,833
Net income						42,479	42,479
Other comprehensive income, net of tax:							
Change in fair value of derivatives, net of tax of \$(20)				29			29
Other comprehensive income							29
Comprehensive income							42,508
Tax benefit from exercise of parent company stock options					470		470
Tax effect of FIN 48						1,188	1,188
Cash dividend declared						(44,582)	(44,582)
Balance at September 30, 2008	3,215	\$16,075	\$11,269	\$(34)	\$253,270	\$191,837	\$472,417

The accompanying notes are an integral part of these statements.

NEW JERSEY NATURAL GAS

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 484,000 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 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:

	2008		2007	
<i>(\$ in thousands)</i>		Bcf		Bcf
Gas in storage	\$189,828	22.1	\$191,460	23.0

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 and are recognized as charges over the term of the respective agreement. Demand charges of \$73.9 million for each fiscal year ended September 30, 2008 and 2007 were recognized in the Statements of Income as part of Gas purchases.

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 Company's Balance Sheets.

Fair values of exchange-traded instruments, principally futures, swaps and 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 3. Derivative Instruments* for additional details regarding financial instrument activities.

The Company has not designated any derivatives as fair value hedges as of September 30, 2008 and 2007.

Revenues

Revenues from the sale of natural gas to customers of the Company are recognized in the period that such natural 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.

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 its economic 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 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 - Adoption of FIN 48*.

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 \$1.1 million in fiscal 2008 and \$1.3 million in fiscal 2007, with average interest rates of 4.8 percent and 5.4 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.

As a result of the October 3, 2008, final rate order (the Board Order) issued by the BPU, as fully discussed in *Note 2. Regulation and October Board Order*, commencing in fiscal 2009, the Company will be allowed to recover a cost of equity component in its AFUDC calculation.

Pursuant to a BPU order, the Company 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 2. Regulation and October Board Order*. These amounts, which represent approximately \$2.6 million and \$3.0 million of deferred interest related to these SBC program costs in fiscal 2008 and 2007, respectively, are included in Other income.

Sales Tax Accounting

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

<i>(Thousands)</i>	September 30,	
	2008	2007
Sales Tax	\$50,200	\$47,900
TEFA	8,400	8,500
Total	\$58,600	\$56,400

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 3.04 percent of average depreciable property in fiscal 2008, and 3.02 percent in fiscal 2007. Pursuant to its Board Order, commencing in fiscal 2009, the BPU has lowered the depreciation amount to be charged in rates to 2.34 percent for the Company. See *Note 2. Regulation and October Board Order*.

Property classifications and estimated useful lives, as of September 30, 2008 and 2007, 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 the New Jersey Department of the Public Advocate, Division of Rate Counsel (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*.

