NEW JERSEY RESOURCES CORP
Form 10-Q
February 07, 2013

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

FORM 10 Q

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

FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2012
OR
o 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 8359

NEW JERSEY RESOURCES CORPORATION
(Exact name of registrant as specified in its charter)

New Jersey (State or other jurisdiction of incorporation or organization)	22 2376465 (I.R.S. Employer Identification Number)
1415 Wyckoff Road, Wall, New Jersey 07719 (Address of principal executive offices)	732 938 1480 (Registrant's telephone number, including area code)

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

Common Stock $2.50 Par Value (Title of each class)	New York Stock Exchange (Name of each exchange on which registered)

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: o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes: x No: o

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 definitions of “large accelerated filer,” “accelerated filer,” and “smaller reporting company" in Rule 12b 2 of the Exchange Act.

Large accelerated filer: x	Accelerated filer: o	Non-accelerated filer: o (Do not check if a smaller reporting company)	Smaller reporting company: o

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

The number of shares outstanding of $2.50 par value Common Stock as of February 5, 2013 was 41,810,073.

New Jersey Resources Corporation

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INFORMATION CONCERNING FORWARD-LOOKING STATEMENTS

Certain statements contained in this report, including, without limitation, statements as to management expectations and beliefs presented in Part I, Item 2. “Management's Discussion and Analysis of Financial Condition and Results of Operations,” Part I, Item 3. “Quantitative and Qualitative Disclosures about Market Risk,” Part II, Item I. “Legal Proceedings” and in the notes to the financial statements are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements can also be identified by the use of forward-looking terminology such as “may,” “intend,” “expect,” “believe,” “will” or “continue” or comparable terminology an made based upon management's current expectations and beliefs as of this date concerning future developments and their potential effect upon New Jersey Resources Corporation (NJR or the Company). There can be no assurance that future developments will be in accordance with management's expectations or that the effect of future developments on the Company will be those anticipated by management.

The Company cautions readers that the assumptions that form the basis for forward-looking statements regarding customer growth, customer usage, qualifications for federal investment tax credits (ITCs) and solar renewable energy certificates (SRECs), financial condition, results of operations, cash flows, capital requirements, market risk and other matters for fiscal 2013 and thereafter include many factors that are beyond the Company's ability to control or estimate precisely, such as estimates of future market conditions, the behavior of other market participants and changes in the debt and equity capital markets. The factors that could cause actual results to differ materially from NJR's expectations include, but are not limited to, those discussed in Item 1A. Risk Factors of NJR's 2012 Annual Report on Form 10-K and Part II, Item 1A of this Form 10-Q, as well as the following:

- weather and economic conditions;
- demographic changes in the New Jersey Natural Gas (NJNG) service territory and their effect on NJNG's customer growth;
- volatility of natural gas and other commodity prices and their impact on NJNG customer usage, NJNG's BGSS incentive programs, NJR Energy Services' (NJRES) operations and on the Company's risk management efforts;
- changes in rating agency requirements and/or credit ratings and their effect on availability and cost of capital to the Company;
- the impact of volatility in the credit markets;
- the ability to comply with debt covenants;
- the impact to the asset values and resulting higher costs and funding obligations of NJR's pension and postemployment benefit plans as a result of downturns in the financial markets, a lower discount rate, and impacts associated with the Patient Protection and Affordable Care Act;
- accounting effects and other risks associated with hedging activities and use of derivatives contracts;
- commercial and wholesale credit risks, including the availability of creditworthy customers and counterparties, liquidity in the wholesale energy trading market;
- the ability to obtain governmental approvals and/or financing for the construction, development and operation of certain non-regulated energy investments;
- risks associated with the management of the Company's joint ventures and partnerships;
- risks associated with our investments in renewable energy projects and our investment in an on-shore wind developer, including the availability of regulatory and tax incentives, logistical risks and potential delays related to construction, permitting, regulatory approvals and electric grid interconnection, the availability of viable projects and NJR's eligibility for ITCs, the future market for SRECs and operational risks related to projects in service;
- timing of qualifying for ITCs due to delays or failures to complete planned solar energy projects and the resulting effect on our effective tax rate and earnings;
- the level and rate at which NJNG's costs and expenses (including those related to restoration efforts resulting from Post Tropical Cyclone Sandy, commonly referred to as Superstorm Sandy) are incurred and the extent to which they

are allowed to be recovered from customers through the regulatory process;

- access to adequate supplies of natural gas and dependence on third-party storage and transportation facilities for natural gas supply;
- operating risks incidental to handling, storing, transporting and providing customers with natural gas;
- risks related to our employee workforce, including a work stoppage;
- the regulatory and pricing policies of federal and state regulatory agencies;
- the possible expiration of the NJNG Conservation Incentive Program (CIP);
- the costs of compliance with the proposed regulatory framework for over-the-counter derivatives;
- the costs of compliance with present and future environmental laws, including potential climate change-related legislation;
- risks related to changes in accounting standards;
- the impact of a disallowance of recovery of environmental-related expenditures and other regulatory changes;
- environmental-related and other litigation and other uncertainties; and
- the impact of natural disasters, terrorist activities, and other extreme events on our operations and customers, including any impacts to utility gross margin and restoration costs resulting from Superstorm Sandy.

While the Company periodically reassesses material trends and uncertainties affecting the Company's results of operations and financial condition in connection with its preparation of management's discussion and analysis of results of operations and financial condition contained in its Quarterly and Annual Reports, the Company does not, by including this statement, assume any obligation to review or revise any particular forward-looking statement referenced herein in light of future events.

New Jersey Resources Corporation
Part I

ITEM 1. FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

	Three Months Ended December 31,	
(Thousands, except per share data)	2012	2011
OPERATING REVENUES		
Utility	$218,849	$191,374
Nonutility	517,170	451,037
Total operating revenues	736,019	642,411
OPERATING EXPENSES		
Gas purchases:		
Utility	111,321	85,630
Nonutility	455,427	406,417
Operation and maintenance	40,070	38,945
Regulatory rider expenses	13,982	12,543
Depreciation and amortization	11,303	9,600
Energy and other taxes	16,725	14,058
Total operating expenses	648,828	567,193
OPERATING INCOME	87,191	75,218
Other income	265	527
Interest expense, net of capitalized interest	5,825	5,005
INCOME BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF AFFILIATES	81,631	70,740
Income tax provision	23,980	16,037
Equity in earnings of affiliates	2,555	2,654
NET INCOME	$60,206	$57,357
EARNINGS PER COMMON SHARE		
BASIC	$1.44	$1.38
DILUTED	$1.44	$1.38
DIVIDENDS PER COMMON SHARE	$0.40	$0.38
WEIGHTED AVERAGE SHARES OUTSTANDING		
BASIC	41,695	41,434
DILUTED	41,758	41,651

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

	Three Months Ended December 31,	
(Thousands)	2012	2011
Net income	$60,206	$57,357
Other comprehensive income, net of tax		
Unrealized (loss) gain on available for sale securities, net of tax of $221 and $(600), respectively [1]	$(320)	$869
Net unrealized (loss) on derivatives, net of tax of $6 and $23, respectively	(10)	(40)
Adjustment to postemployment benefit obligation, net of tax of $(203) and $(150), respectively	413	219

Other comprehensive income	$ 83	$ 1,048
Comprehensive income	$ 60,289	$ 58,405

(1) Available for sale securities are included in other noncurrent assets on the Unaudited Condensed Consolidated Balance Sheets.

See Notes to Unaudited Condensed Consolidated Financial Statements

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ITEM 1. FINANCIAL STATEMENTS
(Continued)

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(Thousands)	Three Months Ended December 31, 2012	2011
CASH FLOWS (USED IN) OPERATING ACTIVITIES		
Net income	$60,206	$57,357
Adjustments to reconcile net income to cash flows from operating activities:		
Unrealized (gain) on derivative instruments	(18,335)	(27,474)
Depreciation and amortization	11,303	9,600
Allowance for equity used during construction	(606)	(42)
Allowance for bad debt expense	562	966
Deferred income taxes	22,233	37,724
Manufactured gas plant remediation costs	(941)	(2,099)
Equity in earnings of affiliates, net of distributions received	1,699	2,711
Cost of removal - asset retirement obligations	(137)	(341)
Contributions to postemployment benefit plans	(21,487)	(21,538)
Changes in:		
Components of working capital	(88,145)	(144,912)
Other noncurrent assets	(14,101)	5,992
Other noncurrent liabilities	2,782	4,591
Cash flows (used in) operating activities	(44,967)	(77,465)
CASH FLOWS (USED IN) INVESTING ACTIVITIES		
Expenditures for		
Utility plant	(32,869)	(19,395)
Solar equipment	(15,320)	(47,611)
Real estate properties and other	(154)	(89)
Cost of removal	(1,276)	(2,323)
Distribution from equity investees	458	—
Withdrawal from restricted cash construction fund	5	28
Cash flows (used in) investing activities	(49,156)	(69,390)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of common stock	5,838	3,248
Tax benefit from stock options exercised	62	62
Proceeds from sale-leaseback transaction	7,076	6,522
Payments of long-term debt	(1,384)	(1,198)
Purchases of treasury stock	—	(3,717)
Payments of common stock dividends	(33,320)	(14,946)
Net proceeds from short-term debt	114,600	157,250
Cash flows from financing activities	92,872	147,221
Change in cash and cash equivalents	(1,251)	366
Cash and cash equivalents at beginning of period	4,509	7,440
Cash and cash equivalents at end of period	$3,258	$7,806
CHANGES IN COMPONENTS OF WORKING CAPITAL		
Receivables	$(142,852)	$(74,161)

Inventories	(54,993)	1,808
Recovery of gas costs	371	26,444
Gas purchases payable	58,354	(26,728)
Prepaid and accrued taxes	21,993	(1,218)
Accounts payable and other	11,298	(6,740)
Restricted broker margin accounts	13,188	3,468
Customers' credit balances and deposits	(10,897)	(72,625)
Other current assets	15,393	4,840
Total	$(88,145)	$(144,912)
SUPPLEMENTAL DISCLOSURES OF CASH FLOWS INFORMATION		
Cash paid for:		
Interest (net of amounts capitalized)	$966	$555
Income taxes	$5	$135
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING ACTIVITIES		
Accrued capital expenditures	$(4,934)	$13,200

See Notes to Unaudited Condensed Consolidated Financial Statements

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ITEM 1. FINANCIAL STATEMENTS
(Continued)

CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

ASSETS

(Thousands)	December 31, 2012	September 30, 2012
PROPERTY, PLANT AND EQUIPMENT		
Utility plant, at cost	$ 1,602,315	$ 1,591,532
Construction work in progress	122,949	102,420
Solar equipment, real estate properties and other, at cost	221,060	192,026
Construction work in progress	2,275	20,558
Total property, plant and equipment	1,948,599	1,906,536
Accumulated depreciation and amortization	(422,271)	(421,659)
Property, plant and equipment, net	1,526,328	1,484,877
CURRENT ASSETS		
Cash and cash equivalents	3,258	4,509
Customer accounts receivable		
Billed	266,424	170,543
Unbilled revenues	53,957	7,017
Allowance for doubtful accounts	(5,328)	(4,797)
Regulatory assets	31,194	32,734
Gas in storage, at average cost	315,945	265,193
Materials and supplies, at average cost	12,104	7,863
Prepaid and accrued taxes	10,525	32,029
Derivatives, at fair value	45,498	48,021
Restricted broker margin accounts	8,741	21,929
Deferred taxes	10,850	29,074
Other	18,268	33,229
Total current assets	771,436	647,344
NONCURRENT ASSETS		
Investments in equity investees	163,337	164,595
Regulatory assets	457,880	441,263
Derivatives, at fair value	523	2,328
Other	29,156	29,598
Total noncurrent assets	650,896	637,784
Total assets	$ 2,948,660	$ 2,770,005

See Notes to Unaudited Condensed Consolidated Financial Statements

New Jersey Resources Corporation
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ITEM 1. FINANCIAL STATEMENTS
(Continued)

CAPITALIZATION AND LIABILITIES

(Thousands)	December 31, 2012	September 30, 2012
CAPITALIZATION		
Common stock equity	$ 863,094	$ 813,865
Long-term debt	530,000	525,169
Total capitalization	1,393,094	1,339,034
CURRENT LIABILITIES		
Current maturities of long-term debt	8,646	7,760
Short-term debt	394,400	279,800
Gas purchases payable	240,768	182,414
Accounts payable and other	74,271	66,765
Dividends payable	—	16,648
Deferred and accrued taxes	5,005	2,072
Regulatory liabilities	—	1,169
New Jersey clean energy program	13,621	5,619
Derivatives, at fair value	22,633	42,440
Customers' credit balances and deposits	37,555	48,452
Total current liabilities	796,899	653,139
NONCURRENT LIABILITIES		
Deferred income taxes	357,068	355,306
Deferred investment tax credits	5,824	5,905
Deferred revenue	5,304	5,502
Derivatives, at fair value	1,727	3,133
Manufactured gas plant remediation	182,000	182,000
Postemployment employee benefit liability	104,590	124,196
Regulatory liabilities	66,743	67,077
Asset retirement obligation	28,312	27,983
Other	7,099	6,730
Total noncurrent liabilities	758,667	777,832
Commitments and contingent liabilities (Note 11)		
Total capitalization and liabilities	$ 2,948,660	$ 2,770,005

See Notes to Unaudited Condensed Consolidated Financial Statements

New Jersey Resources Corporation
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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF THE BUSINESS

New Jersey Resources Corporation (NJR or the Company) provides regulated gas distribution services and certain non-regulated businesses primarily through the following subsidiaries:

New Jersey Natural Gas Company (NJNG) provides natural gas utility service to approximately 493,700 retail customers in central and northern New Jersey and is subject to rate regulation by the New Jersey Board of Public Utilities (BPU). NJNG comprises the Natural Gas Distribution segment;

NJR Clean Energy Ventures (NJRCEV) comprises the Clean Energy Ventures segment and reports the results of operations and assets related to the Company's capital investments in renewable energy projects, including commercial and residential solar projects and on-shore wind investments;

NJR Energy Services Company (NJRES) comprises the Energy Services segment that maintains and transacts around a portfolio of natural gas storage and transportation positions and provides wholesale energy and energy management services;

NJR Energy Holdings Corporation (NJREH) primarily invests in energy-related ventures through its subsidiaries, NJNR Pipeline Company (Pipeline), which holds the Company's 5.53 percent ownership interest in Iroquois Gas Transmission L.P. (Iroquois), and NJR Steckman Ridge Storage Company, which holds the Company's 50 percent combined interest in Steckman Ridge GP, LLC and Steckman Ridge, LP (collectively, Steckman Ridge). Iroquois and Steckman Ridge comprise the Energy Holdings segment;

NJR Retail Holdings Corporation (Retail Holdings) has two principal subsidiaries, NJR Home Services Company (NJRHS) and Commercial Realty & Resources Corporation (CR&R). Retail Holdings and NJR Energy Corporation (NJR Energy) are included in Retail and Other operations.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying Unaudited Condensed Consolidated Financial Statements have been prepared by NJR in accordance with the rules and regulations of the Securities and Exchange Commission (SEC). The September 30, 2012, Balance Sheet data is derived from the audited financial statements of the Company. These Unaudited Condensed Consolidated Financial Statements should be read in conjunction with the financial statements and the notes thereto included in NJR's 2012 Annual Report on Form 10-K.

The Unaudited Condensed Consolidated Financial Statements include the accounts of NJR and its subsidiaries. In the opinion of management, the accompanying Unaudited Condensed Consolidated Financial Statements reflect all adjustments necessary, for a fair presentation of the results of the interim periods presented. These adjustments are of a normal and recurring nature. Because of the seasonal nature of NJR's utility and wholesale energy services operations, in addition to other factors, the financial results for the interim periods presented are not indicative of the results that are to be expected for the fiscal year ended September 30, 2013.

Intercompany transactions and accounts have been eliminated.

Gas in Storage

The following table summarizes gas in storage, at average cost by company as of:

	December 31, 2012		September 30, 2012	
($ in thousands)	Gas in Storage	Bcf	Gas in Storage	Bcf
NJNG	$ 123,624	19.8	$ 145,379	22.2
NJRES	192,321	57.6	119,814	45.5
Total	$ 315,945	77.4	$ 265,193	67.7

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

Available for Sale Securities

Included in Other noncurrent assets on the Unaudited Condensed Consolidated Balance Sheets are certain investments in equity securities of a publicly traded energy company that have a fair value of $10.5 million and $11 million as of December 31, 2012 and September 30, 2012, respectively. Total unrealized gains associated with these equity securities, which are included as a part of accumulated other comprehensive income, a component of common stock equity, were $7.8 million ($4.6 million, after tax) and $8.3 million ($4.9 million, after tax) as of December 31, 2012 and September 30, 2012, respectively.

Disposal of Equipment

In October 2012, one of NJRCEV's commercial solar assets sustained damage as a result of Post Tropical Cyclone Sandy, commonly referred to as Superstorm Sandy (Superstorm Sandy). The Company determined that a minor portion of the damaged equipment was irreparable and, therefore, disposed of the affected portion. As a result, during the three months ended December 31, 2012, the Company recognized a pre-tax loss of $758,000, which is included in other income on the Unaudited Condensed Consolidated Statements of Operations. The Company has insurance coverage that provides for recovery of losses from property damage.

Recent Updates to the Accounting Standards Codification (ASC)

Balance Sheet Offsetting

In December 2011, the FASB issued an amendment to ASC Topic 210, Balance Sheet, requiring additional disclosures about the nature of an entity's rights of setoff and related master netting arrangements associated with its financial and derivative instruments. The objective of the disclosures is to facilitate comparison between financial statements prepared on the basis of U.S. generally accepted accounting principles (U.S. GAAP) and those prepared on the basis of International Financial Reporting Standards (IFRS). The amended guidance will become effective for interim and annual periods beginning on or after January 1, 2013, and will be applied retrospectively. The Company has determined that the new guidance will not impact its financial position, results of operations or cash flows upon adoption.

3. REGULATION

NJNG is subject to cost-based regulation, therefore, it is permitted to recover authorized operating expenses and earn a reasonable return on its utility investment based on the BPU's approval, in accordance with accounting guidance applicable to regulated operations. Accordingly, NJNG capitalizes or defers certain costs that are expected to be recovered from its customers as regulatory assets and recognizes certain obligations representing amounts that are probable future expenditures as regulatory liabilities.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

Regulatory assets and liabilities included on the Unaudited Condensed Consolidated Balance Sheets are comprised of the following:

(Thousands)	December 31, 2012	September 30, 2012
Regulatory assets-current		
Conservation Incentive Program	$25,681	$25,681
Underrecovered gas costs	5,513	7,053
Total current	$31,194	$32,734
Regulatory assets-noncurrent		
Environmental remediation costs		
Expended, net of recoveries	$56,333	$59,745
Liability for future expenditures	182,000	182,000
Deferred income taxes	11,405	11,405
Energy Efficiency Program	28,762	26,025
New Jersey Clean Energy Program (NJCEP)	13,621	5,619
Postemployment and other benefit costs	140,098	142,495
Deferred Superstorm Sandy costs	14,110	—
Other	11,551	13,974
Total noncurrent	$457,880	$441,263
Regulatory liability-current		
Derivatives, net	$—	$1,169
Total current	$—	$1,169
Regulatory liabilities-noncurrent		
Cost of removal obligation	$65,382	$65,994
Derivatives, net	966	1,000
Other	395	83
Total noncurrent	$66,743	$67,077

NJNG's recovery of costs is facilitated through its base tariff rates, Basic Gas Supply Service (BGSS) and other regulatory riders. As recovery of regulatory assets is subject to BPU approval, if there are any changes in regulatory positions that indicate recovery is not probable, the related cost would be charged to income in the period of such determination.

Recent regulatory filings and/or actions include the following:

- In November 2012, the BPU approved new state utilities' funding obligations for NJCEP for the period from January 1, 2013 to June 30, 2013. NJNG's share of the total funding requirement will be approximately $9.8 million. Accordingly, NJNG recorded the obligation and a corresponding regulatory asset on the Unaudited Condensed Consolidated Balance Sheets.

- On October 23, 2012, the BPU approved the Safety Acceleration and Facility Enhancement (SAFE) program, to include a four-year incremental investment program of $130 million, exclusive of allowance for funds used during construction (AFUDC) accruals. The approved SAFE Program will include infrastructure costs subject to review in NJNG's next base rate case to be filed no later than November 2015, the deferral of depreciation expense on SAFE investments and recognizes an overall rate of return on infrastructure investments of 6.9 percent. The deferred cost recovery will include accruals for both debt and equity components of AFUDC while construction is in progress. When construction is completed and plant is placed in service, NJNG will accrue an AFUDC rate at 6.9 percent per year until such time that NJNG receives approval for recovery of all costs through base rates.

- On November 19, 2012, NJNG filed a petition with the BPU requesting deferral accounting for uninsured incremental operating and maintenance costs associated with Superstorm Sandy. In addition, NJNG requested the review of and the appropriate recovery period for such deferred expenses be addressed in the Company's next base rate case.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

- On November 20, 2012, NJNG filed for Accelerated Infrastructure Programs (AIP) base rate cost recovery, requesting an increase of $6.9 million, which represents a cumulative impact of $15.8 million annually, related to AIP I and AIP II infrastructure investments installed in NJNG's distribution and transmission systems through October 31, 2012. The existing weighted average cost of capital remained the same for both AIP I and AIP II. The base rate change is requested to be approved in March 2013.

- On January 1, 2013, a Transitional Energy Facilities Assessment (TEFA) tax reduction went into effect. This is the second of three TEFA rate reductions with the last TEFA rate reduction effective January 2014.

- On January 23, 2013, the BPU approved a stipulation to extend NJNG's current SAVEGREEN Project® (SAVEGREEN) through June 30, 2013. The extension will allow the previously approved SAVEGREEN programs to continue with additional grants, incentives and financing to eligible customers. NJNG's July 9, 2012 petition, for an extension and expansion of the SAVEGREEN programs over a four-year period, remains open.

4. DERIVATIVE INSTRUMENTS

The Company and certain of its subsidiaries are subject to commodity price risk due to fluctuations in the market price of natural gas. To manage this risk, the Company and certain of its subsidiaries enter into a variety of derivative instruments including, but not limited to, futures contracts, physical forward contracts, financial options and swaps to economically hedge the commodity price risk associated with its existing and anticipated commitments to purchase and sell natural gas. In addition, the Company may utilize foreign currency derivatives as cash flow hedges of Canadian dollar denominated gas purchases. These contracts, with a few exceptions as described below, are accounted for as derivatives. Accordingly, all of the financial and certain of the Company's physical derivative instruments are recorded at fair value on the Unaudited Condensed Consolidated Balance Sheets. For a more detailed discussion of the Company's fair value measurement policies and level disclosures associated with the NJR's derivative instruments, see Note 5. Fair Value.

Since the Company chooses not to designate its financial commodity and physical forward commodity derivatives as accounting hedges, changes in the fair value of these derivative instruments are recorded as a component of gas purchases or operating revenues, as appropriate for NJRES, on the Unaudited Condensed Consolidated Statements of Operations as unrealized gains or (losses). For NJRES at settlement, realized gains and (losses) on all financial derivative instruments are recognized as a component of gas purchases and realized gains and (losses) on all physical derivatives follow the presentation of the related unrealized gains and (losses) as a component of either gas purchases or operating revenues.

NJRES also enters into natural gas transactions in Canada and, consequently, is exposed to fluctuations in the value of Canadian currency relative to the US dollar. NJRES utilizes foreign currency derivatives to lock in the currency translation rate associated with natural gas transactions denominated in Canadian currency. The derivatives may include currency forwards, futures, or swaps and are accounted for as derivatives. These derivatives are being used to hedge future forecasted cash payments associated with transportation and storage contracts. The Company has designated these foreign currency derivatives as cash flow hedges of that exposure, and expects the hedge relationship to be highly effective throughout the term. Since NJRES designates its foreign exchange contracts as cash flow hedges, changes in fair value of the effective portion of the hedge are recorded in other comprehensive income (OCI). When the foreign exchange contracts are settled, realized gains and (losses) are recognized in gas purchases on the

Unaudited Condensed Consolidated Statements of Operations.

As a result of NJRES entering into transactions to borrow gas, commonly referred to as “park and loans,” an embedded derivative is created related to potential differences between the fair value of the amount borrowed and the fair value of the amount that may ultimately be repaid, based on changes in forward natural gas prices during the contract term. This embedded derivative is accounted for as a forward sale in the month in which the repayment of the borrowed gas is expected to occur, and is considered a derivative transaction that is recorded at fair value on the Unaudited Condensed Consolidated Balance Sheets, with changes in value recognized in current period earnings.

Changes in fair value of NJNG's financial derivative instruments are recorded as a component of regulatory assets or liabilities on the Unaudited Condensed Consolidated Balance Sheets, as NJNG has received regulatory approval to defer and to recover these amounts through future BGSS rates as an increase or decrease to the cost of natural gas in NJNG's tariff.

The Company elects normal purchase/normal sale (NPNS) accounting treatment on all physical commodity contracts at NJNG. These contracts are accounted for on an accrual basis. Accordingly, gains or (losses) are recognized in earnings when the contract settles and the natural gas is delivered.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

During fiscal 2012, NJRCEV began hedging certain of its expected production of solar renewable energy certificates (SRECs) through forward sale contracts. The Company intends to physically deliver the SRECs upon settlement and, therefore, applies NPNS accounting treatment to the contracts and recognizes related revenue upon transfer of the SRECs.

Fair Value of Derivatives

The following table reflects the fair value of NJR's derivative assets and liabilities recognized on the Unaudited Condensed Consolidated Balance Sheets as of:

		Fair Value			
		December 31, 2012		September 30, 2012	
(Thousands)	Balance Sheet Location	Asset Derivatives	Liability Derivatives	Asset Derivatives	Liability Derivatives
Derivatives designated as hedging instruments:					
NJRES:					
Foreign currency contracts	Derivatives - current	$ 80	$ 71	$ 116	$ 97
	Derivatives - noncurrent	48	—	70	15
Fair value of derivatives designated as hedging instruments		$ 128	$ 71	$ 186	$ 112
Derivatives not designated as hedging instruments:					
NJNG:					
Financial derivative contracts	Derivatives - current	$ 2,713	$ 1,747	$ 6,203	$ 5,034
	Derivatives - noncurrent	—	—	1,000	—
NJRES:					
Physical forward commodity contracts	Derivatives - current	13,416	10,423	19,590	9,530
	Derivatives - noncurrent	84	27	658	216
Financial derivative contracts	Derivatives - current	29,289	10,392	22,112	27,779
	Derivatives - noncurrent	391	1,700	600	2,902
Fair value of derivatives not designated as hedging instruments		$ 45,893	$ 24,289	$ 50,163	$ 45,461
Total fair value of derivatives		$ 46,021	$ 24,360	$ 50,349	$ 45,573

At December 31, 2012, the gross notional amount of the foreign currency transactions was approximately $6.8 million, and ineffectiveness in the hedge relationship is immaterial to the financial results of NJR.

NJRES utilizes financial derivatives to economically hedge the gross margin associated with the purchase of physical gas for injection into storage and the subsequent sale of physical gas at a later date. The gains or (losses) on the financial transactions that are economic hedges of the cost of the purchased gas are recognized prior to the gains or (losses) on the physical transaction, which are recognized in earnings when the natural gas is sold. Therefore, mismatches between the timing of the recognition of realized gains or (losses) on the financial derivative instruments and gains or (losses) associated with the actual sale of the natural gas that is being economically hedged along with fair value changes in derivative instruments creates volatility in the results of NJRES, although the Company's intended economic results relating to the entire transaction are unaffected.

The following table reflects the effect of derivative instruments on the Unaudited Condensed Consolidated Statements of Operations as of:

(Thousands)	Location of gain (loss) recognized in income on derivatives	Amount of gain (loss) recognized in income on derivatives Three Months Ended December 31,	
Derivatives not designated as hedging instruments:		2012	2011
NJRES:			
Physical commodity contracts	Operating revenues	$(5,635)	$(11,908)
Physical commodity contracts	Gas purchases	(206)	4,275
Financial derivative contracts	Gas purchases	29,202	62,454
Total unrealized and realized (losses) gains		$23,361	$54,821

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Not included in the previous table, are (losses) associated with NJNG's financial derivatives that totaled $(6.2) million and $(19.9) million for the three months ended December 31, 2012 and 2011, respectively. These derivatives are part of NJNG's risk management activities that relate to its natural gas purchasing activities and BGSS incentive programs. As these transactions are entered into pursuant to and recoverable through regulatory riders, any changes in the value of NJNG's financial derivatives are deferred in regulatory assets or liabilities and there is no impact to earnings.

As previously noted, NJRES designates its foreign exchange contracts as cash flow hedges, therefore, changes in fair value of the effective portion of the hedges are recorded in OCI and, upon settlement of the contracts, realized gains and (losses) are reclassified from OCI to gas purchases on the Unaudited Condensed Consolidated Statements of Operations. The following table reflect the effect of derivative instruments designated as cash flow hedges on OCI as of:

(Thousands)	Amount of Gain or (Loss) Recognized in OCI on Derivatives (Effective Portion) [1]		Amount of Gain or (Loss) Reclassified from OCI into Income (Effective Portion)		Amount of Gain or (Loss) Recognized on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	
	Three Months Ended December 31,		Three Months Ended December 31,		Three Months Ended December 31,	
Derivatives in cash flow hedging relationships:	2012	2011	2012	2011	2012	2011
Foreign currency contracts	$(95)	$(76)	$79	$13	$—	$—

(1) The settlement of foreign currency transactions over the next twelve months is expected to result in the reclassification of $9,000 from OCI into earnings. The maximum tenor is April 2015.

NJNG and NJRES had the following outstanding long (short) derivatives as of:

		Volume (Bcf)	
		December 31, 2012	September 30, 2012
NJNG	Futures	20.6	16.1
	Swaps	—	3.4
NJRES	Futures	(27.1)	(28.6)
	Swaps	(0.7)	13.2
	Options	—	4.4
	Physical	(12.4)	(3.5)

Broker Margin

Generally, exchange-traded futures contracts require posted collateral, referred to as margin, usually in the form of cash. The amount of margin required is comprised of a fixed initial amount based on the contract and a variable amount based on market price movements from the initial trade price. The Company maintains broker margin accounts for NJNG and NJRES. The balances by company, are as follows:

(Thousands)	Balance Sheet Location	December 31, 2012	September 30, 2012

NJNG	Broker margin - Current assets	$ 1,011	$ 1,713
NJRES	Broker margin - Current assets	$ 7,730	$ 20,216

Wholesale Credit Risk

NJNG and NJRES are exposed to credit risk as a result of their wholesale marketing activities. As a result of the inherent volatility in the prices of natural gas commodities and derivatives, the market value of contractual positions with individual counterparties could exceed established credit limits or collateral provided by those counterparties. If a counterparty failed to perform the obligations under its contract (e.g., failed to deliver or pay for natural gas), then the Company could sustain a loss.

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NJR monitors and manages the credit risk of its wholesale marketing operations through credit policies and procedures that management believes reduce overall credit risk. These policies include a review and evaluation of current and prospective counterparties' financial statements and/or credit ratings, daily monitoring of counterparties' credit limits and exposure, daily communication with traders regarding credit status and the use of credit mitigation measures, such as collateral requirements and netting agreements. Examples of collateral include letters of credit and cash received for either prepayment or margin deposit. Collateral may be requested due to NJR's election not to extend credit or because exposure exceeds defined thresholds. Most of NJR's wholesale marketing contracts contain standard netting provisions. These contracts include those governed by the International Swaps and Derivatives Association (ISDA) and the North American Energy Standards Board (NAESB). The netting provisions refer to payment netting, whereby receivables and payables with the same counterparty are offset and the resulting net amount is paid to the party to which it is due.

The following is a summary of gross credit exposures grouped by investment and noninvestment grade counterparties, as of December 31, 2012. Internally-rated exposure applies to counterparties that are not rated by Standard & Poor's (S&P) or Moody's Investors Service, Inc. (Moody's). In these cases, the company's or guarantor's financial statements are reviewed, and similar methodologies and ratios used by S&P and/or Moody's are applied to arrive at a substitute rating. Gross credit exposure is defined as the unrealized fair value of physical and financial derivative commodity contracts plus any outstanding wholesale receivable for the value of natural gas delivered and/or financial derivative commodity contract that has settled for which payment has not yet been received.

The amounts presented below have not been reduced by any collateral received or netting and exclude accounts receivable for NJNG retail natural gas sales and services.

(Thousands)	Gross Credit Exposure
Investment grade	$ 194,354
Noninvestment grade	2,510
Internally rated investment grade	30,934
Internally rated noninvestment grade	10,174
Total	$ 237,972

Conversely, certain of NJNG's and NJRES' derivative instruments are linked to agreements containing provisions that would require cash collateral payments from the Company if certain events occur. These provisions vary based upon the terms in individual counterparty agreements and can result in cash payments if NJNG's credit rating were to fall below its current level. NJNG's credit rating, with respect to S&P, reflects the overall corporate credit profile of NJR. Specifically, most, but not all, of these additional payments will be triggered if NJNG's debt is downgraded by the major credit agencies, regardless of investment grade status. In addition, some of these agreements include threshold amounts that would result in additional collateral payments if the values of derivative liabilities were to exceed the maximum values provided for in relevant counterparty agreements. Other provisions include payment features that are not specifically linked to ratings, but are based on certain financial metrics.

Collateral amounts associated with any of these conditions are determined based on a sliding scale and are contingent upon the degree to which the Company's credit rating and/or financial metrics deteriorate, and the extent to which liability amounts exceed applicable threshold limits. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that were in a liability position on December 31, 2012 and September 30, 2012, was $700,000 and $1.6 million, respectively, for which the Company had not posted any collateral. If all the thresholds related to the credit-risk-related contingent features underlying these agreements had been invoked on December 31, 2012 and September 30, 2012, the Company would have been required to post an additional $600,000 and $1.2 million, respectively, to its counterparties. These amounts differ from the respective net derivative liabilities reflected on the Unaudited Condensed Consolidated Balance Sheets because the agreements also include clauses, commonly known as “Rights of Offset,” that would permit the Company to offset its derivative assets against its derivative liabilities for determining additional collateral to be posted.

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5. FAIR VALUE

Fair Value of Assets and Liabilities

The fair value of cash and temporary investments, commercial paper and borrowings under revolving credit facilities are estimated to equal their carrying amounts due to the short maturity of those instruments. The estimated fair value of long-term debt, including current maturities and excluding capital leases, is as follows:

(Thousands)	December 31, 2012	September 30, 2012
Carrying value	$479,845	$479,845
Fair market value	$527,371	$530,056

NJR utilizes a discounted cash flow method to determine the fair value of its debt. Inputs include observable municipal and corporate yields, as appropriate for the specific issue and for NJR's credit rating. As of December 31, 2012, NJR discloses its debt within Level 2 of the fair value hierarchy.

Fair Value Hierarchy

NJR applies fair value measurement guidance to its financial assets and liabilities, as appropriate, which include financial derivatives and physical commodity contracts qualifying as derivatives, available for sale securities and other financial assets and liabilities. In addition, authoritative accounting literature prescribes the use of a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value based on the source of the data used to develop the price inputs. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities and the lowest priority to inputs that are based on unobservable market data and include the following:

Level 1	Unadjusted quoted prices for identical assets or liabilities in active markets; NJR's Level 1 assets and liabilities include exchange traded futures and options contracts, listed equities, and money market funds. Exchange traded futures and options contracts include all energy contracts traded on the New York Mercantile Exchange (NYMEX)/Chicago Mercantile Exchange (CME) and the Intercontinental Exchange (ICE) that NJR refers internally to as basis swaps, fixed swaps, futures and options that are cleared through an Futures Commission Merchant (FCM).
Level 2	Price data, which includes both commodity and basis price data other than Level 1 quotes, that is observed either directly or indirectly from publications or pricing services; NJR's Level 2 assets and liabilities include over-the-counter physical forward commodity contracts and swap contracts or derivatives that are initially valued using observable quotes and are subsequently adjusted to include time value, credit risk or estimated transport pricing components for which no basis price is available. Level 2 financial derivatives consist of transactions with non-FCM counterparties (basis swaps, fixed swaps and/or options). For some physical commodity contracts the Company utilizes transportation tariff rates that are publicly available and that it considers to be observable inputs that are equivalent to market data received from an independent source. There are no significant judgments or adjustments applied to the transportation tariff inputs and no market perspective is required. Even if the transportation tariff input was considered to be a “model”, it would still be considered to be Level 2 input as:

1) The data is widely accepted and public
2) The data is non-proprietary and sourced from an independent third party
3) The data is observable and published

These additional adjustments are generally not considered to be significant to the ultimate recognized values.

Level 3 Inputs derived from a significant amount of unobservable market data; these include NJR's best estimate of fair value and are derived primarily through the use of internal valuation methodologies.

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Assets and liabilities measured at fair value on a recurring basis are summarized as follows:

(Thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
As of December 31, 2012:				
Assets:				
Physical forward commodity contracts	$—	$13,500	$—	$13,500
Financial derivative contracts - natural gas	32,192	201	—	32,393
Financial derivative contracts - foreign exchange	—	128	—	128
Available for sale equity securities - energy industry (1)	10,469	—	—	10,469
Other (2)	211	—	—	211
Total assets at fair value	$42,872	$13,829	$—	$56,701
Liabilities:				
Physical forward commodity contracts	$—	$10,450	$—	$10,450
Financial derivative contracts - natural gas	13,175	664	—	13,839
Financial derivative contracts - foreign exchange	—	71	—	71
Other	—	—	—	—
Total liabilities at fair value	$13,175	$11,185	$—	$24,360
As of September 30, 2012:				
Assets:				
Physical forward commodity contracts	$—	$20,248	$—	$20,248
Financial derivative contracts - natural gas	14,270	15,645	—	29,915
Financial derivative contracts - foreign exchange	—	186	—	186
Available for sale equity securities - energy industry (1)	11,009	—	—	11,009
Other (2)	30	—	—	30
Total assets at fair value	$25,309	$36,079	$—	$61,388
Liabilities:				
Physical forward commodity contracts	$—	$9,746	$—	$9,746
Financial derivative contracts - natural gas	16,922	18,793	—	35,715
Financial derivative contracts - foreign exchange	—	112	—	112
Other	—	—	—	—
Total liabilities at fair value	$16,922	$28,651	$—	$45,573

(1) Included in Other noncurrent assets on the Unaudited Condensed Consolidated Balance Sheets.
(2) Includes various money market funds.

In October 2012, following the implementation of Dodd-Frank, ICE converted its cleared energy “swap” contracts to “futures” contracts and the NYMEX amended their product titles to remove the word “swap” from the titles of their “futures” and “option” contracts. In conjunction with these changes, the Company reviewed its valuation methodology for exchange-traded financial instruments including consideration of credit risk adjustment and discounting. The result of this review is that as of December 31, 2012, exchange-traded/FCM cleared financial derivative contracts, previously categorized as Level 2 Basis Swaps and Fixed Swaps, are categorized as Level 1 Futures. The Company's policy is to recognize transfers in and out at the end of the reporting period.

A summary of transfers between Level 1 and Level 2 is as follows:

(Thousands)	
Transfers out of Level 2 into Level 1	December 31, 2012
Assets:	
Financial derivative contracts - natural gas	$ 19,564
Liabilities:	
Financial derivative contracts - natural gas	(8,766)
Total	$ 10,798

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6. INVESTMENTS IN EQUITY INVESTEES

Investment in equity investees includes NJR's equity method and cost method investments.

Equity Method Investments