

SOUTH JERSEY INDUSTRIES INC

Form 10-Q

November 07, 2008

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended September 30, 2008

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-6364

SOUTH JERSEY INDUSTRIES, INC.  
(Exact name of registrant as specified in its charter)

New Jersey  
(State of incorporation)

22-1901645  
(IRS employer identification no.)

1 South Jersey Plaza, Folsom, NJ 08037  
(Address of principal executive offices, including zip code)

(609) 561-9000  
(Registrant's telephone number, including area code)

Common Stock  
(\$1.25 par value per share)  
(Title of each class)

New York Stock Exchange  
(Name of exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

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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, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

|                         |  |                           |                          |
|-------------------------|--|---------------------------|--------------------------|
| Large accelerated filer | <input checked="" type="checkbox"/>                                    | Accelerated filer         | <input type="checkbox"/> |
| Non-accelerated filer   | <input type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company | <input type="checkbox"/> |

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

As of November 3, 2008, there were 29,728,697 shares of the registrant's common stock outstanding.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements - See Pages 3 through 20

SJI - 2

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## SOUTH JERSEY INDUSTRIES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(In Thousands, Except for Per Share Data)

|  | Three Months Ended<br>September 30, |           |
|--|-------------------------------------|-----------|
|  | 2008                                | 2007      |
| Operating Revenues:                                      |                                     |           |
| Utility  | \$ 63,687                           | \$ 83,385 |
| Nonutility   | 146,726                             | 72,843    |
| Total Operating Revenues                                 | 210,413                             | 156,228   |
| Operating Expenses:                                      |                                     |           |
| Cost of Sales - (Excluding depreciation)                 |                                     |           |
| - Utility  | 40,324                              | 61,188    |
| - Nonutility   | 61,935                              | 47,976    |
| Operations   | 17,923                              | 16,084    |
| Maintenance  | 1,925                               | 1,544     |
| Depreciation   | 7,333                               | 6,982     |
| Energy and Other Taxes                                   | 1,646                               | 1,587     |
| Total Operating Expenses                                 | 131,086                             | 135,361   |
| Operating Income   | 79,327                              | 20,867    |
| Other Income and Expense                                 | 496                                 | 303       |
| Interest Charges   | (5,745)                             | (6,966)   |
| Income Before Income Taxes                               | 74,078                              | 14,204    |
| Income Taxes   | (30,367)                            | (5,818)   |
| Equity in Earnings of Affiliated Companies               | 147                                 | 178       |
| Income from Continuing Operations                        | 43,858                              | 8,564     |
| Loss from Discontinued Operations - (Net of tax benefit) | (76)                                | (33)      |
| Net Income   | \$ 43,782                           | \$ 8,531  |
| Basic Earnings Per Common Share:                         |                                     |           |
| Continuing Operations                                    | \$ 1.475                            | \$ 0.290  |
| Discontinued Operations                                  | (0.002)                             | (0.001)   |

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|  |    |         |    |         |
|--|----|---------|----|---------|
| Basic Earnings Per Common Share                      | \$ | 1.473   | \$ | 0.289   |
| Average Shares of Common Stock Outstanding - Basic   |    | 29,729  |    | 29,518  |
| Diluted Earnings Per Common Share:                   |    |         |    |         |
| Continuing Operations                                | \$ | 1.469   | \$ | 0.289   |
| Discontinued Operations                              |    | (0.003) |    | (0.001) |
| Diluted Earnings Per Common Share                    | \$ | 1.466   | \$ | 0.288   |
| Average Shares of Common Stock Outstanding - Diluted |    | 29,865  |    | 29,627  |
| Dividends Declared per Common Share                  | \$ | 0.270   | \$ | 0.245   |

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

SJI - 3

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## SOUTH JERSEY INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)  
(In Thousands, Except for Per Share Data)

|  | Nine Months Ended<br>September 30, |            |
|--|------------------------------------|------------|
|  | 2008                               | 2007       |
| Operating Revenues:                                      |                                    |            |
| Utility  | \$ 393,262                         | \$ 441,073 |
| Nonutility   | 301,038                            | 255,241    |
| Total Operating Revenues                                 | 694,300                            | 696,314    |
| Operating Expenses:                                      |                                    |            |
| Cost of Sales - (Excluding depreciation)                 |                                    |            |
| - Utility  | 261,604                            | 314,408    |
| - Nonutility   | 231,141                            | 198,830    |
| Operations   | 56,805                             | 51,619     |
| Maintenance  | 5,412                              | 4,446      |
| Depreciation   | 21,758                             | 20,884     |
| Energy and Other Taxes                                   | 8,628                              | 8,891      |
| Total Operating Expenses                                 | 585,348                            | 599,078    |
| Operating Income   | 108,952                            | 97,236     |
| Other Income and Expense                                 | 1,235                              | 1,184      |
| Interest Charges   | (17,246)                           | (20,123)   |
| Income Before Income Taxes                               | 92,941                             | 78,297     |
| Income Taxes   | (38,245)                           | (32,350)   |
| Equity in Earnings of Affiliated Companies               | 593                                | 600        |
| Income from Continuing Operations                        | 55,289                             | 46,547     |
| Loss from Discontinued Operations - (Net of tax benefit) | (101)                              | (235)      |
| Net Income   | \$ 55,188                          | \$ 46,312  |
| Basic Earnings Per Common Share:                         |                                    |            |
| Continuing Operations                                    | \$ 1.862                           | \$ 1.581   |
| Discontinued Operations                                  | (0.004)                            | (0.008)    |

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|  |    |         |    |         |
|--|----|---------|----|---------|
| Basic Earnings Per Common Share                      | \$ | 1.858   | \$ | 1.573   |
| Average Shares of Common Stock Outstanding - Basic   |    | 29,699  |    | 29,449  |
| Diluted Earnings Per Common Share:                   |    |         |    |         |
| Continuing Operations                                | \$ | 1.854   | \$ | 1.575   |
| Discontinued Operations                              |    | (0.004) |    | (0.008) |
| Diluted Earnings Per Common Share                    | \$ | 1.850   | \$ | 1.567   |
| Average Shares of Common Stock Outstanding - Diluted |    | 29,828  |    | 29,561  |
| Dividends Declared per Common Share                  | \$ | 0.810   | \$ | 0.735   |

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

SJI - 4

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## SOUTH JERSEY INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)  
(In Thousands)

|  | Three Months Ended<br>September 30, |           |
|--|-------------------------------------|-----------|
|  | 2008                                | 2007      |
| Net Income   | \$ 43,782                           | \$ 8,531  |
| Other Comprehensive Income, Net of Tax:*                         |                                     |           |
| Unrealized (Loss) Gain on Available-for-Sale Securities          | (355)                               | 41        |
| Unrealized Loss on Derivatives - Other                           | (20)                                | (1,277)   |
| Unrealized Loss on Derivatives - Other from Affiliated Companies | (347)                               | (858)     |
| Other Comprehensive Loss - Net of Tax*                           | (722)                               | (2,094)   |
| Comprehensive Income   | \$ 43,060                           | \$ 6,437  |
|  |                                     |           |
|  | Nine Months Ended<br>September 30,  |           |
|  | 2008                                | 2007      |
| Net Income   | \$ 55,188                           | \$ 46,312 |
| Other Comprehensive Income, Net of Tax:*                         |                                     |           |
| Unrealized (Loss) Gain on Available-for-Sale Securities          | (635)                               | 221       |
| Unrealized Gain on Derivatives - Other                           | 499                                 | 64        |
| Unrealized Loss on Derivatives - Other from Affiliated Companies | (154)                               | (858)     |
| Other Comprehensive Loss - Net of Tax*                           | (290)                               | (573)     |
| Comprehensive Income   | \$ 54,898                           | \$ 45,739 |

\* Determined using a combined statutory tax rate of 41.08%.

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.



SJI - 5

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## SOUTH JERSEY INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)  
(In Thousands)

|   | Nine Months Ended<br>September 30, |            |
|---|------------------------------------|------------|
|   | 2008                               | 2007       |
| Net Cash Provided by Operating Activities                                     | \$ 32,072                          | \$ 104,453 |
| Cash Flows from Investing Activities:   |                                    |            |
| Capital Expenditures  | (45,048)                           | (40,915)   |
| Net (Purchase) Proceeds from Sale of Restricted Investments in Margin Account | (11,150)                           | 10,404     |
| Proceeds from Sale of Restricted Investments from Escrowed Loan Proceeds      | -                                  | 4,172      |
| Purchase of Restricted Investments with Escrowed Loan Proceeds                | (75)                               | (127)      |
| Merchandise Loans   | (2,857)                            | (2,695)    |
| Proceeds from Merchandise Loans   | 2,923                              | 2,975      |
| Purchase of Company Owned Life Insurance                                      | (4,287)                            | (3,917)    |
| Investment in Affiliate   | (781)                              | (7,463)    |
| Advances on Notes Receivable - Affiliate                                      | (4,832)                            | -          |
| Net Cash Used in Investing Activities   | (66,107)                           | (37,566)   |
| Cash Flows from Financing Activities:   |                                    |            |
| Net Borrowings (Repayments) of Lines of Credit                                | 40,835                             | (48,915)   |
| Proceeds from Issuance of Long-Term Debt                                      | 25,000                             | -          |
| Payments for Issuance of Long-Term Debt                                       | (247)                              | -          |
| Principal Repayments of Long-Term Debt  | (25,079)                           | (2,364)    |
| Dividends on Common Stock   | (16,042)                           | (14,431)   |
| Proceeds from Sale of Common Stock  | 2,076                              | 5,105      |
| Net Cash Provided by (Used in) Financing Activities                           | 26,543                             | (60,605)   |
| Net (Decrease) Increase in Cash and Cash Equivalents                          | (7,492)                            | 6,282      |
| Cash and Cash Equivalents at Beginning of Period                              | 11,678                             | 7,932      |
| Cash and Cash Equivalents at End of Period                                    | \$ 4,186                           | \$ 14,214  |

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

SOUTH JERSEY INDUSTRIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)  
(In Thousands)

|  | September<br>30,<br>2008 | December<br>31,<br>2007 |
|--|--------------------------|-------------------------|
| Assets                                     |                          |                         |
| Property, Plant and Equipment:             |                          |                         |
| Utility Plant, at original cost            | \$ 1,156,565             | \$ 1,123,992            |
| Accumulated Depreciation                   | (290,215)                | (276,301)               |
| Nonutility Property and Equipment, at cost | 120,225                  | 112,971                 |
| Accumulated Depreciation                   | (14,483)                 | (11,793)                |
| Property, Plant and Equipment - Net        | 972,092                  | 948,869                 |
| Investments:                               |                          |                         |
| Available-for-Sale Securities              | 5,653                    | 6,734                   |
| Restricted                                 | 17,685                   | 6,460                   |
| Investment in Affiliates                   | 2,058                    | 1,694                   |
| Total Investments                          | 25,396                   | 14,888                  |
| Current Assets:                            |                          |                         |
| Cash and Cash Equivalents                  | 4,186                    | 11,678                  |
| Accounts Receivable                        | 93,291                   | 111,899                 |
| Unbilled Revenues                          | 9,788                    | 48,304                  |
| Provision for Uncollectibles               | (5,839)                  | (5,491)                 |
| Natural Gas in Storage, average cost       | 179,330                  | 123,790                 |
| Materials and Supplies, average cost       | 3,730                    | 2,777                   |
| Prepaid Taxes                              | 18,594                   | 6,878                   |
| Derivatives - Energy Related Assets        | 44,448                   | 23,270                  |
| Other Prepayments and Current Assets       | 7,382                    | 5,225                   |
| Total Current Assets                       | 354,910                  | 328,330                 |
| Regulatory and Other Noncurrent Assets:    |                          |                         |
| Regulatory Assets                          | 212,743                  | 188,688                 |
| Prepaid Pension                            | 7,046                    | 1,970                   |
| Derivatives - Energy Related Assets        | 16,300                   | 10,941                  |
| Unamortized Debt Issuance Costs            | 7,231                    | 7,386                   |
| Notes Receivable - Affiliate               | 4,832                    | -                       |

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|  |              |              |
|--|--------------|--------------|
| Contract Receivables                         | 12,678       | 13,220       |
| Other  | 20,083       | 15,149       |
| Total Regulatory and Other Noncurrent Assets | 280,913      | 237,354      |
| Total Assets                                 | \$ 1,633,311 | \$ 1,529,441 |

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

SJI - 7

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SOUTH JERSEY INDUSTRIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)  
(In Thousands)

|  | September<br>30,<br>2008 | December<br>31,<br>2007 |
|--|--------------------------|-------------------------|
| Capitalization and Liabilities                     |                          |                         |
| Common Equity:                                     |                          |                         |
| Common Stock                                       | \$ 37,161                | \$ 37,010               |
| Premium on Common Stock                            | 251,340                  | 248,449                 |
| Treasury Stock (at par)                            | (182)                    | (187)                   |
| Accumulated Other Comprehensive Loss               | (10,605)                 | (10,315)                |
| Retained Earnings                                  | 237,242                  | 206,123                 |
| <br>Total Common Equity                            | <br>514,956              | <br>481,080             |
| <br>Long-Term Debt                                 | <br>357,818              | <br>357,896             |
| <br>Total Capitalization                           | <br>872,774              | <br>838,976             |
| <br>Minority Interest                              | <br>1,255                | <br>440                 |
| Current Liabilities:                               |                          |                         |
| Notes Payable                                      | 159,125                  | 118,290                 |
| Current Maturities of Long-Term Debt               | 106                      | 106                     |
| Accounts Payable                                   | 88,095                   | 101,154                 |
| Customer Deposits and Credit Balances              | 30,323                   | 18,475                  |
| Margin Account Liability                           | -                        | 4,112                   |
| Environmental Remediation Costs                    | 20,035                   | 25,827                  |
| Taxes Accrued                                      | 3,632                    | 5,310                   |
| Derivatives - Energy Related Liabilities           | 31,299                   | 13,735                  |
| Deferred Income Taxes - Net                        | 19,661                   | 20,251                  |
| Deferred Contract Revenues                         | 5,701                    | 5,231                   |
| Dividends Payable                                  | 8,027                    | -                       |
| Interest Accrued                                   | 4,831                    | 6,657                   |
| Pension and Other Postretirement Benefits          | 841                      | 805                     |
| Other Current Liabilities                          | 6,715                    | 8,358                   |
| <br>Total Current Liabilities                      | <br>378,391              | <br>328,311             |
| Deferred Credits and Other Noncurrent Liabilities: |                          |                         |
| Deferred Income Taxes - Net                        | 190,818                  | 175,686                 |
| Investment Tax Credits                             | 1,911                    | 2,150                   |

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|  |                  |                  |
|--|------------------|------------------|
| Pension and Other Postretirement Benefits                      | 28,461           | 29,036           |
| Environmental Remediation Costs                                | 55,181           | 52,078           |
| Asset Retirement Obligations                                   | 23,932           | 24,604           |
| Derivatives - Energy Related Liabilities                       | 10,277           | 4,190            |
| Derivatives - Other  | 3,089            | 2,484            |
| Regulatory Liabilities   | 52,336           | 55,779           |
| Other  | 14,886           | 15,707           |
| <br>Total Deferred Credits<br>and Other Noncurrent Liabilities | <br>380,891      | <br>361,714      |
| <br>Commitments and Contingencies (Note 12)                    |                  |                  |
| <br>Total Capitalization and Liabilities                       | <br>\$ 1,633,311 | <br>\$ 1,529,441 |

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

Notes to Unaudited Condensed Consolidated Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

GENERAL - South Jersey Industries, Inc. (SJI or the Company) currently provides a variety of energy related products and services primarily through the following subsidiaries:

South Jersey Gas Company (SJG) is a regulated natural gas utility. SJG distributes natural gas in the seven southernmost counties of New Jersey.

South Jersey Resources Group, LLC (SJRG) markets wholesale natural gas storage, commodity and transportation in the mid-Atlantic and southern states.

Marina Energy, LLC (Marina) develops and operates on-site energy-related projects.

South Jersey Energy Company (SJE) acquires and markets natural gas and electricity to retail end users and provides total energy management services to commercial and industrial customers.

South Jersey Energy Service Plus, LLC (SJESP) installs residential and small commercial HVAC systems, provides plumbing services and services appliances via the sale of appliance service programs.

**BASIS OF PRESENTATION** — The condensed consolidated financial statements include the accounts of SJI, its wholly owned subsidiaries and subsidiaries in which we have a controlling interest. All significant intercompany accounts and transactions have been eliminated. In management's opinion, the condensed consolidated financial statements reflect all normal and recurring adjustments needed to fairly present SJI's financial position and operating results at the dates and for the periods presented. SJI's businesses are subject to seasonal fluctuations and, accordingly, this interim financial information should not be the basis for estimating the full year's operating results. As permitted by the rules and regulations of the Securities and Exchange Commission, the accompanying unaudited condensed consolidated financial statements contain certain condensed financial information and exclude certain footnote disclosures normally included in annual audited consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). These financial statements should be read in conjunction with SJI's 2007 Annual Report on Form 10-K for a more complete discussion of the Company's accounting policies and certain other information.

**REVENUE BASED TAXES** — SJI collects certain revenue-based energy taxes from customers. Such taxes include New Jersey State Sales Tax, Transitional Energy Facility Assessment (TEFA) and Public Utilities Assessment (PUA). State sales tax is recorded as a liability when billed to customers and is not included in revenue or operating expenses. TEFA and PUA are included in both utility revenue and cost of sales and totaled \$0.9 million in both of the three month periods ended September 30, 2008 and 2007, and \$5.9 million and \$6.3 million in the nine months ended September 30, 2008 and 2007, respectively.

**CAPITALIZED INTEREST** — SJG capitalizes interest on construction at the rate of return on rate base utilized by the New Jersey Board of Public Utilities (BPU) to set rates in its last base rate proceeding. Marina capitalizes interest on construction projects in progress based on the actual cost of borrowed funds. SJG's amounts are included in Utility Plant and Marina's amounts are included in Nonutility Property and Equipment on the condensed consolidated balance sheets. Interest Charges are presented net of capitalized interest on the condensed consolidated statements of income. The amount of interest capitalized by SJI for the three and nine months ended September 30, 2008 and 2007 was not

significant.

DERIVATIVE INSTRUMENTS — The Company manages its risks of purchases and sales, as well as natural gas in storage, using a variety of derivative instruments that include forward contracts, swap agreements, options contracts and futures contracts. These contracts are measured at fair value and recorded in Derivatives — Energy Related Assets or Derivatives — Energy Related Liabilities on the condensed consolidated balance sheets. The consolidated net unrealized pre-tax gain of \$71.9 million and \$17.8 million were recorded in earnings during the three months ended September 30, 2008 and 2007, respectively. For the nine months ended September 30, 2008 and 2007, the net unrealized pre-tax gain of \$2.1 million and \$8.8 million, respectively were recorded in earnings. These unrealized gains and losses are included with realized gains and losses in Operating Revenues – Nonutility.

SJI - 9

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As part of its gas purchasing strategy, SJG uses financial contracts through SJRG to hedge against forward price risk. The costs or benefits of these short-term contracts are recoverable through SJG's Basic Gas Supply Service (BGSS) clause, subject to BPU approval. As of September 30, 2008 and December 31, 2007, SJG had \$13.9 million and \$2.1 million of costs, respectively, included in its BGSS related to open financial contracts.

The Company has entered into interest rate derivatives and similar agreements to hedge exposure to increasing interest rates, and the impact of those rates on cash flows of variable-rate debt. These interest rate derivatives are included in Derivatives-Other on the condensed consolidated balance sheets. There have been no significant changes to the Company's active interest rate swaps since December 31, 2007 which are described in Note 1 to the Consolidated Financial Statements in Item 8 of SJI's Annual Report on Form 10-K as of December 31, 2007.

The differential to be paid or received as a result of these swap agreements is accrued as interest rates change and is recognized as an adjustment to interest expense. As of September 30, 2008 and December 31, 2007, the net unrealized loss on these swaps was \$3.1 million and \$2.5 million, respectively. The market value represents the amount SJI would have to pay the counterparty to terminate these contracts as of those dates. For selected interest rate derivatives, the market value upon termination can be recovered in rates and has therefore been included in Other Regulatory Assets in the condensed consolidated balance sheets in accordance with FAS 71 "Accounting for the Effects of Certain Types of Regulation." The remaining interest rate derivatives have been designated as cash flow hedges.

**GAS EXPLORATION AND DEVELOPMENT** - The Company capitalizes all costs associated with gas property acquisition, exploration and development activities under the full cost method of accounting. Capitalized costs include costs related to unproved properties, which are not amortized until proved reserves are found or it is determined that the unproved properties are impaired. All costs related to unproved properties are reviewed quarterly to determine if impairment has occurred. As of September 30, 2008, \$5.6 million related to the acquisition of interests in proved and unproved properties in Pennsylvania is included with Nonutility Property and Equipment on the condensed consolidated balance sheets.

**TREASURY STOCK** – SJI uses the par value method of accounting for treasury stock. As of September 30, 2008, SJI held 145,776 shares of treasury stock. These shares are related to deferred compensation arrangements where the amounts earned are held in the stock of SJI.

**NEW ACCOUNTING PRONOUNCEMENTS** — In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements", which defines fair value, establishes a framework for measuring fair value in accounting principles generally accepted in the United States of America, and expands disclosures about fair value measurements. In October 2008, the FASB issued FSP 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active," to provide clarification of the application of FAS 157 in a market that is not active and to provide an example to illustrate key considerations in determining the fair value of a financial asset in such a non-active market. This statement was effective in fiscal years beginning after November 15, 2007. However for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis, FAS 157 is effective in fiscal years beginning after November 15, 2008. The adoption of the initial phase of this statement did not have a material effect on the Company's condensed consolidated financial statements. Management does not anticipate that the adoption of the remainder of this statement will have a material effect on the Company's condensed consolidated financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." The statement permits entities to choose to measure certain financial

instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This statement is effective for the first fiscal year beginning after November 15, 2007. The Company has not elected this fair value option, and as a result, the adoption of this statement did not have a material effect on the Company's condensed consolidated financial statements.

SJI - 10

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In April 2007, the FASB posted FASB Staff Position (FSP) FIN 39-1 “Amendment of FASB Interpretation No. 39” which addresses questions received by the FASB staff regarding Interpretation 39 relating to the offsetting of amounts recognized for forward, interest rate swap, currency swap, option, and other conditional or exchange contracts. The guidance in this FSP is effective for fiscal years beginning after November 15, 2007. The adoption of this position did not have a material effect on the Company’s condensed consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R), “Business Combinations.” The statement requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. This statement is effective for the first fiscal year beginning after December 15, 2008. Management is currently evaluating the impact that the adoption of this statement will have on the Company’s condensed consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, “Noncontrolling Interests in Consolidated Financial Statements.” The statement requires all entities to report noncontrolling (minority) interests in subsidiaries in the same way—as equity in the consolidated financial statements. Moreover, Statement No. 160 eliminates the diversity that currently exists in accounting for transactions between an entity and noncontrolling interests by requiring they be treated as equity transactions. This statement is effective for the first fiscal year beginning after December 15, 2008. Management is currently evaluating the impact that the adoption of this statement will have on the Company’s condensed consolidated financial statements.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, “Disclosures about Derivative Instruments and Hedging Activities - an amendment of SFAS No. 133” (FAS 161). This statement requires disclosures of how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for and how derivative instruments and related hedged items affect an entity’s financial position, financial performance, and cash flows. FAS 161 is effective for fiscal years beginning after November 15, 2008. Management is currently evaluating the impact that the adoption of this statement will have on the Company’s condensed consolidated financial statements.

In September 2008, the FASB issued FASB Staff Position (FSP) No. 133-1 and FIN 45-4 “Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161.” The FSP is intended to improve disclosures about credit derivatives by requiring more information about the potential adverse effects of changes in credit risk on the financial position, financial performance, and cash flows of the sellers of credit derivatives. The provisions of the FSP that amend Statement 133 and Interpretation 45 are effective for reporting periods (annual or interim) ending after November 15, 2008. Management is currently evaluating the impact that the adoption of this position will have on the Company’s condensed consolidated financial statements.

**CORRECTION IN THE PRESENTATION OF THE STATEMENT OF CASH FLOWS** - The following items represent corrections made to the nine months ended September 30, 2007 on the statements of condensed consolidated cash flows:

- Cash flows related to merchandise loans to customers for the purpose of attracting conversions to natural gas heating systems should have been classified under the caption Cash Flows from Investing Activities on the statements of condensed consolidated cash flows. Accordingly, cash outflows for loans originated of \$2.7 million

and cash inflows from the principal collection on these loans of \$3.0 million during the nine months ended September 30, 2007 are now included within Cash Flows from Investing Activities. The overall net impact resulted in an insignificant amount of Cash Flows from Operating Activities for the nine months ended September 30, 2007 now being included within Cash Flows from Investing Activities.

SJI - 11

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- Cash flows related to unused loan proceeds that are held in restricted escrow accounts were incorrectly presented on a net basis with the cash flows related to the restricted margin account that is used to support the Company's risk management activities within Cash Flows from Investing Activities on the statements of condensed consolidated cash flows. Accordingly, purchases of restricted investments with unused loan proceeds of \$0.1 million during the nine months ended September 30, 2007 are now included in Purchase of Restricted Investments with Escrowed Loan Proceeds and proceeds from the sale of these restricted investments of \$4.2 million during the nine months ended September 30, 2007 are now included in Proceeds from Sale of Restricted Investments from Escrowed Loan Proceeds. The cash flows related to the restricted margin account remain in Net Proceeds from Sale of Restricted Investments in Margin Account. This change had no overall impact on total Cash Flows from Investing Activities on the statements of condensed consolidated cash flows.

These changes did not impact previously reported revenue or net income and are considered immaterial to the overall presentation of the condensed consolidated financial statements.

## 2. STOCK-BASED COMPENSATION PLAN:

Under the Amended and Restated 1997 Stock-Based Compensation Plan, no more than 2,000,000 shares in the aggregate may be issued to SJI's officers (Officers), non-employee directors (Directors) and other key employees. The plan will terminate on January 26, 2015, unless terminated earlier by the Board of Directors. No options were granted or outstanding during the nine months ended September 30, 2008 and 2007. No stock appreciation rights have been issued under the plan. During the nine months ended September 30, 2008 and 2007, SJI granted 45,241 and 44,106 restricted shares to Officers and other key employees, respectively. These restricted shares vest over a three-year period and are subject to SJI achieving certain market based performance targets as compared to a peer group average, which can cause the actual amount of shares that ultimately vest to range from between 0% to 150% of the original share units granted. During the nine months ended September 30, 2008, SJI granted 8,667 restricted shares to Directors. Shares issued to Directors vest over a three-year service period but contain no performance conditions. As a result, 100% of the shares granted generally vest.

See Note 2 to the Consolidated Financial Statements in Item 8 of SJI's Annual Report on Form 10-K as of December 31, 2007 for the related accounting policy.

The following table summarizes the nonvested restricted stock awards outstanding at September 30, 2008 and the assumptions used to estimate the fair value of the awards:

|                               | Grant<br>Date | Shares<br>Outstanding | Fair Value<br>Per Share | Expected<br>Volatility | Risk-Free<br>Interest<br>Rate |
|-------------------------------|---------------|-----------------------|-------------------------|------------------------|-------------------------------|
| Officers & Key<br>Employees - | Jan. 2006     | 35,310                | \$ 27.950               | 16.9%                  | 4.5%                          |
|                               | Jan. 2007     | 38,624                | \$ 29.210               | 18.5%                  | 4.9%                          |
|                               | Jan. 2008     | 44,479                | \$ 34.030               | 21.7%                  | 2.9%                          |
| Directors -                   | Dec. 2005     | 6,340                 | \$ 29.970               | -                      | -                             |
|                               | Dec. 2006     | 9,261                 | \$ 34.020               | -                      | -                             |
|                               | Jan. 2008     | 8,667                 | \$ 36.355               |                        |                               |

Expected volatility is based on the actual daily volatility of SJI's share price over the preceding three-year period as of the valuation date. The risk-free interest rate is based on the zero-coupon U.S. Treasury Bond, with a term equal to the three-year term of the Officers' and other key employees' restricted shares. As notional dividend equivalents are credited to the holders, which are reinvested during the three-year service period, no reduction to the fair value of the award is required. As the Directors' restricted stock awards contain no performance conditions and dividends are paid or credited to the holder during the three-year service period, the market value of these awards on the date of grant approximates the fair value.

SJI - 12

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The following table summarizes the total compensation cost for the three and nine months ended September 30, 2008 and 2007 (in thousands):

|                          | Three Months Ended    |        | Nine Months Ended     |        |
|--------------------------|-----------------------|--------|-----------------------|--------|
|                          | September 30,<br>2008 | 2007   | September 30,<br>2008 | 2007   |
| Officers & Key Employees | \$ 286                | \$ 249 | \$ 858                | \$ 747 |
| Directors                | 67                    | 52     | 201                   | 156    |
| Total Cost               | 353                   | 301    | 1,059                 | 903    |
| Capitalized              | (37)                  | (28)   | (112)                 | (81)   |
| Net Expense              | \$ 316                | \$ 273 | \$ 947                | \$ 822 |

As of September 30, 2008, there was \$2.0 million of total unrecognized compensation cost related to nonvested share-based compensation awards granted under the restricted stock plans. That cost is expected to be recognized over a weighted average period of 1.9 years.

The following table summarizes information regarding restricted stock award activity during the nine months ended September 30, 2008 excluding accrued dividend equivalents:

|   | Officers & Other<br>Key Employees | Directors | Weighted Average<br>Grant Date<br>Fair Value |
|---|-----------------------------------|-----------|--|
| Nonvested Shares Outstanding,<br>January 1, 2008    | 76,657                            | 15,601    | \$ 29.245                                    |
| Granted   | 45,241                            | 8,667     | 34.404                                       |
| Forfeited   | (3,485)                           | -         | 29.801                                       |
| Nonvested Shares Outstanding,<br>September 30, 2008 | 118,413                           | 24,268    | \$ 31.181                                    |

During the nine months ended September 30, 2008 and 2007, SJI awarded 51,838 shares, which had vested at December 31, 2007, at a market value of \$1.9 million and 69,781 shares, which had vested at December 31, 2006, at a market value of \$2.3 million, respectively. The Company has a policy of issuing new shares to satisfy its obligations under these plans; therefore, there are no cash payment requirements resulting from the normal operation of this plan. However, a change in control could result in such shares becoming nonforfeitable or immediately payable in cash. At the discretion of the Officers, Directors and other key employees, the receipt of vested shares can be deferred until future periods. These deferred shares are included in Treasury Stock on the condensed consolidated balance sheets.

### 3. DISCONTINUED OPERATIONS:

Discontinued Operations consist of the environmental remediation activities related to the properties of South Jersey Fuel, Inc. (SJF) and the product liability litigation and environmental remediation activities related to the prior business of The Morie Company, Inc. (Morie). SJF is a subsidiary of Energy & Minerals, Inc. (EMI), an SJI

subsidiary, which previously operated a fuel oil business. Morie is the former sand mining and processing subsidiary of EMI. EMI sold the common stock of Morie in 1996.

SJI conducts tests annually to estimate the environmental remediation costs for these properties.

SJI - 13

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Summarized operating results of the discontinued operations for the three and nine months ended September 30, were (in thousands, except per share amounts):

|   | Three Months Ended |            | Nine Months Ended |            |
|---|--------------------|------------|-------------------|------------|
|   | September 30,      |            | September 30,     |            |
|   | 2008               | 2007       | 2008              | 2007       |
| Loss before Income Taxes:                                     |                    |            |                   |            |
| Sand Mining   | \$ (22)            | \$ (37)    | \$ (73)           | \$ (316)   |
| Fuel Oil  | (95)               | (13)       | (83)              | (32)       |
| Income Tax Benefits   | 41                 | 17         | 55                | 113        |
| Loss from Discontinued Operations — Net                       | \$ (76)            | \$ (33)    | \$ (101)          | \$ (235)   |
| Earnings Per Common Share from Discontinued Operations — Net: |                    |            |                   |            |
| Basic   | \$ (0.002)         | \$ (0.001) | \$ (0.004)        | \$ (0.008) |
| Diluted   | \$ (0.003)         | \$ (0.001) | \$ (0.004)        | \$ (0.008) |

#### 4. COMMON STOCK:

The following shares were issued and outstanding at September 30:

|                               | 2008       |
|-------------------------------|------------|
| Beginning Balance, January 1  | 29,607,802 |
| New Issues During Period:     |            |
| Dividend Reinvestment Plan    | 60,390     |
| Stock-Based Compensation Plan | 60,505     |
| Ending Balance, September 30  | 29,728,697 |

The par value (\$1.25 per share) of stock issued was recorded in Common Stock and the net excess over par value of approximately \$1.9 million, was recorded in Premium on Common Stock.

**EARNINGS PER COMMON SHARE** — Basic EPS is based on the weighted-average number of common shares outstanding. EPS is presented in accordance with FASB Statement No. 128, “Earnings Per Share,” which establishes standards for computing and presenting basic and diluted EPS. The incremental shares required for inclusion in the denominator for the diluted EPS calculation were 136,718 and 108,703 shares for the three months ended September 30, 2008 and 2007, respectively, and 129,124 and 112,199 shares for the nine months ended September 30, 2008 and 2007, respectively. These shares relate to SJI’s restricted stock as discussed in Note 2.

**DIVIDEND REINVESTMENT PLAN (DRP)** — Through April 2008, shares of common stock offered through the DRP have been new shares issued directly by SJI. Beginning in April 2008, shares of common stock offered by the DRP have been purchased in open market transactions.

#### 5. RESTRICTED INVESTMENTS:

In accordance with the terms of the Marina and certain SJG loan agreements, unused proceeds are required to be escrowed pending approved construction expenditures. As of September 30, 2008 and December 31, 2007, the escrowed proceeds, including interest earned, totaled \$6.5 million.

SJRG maintains a margin account with a national investment firm to support its risk management activities. The balance required to be held in this margin account increases as the net value of the outstanding energy related financial contracts with this investment firm decreases. As of September 30, 2008, the balance in this account was \$11.2 million. As of December 31, 2007, the Company was holding \$4.1 million in a margin account received from this investment firm as the value of the related financial contracts had increased. The balance as of December 31, 2007 is reflected in Margin Account Liability on the condensed consolidated balance sheets.

SJI - 14

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## 6. SEGMENTS OF BUSINESS:

SJI operates in several different reportable operating segments. Gas Utility Operations (SJG) consists primarily of natural gas distribution to residential, commercial and industrial customers. Wholesale Gas Operations include SJRG's activities. SJE is involved in both retail gas and retail electric activities. Retail Gas and Other Operations include natural gas acquisition and transportation service business lines. Retail Electric Operations consist of electricity acquisition and transportation to commercial and industrial customers. On-Site Energy Production consists of Marina's thermal energy facility and other energy-related projects. Appliance Service Operations includes SJESP's servicing of appliances via the sale of appliance service programs as well as on a time and materials basis, and the installation of residential and small commercial HVAC systems.

Information about SJI's operations in different reportable operating segments is presented below (in thousands):

|                                       | Three Months Ended |            | Nine Months Ended |            |
|---------------------------------------|--------------------|------------|-------------------|------------|
|                                       | September 30,      |            | September 30,     |            |
|                                       | 2008               | 2007       | 2008              | 2007       |
| <b>Operating Revenues:</b>            |                    |            |                   |            |
| Gas Utility Operations                | \$ 64,563          | \$ 84,421  | \$ 396,038        | \$ 458,280 |
| Wholesale Gas Operations              | 79,828             | 18,176     | 76,225            | 55,059     |
| Retail Gas and Other Operations       | 37,670             | 29,393     | 138,635           | 128,126    |
| Retail Electric Operations            | 15,313             | 13,502     | 48,876            | 39,079     |
| On-Site Energy Production             | 14,123             | 11,419     | 37,092            | 30,601     |
| Appliance Service Operations          | 4,891              | 4,228      | 14,100            | 11,924     |
| Corporate & Services                  | 4,139              | 3,203      | 13,135            | 9,989      |
| Subtotal                              | 220,527            | 164,342    | 724,101           | 733,058    |
| Intersegment Sales                    | (10,114)           | (8,114)    | (29,801)          | (36,744)   |
| Total Operating Revenues              | \$ 210,413         | \$ 156,228 | \$ 694,300        | \$ 696,314 |
| <b>Operating Income:</b>              |                    |            |                   |            |
| Gas Utility Operations                | \$ 1,184           | \$ 2,190   | \$ 58,613         | \$ 59,637  |
| Wholesale Gas Operations              | 72,122             | 14,319     | 34,474            | 27,624     |
| Retail Gas and Other Operations       | 322                | 164        | 2,311             | 108        |
| Retail Electric Operations            | 619                | 412        | 1,656             | 1,789      |
| On-Site Energy Production             | 4,094              | 2,925      | 9,030             | 7,049      |
| Appliance Service Operations          | 752                | 602        | 1,780             | 531        |
| Corporate and Services                | 234                | 255        | 1,088             | 498        |
| Total Operating Income                | \$ 79,327          | \$ 20,867  | \$ 108,952        | \$ 97,236  |
| <b>Depreciation and Amortization:</b> |                    |            |                   |            |
| Gas Utility Operations                | \$ 7,804           | \$ 7,305   | \$ 23,283         | \$ 21,751  |
| Wholesale Gas Operations              | 28                 | 2          | 59                | 5          |
| Retail Gas and Other Operations       | 4                  | 4          | 13                | 9          |
| Appliance Services Operations         | 73                 | 74         | 227               | 206        |
| On-Site Energy Production             | 784                | 724        | 2,289             | 2,225      |
| Corporate and Services                | 111                | 31         | 312               | 185        |
| Total Depreciation and Amortization   | \$ 8,804           | \$ 8,140   | \$ 26,183         | \$ 24,381  |
| <b>Interest Charges:</b>              |                    |            |                   |            |

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|                                 |           |           |           |           |
|---------------------------------|-----------|-----------|-----------|-----------|
| Gas Utility Operations          | \$ 4,586  | \$ 5,371  | \$ 14,179 | \$ 15,403 |
| Wholesale Gas Operations        | 201       | 563       | 407       | 1,758     |
| Retail Gas and Other Operations | 3         | 19        | 111       | 155       |
| On-Site Energy Production       | 905       | 913       | 2,515     | 2,707     |
| Corporate and Services          | 317       | 1,036     | 942       | 2,906     |
| Subtotal                        | 6,012     | 7,902     | 18,154    | 22,929    |
| Intersegment Borrowings         | (267)     | (936)     | (908)     | (2,806)   |
| Total Interest Charges          | \$ 5,745  | \$ 6,966  | \$ 17,246 | \$ 20,123 |
| Property Additions:             |           |           |           |           |
| Gas Utility Operations          | \$ 13,900 | \$ 12,040 | \$ 37,171 | \$ 36,333 |
| Wholesale Gas Operations        | 1,359     | 330       | 4,697     | 330       |
| Retail Gas and Other Operations | 0         | 18        | 0         | 49        |
| Appliance Service Operations    | 5         | 29        | 25        | 173       |
| On-Site Energy Production       | 1,340     | 1,334     | 2,581     | 4,734     |
| Corporate and Services          | (664)     | 230       | 44        | 883       |
| Total Property Additions        | \$ 15,940 | \$ 13,981 | \$ 44,518 | \$ 42,502 |

SJI - 15

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|                                 | September 30,<br>2008 | December 31,<br>2007 |
|---------------------------------|-----------------------|----------------------|
| Identifiable Assets:            |                       |                      |
| Gas Utility Operations          | \$ 1,251,540          | \$ 1,227,162         |
| Wholesale Gas Operations        | 203,955               | 142,848              |
| Retail Gas and Other Operations | 32,913                | 42,735               |
| Retail Electric Operations      | 9,177                 | 7,082                |
| On-Site Energy Production       | 129,707               | 124,982              |
| Appliance Service Operations    | 17,276                | 16,060               |
| Discontinued Operations         | 2,164                 | 2,604                |
| Corporate and Services          | 86,126                | 58,274               |
| Subtotal                        | 1,732,858             | 1,621,747            |
| Intersegment Assets             | (99,547)              | (92,306)             |
| Total Identifiable Assets       | \$ 1,633,311          | \$ 1,529,441         |

#### 7. RATES AND REGULATORY ACTIONS:

SJG is subject to the rules and regulations of the BPU. In August 2008 the BPU approved the statewide funding of the New Jersey Clean Energy Program (NJCEP) of \$1.2 billion for the years 2009 through 2012. Of this amount, SJG will be responsible for the collection and remittance of approximately \$41.5 million over the four year period to the State. This mechanism recovers costs associated with SJG's energy efficiency and renewable energy programs. NJCEP adjustments affect revenue and cash flows but do not directly affect earnings as related cost are deferred and recovered through rates on an on-going basis.

There have been no other significant regulatory actions or changes to SJG's rate structure since December 31, 2007. See Note 9 to the Consolidated Financial Statements in Item 8 of SJI's Annual Report on Form 10-K as of December 31, 2007.

#### 8. REGULATORY ASSETS & REGULATORY LIABILITIES:

Other than the Deferred Gas Costs and Revenues — Net, discussed below, there have been no significant changes to the nature of the Company's regulatory assets and liabilities since December 31, 2007 which are described in Note 10 to the Consolidated Financial Statements in Item 8 of SJI's Annual Report on Form 10-K as of December 31, 2007.

Regulatory Assets consisted of the following items (in thousands):

|  | September<br>30,<br>2008 | December<br>31,<br>2007 |
|--|--------------------------|-------------------------|
| Environmental Remediation Costs:           |                          |                         |
| Expended - Net                             | \$ 43,930                | \$ 25,960               |
| Liability for Future Expenditures          | 71,161                   | 73,880                  |
| Income Taxes-Flowthrough Depreciation      | 2,974                    | 3,707                   |
| Deferred Asset Retirement Obligation Costs | 21,942                   | 21,572                  |
|  | 32,422                   | 32,686                  |

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Deferred Pension and Other Postretirement Benefit

Costs

|   |                |                |
|---|----------------|----------------|
| Interest Rate Swaps                       | 1,413          | -              |
| Deferred Gas Costs and Revenues - Net     | 10,913         | -              |
| Temperature Adjustment Clause Receivable  | 399            | 6,516          |
| Conservation Incentive Program Receivable | 23,543         | 18,173         |
| Societal Benefit Costs Receivable         | 601            | 2,952          |
| Premium for Early Retirement of Debt      | 1,248          | 1,370          |
| Other Regulatory Assets                   | 2,197          | 1,872          |
| <br>Total Regulatory Assets               | <br>\$ 212,743 | <br>\$ 188,688 |

SJI - 16

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Regulatory Liabilities consisted of the following items (in thousands):

|                                       | September<br>30,<br>2008 | December<br>31,<br>2007 |
|---------------------------------------|--------------------------|-------------------------|
| Excess Plant Removal Costs            | \$ 48,814                | \$ 48,705               |
| Liability for NJCEP                   | 1,672                    | 2,797                   |
| Deferred Gas Costs and Revenues - Net | -                        | 2,586                   |
| Other                                 | 1,850                    | 1,691                   |
| <b>Total Regulatory Liabilities</b>   | <b>\$ 52,336</b>         | <b>\$ 55,779</b>        |

DEFERRED GAS COSTS AND REVENUES — NET — Over/under collections of gas costs are monitored through SJG's Basic Gas Supply Service Clause mechanism. Net undercollected gas costs are classified as a regulatory asset and net overcollected gas costs are classified as a regulatory liability. Derivative contracts used to hedge SJG's natural gas purchases are also included in the BGSS, subject to BPU approval. Deferred gas costs and revenues-net shifted from a \$2.6 million liability at December 31, 2007 to a \$10.9 million asset at September 30, 2008. A change in the fair value of SJG's energy related derivatives accounted for \$11.8 million of the fluctuation.

#### 9. PENSION AND OTHER POSTRETIREMENT BENEFITS:

For the three and nine months ended September 30, 2008 and 2007, net periodic benefit cost related to the employee and officer pension and other postretirement benefit plans consisted of the following components (in thousands):

|   | Pension Benefits      |                       |                       |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | Three Months Ended    |                       | Nine Months Ended     |                       |
|   | September 30,<br>2008 | September 30,<br>2007 | September 30,<br>2008 | September 30,<br>2007 |
| Service Cost                              | \$ 800                | \$ 738                | \$ 2,399              | \$ 2,593              |
| Interest Cost                             | 2,080                 | 1,737                 | 6,240                 | 6,049                 |
| Expected Return on Plan Assets            | (2,605)               | (2,201)               | (7,814)               | (7,817)               |
| Amortizations:                            |                       |                       |                       |                       |
| Prior Service Cost                        | 73                    | 64                    | 219                   | 229                   |
| Actuarial Loss                            | 402                   | 448                   | 1,206                 | 1,482                 |
| Net Periodic Benefit Cost                 | 750                   | 786                   | 2,250                 | 2,536                 |
| Capitalized Benefit Costs                 | (263)                 | (266)                 | (788)                 | (900)                 |
| <b>Total Net Periodic Benefit Expense</b> | <b>\$ 487</b>         | <b>\$ 520</b>         | <b>\$ 1,462</b>       | <b>\$ 1,636</b>       |

|                                | Other Postretirement Benefits |                       |                       |                       |
|--------------------------------|-------------------------------|-----------------------|-----------------------|-----------------------|
|                                | Three Months Ended            |                       | Nine Months Ended     |                       |
|                                | September 30,<br>2008         | September 30,<br>2007 | September 30,<br>2008 | September 30,<br>2007 |
| Service Cost                   | \$ 242                        | \$ 225                | \$ 726                | \$ 756                |
| Interest Cost                  | 739                           | 618                   | 2,217                 | 2,077                 |
| Expected Return on Plan Assets | (549)                         | (482)                 | (1,646)               | (1,620)               |
| Amortizations:                 |                               |                       |                       |                       |
| Prior Service Credits          | (89)                          | (82)                  | (266)                 | (275)                 |

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|                                    |        |        |          |        |
|------------------------------------|--------|--------|----------|--------|
| Actuarial Loss                     | 186    | 139    | 558      | 469    |
| Net Periodic Benefit Cost          | 529    | 418    | 1,589    | 1,407  |
| Capitalized Benefit Costs          | (188)  | (145)  | (563)    | (525)  |
| Total Net Periodic Benefit Expense | \$ 341 | \$ 273 | \$ 1,026 | \$ 882 |

Capitalized benefit costs reflected in the table above relate to SJG's construction program.

During February 2008, SJI contributed \$5.9 million to its pension plans. No contribution was made during the nine months ended September 30, 2007. SJI does not expect to make additional contributions to its employee pension plans in 2008.

See Note 11 to the Consolidated Financial Statements in Item 8 of SJI's Annual Report on Form 10-K as of December 31, 2007, for additional information related to SJI's pension and other postretirement benefits.

SJI - 17

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10. RETAINED EARNINGS:

SJG is restricted as to the amount of cash dividends or other distributions that may be paid on its common stock by an order issued by the BPU in July 2004 that granted SJG an increase in base rates. Per the order, SJG is required to maintain total common equity of no less than \$289.2 million. SJG's total common equity balance was \$392.6 million at September 30, 2008.

Various loan agreements also contain potential restrictions regarding the amount of cash dividends or other distributions that SJG may pay on its common stock. As of September 30, 2008, these loan restrictions did not affect the amount that may be distributed from either SJG's or SJI's retained earnings.

11. UNUSED LINES OF CREDIT:

Bank credit available to SJI totaled \$403.0 million at September 30, 2008, of which \$225.7 million, inclusive of \$66.6 million of letters of credit, was used. Those bank facilities consist of a \$100.0 million revolving credit facility, a \$10.0 million line of credit and \$53.0 million of uncommitted bank lines available to SJG; and a \$200.0 million revolving credit facility and \$40.0 million of uncommitted bank lines available to SJI. The revolving credit facilities expire in August 2011. All of the facilities contain one financial covenant regarding the ratio of total debt to total capitalization, measured on a quarterly basis. SJI and SJG were in compliance with this covenant as of September 30, 2008. Borrowings under these credit facilities are at market rates. The weighted average borrowing cost, which changes daily, was 3.62% and 5.64% at September 30, 2008 and 2007, respectively.

In June 2008, SJG used \$25.0 million of the revolving credit facility to repurchase its outstanding auction-rate Series A 2006 Bonds at par. Those bonds were remarketed to the public in August 2008 as variable rate demand bonds with liquidity support provided by a letter of credit from a commercial bank as discussed in Note 12. The related borrowings under the revolver were repaid at that time. Material terms of the original bonds, such as the 2036 maturity date, floating rate interest that resets weekly, and a first mortgage collateral position, remain unchanged.

12. COMMITMENTS AND CONTINGENCIES:

**GUARANTEES** — The Company has recorded a liability of \$2.0 million in Other Noncurrent Liabilities on the condensed consolidated balance sheets as of September 30, 2008 and December 31, 2007 for the fair value of the following guarantees:

- In April 2007, SJI guaranteed certain obligations of LVE Energy Partners, LLC (LVE) an unconsolidated joint venture in which Marina has a 50% equity interest. LVE entered into a 25-year contract with a resort developer to design, build, own and operate a district energy system and central energy center for a planned resort in Las Vegas, Nevada. LVE began construction of the facility in 2007 and expected to provide full energy services in 2010 when the resort was originally scheduled to be completed. However, the developer of the resort recently announced that it was delaying construction of the project due to the difficult environment in the capital markets and weak economic conditions. The developer has indicated that they are considering different strategies to move the project forward, including opening the project in phases and obtaining a partner, but that it was unlikely construction would resume during 2009.

As of September 30, 2008, the Company had approximately \$0.4 million included in Investment in Affiliates on the condensed consolidated balance sheets related to this project and an unsecured Note Receivable – Affiliate of approximately \$2.3 million due from LVE. The district energy system and central energy center are being financed by

LVE with debt that is non-recourse to SJI and includes a guaranty by the developer of certain fixed payments to be made under the Energy Sales Agreement until the project begins commercial operations. LVE is currently in discussions with the banks that are financing the energy facilities regarding a plan to address the developer's construction delay. Those discussions include a revised timetable and funding schedule for the completion of construction of the energy facilities, and the potential contribution of additional equity. SJI is obligated to invest at least \$30.0 million of equity during the construction period as discussed below and may invest up to an additional \$9.0 million. SJI's risk of loss is limited to its equity contribution and the unsecured Note Receivable.

SJI - 18

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SJI has issued a performance guaranty for up to \$180.0 million to the resort developer to ensure that certain construction milestones relating to the development of the thermal facility are met. Concurrently, SJI is the beneficiary of a surety bond purchased by the project's general contractor that provides SJI with assurance that construction of the thermal facility will meet those same milestones. Those milestones are currently being revised due to delays announced by the project developer. In addition, SJI has guaranteed the obligations of LVE under certain insurance policies during the construction period. The maximum amount that SJI could be obligated for, in the event that LVE does not have sufficient resources to make deductible payments on future claims under these insurance policies, is approximately \$6.0 million. SJI has also guaranteed certain performance obligations of LVE under the operating agreements between LVE and the resort, up to \$20.0 million each year for the term of the agreement, commencing with the first year of operations. SJI and the partner in this joint venture have entered into reimbursement agreements that secure reimbursement for SJI of a proportionate share of any payments made by SJI on these guarantees.

- In August 2007, SJI guaranteed certain obligations of BC Landfill Energy, LLC (BCLE), an unconsolidated joint venture in which Marina has a 50% equity interest. BCLE has entered into a 20-year agreement with a county government to lease and operate a facility that will produce electricity from landfill methane gas. The facility went online in the fourth quarter of 2007. Although unlikely, the maximum amount that SJI could be obligated for, in the event that BCLE does not meet minimum specified levels of operating performance and no mitigating action is taken, or is unable to meet certain financial obligations as they become due, is approximately \$4.0 million each year. SJI and the partner in this joint venture have entered into reimbursement agreements that secure reimbursement for SJI of a proportionate share of any payments made by SJI on these guarantees.

**CAPITAL CONTRIBUTION OBLIGATION** — In December 2007, Marina and its joint venture partner agreed to each contribute approximately \$30.0 million of equity to LVE as part of its construction period financing. LVE will initially use bank and bond financing to fund project construction and then expects to use contributed equity to complete the project. Marina's obligation is secured by an irrevocable letter of credit from a bank. In the event of a default by LVE on its financing arrangements, the partners may be required to make the equity contributions prior to the end of the construction period.

**STANDBY LETTERS OF CREDIT** — As of September 30, 2008, SJI provided \$66.6 million of standby letters of credit through SJI's revolving credit facility. Letters of credit in the amount of \$62.3 million support variable-rate demand bonds issued through the New Jersey Economic Development Authority (NJEDA) to finance Marina's initial thermal plant project. The additional outstanding letters of credit total \$4.3 million, and were posted to enable SJI to market retail electricity and for various construction activities. The Company also provided two additional letters of credit under separate facilities outside of the revolving credit facility. Those letters of credit consist of a \$25.3 million letter of credit provided by SJG to support variable-rate demand bonds issued through the NJEDA to finance the expansion of SJG's natural gas distribution system as discussed in Note 11; and a \$30.7 million letter of credit provided by Marina to support a capital contribution obligation as discussed above. These letters of credit expire in August 2009 and November 2010, respectively.

**ENVIRONMENTAL REMEDIATION COSTS** — SJI incurred and recorded costs for environmental cleanup of 12 sites where SJG or its predecessors operated gas manufacturing plants. SJG stopped manufacturing gas in the 1950s. SJI and some of its nonutility subsidiaries also accrued costs for environmental cleanup of sites where SJF previously operated a fuel oil business and Morie maintained equipment, fueling stations and storage. There have been no changes to the status of the Company's environmental remediation efforts since December 31, 2007 as described in Note 14 to the Consolidated Financial Statements in Item 8 of SJI's Annual Report on Form 10-K as of December 31, 2007. However, the lower end of the range of expected remediation costs, which is recorded as a liability on the

condensed consolidated balance sheets, has decreased \$2.7 million since December 31, 2007. This decrease is the result of expenditures of \$20.9 million during 2008 and revised forecasts of expected remediation costs for all sites as additional information has become available.

SJI - 19

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## 13. FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES:

Effective January 1, 2008, SJI adopted the provisions of FAS 157 that relate to financial assets and financial liabilities as discussed in Note 1. FAS 157 establishes a hierarchy that prioritizes fair value measurements based on the types of inputs used for the various valuation techniques. The levels of the hierarchy are described below:

- Level 1: Observable inputs such as quoted prices in active markets for identical assets or liabilities.
- Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly; these include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.
- Level 3: Unobservable inputs that reflect the reporting entity's own assumptions.

Assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of financial assets and financial liabilities and their placement within the fair value hierarchy.

For financial assets and financial liabilities measured at fair value on a recurring basis, information about the fair value measurements for each major category as of September 30, 2008 is as follows (in thousands):

|  | Total     | Level 1   | Level 2   | Level 3 |
|--|-----------|-----------|-----------|---------|
| <b>Assets</b>                                |           |           |           |         |
| Available-for-Sale Securities (A)            | \$ 5,653  | \$ 5,653  | \$ -      | \$ -    |
| Derivatives – Energy Related Assets (B)      | 60,748    | 28,514    | 32,234    | -       |
|  | \$ 66,401 | \$ 34,167 | \$ 32,234 | \$ -    |
| <b>Liabilities</b>                           |           |           |           |         |
| Derivatives – Energy Related Liabilities (B) | \$ 41,576 | \$ 17,013 | \$ 24,563 | \$ -    |
| Derivatives – Other (C)                      | 3,089     | -         | 3,089     | -       |
|  | \$ 44,665 | \$ 17,013 | \$ 27,652 | \$ -    |

(A) Available-for-Sale Securities are valued using the quoted principal market close prices that are provided by the trustees of these securities.

(B) Derivatives – Energy Related Assets and Liabilities are traded in both exchange-based and non-exchange-based markets. Exchange-based contracts are valued using unadjusted quoted market sources in active markets and are categorized in Level 1 in the fair value hierarchy. Certain non-exchange-based contracts are valued using indicative price quotations available through brokers or over-the-counter, on-line exchanges and are categorized in Level 2. These price quotations reflect the average of the bid-ask mid-point prices and are obtained from sources that management believes provide the most liquid market. Management reviews and corroborates the price quotations to ensure the prices are observable which includes consideration of actual transaction volumes, market delivery points, bid-ask spreads and contract duration.

(C) Derivatives – Other are valued using quoted prices on commonly quoted intervals, which are interpolated for periods different than the quoted intervals, as inputs to a market valuation model. Market inputs can generally be verified and model selection does not involve significant management judgment.



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

**Forward-Looking Statements and Risk Factors** — Certain statements contained in this Quarterly Report may qualify as “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements other than statements of historical fact included in this Report should be considered forward-looking statements made in good faith and are intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. Words such as “anticipate”, “believe”, “expect”, “estimate”, “forecast”, “goal”, “intend”, “objective”, “plan”, “project”, “seek”, “strategy” and similar expressions identify forward-looking statements. Such forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those expressed or implied in the statements. These risks and uncertainties include, but are not limited to, the following: general economic conditions on an international, national, state and local level; weather conditions in our marketing areas; changes in commodity costs; changes in the availability of natural gas; “non-routine” or “extraordinary” disruptions in our distribution system; regulatory, legislative and court decisions; competition; the availability and cost of capital; costs and effects of legal proceedings and environmental liabilities; the failure of customers, suppliers or business partners to fulfill their contractual obligations; and changes in business strategies.

A discussion of these and other risks and uncertainties may be found in the Company’s Annual Report on Form 10-K for the year ended December 31, 2007 and in other filings made by us with the Securities and Exchange Commission. These cautionary statements should not be construed by you to be exhaustive and they are made only as of the date of this Quarterly Report on Form 10-Q, or in any document incorporated by reference, at the date of such document. While SJI believes these forward-looking statements to be reasonable, there can be no assurance that they will approximate actual experience or that the expectations derived from them will be realized. Further, SJI undertakes no obligation to update or revise any of its forward-looking statements, whether as a result of new information, future events or otherwise.

**Critical Accounting Policies — Estimates and Assumptions** — Management must make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and related disclosures. Actual results could differ from those estimates. Five types of transactions presented in our condensed consolidated financial statements require a significant amount of judgment and estimation. These relate to regulatory accounting, derivatives, environmental remediation costs, pension and other postretirement employee benefit costs, and revenue recognition. A discussion of these estimates and assumptions may be found in our Form 10-K for the year ended December 31, 2007.

In recent months, declines in the investment markets have negatively impacted the value of our pension and other postretirement benefit plan assets. As a result, SJI anticipates an increase in the amount of pension and other postretirement benefit costs that will be required to be recognized in 2009 and beyond. We are unable to determine these amounts at this time, as changes in the investment performance between now and the end of the year can significantly impact the ultimate determination of these future costs.

**New Accounting Pronouncements** — See detailed discussions concerning New Accounting Pronouncements and their impact on SJI in Note 1 to the condensed consolidated financial statements.

**Regulatory Actions** — Other than the changes discussed in Note 7 to the condensed consolidated financial statements, there have been no significant regulatory actions since December 31, 2007. See detailed discussion concerning Regulatory Actions in Note 9 to the Consolidated Financial Statements in Item 8 of SJI’s Annual Report on Form 10-K as of December 31, 2007.

Environmental Remediation —Other than the changes discussed in Note 12 to the condensed consolidated financial statements, there have been no significant changes to the status of the Company's environmental remediation efforts since December 31, 2007. See detailed discussion concerning Environmental Remediation in Note 14 to the Consolidated Financial Statements in Item 8 of SJI's Annual Report on Form 10-K as of December 31, 2007.

SJI - 21

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## RESULTS OF OPERATIONS:

SJI operates in several different reportable operating segments. Gas Utility Operations (SJG) consists primarily of natural gas distribution to residential, commercial and industrial customers. Wholesale Gas Operations include SJRG's activities. SJE is involved in both retail gas and retail electric activities. Retail Gas and Other Operations include natural gas acquisition and transportation service business lines. Retail Electric Operations consist of electricity acquisition and transportation to commercial and industrial customers. On-Site Energy Production consists of Marina's thermal energy facility and other energy-related projects. Appliance Service Operations includes SJESP's servicing of appliances via the sale of appliance service programs as well as on a time and materials basis, and the installation of residential and small commercial HVAC systems.

A significant portion of the volatility in operating results is due to the impact of the accounting methods associated with SJRG's storage activities. SJRG purchases and holds natural gas in storage to earn a profit margin from its ultimate sale in the future. SJRG uses derivatives to mitigate commodity price risk in order to substantially lock-in the profit margin that will ultimately be realized. However, gas stored in inventory is accounted for at the lower of average cost or market; the derivatives used to reduce the risk associated with a change in the value of the inventory are accounted for at fair value, with changes in fair value recorded in operating results in the period of change. As a result, earnings are subject to volatility as the market prices of derivatives change, even when the underlying hedged value of the inventory is unchanged. This volatility can be significant from period to period. Over time, gains or losses on the sale of gas in storage will be offset by losses or gains on the derivatives, resulting in the realization of the profit margin expected when the transactions were initiated.

Net Income for the three months ended September 30, 2008 increased \$35.3 million, or 413% to net income of \$43.8 million compared to the three months ended September 30, 2007. Net Income for the nine months ended September 30, 2008 increased \$8.9 million, or 19% to \$55.2 million compared to the nine months ended September 30, 2007. This increase is primarily due to the unrealized gains on derivatives used by SJRG to mitigate commodity price risk, as discussed above. These changes are also discussed in more detail below.

The following tables summarize the composition of selected SJG data for the three and nine months ended September 30 (in thousands, except for degree day data):

|                                    | Three Months Ended<br>September 30, |       | Nine Months Ended<br>September 30, |        |
|------------------------------------|-------------------------------------|-------|------------------------------------|--------|
|                                    | 2008                                | 2007  | 2008                               | 2007   |
| Utility Throughput – dth:          |                                     |       |                                    |        |
| Firm Sales -                       |                                     |       |                                    |        |
| Residential                        | 1,559                               | 1,556 | 14,490                             | 16,069 |
| Commercial                         | 652                                 | 637   | 4,065                              | 4,497  |
| Industrial                         | 13                                  | 17    | 103                                | 138    |
| Cogeneration & Electric Generation | 156                                 | 791   | 528                                | 953    |
| Firm Transportation -              |                                     |       |                                    |        |
| Residential                        | 136                                 | 129   | 1,351                              | 1,273  |
| Commercial                         | 598                                 | 607   | 3,927                              | 4,271  |
| Industrial                         | 3,095                               | 2,835 | 9,542                              | 8,903  |
| Cogeneration & Electric Generation | 1,115                               | 1,288 | 2,040                              | 2,415  |
| Total Firm Throughput              | 7,324                               | 7,860 | 36,046                             | 38,519 |

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|                              |        |        |        |         |
|------------------------------|--------|--------|--------|---------|
| Interruptible Sales          | 1      | 1      | 28     | 39      |
| Interruptible Transportation | 509    | 722    | 2,034  | 2,101   |
| Off-System                   | 1,458  | 3,505  | 7,330  | 13,419  |
| Capacity Release             | 20,196 | 23,738 | 47,253 | 55,217  |
| Total Throughput             | 29,488 | 35,826 | 92,691 | 109,295 |

SJI - 22

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|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |             |
|--|-------------------------------------|------------|------------------------------------|-------------|
|  | 2008                                | 2007       | 2008                               | 2007        |
| Utility Operating Revenues:                      |                                     |            |                                    |             |
| Firm Sales -                                     |                                     |            |                                    |             |
| Residential                                      | \$ 26,587                           | \$ 33,386  | \$ 214,098                         | \$ 247,641  |
| Commercial                                       | 9,650                               | 10,113     | 53,449                             | 57,760      |
| Industrial                                       | 874                                 | 1,013      | 6,051                              | 6,419       |
| Cogeneration & Electric Generation               | 2,166                               | 6,202      | 7,453                              | 8,269       |
| Firm Transportation -                            |                                     |            |                                    |             |
| Residential                                      | 1,081                               | 1,136      | 7,161                              | 5,924       |
| Commercial                                       | 2,124                               | 2,293      | 12,532                             | 11,917      |
| Industrial                                       | 2,974                               | 3,497      | 9,247                              | 9,230       |
| Cogeneration & Electric Generation               | 599                                 | 657        | 1,356                              | 1,603       |
| <br>Total Firm Revenues                          | <br>46,055                          | <br>58,297 | <br>311,347                        | <br>348,763 |
| <br>Interruptible Sales                          | <br>22                              | <br>14     | <br>304                            | <br>450     |
| Interruptible Transportation                     | 334                                 | 451        | 1,301                              | 1,389       |
| Off-System                                       | 14,403                              | 22,008     | 72,989                             | 98,304      |
| Capacity Release                                 | 3,512                               | 3,324      | 9,265                              | 8,406       |
| Other  | 237                                 | 326        | 832                                | 968         |
|  | 64,563                              | 84,420     | 396,038                            | 458,280     |
| Less: Intercompany Sales                         | 876                                 | 1,035      | 2,776                              | 17,207      |
| Total Utility Operating Revenues                 | 63,687                              | 83,385     | 393,262                            | 441,073     |
| <br>Less:  |                                     |            |                                    |             |
| Cost of Sales                                    | \$ 40,324                           | \$ 61,188  | \$ 261,604                         | \$ 314,408  |
| Conservation Recoveries*                         | 1,116                               | 633        | 6,149                              | 2,888       |
| RAC Recoveries*                                  | 695                                 | 472        | 2,084                              | 1,417       |
| Revenue Taxes                                    | 871                                 | 883        | 5,913                              | 6,316       |
| Utility Margin                                   | \$ 20,681                           | \$ 20,209  | \$ 117,512                         | \$ 116,044  |
| <br>Margin:                                      |                                     |            |                                    |             |
| Residential                                      | \$ 12,094                           | \$ 11,841  | \$ 69,230                          | \$ 73,593   |
| Commercial and Industrial                        | 6,185                               | 6,360      | 27,334                             | 29,345      |
| Cogeneration and Electric Generation             | 641                                 | 793        | 1,540                              | 1,772       |
| Interruptible                                    | 11                                  | 31         | 92                                 | 129         |
| Off-system & Capacity Release                    | 572                                 | 596        | 2,160                              | 2,186       |
| Other Revenues                                   | 1,085                               | 603        | 1,868                              | 1,429       |
| Margin Before Weather Normalization & Decoupling | 20,588                              | 20,224     | 102,224                            | 108,454     |
| CIP Mechanism                                    | 93                                  | (15)       | 15,288                             | 7,590       |
| Utility Margin                                   | \$ 20,681                           | \$ 20,209  | \$ 117,512                         | \$ 116,044  |
| <br>Degree Days:                                 | <br>18                              | <br>21     | <br>2,753                          | <br>2,986   |

\*Represents revenues for which there is a corresponding charge in operating expenses. Therefore, such recoveries have no impact on our financial results.

Throughput - Total gas throughput decreased 17.7% and 15.2% for the three and nine months ended September 30, 2008, respectively, compared with the same periods in 2007. Firm throughput declined in both the residential and commercial markets as a result of warmer weather as reflected by the degree day data in the table above, and customer conservation. Off-System sales (OSS) and capacity release volume decreased substantially as SJG's portfolio of assets available for such activities has been reduced under the Conservation Incentive Program, as discussed under "Rates and Regulation" in Item 7 of SJI's Annual Report on Form 10-K as of December 31, 2007.

SJI - 23

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Conservation Incentive Program (CIP) - The effects of the CIP on SJG's net income for the three and nine months ended September 30, 2008 and 2007 and the associated weather comparisons were as follows (\$'s in millions):

|                                     | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |        |
|-------------------------------------|-------------------------------------|--------|------------------------------------|--------|
|                                     | 2008                                | 2007   | 2008                               | 2007   |
| Net Income Benefit:                 |                                     |        |                                    |        |
| CIP – Weather Related               | \$ -                                | \$ -   | \$ 1.6                             | \$ 0.2 |
| CIP – Usage Related                 | 0.1                                 | -      | 7.4                                | 4.2    |
| Total Net Income Benefit            | \$ 0.1                              | \$ -   | \$ 9.0                             | \$ 4.4 |
|                                     | 62.5%                               | 56.2%  | 9.0%                               | 1.3%   |
| Weather Compared to 20-Year Average | warmer                              | warmer | warmer                             | warmer |
|                                     | 14.3%                               | 40.0%  | 7.8%                               | 14.9%  |
| Weather Compared to Prior Year      | warmer                              | warmer | warmer                             | colder |

Operating Revenues – Utility - Revenues for SJG, net of intercompany transactions decreased \$19.7 million, or 23.6% during the third quarter of 2008 compared with the same period in the prior year. Off-System sales (OSS) revenue decreased \$7.6 million, prior to eliminating intercompany transactions, due to the reduction of SJG's portfolio of assets available for OSS that has been reduced under the CIP as discussed above. In addition, total firm revenues decreased during the third quarter of 2008 compared to the same period in the prior year primarily due to lower residential revenues resulting from a lower Basic Gas Supply Service (BGSS) rate in effect during the first nine months of 2008. The 2008 BGSS rate was 12.7% lower than the rate in effect during the same time last year. SJG reduced its BGSS rate in October 2007 primarily due to a combination of actual and forecasted decreases in wholesale gas costs. However, as the Company does not profit from the sale of the commodity, the BGSS rate decrease did not have an impact on Company profitability. Finally, SJG experienced lower sales to the region's electric utility as demand for natural gas to generate electricity during the summer months decreased substantially. Since the majority of SJG's profits from electric generation sales are contractually fixed, the decrease in volume and revenue had little impact on profitability.

During the first nine months of 2008, revenues for SJG, net of intercompany transactions, decreased \$47.8 million, or 10.8%, compared with the same period in the prior year. OSS revenue decreased \$25.3 million, prior to eliminating intercompany transactions, due to the reduction of SJG's portfolio of assets available for OSS as discussed above. Next, weather was 7.8% warmer than last year during this nine-month period which contributed significantly to a \$37.4 million, or 10.7%, reduction in firm sales revenue. Further, the Basic Gas Supply Service (BGSS) rate in effect during the first nine months of 2008 was 12.7% lower than the rate in effect during the same time last year. As previously mentioned, SJG reduced its BGSS rate in October 2007; however, the rate decrease did not have an impact on Company profitability. Partially offsetting these decreases, SJG added 4,214 customers during the 12-month period ended September 30, 2008, which represents a 1.3% increase in total customers.

Operating Revenues — Nonutility — Combined revenues for SJI's nonutility businesses, net of intercompany transactions, increased by \$73.9 million and \$45.8 million for the three and nine months ended September 30, 2008, respectively, compared with the same periods of 2007.

SJE's revenues from retail gas, net of intercompany transactions, increased by \$8.0 million and \$9.4 million for the three and nine months ended September 30, 2008, respectively, compared with the same periods of 2007. This increase is due mainly to substantially higher natural gas prices in 2008 partially offset by the decline in residential

and commercial customer counts. SJE had 11,181 residential customers as of September 30, 2008, compared with 15,129 residential customers as of September 30, 2007. Market conditions and utility pricing are making it difficult to acquire and retain these customers. SJE's commercial customer count also decreased from 1,663 as of September 30, 2007 to 1,316 as of September 30, 2008. During 2007, we strategically reduced our exposure in the heat-sensitive market due to price volatility and weather risk. Prospective marketing efforts are focused on the pursuit of non-heat-sensitive commercial customers.

SJE's revenues from retail electricity, net of intercompany transactions, increased \$0.9 million and \$6.7 million for the three and nine months ended September 30, 2008, respectively, compared with the same periods of 2007, due mainly to higher electricity commodity prices and the addition of several new commercial customers in the New England area.

SJI - 24

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SJRG's revenues, net of intercompany transactions, increased \$61.7 million and \$21.2 million for the three and nine months ended September 30, 2008, respectively, compared with the same periods of 2007. Excluding the impact of the net change in unrealized gains and losses recorded on forward financial contracts due to price volatility, SJRG's revenues increased \$7.7 million and \$28.0 million for the three and nine months ended September 30, 2008, respectively, compared with the same periods of 2007. A summary of SJRG's revenue for the three and nine months ended September 30 is as follows (in millions):

|  | Three Months Ended<br>September 30, |         |         | Nine Months Ended<br>September 30, |         |         |
|--|-------------------------------------|---------|---------|------------------------------------|---------|---------|
|  | 2008                                | 2007    | Change  | 2008                               | 2007    | Change  |
| SJRG Revenue                                   | \$ 79.8                             | \$ 18.1 | \$ 61.7 | \$ 75.9                            | \$ 54.7 | \$ 21.2 |
| Subtract: Unrealized Gains                     | (71.7)                              | (17.7)  | (54.0)  | (2.0)                              | (8.8)   | 6.8     |
| SJRG Revenue, Excluding<br>Unrealized<br>Gains | \$ 8.1                              | \$ 0.4  | \$ 7.7  | \$ 73.9                            | \$ 45.9 | \$ 28.0 |

The increase in revenues for the three months ended September 30, 2008 compared with the same period of 2007 is mainly due to realized gains on storage injection hedges recorded in 2008 versus realized losses recorded in 2007. These hedge gains and losses are a product of market conditions and represent a temporary inventory cycle timing difference. The increase in revenues for the comparative nine-month periods is also attributable to a 47.4% increase in sales of storage volumes. As discussed in Note 1 to the condensed consolidated financial statements, revenues and expenses related to the energy trading activities of SJRG are presented on a net basis in Operating Revenues – Nonutility.

Revenues for Marina increased \$2.7 million and \$6.5 million for the three and nine months ended September 30, 2008, respectively, compared with the same periods of 2007 due mainly to higher rates on chilled and hot water, and increased chilled water consumption. Higher rates were driven by higher underlying commodity prices. The opening of Borgata's new Water Club tower and record warm temperatures in June and July were the principal drivers of the increased chilled water consumption. For the three months ended September 30, 2008 hot water consumption increased 30.1% and chilled water consumption increased 10.2% compared to the same period of 2007. For the nine months ended September 30, 2008, hot water consumption decreased 0.8% and chilled water consumption increased 9.7% compared to the same period of 2007. Typically, revenues from chilled water sales are substantially higher than revenues from hot water sales.

Revenues for SJESP increased \$0.7 million and \$2.2 million for the three and nine months ended September 30, 2008, respectively, compared with the same periods of 2007 due mainly to the increase in sales across all main product lines.

**Margin (pre-tax) — Utility**— SJG's margin is defined as natural gas revenues less natural gas costs; volumetric and revenue based energy taxes; and regulatory rider expenses. We believe that margin provides a more meaningful basis for evaluating utility operations than revenues since natural gas costs, energy taxes and regulatory rider expenses are passed through to customers, and therefore, have no effect on margin. Natural gas costs are charged to operating expenses on the basis of therm sales at the prices approved by the New Jersey Board of Public Utilities through the BGSS tariff.

Total margin increased \$0.5 million, or 2.3%, for the three months ended September 30, 2008 compared with the same period in 2007 due to customer additions, as noted above, and increased profits earned through SJG's Storage Incentive Mechanism (SIM). The SIM allows SJG to retain 20% of storage-related gains and losses as measured against an

established benchmark. The balance of these gains and losses are passed through to customers as part of the BGSS. Partially offsetting these increases were lower margins from electric utility sales discussed above.

Total margin increased \$1.5 million, or 1.3%, for the nine months ended September 30, 2008 compared with the same period in 2007 primarily due to customer additions and higher SIM profits, as noted above. Partially offsetting these increases were lower electric utility sales margins as noted above. The CIP protected \$15.3 million of pre-tax margin in the first nine months of 2008 that would have been lost due to lower customer usage, compared to \$7.6 million in the same period last year. Of these amounts, \$2.7 million and \$0.5 million were related to weather variations and \$12.6 million and \$7.1 million were related to other customer usage variations in 2008 and 2007, respectively.

SJI - 25

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Gross Margin — Nonutility — Gross margin for the nonutility businesses is defined as revenue less all costs that are directly related to the production, selling and delivery of the company's products and services. These costs primarily include natural gas and electric commodity costs as well as certain payroll and related benefits. On the statements of condensed consolidated income, revenue is reflected in Operating Revenues - Nonutility and the costs are reflected in Cost of Sales - Nonutility. As discussed in Note 1 to the Condensed Consolidated Financial Statements, revenues and expenses related to the energy trading activities of SJRG are presented on a net basis in Operating Revenues - Nonutility.

For the three and nine months ended September 30, 2008, combined gross margins for the nonutility businesses, net of intercompany transactions, increased \$59.9 million and \$13.5 million, respectively, compared with the same periods in 2007. This increase is primarily due to the following:

- Gross Margin for SJRG increased \$58.0 million and \$7.5 million for the three and nine months ended September 30, 2008, respectively, compared with the same periods of 2007. Excluding the impact of the net change in unrealized gains and losses recorded on forward financial contracts as discussed above, gross margin for SJRG increased \$4.1 million and \$14.4 million for the three and nine months ended September 30, 2008, respectively, compared with the same periods of 2007. These increases are mainly due to the recognition of storage hedge gains and losses – See Operating Revenues – Nonutility and a refund of previously expensed transportation charges. Storage assets allow SJRG to lock in the differential between purchasing natural gas at low current prices and selling equivalent quantities at higher future prices. Gross margin is generated via seasonal pricing differentials. Future margins could fluctuate significantly due to the volatile nature of wholesale gas prices.
- Gross Margin for Marina increased \$1.6 million and \$3.1 million for the three and nine months ended September 30, 2008, respectively, compared with the same periods of 2007. These increases are due mainly to higher chilled water sales – See Operating Revenues - Nonutility. Gross margin as a percentage of Operating Revenues remained relatively unchanged for the three and nine months ended 2008, respectively, compared with the same periods of 2007.
- Gross margin from SJE's retail gas sales for the three months ended September 30, 2008 did not change significantly compared with the same period in 2007. Retail gas margins increased \$1.8 million for the nine months ended September 30, 2008 compared with the same period of 2007. Gross margin as a percentage of Operating Revenues decreased 1.2 percentage points for the three months ended September 30, 2008 compared to the same period in 2007. This decrease is due mainly to compressed margins across all customer classes resulting from increased competition. Gross margin as a percentage of Operating Revenues increased 1.1 percentage points for the nine months ended September 30, 2008 compared to the same period in 2007. The increase is due mainly to the partial recovery of losses from a full requirements customer in the commercial market that were recognized in 2006. The 2008 margin also includes the impact of our initiatives to actively capitalize on market volatility which resulted in securing more attractive spreads particularly in the first quarter.
- Gross margin from SJE's retail electricity sales during the three and nine months ended September 30, 2008 did not change significantly as compared with the same periods of 2007. Gross margin as a percentage of Operating Revenues remained relatively unchanged for the three and nine months ended September 30, 2008, respectively, compared to the same periods of 2007.
- Gross margin for SJESP during the three months ended September 30, 2008 did not change significantly as compared with the same period of 2007. Gross margins increased \$1.0 million for the nine months ended September 30, 2008 compared with the same period of 2007. Gross margin as a percentage of Operating Revenues remained

relatively unchanged from the three and nine months ended September 30, 2008, respectively, compared to the same periods of 2007. Higher margins resulted from strong installation, time and materials and heater and air conditioner maintenance contracts sales and impact of several cost-cutting initiatives.

SJI - 26

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Operations Expense — A summary of net changes in operations expense, for the three and nine months ended September 30, follows (in thousands):

|                                     | Three<br>Months<br>Ended<br>September<br>30,<br>2008 vs.<br>2007 | Nine Months<br>Ended<br>September<br>30,<br>2008 vs.<br>2007 |
|-------------------------------------|--|--|
| Utility                             | \$ 1,520   | \$ 4,721   |
| Nonutility:                         |  |  |
| Wholesale Gas                       | 233  | 746  |
| Retail Gas and Other                | (163)  | (177)  |
| Retail Electricity                  | (63)   | (8)  |
| On-Site Energy Production           | 343  | 1,022  |
| Appliance Service                   | (3)  | (290)  |
| Total Nonutility                    | 347  | 1,293  |
| Intercompany Eliminations and Other | (28)   | (828)  |
| Total Operations                    | \$ 1,839   | \$ 5,186   |

Utility operations expense increased \$1.5 million and \$4.7 million for the three and nine months ended September 30, 2008, respectively, as compared with the same periods in 2007. These increases are primarily the result of increased spending under the New Jersey Clean Energy Programs (NJCEP) which increased \$0.5 million and \$3.3 million during the three and nine months ended September 30, 2008 compared to the same periods last year, respectively. Such costs are recovered on a dollar-for-dollar basis; therefore, SJG experienced an offsetting increase in revenues during the period. The BPU-approved NJCEP allows for full recovery of costs, including carrying costs when applicable. As a result, the increase in expense had no impact on net income. Other increases in utility operations expense were not significant.

Nonutility Wholesale Gas Operations expense increased \$0.2 million and \$0.7 million for the three and nine months ended September 30, 2008, respectively, compared with the same periods of 2007 due mainly to additional personnel costs to support continued growth.

Nonutility On-Site Energy Production Operations expense increased \$0.3 million and \$1.0 million for the three and nine months ended September 30, 2008, respectively, compared with the same periods of 2007 due mainly to increased engine maintenance costs at our landfill sites and additional personnel costs to support continued growth.

Nonutility Appliance Service Operations expense decreased \$0.3 million in the nine months ended September 30, 2008 compared with the same period in 2007 due mainly to the benefit of several cost cutting initiatives that were implemented towards the end of 2007.

Other changes in Operations Expense were not significant.

Maintenance – Maintenance expense increased during both the three and nine months ended September 30, 2008, compared with the same periods in 2007, primarily due to higher levels of Remediation Adjustment Clause (RAC) amortization. RAC-related expenses do not affect earnings as SJG recognizes an offsetting amount in revenues.

Other Operating Expenses —Changes in other consolidated operating expenses which consist of Maintenance, Depreciation, and Energy and Other Taxes for the three and nine months ended September 30, 2008 compared with the same period in 2007, were not significant.

Interest Charges – Interest charges decreased by \$1.2 million for the three-month period ended September 30, 2008 compared with the same period in 2007, due primarily to lower interest rates on short-term debt and lower total debt levels. For the nine-month period ended September 30, 2008, interest charges decreased by \$2.9 million compared with the same period in 2007, due primarily to lower average levels of short-term debt over the entire period, coupled with lower interest rates on short-term debt. Short-term debt declined primarily due to lower natural gas inventory levels at our commodity marketing business during much of the year. Partially offsetting these factors were higher interest rates incurred on SJG's auction-rate debt.

Discontinued Operations— The losses are primarily comprised of environmental remediation and product liability litigation associated with previously disposed of businesses.

SJI - 27

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## LIQUIDITY AND CAPITAL RESOURCES:

Liquidity needs are driven by factors that include natural gas commodity prices; the impact of weather on customer bills; lags in fully collecting gas costs from customers under the Basic Gas Supply Service charge; working capital needs of our energy trading and marketing activities; the timing of construction and remediation expenditures and related permanent financings; the timing of equity contributions to unconsolidated affiliates; mandated tax payment dates; both discretionary and required repayments of long-term debt; and the amounts and timing of dividend payments.

**Cash Flows from Operating Activities** — Liquidity needs are first met with net cash provided by operating activities. Net cash provided by operating activities totaled \$32.1 million and \$104.5 million for the first nine months of 2008 and 2007, respectively. Net cash provided by operating activities varies from year-to-year primarily due to the impact of weather on customer demand and related gas purchases, customer usage factors related to conservation efforts and the price of the natural gas commodity, inventory utilization and gas cost recoveries. The decrease in cash provided by operating activities for the nine months ended September 30, 2008 compared to the same period in 2007 is primarily the result of higher natural gas prices during the first half of 2008 which resulted in an increase of \$50.7 million of costs in 2008 to fill our natural gas inventories. In addition, the Company incurred an additional \$15.6 million in planned environmental remediation costs during the first nine months of 2008 compared to the same period in 2007.

**Cash Flows from Investing Activities** — SJI has a continuing need for cash resources and capital, primarily to invest in new and replacement facilities and equipment. Net cash outflows for capital expenditures, which are primarily construction projects, for the first nine months of 2008 and 2007 amounted to \$45.0 million and \$40.9 million, respectively. We estimate the net cash outflows for construction projects for fiscal years 2008, 2009 and 2010 to be approximately \$78.0 million, \$71.5 million and \$52.2 million, respectively. The estimated cash outflows for 2008 and 2009 increased from prior estimates due to additional planned expenditures for delivery system infrastructure improvements. Included in the 2008 estimates is \$4.8 million in capital costs accrued but not paid as of December 31, 2007.

In support of its risk management activities, SJRG is required to maintain a margin account with a national investment firm as collateral for its forward contracts, swap agreements, options contracts and futures contracts. This margin account is included in Restricted Investments or Margin Account Liability, depending upon the value of the related financial contracts, (the change in the Margin Account Liability is reflected in cash flows from Operating Activities) on the condensed consolidated balance sheets. The required amount of restricted investments changes on a daily basis due to fluctuations in the market value of the related outstanding contracts and are difficult to predict.

**Cash Flows from Financing Activities** — Short-term borrowings under lines of credit from commercial banks are used to supplement cash from operations, to support working capital needs and to finance capital expenditures as incurred. From time to time, short-term debt incurred to finance capital expenditures is refinanced with long-term debt. In June 2008, SJG repurchased \$25.0 million of its auction-rate securities at par by drawing under its lines of credit. That action resulted in a \$25.0 million reduction in long-term debt on SJG's balance sheet. SJG converted these auction-rate securities to variable rate demand bonds and remarketed them to the public during the third quarter.

Bank facilities available to SJI totaled \$403.0 million at September 30, 2008, of which \$225.7 million, inclusive of \$66.6 million of letters of credit, was used. Those bank facilities consist of a \$100.0 million revolving credit facility, a \$10.0 million line of credit and \$53.0 million of uncommitted bank lines available to SJG; and a \$200.0 million revolving credit facility and \$40.0 million of uncommitted bank lines available to SJI. The revolving credit facilities expire in August 2011 and contain one financial covenant regarding the ratio of total debt to total

capitalization, measured on a quarterly basis. SJI and SJG were in compliance with this covenant as of September 30, 2008. Based upon the existing credit facilities and a regular dialogue with our banks, we believe there will continue to be sufficient credit available to meet our business' future liquidity needs.

SJI supplements its operating cash flow and credit lines with both debt and equity capital. Over the years, SJG has used long-term debt, primarily in the form of First Mortgage Bonds and Medium Term Notes (MTN), secured by the same pool of utility assets, to finance its long-term borrowing needs. These needs are primarily capital expenditures for property, plant and equipment. Other than the conversion of the auction-rate bonds into variable rate demand bonds discussed in Note 11 to the Condensed Consolidated Financial Statements, no long-term debt has been issued since 2006.

SJI - 28

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SJI has raised equity capital over the years through its Dividend Reinvestment Plan (DRP). Participants in SJI's DRP received newly issued shares. Through the end of March 2008, we offered a 2% discount on DRP investments as it was the most cost-effective way to raise equity capital in the quantities we were seeking. Beginning in April 2008, the 2% discount was eliminated and DRP participants began receiving shares purchased in the market. Through the DRP, SJI raised \$2.1 million of equity capital by issuing 60,390 shares during the first nine months of 2008, and \$5.1 million of equity capital by issuing 145,191 shares in the first nine months of 2007. We do not anticipate raising significant amounts of additional equity capital through the DRP in 2008. In September 2008 we announced our intent to establish a stock repurchase program for SJI that could result in the repurchase of up to 1.5 million shares of SJI common stock at any time prior to October 2012. No purchases have been made to date.

SJI's capital structure was as follows:

|                 | As of<br>September 30, 2008 | As of<br>December 31, 2007 |
|-----------------|-----------------------------|----------------------------|
| Common Equity   | 49.9%                       | 50.3%                      |
| Long-Term Debt  | 34.7                        | 37.3                       |
| Short-Term Debt | 15.4                        | 12.4                       |
| Total           | 100.0%                      | 100.0%                     |

SJI's long-term, senior secured debt is rated "A" and "Baa1" by Standard & Poor's and Moody's Investor Services, respectively. These ratings have not changed in the past five years.

SJI has paid dividends on its common stock for 56 consecutive years and has increased that dividend each year for the last nine years. The Company currently looks to grow that dividend by at least 6% to 7% per year and has a targeted payout ratio of between 50% and 60%. In setting the dividend rate, the Board of Directors of SJI considers future earnings expectations, payout ratio, and dividend yield relative to those at peer companies as well as returns available on other income-oriented investments.

#### COMMITMENTS AND CONTINGENCIES:

SJI has a continuing need for cash resources and capital, primarily to invest in new and replacement facilities and equipment, working capital, and for environmental remediation costs. Net cash outflows for capital expenditures and remediation projects for the first nine months of 2008 amounted to \$45.0 and \$20.7 million, respectively. Management estimates net cash outflows for construction projects for 2008, 2009 and 2010, to be approximately \$78.0 million, \$71.5 million and \$52.2 million, respectively, which has increased from prior estimates due to additional planned expenditures for delivery system infrastructure improvements. Total cash outflows for remediation projects are expected to be \$28.1 million, \$15.0 million and \$16.0 million for 2008, 2009 and 2010, respectively. As discussed in Notes 9 and 14 to the Financial Statements in Item 8 of SJI's 10-K as of December 31, 2007, certain environmental costs are subject to recovery from insurance carriers and ratepayers.

SJI is obligated on the letters of credit supporting the variable-rate demand bonds issued through the New Jersey Economic Development Authority by Marina. Commercial banks have issued \$62.3 million of renewing letters of credit under SJI's revolving credit agreement to support the financing of the original construction and recent expansion of Marina's Atlantic City thermal plant project.

SJG has certain commitments for both pipeline capacity and gas supply for which it pays fees regardless of usage. Those commitments as of September 30, 2008, average \$45.8 million annually and total \$166.8 million over the contracts' lives. Approximately 47% of the financial commitments under these contracts expire during the next five years. SJG expects to renew each of these contracts under renewal provisions as provided in each contract. SJG recovers all prudently incurred fees through rates via the Basic Gas Supply Service clause.

There were no significant changes to the Company's contractual obligations described in Note 14 to the Consolidated Financial Statements in Item 8 of SJI's Annual Report on Form 10-K as of December 31, 2007, except for commodity supply purchase obligations which increased by approximately \$57.5 million in total since December 31, 2007, due to the origination of new contracts during the third quarter.

In addition, as discussed in Note 7, SJG's contractual cash obligation under the NJCEP increased by \$32.8 million for the years 2009 through 2012. Expenditures made for this program are recoverable through rates and do not directly affect earnings.

SJI - 29

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**Off-Balance Sheet Arrangements**– An off-balance sheet arrangement is any contractual arrangement involving an unconsolidated entity under which the company has either made guarantees, or has certain other interests or obligations.

The Company has recorded a liability of \$2.0 million in Other Noncurrent Liabilities on the condensed consolidated balance sheets as of September 30, 2008 for the fair value of the following guarantees:

- In April 2007, SJI guaranteed certain obligations of LVE Energy Partners, LLC (LVE) an unconsolidated joint venture in which Marina has a 50% equity interest. LVE entered into a 25-year contract with a resort developer to design, build, own and operate a district energy system and central energy center for a planned resort in Las Vegas, Nevada. LVE began construction of the facility in 2007 and expected to provide full energy services in 2010 when the resort was originally scheduled to be completed. However, the developer of the resort recently announced that it was delaying construction of the project due to the difficult environment in the capital markets and weak economic conditions. The developer has indicated that they are considering different strategies to move the project forward, including opening the project in phases and obtaining a partner, but that it was unlikely construction would resume during 2009. The district energy system and central energy center are being financed by LVE with debt that is non-recourse to SJI and includes a guaranty by the developer of certain fixed payments to be made under the Energy Sales Agreement until the project begins commercial operations. LVE is currently in discussions with the banks that are financing the energy facilities regarding a plan to address the developer's construction delay. Those discussions include a revised timetable and funding schedule for the completion of construction of the energy facilities, and the potential contribution of additional equity. SJI is obligated to invest at least \$30.0 million of equity during the construction period as discussed below and may invest up to an additional \$9.0 million. The Company holds a significant variable interest in LVE but is not the primary beneficiary. SJI's risk of loss is limited to its equity contribution and the unsecured Note Receivable. SJI has issued a performance guarantee for up to \$180.0 million to the resort developer to ensure that certain construction milestones relating to the development of the thermal facility are met. Concurrently, SJI is the beneficiary of a surety bond purchased by the project's general contractor that provides SJI with assurance that construction of the thermal facility will meet those same milestones. Those milestones are currently being revised due to delays announced by the project developer. In addition, SJI has guaranteed the obligations of LVE under certain insurance policies during the construction period. The maximum amount that SJI could be obligated for, in the event that LVE does not have sufficient resources to make deductible payments on future claims under these insurance policies, is approximately \$6.0 million. SJI has also guaranteed certain performance obligations of LVE under the operating agreements between LVE and the resort, up to \$20 million each year for the term of the agreement, commencing with the first year of operations. SJI and the partner in this joint venture have entered into reimbursement agreements that secure reimbursement for SJI of a proportionate share of any payments made by SJI on these guarantees.
- SJI has also guaranteed certain obligations of BC Landfill Energy, LLC (BCLE), an unconsolidated joint venture in which Marina has a 50% equity interest. BCLE has entered into a 20-year agreement with a county government to lease and operate a facility that will produce electricity from landfill methane gas. The facility went online in the fourth quarter of 2007. Although unlikely, the maximum amount that SJI could be obligated for, in the event that BCLE does not meet minimum specified levels of operating performance and no mitigating action is taken, or is unable to meet certain financial obligations as they become due, is approximately \$4.0 million each year. SJI and the partner in this joint venture have entered into reimbursement agreements that secure reimbursement for SJI of a proportionate share of any payments made by SJI on these guarantees. SJI holds a variable interest in BCLE but is not the primary beneficiary.

Capital Contribution Obligation - In December 2007, Marina and its joint venture partner agreed to each contribute approximately \$30 million of equity to LVE as part of its construction period financing. LVE will initially use bank and bond financing to fund project construction and then expects to use contributed equity to complete the project. Marina's obligation is secured by an irrevocable letter of credit from a bank. In the event of a default by LVE on its financing arrangements, the partners may be required to make the equity contributions prior to the end of the construction period.

SJI - 30

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Pending Litigation — SJI is subject to claims arising in the ordinary course of business and other legal proceedings. We accrue liabilities related to claims when we can determine the amount or range of amounts of probable settlement costs. SJI has been named in, among other actions, certain product liability claims related to our former sand mining subsidiary. Management does not currently anticipate the disposition of any known claims to have a material adverse effect on SJI's financial position, results of operations or liquidity.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

Commodity Market Risks — Certain regulated and nonregulated SJI subsidiaries are involved in buying, selling, transporting and storing natural gas and buying and selling retail electricity for their own accounts as well as managing these activities for other third parties. These subsidiaries are subject to market risk due to price fluctuations. To hedge against this risk, we enter into a variety of physical and financial transactions including forward contracts, swaps, futures and options agreements. To manage these transactions, SJI has a well-defined risk management policy approved by our Board of Directors that includes volumetric and monetary limits. Management reviews reports detailing activity daily. Generally, the derivative activities described above are entered into for risk management purposes.

SJG and SJE transact commodities on a physical basis and typically do not enter into financial derivative positions directly. SJRG manages risk for these entities as well as for its own portfolio by entering into the types of transactions noted above. As part of its gas purchasing strategy, SJG uses financial contracts through SJRG to hedge against forward price risk. These contracts are recoverable through SJG's BGSS, subject to BPU approval. It is management's policy, to the extent practical, within predetermined risk management policy guidelines, to have limited unmatched positions on a deal or portfolio basis while conducting these activities. As a result of holding open positions to a minimal level, the economic impact to SJRG of changes in value of a particular transaction is substantially offset by an opposite change in the related hedge transaction.

SJI entered into certain contracts to purchase, sell, and transport natural gas. For those derivatives not designated as hedges, the net unrealized pre-tax gain of \$71.9 million and \$17.8 million during the three months ended September 30, 2008 and 2007, respectively is included with realized gains and losses in Operating Revenues — Nonutility. For the nine months ended September 30, 2008 and 2007, the net unrealized pre-tax gain of \$2.1 million and \$8.8 million, respectively is included with realized gains and losses in Operating Revenues - Nonutility. The fair value and maturity of these energy-trading contracts determined under the mark-to-market method as of September 30, 2008 is as follows (in thousands):

| Assets                 | Source of Fair Value | Maturity < 1 Year | Maturity 1 - 3 Years | Maturity Beyond 3 Years | Total     |
|------------------------|----------------------|-------------------|----------------------|-------------------------|-----------|
| Prices Actively Quoted | NYMEX                | \$ 21,728         | \$ 6,237             | \$ 549                  | \$ 28,514 |
| Other External Sources | Basis                | 22,720            | 9,325                | 189                     | 32,234    |
| Total                  |                      | \$ 44,448         | \$ 15,562            | \$ 738                  | \$ 60,748 |

  

| Liabilities | Source of Fair Value | Maturity < 1 Year | Maturity 1 - 3 Years | Maturity Beyond 3 Years | Total |
|-------------|----------------------|-------------------|----------------------|-------------------------|-------|
|             |                      |                   |                      |                         |       |

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|                        |       |    |        |    |        |    |     |    |        |
|------------------------|-------|----|--------|----|--------|----|-----|----|--------|
| Prices Actively Quoted | NYMEX | \$ | 12,031 | \$ | 4,928  | \$ | 54  | \$ | 17,013 |
| Other External Sources | Basis |    | 19,268 |    | 5,206  |    | 89  |    | 24,563 |
| Total                  |       | \$ | 31,299 | \$ | 10,134 | \$ | 143 | \$ | 41,576 |

NYMEX (New York Mercantile Exchange) is the primary national commodities exchange on which natural gas is traded. Basis represents the price of a NYMEX natural gas futures contract adjusted for the difference in price for delivering the gas at another location. Contracted volumes of our NYMEX contracts are 4.0 million decatherms (dth) with a weighted-average settlement price of \$8.95 per dth. Contracted volumes of our basis contracts are 22.4 million dth with a weighted average settlement price of \$1.29 per dth.

SJI - 31

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A reconciliation of SJI's estimated net fair value of energy-related derivatives follows (in thousands):

|  |           |
|--|-----------|
| Net Derivatives — Energy Related Assets, January 1, 2008           | \$ 16,286 |
| Contracts Settled During Nine Months Ended September 30, 2008, Net | (18,460)  |
| Other Changes in Fair Value from Continuing and New Contracts, Net | 21,346    |
| Net Derivatives — Energy Related Assets September 30, 2008         | \$ 19,172 |

Interest Rate Risk — Our exposure to interest-rate risk relates primarily to short-term, variable-rate borrowings. Short-term, variable-rate debt outstanding at September 30, 2008 was \$159.1 million and averaged \$75.8 million during the first nine months of 2008. A hypothetical 100 basis point (1%) increase in interest rates on our average variable-rate debt outstanding would result in a \$0.4 million increase in our annual interest expense, net of tax. The 100 basis point increase was chosen for illustrative purposes, as it provides a simple basis for calculating the impact of interest rate changes under a variety of interest rate scenarios. Over the past five years, the change in basis points (b.p.) of our average monthly interest rates from the beginning to end of each year was as follows: 2007 – 45 b.p. decrease; 2006 — 67 b.p. increase; 2005 — 194 b.p. increase; 2004 — 115 b.p. decrease; and 2003 — 28 b.p. decrease. For September 2008, our average interest rate on variable-rate debt was 2.99%.

We issue long-term debt either at fixed rates or use interest rate derivatives to limit our exposure to changes in interest rates on variable-rate, long-term debt. As of September 30, 2008, the interest costs on all but \$7.1 million of our long-term debt was either at a fixed-rate or hedged via an interest rate derivative. Consequently, interest expense on existing long-term debt is not significantly impacted by changes in market interest rates. However, due to general market conditions during 2008, the demand for auction-rate securities was disrupted resulting in increased interest rate volatility for tax-exempt auction-rate debt. As a result, the \$25.0 million of tax-exempt auction-rate debt issued by the Company (and repurchased in June 2008) was exposed to changes in interest rates that were not completely mitigated by the related interest rate derivatives. The auction rate debt was converted to another form of variable rate debt and resold in the public market in August 2008. The original interest rate derivatives remain in place and are expected to substantially offset changes in interest rates on the security.

As of September 30, 2008, SJI's active interest rate swaps were as follows:

| Amount        | Fixed Interest Rate | Start Date | Maturity   | Type       | Obligor |
|---------------|---------------------|------------|------------|------------|---------|
| \$ 3,900,000  | 4.795 %             | 12/01/2004 | 12/01/2014 | Taxable    | Marina  |
| \$ 8,000,000  | 4.775 %             | 11/12/2004 | 11/12/2014 | Taxable    | Marina  |
| \$ 20,000,000 | 4.080 %             | 11/19/2001 | 12/01/2011 | Tax-exempt | Marina  |
| \$ 14,500,000 | 3.905 %             | 03/17/2006 | 01/15/2026 | Tax-exempt | Marina  |
| \$ 500,000    | 3.905 %             | 03/17/2006 | 01/15/2026 | Tax-exempt | Marina  |
| \$ 330,000    | 3.905 %             | 03/17/2006 | 01/15/2026 | Tax-exempt | Marina  |
| \$ 7,100,000  | 4.895 %             | 02/01/2006 | 02/01/2016 | Taxable    | Marina  |
| \$ 12,500,000 | 3.430 %             | 12/01/2006 | 02/01/2036 | Tax-exempt | SJG     |
| \$ 12,500,000 | 3.430 %             | 12/01/2006 | 02/01/2036 | Tax-exempt | SJG     |

#### Evaluation of Disclosure Controls and Procedures

The Company's management, with the participation of its chief executive officer and chief financial officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of September 30, 2008. Based on that evaluation, the Company's chief executive officer and chief financial officer concluded that the disclosure controls and procedures employed at the Company are effective.

#### Changes in Internal Control Over Financial Reporting

There has not been any change in the Company's internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, during the fiscal quarter ended September 30, 2008 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

SJI - 32

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## PART II — OTHER INFORMATION

## Item 1. Legal Proceedings

Information required by this Item is incorporated by reference to Part I, Item 2, Pending Litigation, beginning on page 31.

## Item 1A. Risk Factors

The following paragraph should be read in conjunction with the risk factors included in Part I, Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2007:

The inability to obtain capital, particularly short-term capital from commercial banks, could negatively impact the daily operations and financial performance of SJI.

SJI uses short-term borrowings under committed and uncommitted credit facilities provided by commercial banks to supplement cash provided by operations, to support working capital needs, and to finance capital expenditures, as incurred. If the customary sources of short-term capital were no longer available due to market conditions, SJI may not be able to meet its working capital and capital expenditure requirements and borrowing costs could increase.

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

## Issuer Purchases of Equity Securities

The following table presents information about purchases by SJI of its own common stock during the three months ended September 30, 2008:

| Period         | Total Number of Shares Purchased <sup>1</sup> | Average Price Paid Per Share <sup>1</sup> | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs <sup>2</sup> | Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs <sup>2</sup> |
|----------------|---|---|---|---|
| July 2008      | 23,782  | \$ 37.63                                  | -   | -   |
| August 2008    | 2,784   | \$ 35.86                                  | -   | -   |
| September 2008 | -   | -   | -   | -   |
| Total          | 26,566  |   | -   | -   |

<sup>1</sup>The total number of shares purchased and the average price paid per share represent shares purchased in open market transactions under the South Jersey Industries Dividend Reinvestment Plan (the "DRP") by the administrator of the DRP.

<sup>2</sup>On September 22, 2008, SJI publicly announced a share repurchase program under which the Company can purchase up to 5% of its currently outstanding common stock over the next four years. As of September 30, 2008,

no shares have been purchased under this program.

SJI - 33

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Item 6. Exhibits

(a) Exhibits

Exhibit Description

No.

- 31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) of the Exchange Act.
- 31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) of the Exchange Act.
- 32.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(b) of the Exchange Act as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code).
- 32.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(b) of the Exchange Act as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code).

SIGNATURES

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

SOUTH JERSEY INDUSTRIES, INC.

(Registrant)

Dated: November 7, 2008

By: /s/ Edward J. Graham  
Edward J. Graham  
Chairman, President & Chief Executive Officer

Dated: November 7, 2008

By: /s/ David A. Kindlick  
David A. Kindlick  
Vice President & Chief Financial Officer

SJI - 34

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