SOUTH JERSEY INDUSTRIES INC
Form 10-K
March 01, 2007

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

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended **December 31, 2006**

[ ] 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	**22-1901645**
(State of incorporation)	(IRS employer identification no.)

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

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

Securities registered pursuant to Section 12(b) of the Act:

Common Stock ($1.25 par value per share)	**New York Stock Exchange**
(Title of each class)	(Name of exchange on which registered)

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act: Yes [X] No [ ]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Act: Yes [ ] No [X]

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

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

Large accelerated filer [X]	Accelerated filer [ ]	Non-accelerated filer [ ]

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

The aggregate market value of approximately 29,176,671 shares of voting stock held by non-affiliates of the registrant as of June 30, 2006 was $799,149,019. As of February 23, 2007, there were 29,340,537 shares of the registrant's common stock outstanding.

Documents Incorporated by Reference:

In Part I of Form 10-K: None
In Part II of Form 10-K: None
In Part III of Form 10-K: Portions of the registrant's proxy statement filed within 120 days of the close of the registrant's fiscal year in connection with the registrant's 2006 annual meeting of shareholders are incorporated by reference into Part III of this Form 10-K.

Forward Looking Statements

Certain statements contained in this Annual Report on form 10-K 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 by the Company and are intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. When used in this Report, or any other of the Company's documents or oral presentations, words such as "anticipate", "believe", "expect", "estimate", "forecast", "goal", " "objective", "plan", "project", "seek", "strategy" and similar expressions are intended to identify forward-looking statemer 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 risks set forth under "Risk Factors" in Part I, Item 1A of this Annual Report on Form 10-K and elsewhere throughout this Report. These cautionary statements should not be construed by you to be exhaustive and they are made only as of the date of this Report. 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.

Available Information

The Company's Internet address is www.sjindustries.com. We make available free of charge on or through our website SJI's annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission (SEC). The SEC maintains an Internet site that contains these reports at http://www.sec.gov. Also, copies of SJI's annual report will be made available, free of charge, upon written request. The content on any web site referred to in this filing is not incorporated by reference into this filing unless expressly noted otherwise.

Units of Measurement

For Natural Gas:

1 Mcf	= One thousand cubic feet
1 MMcf	= One million cubic feet
1 Bcf	= One billion cubic feet
1dth	= One decatherm
1 MMdth	= One million decatherms

PART I

Item 1. Business

Description of Business

The registrant, South Jersey Industries, Inc. (SJI), a New Jersey corporation, was formed in 1969 for the purpose of owning and holding all of the outstanding common stock of South Jersey Gas Company, a public utility, and acquiring and developing non-utility lines of business.

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

Additional Information on the nature of our business can be found in "Management's Discussion and Analysis of Financial Condition and Results of Operations," under Item 7 of this report.

Financial Information About Industry Segments

Information regarding Industry Segments is incorporated by reference to Note 7 of the consolidated financial statements included under Item 8 of this report.

Sources and Availability of Raw Materials

South Jersey Gas Company

Transportation and Storage Agreements

SJG has direct connections to two interstate pipeline companies, Transcontinental Gas Pipeline Corporation (Transco) and Columbia Gas Transmission Corporation (Columbia). During 2006, SJG purchased and had delivered approximately 47.4 MMdth of natural gas for distribution to both on-system and off-system customers. Of this total, 34.9 MMdth was transported on the Transco pipeline system and 12.5 MMdth was transported on the Columbia pipeline system. SJG also secures firm transportation and other long term services from three additional pipelines upstream of the Transco and Columbia systems. They include Columbia Gulf Transmission Company (Columbia Gulf), Texas Gas Transmission Corporation (Texas Gas) and Dominion Transmission Inc. (Dominion). Services provided by these upstream pipelines are utilized to deliver gas into either the Transco or Columbia systems for ultimate delivery to SJG. Services provided by all of the above-mentioned pipelines are subject to the jurisdiction of the Federal Energy Regulatory Commission (FERC).

Transco:

Transco is SJG’s largest supplier of long-term gas transmission services. These services include six year-round and one seasonal firm transportation (FT) service arrangements. When combined, these services enable SJG to purchase from third parties and have delivered to its city gate stations by Transco a total of 280,525 dth of gas per day (dth/d). The terms of the year-round agreements extend for various periods from 2007 to 2025 while the term of the seasonal agreement extends to 2011.

SJG also has six long-term gas storage service agreements with Transco that, when combined, are capable of storing approximately 6.0 MMdth. Through these services, SJG can inject gas into market area storage during periods of low demand and withdraw gas at a rate of up to 90,017 dth/d during periods of high demand. The terms of the storage service agreements extend for various periods from 2008 to 2013.

Dominion:

SJG has a storage service with Dominion which provides a maximum withdrawal capacity of 10,000 dth per day during the period between November 16 and March 31 of winter season with 423,000 dth of storage capacity. Gas is delivered through both the Dominion and Transco pipeline systems.

Columbia:

SJG has two firm transportation agreements with Columbia which, when combined, provide for 45,022 dth/d of firm deliverability.

SJG also subscribes to a firm storage service from Columbia, to March 31, 2009, which provides a maximum withdrawal quantity of 52,891 dth/d during the winter season with an associated 3,473,022 dth of storage capacity.

Gas Supplies

SJG has two long-term gas supply agreements with a single producer and marketer that expire on October 31, 2007. Under these agreements, SJG can purchase a delivered quantity of up to 7,036,580 dth of natural gas per year. When advantageous, SJG can purchase spot supplies of natural gas in place of or in addition to those volumes reserved under long-term agreements. In recent years, SJG has replaced long-term gas supply contracts with short-term agreements. The short-term agreements are typically for several months in duration. The above contracts will not be renewed.

Supplemental Gas Supplies

During 2006 SJG entered into two separate Liquefied Natural Gas (LNG) sales agreements with third party suppliers. The term of one agreement extended through October 31, 2006, and had an associated contract quantity of 140,000 dth. The second agreement, which extends through July 1, 2007, replaced the first agreement and provides SJG with up to 216,000 dth of LNG.

SJG operates peaking facilities which can store and vaporize LNG for injection into its distribution system. SJG's LNG facility has a storage capacity equivalent to 434,300 dth of natural gas and has an installed capacity to vaporize up to 96,750 dth of LNG per day for injection into its distribution system.

SJG also operates a high-pressure pipe storage field at its New Jersey LNG facility which is capable of storing 12,420 dth of gas and injecting up to 10,350 dth/d of gas per day into SJG's distribution system.

Peak-Day Supply

SJG plans for a winter season peak-day demand on the basis of an average daily temperature of 2 degrees F. Gas demand on such a design day was estimated for the 2006-2007 winter season to be 501,901 dth. SJG projects that it has adequate supplies and interstate pipeline entitlements to meet its design requirements. On February 18, 2006, SJG experienced its highest peak-day demand for the year of 355,919 dth with an average temperature of 23.68 degrees F.

Natural Gas Prices

SJG's average cost of natural gas purchased and delivered in 2006, 2005 and 2004, including demand charges, was $9.27 per dth, $9.36 per dth and $7.11 per dth, respectively.

South Jersey Energy Company

Transportation and Storage Agreements

Access to gas suppliers and cost of gas are significant to the operations of SJE. No material part of the business of SJE is dependent upon a single customer or a few customers. SJE purchases delivered gas only, primarily from SJRG. Consequently, SJE maintains no transportation or storage agreements.

South Jersey Resources Group

Transportation and Storage Agreements

National Fuel Gas Supply Corporation:

SJRG has a long-term storage service agreement with National Fuel Gas Supply Corporation (National Fuel) which extends through March 31, 2008, under which up to 4,746,000 Mcf of gas may be stored during the summer season and up to 48,000 Mcf/d may be withdrawn during the winter season. SJRG entered into a new 11-year contract with National Fuel for an additional 224,576 Mcf of similar storage capacity as of March 31, 2008.

SJRG also has a long-term firm transportation agreement with National Fuel associated with the above-mentioned storage service which extends through March 31, 2008. Under this agreement, National Fuel will provide SJRG with a maximum daily injection transportation quantity of 28,500 Mcf with primary receipt points on Tennessee Gas Pipeline and National Fuel's system storage. The agreement also provides for a maximum daily withdrawal transportation quantity of 48,000 Mcf with primary delivery points on Transcontinental Gas Pipe Line and National Fuel's system storage. Firm transportation rights associated with the new agreement consist of an additional 1,123 Mcf of injection capacity and 2,042 Mcf of withdrawal capacity with primary receipt points on Tennessee Gas pipeline and firm withdrawal rights on Transcontinental pipeline.

Transco

SJRG has a storage agreement with Transco for storage service at Transco's WSS facility which expires in October 2017. Under this evergreen contract, up to 24,500 Mcf/d may be injected during the summer season and up to 51,837 Mcf/d may be withdrawn during the winter season. Up to 4,406,000 Mcf of gas may be stored by SJRG at this facility.

SJRG also has a firm transportation agreement with Transco which expires in October 2017. Under this evergreen contract, Transco will provide SJRG with a maximum daily injection transportation quantity of 20,000 Mcf with firm receipt points in Texas and Louisiana and firm delivery points at South Jersey Gas in New Jersey.

Patents and Franchises

South Jersey Gas Company

SJG holds nonexclusive franchises granted by municipalities in the seven-county area of southern New Jersey that it serves. No other natural gas public utility presently serves the territory covered by SJG’s franchises. Otherwise, patents, trademarks, licenses, franchises and concessions are not material to the business of SJG.

Seasonal Aspects

South Jersey Gas Company

SJG experiences seasonal fluctuations in sales when selling natural gas for heating purposes. SJG meets this seasonal fluctuation in demand from its firm customers by buying and storing gas during the summer months, and by drawing from storage and purchasing supplemental supplies during the heating season. As a result of this seasonality, SJG’s revenues and net income are significantly higher during the first and fourth quarters than during the second and third quarters of the year.

Non-Utility Companies

Among SJI’s non-utility activities, wholesale and retail gas marketing have seasonal patterns similar to SJG’s. Activities such as energy services and energy project development do not follow seasonal patterns. Other activities such as retail electric marketing and appliance service can have seasonal earnings patterns that are different from the utility. While growth in the earnings contributions from nonutility operations has improved SJI’s second and third quarter net income levels, the first and fourth quarters remain the periods where most of SJI’s revenue and net income is produced.

Working Capital Practices

Reference is made to “Liquidity and Capital Resources” on pages 30 to 32 of this report.

Customers

No material part of the Company’s business is dependent upon a single customer or a few customers, the loss of which would have a material adverse effect on SJI performance on a consolidated basis. One of SJI’s subsidiaries, Marina Energy, does currently receive the majority of its revenues and income from one customer. However, that customer is under a long-term contract through 2026.

Backlog

Backlog is not material to an understanding of SJI’s business or that of any of its subsidiaries.

Government Contracts

No material portion of the business of SJI or any of its subsidiaries is subject to renegotiation of profits or termination of contracts or subcontracts at the election of any government.

Competition

Information on competition for SJI and its subsidiaries can be found on page 21 of this report.

Research

During the last three fiscal years, neither SJI nor any of its subsidiaries engaged in research activities to any material extent.

Environmental Matters

Information on environmental matters for SJI and its subsidiaries can be found in Note 14 of the consolidated financial statements included under Item 8 of this report.

Employees

SJI and its subsidiaries had a total of 611 employees as of December 31, 2006. Of that total, 360 employees are unionized. Employees totaling 310 and 50 are covered under collective bargaining agreements that expire in January 2009 and January 2008, respectively. We consider relations with employees to be good.

Financial Information About Foreign and Domestic Operations and Export Sales

SJI has no foreign operations and export sales have not been a significant part of SJI’s business.

Item 1A. Risk Factors

SJI and its subsidiaries operate in an environment that involves risks, many of which are beyond our control. SJI has identified the following risk factors that could cause SJI’s operating results and financial condition to be materially adversely affected. Investors should carefully consider these risk factors and should also be aware that this list is not all inclusive of existing risks. In addition, new risks may emerge at any time, and SJI cannot predict those risks or the extent to which they may affect SJI’s businesses or financial performance.

- **SJI is a holding company and its assets consist primarily of investments in subsidiaries.** Should SJI’s subsidiaries be unable to pay dividends or make other payments to SJI for financial, regulatory, legal or other reasons, SJI’s ability to pay dividends on its common stock could be limited. SJI’s stock price could be adversely affected as a result.
- **SJI’s business activities are concentrated in southern New Jersey.** Changes in the economies of southern New Jersey and surrounding regions could negatively impact the growth opportunities available to SJI and the financial condition of customers and prospects of SJI.

- **Changes in the regulatory environment or unfavorable rate regulation at its utility may have an unfavorable impact on SJI's financial performance or condition.** SJI's utility business is regulated by the New Jersey Board of Public Utilities which has authority over many of the activities of the business including, but not limited to, the rates it charges to its customers, the amount and type of securities it can issue, the nature of investments it can make, the nature and quality of services it provides, safety standards and other matters. The extent to which the actions of regulatory commissions restrict or delay SJG's ability to earn a reasonable rate of return on invested capital and/or fully recover operating costs may adversely affect its results of operations, financial condition and cash flows.
- **SJI may not be able to respond effectively to competition, which may negatively impact SJI's financial performance or condition.** Regulatory initiatives may provide or enhance opportunities for competitors that could reduce utility income obtained from existing or prospective customers. Also, competitors in all of SJI's business lines may be able to provide superior or less costly products or services based upon currently available or newly developed technologies.
- **Warm weather, high commodity costs, or customer conservation initiatives could result in reduced demand for some of SJI's energy products and services.** While SJI's utility currently has a conservation incentive program clause that protects its revenues and gross margin against usage that is lower than a set level, the clause is currently approved as a three-year pilot program. Should this clause expire without replacement, lower customer energy utilization levels would likely reduce SJI's net income.
- **High natural gas prices could cause more of SJI's receivables to be uncollectible.** Higher levels of uncollectibles from either residential or commercial customers would negatively impact SJI's income and could result in higher working capital requirements.
- **SJI's net income could decrease if it is required to incur additional costs to comply with new governmental safety, health or environmental legislation.** SJI is subject to extensive and changing federal and state laws and regulations that impact many aspects of its business; including the storage, transportation and distribution of natural gas, as well as the remediation of environmental contamination at former manufactured gas plant facilities.
- **SJI's wholesale commodity marketing business is exposed to the risk that counterparties that owe money or energy to SJI will not be able to meet their obligations for operational or financial reasons.** SJI could be forced to buy or sell commodity at a loss as a result of such failure. Such a failure, if large enough, could also impact SJI's liquidity.
- **Increasing interest rates will negatively impact the net income of SJI.** Several of SJI's subsidiaries are capital intensive, resulting in the incurrence of significant amounts of debt financing. While almost all of SJI's existing long-term debt has been issued at fixed rates, new issues of long-term debt and all variable rate short-term debt are exposed to the impact of rising interest rates.
- **A downgrade in SJG's credit rating could negatively affect its ability to access adequate and cost effective capital.** SJG's ability to obtain adequate and cost effective capital depends largely on its credit ratings, which are greatly influenced by financial condition and results of operations. If the rating agencies downgrade SJG's credit ratings, particularly below investment grade, SJG's borrowing costs would increase. In addition, SJG would likely be required to pay higher interest rates in future financings and potential funding sources would likely decrease. To the extent that a decline in SJG's credit rating has a negative effect on SJI, SJI could be required to provide additional support to certain counterparties of the wholesale gas operations.
- . **Hedging activities of the company designed to protect against commodity price or interest rate risk may cause fluctuations in reported financial results and SJI's stock price could be adversely affected as a result.** Although SJI enters into various contracts to hedge the value of energy assets, liabilities, firm commitments or forecasted transactions, the timing of the recognition of gains or losses on these economic hedges in accordance with accounting principles generally accepted in the United States of America does not always match up with the gains or losses on the items being hedged. The difference in accounting can result in volatility in reported results, even though the expected profit margin is essentially unchanged from the dates

the transactions were consummated.

- **The inability to obtain natural gas would negatively impact the financial performance of SJI.** Several of SJI's subsidiaries have businesses based upon the ability to deliver natural gas to customers. Disruption in the production of natural gas or transportation of that gas to SJI from its suppliers, could prevent SJI from completing sales to its customers.

- **Transporting and storing natural gas involves numerous risks that may result in accidents and other operating risks and costs.** SJI's gas distribution activities involve a variety of inherent hazards and operating risks, such as leaks, accidents, mechanical problems, natural disasters or terrorist activities which could cause substantial financial losses. In addition, these risks could result in loss of human life, significant damage to property, environmental pollution and impairment of operations, which in turn could lead to substantial losses. In accordance with customary industry practice, SJI maintains insurance against some, but not all, of these risks and losses. The occurrence of any of these events not fully covered by insurance could adversely affect SJI's financial position and results of operations.
- **Adverse results in legal proceedings could be detrimental to the financial condition of SJI.** Management does not expect the disposition of any known claims to have a material adverse effect on its financial position or net income. However, the outcomes of legal proceedings can be unpredictable and can result in adverse judgments.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The principal property of SJI consists of SJG's gas transmission and distribution systems that include mains, service connections and meters. The transmission facilities carry the gas from the connections with Transco and Columbia to SJG's distribution systems for delivery to customers. As of December 31, 2006, there were approximately 107.3 miles of mains in the transmission systems and 5,677 miles of mains in the distribution systems.

SJG owns office and service buildings, including its corporate headquarters, at seven locations in the territory. There is also a liquefied natural gas storage and vaporization facility at one of these locations.

As of December 31, 2006, SJG's utility plant had a gross book value of $1,079.6 million and a net book value, after accumulated depreciation, of $821.8 million. In 2006, $56.0 million was spent on additions to utility plant and there were retirements of property having an aggregate gross book cost of $6.6 million.

Virtually all of SJG's transmission pipeline, distribution mains and service connections are in streets or highways or on the property of others. The transmission and distribution systems are maintained under franchises or permits or rights-of-way, many of which are perpetual. SJG's properties (other than property specifically excluded) are subject to a lien of mortgage under which its first mortgage bonds are outstanding. We believe these properties are well maintained and in good operating condition.

Nonutility property and equipment totaling $98.1 million consists primarily of Marina's energy projects, in particular the thermal energy plant in Atlantic City, N.J.

Energy and Minerals Inc. (EMI) owns 235 acres of land in Vineland, New Jersey.

South Jersey Fuel, Inc., an inactive subsidiary, owns land and a building in Deptford Township and owns real estate in Upper Township, New Jersey.

R&T Castellini, Inc., an inactive subsidiary, owns land and buildings in Vineland, New Jersey.

SJI owned approximately 139 acres of land in Folsom, New Jersey as of December 31, 2006.

Item 3. Legal Proceedings

SJI is subject to claims arising in the ordinary course of business and other legal proceedings. We accrue liabilities related to these claims when we can determine the amount or range of amounts of probable settlement costs for these claims. Among other actions, SJI is named in 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 4. Submission Of Matters To A Vote of Security Holders

No matter was submitted to a vote of security holders during the fourth quarter of the 2006 fiscal year.

Item 4A. Executive Officers of the Registrant

Set forth below are the names, ages and positions of our executive officers along with their business experience during the past five years. All executive officers of SJI are elected annually and serve at the discretion of the Board of Directors. All information is as of the date of the filing of this report.

Name, age and position with the Company	Period Served
Edward J. Graham, Age 49	
Chairman	April 2005 - Present
Chief Executive Officer	February 2004 - Present
President	January 2003 - Present
Chief Operating Officer	January 2002 - February 2004
Executive Vice President	January 2002 - January 2003
Vice President	June 1998 - January 2002
David A. Kindlick, Age 52	
Chief Financial Officer	January 2002 - Present
Vice President	June 1997 - Present
Treasurer	April 2001 - January 2004
Jeffery E. DuBois, Age 48	
Vice President	January 2004 - Present
Assistant Vice President (SJG)	January 2002 - January 2004
Michael J. Renna, Age 39	
Vice President	January 2004 - Present
Assistant Vice President	January 2002 - January 2004
Albert V. Ruggiero, Age 58 (1)	
Vice President	October 1998 - Present
Richard H. Walker, Jr., Age 56	
Vice President, General Counsel and Secretary	January 2006 - Present
	May 2003 - January 2006

Vice President, Corporate Counsel & Corporate Secretary	
Corporate Counsel & Corporate Secretary	April 2002 - May 2003
Assistant Secretary	April 1998 - April 2002

(1) Mr. Ruggiero has announced his intention to retire, effective June 30, 2007.

PART II

Item 5. Market for the Registrant's Common Equity Related Stockholder Matters, and Issuer Purchases of Equity Securities

Market Price of Common Stock and Related Information

Quarter Ended 2006	Market Price Per Share High	Low	Dividends Declared Per Share	Quarter Ended 2005	Market Price Per Share High	Low	Dividends Declared Per Share
March 31	$ 30.15	$ 26.72	$ 0.2250	March 31	$ 29.20	$ 24.94	$ 0.2125
June 30	$ 27.89	$ 25.63	$ 0.2250	June 30	$ 31.50	$ 26.66	$ 0.2125
September 30	$ 30.09	$ 27.20	$ 0.2250	September 30	$ 32.38	$ 27.52	$ 0.2125
December 31	$ 34.26	$ 29.10	$ 0.2450	December 31	$ 30.80	$ 25.80	$ 0.2250

These quotations are based on the list of composite transactions of the New York Stock Exchange. Our stock is traded on the New York Stock Exchange under the symbol SJI. We have declared and expect to continue to declare regular quarterly cash dividends. As of December 31, 2006, the latest available date, our records indicate that there were 7,855 shareholders of record.

Information required by this item is also found in Note 5 of the consolidated financial statements included under Item 8 of this report.

SJI has a stated policy of increasing its dividend by at least 6% to 7% annually.

In December 2006, non-employee members of SJI's Board of Directors received an aggregate of 9,261 shares of unregistered stock, valued at that time at $315,059, as part of their compensation for serving on the Board.

Item 6. Selected Financial Data

2006 HIGHLIGHTS
Five-Year Summary of Selected Financial Data
(In Thousands Where Applicable)

South Jersey Industries, Inc. and Subsidiaries

	Year Ended December 31,				
	2006	2005 (As Restated See Note 16)	2004 (As Restated See Note 16)	2003 (As Restated See Note 16)	2002 (As Restated See Note 16)
Operating Results:					
Operating Revenues	$ 931,428	$ 906,016	$ 819,416	$ 703,898	$ 520,423
Operating Income	$ 145,802	$ 86,818	$ 91,079	$ 76,545	$ 77,608
Income Applicable to Common Stock:					
Continuing Operations	$ 72,250	$ 39,770	$ 43,173	$ 33,789	$ 34,439
Discontinued Operations - Net (1)	(818)	(669)	(680)	(775)	(424)
Cumulative Effect of a Change in Accounting Principle - Net	-	-	-	(426)	-
Net Income Applicable to Common Stock	$ 71,432	$ 39,101	$ 42,493	$ 32,588	$ 34,015
Total Assets	$ 1,573,032	$ 1,441,712	$ 1,243,666	$ 1,126,203	$ 1,053,834
Capitalization:					
Common Equity	$ 443,036	$ 393,645	$ 343,363	$ 296,412	$ 237,156
Preferred Stock (2)	-	-	1,690	1,690	1,690
Long-Term Debt	358,022	319,066	328,914	308,781	274,099
Total Capitalization	$ 801,058	$ 712,711	$ 673,967	$ 606,883	$ 512,945
Ratio of Operating Income to Fixed Charges (3)	5.3x	4.1x	4.4x	3.7x	3.7x
Diluted Earnings Per Common Share (Based on Average Diluted Shares Outstanding):					
Continuing Operations	$ 2.47	$ 1.40	$ 1.56	$ 1.33	$ 1.46
Discontinued Operations - Net (1)	(0.03)	(0.02)	(0.03)	(0.03)	(0.02)

Cumulative Effect of a Change in Accounting Principle - Net		-		-		-		(0.02)		-
Diluted Earnings Per Common Share	$	2.44	$	1.38	$	1.53	$	1.28	$	1.44
Return on Average Common Equity (4)		16.9%		12.5%		13.0%		12.5%		14.5%

Share Data:										
Number of Shareholders of Record		7.9		8.1		8.1		8.3		8.4
Average Common Shares		29,175		28,175		27,382		25,118		24,076
Common Shares Outstanding at Year End		29,326		28,982		27,760		26,458		24,412
Dividend Reinvestment Plan:										
Number of Shareholders		5.3		5.3		5.2		5.1		5.1
Number of Participating Shares		2,194		2,722		2,764		2,750		2,608
Book Value at Year End	$	15.11	$	13.58	$	12.37	$	11.20	$	9.71
Dividends Declared per Common Share	$	0.92	$	0.86	$	0.82	$	0.78	$	0.76
Market Price at Year End	$	33.41	$	29.14	$	26.28	$	20.25	$	16.51
Dividend Payout (5):										
From Continuing Operations		37.2%		60.9%		52.0%		58.0%		53.1%
From Total Net Income		37.6%		62.0%		52.8%		60.1%		53.8%
Market-to-Book Ratio		2.2x		2.1x		2.1x		1.8x		1.7x
Price Earnings Ratio (4)		13.5x		20.8x		16.8x		15.2x		11.3x

(1) Represents discontinued business segments: sand mining and distribution operations sold in 1996 and fuel oil operations with related environmental liabilities in 1986 (See Note 2 to Consolidated Financial Statements).

(2) On May 2, 2005, South Jersey Gas (SJG) redeemed its 8% Redeemable Cumulative Preferred Stock at par.

(3) Calculated as Operating Income divided by Interest Charges.

(4) Calculated based on Income from Continuing Operations.

(5) Prior to 2002, dividends declared for the fourth quarter were paid in early January of the following year. However, beginning in 2002, dividends declared for the fourth quarter were paid in December, resulting in five quarterly dividends paid in 2002. For comparability, the payout ratios for 2002 are based on the first four quarterly dividends paid in 2002.

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations

RESTATEMENT — As discussed in Note 16 to the consolidated financial statements, the Company's financial statements for the years ended December 31, 2005 and 2004 have been restated. The accompanying management's discussion and analysis gives effect to that restatement.

OVERVIEW — SJI is an energy services holding company that provides a variety of products and services through the following wholly owned subsidiaries:

South Jersey Gas Company (SJG)

SJG, a New Jersey corporation, is an operating public utility company engaged in the purchase, transmission and sale of natural gas for residential, commercial and industrial use. SJG also sells natural gas and pipeline transportation capacity (off-system sales) on a wholesale basis to various customers on the interstate pipeline system and transports natural gas purchased directly from producers or suppliers to their customers. SJG contributed approximately 50.1% of SJI’s net income on a consolidated basis in 2006.

SJG’s service territory covers approximately 2,500 square miles in the southern part of New Jersey. It includes 112 municipalities throughout Atlantic, Cape May, Cumberland and Salem Counties and portions of Burlington, Camden and Gloucester Counties, with an estimated permanent population of 1.2 million. SJG benefits from its proximity to Philadelphia, PA and Wilmington, DE on the western side of its service territory and Atlantic City, NJ and the burgeoning shore communities on the eastern side. Economic development and housing growth have long been driven by the development of the Philadelphia metropolitan area. In recent years, housing growth in the eastern portion of the service territory has increased substantially and now accounts for approximately half of SJG’s annual customer growth. The foundation for growth in Atlantic City and the surrounding region rests primarily with new gaming and non-gaming investments that emphasize destination style attractions. The casino industry is expected to remain a significant source of regional economic development going forward. The ripple effect from Atlantic City continues to produce new housing and commercial and industrial construction. Combining with the gaming industry catalyst is the ongoing conversion of southern New Jersey’s oceanfront communities from seasonal resorts to year round economies. New and expanded hospitals, schools, and large scale retail developments throughout the service territory have contributed to SJG’s growth. Presently, SJG serves approximately 64% of households within its territory with natural gas. SJG also serves southern New Jersey’s diversified industrial base that includes processors of petroleum and agricultural products; chemical, glass and consumer goods manufacturers; and high technology industrial parks.

As of December 31, 2006, SJG served a total of 330,049 residential, commercial and industrial customers in southern New Jersey, compared with 322,424 customers at December 31, 2005. No material part of SJG’s business is dependent upon a single customer or a few customers. Gas sales, transportation and capacity release for 2006 amounted to 136 MMDth (million decatherms), of which 48 MMDth were firm sales and transportation, 3 MMDth were interruptible sales and transportation and 85 MMDth were off-system sales and capacity release. The breakdown of firm sales and transportation includes 43.2% residential, 23.9% commercial, 30.2% industrial, and 2.7% cogeneration and electric generation. At year-end 2006, SJG served 307,919 residential customers, 21,652 commercial customers and 478 industrial customers. This includes 2006 net additions of 7,267 residential customers and 358 commercial and industrial customers.

SJG makes wholesale gas sales for resale to gas marketers for ultimate delivery to end users. These “off-system” sales are made possible through the issuance of the Federal Energy Regulatory Commission (FERC) Orders No. 547 and

636. Order No. 547 issued a blanket certificate of public convenience and necessity authorizing all parties, which are not interstate pipelines, to make FERC jurisdictional gas sales for resale at negotiated rates, while Order No. 636 allowed SJG to deliver gas at delivery points on the interstate pipeline system other than its own city gate stations and release excess pipeline capacity to third parties. During 2006, off-system sales amounted to 18.2 MMdth. Also in 2006, capacity release and storage throughput amounted to 66.5 MMdth.

Supplies of natural gas available to SJG that are in excess of the quantity required by those customers who use gas as their sole source of fuel (firm customers) make possible the sale and transportation of gas on an interruptible basis to commercial and industrial customers whose equipment is capable of using natural gas or other fuels, such as fuel oil and propane. The term “interruptible” is used in the sense that deliveries of natural gas may be terminated by SJG at any time if this action is necessary to meet the needs of higher priority customers as described in SJG’s tariffs. Usage by interruptible customers, excluding off-system customers, in 2006, amounted to approximately 5.6 MMDth, approximately 2.7% of the total throughput.

South Jersey Energy Solutions, LLC

Effective January 1, 2006, SJI established South Jersey Energy Solutions, LLC, (SJES) as a direct subsidiary for the purpose of serving as a holding company for all of SJI's non-utility businesses. The following businesses are wholly owned subsidiaries of SJES:

South Jersey Energy Company (SJE)

SJE provides services for the acquisition and transportation of natural gas and electricity for retail end users, markets total energy management services, and prior to June 30, 2006, marketed an air quality monitoring system. As of December 31, 2006, SJE marketed natural gas and electricity to approximately 15,500 customers, which consist of approximately 85% residential gas customers and 15% commercial/industrial customers. Most customers served by SJE are located within southern New Jersey. In 2006, SJE contributed approximately 1.0% of SJI's net income on a consolidated basis.

South Jersey Resources Group, LLC (SJRG)

SJRG markets natural gas storage, commodity and transportation assets on a wholesale basis. Customers include energy marketers, electric and gas utilities and natural gas producers. SJRG's marketing activities occur mainly in the mid-Atlantic and southern regions of the country. SJRG also conducts price risk management activities by entering into a variety of physical and financial transactions including forward contracts, swap agreements, option contracts and futures contracts. In 2006, SJRG transacted 81.5 Bcf of natural gas. SJRG contributed approximately 42.2% of SJI's net income on a consolidated basis.

Marina Energy, LLC (Marina)

Marina develops and operates energy-related projects. Marina's largest project provides cooling, heating and emergency power to the Borgata Hotel Casino & Spa in Atlantic City, NJ. Marina added service to Borgata's expanded facilities in July 2006 and service to a new hotel tower is expected to begin in December 2007.

Marina's other recent projects include:

- A 51% equity interest in AC Landfill Energy, LLC (ACLE) which began commercial operation in Egg Harbor Township, NJ of a 1,600 kilowatt landfill gas-fired electricity production facility in March 2005 and a 1,900 kilowatt facility in August 2006. Engineering for an additional 1,900 kilowatt facility began in the fourth quarter of 2006 and is expected to be operational in the fourth quarter of 2007.

- A 51% equity interest in WC Landfill Energy, LLC (WCLE) which began commercial operation in White Township, NJ of a 3,800 kilowatt landfill gas-fired electricity production facility in November 2006.

- A 50% equity interest in a partnership that will lease and operate a 7,200 kilowatt landfill gas-fired electricity production facility in Burlington County, NJ. This facility is expected to be operational in the third quarter of 2007.

Marina contributed approximately 4.8% of SJI's net income on a consolidated basis.

South Jersey Energy Service Plus, LLC (SJESP)

SJESP installs and services residential and small commercial HVAC systems, provides plumbing services, and services appliances via the sale of appliance service programs as well as on a time and materials basis. SJESP serves southern New Jersey where it is the largest local appliance service company with nearly 50 experienced, NATE certified technicians and installers. As of December 31, 2006, SJESP had over 75,000 service contract customers, representing nearly 150,000 service contracts for the repair and maintenance of major appliances, such as house heaters, water heaters, gas ranges, and electric central air conditioning units. SJESP contributed approximately 2.3% of SJI's net income on a consolidated basis.

Other

SJI Services, LLC was established January 1, 2006, for the purpose of providing services such as information technology, human resources, government relations, corporate communications, materials purchasing, fleet management and insurance to SJI and its other subsidiaries.

Energy & Minerals, Inc. (EMI) principally manages liabilities associated with discontinued operations of nonutility subsidiaries.

SJI also has a joint venture investment with Conectiv Solutions, LLC in Millennium Account Services, LLC (Millennium). Millennium provides meter reading services to SJG and Atlantic City Electric Company in southern New Jersey.

Primary Factors Affecting SJI's Business

SJI's stated long-term goals are to: 1) Grow earnings per share from continuing operations by an average of at least 6% to 7% per year; 2) Increase the dividend on common stock by at least 6% to 7% annually; and 3) Maintain a low-to-moderate risk platform. Management established those goals in conjunction with SJI's Board of Directors based upon a number of different internal and external factors that characterize and influence SJI's current and expected future activities.

The following is a summary of the primary factors we expect to have the greatest impact on SJI's performance and ability to achieve long-term goals going forward:

Business Model — In developing SJI's current business model, our focus has been on our core utility and natural extensions of that business. That focus enables us to concentrate on business activities that match our core competencies. We have no plans to become involved in business opportunities that do not fit this model.

Customer Growth — The vibrancy of the economic development in and adjacent to southern New Jersey, our primary area of operations, and related strong demand for new housing has enabled our utility to increase its customer base at an average rate of 2.8% over the past five years. While housing growth most significantly benefits utility performance, it also translates into additional opportunities to market retail products and services through our nonutility businesses.

Regulatory Environment — SJG is primarily regulated by the New Jersey Board of Public Utilities (BPU). The BPU sets the rates that SJG charges its rate-regulated customers for services provided and establishes the terms of service under which SJG operates. We expect the BPU to continue to set rates and establish terms of service that will enable SJG to obtain a fair and reasonable return on capital invested. The BPU approved a change in base rates in July 2004, (discussed in greater detail in Note 9 to the consolidated financial statements) that significantly increased utility margins in 2005, compared with 2004. The BPU also approved a Conservation Incentive Program (CIP) effective October 1, 2006, discussed in greater detail under Results of Operations, that will protect SJG's net income from reductions in gas used by residential and commercial customers.

Weather Conditions and Customer Usage Patterns — Usage patterns can be affected by a number of factors, such as wind, precipitation, temperature extremes and customer conservation. SJG's earnings are largely protected from fluctuations in temperatures by the Conservation Incentive Program (CIP), which superseded the Temperature Adjustment Clause (TAC), effective October 1, 2006. The CIP has a stabilizing effect on utility earnings as SJG adjusts revenues where actual usage per customer experienced during an annual period varies from an established baseline usage per customer. Our nonutility gas retail marketing business is directly affected by weather conditions, as it does not have accounting mechanisms that address weather volatility. The impact of different weather conditions on the earnings of our nonutility businesses is dependent on a range of different factors. Consequently, weather may impact the earnings of SJI's various subsidiaries in different, or even opposite, ways. Further, the profitability of individual subsidiaries may vary from year-to-year despite experiencing substantially similar weather conditions.

Changes in Natural Gas Prices — In recent years, prices for natural gas have become increasingly volatile. The utility's gas costs are passed on directly to customers without any profit margin added by SJG. The price the utility charges its periodic customers is set annually, with a regulatory mechanism in place to make limited adjustments to that price during the course of a year. In the event that gas cost increases would justify customer price increases greater than those permitted under the regulatory mechanism, SJG can petition the BPU for an incremental rate increase. High prices can make it more difficult for our customers to pay their bills and may result in elevated levels of bad-debt expense. Among our nonutility activities, the one most likely to be impacted by changes in natural gas prices is our retail gas marketing business. Our ability to add and retain customers is affected by the relationship between the price that the utility charges customers for gas and the cost of gas available in the market at specific points in time.

Energy Project Development — Marina Energy, LLC, SJI's energy project development business, focuses on designing, building, owning and/or operating energy production facilities on, or adjacent to, customer sites. That business is currently involved with six projects that are either operating, or are under development. Based upon our experience to date, market issues that impact the reliability and price of electricity supplied by utilities, and discussions that we are having regarding additional projects, we expect to continue to expand this business. However, the price of natural gas also has a direct effect on the economics of these projects.

Changes in Interest Rates — SJI has operated in a relatively low interest rate environment over the past several years. Rising interest rates would raise the expense associated with existing variable-rate debt and all issuances of new debt. We have sought to mitigate the impact of a potential rising rate environment by fixing the costs on long-term debt, either by directly issuing fixed-rate debt, or by entering into derivative transactions to hedge against rising interest rates.

Labor and Benefit Costs — Labor and benefit costs have a significant impact on SJI's profitability. Benefit costs, especially those related to health care, have risen in recent years. We sought to manage these costs by revising health care plans offered to existing employees, capping postretirement health care benefits, and changing health care and pension packages offered to new hires. Our workforce totaled 611 employees at the end of 2006, with 59% of that total being unionized. During 2004, we agreed to new contracts with all of our bargaining units that encompass the changes mentioned above. The contracts run through at least January 2008, with the largest bargaining units signed through January 2009. We expect savings from these changes to gradually increase as new hires replace retiring employees. In an effort to accelerate the realization of those benefits, we offered an early retirement incentive program at the end of 2004 through 2005.

Balance Sheet Strength — Our goal is to maintain a strong balance sheet with an average annual equity-to-capitalization ratio of 46% to 50%. Our equity-to-capitalization ratio, inclusive of short-term debt, was 44.4% and 45.6% at the end of 2006 and 2005, respectively. A strong balance sheet permits us to maintain the financial flexibility necessary to take advantage of growth opportunities and to address volatile economic and commodity markets while maintaining a low-to-moderate risk platform.

CRITICAL ACCOUNTING POLICIES — ESTIMATES AND ASSUMPTIONS: As described in the notes to our consolidated financial statements, management must make estimates and assumptions that affect the amounts reported in the consolidated financial statements and related disclosures. Actual results could differ from those estimates. Five types of transactions presented in our consolidated financial statements require a significant amount of judgment and estimation. These relate to regulatory accounting, energy derivatives, environmental remediation costs, pension and other postretirement benefit costs, and revenue recognition.

Regulatory Accounting — SJI's largest subsidiary, SJG, maintains its accounts according to the Uniform System of Accounts as prescribed by the New Jersey Board of Public Utilities (BPU). As a result of the ratemaking process, SJG is required to follow Financial Accounting Standards Board (FASB) Statement No. 71, "Accounting for the Effects of Certain Types of Regulation." SJG is required under Statement No. 71 to recognize the impact of regulatory decisions on its financial statements. SJG is required under its Basic Gas Supply Service clause (BGSS) to forecast its natural gas costs and customer consumption in setting its rates. Subject to BPU approval, SJG is able to recover or return the difference between gas cost recoveries and the actual costs of gas through a BGSS charge to customers. SJG records any over/under recoveries as a regulatory asset or liability on the consolidated balance sheets and reflects it in the BGSS charge to customers in subsequent years. SJG also enters into derivatives that are used to hedge natural gas purchases. The offset to the resulting derivative assets or liabilities is also recorded as a regulatory asset or liability on the consolidated balance sheets.

In addition to the BGSS, other regulatory assets consist primarily of remediation costs associated with manufactured gas plant sites (discussed below under Environmental Remediation Costs), deferred pension and other postretirement benefit cost, and several other assets as detailed in Note 10 to the consolidated financial statements. If there are changes in future regulatory positions that indicate the recovery of such regulatory assets is not probable, SJG would charge the related cost to earnings. Currently there are no such anticipated changes at the BPU.

Energy Derivatives — SJI recognizes assets or liabilities for energy-related contracts that qualify as derivatives that are entered into by its subsidiaries when contracts are executed. We record contracts at their fair value in accordance with FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended. We record changes in the fair value of the effective portion of derivatives qualifying as cash flow hedges, net of tax, in Accumulated Other Comprehensive Loss and recognize such changes in the income statement when the hedged item affects earnings. Changes in the fair value of derivatives not designated as hedges are recorded in earnings in the current period. We currently have no energy-related derivative instruments designated as cash flow hedges. Certain derivatives that result in the physical delivery of the commodity may meet the criteria to be accounted for as normal purchases and normal sales if so designated, in which case the contract is not marked-to-market, but rather is accounted for when the commodity is delivered. Due to the application of regulatory accounting principles under FASB Statement No. 71, derivatives related to SJG's gas purchases that are marked-to-market, are recorded through the BGSS. SJG occasionally enters into financial derivatives to hedge against forward price risk. These derivatives are recorded at fair value with an offset to regulatory assets and liabilities through SJG's BGSS, subject to BPU approval (See Notes 9 and 10 to the consolidated financial statements). We adjust the fair value of the contracts each reporting period for changes in the market. We derive the fair value for most of the energy-related contracts from markets where the contracts are actively traded and quoted. For other contracts, SJI uses published market surveys and, in certain cases, unrelated third parties to obtain quotes concerning the contracts' current value. Market quotes tend to be more plentiful for contracts maturing in two years or less.

Environmental Remediation Costs — Outside consulting firms assist us in estimating future costs for environmental remediation activities. We estimate future costs based on projected investigation and work plans using existing technologies. We estimate the range of future costs from $71.8 million to $253.7 million. In preparing consolidated financial statements, SJI records liabilities for future costs using the lower end of the range because a single reliable estimation point is not feasible due to the amount of uncertainty involved in the nature of projected remediation efforts and the long period over which remediation efforts will continue. We update estimates each year to take into account past efforts, changes in work plans, remediation technologies, government regulations and site specific requirements (See Note 14 to the consolidated financial statements).

Pension and Other Postretirement Benefit Costs — The costs of providing pension and other postretirement employee benefits are impacted by actual plan experience as well as assumptions of future experience. Employee demographics, plan contributions, investment performance, and assumptions concerning mortality, return on plan assets, discount rates and health care cost trends all have a significant impact on determining our projected benefit obligations. We evaluate these assumptions annually with the assistance of our investment manager and actuary, and we adjust them accordingly. These adjustments could result in significant changes to the net periodic benefit costs of providing such benefits and the related liabilities recognized by SJI. While SJI expects that its change in mortality tables (to the RP-2000 table) will result in an increase in benefit costs, a 20 basis point increase in the discount rate and higher than expected returns on plan assets during 2006 are expected to offset this increase. (See Note 11 to the consolidated financial statements.)

Revenue Recognition — Gas and electricity revenues are recognized in the period the commodity is delivered to customers. SJG, SJRG and SJE bill customers monthly. A majority of SJG and SJE customers have their meters read on a cycle basis throughout the month. For SJG and SJE retail customers that are not billed at the end of each month, we record an estimate to recognize unbilled revenues for gas/electricity delivered from the date of the last meter reading to the end of the month. SJG’s and SJE’s unbilled revenue for natural gas is estimated each month based on monthly deliveries into the system; unaccounted for natural gas based on historical results; customer-specific use factors, when available; actual temperatures during the period; and applicable customer rates. SJE’s unbilled revenue for retail electricity is based on customer-specific use factors and applicable customer rates. We bill SJG customers at rates approved by the BPU. SJE and SJRG customers are billed at rates negotiated between the parties.

We recognize revenues related to SJESP's appliance service contracts seasonally over the full 12-month term of the contract. Revenues related to services provided on a time and materials basis are recognized on a monthly basis as the services are provided.

Marina recognizes revenue on a monthly basis as services are provided and for on-site energy production that is delivered to its customers.

The BPU allows SJG to recover gas costs in rates through the Basic Gas Supply Service (BGSS) price structure. SJG defers over/under recoveries of gas costs and includes them in subsequent adjustments to the BGSS rate. These adjustments result in over/under recoveries of gas costs being included in rates during future periods. As a result of these deferrals, utility revenue recognition does not directly translate to profitability. While SJG realizes profits on gas sales during the month of providing the utility service, significant shifts in revenue recognition may result from the various recovery clauses approved by the BPU. This revenue recognition process does not shift earnings between periods, as these clauses only provide for cost recovery on a dollar-for-dollar basis (See Notes 9 and 10 to the consolidated financial statements).

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

RATES AND REGULATIONS — As a public utility, SJG is subject to regulation by the New Jersey Board of Public Utilities (BPU). Additionally, the Natural Gas Policy Act, which was enacted in November 1978, contains provisions for Federal regulation of certain aspects of SJG's business. SJG is affected by Federal regulation with respect to transportation and pricing policies applicable to pipeline capacity from Transcontinental Gas Pipeline Corporation (SJG's major supplier), Columbia Gas Transmission Corporation, Columbia Gulf Transmission Company, Dominion Transmission, Inc., and Texas Gas Transmission Corporation, since such services are provided under rates and terms established under the jurisdiction of the FERC. SJG's retail sales are made under rate schedules within a tariff filed with and subject to the jurisdiction of the BPU. These rate schedules provide primarily for either block rates or demand/commodity rate structures. SJG's primary rate mechanisms include base rates, the Basic Gas Supply Service Clause, Temperature Adjustment Clause and Conservation Incentive Program.

Basic Gas Supply Service Clause (BGSS) - In December 2002, the BPU approved the BGSS price structure which gave customers the ability to make more informed decisions regarding their choices of an alternate supplier by having a utility price structure that is more consistent with market conditions. The cost of gas purchased from the utility by consumers is set annually by the BPU through a BGSS within SJG's tariff. When actual gas costs experienced are less than those charged to customers under the BGSS, customer bills in the subsequent BGSS period(s) are reduced by returning the overrecovery with interest. When actual gas costs are more than is recovered through rates, SJG is permitted to charge customers more for gas in future periods to recover the shortfall.

Temperature Adjustment Clause (TAC) - Through September 30, 2006, SJG's tariff included a TAC to mitigate the effect of variations in heating season temperatures from historical norms. Each TAC year ran from November 1 through May 31 of the following year. Once the TAC year ended, the net earnings impact was filed with the BPU for future recovery. As a result, the cash inflows or outflows generally would not begin until the next TAC year. Because of the timing delay between the earnings impact and the recovery, the net result can be either a regulatory asset or liability. The effects of the TAC on SJG's net income for the last three years and the associated weather comparisons were as follows:

	2006	2005	2004
Net Income Benefit/(Reduction)	$5.1 million	$(0.2) million	$0.2 million

Weather Compared to 20-Year TAC Average	15.0 % warmer	3.0 % colder	1.0 % warmer
Weather Compared to Prior Year	17.5 % warmer	2.9 % colder	5.8 % warmer

Conservation Incentive Program (CIP) - The CIP is a BPU approved three-year pilot program that began October 1, 2006 and is designed to eliminate the link between SJG profits and the quantity of natural gas SJG sells, and foster conservation efforts. With the CIP, SJG's profits will be tied to the number of customers served and how efficiently SJG serves them, thus allowing SJG to focus on encouraging conservation and energy efficiency among their customers without negatively impacting net income. The CIP tracking mechanism adjusts earnings based on weather, as did the TAC, and also adjusts SJG's earnings where actual usage per customer experienced during an annual period varies from an established baseline usage per customer.

Similar to the TAC, utility earnings are recognized during current periods based upon the application of the CIP. The cash impact of variations in customer usage will result in cash being collected from, or returned to, customers during the subsequent CIP year, which runs from October 1 to September 30.

The CIP protected $4.6 million in earnings in 2006, which would have been lost due to warm weather and lower customer usage. Of that amount, $2.9 million was related to weather and $1.7 million was related to customer usage. For customer usage variations, the CIP is expected to contribute up to $4.6 million to earnings during the initial twelve months after implementation. The incremental earnings are derived from baseline usages per customer which have been set above the average utilization rate recently experienced by SJG’s customers.

As part of the CIP, SJG is required to implement additional conservation programs including customized customer communication and outreach efforts, targeted upgrade furnace efficiency packages, financing offers, and an outreach program to speak to local and state institutional constituents. SJG is also required to reduce gas supply and storage assets and their associated fees. Note that changes in fees associated with supply and storage assets have no effect on SJG’s net income as these costs are passed through directly to customers.

Earnings accrued and payments received under the CIP are limited to a level that will not cause SJG’s return on equity to exceed 10% (excluding earnings from off-system gas sales and certain other tariff clauses) and the annualized savings attained from reducing gas supply and storage assets.

Other Rate Mechanisms - SJG’s tariff also contains provisions permitting the recovery of environmental remediation costs associated with former manufactured gas plant sites, energy efficiency and renewable energy program costs, consumer education program costs and low-income program costs. These costs are recovered from customers through the Societal Benefits Clause.

See additional detailed discussions on Rates and Regulatory Actions in Note 9 to the consolidated financial statements.

ENVIRONMENTAL REMEDIATION — See detailed discussion concerning Environmental Remediation in Note 14 to the consolidated financial statements.

COMPETITION — SJG’s franchises are non-exclusive. Currently, no other utility provides retail gas distribution services within SJG’s territory. SJG does not expect any other utilities to do so in the foreseeable future because of the extensive investment required for utility plant and related costs. SJG competes with oil, propane and electricity suppliers for residential, commercial and industrial users, with alternative fuel source providers (wind, solar and fuel cells) based upon price, convenience and environmental factors, and with other marketers/brokers in the selling of wholesale natural gas services. The market for natural gas commodity sales is subject to competition due to deregulation. We enhanced SJG’s competitive position while maintaining margins by using an unbundled tariff. This tariff allows full cost-of-service recovery, except for the variable cost of the gas commodity, when transporting gas for our customers. Under this tariff, SJG profits from transporting, rather than selling, the commodity. SJG’s residential, commercial and industrial customers can choose their supplier while we recover the cost of service through transportation service (See Customer Choice Legislation below).

SJE competes with utilities and other third-party marketers to sell the unregulated natural gas and electricity commodity to customers. Marketers compete largely on price, which is driven by the commodity market. While the utilities are typically indifferent as to where customers get their gas or electricity, the price they set for the commodity they sell creates competition for SJE. Based on its market share, SJE is the largest marketer of natural gas in southern New Jersey with approximately 15,500 customers as of December 31, 2006. In addition, similar to SJG, SJE faces competition from other energy products.

SJRG competes in the wholesale natural gas market against a wide array of competitors on a cost competitive, term of service, and reliability basis. SJRG has been a reliable energy provider in this arena for ten years. There has been significant consolidation of energy wholesale operations and large financial institutions have also entered the marketplace. We expect this trend to continue in the near term, which could result in downward pressure on the volume of transactions and the related margins available.

Marina competes with other companies that develop and operate on-site energy production. Marina also faces competition from customers' preferences for alternative technologies for energy production, as well as those customers that address their energy needs internally.

SJESP competes primarily with smaller, local contractors in southern New Jersey that install residential and commercial HVAC systems and provide major appliance repair and plumbing services. These contractors typically only serve their local communities and do not serve the entire southern part of New Jersey.

CUSTOMER CHOICE LEGISLATION— All residential natural gas customers in New Jersey can choose their natural gas commodity supplier under the terms of the "*Electric Discount and Energy Competition Act of 1999*." This bill created the framework and necessary time schedules for the restructuring of the state's electric and natural gas utilities. The Act established *unbundling*, where redesigned utility rate structures allow natural gas and electric consumers to choose their energy supplier. It also established time frames for instituting competitive services for customer account functions and for determining whether basic gas supply services should become competitive. Customers purchasing natural gas from a provider other than the local utility (marketer) are charged for the gas costs by the marketer and charged for the transportation costs by the utility. For a period of several years, marketers had successfully attracted gas commodity customers by offering natural gas at prices competitive with those available under regulated utility tariffs. However, during the third quarter of 2005, marketers found it increasingly difficult to compete with the local utility because of changing market conditions and rising gas costs. SJE responded to these difficult market conditions by returning all of their approximately 69,000 residential gas customers to the utility at the end of the third quarter of 2005. The total number of customers in SJG's service territory purchasing natural gas from a marketer fell from 89,537 to 9,797 during 2005. Beginning in the first quarter of 2006, marketers began to attract customers back through new offers, bringing SJG's total number of customers purchasing the gas commodity from a marketer to 22,505 as of December 31, 2006.

RESULTS OF OPERATIONS:

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 price 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 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 in 2006 increased $32.3 million, or 82.7% to $71.4 million compared to 2005. This increase is primarily due to:

- a 163% increase in gross margin generated from SJRG related to $30.8 million of unrealized gains (pre-tax) on energy related derivatives contracts recognized in 2006 and favorable time spreads on storage asset positions;
- a 2.4% increase in SJG customers and;
- a $5.0 million reduction in utility operations expense.

These increases were offset by the impact of SJE returning all of its residential customers back to the utility in the third quarter of 2005 and a 16% increase in borrowing costs during 2006.

Net Income in 2005 decreased $3.4 million, or 8.0% to $39.1 million compared to 2004. This decrease is primarily due to:

- a 120% decrease in gross margin generated from SJRG related to $15.9 million of unrealized losses (pre-tax) on energy related derivative contracts recognized in 2005;
- the impact of SJE returning all of its residential customers back to the utility in the third quarter of 2005 and;
- an uncollectible reserve adjustment relating to a retail gas customer.

These decreases were offset by a $6.3 million increase as a result of SJG's base rate increase approved in July 2004; a 2.8% increase in SJG customers; and a 5.0% increase in production from Marina’s thermal plant.

These changes are discussed in more detail below.

Operating Revenues and Volumes — Utility — The following table summarizes the composition of gas utility volumes, revenues and margin for the three years ended December 31 (in thousands, except for customer data):

	2006		2005		2004	
Utility Volumes - dth						
Residential	20,786	15%	25,219	16%	24,734	18%
Commercial and industrial	26,016	19%	29,252	18%	30,389	22%
Cogeneration and electric generation	1,356	1%	2,093	1%	1,384	1%
Interruptible	3,567	3%	2,955	2%	2,741	2%
Off-system, capacity release & storage	84,679	62%	101,164	63%	78,914	57%
Total Throughput	136,404	100%	160,683	100%	138,162	100%
Utility Operating Revenues - dollars:						
Residential	$ 338,969	56%	$ 277,446	48%	$ 225,201	46%
Commercial and industrial	131,208	22%	119,618	21%	100,777	20%
Cogeneration and electric generation	10,939	2%	18,175	3%	9,819	2%
Interruptible	2,977	0%	3,396	1%	3,103	1%
Off-system, capacity release & storage	116,344	20%	155,811	27%	147,585	30%
Other revenues	1,562	0%	1,959	0%	8,463	1%
Total utility operating revenues	601,999	100%	576,405	100%	494,948	100%
Less:						
Cost of sales	431,615		404,144		326,981	
Conservation recoveries *	6,862		7,933			